

SOP 50 57

7a Servicing and Liquidation

Presented by:

Ethan W. Smith, Esq.

WPASGL, April 11, 2013

**STARFIELD
SMITH, PC**

ATTORNEYS AT LAW



Agenda:

- I. Introduction
- II. Key Definitions
- III. Lender Responsibility
- IV. Servicing Actions
- V. Liquidation Actions
- VI. Environmental Considerations
- VII. Guaranty Purchase
- VIII. OIG Referrals

I. Introduction

- Effective 3/1/2013
 - Applies to all S&L actions after this date
- SBA Information Notice 5000-1262
- 1st major revision of servicing requirements since 1998
- Combines all S&L requirements for 7a loans in one SOP (165 pages)

Introduction

□ Policy and Goals

Balance SBA's interest in:

1. Helping small businesses to succeed
2. Minimizing losses to the Agency

II. Key Definitions

Principles of Interpretation

- ❑ **Good Faith**, whether capitalized or not, means the absence of any intention to seek an unfair advantage or to defraud another party; i.e., an honest and sincere intention to fulfill one's obligations in the conduct or transaction concerned.
- ❑ **Including**, whether capitalized or not, means "including but not limited to," i.e., the list is exemplary and not exhaustive.
- ❑ **Must**, whether capitalized or not, means that the action is mandatory.
- ❑ **Should**, whether capitalized or not, means that the action is recommended but not required.
- ❑ **Loan Program Requirements** mean the requirements pertaining to SBA's 7(a) Loan Program, as revised from time to time, imposed by statutes, regulations, use of the word "must" in SOPs, contracts, Loan Authorizations, and SBA Notices and program guides. (13 C.F.R. § 120.10)

Key Definitions

Loan Characterization

- ❑ **Early Default** an event of default that occurred either within 18 months of the initial disbursement of the loan (or within 18 months of the final disbursement of the loan if the final disbursement occurred more than six months after the initial disbursement), unless the Borrower cured the default and made the scheduled loan payments for 12 consecutive months following the 18 month period:
 - Failure to make a scheduled loan payment;
 - Funding a scheduled loan payment from the sale of collateral rather than from business operations;
 - Deferment of more than three consecutive scheduled full payments; or
 - d. Any other event of default that required the loan to be classified in liquidation status, e.g., bankruptcy.
- ❑ **Seasoned Loan** or a loan that is “Seasoned” means a loan that is not an Early Default Loan

Key Definitions

People

- ❑ **Close Relative** a spouse, parent, child or sibling, or the spouse of a parent, child or sibling. (13 C.F.R. § 120.10)
- ❑ **Key Employee** means any Person hired by a business to manage its day-to-day operations, including, for example, the hiring and firing of employees, and the expenditure of money.
- ❑ **Obligor** means and includes every Person with direct liability for repaying an SBA loan such as the Borrower and any assumptor, and every Person with contingent liability such a Guarantor.
- ❑ **Associate** means an Officer, Director, Manager, Partner, Key Employee or owner of 20% or more of the equity of an entity/business

Key Definitions

Actions

- ❑ **Loan Action**, (formerly known as an SBA Form 327 Action), means an activity or decision regarding a specific SBA loan including a decision to engage or not to engage in a particular activity.
- ❑ **Loan Action Record** means the paper or electronic document used to *memorialize* the decision and justification for a specific Loan Action. It may consist of any type of document provided that it contains: Borrower's name; SBA loan number; Lender's name and contact info.; a reasonable *description* of the Loan Action; the *justification* for the Loan Action including an analysis of any Supporting Documentation; and a *citation* to the applicable SOP provision that provides authority for the Loan Action.
- ❑ **Non-routine Litigation** means: (a) all litigation where factual or legal *issues are in dispute* and require resolution through adjudication; (b) any litigation where *legal fees* are estimated to exceed \$10,000 in the aggregate; (c) any litigation involving a loan where a Lender has an actual or potential *conflict of interest* with SBA; or (4) any litigation involving a 7(a) Loan where the Lender has made a *separate loan* to the same Borrower which is not an SBA loan. (13 C.F.R. § 120.540(c)(1))

Key Definitions

Valuation

- ❑ **Liquidation Value** is the likely price collateral will sell for if sold quickly and with limited exposure to potential buyers. An Appraisal is necessary to determine the Liquidation Value of real or personal property collateral unless it consists of: a. Cash or Equivalent; or b. Motor Vehicles and Stock (use NADA or Kelley Blue Book value, official stock exchange prices, etc.)
- ❑ **Recoverable Value** means the net dollar amount that a prudent lender could reasonably expect to recover by liquidating a particular piece of collateral. Recoverable Value is determined by deducting the following amounts from the Liquidation Value of the collateral: (a) the balance owed on senior liens (less amounts waived or subordinated by a Loan Document); (b) Recoverable Expenses associated with any necessary lien foreclosure action; and (c) if the collateral is likely to be acquired by SBA or the Lender at the foreclosure sale (e.g., real property), the expenses associated with the care, preservation and resale of the acquired collateral.

Key Definitions

Quantification

- ❑ **Material Loss** means: (a) with regard to personal property collateral—a single loss or the aggregate amount of multiple losses totaling \$5,000 or more; and (b) with regard to real property collateral—a loss in the amount of \$10,000 or more.
- ❑ **Financial Hardship** means an inability to pay for basic living expenses, i.e., the costs that must be paid to obtain the following categories of goods and services necessary for the survival of an Obligor, their spouse and dependents as defined by the most current version of the Collection Financial Standards published by the Internal Revenue Service:
 - (1) food and clothing; (2) out-of-pocket health care expenses; (3) housing and utilities; and (4) transportation.

Key Definitions

Bidding

- ❑ **Credit Bid** an offer to purchase at a foreclosure sale submitted by a creditor who, instead of paying cash, will "credit" the bid amount against the debt owed to the creditor.
- ❑ **Protective Bid** means an offer made by a secured creditor to pay a designated price for property at a foreclosure sale to "protect" the secured creditor's interest in the property that might otherwise be eliminated by the foreclosure sale.

Key Definitions

Expenses

- ❑ **Recoverable Expense** means an SBA approved, necessary, reasonable and customary cost incurred to collect amounts due under the Note, to enforce the terms of the Loan Documents, or to preserve or dispose of collateral, which according to the terms of the Note, can be recouped by adding it to the principal balance of the loan.
- ❑ **Non-recoverable Expense** means a cost that is not SBA-approved and cannot be recouped by being added to the principal balance of the Note, because, e.g., the cost was not: (a) related to collection of amounts due under the Note, enforcement of the terms of the Loan Documents, or the preservation or disposal of the collateral; (b) necessary, reasonable or customary; or (c) incurred in accordance with prudent lending practices or SBA Loan Program Requirements.

Key Definitions

SBA Concepts

- ❑ **Purchase**, whether capitalized or not, when used in conjunction with SBA's 7(a) loan guaranty ("guaranty purchase") refers to SBA's purchase of the guaranteed portion of a 7(a) Loan.
- ❑ **Preference** means an arrangement not pre-approved by SBA that gives a 7(a) Lender a preferred position compared to SBA relating to the making, servicing, or liquidation of an SBA loan. (13 C.F.R. § 120.10) E.g., a Lender would receive a Preference if it released the collateral for an SBA loan in order to use it as security for a non-SBA loan to the same Borrower.

III. Lender Responsibility

- Servicing and Liquidation
- Litigation
- Decision Making
- Record keeping
- Monitoring
- Reporting

Servicing and Liquidation

Lenders must service and liquidate the

- Entire SBA portfolio and
- Entire debt
 - Not just unguaranteed portion

Litigation

- Lenders must conduct all litigation necessary to ensure recovery on all SBA loans in their portfolio
 - Except those loans referred to treasury

Decision Making – Notice to SBA

- ❑ Decrease loan amount or guaranty
- ❑ Extend final disbursement date
- ❑ Cancel guaranty
- ❑ Extend Maturity
- ❑ Modify Note
- ❑ Changes to borrower structure
- ❑ Change classification of loan (PIF, Liq. Regular Servicing)
- ❑ Assumption approval without release
- ❑ Revolver to non-revolver
- ❑ Sell < 90%

Decision Making – SBA Approval

- ❑ Exception to policy
- ❑ Preference
- ❑ Conflict of interest
- ❑ Sale/Lease of collateral to:
 - Obligor
 - Lender
 - Associates
 - Close Relatives
 - Employee of Lender
- ❑ Release of Obligor
- ❑ Compromise Principal
- ❑ Prepayment w/ SRF
- ❑ Litigation Plans
- ❑ Hazardous substances
 - Title to CRE
 - Operation of business
- ❑ Increase loan amount
- ❑ Reinstatement
- ❑ Emergency Purchase
- ❑ Sell > 90%

Record keeping

- All actions must be documented
 - Include supporting documents and rationale
- All other records (correspondence, notes, etc.)
- Retention:
 - Comply with regulator requirements
 - At least 6 years after final disposition
 - Litigation hold – stops normal destruction policy if litigation is reasonably anticipated

Monitoring

□ Lenders must monitor:

■ Obligors

- Name
- Location
- Financial statements
- Financial condition
 - If concerns are raised, request 4506
 - No penalties are permitted for failure to provide financial info.

■ Liens

■ Taxes

■ Senior loans

Reporting

- Monthly 1502
- Quarterly Status Reports (post-purchase)
- Site Visit Report
- Wrap-up report

IV. Servicing Actions

- General Requirements
- Note Modification
- Collateral Modification
- Insurance
- Covenants
- Assumption, Assignment or Sale
- Deferments
- Senior Loans

General Requirements

1. Document receipt of servicing request
 - Record in file (paper or electronic)
 - Request must be in **WRITING**
2. Review Supporting Documents
 - Credit issues:
 - Current financial statement
 - Last 2 FTR's
 - Collateral issues
 - Valuation
 - Lien search
 - Proof of balance on senior liens

General Requirements

3. Additional Supporting Documents (as necessary)

- Credit Report
- Guarantor financials/FTR's
- Purchase/Refi. Documents
- Environmental
- Authorizing documents (i.e.: resolutions)

4. Analyze

- Financially viable
- Collateral coverage (recoverable value)

General Requirements

5. Correct problems

- Loan document errors
- Technical defaults
- Collateral problems

6. Conditions of Approval

- Consideration
 - Correction
 - Waivers/Releases
 - Additional collateral
- Written consent of all Obligors

General Requirements

7. Comply with applicable SBA requirements
 - Authority
 - Notice
 - Approval
8. Implement Loan Action
 - Document Modification
 - New documents
 - Record/File as applicable
9. Retain records

Note Modification

- ❑ Payment date
- ❑ Revolver to non-revolver
- ❑ Payment amount
- ❑ Interest rate
 - (within program maximums)
- ❑ Maturity Date
 - Up to 10 years past original maturity date
 - Request prior to original maturity
- ❑ Increase/Decrease principal balance
- ❑ Secondary market / SBA approval (as applicable)
- ❑ Payment of additional G-Fee

Collateral Modification

- Subordinations
 - Repayment ability
 - Closed-ended
 - Adequate security
 - No cash out
 - Same or better terms
- Substitutions
 - Same as Subordination requirements
 - Environmental
 - Logistics
 - Insurance
 - Title insurance for “primary” collateral
 - SBA Approval (guarantor)

Collateral Modification

□ Releases

- Repayment ability
- Proceeds of sale for business purposes
- Remaining collateral “adequate”
- Pay down \geq Recoverable Value
- No jeopardy to payment, recovery or program integrity
- Obligors should provide OIC documentation (Ch.20)

□ Intercreditor Agreements

- “no adverse impact”
 - What?

Insurance

- Title
 - Required for substitute primary collateral
 - Secondary collateral – ad hoc
 - REO installment sale???
- Hazard
 - Adequate coverage to be maintained
 - Sale of assets or significant depreciation
 - Forced placement to protect Recoverable Value – “Prudent Lending”
 - Proceeds only released to Borrower through “Controlled Distribution”
- Life
 - Only modify if reason for insurance no longer exists
 - Payment of premiums – Prudent Lender, ad hoc basis
 - Release to beneficiaries – Financial Hardship
- Flood
 - If originally required, may not be waived, except if community drops out of NFIP
 - Lapse – force place within 45 days of notice to borrower of lapse

Covenants

- Financial Statements
 - Seasoned Loan
 - “Temporary”
- Comp., Dividends, Fixed Assets, WC
 - Seasoned
 - No deferments for prior 24 months
 - Cash flow analysis for prior 3 months
- Standby
 - Same as previous
 - No modification of Standby for Equity Injection

Assumption, Assignment or Sale

- Assumption
 - Eligibility required, unless workout/liquidation
 - No release – collateral or obligors
 - Due on sale or death
 - Seller may not retain CRE
- Assignment
 - Sale only to another participating lender
 - SBA approval
- Sale of loan in liquidation status
 - Only after guaranty purchase approval
 - No sale to Borrower – other Associates require SBA approval
 - No compromise of principal balance
 - Price bears reasonable relationship to Recoverable Value

Deferments

- ❑ “temporary solution to a temporary problem”
- ❑ Delinquent and future payments can be deferred w/o reclassifying in liquidation status
- ❑ Not appropriate if loan is > 60 days past due
- ❑ Deferments may not exceed 6 consecutive months at a time – additional deferments require justification
- ❑ Secondary market – one time, 3 month deferment w/o investor approval
- ❑ Interest accrues during deferment period
- ❑ Payments during deferment encouraged, but not required

Senior Loans

- Sr. lien default
 - Updated lien search
 - Verify balance of Sr. lien
 - Language re verification of no advances/default charges
 - Appraisal – compute Recoverable Value
 - Required notices
 - Plan strategy – cost/benefit analysis

Senior Loans

- Options:
 - Bring Sr. loan current
 - Facilitate workout
 - Buy time to complete negotiated sale or foreclose SBA lien
 - Purchase/Pay off Sr. Loan
 - Justified by appraisal
 - Exit strategy
 - Participate in Sr. lender foreclosure action
 - Litigate
 - Protective Bid if Recoverable Value > 10% of Liquidation Value – Prudent lender exception
 - Right of redemption if available

V. Liquidation Actions

- ❑ Liquidation Status
- ❑ Site Visits
- ❑ Workouts
- ❑ Real Property Liquidation
- ❑ Personal Property Liquidation
- ❑ Acquired Collateral
- ❑ Offer In Compromise
- ❑ Litigation
- ❑ Expenses
- ❑ Guaranty Purchase
- ❑ Denial of Liability
- ❑ Inspector General Referrals
- ❑ Charge-off and Wrap-up

Liquidation Status

- When? Lender **should** classify in liquidation when:
 - >60 days past due with no prospect of cure
 - Sr. lienholder foreclosure
 - Lawsuit that will adversely affect repayment
 - Obligor bankruptcy
 - Business closure w/o arrangements for repayment
 - Substantial collateral abandoned or in jeopardy
 - Receiver appointed
 - Anything else that would adversely affect repayment

Liquidation Status

- Demand Letter – all obligors
 - Acceleration
 - Active duty military – comply with Servicemember’s Civil Relief Act (SCRA)
- Locate Obligor and Collateral
- Liquidation Plan (should, not must)
 - Exception for CLP loans – Mandatory
- Remove from Liquidation Status
 - Return to Regular Servicing (after 3 timely payments)
 - PIF
 - Charge off after approval of Wrap-up

Site Visits

- Pre-default: follow conventional loan requirements
- Post-default: required if recoverable value would constitute a Material Loss (\$5k-\$10k)
 - Payment default: w/in 60 days of default
 - Other defaults: w/in 15 days of occurrence of adverse event
 - “or sooner if the collateral could be removed, lost or dissipated”
 - Be reasonably prompt.

Site Visits

- Goals (should):
 - Inspect & inventory collateral
 - Establish Recoverable Value of Collateral
 - Determine occupancy
 - Assess environmental
 - Develop liquidation strategy
 - Ascertain Workout Feasibility
 - Arrange to repossess PPC (if appropriate)
 - Arrange for CPC
 - Security, insurance, maintenance, etc.

Workouts

- ❑ Sold loans should be repurchased prior to workout
- ❑ Feasibility Test. Is Borrower:
 1. Competent? (has skills to turn around)
 2. Cooperative?
 3. Acting in Good Faith?
 4. Financially & operationally “viable”
- ❑ Timing – ASAP, within 60 days (of?)

Workouts

□ Consideration:

1. Correct document errors
2. Waive defenses
3. Release Lender Liability (and all other) claims
4. Provide additional collateral; and
5. Consent to speedy liquidation if workout fails
 - Enforceable?

Workouts

□ Options:

- Forbearance
- Reinstate Maturity Date (after Acceleration)
- Deferment
- Modification of Repayment Terms
- Loan Assumption
- Subordination to short-term WC loan
- Bring Sr. loan current
- Voluntary sale of collateral

□ SBA approval **NOT** required!

Real Property Liquidation

- Required if Recoverable Value > \$10k
 - Unless compelling documented reason for not doing so
- Due diligence
 - Searches, military status, site visit, loan documents, title, sr. liens, etc.
 - Consider: disposition of Sr. liens, liquidation strategy, leases, hazard insurance status, etc.
 - Historic Register?
 - Valuation
 - Environmental
 - Need to collect deficiency
 - Cost/benefit analysis

Real Property Liquidation

□ Liquidation Methods:

- Release for consideration
- Voluntary sale by Obligor
 - Maintain control over sale, ensure reasonable sale price; control proceeds of sale
- Deed in lieu
 - Consider state specific effects on deficiency collection and foreclosure of subordinate lienholders
 - Obligors must confirm amount to be applied to loan
- Foreclosure
 - Attempt OIC prior to foreclosing on primary residence of Obligor
 - Judicial vs. Non-Judicial foreclosure – state specific considerations
- Rent collection
 - Letter to tenant or Receiver
- Receiver
 - Requires SBA approval
 - Litigation Plan
 - “Exceptional Circumstances”
- Short Sale – at least = Recoverable Value and no release of Obligor

Real Property Liquidation

□ Credit Bids

■ Consider:

1. Recoverable value
2. Loan Balance
3. Need/ability to collect deficiency judgment

■ Base the bid on Recoverable Value

- May not bid loan amount if it will eliminate ability to collect deficiency
 - State variations

□ Eviction if Obligor or any Third Parties refuse to vacate

□ Abandonment

- Allowable if Recoverable Value is less than \$10k

Personal Property Liquidation

- Required if Recoverable Value > \$5k
 - Unless compelling documented reason for not doing so
- Due diligence
 - Searches, taxes, military status, site visit, loan documents, sr. liens, etc.
 - Collateral type: titled vehicles, airplanes, vessels
 - Consider: disposition of Sr. liens, liquidation strategy, landlords, hazard insurance status, etc.
 - Valuation
 - Environmental issues – hazardous materials on premises?
 - Cost/benefit analysis

Personal Property Liquidation

- ❑ Liquidation Methods:
 - Release for consideration
 - Voluntary sale by Obligor
 - ❑ Maintain control over sale, ensure reasonable sale price; control proceeds of sale
 - ❑ Must maximize recovery
 - UCC Sale
 - ❑ Private Sale
 - ❑ Public Sale – encouraged – why?
 - Auction
 - Sealed Bid
 - ❑ Requirements: possession (absent breach of the peace”); reasonable notice (10 days) to all obligors and junior lienholders
 - ❑ Bill of Sale
 - Judicial Foreclosure
 - Collection of AR
 - ❑ By Borrower – need reasonable controls over proceeds
 - ❑ By Lender – notice of intent to cease collection to preserve deficiency judgment
 - Setoff against deposit account (possession or control)

Personal Property Liquidation

□ Liquidation Methods (continued)

- Surrender Life Insurance Cash Value
 - Last collateral liquidated
 - Do not surrender if compelling reason not to do so
- Fixture foreclosure
- Marine Mortgage Foreclosure (Admiralty law)

□ Considerations:

- Choosing an auction co.: experience, results, bonding, insurance, fees, capacity, reputation, etc.
- Leased equipment – any value that would justify lease payoff?
- PMSI lienholders
- Collateral that includes Hazardous Substances

Personal Property Liquidation

□ Credit Bids:

- Non-judicial (UCC) sales
 - Advertise aggressively to maximize price
 - Do not credit bid or establish a reserve as it will discourage active bidding
- Judicial Foreclosure
 - Credit bid must be entered
 - Based on Recoverable Value, not to exceed loan balance
 - Consider need to obtain deficiency judgment

□ Abandonment

- Only if Recoverable Value does not exceed \$5k
 - Document and justify decision in file

Acquired Collateral

- Goal: maximize recovery in shortest amount of time
- Only take title if needed to maximize recovery
- Take title in Lender's name, not SBA
 - Exception: contaminated RE – should not become REO
- Timeframe for disposal:
 - 12 months from Acquisition

Acquired Collateral

□ Responsibilities:

- Take possession & secure collateral – eviction
- Inventory all PPC
- Pay utilities, insurance & taxes
- Maintenance

□ Expenses:

- Necessary, reasonable & customary
- Deduct from proceeds of sale; or
- Submit to SBA for reimbursement

Acquired Collateral

□ Sale:

- Method: highest recovery in shortest time
- Avoid associates of lender or borrower w/o SBA approval
- Transfer title by quitclaim deed/non-recourse Bill of Sale
- Price based on Valuation
- Brokers may be used
 - Reasonable fee
 - No conflict of interest
 - Price based on appraisal

Acquired Collateral

- Sale (continued)
 - Offers must be in writing
 - Term sales
 - Must maximize recovery
 - Buyer prequalified for financing
 - 20% down
 - Execute Note
 - Assignable
 - Term < 15 years
 - Not interest only
 - Appropriate interest rate
 - Secured by property sold and guarantees
 - Costs paid by buyer, including title & insurance

Acquired Collateral

□ Lease

- Only if acquired collateral cannot be sold (after sale is held) & lease will maximize recovery
- Lease must be written and market
- No lease to Obligor or associates

□ Abandonment

- REO may **not** be abandoned – alternate disposal required
- PPC may be abandoned
- Liability from abandonment/alternate disposal must be mitigated
- Recoverable Value < \$10k (REO); < \$5k (PPC)

Offer In Compromise

- What is it?
 - “Settlement” with an Obligor
 - Must reflect “true” ability to pay
 - No “horse trading”
- When appropriate?
 - After liquidation is complete
 - Exception: personal residence which is part of an OIC
 - AFTER SBA APPROVAL!
- Obligors have no “right” to an OIC

Offer In Compromise

□ General Requirements:

- Liquidation status
- No Bankruptcy
- Full amount cannot be recovered
- No fraud, misrepresentation, or financial misconduct
- Amount offered bears “reasonable relationship” to Recoverable Value from enforced collection

Offer In Compromise

- Going Concern:
 - OIC will avoid business closure
 - All other options exhausted
 - Feasibility test
 - Part of global debt restructure agreed to by all other creditors
 - Treatment of SBA must be “fair & equitable” compared to other creditors

Offer In Compromise

- Required documents (unless basis is litigative risk):
 - SBA Form 1150 (written offer)
 - Include special circumstances
 - Current financial statement of Obligor making offer, plus last YE financial statements and last 2 FTR's
 - If there are Affiliates, consolidated financials are required
 - Credit report
 - Tax transcripts
 - Any other independent financial information

Offer In Compromise

□ Analysis:

■ Consider:

- Likely net recovery through enforced collection
 - Time and expense associated with collection
 - Obligor's income and ability to pay
 - Possibility of fraudulent transfer/concealment of assets
 - Obligor's cooperativeness
- ### ■ Amount must exceed \$5,000 and bear a reasonable relationship to recovery through enforced collection
- Financial Hardship exception
- ### ■ Inadequate offers should be countered
- If no adequate agreement can be reached after negotiation, charge off and refer to treasury

Offer In Compromise

□ Payment Terms:

- Cash is preferred – payment within 60 days of SBA approval
- Term compromise
 - Maximize recovery
 - Written agreement
 - Note
 - Collateral
 - If default under OIC, full amount under original note due in full
 - Remedies (confession of judgment, delivery of deed/bill of sale, etc.)
- Mutual release upon full payment
- Apply amounts received to principal balance

Litigation

- Necessary, reasonable and customary
- Cost effective
 - Due diligence
 - If not cost effective, refer to treasury
- Legal Counsel requirements:
 - Licensed in state
 - Expertise in collection & bankruptcy
 - Adequate malpractice insurance
 - No conflict of interest

Litigation

□ Litigation Plans

■ SBA approval required for:

- Non-routine litigation
- Legal fees > \$10,000 (15% variance)
- SBA should respond within 15 days; however failure to respond ≠ consent

□ Provide SBA copies of all documents for non-routine litigation

Litigation

□ Attorney's Fees

■ Eligible:

- Fees & Costs related to necessary litigation to recover

■ Ineligible:

- Overhead & administrative time
- Multiple attorneys
- Routine liquidation activities
 - Demand letter; liquidation plan; purchase package, etc.
- In-house counsel
- Travel costs
- Claims against SBA
- Fees that exceed recovery
- Receiver fees for routine liquidation activities

Litigation

- Bankruptcy
 - Automatic stay
 - Notice of Bankruptcy to SBA
 - Required activities
 - Proof of Claim
 - Protect SBA's interests
 - Report suspected fraud
 - Motion for relief from stay
 - Monitor proceedings
 - Contest discharge in cases of fraud
 - Vote on reorganization plan

Litigation

□ Probate

- File claim against decedent's estate
- Monitor proceedings
- Review estate inventory
- Represent SBA's interests

□ Judgments

- Enter judgments in jurisdictions likely to lead to recovery
- Execute within 90 days of judgment entry
- Judgment may be assigned to SBA if SBA most cost effective way to recover

Expenses

□ Non-Recoverable:

- Expenses not related to collection or collateral preservation
- Unnecessary fees & costs
- Late fees
- Unapproved receiver fees
- Fees associated with lender liability
- Fees for others to perform routine servicing and liquidation activities

Expenses - Recoverable

□ Search fees

- UCC
- Title
- Credit
- Asset search

□ Third Party Reports

- Appraisals
- Valuations
- Environmental
- Site visit reports

□ CPC

- Utility bills
- Insurance premiums
- Caretaker fees
- Repairs
- Taxes
- Expenses related to non-tax senior liens

Expenses

□ Application

1. Recoverable expenses
2. Principal
3. Accrued interest

□ Methods of Recoupment:

- Deduct from recoveries
- CPC request
 - With 10 Tab submission;
 - When expenses > \$5,000 per loan
 - With Wrap-up report

Expenses

- Allocation among multiple loans:
 - Allocate expenses related to collateral recovery according to lien priority
 - Allocate other expenses among loans on a pro-rata basis
- Requests for reimbursement must be documented and substantiated

Charge-off and Wrap-up

- Appropriate when:
 - All liquidation activities are complete
 - Cost of further collection will exceed recovery
 - Balance is otherwise uncollectible
 - Wrap-up to be submitted within 90 days of completion of liquidation

Charge-off and Wrap-up

- Wrap-up Report contents:
 - Loan info.
 - Obligor info.
 - Obligor status – still liable?
 - Demand Letters for each Obligor
 - Narrative of efforts to locate missing Obligors
 - Estimate of potential recovery from each Obligor
 - Status & disposition of collateral
 - Site visit
 - Expenses
 - Recoveries
 - Recommendation

Charge-off and Wrap-up

- Treasury Referral
 - Mandatory, except for Obligors that received discharge in Bankruptcy
 - Recoveries shared with Lender on a pro-rata basis
- 1099 for written-off or uncollectible debt
- Credit bureau reporting

VI. Environmental Considerations

- When Environmental Investigation Required:
 - Substitute CRE collateral
 - Release lien for less than Recoverable Value based on unsubstantiated allegations of contamination
 - Foreclosure (deed in lieu) on CRE
 - Taking over operation of business that handles hazardous substances

VI. Environmental Considerations

□ Servicing

- E.I. conducted in accordance with 50 10

□ Liquidation

- Consider: equity, use of property, results of prior E.I., etc.
- Use environmental professional (except E.Q.)
- Reliance letter

VI. Environmental Considerations

- Environmental Site Assessment (ESA)
 - High Risk: UST's, NAICS Codes (50 10 App. 4), use of property, etc.
 - Begin with Phase I
 - Non-industrial condominiums may begin with TSA or EQRSRA
 - Low-Risk – may begin with TSA or EQRSRA
 - Conduct additional investigations depending upon results

VI. Environmental Considerations

- Gas Stations / Dry Cleaners
 - Phase II required
 - Equipment testing
- Business Using Hazardous Substances
 - Environmental Regulatory Compliance Audit
 - Required before taking over operation of business
 - Use Receiver (after SBA approval)

VI. Environmental Considerations

- ❑ ESA's should be less than 180 days old when relied on
- ❑ Obtain legal opinion prior to conducting environmental remediation to confirm Lender will not assume liability by doing so
- ❑ Title to contaminated property should not be taken, unless a prudent lender would do so based on estimated net recovery
 - Seek SBA approval!

VII. Guaranty Purchase

- ❑ Loan must be 60 days past due
- ❑ Loan must be in Liquidation Status
- ❑ SBA will only pay Lenders 120 days interest
 - Interest owed to secondary market investors may exceed this amount – Lender is liable for interest over 120 days
- ❑ Loans approved after 5/14/2007
 - PPC must be liquidated, unless:
 - ❑ Bankruptcy
 - ❑ Lender refuses to repurchase from secondary market
- ❑ Deadlines:
 - Pre-Purchase: within 180 days of loan maturity or completion of liquidation
 - Post-Purchase: within 45 days of SBA purchase from investor

VII. Guaranty Purchase

□ Denials

- Material non-compliance
- Contributed to a Material Loss
- Improper origination, servicing or liquidation
- Misrepresentation by Lender
- Ineligible loan

□ Repairs

- Measure of damages is based on Recoverable Value of collateral

VII. Guaranty Purchase

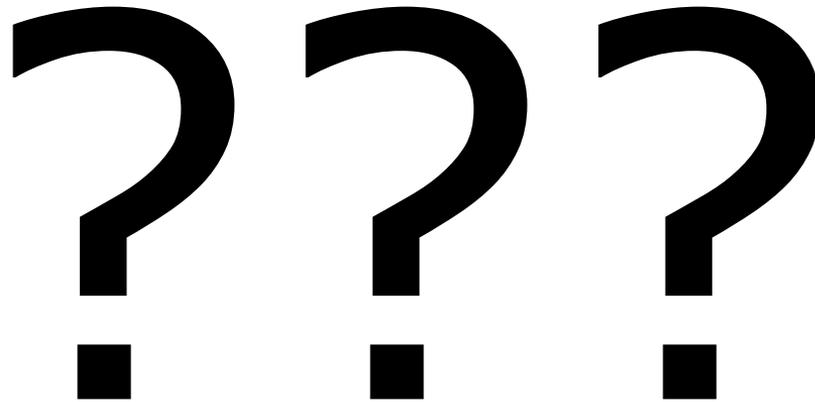
□ Denials

- Ineligible loan
- Use of suspended or debarred Agent
- Early Defaults – imprudent underwriting
- Missing 4506
- Misuse of Loan Proceeds
- Undocumented Equity Injection
- Failure to obtain proper lien position
- No collateral inventory
- Failure to conduct site visit
- Failure to safeguard collateral
- Lender preference

VIII. OIG Referrals

- ❑ Lenders must report any known or suspected irregularities involving program participants or applicants
- ❑ Loan application fraud
 - False statements or documents made/submitted by loan Applicants
 - ❑ May include misrepresentation by omission
- ❑ Loan Closing Fraud
 - False documents submitted to comply with closing requirements
 - ❑ Equity Injection
- ❑ Loan Agent Fraud
- ❑ Misuse of Loan Proceeds
- ❑ Conversion of Collateral
- ❑ Misconduct by SBA or Lender personnel

Questions



Thank you! Ethan W. Smith, Esq.
esmith@starfieldsmith.com



www.starfieldsmith.com