Small Business Administration (SBA) Lending Programs and the American Recovery and Reinvestment Act of 2009
A Web and Telephone Seminar
(Hosted by the Office of the Comptroller of the Currency (OCC))
September 21, 2009

Responses to Online Questions from the Web and Telephone Seminar

---

1.
Q: How many new lenders have entered SBA lending programs as a result of incentives established by the Recovery Act? Also, is there public data available on the volume and performance of SBA loans?

A: More than 500 lenders that had not participated in SBA lending since September 2008 were drawn back into the programs after the enactment of the Recovery Act. Prior to the act's passing, some lenders had stepped away from the programs because of poor servicing of guarantees or a perception that the SBA had become too tough. The SBA believes that changes in its organization and processing procedures make this an opportune time to return to SBA lending. The SBA has, occasionally, published in its annual reports the standard default rates for its programs.

2.
Q: As a small business lending company, can the Grow America Fund issue loans in Wisconsin or do we need to find a local lender?

A: The Grow America Fund does not lend in Wisconsin or have a local partner there. To find a lender in your community, contact your local SBA district office.

3.
Q: Are there data that show whether SBA loans have experienced higher default rates than conventional loans over the past 12 to 24 months of this economic downturn?

A: The SBA has learned from its lenders that the trends in SBA 7(a) and 504 loan defaults generally follow the pattern observed in their overall loan portfolios. However, direct comparisons between bank defaults and SBA loan guarantees are hard to make. During the economic downturn, loan defaults increased, peaking several months ago. The SBA watches these monthly trends and has discovered that default rates between the 7(a) and 504 program vary and fall into the low-to-middle single digit range.

4.
Q: Are SBA 7(a) loans granted by a certified development company?

A: No. Only SBA 504 loans (second mortgages) must be originated by certified development companies. SBA 7(a) loans can be granted by a commercial bank, thrift, or any organization that has received approval from the SBA. As mentioned by Pat Thompson in her presentation, the Grow America Fund is a community development financial institution and a nonprofit small business development loan company. Most SBA 7(a) lenders are commercial banks or thrifts.

5.
Q: The Recovery Act temporarily increased the 7(a) loan guarantee to 90 percent and eliminated or reduced certain fees. Will the SBA receive additional funding to extend these provisions into next year and beyond?

A: The Administrator of SBA has requested from Congress additional funding beyond that authorized in the Recovery Act. In accordance with the Office of Management and Budget, the SBA's credit performance ties together the higher guarantee and the fee release for the 7(a) program. Therefore, the extension of one provision similarly extends the other provision. Ultimately, Congress must pass legislation to authorize additional Recovery Act funds for the SBA. If Congress does not act, the SBA will inform the industry promptly about how to wind down the program.

6.
Q: Can SBA 7(a) loans be used to refinance existing loans or bank debts?

A: The SBA liberalized some of its recently published standard operating procedures for refinancing existing debt. Under certain conditions, the loans may be used to refinance existing loans or bank debts. However, this possibility should be discussed with the SBA staff at the Citrus Heights Processing Center at the Sacramento District Office or the bank's local SBA district office.

7.
Q: What proportion of the 90 percent guaranteed 7(a) loans that default are paid in full by the SBA? In addition, how important are bank servicing errors in lowering the full guarantee payment by the SBA?

A: Based on SBA data, 95 percent of loan guarantee requests are paid, as are 95 percent of the dollars requested. (By coincidence, these percentages are equal. That is, 19 times out of 20, a lender receives a check for the full amount of what was requested. Only five percent of the loan guarantee requests need repair or are denied. This figure also includes loans that are voluntarily withdrawn or canceled by the lender.)

8.
Q: Some of my clients have a portfolio of nonperforming commercial loans. Can my clients convert some of these loans to SBA 7(a) loans if the loans qualify within the guidelines?

A: No. If a loan is currently nonperforming, it does not qualify within the SBA loan guidelines.

9.
Q: If an SBA 504 loan is used to purchase an existing business, what percent down payment is required from the borrower?

A: The basic down payment required from the borrower is 10 percent. If the loan involves change of ownership, the community development corporation must review the management and level of debt and determine whether an additional borrower's contribution of 5 percent is necessary. Working in concert with the first mortgage lender, the certified development company is best suited to judge whether a borrower's business experience warrants a lower equity contribution. The SBA believes that it is important for local certified development companies to make this credit judgment.

10.
Q: Can rental real estate businesses participate in the SBA 504 program?

A: No. The 504 program is intended for purchasing tangible hard assets, not for building real estate investment properties.

11.
Q: Can the 504 program be used by businesses in the affordable housing industry?

A: Typically, businesses in the affordable housing industry do not fall under the statutory authority of the 504 program. In general, speculative real estate investments are not a viable use of the 504 program.

12.
Q: How would the OCC “grade” an SBA 504 loan that has a 50 percent loan-to-value ratio (LTV)?

A: There is no single “grade” for 504 loans. Loan classifications are based on a number of factors, only one of which is the adequacy of collateral. The OCC examiners will evaluate 504 loans on the same basis that they would any non-SBA guaranteed loan. In general, the guaranteed portion of the loan would be rated “Pass.”

13.
Q: How does the OCC view an SBA 504 construction loan with an 80 percent to 90 percent LTV when there is an approved take out in place to remove a portion of the construction financing?

A: An SBA authorization does not mitigate high LTV exceptions. Any loan exceeding 85 percent should be reported as exceeding supervisory limits until the construction loan has been reduced.

14.
Q: For the America’s Recovery Capital or ARC loan program, what is the estimated timeline for interest payments to be released once the documentation has been received and the request approved?

A: The SBA generally pays interest monthly. A lender typically receives interest payments the month after processing is completed.

15.
Q: Given that there is a zero weight for risk-based capital, is it true that a bank does not need to reserve against it?

A: ARC loans or 7(a) loans have guarantees. The guaranteed portion of these loans is combined with other loans with similar risk characteristics in determining the loan loss reserve. The appropriate method required by generally accepted accounting principles and regulatory policy is used to determine the loan loss reserve. If a bank has the guaranteed portion of the loan, generally, it would not need to reserve against it. A loan loss reserve would not need to be established for ARC loans, which are 100 percent guaranteed.

16.
Q: Can an ARC loan that is unsecured, does not accrue interest, and is structured with a deferred payment, be carried as a “Pass” accruing loan on the bank’s books?

A: ARC loans are 100 percent guaranteed by the SBA and generally would be carried as a "Pass" loan. However, final grading may depend on other factors, such as strengths or weaknesses in other credits, which might affect a borrower's ability to repay the ARC loan once the initial grace period has lapsed.

17.
Q: Are ARC loans available for borrowers currently not receiving an SBA loan?

A: Yes. Many ARC loans are made to non-SBA borrowers. SBA 7(a) loans and SBA 504 debentures approved prior to February 17, 2009, do not qualify as debt that can be covered by ARC loans.

18.
Q: ARC loan activity has been relatively low in my part of the country. Will a low demand affect the continuance of this program?

A: The ARC loan program is a statutory program provided at the request of Congress. The $355 million in funds authorized for this program limits the total number of loans to roughly 10,000. As of September 2009, the SBA had made about $75 million in ARC loans. The program will continue as long as funding is available or until September 2010, whichever comes first. Not surprisingly, program participation varies across the country. For example, one of the SBA's highest participation areas currently is Minnesota.

19.
Q: How can a lender use an ARC loan as part of a larger loan?

A: ARC loans can be used only to pay the principle and interest on an existing loan for up to six months. As an example, let's say you have a lending relationship in which the principle and interest payments for six months on a larger loan total $35,000. In your relationship as the lender, you could use the ARC loan to cover the six months of principle and interest. That would free up an equivalent amount of capital that the business had been paying you to help it cover some of its other immediate expenses brought on by the current recession. You must evaluate, working with that business, whether it has a viable plan to reasonably resume the original loan payments at the end of the total 18-month disbursement and deferral period. Following that period (i.e., 18 months after making the ARC loan), the business must make the principal payments for the ARC loan. This example illustrates how an ARC loan can help leverage a substantially larger amount of credit than a $35,000 ARC loan.

20.
Q: How are ARC loans credit scored?

A: The SBA subscribes to a credit service at no cost to the borrower or lender. The service filters the issuance of SBA loans and does not prohibit the granting of an ARC loan. A credit score that exceeds a threshold suggests that the business is stronger than anticipated for an ARC loan, and the SBA requires supporting documentation from the lender explaining that the business is under economic distress. Under these circumstances, the lender should submit the loan to the SBA's processing center rather than to its delegated authority. More than 80 percent of ARC loans have been made by delegated authority.

21.
Q: Does the SBA work with the Internal Revenue Service (IRS) to exempt lenders from having to impute interest for ARC loan transactions, or must the lender file a 1099 form?

A: The IRS has stated to the SBA that there will not be any imputed interest charge to ARC loan borrowers, and lenders do not have to file a 1099 form.

22.
Q: If a personal-loan guarantor refers a business borrower to an ARC loan rather than asking the borrower to inject its own funds into the business to cover expenses, would the business qualify for an ARC loan, or would the personal guarantor be forced to contribute capital first, exhaust that resource, and then turn to the ARC program?

A: The SBA has no guidance on this particular situation. It is up to the lender to choose a course of action to take. There is nothing to preclude lenders from making ARC loans before pursuing funds from personal guarantors.

23.
Q: Are ARC loans available to home builders?

A: The ARC loan Program Guide explains that businesses of a speculative nature, including speculative home builders, are ineligible for an ARC loan. However, home builders engaged in building homes under contract with an identified purchaser that are eligible for 7(a) loans generally would also be eligible for ARC loans.

24.
Q: Can a dealer floor plan be used for a used car dealer?

A: Yes, if available collateral is allowed in the SBA program. Eligible collateral in the Dealer Floor Plan Pilot Initiative includes used cars, manufactured homes, recreational vehicles, boats, and other assets that can be titled in any state in the United States.

25.
Q: Can you quickly review the major upcoming changes in the standard operating procedure revisions?

A: Standard operating procedure topics of interest are highlighted on the SBA Web site. For example, the SBA clarifies and offers guidance about business acquisitions, which have greatly concerned lenders; when appraisals are necessary or unnecessary in the 504 program, and refinancing, in the 7(a) program. Contact your local SBA district office or visit the SBA Web site for additional information.