

# HOW TO LOSE YOUR SBA GUARANTY

*in 10 "Easy" Steps...*

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Presented by:

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# Agenda:

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- Basic Program Concepts/Terms
  - Nature of the Guaranty
  - Delegated Authority (PLP) and “GIGO”
  - Centralization/NGPC
  - Early Default/Problem Loans
  - Repairs/Denials
- Case Studies
  - Top reasons for repairs/denials
- Recommendations/Best Practices

# Case Study #1 - Eligibility

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## □ Affiliation

- Loan Structuring to exceed program maximums
- Lender failure to perform sufficiently detailed affiliation analysis
- FULL DENIAL

## □ Ineligible Business

- Loan to purchase CRE and convert use to Brazilian Restaurant
- Existing use at time of closing – ineligible
- Lender failure to monitor UOP and change of use
- FULL DENIAL

# Case Study #2 – Improper PLP Processing

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- Lender refinance its own debt
  - \$350k interim loan for equipment purchase
  - SOP does not allow PLP processing to refi same lender debt, unless an interim loan approved within 90 days of PLP #
  - Delay caused by fire
  - Lender obtains PLP 10 mos. after interim loan approval and closing
  - \$350k REPAIR

# Case Study #3 – Program Integrity

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- ❑ Bank officer part owner of CRE developer
- ❑ Bank approves loans to CRE purchasers
- ❑ Potential conflict of interest not disclosed to SBA
- ❑ FULL DENIAL

# Case Study #4 - Financials

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- ❑ Early Default/Problem Loan
- ❑ Lender unable to produce 4506 Transcripts
- ❑ Logic conundrum – difficult to prove a negative
- ❑ Often lenders underwrite Change of Ownership as startup when seller refuses to provide financials – beware!
- ❑ “Materiality” standard is not always followed
- ❑ FULL DENIAL

# Case Study #5 – Environmental

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- ❑ Gas station loan
- ❑ Environmental consultant recommends additional testing
- ❑ Lender does not require additional testing
- ❑ Contamination at default
  - Lender cannot prove CRE was “clean” at closing
- ❑ REPAIR – cost of cleanup

# Case Study #6 – Use of Proceeds

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- ❑ Lender has burden to prove proper UOP
- ❑ Lender does not reallocate proceeds in LA
- ❑ Proceeds designated for one purpose used for another purpose (i.e.: inventory \$ used for working capital; renovation \$ used for debt refi., etc.)
- ❑ REPAIR i/a/o improperly disbursed proceeds



# Case Study #7 – Refinance

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- Lender refinances several debts of Borrower
  - Ineligible purpose – 1 debt refinanced financed the buy-in of 1 principal
    - “Creeping control” – ineligible
  - Ineligible debt – same debt was also owed to SBIC
  
- REPAIR i/a/o line item allocated to refinance the ineligible debt

# Case Study #8 – Collateral

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## □ Lien Position

## □ Guarantors

- Application: Ownership 41%/41%/18%
- Operating Agreement: 33.3%/33.3%/33.3%
- Lender failed to verify ownership
- “18%” owner actually owned 1/3
  - Guaranty required
  - Individual has means and refuses to share financial info.

## □ FULL DENIAL

# Case Study #9 – Insurance

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- Life – loan to sole proprietor
  - Failure to obtain life insurance
  - Borrower dies
  - REPAIR i/a/o loan balance less collateral recovery
  
- Casualty – Acord Certificate
  - Failure to get copy of binder
  - Insurance company contests claim for coverage after fire destroys business
  - REPAIR i/a/o difference between replacement cost and litigation settlement amount

# Case Study #10 – 912 Issues

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- ❑ Principal answers “No” to questions 7, 8 & 9 on 912 Form
- ❑ Principal convicted of 2 misdemeanors (sexual assault) in 1993 and had felony arrest (battery) in 2002 (charges dropped)
- ❑ Lender performs criminal background search prior to closing – no records found
- ❑ Lender discovers misrepresentation on subsequent conventional loan application
- ❑ What should the lender do?

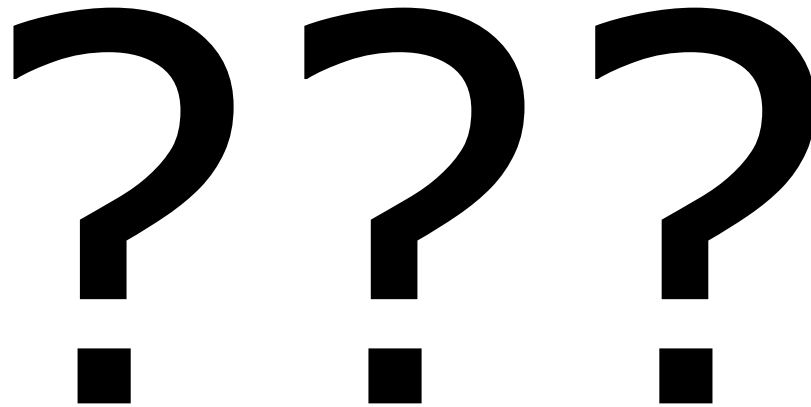
# Recommendations/Best Practices

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- ❑ Begin with the end in mind
- ❑ Submit “close calls” for GP processing
- ❑ Use 10 Tabs as post-closing audit checklist
- ❑ Independent loan level risk based reviews
- ❑ Constant improvement in front-end practices
- ❑ Avoid GIGO

# Questions

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**Thank you! Ethan W. Smith, Esq.**  
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