

## Small Business Administration

## § 107.830

the Equity Securities of the issuer or a subordination of your lien or creditor position does not count toward your overline; or

(3) The total financing cost to the Small Business exceeds the cost of money limits of §107.855.

(b) *Pledge of Licensee's assets as guaranty.* For purposes of this section, a guaranty with recourse only to specific asset(s) you have pledged is equal to the fair market value of such asset(s) or the amount of the debt guaranteed, whichever is less.

### §107.825 Purchasing securities from an underwriter or other third party.

(a) *Securities purchased through or from an underwriter.* You may purchase the securities of a Small Business through or from an underwriter if:

(1) You purchase such securities within 90 days of the date the public offering is first made;

(2) Your purchase price is no more than the original public offering price; and

(3) The amount paid by you for the securities (less ordinary and reasonable underwriting charges and commissions) has been, or will be, paid to the Small Business, and the underwriter certifies in writing that this requirement has been met.

(b) *Recordkeeping requirements.* If you have outstanding Leverage or plan to obtain Leverage, you must keep records available for SBA's inspection which show the relevant details of the transaction, including, but not limited to, date, price, commissions, and the underwriter's certifications required under paragraph (c) of this section.

(c) *Underwriter's requirements.* If you have outstanding Leverage or plan to obtain Leverage, the underwriter must certify whether it is your Associate. You may pay reasonable and customary commissions and expenses to an Associate underwriter for the portion of an offering that you purchase, provided it is no more than 25 percent of the total offering. If you buy more than 25 percent of the offering, the amount you pay to the Associate underwriter must not exceed the total of the application and closing fees and re-

imbursable expenses permitted by §107.860.

(d) *Securities purchased from another Licensee or from SBA.* You may purchase from, or exchange with, another Licensee, Portfolio securities (or any interest therein). Such purchase or exchange may only be made on a non-recourse basis. You may not have more than one-third of your total assets (valued at cost) invested in such securities. If you have previously sold Portfolio Securities (or any interest therein) on a recourse basis, you shall include the amount for which you may be contingently liable in your overline computation.

(e) *Purchases of securities from other non-issuers.* You may purchase securities of a Small Business from a non-issuer not previously described in this §107.825 if:

(1) Such acquisition is a reasonably necessary part of the overall sound Financing of the Small Business under the Act; or

(2) The securities are acquired to finance a change of ownership under §107.750.

### STRUCTURING LICENSEE'S FINANCING OF AN ELIGIBLE SMALL BUSINESS: TERMS AND CONDITIONS OF FINANCING

### §107.830 Minimum duration/term of financing.

(a) *General rule.* The duration/term of all your Financings must be for a minimum period of one year.

(b) *Restrictions on mandatory redemption of Equity Securities.* If you have acquired Equity Securities, options or warrants on terms that include redemption by the Small Business, you must not require redemption by the Small Business within the first year of your acquisition except as permitted in §107.850.

(c) *Special rules for Loans and Debt Securities—(1) Term.* The minimum term for Loans and Debt Securities starts with the first disbursement of the Financing.

(2) *Prepayment.* You must permit voluntary prepayment of Loans and Debt Securities by the Small Business. You must obtain SBA's prior written approval of any restrictions on the ability of the Small Business to prepay

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other than the imposition of a reasonable prepayment penalty under paragraph (c)(3) of this section.

(3) *Prepayment penalties.* You may charge a reasonable prepayment penalty which must be agreed upon at the time of the Financing. If SBA determines that a prepayment penalty is unreasonable, you must refund the entire penalty to the Small Business. A prepayment penalty equal to 5 percent of the outstanding balance during the first year of any Financing, declining by one percentage point per year through the fifth year, is considered reasonable.

[61 FR 3189, Jan. 31, 1996, as amended at 69 FR 8098, Feb. 23, 2004]

### § 107.835 Exceptions to minimum duration/term of Financing.

You may make a Short-term Financing for a term less than one year if the Financing is:

(a) An interim Financing in contemplation of long-term Financing. The contemplated long-term Financing must be in an amount at least equal to the short-term Financing, and must be made by you alone or in participation with other investors; or

(b) For protection of your prior investment(s); or

(c) For the purpose of Financing a change of ownership under §107.750. The total amount of such Financings may not exceed 20 percent of your Loans and Investments (at cost) at the end of any fiscal year; or

(d) For the purpose of aiding a Small Business in performing a contract awarded under a Federal, State, or local government set-aside program for "minority" or "disadvantaged" contractors.

[61 FR 3189, Jan. 31, 1996, as amended at 64 FR 52646, Sept. 30, 1999; 69 FR 8098, Feb. 23, 2004]

### § 107.840 Maximum term of Financing.

The maximum term of any Loan or Debt Security Financing must be no longer than 20 years.

### § 107.845 Maximum rate of amortization on Loans and Debt Securities.

The principal of any Loan (or the loan portion of any Debt Security) with a term of one year or less cannot

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be amortized faster than straight line. If the term is greater than one year, the principal cannot be amortized faster than straight line for the first year.

[69 FR 8098, Feb. 23, 2004]

### § 107.850 Restrictions on redemption of Equity Securities.

(a) A Portfolio Concern cannot be required to redeem Equity Securities earlier than one year from the date of the first closing unless:

(1) The concern makes a public offering, or has a change of management or control, or files for protection under the provisions of the Bankruptcy Code, or materially breaches your Financing agreement; or

(2) You make a follow-on investment, in which case the new securities may be redeemed in less than one year, but no earlier than the redemption date associated with your earliest Financing of the concern.

(b) The redemption price must be either:

(1) A fixed amount that is no higher than the price you paid for the securities; or

(2) An amount that cannot be fixed or determined before the time of redemption. In this case, the redemption price must be based on:

(i) A reasonable formula that reflects the performance of the concern (such as one based on earnings or book value); or

(ii) The fair market value of the concern at the time of redemption, as determined by a professional appraisal performed under an agreement acceptable to both parties.

(c) Any method for determining the redemption price must be agreed upon no later than the date of the first (or only) closing of the Financing.

[61 FR 3189, Jan. 31, 1996, as amended at 64 FR 52646, Sept. 30, 1999; 69 FR 8098, Feb. 23, 2004]

### § 107.855 Interest rate ceiling and limitations on fees charged to Small Businesses ("Cost of Money").

"Cost of Money" means the interest and other consideration that you receive from a Small Business. Subject to lower ceilings prescribed by local law, the Cost of Money to the Small

Business must not exceed the ceiling determined under this section.

(a) *Financings to which the Cost of Money rules apply.* This section applies to all Loans and Debt Securities. As required by §107.800(b), you must include as Debt Securities any equity interests with redemption provisions that do not meet the restrictions in §107.850.

(b) *When to determine the Cost of Money ceiling for a Financing.* You may determine your Cost of Money ceiling for a particular Financing as of the date you issue a Commitment or as of the date of the first closing of the Financing. Once determined, the Cost of Money ceiling remains fixed for the duration of the Financing.

(c) *How to determine the Cost of Money ceiling for a Financing.* At a minimum, you may use a Cost of Money ceiling of 19 percent for a Loan and 14 percent for a Debt Security. To determine whether you may charge more, do the following:

(1) Choose a base rate for your Cost of Money computation. The base rate may be either the Debenture Rate currently in effect plus the applicable Charge determined under §107.1130(d)(1), or your own "Cost of Capital" as determined under paragraph (d) of this section.

(2) For a Loan, add 11 percentage points to the base rate; for a Debt Security, add 6 percentage points. In either case, round the sum down to the nearest eighth of one percent.

(3) If the result is more than 19 percent (for a Loan) or 14 percent (for a Debt Security), you may use it as your Cost of Money ceiling.

(4) If two or more Licensees participate in the same Financing of a Small Business, the base rate used in this paragraph (c) is the highest of the following:

(i) The current Debenture Rate plus the applicable Charge determined under §107.1130(d)(1);

(ii) The Cost of Capital of the lead Licensee; or

(iii) The weighted average of the Cost of Capital for all Licensees participating in the Financing.

(d) *How to determine your Cost of Capital.* "Cost of Capital" is an optional computation of the weighted average interest rate you pay on your "qualified borrowings". "Qualified bor-

rowings" means your Debentures together with your borrowings at or below the usual interest rate charged by banks in your locality on the date your loan was made.

(1) For any fiscal year, you may compute your Cost of Capital:

(i) As of the first day of your fiscal year, to remain in effect for the entire year; or

(ii) As of the first day of every fiscal quarter during the fiscal year, to remain in effect for the duration of the quarter.

(2) For each qualified borrowing outstanding at your last fiscal year or fiscal quarter end, multiply the ending principal balance (net of related unamortized fees) by the number of days during the past four fiscal quarters that the borrowing was outstanding, and divide the result by 365.

(3) Add together the amounts computed for all borrowings under paragraph (d)(2) of this section. The result is your weighted average borrowings.

(4) For all qualified borrowings outstanding at your last fiscal year or fiscal quarter end, determine the aggregate interest expense for the past four fiscal quarters, excluding amortization of loan fees. For the purposes of this paragraph (d)(4):

(i) Interest expense on Debentures includes the 1 percent Charge paid by a Licensee under §107.1130(d)(1); and

(ii) Section 301(d) Licensees with outstanding subsidized Debentures are presumed to have paid interest at the rate stated on the face of such Debentures, without regard to any subsidy paid by SBA.

(5) Divide the interest expense from paragraph (d)(4) of this section by the weighted average borrowings from paragraph (d)(3) of this section, and multiply by 100. The result is your Cost of Capital, which you may use to compute a Cost of Money ceiling under paragraph (c) of this section.

(e) *SBA review of Cost of Capital computation.* You must keep your Cost of Capital computations in a separate file available for SBA's review.

(1) A computation that is kept in such a file and is audited by your independent public accountant is considered correct unless SBA demonstrates otherwise.

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(2) If a computation is not kept in such a file or is unaudited, you must prove its accuracy to SBA's satisfaction.

(f) *Charges included in the Cost of Money.* The Cost of Money includes all interest, points, discounts, fees, royalties, profit participation, and any other consideration you receive from a Small Business, except for the specific exclusions in paragraph (g) of this section. For equity interests subject to the Cost of Money rules (see paragraph (a) of this section), you must include:

(1) The portion of the fixed redemption price that exceeds your original cost.

(2) Any amount of a redemption that is paid out of accounts other than the Small Business's capital accounts (capital, paid-in surplus, or retained earnings of a corporation; or partners' capital of a partnership).

(g) *Charges excluded from the Cost of Money.* You may exclude from the Cost of Money:

(1) Discount on the loan portion of a Debt Security, if such discount exists solely as the result of the allocation of value to detachable stock purchase warrants in accordance with generally accepted accounting principles.

(2) Closing fees, application fees, and expense reimbursements, each as permitted under § 107.860.

(3) Reasonable prepayment penalties permitted under § 107.830(d)(3).

(4) Out-of-pocket conveyance and/or recordation fees and taxes.

(5) Reasonable closing costs.

(6) Fees for management services as permitted under § 107.900.

(7) Reasonable and necessary out-of-pocket expenses you incur to monitor the Financing.

(8) Board of director fees not in excess of those paid to other outside directors, if your board representation meets the requirements of § 107.730(e).

(9) A reasonable fee for arranging financing for a Small Business from a source that is neither a Licensee nor an Associate of yours. The Small Business must agree in writing to pay such a fee before you arrange the financing.

(10) The difference between the contractual interest rate of the Financing and a default rate of interest permitted as follows:

(i) If a Small Business is in default, you may charge a default rate of interest as much as 7 percentage points higher than the contractual rate until the default is cured.

(ii) For this purpose, "default" means either failure to pay an amount when due or failure to provide information required under the Financing documents.

(11) Royalty payments based on improvement in the performance of the Small Business after the date of the Financing.

(12) Gains realized on the disposition of Equity Securities issued by the Small Business.

(h) *How to evaluate compliance with the Cost of Money ceiling.* You must determine whether a Financing is within the Cost of Money ceiling based on its discounted cash flows, as follows:

(1) Beginning with the date of the first disbursement ("period zero"), identify your cash inflows and cash outflows for each period of the Financing. The appropriate period to use (such as years, quarters, or months) depends on how you have structured the disbursements and payments.

(2) Discount the cash flows back to the first disbursement date using the Cost of Money ceiling from paragraph (d) of this section as the discount rate.

(3) If the result is zero or less, the Financing is within the Cost of Money ceiling; if it is greater than zero, the Financing exceeds the Cost of Money ceiling.

[61 FR 3189, Jan. 31, 1996, as amended at 63 FR 5867, Feb. 5, 1998; 64 FR 52646, Sept. 30, 1999; 65 FR 69432, Nov. 17, 2000; 77 FR 20294, Apr. 4, 2012]

### **§ 107.860 Financing fees and expense reimbursements a Licensee may receive from a Small Business.**

You may collect Financing fees and receive expense reimbursements from a Small Business only as permitted under this § 107.860.

(a) *Application fee.* You may collect a nonrefundable application fee from a Small Business to review its Financing application. The application fee may be collected at the same time as the closing fee under paragraph (c) or (d) of this section, or earlier. The fee must be:

(1) No more than 1 percent of the amount of Financing requested (or, if two or more Licensees participate in the Financing, their combined application fees are no more than 1 percent of the total Financing requested); and

(2) Agreed to in writing by the Financing applicant.

(b) *SBA review of application fees.* For any fiscal year, if the number of application fees you collect is more than twice the number of Financings closed, SBA in its sole discretion may determine that you are engaged in activities not contemplated by the Act, in violation of §107.500.

(c) *Closing fee—Loans.* You may charge a closing fee on a Loan if:

(1) The fee is no more than 2 percent of the Financing amount (or, if two or more Licensees participate in the Financing, their combined closing fees are no more than 2 percent of the total Financing amount); and

(2) You charge the fee no earlier than the date of the first disbursement.

(d) *Closing fee—Debt or Equity Financings.* You may charge a Closing Fee on a Debt Security or Equity Security Financing if:

(1) The fee is no more than 4 percent of the Financing amount (or, if two or more Licensees participate in the Financing, their combined closing fees are no more than 4 percent of the total Financing amount); and

(2) You charge the fee no earlier than the date of the first disbursement.

(e) *Limitation on dual fees.* If another Licensee or an Associate of yours collects a transaction fee under §107.900(e) in connection with your Financing of a Small Business, the sum of the transaction fee and your application and closing fees cannot exceed the maximum application and closing fees permitted under this §107.860.

(f) *Expense reimbursements.* You may charge a Small Business for the reasonable out-of-pocket expenses, other than Management Expenses, that you incur to process its Financing application. If SBA determines that any of your reimbursed expenses are unreasonable or are Management Expenses, SBA will require you to include such amounts in the Cost of Money or refund them to the Small Business.

(g) *Breakup fee.* If a Small Business accepts your Commitment and then fails to close the Financing because it has accepted funds from another source, you may charge a “breakup fee” equal to the closing fee that you would have been permitted to charge under paragraph (c) or (d) of this section.

[61 FR 3189, Jan. 31, 1996; 61 FR 41496, Aug. 9, 1996]

#### § 107.865 Control of a Small Business by a Licensee.

(a) *In general.* You, or you and your Associates (in the latter case, the “Investor Group”), may exercise Control over a Small Business for purposes connected to your investment, through ownership of voting securities, management agreements, voting trusts, majority representation on the board of directors, or otherwise. The period of such Control will be limited to the seventh anniversary of the date on which such Control was initially acquired, or any earlier date specified by the terms of any investment agreement.

(b) *Presumption of control.* Control over a Small Business based on ownership of voting securities will be presumed to exist whenever you or the Investor Group own or control, directly or indirectly:

(1) At least 50 percent of the outstanding voting securities, if there are fewer than 50 shareholders; or

(2) More than 25 percent of the outstanding voting securities, if there are 50 or more shareholders; or

(3) At least 20 percent of the outstanding voting securities, if there are 50 or more shareholders and no other party holds a larger block.

(c) *Rebuttals to presumption of Control.* A presumption of Control under paragraph (b) of this section is rebutted if:

(1) The management of the Small Business owns at least a 25 percent interest in the voting securities of the business; and

(2) The management of the Small Business can elect at least 40 percent of the board members of a corporation, general partners of a limited partnership, or managers of a limited liability company, as appropriate, and the Investor Group can elect no more than 40 percent. The balance of such officials

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may be elected through mutual agreement by management and the Investor Group.

(d) *Extension of Control.* With SBA's prior written approval you, or the Investor Group, may retain Control for such additional period as may be reasonably necessary to complete divestiture of Control or to ensure the financial stability of the portfolio company.

(e) *Additional Financing for businesses under Licensee's Control.* If you assume Control of a Small Business, you may later provide additional Financing, without an exemption under §107.730(a)(1).

[61 FR 3189, Jan. 31, 1996, as amended at 63 FR 5867, Feb. 5, 1998; 64 FR 52646, Sept. 30, 1999; 67 FR 64790, Oct. 22, 2002]

## § 107.880 Assets acquired in liquidation of Portfolio securities.

You may acquire assets in full or partial liquidation of a Small Business's obligation to you under the conditions permitted by this §107.880. The assets may be acquired from the Small Business, a guarantor of its obligation, or another party.

(a) *Timely disposition of assets.* You must dispose of assets acquired in liquidation of a Portfolio security within a reasonable period of time.

(b) *Permitted expenditures to preserve assets.* (1) You may incur reasonably necessary expenditures to maintain and preserve assets acquired.

(2) You may incur reasonably necessary expenditures for improvements to render such assets saleable.

(3) You may make payments of mortgage principal and interest (including amounts in arrears when you acquired the asset), pay taxes when due, and pay for necessary insurance coverage.

(c) *SBA approval of expenditures.* This paragraph (c) applies if you have outstanding Leverage or are applying for Leverage. Any application for SBA approval under this paragraph must specify all expenses estimated to be necessary pending disposal of the assets. Without SBA's prior written approval:

(1) Your total expenditures under paragraphs (b)(1) and (b)(2) of this section plus your total Financing(s) to the Small Business must not exceed your overline limit under §107.740; and

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(2) Your total expenditures under paragraph (b) of this section plus your total Financing(s) to the Small Business must not exceed 35 percent of your Regulatory Capital.

### LIMITATIONS ON DISPOSITION OF ASSETS

## § 107.885 Disposition of assets to Licensee's Associates or to competitors of Portfolio Concern.

*Sale of assets to Associate.* Except with SBA's prior written approval, you are not permitted to dispose of assets (including assets acquired in liquidation) to any Associate if you have outstanding Leverage or Earmarked Assets. As a prerequisite to such approval, you must demonstrate that the proposed terms of disposal are at least as favorable to you as the terms obtainable elsewhere.

[61 FR 3189, Jan. 31, 1996, as amended at 67 FR 64791, Oct. 22, 2002]

### MANAGEMENT SERVICES AND FEES

## § 107.900 Management fees for services provided to a Small Business by Licensee or its Associate.

This §107.900 applies to management services that you or your Associate provide to a Small Business during the term of a Financing or prior to Financing. It does not apply to management services that you or your Associate provide to a Small Business that you do not finance. Fees permitted under this section are not included in the Cost of Money (see §107.855).

(a) *Permitted management fees.* You or your Associate may provide management services to a Small Business financed by you if:

(1) You or your Associate have entered into a written contract with the Small Business;

(2) The fees charged are for services actually performed;

(3) Services are provided on an hourly fee, project fee, or other reasonable basis; and

(4) You can demonstrate to SBA, upon request, that the rate does not exceed the prevailing rate charged for comparable services by other organizations in the geographic area of the Small Business.

(b) *Fees for service as a board member.* You or your Associate may receive fees