



How to Effectively Manage SBA Loans

Table of Contents:

Overview.....	2
Payment Modifications.....	3
Forbearance Agreements.....	4
Liquidations.....	6
About Windsor Advantage, LLC.....	8

OVERVIEW

No Lender likes hearing the news that one of their loans has gone into default. For SBA loans, this news can bring extra anxiety given the additional compliance required in SBA loan liquidations. Those familiar with the SBA 7(a) Loan Program know the SBA's decision to honor the guarantee rests in part on a Lender's compliant handling of a default scenario.

A Lender has three main options when an SBA 7(a) loan enters default status:

1. **Payment Modification**
2. **Forbearance Agreement**
3. **Liquidate**

Since 2010, Windsor Advantage has handled hundreds of government guaranteed loan liquidations. This experience has provided Windsor a unique view into the risks and process. In this article, we'll discuss the rules surrounding each of the three main options to ensure compliance and risk mitigation for repair or denial.

About the Author

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PAYMENT MODIFICATIONS

What Are They?

A payment modification is a change to the repayment terms of a Note that does not alter the overall structure of the Note. Typically, a modification is the deferment of a portion or entire loan payment for a certain period of time but can also include such actions as changing the due date of the loan payments.

When Are They Appropriate?

A payment modification is only appropriate when the Borrower cannot make scheduled loan payments for an interim period. The difficulty (i.e. tight cash flows) must be temporary in nature and addressed by the payment modification. If a Borrower's issues are permanent and/or will not be improved by granting a deferment, then the Lender should consider other options.

What Are SBA Rules?

Loans Not Sold on the Secondary Market

For loans not sold on the secondary market, a Lender can grant a payment deferment (principal and interest) for up to six months. During the deferment, the Lender must keep a close eye on the business through regular follow up and review of financial statements. At the end of the deferment period, the Lender can determine whether additional deferment is needed. However, if the deferment period is to extend beyond six months, the Lender must have a documented justification for the extension.

Loans Sold on the Secondary Market

For loans sold on the secondary market, Lenders may grant a full deferment of principal and interest payments of up to three months unilaterally. Anything in excess must receive the prior written approval of the secondary market investor.

FORBEARANCE AGREEMENTS

What Are They?

A forbearance agreement is a change to the repayment terms of a Note that alters the overall structure of the Note and usually includes an agreement by the Lender not to accelerate during the term of the agreement as long as the conditions are honored. A forbearance agreement is typically utilized during a loan workout as a final means to assist the Borrower with full repayment. Examples of changes made to a Note under a forbearance agreement include extending the maturity or fixing the interest rate.

When Are They Appropriate?

A forbearance agreement is appropriate when the Borrower cannot make the scheduled loan payments and the difficulty will not be helped by a temporary payment modification but requires a more substantial alteration to the terms of the Note. Additionally, forbearance agreements are only appropriate when the Lender anticipates the Borrower will be able to pay off the loan in full.

Since the goal of a forbearance agreement is to aid in the orderly repayment of the loan in full, these agreements frequently include extension of the maturity date of the Note to allow the Borrower to re-amortize and secure lower monthly payments, thus creating an opportunity for the Borrower to pay the loan in full over a longer period.



Case Studies – Payment Modifications

The State Health Department declined to renew an assisted living facility's business ALF license and the Borrower decided to close the facility for renovations and reopen as an independent living facility. The Lender, with investor's approval, granted the Borrower five months of full P&I deferment. The Borrower made all renovations, reopened and has so far made all payments on time.

A business in Alaska was affected by the earthquake in November of 2018 and requested two months of full P&I deferment in order to make the necessary repairs and get back up and running. The Lender granted this under unilateral authority and payments continued thereafter without any issues.

FORBEARANCE AGREEMENTS

What Are SBA Rules?

As a result of forbearance agreements being more substantive in nature, most terms require the Lender to place the loan in liquidation status with the SBA prior to proceeding. Once an agreement has been reached, the loan can be placed back into regular servicing with the SBA under the terms of the new agreement.

Loans Not Sold on the Secondary Market

For loans not sold on the secondary market, a Lender has relatively wide latitude as to the terms of a forbearance agreement. SBA allows Lenders to extend the maturity date of a loan up to 10 years if the conditions will aid in the orderly repayment of a loan.

Loans Sold on the Secondary Market

Similar to payment modifications, a Lender must obtain secondary market approval of any modifications beyond a three-month full deferment. If the investor agrees to the proposed terms of the forbearance agreement, the Lender is free to proceed. If the investor does not agree, the Lender should repurchase the loan from the secondary market, place the loan in liquidation status with the SBA and subsequently enter into the agreement with the Borrower.

As with loans that are not sold on the secondary market, the SBA may allow Lenders to extend the maturity date of a loan up to 10 years if it will aid in the orderly repayment of a loan.



Case Study – Forbearance Agreement

A small urgent care medical center faced declining cash flows due to a large health center moving in nearby. The Borrower was only able to service monthly payments of roughly half their regular payment amount. The Lender entered into a forbearance agreement under which the maturity date was extended and the Borrower is expected to pay off in full over the extended term with the reduced payments. This avoided a liquidation scenario that would have been a worse outcome for both the Lender and Borrower.

LIQUIDATIONS

What Are They?

Liquidation refers to the Lender's efforts to sell the Borrower's collateral property in order to maximize recovery on the loan prior to writing off the balance as a loss.

When Are They Appropriate?

Liquidation is usually the appropriate route for a Lender to take when the Borrower cannot make the scheduled loan payments and does not have a realistic possibility of paying off the loan in full following consideration of extended terms.

What Are SBA Rules?

When the Lender determines that liquidation is the most appropriate action for a loan, the first step is to move the loan into liquidation status with the SBA. If the loan is sold on the secondary market, the Lender should also request that the SBA repurchase the loan from the investor immediately after the decision has been made.

Within 45 days of SBA's repurchase of a loan from the secondary market, the Lender must submit a Guaranty Purchase Package, which serves to update the SBA on the history of the loan from inception to default. Lenders then have two years from the SBA's repurchase of a loan to complete liquidation activities (if Lenders have a justifiable reason that liquidation will take longer than 24 months, they may request that the SBA extend the deadline).

Outlined on the following page are the main SBA rules regarding liquidation that Lenders should keep in mind.

LIQUIDATIONS

Document and Justify All Lender Decisions

All of the Lender's decisions regarding liquidation and abandonment of collateral must be clearly documented and justified in the Lender's loan file. In particular:

- Title and UCC searches must be obtained in order to confirm the Lender is in the required position.
- Appraisals of all collateral must be obtained.
- Any Lender decision to abandon collateral or sell for less than the forced liquidation value indicated in the appraisal must be justified.

Lender Must Liquidate All Collateral if Cost-Effective

The SBA requires the Lender to liquidate all collateral on the loan to the extent it is cost-effective to do so. If the Lender determines that it would be cost prohibitive to liquidate a piece of collateral, it must include justification for this decision in the loan file. In general, the SBA allows Lenders to abandon collateral if its recoverable value is less than \$5,000 for business personal property or less than \$10,000 for real estate.

Litigation Plans

If the Lender anticipates that it will incur \$10,000 or more in legal fees as part of its efforts to liquidate the collateral (i.e. foreclosures), the Lender must submit a litigation plan to the SBA in order to obtain prior approval of the proposed legal fees. Failure to do so could result in the SBA declining to reimburse the Lender pro-rata for the legal fees incurred.

Wrap-Up and Charge Off

Within 30 days of the completion of liquidation activities, the Lender must submit a Wrap-Up Report to the SBA, which serves to update the SBA on all liquidation activities and recoveries. If the Lender incurred expenses in liquidation, it should also submit the Care and Preservation of Collateral tabs to the SBA at this point to request pro-rata reimbursement of its expenses from the SBA.

While SBA loan defaults can be intimidating, we hope this article has shown that with careful attention to the rules surrounding each option, Lenders can remove a substantial amount of the uncertainty and anxiety from the process, minimize the chances of a repair or denial and maximize the likelihood that the SBA will honor the guarantee on the defaulted loan in full.

ABOUT WINDSOR ADVANTAGE, LLC



Windsor Advantage provides banks, credit unions and CDFIs with a comprehensive outsourced SBA 7(a) and USDA lending platform.

Since 2010, Windsor has processed more than \$2.3 billion in government guaranteed loans and currently services a portfolio in excess of \$1.4 billion (as of August 30, 2019) for over 90 lenders headquartered in 30 states. With more than 150 years of cumulative SBA lending experience, cutting edge technology, rigid controls and consistent processes, Windsor is uniquely qualified to assist any size lender with implementing a thoughtful and profitable government guaranteed lending initiative.

Windsor Advantage has offices in Chicago, Illinois; Indianapolis, Indiana; Charleston, South Carolina; and Seattle, Washington.

For more information, please call (312) 248-8530 or email info@windsoradvantage.com.

Windsor Clients Headquartered in 30 States

