

**FUTURE  
*LENDING*  
LEADERS**  
CLASS OF 2025

**7(a) INDUSTRY  
REVIEW**

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**EDITION IV**



# **FUTURE LENDING LEADERS CLASS OF 2025**

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**EDITION IV**

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# 7(a) INDUSTRY REVIEW

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# FOREWARD

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The past year has marked one of the most pivotal chapters in the history of the SBA 7(a) Loan Program. A new Administration, a sweeping overhaul of the SOP, and a rapidly shifting lending environment have ushered in a period of change and complexity. In moments like these, the need for forward-thinking, adaptive leadership has never been more critical.

Launched just four years ago, NAGGL's Future Lending Leaders (FLL) program was created with this very purpose: to develop and equip the next generation of 7(a) leaders who will carry the program into the future with integrity, innovation, and insight.

The twelve rising leaders that make up the FLL Class of 2025 have embraced the uncertainty, shown remarkable resilience, and leaned into growth, both professionally and personally. Through mentorship, peer learning, and deep industry engagement, they've emerged not only more capable, but more connected to their colleagues and to the mission of 7(a) lending.

As we present the fourth edition of the 7(a) Industry Review, we're proud to share a series of thoughtful and timely articles written by this year's Future Lending Leaders. These editorials offer firsthand perspectives on today's SBA landscape and reflect the unique experiences and convictions of those who will help shape what comes next for the 7(a) industry.

To the Class of 2025: Your voice matters. Your contributions are already making a difference. And the future of the 7(a) Program is brighter because of your leadership.



Tony Wilkinson | President & CEO | NAGGL



## Role Models in SBA Lending

Robin Studniski | Stearns Bank

What do you imagine when you think of a stereotypical banker from days gone by? We can all imagine this character, whether it's cruel Mr. Potter from "*It's a Wonderful Life*," painfully serious Mr. Dawes from "*Mary Poppins*," or manipulative Miranda Priestly from "*The Devil Wears Prada*." While the characters change, one thing has stayed the same: they appear stern, gruff and unapproachable. Today's lenders have emerged from the greedy self-centered villains to true partners and advocates for their customers and mentors for those exploring a banking career. Nowhere is this more evident than in the SBA lending space.

We all have role models, whether in sports, our careers or in academics. Role models represent a vision we can see for ourselves and something we aspire to be. Mentors that have some shared experiences can be very impactful. For example, if a military veteran is thinking about opening or purchasing a small business, and the SBA department employs a former service member, the applicant will feel a sense of being understood in an otherwise daunting process. This can be true for women, minorities, retirees, young professionals, etc. A mentor saw my passion for connecting with people and my genuine desire to help others. That mentor encouraged me to bring my life experiences, talents and strong work ethic to the bank space.

The skills and experience that were identified in me and I brought to the bank have turned into a meaningful and fulfilling career thus far. The opportunity to work with business owners, advocate for them and provide them the capital resources they need to move their business forward is a privilege. Some of my favorite customer stories include helping young entrepreneurs through the lending process and building lasting relationships with similar industry leaders.

The greatest connections have come from feeling that shared connection or conviction for the cause and being genuine.

As humans we are attracted to people that we like, trust, and that understand our unique needs and experiences. Those attributes come from seeing ourselves as capable and enabled to take the seat. It is important that our viewpoints and nurturing instincts are shared. This is an opportunity for continued growth and learning for both the mentor and mentee.

When business owners bring their passion and conviction for their business to a lender to seek capital to expand, feeling connected to the decision makers can be a catalyst for making things happen. The connection can come from shared values, shared experiences or even shared milestones in life. The ability for business owners to relate to any banker is there; however, the opportunity to connect on a deeper level can come when talking with a banker that has a common bond with that applicant.

As a society we've come a long way long way to making progress on breaking down barriers for the underserved in banking and lending. Today I have the opportunity to be a leader within a bank that embraces the vision to connect with not only customers but with management, peers and inexperienced/new staff. It's a privilege for me to be part of a team that not only focuses on bottom line production but finds value in reaching out to those that might not feel comfortable forming lasting and meaningful relationships that will strengthen our economy through experienced lenders and successful entrepreneurs. Nowhere is this more evident than in SBA lending and the impact these connections have in our lending community and in the success of small business entrepreneurs.

# **5 Game-Changing Ways SBA Lenders Can Elevate the Borrower Experience**

Ryan Chan | Five Star Bank

Small businesses are the backbone of the U.S. economy, and SBA loans provide these businesses with crucial access to capital. However, the SBA lending process can often feel overwhelming for applicants due to complex paperwork, lengthy approval times, and strict compliance requirements. This frustration affects both applicants and lenders, but it doesn't necessarily have to be that way. By prioritizing the client experience, lenders can streamline operations, build stronger relationships, and set themselves apart in a competitive market. Here are five game-changing strategies to enhance the SBA client experience:

## **1. Simplifying the Application Process**

One of the biggest challenges faced by SBA clients is the complexity of the loan application process. Many business owners, especially first-time borrowers, find the requirements overwhelming. Lenders can improve this experience by providing clear, step-by-step guidance through direct communication and follow-up emails. Offering an easy-to-follow checklist tailored to different business needs can help applicants stay organized and avoid unnecessary delays. Since not all applicants have experience allowing for government guaranteed financing, lenders should be prepared to offer additional support.

Leveraging digital tools can further streamline the application process by enabling electronic document collection and signatures, reducing paperwork, and minimizing back-and-forth communication. A well-structured application process not only improves borrower satisfaction but also results in fewer errors, faster approvals, and a more efficient workflow for lenders.

## **2. Communicate Proactively and Clearly – Even When It’s Difficult**

Lack of clear communication is one of the most common frustrations among small business owners seeking SBA financing, often leading to confusion and delays. To create a better experience, lenders must set clear expectations on loan timelines, approval steps, and potential challenges from the start. Providing regular updates via email, phone, or text messages will help ensure timely information at every stage of the process.

Effective communication is especially critical when unexpected issues arise, such as requests for additional documentation, underwriting concerns, or SBA processing delays. Even when delivering difficult news, transparency about the reasons and next steps helps applicants feel more in control and builds trust in the lending relationship.

## **3. Reducing Processing Times with Technology**

Time is money, and small business owners rely on quick access to capital to seize opportunities, manage cash flow, and sustain growth. Long processing times can create significant obstacles, potentially causing borrowers to miss out on key business opportunities. Lenders can accelerate approval timelines by using technology to streamline the underwriting process and can track their loan status, upload required documents, and receive automated notifications can improve efficiency and reduce frustration. Additionally, artificial intelligence (“AI”) and machine learning are transforming the lending industry by identifying inconsistencies in applications and flagging potential risks, allowing for a smoother and faster approval process. As technology evolves, embracing digital innovations will be key to staying competitive and meeting (or exceeding) client expectations.

#### **4. Offering Personalized Support and Guidance**

SBA borrowers often need more than just a loan— they need information and strategic guidance. Lenders who take on an advisory role provide immense value by educating borrowers on different SBA loan options to help them select the best fit. Many business owners are unaware of the full range of SBA products available, so having an informed lender to guide them through the process is invaluable.

Beyond the loan, lenders can continue to provide support through financial health checkups and guidance on cash flow management. This collaborative approach positions lenders as trusted financial partners rather than just a transactional provider, fostering long-term relationships that can extend beyond a single loan transaction.

#### **5. Strengthening Post-Funding Support and Relationship Management**

The borrower experience should not end once the loan is funded. Many small business owners continue to face financial challenges, expansion opportunities, and unexpected hurdles, long after receiving their SBA financing. Lenders should maintain engagement by checking in periodically to discuss business performance, financial health, and any new financing needs. SBA does require regular portfolio monitoring, so why not use this opportunity to reinforce the client relationship.

Regular communication helps lender identify early warning signs of potential financial difficulties, allowing for proactive solutions to be explored and implemented before issues escalate. Keeping borrowers informed about changes in SBA programs, new financing options, and best practices, ensures that borrowers remain compliant and aware of additional opportunities. Strengthening post-funding support ultimately benefits both the borrower and the lender, creating a mutually beneficial, long-term financial relationship.

## **Conclusion: SBA Lending is a Partnership, Not Just a Transaction**

SBA lending is more than just making loans—it's about building partnerships that support small business success. Lenders who prioritize the borrower experience by streamlining processes, improving communication, leveraging technology, and providing ongoing support will cultivate long-term relationships and stand out in a competitive market.

Enhancing the borrower experience isn't just about making the process easier; it's about empowering small businesses to thrive. And when small businesses succeed, communities grow, jobs are created, and the entire economy benefits. SBA lenders have the opportunity to be more than just a funding source—they can be the cornerstone of small business success.

## **SBA 7(a) Small Loans**

Kiril Dimov | BayFirst National Bank

The Small Business Administration (SBA) loan program is celebrating over 70 years of service to America's small businesses. SBA was founded under the 1953 Small Business Act to "aid, counsel, assist and protect, insofar as is possible, the interests of small business concerns."

<sup>1</sup> SBA's creation was a direct emphasis on the needs of small businesses, with additional focus geared towards victims of natural disasters and assisting small businesses obtain government contracts. Additionally, SBA provides outreach to women, minorities and armed forces veterans. While the maximum loan size that a lender can provide to an applicant is \$5,000,000, many of the small businesses seeking financing are candidates for SBA's 7(a) Small Loan product.

SBA defines 7(a) Small Loans as loans that are \$350,000 or less and exclude Standard 7(a) loans, SBA Express, Export Express, CAPLines, Export Working Capital Program (EWCP) and Pilot Loans.<sup>2</sup> The average loan size has varied in the last several years. For fiscal year 2019, 77.19% of 7(a) loans were \$500,000 or less and 51.91% were \$150,000 or less. These percentages decreased over the next two years as the average loan size increased but the majority of 7(a) loans remained below

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<sup>1</sup> [Celebrating 70 years of service to America's small businesses | U.S. Small Business Administration](#)

<sup>2</sup> SOP 50 10 8, page 403

\$500,000. In fiscal year 2021, 62.90% of 7(a) loans were \$500,000 or below. The small loans percentages increased over the last 3 years and for fiscal year 2024, 79.99% of 7(a) loans were \$500,000 and less and 54.16% were \$150,000 and less.<sup>3</sup> While these numbers indicate that the smallest businesses are being provided with financing, the documentation requirements can hinder small businesses from obtaining needed financing.

Where should a lender start? For all SBA 7(a) loans, the lender must begin with the “Core Requirements for all 7(a) and 504 Loans” found in Section “A” of SOP 50 10.<sup>4</sup> 7(a) core requirements include guidance on primary applicant eligibility, special transaction structures, uses of proceeds, ethics, fees, and agents, and other eligibility factors such as guaranties, insurance, tax transcript environmental and historic properties requirements.

The 7(a) Small loan program guidance does allow lenders some flexibility to streamline the process. One significant benefit is that SBA provides a maximum guaranty percentage of 85% for 7(a) Small loans of \$150,000 or less. Additionally, all 7(a) Small loan applications must begin with a screening for a FICO Small Business Scoring Service Score (SBSS Score). Utilizing the SBSS Score can streamline the underwriting process and reduce some of the processing time.

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<sup>3</sup> NAGGL Annual Conference, 11/1/2024 – Opening General Session, John Miller, SBA – Office of Capital Access

<sup>4</sup> SOP 50 10 8, pages 13-109

Because of the costs associated with utilizing the SBSS Score, the lender should refrain from using the SBSS Score multiple times for the same loan application and should never use the SBSS Score as a tool for underwriting a loan that will be processed conventionally without an SBA guaranty.

If the applicant does not meet the SBSS Score, then the lender must process the application under the same requirements as a Standard 7(a) loan. However, if the applicant does meet the acceptable SBSS Score, then the SBSS Score will satisfy the requirement to consider the following:

1. Credit history of the applicant
2. The strength of the business
3. Past, present, projected cash flow and future prospects, and
4. The applicant's ability to repay the loan with earnings from the business, subject to the following additional analysis that must be documented in the lender's credit memorandum:
  - a. Brief description and history of the business and management team of the applicant business
  - b. Explanation of necessity of working capital if the loan is greater than \$50,000 and 50% or more of the loan proceeds are used for working capital
  - c. Owner/guarantor analysis, including obtaining personal financial statements, consistent with the lender's policies and

- procedures for their similarly sized non-SBA guaranteed commercial loans
- d. Reason as to why credit is not available elsewhere
  - e. A description of the collateral and the value
  - f. Necessity for life insurance, if needed, per the lender's requirement for their small conventional loans
  - g. Any other specific topics such as judgments, liens, pending litigation, debt refinance, affiliation, seller financing and standby agreements, and franchise<sup>5</sup>

The challenge of time and effort in the documentation and processing of a 7(a) Small loan for a lender is tangible. However, having a higher guaranty percentage for loans of \$150,000 or less, and the utilization of the SBSS Score can help streamline the process and allow lenders the flexibility to provide access to capital to these businesses that rely on the SBA loan program. Keys to success are always starting with the core requirements outlined in SOP 50 10 and creating robust internal written policies so that lenders have clearly detailed guidance for areas that SBA continues to allow lenders to follow their own procedures.

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<sup>5</sup> SOP 50 10 8 – pages 169-170

## Is it Time for Professional SBA Help?

Isaac Peloquin | Cooperative Business Services, LLC

SBA permits lending institutions to use a Lender Service Provider (LSP) to assist with the critical tasks of their Small Business Administration (SBA) portfolios. A Lender Service Provider is defined as an agent who carries out lender functions in originating, disbursing, servicing, or liquidating a specific SBA business loan or loan portfolio for compensation from the lender.<sup>6</sup> An LSP provides an opportunity to create efficiencies in the lending process. What should be considered when determining if it is time for your organization to engage one of these agents?

An LSP should never be used to substitute or replace the lender's responsibility in any area of SBA lending. SOP 50 10 directly clarifies that a *lender must have a continuing ability to evaluate, process, close, service, liquidate and litigate small business loans (13 CFR § 120.410). A lender may contract with a third-party Lender Service Provider to assist with one or more of these functions. However, the lender itself, not the LSP, must be able to demonstrate that it exercises day-to-day responsibility for evaluating, processing, closing, disbursing, servicing, liquidating, and litigating its SBA portfolio. SBA determines whether an agent is an LSP on a loan-by-loan basis. If an agent meets the definition of an LSP, a formal agreement between the agent and lender is required and must be reviewed and approved by SBA.*<sup>7</sup>

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<sup>6</sup> SOP 50 10 8 Page 407

<sup>7</sup> P 50 10 8 Page 71

When considering if an LSP engagement is right for a specific lender, a few points should be considered. Some of those considerations may include:

- Is there a perceived gap in a specific SBA function related to staffing deficiencies or need for assistance during a buildout of a department or rollout of a new SBA product?
- Is there a need that may arise during the initial staffing phase of a newly created SBA department or on an as needed basis for a well-established SBA shop?
- Is there a specific area, such as servicing or liquidation, where the lender lacks experienced staff where an LSP can augment the functions of that department? In these situations, the lender must still adhere to SBA's requirement that the lender is able to demonstrate day-to-day responsibility for all aspects relating to SBA program requirements.

Once an appropriate need is identified and the lender wishes to use the services of an LSP, the lender must prepare an LSPA (Lender Service Provider Agreement) package for SBA's approval. This package will contain an LSPA cover letter, the LSPA checklist, Risk Management Certification, and an executed copy of the Lender Service Provider Agreement.

SBA expects lenders to exercise due diligence and prudent oversight of the third-party vendors, including an LSP, and must have written policies and procedures governing these relationships.<sup>8</sup> The lender, not the LSP,

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<sup>8</sup> SOP 50 56 page 18

must maintain all loan files, related documents and records under their direct control. Additionally, the lender continues to have full responsibility for the conduct of its associates, which again, includes any LSP that the lender contracts with. This responsibility includes reporting any suspected or known fraud.

A consideration that must not be overlooked is the cost of services provided to the lender. It is imperative to note that the lender may not pass the cost of an LSP to the applicant and/or borrower. Often an LSP will offer a projection-based cost analysis during the proposal stage of discussions to assist in analyzing the lender's return on investment. These projections are highly variable and will be directly related to the loan volume and number of services provided by the prospective LSP.

While there are considerations relating to engaging an LSP for assistance with the SBA process, there are also significant possible benefits. The most common benefits include:

- Specific area of focus such as legal or closing compliance
- Enhanced customer experience from an expected improved process flow
- Access to technology and automated tools which otherwise may not be financially feasible for small to medium size lending operations

In summary, the decision to engage an LSP is a serious consideration for any lending institution. While outsourcing may reduce staffing costs, the decision to engage a third-party provider should arise from a clear

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need. Only after thorough vetting, as the lender would do with any vendor, should a lender proceed. Reaching out to peers as well as the lender's SBA Lender Relations Specialist can be an effective method in the vetting process of a specific LSP. With proper planning, receipt of SBA's prior approval, and implementation, a lender and LSP relationship can be a beneficial venture that improves quality of service for both the lender and the applicant/borrower.

# Sailing Through Business Acquisition Best Practices

Alexander Griffin | Security National Bank of Texas

Ahoy! Welcome aboard our journey through the ebbs and flows of SBA business acquisitions. In 2025 more than 11,200<sup>9</sup> Americans will turn 65 every day. Until the end of 2027, the retirement age group will increase at a greater rate than any other. Coined the “Silver Tsunami”<sup>10</sup>, many of the retirees’ small businesses will change hands via the SBA 7(a) product. Let’s dive in and discuss three main credit pillars lenders should focus on when navigating changes of ownership.

Just like on the open ocean, the experience of a top tier applicant to be the captain makes for smoother sailing. A top-tier applicant in an acquisition is a manager, employee or partial owner already working at the company. In the endeavor to mitigate risk, nothing beats an insider who already knows where the skeletons are buried. Additionally, an existing employee already has relationships with the existing staff, strengthening a tie with a small businesses’ most vital resource – its employees.

The second-tier applicant is an individual or group of owners with five or more years of direct industry experience. While maybe not a perfect fit, the individual(s) arguably has expertise in the most important area – the ins and outs of the industry. Ideally, the client will have had a consistent tenure at one or two companies as opposed to someone who changes

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<sup>9</sup> [How Many People Are Retiring Every Year for the Next 4 Years?](#) (Yahoo Finance)- April 24, 2024

<sup>10</sup> [The New Silver Tsunami](#) (Forbes) November 28, 2020

employment within an industry every one to two years. Holding a management role at a similar company further elevates this tiered applicant.

The third and final tier of experience is less than five years direct industry experience or relatable indirect industry experience. This tier deserves an elevated level of scrutiny from lenders. A key factor to examine involves previous leadership roles. Questions to ask are how many employees are managed and what are the quantitative results of the team? Another area to focus on is their sector knowledge which should be addressed in a robust business plan. Paying special attention to the borrower's business plan evidences the lengths of due diligence a prospective borrower has performed. Other questions a credit department should ask include: how will this applicant integrate with the company's employees? What changes, if any, does the client intend to make and what is the timeline? Does the owner's skill set truly fit for this respective business?

While the captain of the ship is critical to its success, the ship itself needs to be in good condition to ensure a voyage's successful outcome. Healthy cash flow is the resin that holds our metaphorical ship together. When considering cash flow metrics, a prudent lender could require businesses to exhibit 1.50x DSCR after an owner's draw for the past two reporting periods prior to entertaining the deal. While SBA only requires a 1.15x DSCR<sup>11</sup>, the additional cash flow cushion provides a margin of error for the new owners. Unfortunately, not all small business sellers disclose the flaws in their business during a sale. As risk mitigation is essential to the lender's

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<sup>11</sup> SOP 50 10 8. pages 131-132

longevity in the SBA program, lenders want to ensure the applicant's success as best as possible. Reducing SBA's exposure is a vital way a bank can protect an applicant from business transaction risk.

Oftentimes in business acquisitions, sellers will have addbacks for non-business expenses called seller's discretionary earnings (SDE). These addbacks can give a lender additional comfort on a deal and can vastly improve a prospect's cash flow. It is important to exhibit professional skepticism when analyzing these addbacks; each lender has different criteria when determining what to include as a true addback to cash flow. It is prudent to have an audit trail which documents and corroborates addbacks. This provides additional assurance from a credit perspective that seller's claims can be validated.

Industry trends are always a critical factor for the success of the new owner. From a macro perspective, is the industry growing or shrinking? Especially pertinent in 2025, is international trade a material aspect of your client's business? If the business is in a shrinking industry, what will the applicant do to diversify the business? In a growing industry, how will the business continue to stay relevant and ahead of its competitors? Is there any new technology on the horizon that would render the business irrelevant in the next ten years, before the loan is repaid? In a rising cost environment, is the business able to pass additional costs on to the consumer or will they have to absorb the cost increase themselves?

It is equally important to understand the microenvironment in which the business operates in. What is the relevance of the

business's product or service in its given market? Does the business's revenue stream compare favorably with its demographic pool? How many new competitors have entered the market and what geographically constitutes the market?

Any captain will tell say resources are vital to the voyage. Just like a compass and map, a borrower's post transaction liquidity, collateral, and guarantors enable an individual to successfully navigate his acquisition. Post-transaction liquidity is an imperative aspect of any business acquisition. While a lender may consider including permanent working capital in its transaction, a borrower should have reserves for a rainy day. Specifically, they should have excess funds to cover both unforeseen personal expenses and business expenses. When working capital is unfeasible, borrowers frequently seek investment from minority owners to supplement post-transaction liquidity concerns.

Outside collateral provides additional credit risk mitigation for the lender. Protecting the SBA's dollars should always be at the forefront of the lender's mind. In business acquisitions, residential, commercial, and rental property collateral provides lenders with the additional comfort to finance deals with more "blue sky going-concern value" or goodwill.

Lastly, global cash flow or guarantors provide a pivotal mitigant to credit risk. As prudent lenders, consider an affiliate's cash flow when lending on a transaction. Oftentimes these entities provide a significant boost to a prospect's overall viability or, conversely, drain the owner's cash reserves. When necessary, lenders should require these entities to provide a corporate guaranty to strengthen the credit request and likelihood of repayment. While a dose of

optimism is healthy, skepticism and realism should take precedence when securing any guaranteed SBA loan facility.

As we enter port on our voyage, let us reflect on the three main credit pillars to consider in change-of-ownership transactions. First, the borrower's experience and time in the industry provide a strong indicator of success. Next, the subject business, its employees, cash flow, and operating environment are crucial data points to consider. Lastly, the personal resources of the applicant, including post transaction liquidity, outside collateral, and global cash flow, aid in securing the transaction should it hit bumpy waters. By taking calculated, rational steps towards risk mitigation, lenders can enable their clients to acquire and grow these vital small businesses.

## Validating Projections

Leland Willis | United Community

Are you still using a crystal ball for projection analysis? The SBA guaranty could be in jeopardy if SBA determines the projections were not properly “validated”.

SBA requires detailed projections, with supporting assumptions for any new business or when historical cash flow of an existing business is insufficient to cover the proforma debt service in the last full fiscal year and the most recent interim period.<sup>12</sup> Projections are also required for new lines of business or a separate division. Lenders may also require projections that are consistent with their internal policies and procedures and primary regulator requirements.

Lenders must do more than merely a box checking exercise. Analysis of the projections and validation of the assumptions is required to determine the reasonableness of the information provided.

The first step in the process is fact finding by asking the applicant probing questions.

- Where did the borrower get their financial information?
- Did it come from personal experience? Is this experience good or bad?
- Did the projections come from a Franchisor, seller, broker, CPA or some other entity? If so, are those sources qualified and trustworthy?
- How involved was the borrower in the creation of the projections?
- Is the applicant financially savvy and able to create forward-looking financial statements?

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<sup>12</sup> SOP 50 10 8; page 131

- Did some other entity create the projections for the borrower?
- What is the applicant's experience?
- What is the applicant's interest in the deal and is there a potential conflict of interest?

The next step is to unpack the borrower's business plan. This will assist the lender with a feel for what the project is in the client's own words. It is important to know what expectations are and be able to gauge their competency. Look for signs of artificial intelligence (AI) being used. While the use of AI is not necessarily a negative, it may not provide the same level of insight into the borrower that could be gleaned before this type of technology was utilized.

On the face of it, projections are worthless if no one has analyzed if the assumptions are reasonable. The lender's approval document should address key assumptions and why they appear to be reasonable and attainable. For example:

- Are the projected revenues appropriate for the business and industry?
- Is year over year revenue growth realistic?
- Are the operating and profit margins generally in line for a business in that industry?
- Have the variable and fixed expenses been identified?
- Variable expenses can be critical to a new line of business as an unforeseen risk
- Have fixed expenses, which are always present regardless of revenue production, properly account for?
- Have expenses been understated which can drain cash from the business?

This type of analysis is a high-level test before digging deeper into the individual expense categories. Often new owners and

operators will underestimate the cost of running their business, therefore a careful review of the projections and assumptions is critical as well as a discussion with the applicant as to the reasonableness of the projections.

How does a lender go about doing all the above? Existing loans are a great place to start by using previous loans as a benchmark. The lender can use the analytics of previously made loans and projections to compare the new request with. Even better would be to leverage the existing portfolio of loans and look at the historical financial statements as a comparison. Lenders should have a deeper understanding of a business's general operations from loans in their existing portfolio.

Lenders often have a tool to spread historical statements that makes year over year comparisons easier. These tools often provide ratio calculations. By using the lender's existing portfolio of loans and comparing the projections to historical performance, that can be another effective indicator of the appropriateness of the projections. As a best practice tip - build a searchable database by NAICS code for loans in your portfolio.

If the applicant is a new industry, leverage online resource providers like Risk Management Association (RMA), Moody's, and Vertical IQ to obtain industry accepted ratios. RMA, for example, provides a breakout of ratios based on revenue size.

For franchise requests, refer to the Franchise Disclosure Document (FDD). It will provide a high-level financial overview of existing franchises. Use the FDD as a comparative tool. The applicant might be projecting top tier performance out of a location half the size of an average franchise location.

Presenting the projections in the lender's credit approval document with fact-based analysis, supported by benchmark comparisons and addressing the major assumptions proves to SBA that the lender did indeed "validate" the projections

and provides documentation and justification as to why the approval was prudent. By taking the above steps, no crystal ball is needed as the lender can trust their analysis.

## **Partial Changes of Ownership: A New Tool with Seller Flexibility**

Mark Seymour | B:Side Capital

Sometimes buying a slice of the pie can be a better option than buying the whole thing. Partial Changes of Ownership -- also known as partial business acquisitions, buy-ins, or equity investments, are a relatively new eligible use of proceeds for SBA 7(a) loans, and are a great tool in any SBA lender's toolbox. The key for SBA lenders is to understand the eligibility requirements, how they apply to these unique structures, and the benefits/risks of partial changes of ownership.

Before applying the principles of partial changes of ownership, it is significant to understand the requirements provided by SBA's Standard Operating Procedures (SOP). First and foremost, the change of ownership must promote the sound development and/or preserve the existence of a small business.<sup>13</sup> This means that the proposed change of ownership must be in the best interest of the applicant (in this case the word "applicant" refers to both the business entity itself and/or the actual individual owner entity purchasing an ownership share) and benefit the applicant by allowing the operating entity to continue operations and to serve its customers/communities. Additionally, both the business and the individual or entity acquiring a new ownership interest must be co-borrowers on the new loan.<sup>14</sup> In addition, any selling owner (one who receives loan proceeds in exchange for selling part of their

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<sup>13</sup> SOP 50 10 8 page 115

<sup>14</sup> SOP 50 10 8 page 117

ownership) who remains as a direct or indirect owner and owns less than 20% of the business post-sale must provide a guaranty for the full loan amount for a period of 2 years after loan disbursement. And all individuals or entities that hold ownership interests of 20% or more must provide unlimited guaranties.

It is also important to remember that the maximum 7(a) loan use of proceeds for any change of ownership is capped at the business valuation amount.<sup>15</sup> Obtaining an accurate business valuation that complies with the SBA requirements is a key step for change of ownership projects as the amount of 7(a) financing available is tied to the appraised value of the business. When the valuation is lower than the purchase price in the sales agreement, any financed capital required must be subordinate to the 7(a) loan. This is a significant safeguard as lenders and borrowers need to ensure a reasonable purchase price. Along with the business valuation report, lenders need to obtain and review the purchase and sales agreement. For complete or partial change of ownership loan applications, the lender must obtain financial information from the seller, including 3 years of tax returns and interim financial statements. The tax transcripts of the seller must be verified using IRS Form 4506-C or 8821. A site visit of the business that is being acquired is also an SBA requirement.

Now that we have highlighted the SOP requirements governing this type of financing, the next important step is knowing when to apply these requirements. Step one is identifying a potential, creditworthy project that involves a change of ownership. While determining a

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<sup>15</sup> SOP 50 10 8 page 115

creditworthy project is outside of the purview of this article, lenders need to remember prudent lending principles and apply them accordingly. Once a change of ownership project has been identified and a letter of intent or draft purchase agreement has been provided, it is crucial that lenders key in on the needs of the buyers and the sellers. Namely, if the seller is looking to remain with the business as an employee, owner, director, etc., an applicant may opt for a partial change of ownership structure. This is because complete changes of ownership offer less flexibility to the seller, who cannot stay with the business beyond a maximum 12-month consultation period.

To further flesh out this key difference between complete and partial changes of ownership, let's use an example:

*Example #1 - Nilbo Daggins currently owns 100% of Ring, Inc and he would like to sell 100% of his business to his good friend and longtime employee Dandalf. However, Nilbo has some reservations about fully letting go of his business and would like to stay as an employee for at least two more years.*

*If a lender were to apply the 7(a) rules of a complete change of ownership, Nilbo would not be able to stay beyond a 1 year consulting period.*

*Upon advice from his financial consultant and tax/legal team, Nilbo decides to revise the purchase agreement to instead sell less than 100% of his stock in Ring, Inc to Dandalf and retain a percentage of ownership less than 20%.*

Under this structure, Nilbo gets to stay indefinitely at Ring, Inc., but as a selling owner retaining an ownership interest less than 20%, he will need to provide a guaranty for the full amount for a period of 2 years after loan disbursement. This structure also promotes the sound development of the business as Nilbo's continued presence at the company helps ensure a smooth transition between the old and new ownership. This selling point extends to Dandalf, as he maintains the benefit of continuity within the business, gains the luxury of time while learning the ins and outs of the business, and gets to continue to work with his good friend. By utilizing the partial change of ownership structure, the lender would be able to make both the buyer and seller happy and also keep the project eligible under a government-guaranteed loan program.

*Example #2 - Dr. A and Dr. B each own 50% of a surgical center. Dr. B would like to retire and sell her 50% interest to Dr. C. The structure of this credit will be that Dr. A will be a guarantor on the loan and Dr. C and the surgical center will be co-borrowers. Dr. A is interested because finding another qualified surgeon is difficult and Dr. A wants to keep the business going. Additionally, it allows Dr. A flexibility to sell to Dr. C (or another party) down the road if desired. Dr. C gets to enter the business as an owner and Dr. B gets to exit and retire.*

As shown by these two examples, applying partial change of ownership structures can be beneficial in a variety of ways. Like all loans that finance changes of ownership, however, there are associated risks. Primarily, these types of projects tend to finance

intangible assets/blue sky/goodwill, which do not have lendable equity. As a result, these projects are frequently undercollateralized. By utilizing the SBA 7(a) program and complying with the program's collateral rules/requirements, lenders can gain additional comfort with a government guaranty.

In conclusion, partial changes of ownership are a versatile, eligible use of the 7(a) Loan Program that can finance unique projects and grant the sellers/buyers additional flexibility by letting sellers stay with the business and by presenting fewer restrictions as compared to complete changes of ownership.

# Documenting Construction Loan Disbursements

Kathryn Bailey | First Bank of the Lake

If you thought underwriting and closing a construction loan was fun, just wait! Properly documenting and managing construction loan disbursements is crucial for protecting SBA borrowers and the lender's SBA loan guaranty. Construction loans come with their own set of challenges, and in this article, we will dive into some best practices to consider when disbursing construction loans.

While we won't focus on pre-closing construction requirements in depth in this article, it is impossible to discuss construction loan disbursements without first mentioning the construction loan budget. Prior to closing a construction loan, it is vital that the budget is strong. This includes the necessary funds needed for the borrower's fixed price construction contract, but also for contingency, soft costs, and monitoring. In reality, it is rare to finish a construction project without any changes to the project, commonly known as change orders, so an appropriate contingency is important in setting borrowers up for success when unexpected changes and subsequent costs arise. A strong, carefully crafted budget will help eliminate surprises while the loan is in the disbursement phase.

Whether the construction component is \$350,000 or less, or the construction proceeds are over \$350,000, it is still prudent to follow strong disbursement procedures internally. Lenders should also ensure the borrower's General Contractor (GC) understands and agrees to these procedures before the applicant enters into a construction contract.

The following documentation should be collected during the disbursement of construction loans:

- Lien Waivers

- Collecting the appropriate lien waivers from the GC and their Subcontractors mitigates the risk that mechanic liens will be filed on the construction job. When the GC submits a request for payment, they should also include corresponding lien waivers. For progress payments, the GC should include progress conditional lien waivers from them and all subcontractors and suppliers. Unconditional lien waivers should then be collected at the time of any subsequent pay application to affirm all have been paid. For final payment, the GC should include their final conditional lien waiver and unconditional final lien waivers from all subcontractors and suppliers to ensure they have been paid in full on the project. If subcontractors and suppliers remain unpaid at time of final payment application, the lender may be willing to accept conditional final lien waivers but should consider making final payments payable to each unpaid subcontractor and supplier instead of to the GC. When referring to “final payment,” this should be the retainage that is owed to the GC at the end of the project. The Fixed Price Contract should include language confirming that 10% retainage will be held back, unless the specific state the project is in has its own requirement.
  
- Depending on how many subcontractors are working on the project, it can be tedious to monitor the lien waivers required. Maintaining a tracker can be a helpful tool that lists out the names of all contractors involved in the project, details how much they are paid per draw, and indicate when their conditional/unconditional lien waivers are collected on a per draw basis. It can also be a great tool to ensure all final

unconditional lien waivers are received to document that all contractors have been paid in full. Third-party Construction Risk Management (CRM) can also come in handy here – typically CRMs provide various types of funds control methods, which can include lien waiver collection, and even pay each sub/supplier directly.

- Listing of Subcontractors/Suppliers
  - o Collecting a list from the GC of their subcontractors/suppliers will provide transparency in knowing who is working on the project and will aid in the monitoring and collection of lien waivers. In the pay application package from the GC, request that a listing of all subs/suppliers is included, along with the dollar amount each of they are being paid per draw. Lenders should ensure that the appropriate lien waivers are collected from the subs, equaling the amounts being paid to them.
  
- Change Orders
  - o During the construction period, it is important that no changes are made to the project without the lender's prior review and approval. Before closing, obtain an agreement from the borrower and contractor that no change orders shall be implemented by the parties without the lender's prior written approval. Consider creating a Construction Addendum to include this language and all other requirements. If change orders do come up during construction, a Contingency Calculator is a valuable tool to help ensure the project stays on budget.

- Contingency Calculator
  - o To avoid burning through all construction contingency funds too early on in the project, it is prudent to only allow access to the percentage of contingency funds based on the completion percentage of the project. As change orders are received, add them into a contingency calculator, along with the completion percentage of the project. Using those pieces of information can help to confirm whether or not the construction budget is still on track. Remember that the lender and SBA are not obligated to fund or provide funds for any additional cost overruns, and the borrower may be responsible to pay cost overruns out of pocket if the contingency is not sufficient.
  
- Construction Monitoring
  - o Third-Party CRM can be used in various ways, depending on the details of the project. CRMs can provide an Initial Project Review (“IPR”) before closing, where they review the construction documents to ensure the project can be completed on time and in budget, according to the contract, schedule, and plans and specs provided. According to the findings in the IPR and a review of the GC, lenders can then consider using the CRM for various types of funds control disbursement. Lenders may either advance funds to the GC where the GC will pay his subs/suppliers individually, or they may feel more comfortable with full funds control through the CRM, where they will pay the subs/suppliers directly. This method of full funds control can provide assurance that the subs/suppliers are being paid and mitigate the risk of liens being filed.

- CRMs can also just provide site inspections to ensure that the construction project is on schedule and is being completed in accordance with the plans and specifications initially provided. For projects with a construction component of \$350,000 or less, lenders might consider requiring a site inspection at 50% and 100% completion rather than one per draw. If this exception is made, it is prudent to request pictures from the GC to substantiate the draw request in lieu of site inspections.

While it can be easy to focus on just getting an SBA loan to the closing table, this article only scratches the surface on the importance of construction disbursements and things to consider. Lenders must adopt best practices for monitoring and disbursing their construction loans to minimize the risk of losing the SBA guaranty and to ensure that their borrowers are set up for success!

## Vehicle Titles: Driving Toward a Simpler Process

Brandia Bradshaw | Live Oak Bank

The SBA industry shared a collective cheer when the SBA published Procedural Notice 5000-862692 effective December 6, 2024. One of the key reasons for this excitement was the update regarding placing a lien on a vehicle when it provides a minimal recovery value of less than \$10,000. The excitement continued with the recent technical update of the SOP 50 10 8 which raised the threshold again to \$20,000. This is a positive step, the question remains: is it enough?

To help answer that question, below are some results from a recent survey<sup>16</sup> answered by members of NAGGL from 40 SBA lending institutions ranging from under \$50MM in assets to over \$10B<sup>17</sup> in assets, providing a diverse sample of insights:

- 100% of respondents originate loans with vehicle collateral.
- 90% responded that the process of collecting and perfecting liens on vehicle titles is cumbersome from a bank operations perspective and 83% thought it also was cumbersome from the client perspective.
- Only 8% felt the current threshold was sufficient and did not need further revision.

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<sup>16</sup> Unpublished survey conducted by Brandia Bradshaw; “SBA Collateral: Vehicle Titles” (January 2025)

[https://forms.office.com/Pages/ResponsePage.aspx?id=JF\\_4JloVuUS7gl5Rao9C5O8L0Uhl2CtKko3tRZ\\_3a0lUQUjP7VklRRERUOVBYNENLTFJLVpOU0xKNC4u](https://forms.office.com/Pages/ResponsePage.aspx?id=JF_4JloVuUS7gl5Rao9C5O8L0Uhl2CtKko3tRZ_3a0lUQUjP7VklRRERUOVBYNENLTFJLVpOU0xKNC4u)

<sup>17</sup> See Appendix A

The challenges of perfecting liens and servicing of vehicle collateral are significant and the recovery on this collateral is often minimal. Origination and servicing involve extensive paperwork, fees, releases, and expertise in the nuances of different state regulations<sup>18</sup>. Given the effort, time, money, and resources it takes to perfect the title and any subsequent liquidation on behalf of the borrower and lender, many in the industry question whether the burden is justified. As we often say around the office, is *the juice worth the squeeze?*

## **Challenges in Vehicle Title Processing**

### **Origination Challenges**

Lenders must coordinate with dealerships or private sellers to secure proper documentation, estimate fees, and handle title replacements. Third-party delays can lead to multiple follow-ups and increased processing time. Additionally, lenders must determine appropriate fees to charge for processing the title(s), which can fluctuate based on state requirements. These uncertainties may result in unexpected costs for borrowers and potential closing delays.

Some lenders establish an escrow account, if the recorded perfected title has not been obtained, to ensure that the loan proceeds allocated to vehicles are held back at closing. However, SBA only allows loan proceeds to be held for 5 days which is not typically

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<sup>18</sup> Mr. Jenkins; “*Understanding the Cost to Transfer a Vehicle Title: A Complete Guide for Buyers and Sellers*” (December 29, 2024) <https://bluenotary.us/cost-to-transfer-vehicle-title/>

enough time to receive the title with lender lien. Other institutions fund in good faith when all the proper paperwork is filed and often end up waiting for months for perfected titles due to delays by third parties. This creates additional administrative burdens as lenders must continually monitor and follow up on outstanding titles.

Approximately 15 states offer electronic vehicle titles which can help speed up the process, however there are still about 35 states that still only accept paper vehicle titles<sup>19</sup>, which can take an average of over a month to process<sup>20</sup>.

### ***Servicing Challenges***

Title-related servicing requests are common as vehicles are wrecked, traded in, or sold. For companies with vehicle fleets, this can mean multiple servicing requests per year, significantly increasing administrative workload. It can take 2-6 weeks for the paperwork and release to be completed<sup>21</sup>. Half of the survey respondents engage a third-party vendor to assist with vehicle titles due to the complexities, further increasing fees that are often passed onto the borrowers. However, the trade-off for those services can be valuable ensuring the lien is filed and/or released in a timely manner and

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<sup>19</sup> Wikipedia: “*Electronic Lien and Title*” (June 14, 2024)  
[https://en.wikipedia.org/wiki/Electronic\\_lien\\_and\\_title](https://en.wikipedia.org/wiki/Electronic_lien_and_title)

<sup>20</sup> Dustin Hawley: “*How Long Does It Take To Transfer a Car Title?*” (April 9, 2023)  
<https://www.jdpower.com/cars/shopping-guides/how-long-does-it-take-to-transfer-a-car-title>

<sup>21</sup> Progressive: “*How long does it take to get the title after paying off a car?*”  
<https://www.progressive.com/answers/car-title-after-paying-off-loan/>

following the correct process for each jurisdiction. Ultimately, this could help protect the guaranty.

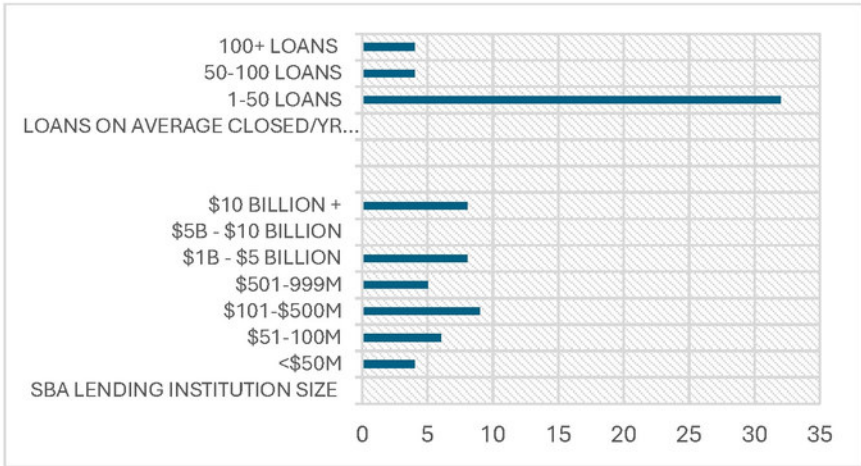
### ***Unintended Consequences: A Barrier to Access to Capital***

The complexity of vehicle title requirements has led some lenders to avoid loans with multiple vehicles or industries that heavily rely on vehicle collateral. Several survey respondents indicated that these operational burdens deter lenders from approving such loans, creating a roadblock to access to capital. Additionally, the delays in perfecting liens can postpone the funding of critical business capital, with one article summing up the overall challenges stating, *“These loans are difficult to qualify for and take a long time to fund.”*<sup>22</sup>

Regardless of lender size, most survey respondents said they did less than 50 loans a year with vehicle collateral.

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<sup>22</sup> United Capital Source: *“SBA Commercial Vehicle Loans: The Essential Guide”*  
<https://www.unitedcapitalsource.com/blog/sba-commercial-vehicle-loans/>



This raises further questions:

- Would more loans get done if vehicle collateral rules were expanded?
- Are industries heavily dependent on vehicles underserved by SBA?
- Is the capital flow to businesses unnecessarily delayed due to paperwork and lien processing inefficiencies?

### ***Exploring Potential Solutions***

Striking a balance between protecting SBA program integrity while reducing barriers for borrowers and lenders is essential. Many survey respondents did not think the recent changes have gone far enough. Examining these challenges can be a catalyst for innovative ideas. Here are some potential alternatives SBA could consider:

### 1. ***Increase the Vehicle Collateral Threshold***

- Require only vehicles valued over a higher set dollar amount to be taken as collateral.
  - Due to depreciation and inflation, the threshold would have to be moved much higher than \$20,000 for the impact to really be felt by borrowers and lenders.
- Apply this rule only when the vehicle is deemed essential to business operations.
- Define "essential to business operations" clearly, allowing lenders to establish consistent policies.

### 2. ***Tie Vehicle Collateral Requirements to Loan Size***

- Establish a collateral threshold based on vehicle value relative to the total loan amount.
- Example: If a \$5,000,000 loan includes four vehicles valued at \$60,000 total (1.2% of the loan amount), that specific loan could be exempt from taking vehicle collateral.
- Implement a standardized threshold (e.g., 3-5% of total loan amount) to ensure consistency across SBA 7(a) loans and minimize potential losses.

### 3. ***Account for Vehicle Depreciation***

- According to Kelley Blue Book, on average, new cars depreciate about 20% over the first year and continue

a downward trend with an additional loss of value at about 60% of purchase price over 5 years<sup>23</sup>.

4. Given that SBA views collateral as secondary in loan-making decisions, modernizing vehicle collateral requirements could improve loan processing efficiency without significantly increasing risk.

## 5. ***Consider Potential Recovery***

- SBA SOP 50 57 states that “Lenders may abandon the pursuit of recovery from personal property collateral if the property has insignificant Recoverable Value, i.e., the individual or aggregate Recoverable Value is less than \$5,000. Lenders must document their decision and justification for abandoning collateral, including the basis for the Recoverable Value estimate, in their Loan File.”
- Considering depreciation and having to sell in a liquidation scenario where typically the lender is not getting full price, the remaining funds to offset losses are going to be nominal. Often, it will fall into the category of collateral that could be abandoned anyway. So, is the new \$20,000 threshold really doing much to protect the lender and SBA from loss?

## ***Conclusion***

Addressing vehicle title challenges presents an opportunity to improve efficiency in SBA lending.

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<sup>23</sup> Chris Hardesty: “How to Beat Car Depreciation” (10/17/2024)  
<https://www.kbb.com/car-advice/how-to-beat-car-depreciation/>

Revising vehicle collateral requirement-thresholds could reduce loan processing burdens, expand access to capital, and accelerate funding for businesses that rely on fixed assets that include vehicles. As the industry continues to adapt, collaboration between lenders and SBA policymakers will be crucial in driving meaningful reforms that benefit both financial institutions and small businesses while maintaining program integrity. While the recent changes may offer some improvement, there is not much juice for the squeeze, and collectively the industry is thirsty for more.

# Guide to Reviewing Purchase Agreements

Dorothy Ligas | First Citizens Bank

Purchase agreements often contain complex legal terms that can be challenging to interpret. To effectively manage and ensure timely loan funding, as part of a due diligence review of a closing file, reviewers must understand these documents, identify key details, and provide clear feedback to applicants. This knowledge helps streamline the process and prevents unnecessary delays.

A fundamental aspect of review is ensuring that the purchase agreement is assigned to the correct borrowing entity whether it's the Eligible Passive Company (EPC) or the Operating Company (OC). Additionally, determining the closing date and whether an extension is required is crucial.

Beyond these basics, reviewers must assess the type of sale to determine if it involves commercial real estate (CRE), a business acquisition, or a stock purchase. Understanding what is included in the sale such as inventory, equipment, or other assets is also essential.

Below is an outline of key considerations and questions to ask when reviewing any purchase agreement.

## Key Elements of a Purchase Agreement Review

### 1. Parties to the Contract

- Confirm and verify the legal names of the buyer and seller against formation documentation.

## **2. Documents to Review**

- Purchase Agreement and any amendments.

## **3. Business Description**

- Details of the company and its operations.
- Attestation of the seller's legal authority to authorize the sale.
- Legal representations and warranties.

## **4. Terms of the Sale**

- Define the type of sale: Asset Purchase, Stock Purchase, or CRE.
- Purchase price and payment structure.
- Required deposits and the date they become non-refundable.
- Closing date and commencement of transfer (time is of the essence).
- Conditions to be met before closing, such as loan approvals, inspections, and appraisals.
- Breakdown of assets and allocation of the purchase price.
- Post-Closing conditions or purchase price adjustments.
- Inclusion of inventory or equipment; confirmation of count, value, and terms.
- Transfer of any state-controlled assets (e.g., liquor licenses) and/or franchise agreements, contracts.
- Contingencies - all dates are confirmed and satisfied.
- Any credits, rebates that benefit the applicant, or holdbacks.

## **5. Covenants in the Agreement**

- Seller's obligations at closing, including taxes, loan payoffs, employee wages, prepaid deposits, and work-in-progress.
- Non-compete agreements, including verification of the duration, geographic scope, and any associated costs.

## **6. Transfers**

- Define buyer and seller responsibilities post-close.
- Will the seller remain involved in any capacity (e.g., training, customer obligations)?
- Bill of Sale (required in all deals except CRE) to confirm the transaction's conclusion.
- Seller Requirement - must exit for in complete change of ownership transactions.

## **7. Licenses, Bulk Sale, and Government Requirements**

- Bulk Sale Laws: Some states (California, Delaware, Illinois, New Jersey, New York, Connecticut, and Pennsylvania) require compliance; need to confirm with legal counsel.
- Are all required licensure and permits in place or are they conditional?
- Obtain required state notices for posting and completion.
- Verification of seller tax payments and outstanding filings.
- Licensing considerations - does the seller need to remain involved for the transfer of business-related licenses? If the license is held by the seller, then the seller is a required guarantor in

partial change of ownership transactions—even if ownership percentage is less than 20%.

- Asset allocations as listed in contracts.
- Franchise agreement - costs, documentation, and required approvals.
- Notice to creditors (check jurisdictional requirements with counsel).
- Employment agreements—determine employee vs. consultant roles; term should not exceed one year.

### **8. Governmental compliance**

- Does the agreement confirm that premises and equipment comply with applicable government regulations as of the closing date?
- Are all seller obligations, including taxes, paid to ensure a good-faith transaction?

### **9. Credit Approval Conditions**

- What is being assigned - “customer lists, leases, contracts?”
- What approvals or actions must be completed before closing?

It is important to ensure that both the lending institution and the borrower are protected in any sale transaction. An important aspect of a due diligence review is to guide borrowers toward a successful closing by helping them understand key terms and obligations in their purchase agreement while ensuring that a transaction is eligible and meets SBA program requirements.

By developing a strong working knowledge of these agreements and creating a comprehensive closing

compliance checklist, reviewers can improve efficiency, reduce delays, and facilitate smoother transactions. A successful closing process includes a thorough understanding and review of the purchase agreement.

## Post Closing Lien Searches: A Critical Compliance Step

Jessica Barr | Lake Michigan Credit Union

As participants in the US Small Business Administration (SBA) program, lenders are acutely aware of the importance of a Post Closing Lien Search as a crucial step in protecting required collateral lien positions and ensuring compliance with the SBA Loan Program. So, why do lenders continue to be cited for this exception in their Risk Based Reviews?

SOP 50 10 8 states: **“The Lender must obtain all required collateral with evidence of proper lien priority and must meet all other required terms and conditions as applicable before or at the time of disbursement, including obtaining valid and enforceable security interests in any loan collateral.”**<sup>24</sup> At annual conferences and during Regional Committee meetings, lenders have shared that the SBA Office of Credit Risk Management (OCRM) has stated post-closing lien searches continue to be one of the most common exceptions in all Risk Based Review audits. And with defaults on the rise and the amount guaranties honored by SBA up over 50%<sup>25</sup>, it is more important than ever to ensure proper lien documentation is in the loan file. When lenders fail to confirm lien position, they risk a repair or denial of the SBA guaranty which can have significant financial and reputational consequences.

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<sup>24</sup> Section B, Chapter 5, pages 321-322

<sup>25</sup> Loan Program Performance Report; Purchase Amount by Program as of 9/30/2024

This article aims to outline the importance of not only the Post Close Lien Search, but documenting lender efforts to confirm lien position with specific requirements for different types of collateral including real estate, business personal property and title collateral. This is important for all SBA lenders, and especially critical for lenders who sell their loans on the secondary market. When a loan is sold on the secondary market, and SBA Form 1086<sup>26</sup> is executed, the lender is attesting that they have **“... underwritten, closed and serviced the loan in a prudent manner and in accordance with all SBA Loan Program Requirements as that term is defined in 13 C.F.R §120.10”**. This includes ensuring the lien position matches that of the E-Tran Terms and Conditions. Selling a loan before confirming lien position can create loan buyback risks and reputational damage with investors.

Post-closing lien searches are a critical quality control measure that confirms the lien position outlined in the E-Tran Terms & Conditions. While many lenders understand this and traditionally process internal lien searches, failing to formally document these lien searches can lead to serious issues. One of these issues is undetected prior liens. If another creditor has filed a lien between the date pre-closing searches were performed and when the lender’s lien was filed, the lien position will be compromised. Filing errors can also be corrected if caught early. These may include mistakes in debtor names on UCC filings, improper mortgage vesting language or not collecting a life insurance

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<sup>26</sup> Secondary Market Loan Sale Agreement (SBA Form 1086) Section 2.1

collateral assignment acknowledgement, which can render a lien invalid and put the SBA Guaranty at risk if the SBA determines a lender failed to secure the required lien position based on the E-Tran Terms and Conditions. The loan could be flagged for denial or repair of the guaranty in the event of default. Additionally, there could also be Secondary Market implications.

Lenders must document their loan file with evidence of their post-closing searches, including dates of these searches, prior to any execution of SBA Form 1086. Supporting documentation, dated, and in file should include the following based on the type of collateral:

1. Real Property

- ALTA Loan Policy or post-closing recording/filing search
- If the title commitment is not yet available (since it can take months to obtain in some cases), lenders should document the file with these minimum verifications:
  1. The title insurance premium has been paid.
  2. The file contains proof that the Deed of Trust or Mortgage was submitted for recording.
  3. A Marked-Up Title Commitment has been obtained.
  4. The title insurance commitment includes gap coverage (protection for the period between closing and recording).
  5. The lender maintains documentation of periodic follow-ups to obtain the final title

policy using their internal tracking system.

## 2. Business Personal Property/All Business Assets

- Confirmation that the applicable UCC-1 Filing is recorded.
- Conduct a UCC filing search for the debtor's name and other variations of the debtor's name and save evidence of the search in the loan file.

## 3. Titled Collateral

- Conduct a title search through the DMV or relevant agency to confirm lender as lienholder on title and confirm no competing liens exist.

To remain compliant and audit ready, lenders should ensure they are keeping detailed records of all post-closing lien searches and lien confirmations. They should be following up proactively on missing title policies, UCC filings and lien recordings. Lenders should be using tickler tracking systems to ensure receipt of lien confirmations.

Post-closing lien searches and lien position confirmations are not just administrative tasks but an essential risk mitigation tool for SBA 7(a) lenders. Ignoring them or not properly saving evidence to the loan file could lead to OCRM exceptions, incorrect lien positions that can result in repairs or denials of the guaranty and secondary market issues. To safeguard the lender's portfolio, as a best practice, following these important steps:

1. Use a good post-closing checklist!
2. Conduct timely post-closing lien searches and document the file
3. Make sure the search date is documented and is before the date of executing SBA Form 1086
4. Use a tickler tracking tool for follow for outstanding items

By prioritizing these steps and verifying the proper lien position prior to selling the loans on the secondary market, lenders are able to ensure compliance, reduce risk, and further support the integrity of the SBA loan program.

## **Deferrals! To Yay or Nay**

Joe Chiarappa | First Savings Bank

When a lender is approached with a request for a deferral or payment modification it is important to understand what goes into a decision for this type of servicing action. A deferment is defined as “A temporary solution to a temporary problem.”<sup>27</sup> When first approached with a request for a deferral the lender must determine why the borrower is asking for a deferment. Does the need and the duration of the deferral fit the perceived need? There are three main points to consider with reviewing a deferral request. Those include understanding the ‘why’ behind the requested deferral, what is the recovery time of the incident triggering the requested deferral, and an updated financial review of the borrower.

Let’s look at a hypothetical example. The owner of a laundry business requested a 3-month deferment because the road in front of the business was being expanded from 2 to 4 lanes. The construction work that was taking place obstructed customers from entering the parking lot. This loan was not sold on the secondary market. If a loan is sold on the secondary market, the lender may grant only one payment deferral of up to three consecutive months without the prior consent of the investor.<sup>28</sup> Once the initial request is received by the lender, the first step in the process is to begin with a review of the loan file. The Loan Authorization/E-Tran terms and conditions, along with the Business Loan Agreement and other origination documents, should be reviewed to ascertain if the borrower is in compliance

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<sup>27</sup> SOP 50 57 3.1, page 90

<sup>28</sup> SOP 50 57 3.1, page 91

with those documents. This review should include determining if the borrower has submitted annual updated financial information. The lender should verify if all required insurance, including hazard, flood, liability, life, etc. is in full force and effect and that none of the deductibles have been increased without the lender's approval. The status of property taxes and any other senior liens must also be confirmed to be current and in good standing. Additionally, if there are any junior creditors or seller notes, are these creditors also going to defer their loan payments? After all, why should the SBA lender who has a senior lien approve a deferral if junior creditors or standby sellers will continue to be paid? If there are any technical defaults, the lender must identify these issues and determine if they can be cured as part of the overall servicing request, or if the request should be declined if the default cannot be cured.

The borrower should be made aware of documentation deficiencies that would need to be addressed before proceeding with the approval of the deferral. Perhaps a lending institution may need an updated form signed, or life insurance has lapsed, or there is an unauthorized change of ownership without the lender's knowledge or consent. It is important to remember when a servicing request is made is the best time to require the borrower cure all of these issues and any documentation deficiencies to get the loan into compliance with both SBA and the lending institution's policies and requirements. The purpose of this is to not only protect the SBA guaranty but to make sure the lender fully understands the borrower's financial status and the true impact of the triggering event. Upon receipt of updated financials, it is prudent that the lender review those

financials for positive or negative trends as well as understanding how the borrower has executed the original business plan proposed at underwriting or how/why it has deviated. The purpose of this review is to peel the layers back on the onion to ensure compliance with the 7(a) program and recognize potential weaknesses with the overall credit.

In our example, upon receipt of required financial information, it was determined the borrower's debt service coverage (DSC) had increased from 1.35:1 at origination to nearly 1:50:1 reflecting a positive and favorable trend. Additionally, the lender confirmed with the city where this business was located to validate the construction and the subsequent timeline. The city validated that construction would take approximately 2.5 months to complete. Per the SOP, "Payments during a deferment period are not mandatory, but are preferred since even a small payment, such as a \$1.00, will keep the borrower in the habit of making payments and will also keep the borrowers pre-authorized debit method of payment active."<sup>29</sup> Therefore, if a borrower is able to resume payments before the expiration of the deferment period, or if they are able to make partial payments, they should be encouraged to do so.

After understanding the need for the deferral, validating the details, reviewing the financials, and understanding the projected complete date of the construction, in our scenario, a 3-month deferral would be reasonable and prudent. It was clear that this was a temporary hurdle for the borrower and the borrower had also displayed the

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<sup>29</sup> SOP 50 57 3.1, page 91

ability to cash flow their existing debt load once the business returned to normal operations.

Not all loans result in approval of a deferral request. Many lenders can recall when a request is made for a deferral, but it is a temporary band-aid to a permanent problem. For example, a borrower who habitually is late on their monthly loan payment and doesn't remit financials per their loan documents could be experiencing a more long-term problem that isn't solved by a short-term loan payment deferral. Despite the poor payment history, lenders must take the time to review each loan request within their portfolio and use it as an opportunity to assist borrowers for long-term success. And each servicing request is an example opportunity to review the file for any technical defaults and documentation deficiencies that can be cured as part of the servicing action review process.

The goal is to protect the SBA guaranty while assisting borrowers during a season when they may be experiencing adverse events. It is easier said than done. A deferment is not a death sentence but an opportunity to help borrowers to the next positive step in their growth when the issue at hand is temporary in nature.

## **Seeking SBA Approval on COVID-19 EIDL Subordination Requests**

Nina Yuen | Western Alliance Bank

Ready to lock in approval and close that next deal, only to discover that the proposed collateral will be in a junior position behind an SBA COVID-19 EIDL loan? Between March 2020 and January 2022, SBA offered low-interest COVID Economic Injury Disaster Loans (EIDL) up to \$2,000,000 to small businesses to assist with economic disruptions resulting from the pandemic and help small businesses overcome the temporary loss of revenue. Loan proceeds could be used to pay for the following types of expenses:

- Fixed debts
- Payroll
- Accounts payable
- Other bills

Unlike Paycheck Protection Program (PPP) loans, EIDL loans were not forgivable. SBA offered long-term repayment of up to 30 years, based on the borrower's ability to repay. The interest rate was 3.75% for small businesses without credit available elsewhere or 2.75% for non-profits. Businesses with credit available elsewhere were not eligible. As part of the application, small businesses and non-profits could request an EIDL advance up to \$10,000 (\$1,000 per employee) of

emergency economic relief with no required repayment, even if they were not approved for a COVID EIDL loan.<sup>30</sup>

SBA filed a lien on the borrower's business assets for EIDL loans greater than \$25,000. For loans greater than \$500,000, SBA also took a lien on the borrowing entity's commercial real estate property, if available. Primary residences owned by the business principals were never taken as collateral. The only time a residential property may have been considered required collateral was when it was used as a rental property. SBA has recognized that the assets pledged to secure EIDL loans may also be needed as collateral for new commercial loans. Often, new lenders are only willing to provide financing if they are granted a senior position in the collateral. To support borrowers in securing additional financing for ongoing growth, SBA has indicated willingness to review requests to subordinate their lien positions, provided the borrower is current on its EIDL loan payments. So how does a lender go about requesting lien subordinations?

The first step is to have the borrower email the Covid EIDL Servicing Center (CESC) at [CovidEIDLservicing@sba.gov](mailto:CovidEIDLservicing@sba.gov) to request a copy of the

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<sup>30</sup> SBA.gov - <https://www.sba.gov/funding-programs/loans/covid-19-relief-options/eidl>

latest “Application for Lien Subordination” form.

Currently, there are two different application forms<sup>31</sup>:

- **SBA Form 2527** – for Non Real-Estate lien subordination
- **SBA Form 2520** – for Real Estate lien subordination

Depending on the request, the borrower will need to sign and complete one (or both) application forms. The request for the forms must come directly from the borrower. SBA will not release a blank copy to the lender. SBA will confirm if the loan number and email address from the requesting party matches their records. To expediate the request, the following information should be included when emailing SBA<sup>32</sup>:

### **Subject Line**

- Loan or application number and reason for request

### **Body of Email**

- Loan or application number
- Reason for request
- Business name

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<sup>31</sup> U.S. Small Business Administration- Office of Capital Access – 7(a) Connect Quarterly Update, 10/8/24

<sup>32</sup> SBA.gov - <https://www.sba.gov/funding-programs/loans/covid-19-relief-options/covid-19-economic-injury-disaster-loan/manage-your-eidl#request-a-lien-subordination-or-other-servicing-actions>

- Applicant name and contact information

Upon receipt of the application form from SBA, the lender can help the borrower complete the form. The questions within the form provide SBA with the reason for the lien subordination request, business entity and ownership information, and a list of collateral to be subordinated. On top of completing the form, additional documentation must be included with the package. Some of the requested documentation includes a “Borrower Authorization” form allowing SBA to release information regarding the EIDL loan to the requesting financial institution, copy of a UCC lien search, and proof of hazard insurance. Although the application form includes an option for electronic signatures, SBA EIDL processors have indicated that scanned copies of “wet” signatures are required. Once the form is completed and the requested documentation is compiled, the entire package must be sent to CESC at [CovidEIDLservicing@sba.gov](mailto:CovidEIDLservicing@sba.gov) for processing. When the borrower signs the “Borrower Authorization” form granting access to information on their EIDL loans, the subordination request package can be submitted by the lender, with a copy to the borrower. This will keep the lender updated once the subordination request is approved. SBA will need the lender’s contact information to sign the “Subordination Agreement in Favor of Lender” document.

On the 7(a) Connect Quarterly Update on 10/8/2024, SBA discussed the current turn times at the processing center. Upon receipt of a complete package, the turnaround time for EIDL subordination requests is approximately seven (7) business days if approved:

- 1-2 business days for initial review
- 3-5 days for SBA's Legal Counsel to prepare the Subordination Agreement

A copy of the "Subordination Agreement in Favor of Lender" Agreement signed by SBA's Legal Counsel will be emailed back to the financial institution with instructions to sign and return a copy back to [CESC.UCCFilings@sba.gov](mailto:CESC.UCCFilings@sba.gov), within five (5) business days to formally document the request.

Based on my experience, SBA has generally approved the EIDL subordination requests without any issues or additional requirements. However, SBA clarified during the October 2024 7(a) Connect Quarterly Update that there will be paydown requirements for lien subordination requests for the following scenarios:

- Cash-out refinance of junior debt
- Business expansion
- Buy-outs and buy-ins

In a recent discussion with an SBA processor in the COVID-EIDL department, additional scenarios requiring some form of principal paydown included the following:

- Purpose other than ongoing operations
- Debt consolidation
- New loan requiring an injection of company cash
- Any scenarios that result in cash out to the borrower
- Funds a real estate or business acquisition
- Is for investment purposes
- Is to an affiliated entity with no quantifiable benefit to the borrowing entity with the EIDL loan

COVID EIDL loans were approved for operational disaster assistance, with funds not to be used for expansion. SBA does not have a specified amount that needs to be paid down. It will vary on a case-by-case basis.

In situations where the borrower is unable to make the requested paydown, what options are available? The borrower may be able to apply for a hardship accommodation with SBA by sending a letter explaining the reasons why the requested paydown is not feasible. It is recommended that the borrower specify an amount that they can pay. However, it is not guaranteed that SBA will approve the request. Another option is for the Lender to evaluate its collateral pool and see if a senior lien ahead of SBA is truly necessary. There may not be much value in the collateral, primarily in the business assets, so the Lender may be comfortable being in a junior lien position. If fixed assets are being acquired with the proposed new loan, the lender could always

perfect a Purchase Money Security Interest (PMSI) to obtain a first lien position on new assets acquired.

Given the potential for issues or delays, it is recommended that the requests are submitted to SBA as soon as there is the likelihood the new financing will be approved. Lenders should start working with their borrowers by having the application forms completed and compiling the documentation as part of the underwriting process. This way, the request package will be ready for submission when the time comes and avoid delays in loan closings.

## **APPENDIX A**

### **SURVEY QUESTIONS PROVIDED TO THE NAGGL MEMBERSHIP & NUMERICAL RESULTS**

- 1.) What size of an SBA Lending Institution are you answering on behalf of?
  - a. <\$50M (4)
  - b. \$51-100M (6)
  - c. \$101M-\$500M (9)
  - d. \$501-999M (5)
  - e. \$1 Billion - \$5 Billion (8)
  - f. \$5-10 Billion (0)
  - g. \$10 Billion+ (8)
- 2.) How many loans on average per year does your lending institution close with vehicles as part of the collateral?
  - a. 1-50 loans/year (32)
  - b. 50-100 loans/year (4)
  - c. 100+ loans/year (4)
- 3.) Do you see the process of collecting and perfecting liens on vehicle titles as cumbersome from a bank operations perspective?
  - a. Yes (36)
  - b. No (4)
- 4.) Do you see the process of providing and perfecting liens on vehicle titles as cumbersome from a client perspective?
  - a. Yes (33)
  - b. No (7)
- 5.) If you answered yes to questions 3 and/or 4, please give some of the challenges you have encountered with vehicle titles:
- 6.) Do you pay a third-party vendor to help process vehicle titles?
  - a. Yes (20)
  - b. No (20)
- 7.) Has your lending institution ever had a repair or denial on a guaranty request for not having vehicle properly collateralized?
  - a. Yes (5)
  - b. No (22)
  - c. I am not sure (13)

- 8.) If there has been a repair or denial due specifically to an issue with a properly collateralized vehicles, what is the estimated amount of the loss?
- a. <\$20,000 (3)
  - b. <\$50,000 (1)
  - c. >\$50,000 (1)
  - d. No loss has every been sustained due to vehicles (19)
  - e. I do not have that data (15)
- 9.) If the SBA were willing to update policy around vehicle collateral, which option would be most beneficial to the bank and clients, making the process easier for both, while still protecting the integrity and spirit of the SBA loan program.
- a. Set a threshold that would only require vehicles as collateral if they were valued over \$15,000/vehicle. (6)
  - b. Set a threshold based on the value of the vehicles as collateral in relation to the total loan amount. Ex: there are 2 vehicles worth a total of \$20,000 on a \$5mil loan, accounting for less than 1% of the loan amount. Since the total value of vehicles is less than 5% of the loan amount, they would not be required as collateral. (8)
  - c. Only require vehicles that will be purchased with UOP to be collateral. (7)
  - d. Require vehicles that are essential to business operations be collateral, but only when the vehicle is valued over \$15,000. (15)
  - e. SBA should not update the policy; it is good as it stands. (3)
- 10.) Please offer any additional thoughts or suggestions you may have around vehicle titles as collateral.

