



SBA Procedural Notice

TO: All SBA Employees, 7(a) Lenders, and Certified Development Companies

CONTROL NO.: 5000-846607

EFFECTIVE: May 9, 2023

SUBJECT: Implementation of the Final Rule on Affiliation and Lending Criteria for the SBA Business Loan Programs (88 FR 21074, effective May 11, 2023) and raising of the maximum loan amount for 7(a) Small loans

The purpose of this Notice is to address the implementation of SBA's Final Rule on Affiliation and Lending Criteria for the SBA Business Loan Programs ([88 FR 21074](#), effective May 11, 2023) (Rule) in the 7(a) and 504 Loan Programs. In accordance with the Rule, SBA is revising certain policies and procedures in Standard Operating Procedure (SOP) 50 10 6, to be effective to all applications received by SBA on or after May 11, 2023.

For any applications that were declined and that would benefit by being reconsidered under these new procedures, and for those applications that have already been submitted for non-delegated processing but have not yet been decisioned and that would benefit by the new procedures, beginning May 11, 2023, the SBA Lender may ask the appropriate SBA loan processing center for a reconsideration under the new procedures.

Additionally, effective May 11, 2023, the maximum loan amount for a 7(a) Small loan is \$500,000, an increase from \$350,000 or less.

13 CFR § [120.150](#), "What are SBA's lending criteria?"

The following text replaces SOP 50 10 6, Part 2, Section B, Ch. 1, Para. C. 2 and 3.

2. Underwriting Standard 7(a) Loans (Loans greater than \$500,000):

a) Lender's Credit Analysis:

The Lender's credit memorandum and analysis must address the Applicant's ability and likelihood to repay the loan from the cash flow of the business and past performance by documenting the following:

- i. A description and history of the business, including:

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Must be accompanied by SBA Form 58

- a) Nature of the business;
 - b) Length of time in business under current management;
 - c) Depth of management experience in the industry or a related industry;
 - d) Brief description of the business's management team including principal's involvement in the daily onsite management of the business or how the daily operations will be managed if the principals are not there on a daily basis.
- ii. Financial analysis of repayment ability:
- a) For existing businesses based on the three most recent years of historical financial information (tax returns or balance sheet with debt schedule and income statement) plus an interim financial statement. ([13 CFR § 120.191](#))
 - b) For new businesses, based on detailed projections, including the supporting assumptions which reflect positive cash flow within 2 years.
 - c) The financial analysis for all Applicants must address the following as applicable:
 - i) Historical cash flow for existing businesses, that demonstrates total debt service coverage after the SBA loan; if the historical cash flow from the most recent full year and the interim financial statements do not show sufficient debt service coverage, Lender must obtain from the Applicant and analyze 2 years of detailed projections including the supporting assumptions justifying relying on projections instead of historical performance;
 - ii) Calculation of operating cash flow (OCF) defined as earnings before interest, taxes, depreciation, and amortization (EBITDA);
 - iii) Justification for additions and subtractions to cash flow such as the following:
 - (a) Unfunded capital expenditures;
 - (b) Non-recurring income;
 - (c) Expenses and distributions;
 - (d) Distributions for S-Corp taxes;
 - (e) Rent payments;
 - (f) Owner's Draw; and/or
 - (g) Global cash flow analysis that includes assessment of impact on cash flow to/from any affiliate business;
 - iv) The effect any affiliates may have on the ultimate repayment ability of the Applicant.

- iii. Debt Service (DS) is defined as the future required principal and interest payments on all business debt inclusive of new SBA loan proceeds. The Applicant's debt service coverage ratio (OCF/DS) must be equal to or greater than 1.15 on a historical and/or projected cash flow basis and 1:1 on a global basis. To perform a complete analysis of debt service, it is important for a Lender to obtain a current debt schedule prepared by the Applicant, including any shareholder debt.
- iv. For cash flow projections, the Lender must calculate the debt service coverage and provide the assumptions supporting the projected cash flow coverage, including as applicable:
 - a) Justification for revenue growth, i.e. new product lines, sales channels, and new production facilities;
 - b) Justification for any reduction in expenses; and
 - c) A comparison to current industry trends.
- v. Spread of pro-forma Business Balance Sheet (current business balance sheet adjusted for all changes in assets and liabilities as a result of the SBA loan, other debt, any required equity injection and use of loan proceeds);
- vi. Ratio calculations (based on the pro-forma Balance Sheet and historical and projected Income Statements) for the following financial ratio benchmarks: Current Ratio, Debt/Tangible Net Worth, Debt Service Coverage, and any other ratios the Lender considers significant for the business/ industry (e.g., inventory turnover, receivables turnover, and payables turnover, etc.) including discussion of Lender's comparison to industry trends;
- vii. Analysis of working capital adequacy, at a minimum over the next 12 months;
- viii. Assessment of collateral adequacy adjusted in accordance with paragraph C.3.d., Collateral Requirements for Standard 7(a) Loans in this Chapter below to offset risk of default;
- ix. Insurance Requirements, including:
 - a) Life Insurance – on whom and how much, in accordance with Lender's policies for similarly-sized, non-SBA guaranteed commercial loans.
 - b) Business hazard & liability insurances.
 - c) Other Insurances, such as specialty insurance appropriate for the type of business, e.g. malpractice insurance or product liability insurance.
- x. Lender must document the refinancing of any debts as part of the loan request in accordance with the policies and procedures the Lender uses for its similarly-sized non-SBA guaranteed commercial loans.

- xi. Lender's rationale for recommending approval, including a discussion and analysis of the following:
 - a) When 50 percent or more of the loan proceeds will be used for working capital, Lender must explain in its credit memorandum why this level of working capital is necessary and appropriate for the subject business;
 - b) Competition;
 - c) Seller financing;
 - d) Stand-by agreements;
 - e) 90+ day delinquencies;
 - f) Trade disputes and/or;
 - g) Federal, State, or local citations which would preclude the Applicant from normal business operations;
 - h) For a change of ownership, discussion/analysis of the business valuation used to support the purchase price;
 - i) Discussion of any liens, judgments, bankruptcy filings or pending litigation including divorce proceedings; and
 - j) Discussion of other relevant information (for example, if the application involves a franchise, Lender must review any credit information provided such as the number of failed franchisees and cash flow projections provided by the franchisor).

b) Equity requirements ([13 CFR § 120.150\(f\)](#)):

Except for transactions for changes in ownership as stated below, Lender's requirement for equity and equity injection must be consistent with its requirements for similarly-sized, non-SBA guaranteed commercial loans. However, the Lender may use its discretion to reduce the amount of equity and/or equity injection required if it determines that the Applicant needs leverage that exceeds the Lender's conventional requirements.

- i. Changes of ownership:
 - a) Resulting in a new owner (complete change of ownership): At a minimum, SBA requires an equity injection of at least 10 percent of the total project costs, (all costs required to complete the change of ownership, regardless of the source of funds) for such transactions.
 - i) Seller debt may not be considered as part of the equity injection unless either:
 - (a) It is on full standby for the first 24 months of the 7(a) loan; or
 - (b) A debt that is on partial standby (interest payments only being made) may be considered equity when there is historical business

cash flow available to make the payments, and at least a quarter of the SBA-required equity injection is from a source other than the seller.

Note: Equity injection is new cash or other acceptable assets added into the project that is not on the Applicant's balance sheet prior to the equity injection.

- ii) When an existing business acquires a business that is in the same 6 digit NAICS code with identical ownership and in the same geographic area as the acquiring entity, SBA considers this to be a business expansion, and SBA will not require a minimum equity injection.
 - iii) Loans to ESOPs for the purpose of purchasing a controlling interest (at least 51 percent) in the employer small business are not subject to the SBA requirement for equity injection.
- b) Change of ownership between existing owners ("complete partner buyout"): If the 7(a) loan will finance more than 90% of the purchase price of a partner buyout, both of the following must be met:
 - i) The remaining owner(s) must certify that they have been actively participating in the business operation and held the same or an increasing ownership interest in the business for at least the past 24 months. Lender must include in the credit memorandum confirmation that the Borrower has made the required certification and retain such certification in the file.
 - ii) The business balance sheets for the most recent completed fiscal year and current quarter must reflect a debt-to-worth ratio of no greater than 9:1 prior to the change in ownership.
 - iii) In the event the Lender is unable to document that both (a) and (b) above are satisfied, the remaining owner(s) must contribute cash in the amount of at least 10% of the purchase price of the business, as reflected in the purchase and sale agreement.
- c) Partial changes of ownership (Changes of ownership other than complete changes of ownership or complete partner buyouts):
 - i) The business balance sheets for the most recent completed fiscal year and current quarter must reflect a debt-to-worth ratio of no greater than 9:1 prior to the change in ownership.
 - ii) In the event the Lender is unable to document that (i) above is satisfied, the borrowers must contribute cash in the amount of at least 10% of the partial change of ownership purchase price, as reflected in the purchase and sale agreement.
- ii. Source of Equity Injection: If the Lender or SBA requires an equity injection, the Lender must use the same processes to verify the equity

injection as it uses for its similarly-sized, non-SBA guaranteed commercial loans.

3. Collateral for Standard 7(a) Loans (Loans greater than \$500,000):

- a. For loans of \$50,000 or less, the Lender is not required to take collateral. (Guaranties still must be obtained in accordance with Section A, Ch. 6, Para. A.)
- b. Lenders must use practices to identify collateral that conform to procedures for their similarly-sized, non-SBA guaranteed commercial loans.
- c. Adequacy of Collateral.

A loan request is not to be declined solely on the basis of inadequate collateral. In fact, one of the primary reasons Lenders use the SBA-guaranteed program is for those Applicants that demonstrate repayment ability but lack adequate collateral to repay the loan in full in the event of default. However, SBA does not permit its guaranty to be a substitute for available collateral.

- d. Collateral Requirements for Standard 7(a) Loans.
 - i. SBA considers a loan as “fully secured” if the Lender has taken security interests in all assets being acquired, refinanced, or improved with the 7(a) loan and available fixed assets of the Applicant with a combined Net Book Value as adjusted below, up to the loan amount. For 7(a) loans, the term “fixed assets” means real estate, including land and structures, machinery and equipment owned by the business or an EPC.
 - a) New machinery and equipment (excluding furniture and fixtures) may be valued at no more than 75% of price minus any prior liens for the calculation of “fully secured”;
 - b) Used or existing machinery and equipment (excluding furniture & fixtures) may be valued at no more than 50% of Net Book Value or 80% with an Orderly Liquidation Appraisal minus any prior liens for the calculation of “fully secured”;
 - c) Improved real estate can be valued at no more than 85% and unimproved real estate can be valued at 50% of the market value for the calculation of “fully secured” and the value must be determined in accordance with the requirements set forth in Real Estate Appraisal and Business Valuation Requirements below; and
 - d) Furniture and Fixtures may be valued at no more than 10% of Net Book Value or appraised value.
 - ii. If there is a collateral shortfall (not “fully secured”) on the SBA-guaranteed loan the Lender:
 - a) Must take available equity in the personal real estate (residential and investment property, including other commercial real estate) of any owners of 20% or more of the Applicant and guarantors except Supplemental Guarantors. Liens on personal real estate may be

limited to the amount of the collateral shortfall. In addition, liens on personal real estate may be limited to 150% of the equity in the collateral.

- b) May include trading assets as necessary (using no more than 10% of current book value for the calculation).
 - iii. SBA does not require a Lender to collateralize a loan with real estate (including commercial, residential and investment properties owned by the Applicant or personally by the owners) to meet the “fully secured” definition when the equity in the real estate is less than 25% of the property’s fair market value. The Lender must document in their loan file the source (other than the personal financial statement) for making the determination of less than 25% equity.
 - iv. When loan proceeds from a Standard 7(a) Loan will be used to acquire, refinance, or improve assets, a first security interest in those assets must be obtained.
 - v. For loans that are collateralized by commercial real estate that was acquired, refinanced, or improved with proceeds of the loan, Lenders must obtain an appraisal that complies with Real Estate Appraisal and Business Valuation Requirements, below, and with Section A, Ch. 6, Para. E, Environmental Policies and Procedures.
- e. Real Estate Appraisal and Business Valuation Requirements

The regulation governing real estate appraisal is set forth at [13 CFR § 120.160\(b\)](#).

- i. Commercial Real Estate:
 - a) For all 7(a) loans secured by commercial real property when loan proceeds will be used to acquire, refinance or improve real estate, Lenders must obtain an appraisal by a State licensed or certified appraiser. Appraisals must be in compliance with the Uniform Standards of Professional Appraisal Practice (USPAP). Additionally, SBA requires that completed appraisals be dated within 12 months of the application for guaranty. For federally-regulated Lenders, no exemption is granted under the [Interagency Appraisal and Evaluation Guidelines](#) dated December 2, 2010, for Transactions Insured or Guaranteed by a U.S. Government Agency.
 - b) The appraiser must be:
 - i) Independent and have no appearance of a conflict of interest (such as a direct or indirect financial or other interest in the property or transaction, independent of the loan production function, and not involved in the approval of the transaction); and

- ii) Either State-licensed or State-certified, with the following exception: when the commercial property's estimated value is over \$1,000,000, the appraiser must be State-certified.
- c) In order for the appraiser to identify the scope of work appropriately, the appraisal must identify the Lender as the client and/or an intended user of the appraisal, as those terms are defined in USPAP, except that federally-regulated Lenders may follow their primary regulator's FIRREA requirements to the extent they permit otherwise. The Lender may not use an appraisal prepared for the seller or the Applicant. The cost may be passed on to the Applicant.
- d) The appraisal must be an "Appraisal Report" prepared in compliance with USPAP.
- e) If the loan will be used to finance new construction or the substantial renovation of an existing building, the appraisal must estimate what the market value will be at completion of construction. ("Substantial" means rehabilitation expenses of more than one-third of the purchase price or fair market value at the time of the application.) After construction is completed, Lender must obtain a statement from the appraiser, general contractor, project architect, or construction management firm that the building was built with only minor deviations (if any) from the plans and specifications upon which the original estimate of value was based. If the Lender cannot obtain such a statement, then the Lender may not close the loan without SBA's prior written permission.
- f) If the SBA-guaranteed loan was used to cover the construction period, the Lender must notify the appropriate SBA CLSC of any deviation(s) and work with the SBA CLSC to determine an appropriate course of action, including the securing of additional collateral. The Lender's notification to SBA must provide a sufficient understanding of the reasons for the differences in values between the estimated and actual values as well as a recommendation as to a remedy to offset the difference in values such as additional equity or additional collateral. If additional collateral is being required, the Lender must identify both the fair market and liquidation values of the additional collateral. If the Lender is unable to obtain a statement that the building was built with only minor deviations (if any) from the plans and specifications upon which the original estimate of value was based, but is able to obtain a new appraisal demonstrating that the market value meets or exceeds the original estimate of value, then no additional action on the part of the Lender is necessary.
- g) If the loan will be used to acquire an existing building that does not require construction, the appraiser should estimate market value on an as-is basis. If the appraiser estimates the value other than on an

as-is basis, the narrative must include an explanation of why the as-is basis was not used.

- h) When valuing the collateral, the Lender must not include the contributory value of any rental income or the value of any intangible assets contained in the appraisal.
- i) An appraisal may be submitted as part of the loan application to assist with the underwriting or as part of the loan closing. In no case may the Lender rely on an appraisal that was prepared more than 12 months prior to the date of the application.
- j) If the Lender is going to require the appraisal at closing, the loan application must include an estimate of the value of the real estate and the estimate must be identified in the loan Authorization and/or credit memorandum with the requirement for an appraisal that supports the estimated value at time of closing.
- k) If at time of closing the appraised value:
 - i) Is 90% or more of the estimated value, the Lender may close the loan but must include a written explanation as to why the appraisal is less than the estimated value in the loan file; or
 - ii) Is less than 90% of estimated value, the Lender may not close the loan without SBA's prior written permission (see exception below for PLP Lenders). The Lender's justification to SBA must provide a sufficient understanding of the reasons for the differences in values between the estimated and actual values as well as a recommendation as to a remedy to offset the difference in values such as additional equity or additional collateral. If additional collateral is being required, the Lender must identify both the fair market and liquidation values of the additional collateral.
 - iii) Exception for PLP Lenders: PLP Lenders are permitted to close a loan when the appraisal is less than 90% of the estimated value but the Lender must include a written justification as part of its file that may be reviewed by SBA at time of guaranty purchase or when conducting lender oversight activities. The justification must include a thorough analysis by the Lender of the reasons for the appraisal being low and an explanation as to what steps the Lender took to offset the risk to SBA from the low appraisal such as additional equity or additional collateral.
- ii. Non-commercial real estate or real estate securing a personal guaranty:

SBA has no specific appraisal requirements for non-commercial real estate (such as a residence) or real estate (commercial or non-commercial) taken as collateral to secure a personal guaranty.

iii. Other Fixed Assets:

If the valuation of fixed assets is greater than their Net Book Value, an independent appraisal by a qualified individual must be obtained by the Lender to support the higher valuation. The appraiser must be independent of the loan production function, not involved in the approval of the transaction, and must not have the appearance of a conflict of interest. A valuation of the fixed assets provided as part of a business valuation will not meet these requirements, except as part of a going concern appraisal.

iv. Additional Appraisal Requirements for all Changes of Ownership:

For businesses that have been transferred within 36 months prior to the date of the loan application, SBA requires:

- a) An appraisal of the business real estate that meets the appraisal requirements above; and
- b) Either a “review” of the appraisal by another appraiser selected directly by the Lender or a site visit by a senior member of the Lender’s staff. The Lender must document the file and include the date of the visit and a description of the items reviewed on site.

v. Business Valuation Requirements – Change of Ownership:

- a) Determining the value of a business (not including real estate which is separately valued through a real estate appraisal) is the key component to the analysis of any loan application for a change of ownership. An accurate business valuation is required because the change in ownership will result in new debt unrelated to business operations and potentially the creation of intangible assets. A business valuation assists the buyer in making a determination that the seller’s asking price is supported by an independent Qualified Source (see definition in Appendix 3).
- b) In order for the individual performing the business valuation to identify the scope of work appropriately, the business valuation must be requested by and prepared for the Lender. The scope of work should identify whether the transaction is an asset purchase or stock purchase and be specific enough for the individual performing the business valuation to know what is included in the sale (including any assumed debt). The business valuation must include the individual’s conclusion of value, the qualifications of the individual performing the business valuation and their signature certifying to the information contained in the business valuation. The Lender may not use a business valuation prepared for the Applicant or the seller. The cost of the business valuation may be passed on to the Applicant.
 - i) Non-Special Purpose Properties:

- (a) If the amount being financed (including any 7(a), 504, seller, or other financing) minus the appraised value of real estate and/or equipment being financed is \$250,000 or less, the Lender may perform its own valuation of the business being sold, unless the Lender's internal policies and procedures require an independent business valuation from a Qualified Source.
 - (b) If the amount being financed (including any 7(a), 504, seller, or other financing) minus the appraised value of real estate and/or equipment is greater than \$250,000 or if there is a close relationship between the buyer and seller (for example, transactions between existing owners or family members), the Lender must obtain an independent business valuation from a Qualified Source.
- ii) Special Purpose Properties: A "Special Purpose Property" is a limited-market property with a unique physical design, special construction materials, or a layout that restricts its utility to the specific use for which it was built.
- (a) If the amount being financed (including any 7(a), 504, seller, or other financing) minus the appraised value of real estate and/or equipment being financed is \$250,000 or less, the Lender may perform its own valuation of the business being sold, unless the Lender's internal policies and procedures require an independent business valuation from a Qualified Source.
 - (b) If the amount being financed (including any 7(a), 504, seller, or other financing) minus the appraised value of real estate and/or equipment being financed is over \$250,000 or if there is a close relationship between the buyer and seller (for example, transactions between existing owners or family members) and the business operates from a Special Purpose Property, the Lender must obtain an independent business valuation performed by a Certified General Real Property Appraiser. The appraiser must be independent of the loan production function, not involved in the approval of the transaction, and must not have the appearance of a conflict of interest.
 - (c) The business valuation must allocate separate values to the individual components of the transaction including land, building, equipment, and intangible assets.
 - (d) The Certified General Real Property Appraiser must have completed no less than four going concern appraisals of equivalent special use property as the property being appraised, within the last 36 months, as identified in the qualifications portion of the Appraisal Report.

- (e) Each business valuation assignment under this section must be undertaken with a specific instruction for the Certified General Real Property Appraiser to conduct the appraisal in compliance with current USPAP guidelines.
- iii) If the application will be submitted to the LGPC, the business valuation must be submitted as part of the loan application.
- iv) If the application will be submitted under PLP authority, the business valuation may be obtained and reviewed after the issuance of an SBA Loan Number and prior to closing. If the Lender is processing the application under PLP authority and requests the business valuation after issuance of an SBA Loan Number, the credit memorandum must include an estimate of the value of the business. The credit memorandum must be updated after receipt of the business valuation to include a comparison of the loan amount and the business valuation.
- v) Any amount(s) of the loan proceeds that will be used to facilitate a change of ownership may not exceed the business valuation.
- vi) Lender Verification of Business valuation Financial Data:
Lender must obtain a copy of the financial information relied upon by the individual who performed the business valuation and verify that information against the seller's IRS transcripts to ensure the accuracy of the information.

The following text replaces underwriting and collateral requirements for 7(a) Small and SBA Express loans.

1. Underwriting 7(a) Small Loans and SBA Express Loans

a. 7(a) Small Loans:

(Note: If any requested increase to a 7(a) Small Loan or SBA Express loan results in total 7(a) loan(s) in excess of \$500,000 (including loans made within 90 days of another), the Lender must follow the underwriting procedures for Standard 7(a) loans.

- i. All 7(a) Small Loan applications will begin with a screening for a FICO[®] Small Business Scoring ServiceSM Score (SBSS Score).
 - a) The SBSS Score is calculated based on a combination of consumer credit bureau data, business bureau data, Borrower financials, and application data (The SBSS Score is not to be confused with the Small Business Predictive Score (SBPS) used by SBA's Office of Credit Risk Management). The minimum credit score is based on the lower end of the risk profile of the current SBA portfolio. The minimum acceptable SBSS score is 155, but that score may be adjusted up or

down from time to time. SBA will post on its website the minimum acceptable SBSS credit score for 7(a) Small Loan applications at www.sba.gov/partners/lenders/7a-loan-program.

- b) If the Applicant receives an acceptable SBSS Score, the Lender will close and disburse the loan in accordance with the same processes and procedures it uses for its similarly-sized, non-SBA guaranteed loans.
- c) If the Applicant does not receive an acceptable SBSS Score:
 - i) Lenders may submit via E-Tran a 7(a) loan application for processing under non-delegated procedures to the LGPC; or
 - ii) PLP Lenders may approve an application that does not receive an acceptable SBSS credit score using their PLP authority. PLP Lenders may override an unacceptable SBSS score by completing a cashflow analysis that demonstrates the reasonable reassurance of repayment. SBA will not deny the Lender request for loan guaranty based solely upon the Lender's decision to use its PLP authority to underwrite the cashflow of the business.

ii. SBA Express loans:

Lenders must use appropriate, prudent, and generally accepted industry credit analysis processes and procedures (which may include credit scoring), and these procedures must be consistent with those used for the Lender's similarly-sized non-SBA guaranteed commercial loans.

- iii. For 7(a) Small and SBA Express loans, Lenders may use a business credit scoring model (such a model cannot rely solely on consumer credit scores) to assess character, reputation, and credit history of the applicant and/or repayment ability if they do so for their similarly-sized, non-SBA guaranteed commercial loans.
 - i) The business credit scoring model may only be used in addition to the Lender's appropriate, prudent, and generally accepted industry credit analysis and procedures.
 - ii) If used, the business credit scoring results must be documented in each loan file and available for SBA review.
 - iii) Lenders must validate (and document) with appropriate and accepted statistical methodologies that their business credit scoring model is predictive of loan performance and they must provide that documentation to SBA upon request.
 - iv) Although SBLCs do not make non-SBA guaranteed loans, SBA has determined they may use credit scoring. SBLCs are required to provide credit scoring model validation to SBA on an annual basis.
- iv. For 7(a) Small SBA Express loans, the credit decision, including how much to factor in a past bankruptcy or whether to require an equity

injection, is left to the business judgment of the Lender. Also, if the Lender requires an equity injection and, as part of its standard processes for similarly-sized, non-SBA guaranteed commercial loans verifies the equity injection, it must do so for its 7(a) Small and SBA Express loans. While the credit decision is left to the business judgment of the Lender, early loan defaults will be reviewed by SBA pursuant to [SOP 50 57](#).

2. Collateral for 7(a) Small Loans and SBA Express

See Part 2, Section A, Chapter 6, Paragraph A for guaranty requirements.

- a. With respect to collateral, Lenders must use commercially reasonable and prudent practices to identify collateral, which conforms to procedures at least as thorough as those used for their similarly-sized non-SBA guaranteed commercial loans. Decisions regarding what collateral must be taken to secure a loan are based on the circumstances of the individual loan, including size, and must meet the minimum requirements set forth in this section.

- i. For loans of \$50,000 or less, Lenders are not required to take collateral.
- ii. For loans over \$50,000, the Lender must follow the written collateral policies and procedures that it has established and implemented for its similarly-sized, non-SBA guaranteed commercial loans.

- b. Adequacy of Collateral:

A loan request is not to be declined solely on the basis of inadequate collateral. In fact, one of the primary reasons Lenders use the SBA-guaranteed program is for those Applicants that demonstrate repayment ability but lack adequate collateral to repay the loan in full in the event of default. However, SBA does not permit its guaranty to be a substitute for available collateral.

- c. Real Estate Appraisal and Business Valuation Requirements

The regulation governing real estate appraisal is set forth at [13 CFR § 120.160\(b\)](#).

- i. Commercial Real Estate:

- a) For all loans secured by commercial real property when loan proceeds will be used to acquire, refinance or improve real estate: The appraiser must be:
 - i) Independent and have no appearance of a conflict of interest (such as a direct or indirect financial or other interest in the property or transaction, independent of the loan production function, and not involved in the approval of the transaction); and
 - ii) Either State-licensed or State-certified, with the following exception: when the commercial property's estimated value is over \$1,000,000, the appraiser must be State-certified.

- b) In order for the appraiser to identify the scope of work appropriately, the appraisal must identify the Lender as the client and/or an intended user of the appraisal, as those terms are defined in USPAP, except that federally-regulated Lenders may follow their primary regulator's FIRREA requirements to the extent they permit otherwise. The Lender may not use an appraisal prepared for the seller or the Applicant. The cost may be passed on to the Applicant.
- c) The appraisal must be an "Appraisal Report" prepared in compliance with USPAP.
- d) If the loan will be used to finance new construction or the substantial renovation of an existing building, the appraisal must estimate what the market value will be at completion of construction. ("Substantial" means rehabilitation expenses of more than one-third of the purchase price or fair market value at the time of the application.) After construction is completed, Lender must obtain a statement from the appraiser, general contractor, project architect, or construction management firm that the building was built with only minor deviations (if any) from the plans and specifications upon which the original estimate of value was based. If the Lender cannot obtain such a statement, then the Lender may not close the loan without SBA's prior written permission.
- e) If the SBA-guaranteed loan was used to cover the construction period, the Lender must notify the appropriate SBA CLSC of any deviation(s) and work with the SBA CLSC to determine an appropriate course of action, including the securing of additional collateral. The Lender's notification to SBA must provide a sufficient understanding of the reasons for the differences in values between the estimated and actual values as well as a recommendation as to a remedy to offset the difference in values such as additional equity or additional collateral. If additional collateral is being required, the Lender must identify both the fair market and liquidation values of the additional collateral. If the Lender is unable to obtain a statement that the building was built with only minor deviations (if any) from the plans and specifications upon which the original estimate of value was based, but is able to obtain a new appraisal demonstrating that the market value meets or exceeds the original estimate of value, then no additional action on the part of the Lender is necessary.
- f) If the loan will be used to acquire an existing building that does not require construction, the appraiser should estimate market value on an as-is basis. If the appraiser estimates the value other than on an as-is basis, the narrative must include an explanation of why the as-is basis was not used.
- g) When valuing the collateral, the Lender must not include the contributory value of any rental income or the value of any intangible assets contained in the appraisal.

- h) An appraisal may be obtained as part of the loan application to assist with the underwriting or as part of the loan closing. In no case may the Lender rely on an appraisal that was prepared more than 12 months prior to the date of the application.
- i) If the Lender is going to require the appraisal at closing, the loan application must include an estimate of the value of the real estate and the estimate must be identified in the loan Authorization and/or Lender's credit memorandum with the requirement for an appraisal that supports the estimated value at time of closing.
- j) If at time of closing the appraised value:
 - i) Is 90% or more of the estimated value, the Lender may close the loan but must include a written explanation as to why the appraisal is less than the estimated value in the loan file; or
 - ii) Is less than 90% of the estimated value, Lenders are permitted to close the loan, but the Lender must include a written justification as part of its file that may be reviewed by SBA at time of guaranty purchase or when conducting lender oversight activities. The justification must include a thorough analysis by the Lender of the reasons for the appraisal being low and an explanation as to what steps the Lender took to offset the risk to SBA from the low appraisal such as additional equity or additional collateral.
- ii. Non-commercial real estate or real estate securing a personal guaranty:

SBA has no specific appraisal requirements for non-commercial real estate (such as a residence) or real estate (commercial or non-commercial) taken as collateral to secure a personal guaranty.
- iii. Other Fixed Assets:

If the valuation of fixed assets is greater than their Net Book Value, an independent appraisal by a qualified individual must be obtained by the Lender to support the higher valuation. The appraiser must be independent of the loan production function, not involved in the approval of the transaction, and must not have the appearance of a conflict of interest. A valuation of the fixed assets provided as part of a business valuation will not meet these requirements, except as part of a going concern appraisal.
- iv. Business Valuation Requirements – Change of Ownership:
 - a) Determining the value of a business (not including real estate which is separately valued through a real estate appraisal) is the key component to the analysis of any loan application for a change of ownership. An accurate business valuation is required because the change in ownership will result in new debt unrelated to business operations and potentially the creation of intangible assets. A business valuation assists the buyer in making a determination that the seller's asking

price is supported by an independent Qualified Source (See definition in Appendix 3).

- b) In order for the individual performing the business valuation to identify the scope of work appropriately, the business valuation must be requested by and prepared for the Lender. The scope of work should identify whether the transaction is an asset purchase or stock purchase and be specific enough for the individual performing the business valuation to know what is included in the sale (including any assumed debt). The business valuation must include the individual's conclusion of value, the qualifications of the individual performing the business valuation and their signature certifying to the information contained in the business valuation. The Lender may not use a business valuation prepared for the Applicant or the seller. The cost of the business valuation may be passed on to the Applicant.
- i) Non-Special Purpose Properties:
 - (a) If the amount being financed (including any 7(a), 504, seller, or other financing) minus the appraised value of real estate and/or equipment being financed is \$250,000 or less, the Lender may perform its own valuation of the business being sold, unless the Lender's internal policies and procedures require an independent business valuation from a Qualified Source.
 - (b) If the amount being financed (including any 7(a), 504, seller, or other financing) minus the appraised value of real estate and/or equipment is greater than \$250,000 or if there is a close relationship between the buyer and seller (for example, transactions between existing owners or family members), the Lender must obtain an independent business valuation from a Qualified Source.
- ii) Special Purpose Properties: A "Special Purpose Property" is a limited-market property with a unique physical design, special construction materials, or a layout that restricts its utility to the specific use for which it was built.
 - (a) If the amount being financed (including any 7(a), 504, seller, or other financing) minus the appraised value of real estate and/or equipment being financed is \$250,000 or less, the Lender may perform its own valuation of the business being sold, unless the Lender's internal policies and procedures require an independent business valuation from a Qualified Source.
 - (b) If the amount being financed (including any 7(a), 504, seller, or other financing) minus the appraised value of real estate and/or equipment being financed is over \$250,000 or if there is a close relationship between the buyer and seller (for example, transactions between existing owners or family members) and the

business operates from a Special Purpose Property, the Lender must obtain an independent business valuation performed by a Certified General Real Property Appraiser. The appraiser must be independent of the loan production function, not involved in the approval of the transaction, and must not have the appearance of a conflict of interest.

- (c) The business valuation must allocate separate values to the individual components of the transaction including land, building, equipment, and intangible assets.
 - (d) The Certified General Real Property Appraiser must have completed no less than four going concern appraisals of equivalent special use property as the property being appraised, within the last 36 months, as identified in the qualifications portion of the Appraisal Report.
 - (e) Each business valuation assignment under this section must be undertaken with a specific instruction for the Certified General Real Property Appraiser to conduct the appraisal in compliance with current USPAP guidelines.
- iii) The business valuation may be obtained and reviewed after the issuance of an SBA Loan Number and prior to closing. If the Lender requests the business valuation after issuance of an SBA Loan Number, the credit memorandum must include an estimate of the value of the business. The credit memorandum must be updated after receipt of the business valuation to include a comparison of the loan amount and the business valuation.
 - iv) Any amount(s) of the loan proceeds that will be used to facilitate a change of ownership may not exceed the business valuation.
 - v) Lender Verification of Business valuation Financial Data:
Lender must obtain a copy of the financial information relied upon by the individual who performed the business valuation and verify that information against the seller's IRS transcripts to ensure the accuracy of the information.

§ [120.160\(c\)](#), “Hazard Insurance.”

The following requirements supersede SOP 50 10 6 guidance on hazard insurance. Requirements for marine, flood, life, and other insurances remain unchanged.

- a. For 504 loans of all sizes, SBA requires hazard insurance on what is being financed by the 504 loan.
- b. For 7(a) loans greater than \$500,000 and for 504 projects greater than \$500,000:
 - i. SBA requires hazard insurance on all assets pledged as collateral. The Borrower must

also maintain a separate policy if the business is located in a state that requires additional coverage such as wind, hail, earthquake, or other.

- ii. Real Estate
 - a) Coverage must be in the amount of the full replacement cost.
 - b) If full replacement cost insurance is not available, coverage must be for the maximum insurable value.
 - c) Insurance coverage must contain a MORTGAGEE CLAUSE (or substantial equivalent) in favor of the 7(a) Lender (for 7(a)), or the CDC/SBA (for 504). This clause must provide that any action or failure to act by the mortgagor or owner of the insured property will not invalidate the interest of the 7(a) Lender (for 7(a)), or the CDC/SBA (for 504). The policy or endorsements must provide for at least 10 days prior written notice to the 7(a) Lender (for 7(a)), or the CDC/SBA (for 504), of policy cancellation.
- iii. Personal Property
 - a) Coverage must be in the amount of full replacement cost.
 - b) If full replacement cost insurance is not available, coverage must be for maximum insurable value.
 - c) Insurance coverage must contain a LENDER'S LOSS PAYABLE CLAUSE (or substantial equivalent) in favor of the 7(a) Lender (for 7(a)), or the CDC/SBA (for 504). This clause must provide that any action or failure to act by the debtor or owner of the insured property will not invalidate the interest of the 7(a) Lender (for 7(a)), or the CDC/SBA (for 504). The policy or endorsements must provide for at least 10 days prior written notice to the 7(a) Lender (for 7(a)), or the CDC/SBA (for 504), of policy cancellation.
- c. For 7(a) loans \$500,000 or less and for 504 projects \$500,000 or less:
 - i. Hazard insurance is required for all real estate acquired, refinanced, or improved with the proceeds of an SBA loan.
 - a) Coverage must be in the amount of the full replacement cost.
 - b) If full replacement cost insurance is not available, coverage must be for the maximum insurable value.
 - c) Insurance coverage must contain a MORTGAGEE CLAUSE (or substantial equivalent) in favor of the 7(a) Lender (for 7(a)), or the CDC/SBA (for 504).
 - ii. For 7(a) loans, for non-real estate collateral, SBA requires hazard insurance in accordance with the SBA Lender's hazard insurance policies for their similarly-sized non-SBA guaranteed commercial loans.

§ [120.193](#), "Reconsideration after denial."

The following requirements supersede SOP 50 10 6 guidance on reconsideration of declined non-delegated loan applications.

For 7(a) and 504 loans, requests for exceptions to policy and for second reconsideration of a non-delegated loan declined by an SBA loan processing center, may be submitted by the SBA Lender to the SBA loan processing center. The SBA loan processing center will analyze the request and make a recommendation to the Director, Office of Financial Assistance or designee, whose decision is final.

§ [120.130](#), “Restrictions on uses of proceeds.” and § [120.202](#), “Restrictions on loans for changes in ownership.”

For Standard 7(a), 7(a) Small, and SBA Express loans, the following requirements supersede SOP 50 10 6 guidance on uses of 7(a) loan proceeds to effect partial changes of ownership.

Loan proceeds (including the replacement of funds used or borrowed for any such purpose), may not be used for payments, distributions, or loans to an Associate of the Applicant (as defined in § [120.10](#)), except for compensation for services actually rendered at a fair and reasonable rate or to facilitate 7(a) loans for changes of ownership in accordance with § [120.202](#) and the following:

An SBA-guaranteed loan cannot be made solely to an individual. The small business must be either the Borrower or a Co-Borrower.

For Standard 7(a), 7(a) Small, and SBA Express, changes of ownership other than complete changes of ownership or complete partner buyouts (partial change of ownership): Loan proceeds may be used to fund the purchase of a portion of one or more owner’s interest in the business or of the business itself.

- a. Both the business and the individual owner(s) who is acquiring the ownership interest must be co-borrowers on the new loan.
- b. The small business is redeeming a partial ownership interest from one or more owners. All remaining owners are subject to the requirements for guaranties in SOP 50 10 6, Part 2, Section A, Ch. 6, Para. A, Guaranties; however, the percentages of ownership for this requirement will be based on the post sale percentage of ownership in the business. Note that for ESOP transactions, there is a statutory requirement that if the seller of the employer small business remains as a partial owner, the seller must provide a full, unlimited guarantee regardless of ownership – this statutory requirement cannot be waived.
- c. The seller may stay on as an owner, officer, director, stockholder, Key Employee, or employee of the business.

Except as stated above, all other policies and procedures for 7(a) changes of ownership in SOP 50 10 6 apply to partial changes of ownership.

§ [121.301\(f\)](#), “What size standards and affiliation principles are applicable to financial assistance programs?”

Effective May 11, 2023, SBA will no longer publish the SBA Franchise Directory, and SBA Lenders will no longer be required to enter a franchise identifier number into E-Tran. SBA Lenders are responsible for ensuring the Applicant meets Loan Program Requirements.

The following requirements replace all text at SOP 50 10 6, Part 2, Section A, Ch. 1, Para. D. 4 – 6.

4. **Affiliation** [13 CFR 121.301](#)

The Small Business Act defines a small business concern as one which is independently owned and operated, and which is not dominant in its field of operation. SBA interprets this statutory definition to require, in certain circumstances, the inclusion of other entities (“Affiliates”) owned by the applicant or an owner of the applicant in determining the size of the applicant.

The following principles apply for the Business Loan, Disaster Loan, and Surety Bond Guarantee Programs:

a. **Affiliation Based on Ownership**

Note: NAICS codes can be found at 13 CFR § [121.201](#), and a searchable database of industries and NAICS codes is located at [naics.com](#).

- i. When the Applicant owns more than 50 percent of another business, the Applicant and the other business are affiliated.
- ii. When a business owns more than 50 percent of an Applicant, the business that owns the Applicant is affiliated with the Applicant. Additionally, if the business entity owner that owns more than 50 percent of the Applicant also owns more than 50 percent of another business that operates in the same 3-digit NAICS subsector as the Applicant, then the business entity owner, the other business and the Applicant are all affiliated.
- iii. When an individual owns more than 50 percent of the Applicant and the individual also owns more than 50 percent of another business entity that operates in the same 3-digit NAICS subsector as the Applicant, the Applicant and the individual owner’s other business entity are affiliated.
- iv. When the Applicant does not have an owner that owns more than 50 percent of the Applicant, if an owner of 20 percent or more of the Applicant is a business that operates in the same 3-digit NAICS subsector as the Applicant, the Applicant and the owner are affiliated.
- v. When the Applicant does not have an owner that owns more than 50 percent of the Applicant, if an owner of 20 percent or more of the Applicant also owns more than 50 percent of another business entity that operates in the same 3-digit NAICS subsector as the Applicant, the Applicant and the owner’s other business entity are affiliated.
- vi. Ownership interests of spouses and minor children must be combined when determining amount of ownership interest.
- vii. When determining the percentage of ownership that an individual owns in a business, SBA considers the pro rata ownership of entities. For example, John

Smith, Jane Doe, and Jane Doe, Inc., each own an interest in the Applicant. Jane Doe owns 15 percent of the Applicant, and she also owns 100 percent of Jane Doe, Inc. Jane Doe, Inc. owns 50 percent of the Applicant. SBA considers Jane Doe to own 65 percent of the Applicant.

- b. Affiliation Based on Stock Options, Convertible Securities, and Agreements to Merge
 - i. For purposes of this subparagraph, SBA considers stock options, convertible securities, and agreements to merge (including agreements in principle) to have a present effect on the ownership of the entity. SBA treats such options, convertible securities, and agreements as though the rights granted have been exercised.
 - ii. Agreements to open or continue negotiations towards the possibility of a merger or a sale of stock at some later date are not considered “agreements in principle” and are thus not given present effect.
 - iii. Options, convertible securities, and agreements that are subject to conditions precedent which are incapable of fulfillment, speculative, conjectural, or unenforceable under state or Federal law, or where the probability of the transaction (or exercise of the rights) occurring is shown to be extremely remote, are not given present effect.
 - iv. SBA will not give present effect to individuals', concerns', or other entities' ability to divest all or part of their ownership interest to avoid a finding of affiliation.
- c. Determining the Concern's Size
 - i. In determining the concern's size, SBA counts the receipts, employees (see § 121.201), or the alternate size standard (if applicable) of the concern whose size is at issue and all of its domestic and foreign affiliates, regardless of whether the affiliates are organized for profit.
 - ii. An EPC and its OC(s) are treated as one business.
 - iii. Exceptions to Affiliation - For exceptions to affiliation, see § 121.103(b).

Paragraphs 5 and 6 are deleted.

Questions

Questions concerning this Notice may be directed to the Lender Relations Specialist in the [local SBA Field Office](#).

Patrick Kelley
Associate Administrator
Office of Capital Access