(5) Reduce the gain computed in paragraph (d)(4) of this section by your estimate of related future income tax expense. Subject to any adjustment required by paragraph (d)(6)of this section, the result is your Adjusted Unrealized Gain for use in paragraph (c)(2) of this section.

(6) If any securities that are the source of either Class 1 or Class 2 Appreciation are pledged or encumbered in any way, you must reduce the Adjusted Unrealized Gain computed in paragraph (d)(5) of this section by the amount of the related borrowing or other obligation, up to the amount of the Unrealized Appreciation on the securities.

§ 107.1850 Exceptions to Capital Impairment provisions for Licensees with outstanding Participating Securities.

The provisions in this § 107.1850 apply only if at least two-thirds of your outstanding Leverage consists of Participating Securities, and at least two-thirds of your Loans and Investments (at cost) consist of Equity Capital Investments.

(a) *Forbearance period for Participating Securities issuers.* During the first forty-eight (48) months following your first issuance of Participating Securities, you will not have a condition of Capital Impairment if your Capital Impairment Percentage is below 85 percent.

(b) *Extended forbearance period for early stage investors.* If at least two-thirds of your Loans and Investments (at cost) are in Start-Up Financings, the forbearance period in paragraph (a) of this section is extended to 60 months.

(c) *Forbearance based on actions by Licensee.* The provisions of this paragraph (c) apply only during the fifth and sixth years following your first issuance of Participating Securities. If your Capital Impairment Percentage, as determined either by you or by SBA, exceeds the maximum permitted under § 107.1830(c) but is below 85 percent, you will not have a condition of Capital Impairment if you do either of the following within thirty (30) days of such determination:

(1) Increase your Regulatory Capital by a cash contribution placed in an escrow account or other account satisfactory to SBA, for its benefit. The contribution must equal, during the fifth year, 15 percent of your outstanding Leverage or, during the sixth year, 30 percent.

(2) Provide a guarantee, satisfactory to SBA and for its benefit, for the amount of the cash contribution required in paragraph (c)(1) of this section. SBA will credit any escrowed funds or guarantee received in the fifth year toward the requirements for the sixth year.

(d) *Conditions for forbearance under paragraph (c) of this section.* (1) You cannot count any funds placed in an escrow or other account under paragraph (c) of this section as Leverageable Capital.

(2) Any fee and/or any claim to repayment by the party making the capital contribution or by the guarantor must be deferred and subordinate to all outstanding Leverage plus any unpaid Earned Prioritized Payments and earned Adjustments.

(3) If there is an acceleration or mandatory redemption under § 107.1810 or § 107.1820, any funds in the escrow account and/or any guarantee received under paragraph (c) of this section will be applied toward repaying any amounts due SBA.

(4) If you reduce your Capital Impairment Percentage to zero, SBA will release and return any escrowed funds and/or any guarantee received under paragraph (c) of this section.

Subpart K—Ending Operations as a Licensee

§ 107.1900 Surrender of license.

You may not surrender your license without SBA's prior written approval. Your request for approval must be accompanied by an offer of immediate repayment of all of your outstanding Leverage (including any prepayment penalties thereon), or by a plan satisfactory to SBA for the orderly liquidation of the Licensee.

Subpart L—Miscellaneous

§ 107.1910 Non-waiver of SBA's rights or terms of Leverage security.

SBA's failure to exercise or delay in exercising any right or remedy under the Act or the regulations in this part does not constitute a waiver of such right or remedy. SBA's failure to require you to perform any term or provision of your Leverage does not affect SBA's right to enforce such term or provision. Similarly, SBA's waiver of, or failure to enforce, any term or provision of your Leverage or of any event or condition set forth in §§ 107.1810 or 107.1820 does not constitute a waiver of any succeeding breach of such term or provision or condition.

§ 107.1920 Licensee's application for exemption from a regulation in part 107.

You may file an application in writing with SBA to have a proposed action exempted from any procedural or substantive requirement, restriction, or prohibition to which it is subject under this part, unless the provision is mandated by the Act. SBA may grant an exemption for such applicant, conditionally or unconditionally, provided the exemption would not be contrary to the purposes of the Act. Your application must be accompanied by supporting evidence which demonstrates to SBA's satisfaction that:

(a) The proposed action is fair and equitable; and

(b) The exemption requested is reasonably calculated to advance the best interests of the SBIC program in a manner consonant with the policy objectives of the Act and the regulations in this part.

§ 107.1930 Effect of changes in this part 107 on transactions previously consummated.

The legality of a transaction covered by the regulations in this part is governed by the regulations in this part in effect at the time the transaction was consummated, regardless of later changes. Nothing in this part bars SBA enforcement action with respect to any transaction consummated in violation of provisions applicable at the time, but no longer in effect.

Dated: January 22, 1996.

John T. Spotila,

Acting Administrator.

[FR Doc. 96–1351 Filed 1–30–96; 8:45 am]

BILLING CODE 8025–01–P

13 CFR Parts 108, 116, 120, 122, 131

Business Loan Programs

AGENCY: Small Business Administration (SBA).

ACTION: Final rule.

SUMMARY: SBA has completed an extensive review of all of its regulations, and it has decided to eliminate some regulations and consolidate, clarify, and simplify the remainder. This final rule consolidates five current CFR parts into one Part to be known as Part 120. This surviving Part 120 covers virtually all policies and regulations, other than size standards, applicable to SBA's business (non-disaster) loan programs. Almost all provisions have been reworded, renumbered, and relocated. There are a few new or revised policies. Several sections have been deleted. However, most of the revisions merely streamline and clarify the regulations and do not represent substantive change.

DATES: This rule is effective March 1, 1996. This rule applies with respect to all applications for financial assistance filed on or after March 1, 1996.

FOR FURTHER INFORMATION CONTACT: John R. Cox, (202) 205–6490.

SUPPLEMENTARY INFORMATION: On December 15, 1995, SBA published in the Federal Register (60 FR 64356) a notice of proposed rulemaking with respect to the consolidation of five current CFR parts into one Part to be known as Part 120. SBA received and considered 136 timely comments in response to the proposed rule. SBA has adopted many of the comments in issuing this final rule. Each of the significant comments is addressed below. In addition, SBA has made technical changes and clarifications in this final rule, where appropriate.

This final rule combines Parts 108, 116, 120, 122 and 131 of 13 CFR into one new Part to be known as Part 120. This new Part 120 will regulate all of SBA's non-disaster financial assistance to small businesses under its general business loan program (''7(a) loans''), its microloan demonstration program (''Microloans''), and its development company program (''504 loans'').

Many repetitive and overlapping sections from the current regulations are eliminated in this final rule. Formerly, provisions applicable to a business loan program were often located in different Parts. Sometimes unintended differences developed between the loan programs in the interpretation or implementation of similar program policies because of minor inconsistencies in the language of the provisions in the several Parts. These inconsistencies have been eliminated.

In this final rule, the basic requirements that apply to all of the business loan programs are located in subpart A. These include elements currently found in portions of Parts 108, 116 and 120. Policies specific to a particular program are in the separate subpart applying to that program. Rules specific to 7(a) loans are in subpart B and include elements currently in portions of Parts 116, 120, and 122. Regulations applying to SBA's special purpose loans currently in Part 122 and a portion of Part 116 are in Subpart C. Subparts D, E, and F contain rules regarding lenders, program administration, and the secondary market currently found in Part 120. The loan moratorium provisions presently in Part 131 are located in subpart E. Subpart G contains rules specific to Microloans currently in Part 122. Regulations applying to 504 loans currently located in Part 108 are in subpart H.

Definitions

Many comments were received which addressed the definition of Associate in § 120.10. Most commenters expressed the opinion that the definition was too broad and, if promulgated, would adversely affect the ability of small businesses to use SBA's lending programs. Of particular concern was the inclusion of a ''Close Relative'' of a principal of an entity in the definition of Associate of a small business, Lender or CDC. As a result of the comments, SBA re-examined this definition and modified it. An Associate of a Lender or CDC will include a holder of 20 percent or more of the value of a Lender's or CDC's stock or debt instruments, as well as an entity in which the Close Relative of an Officer, Director, key employee, or holder of at least a 20 percent interest in the Lender or CDC. The definition of an Associate of a small business was amended to include an owner of more than 20 percent of the equity of the small business, but not an entity in which a Close Relative of such an owner is also an owner.

Subpart A

Numerous commenters indicated that § 120.101, pertaining to the unavailability of credit, needed clarification with respect to the substantiation required to support a Lender's or CDC's certification. SBA is promulgating this section as proposed because it plans to provide information on how to provide the required substantiation in its Standard Operating Procedures (SOPs).

Proposed § 120.102, which imposed a requirement that the personal resources of the owners of an applicant for a business loan be injected into the applicant generated more than 80 comments from the public. The overwhelming majority of the responses objected to the application of a personal resources test to the 504 program because that program is an economic development program. After considering the responses received, SBA has revised the final rule to require an injection of personal resources at a level dependent on the amount of a total financing package which includes an SBA business loan. This means that the injection of personal resources will bear a designated correlation to the total financing package of SBA and non-SBA assistance. This regulation will ensure that applicants for SBA financial assistance will be able to ascertain the demand on their personal resources, with some certainty, before they seek SBA financial assistance.

Section 120.110 lists types of businesses which are not eligible for SBA financial assistance. Several commenters suggested SBA further explain when a business is engaged in a religious activity for purposes of ineligibility under § 120.110(k), and to eliminate the proposed requirement that a business be principally engaged in the activity. SBA has decided to retain the prohibition on providing assistance to a business principally engaged in a religious activity. SBA believes that this standard comports with Constitutional requirements. SBA intends to administer the standard in a manner which balances the needs of small businesses with applicable legal requirements. However, given the uncertainty of the state of legal precedent relative to the Establishment Clause, SBA will continue to review this issue, and may make such prospective changes in the regulation as may be required.

In addition, for purposes of consistency SBA will use a standard of no more than one-third of gross annual revenue derived from the prescribed activity to determine the eligibility of businesses engaged in legal gambling activities or packaging SBA loans for purposes of §§ 120.110 (g) and (m).

Proposed § 120.111 would permit an Eligible Passive Company to be eligible for 7(a) and 504 loan assistance if it leases real or personal property to an otherwise eligible small business. SBA received many comments suggesting that it permit a revocable or irrevocable trust to be such an entity. SBA has decided to delete the requirement that when a trust is an Eligible Passive Company it must be an irrevocable trust in favor of one permitting eligibility for revocable trusts in prescribed circumstances. In order to be eligible, the trustor must warrant and certify that the trust will not be revoked or substantially amended without SBA's consent, and the trustor's personal guarantee will be required to provide adequate assurances of continuity and financial support. SBA will monitor its experience with revocable trusts and make modification to this provision if such experience warrants it.

Under current rules, an Eligible Passive Company may not use the proceeds of a business loan for working capital. Only an active company may obtain working capital as part of a business loan. SBA recognizes that this requirement has been burdensome and has caused some applicants to obtain two separate loans for the benefit of the same Operating Company. Accordingly, § 120.120(b) will allow an Eligible Passive Company to use part of business loan funds for the working capital of the Operating Company if the Operating Company is a co-Borrower.

With respect to proposed § 120.195, which required the reporting of fees

paid in connection with obtaining business loan assistance by a Lender, CDC, Intermediary Lender, and Borrower, SBA has decided to retain only a requirement relating to the Borrower since other regulations cover the obligation by the other parties to report fees. By eliminating a reference to other parties, SBA avoids unnecessary duplication.

Subpart B

Proposed § 120.200 specified that bonding is required as collateral for a 7(a) loan in which construction is financed. Two commenters recommended that a minimum amount of construction should be designated in § 120.200 before payment and performance bonds and builder's risk insurance would be required. Another commenter expressed concern that the proposed regulation would require formal waivers of bonding and insurance requirements on a case-by-case basis. Another comment noted that the revised provision does not appear to cover direct loans approved by SBA. SBA has made minor changes in the language of the provision to clarify that the provision covers direct and guaranteed loans. SBA has decided not to establish a specific size limit on the construction project which would trigger the bonding and insurance requirements, electing instead to address the specific construction project size in an SOP.

One commenter suggested that the proposed revised language in § 120.201 was so restrictive as to disqualify any refinancing of unsecured or undersecured debt regardless of circumstances. That was not the intent of the proposal. However, the final regulation specifies that SBA will not permit 7(a) financing to be used to shift a creditor's potential loss to SBA.

SBA has decided to delete proposed § 120.203 relating to revolving credit, as unnecessary. Revolving line of credit financing is currently authorized under § 120.390 for the CapLines program, and the Agency wants the flexibility to consider special finance needs of small business, such as ''floor plan'' financing, at a later date.

With respect to proposed § 120.213, SBA carefully considered suggestions to add language to the regulation pertaining to preemptive federal interest rates and the quarterly publication by SBA of maximum allowable fixed interest rates in the Federal Register. SBA has decided that it is unnecessary to address in the regulations the legal conclusion that maximum interest rates prescribed by SBA are exempt by statute from any maximum rates established under state law. It is SBA's intent to publish on a quarterly basis in the Federal Register notice of the maximum fixed interest rate permitted on guaranteed and direct loans. The final rule retains the language in the proposed rule.

Proposed § 120.214(f) has been rewritten in order to clarify that SBA has the authority to establish higher interest for smaller loans, and that the authority applies to both variable and fixed rate loans. The proposal has been finalized at § 120.215. Proposed § 120.214(g), has been renumbered and is now § 120.214(f).

A number of commenters suggested that SBA should amend proposed § 120.220(b), claiming that the policy of terminating a guarantee for nonpayment of the guarantee fee is too harsh. SBA has considered the comments, but has decided to retain the present policy of terminating guarantees for nonpayment of guarantee fees as one means of assuring timely submission of guarantee fees. In addition, under the Lender's agreement with SBA, payment of the guarantee fee is the consideration necessary to support SBA's guarantee commitment. Minor editorial changes have been made in this section to reflect that a guarantee fee payment may be reimbursed to the Lender from funds allocated in the working capital portion of a guaranteed loan.

Two commenters suggested that SBA should clarify in § 120.220(c) that the annual fee payable by a Lender cannot be charged to a Borrower. SBA has adopted the suggestion.

SBA has deleted proposed § 120.221(b), relating to commitment fees for Export Working Capital loans. This provision was based on the former Export Revolving Line of Credit program and is no longer applicable to any program.

A commenter suggested that SBA define the term ''Extraordinary servicing'' as proposed in § 120.221(c). SBA believes that any further description of special or extraordinary servicing practices would be more appropriate for its SOPs, and therefore declines to adopt the suggestion. The suggestion to permit prepayment fees, which were prohibited under proposed § 120.221(e), has not been adopted by SBA. The Agency believes that a small business should be allowed to prepay a 7(a) loan without incurring additional costs, and the prohibition on charging prepayment fees is a positive marketing tool for making 7(a) financial assistance available to small business.

SBA has added referral fees to the list of fees in § 120.222(b) which a Lender or Associate may not charge a Borrower since such fees are not fees which relate to services normally provided by a Lender. SBA has included a Service Provider as an entity in § 120.222(d) with which a Lender or Associate cannot share a premium received from the sale of an SBA guaranteed loan in the secondary market. The inclusion of a Service Provider in the prohibition reduces further the possibility of a conflict of interest or the appearance thereof.

Subpart C

Two commenters noted that under the provisions of proposed § 120.314, SBA was precluded from requiring personal guarantees for DAL–2 financial assistance. SBA intended the prohibition for requiring personal guarantees to be applicable only to DAL–1 financial assistance, and the provision has been corrected to reflect that intent.

One commenter suggested that SBA should state in the provisions pertaining to the Export Working Capital Program (EWCP) that limits on lender fees and interest rates are not prescribed. In final § 120.344, SBA has addressed the issue of extraordinary fees and interest rates pertaining to the EWCP. SBA does not set a maximum rate of interest which may be charged for this program.

At the suggestion of a commenter, the reference to loan proceeds to develop or penetrate foreign markets has been deleted from § 120.342 and moved to § 120.347, pertaining to eligible use of proceeds for International Trade Loans. EWCP loan proceeds are to be used only to finance export transactions.

Two commenters noted that proposed § 120.348 did not address a limitation on the fixed-asset portion of International Trade Loans. The provision has been amended to specify limitations on portions of loan amounts allocated for fixed assets and non-fixed assets.

At the suggestion of one commenter, SBA has clarified § 120.377 to provide that only a manufacturing concern may use loan proceeds for working capital for this particular loan program.

Two commenters suggested SBA should address the DELTA loan program in § 120.380. While the DELTA loan program is not a permanently funded SBA program, SBA has elected to briefly describe it in § 120.381(c).

Subpart D

Although § 120.420, which allows nondepository lenders to pledge notes evidencing SBA guaranteed loans or to sell the unguaranteed portions is not new, two commenters asked that depository lenders be allowed the same

option. SBA has rejected this suggestion. This option is not available to depository lenders because they have a depository base which provides liquidity, whereas the nondepository lenders have no such base. They have only a capital base which must be left unimpaired. To provide them with some liquid assets, SBA allows them to sell the unguaranteed portions of SBA guaranteed loans.

Two commenters wrote that a conflict exists between §§ 120.420(a) and 120.453(c). SBA adopted the commenter's suggestion to include language which makes clear that nondepository lenders who are also PLP lenders may sell the entire unguaranteed portion, not just 90 percent, of SBA guaranteed loans with SBA's consent.

Section 120.420(b)(2) concerning retention of economic risk, has been revised to require a nondepository lender which has sold the unguaranteed portion of a loan, to establish a sufficient reserve fund at the time of sale. The two other options available in the current regulations have not been used and are not being retained, and SBA has only approved proposals that have included a reserve fund.

One commenter proposed that § 120.441, concerning the Certified Lenders Program, be amended to permit certification of individual loan officers rather than the lending institution. SBA has considered this idea previously. SBA relies on the capability of its lenders, not individual loan officers. Therefore, SBA has decided not to alter the present procedure at this time. The current selection criteria already permit consideration of the experience of individual loan officers in certifying lenders.

Concerning the provision at § 120.442 which sets forth grounds for suspension or revocation of eligibility to participate in the CLP program, one commenter suggested including ethics violations as a basis for suspension or revocation. SBA will consider including this in its SOP which, if violated, would fall within the language ''violations of applicable * * * published SBA policies and procedures.'' SBA will follow suit with the PLP program, which has a similar revocation and suspension provision. SBA also emphasizes that the reasons listed in § 120.442 are simply examples of causes for suspension or revocation and not an exclusive list.

One commenter requested that PLP lenders be allowed to process loans which refinance interim loans under § 120.452(a)(2). SBA has decided to permit such loans if made for other than construction purposes and if the interim loan was approved by the lender within 90 days of receipt of the PLP loan number or the refinancing.

SBA received two comments requesting clarification on whether a lender was required to be a CLP lender before being eligible to apply for PLP status. Both commenters approved of the eligibility requirement. In the final rule, SBA is eliminating this requirement. It is not necessary to develop lenders into PLP lenders in stages. If a lender does not perform well as a PLP lender, SBA can revoke its PLP status.

Several commenters suggested that SBLCs be allowed to extend credit through other programs. SBA has been considering this for some time and has decided to amend § 120.470 by allowing SBLCs to provide SBA guaranteed loans to Intermediaries participating in the SBA Microloan program.

A commenter suggested raising the minimum bond coverage a Small Business Lending Company is required to have, from $25,000 to $500,000. SBA agrees with the commenter that $25,000 is too low and is adopting the suggestion by amending § 120.470(b)(10).

Subpart E

SBA received several comments concerning § 120.524(a) which sets forth grounds under which SBA may deny liability. The commenters opposed the proposed language which would allow SBA to deny liability upon any failure of a lender to take certain actions, as compared to the current language of the regulation which allows SBA to deny liability only upon substantial failure. SBA has decided not to adopt this suggestion. The final regulation makes it clear that SBA may deny liability on the basis of any material noncompliance with SBA's regulations or the terms of applicable loan documentation.

The provisions of § 120.532 *et seq.*, which describe the loan moratorium program, have been deleted from this final rule and will be inserted into the Agency's SOPs. The requirements of this program are already provided for by statute and the regulations are therefore redundant. SBA has retained in the regulations a short description of the program, and provides notice that complete information concerning moratoriums is available at local SBA district offices.

One commenter opined that § 120.540(a) requires additional language concerning when SBA or a lender may liquidate collateral securing a loan. SBA agrees and is including language that allows liquidation if the loan is in default.

One commenter suggested that § 120.540(c)(1) be revised to allow lenders to liquidate collateral as they normally would, rather than having to attempt to sell at auction. SBA has adopted the commenter's suggestion and the section now allows a lender to use negotiated sales if consistent with its usual practice for liquidating non-SBA-related assets.

One commenter discussed the revisions to the homestead protection provisions found at § 120.550 *et* seq. Much of the details have been removed with the intention of publishing them in an SOP. The writer was concerned that persons interested in these provisions will not know what is needed to comply with the requirements of this program. With the publication of the procedures in an SOP, persons wishing to know more about this program will be able to obtain the information easily from any local SBA district office.

Subpart F

Only one comment was received on Subpart F. The commenter requested that a definition of ''Associates of a Pool Assembler'' be added to the definitional section. This comment was not adopted since ''Associate'' is defined in § 120.10 and there is no need for a different definition for this Subpart. Minor changes were made to this Subpart for clarification.

Subpart G

Only one comment was received on Subpart G. The commenter suggested that proposed § 120.707(d) be revised to require Intermediaries to assign all guarantees and liens from their Microloans to SBA. This comment was not adopted. SBA believes that it is adequately protected by the current requirement that the Intermediary pledge to SBA a first lien position in the Microloan Revolving Fund, Loan Loss Reserve Fund, and all notes receivable. Minor changes were made to this Subpart for clarification.

Subpart H

§ 120.801. SBA received several comments regarding this introductory section describing the 504 program in general terms. All pointed out that a small business must apply for 504 financing through a CDC servicing the area in which the Project is located, not in which the business is located. SBA concurs and makes the correction in this final rule. SBA also has made several other minor revisions to this section in response to comments.

§ 120.810. Several comments suggested minor changes in one or more definitions that apply to the 504 program. SBA disagrees with all of the comments, except one regarding Substantial Increase in Unemployment. The commenter questioned the need for such a definition, questioning the SBA's ability to quantify the increases mentioned in the definition. SBA concurs and has deleted the definition (see § 120.881).

§ 120.827. As a result of a comment, SBA amended this section to make it clear that a CDC may itself provide financial and technical assistance to small businesses, as well as help small businesses to obtain such assistance from other sources.

§ 120.828. SBA received 13 comments on this section. As discussed more thoroughly in the following discussion of expansion into additional Areas of Operation, small businesses in some areas of the country receive excellent 504 assistance measured, at least, by loan activity, while in other areas, few, if any, small businesses have received assistance. SBA attempted to address this fact by, among other things, designating a minimum number of loan approvals which a CDC must process in order to retain certification. The present rule requires a minimum of 2 loan approvals averaged over the preceding 2 years. In the proposed rule, SBA altered the requirement to be ''the minimum number of 504 loans set by SBA in an annual program announcement.'' The purpose of the proposed change was to give SBA the flexibility to adjust the number as required to reflect an expected increase in loan volumes.

Without exception, every comment opposed this change, believing it imposed a burden both on the industry and SBA to adjust the standard every year in a program announcement. The industry trade association recommended changing the annual language to ''from time to time.'' Most of the other comments suggested that SBA retain its existing regulation. Based upon such comments, SBA has decided to retain the standard of 2 per year. The only change from the existing regulation is that SBA feels it is no longer necessary to use an average of the previous two years.

Many of the comments confused this issue with the performance standard for expansion into another Area of Operation. SBA wishes to emphasize that the standard in § 120.828 has nothing to do with expansion or competition.

§ 120.829. Three comments were received regarding this section. Title V of the Small Business Investment Act requires a CDC's portfolio to reflect a Job Opportunity Average. At the present time, the requirement is one Job Opportunity per $35,000 of 504 funding. That figure has been in effect for many years. The current regulation permits the AA/FA to allow a CDC's average to be up to 25 percent higher in certain areas. In the proposed rule, SBA rounded the 25 percent maximum ($43,875) up to $45,000. Otherwise SBA retained the current rule.

SBA received comments suggesting that SBA increase both the base $35,000 and the exception because of inflation. In addition, one comment recommended that SBA delete all of the exceptions in § 120.829 except Alaska and Hawaii because the rule is impossible to administer. SBA rejects both suggestions, principally because it is not aware that the industry has been having any problem complying with the Job Opportunity Average requirement at its present level. However, SBA does agree that redevelopment areas as defined in 42 U.S.C. 3161 should be deleted from the provision. The purpose of the 25 percent differential was to assist distressed geographical areas needing development. However, once designated, redevelopment areas remain so designated forever. Because they have become so common, the effect would be to increase the Job Opportunity Average for entire Areas of Operations to $45,000 rather than $35,000, if the CDC and SBA followed the regulation exactly. From a review of the Job Opportunity Averages submitted by CDCs in their annual reports, it is clear that the increased average in redevelopment areas is not required by CDCs or is not being followed. Furthermore, areas that were once distressed, but no longer are, would continue to be eligible for the higher average, even though it is no longer needed. For these reasons, SBA has determined that redevelopment areas be deleted from the section.

§ 120.830. Several comments objected that the definition of ''Associates'' would cause increased and burdensome reporting requirements. SBA believes that the amended definition of Associate cures this problem.

§ 120.831. The proposed rule included a new requirement that a CDC disclose to SBA and the Borrower any referral fees or other payment made or received by the CDC from the Lender or other party to the 504 transaction. A comment from the industry trade association indicated that it understood that SBA may want this disclosure, but that it should be required of all SBA guaranteed lenders, not just CDCs. In the interest of program consistency, SBA agrees, has broadened the language to include all lenders, and has consolidated the section with § 120.195 so that it applies to all business loans.

§ 120.835. Throughout the history of the 504 program there has been a great divergence among CDCs in the number of loan approvals each year. While some CDCs have exhibited continued growth measured by their loan approvals and ability to package, process and service loans, other CDCs have lagged behind. There are many complicated reasons for this, but the net result has been a patchwork of 504 service (measured by loan approvals) across the country, with many small businesses in some areas receiving 504 assistance while in other areas few, if any, small businesses have received such assistance.

SBA attempted to address this issue by permitting CDCs to expand temporarily into adjacent areas, and, then, in 1993, by designating a minimum number of loan approvals per year which a CDC must average over the previous two fiscal year periods to retain certification as a CDC. The current number of required loan approvals is two. SBA also established the status of an Associate Development Company (''ADC''). Those CDCs unable or unwilling to meet the minimum number of loan approvals may become ADCs, thereby continuing to participate in the program goals of economic and community development without having to make loans. A number of CDCs have been decertified as a result of this policy and have opted for ADC status.

However, a focus on removal from CDC status does not address the real question of adequacy of service within an Area of Operations. What constitutes adequate service within a community? The statutory objectives of the 504 program are to provide a portion of long term fixed-asset financing for small business projects that provide jobs and result in economic development. Clearly, these goals cannot be met in an Area of Operations unless loans are being packaged, processed, approved, closed and serviced by one or more CDCs. Unfortunately, SBA is aware of too many locations across the country in which present CDCs are unable or unwilling to meet the small business demand for 504 loans. Transferring an existing CDC to ADC status does not address this inadequacy. SBA has concluded that the answer lies not in decertification, but in competition and customer service.

Therefore, SBA proposed in § 120.835 that existing CDCs be permitted to expand into Areas of Operations that are not being adequately serviced. Under

the proposed rule, the expanding CDC would have to show that the proposed Area of Operations is not being adequately served by the existing CDCs and that the expanding CDC is well-qualified to serve it. SBA did not propose any geographic or size limitation on CDCs applying to service a location, but suggested that such factors would be considered in evaluating the application. As proposed, a CDC would apply in writing to the SBA district office serving the geographic area in which the CDC proposes to expand.

In the proposed rule, SBA solicited comment on the factors to be considered in determining whether an area is being adequately serviced. As a result of many discussions with industry members, SBA had concluded that, in general, the starting point for any determination would be the number of loan approvals averaged by the existing CDCs in the Area of Operations over the last two fiscal years. Even if the number of loan approvals does not accurately represent the competence of a CDC, it does accurately reflect the market penetration of 504 financing in the proposed area of expansion.

SBA had also concluded that there is no minimum loan approval number appropriate to every CDC in every location across the country. A small CDC with a rural Area of Operations and slow economic activity may be providing adequate service at a low level of approvals while a larger CDC in a metropolitan region with much economic activity may be providing inadequate service, despite having a greater number of loan approvals. In the proposed rule, SBA advanced the population of an Area of Operations as the base factor, but indicated that industry members had suggested other possibilities such as the number of small businesses in the Area of Operations.

As a result of numerous consultations with the industry and small businesses, SBA had also concluded at the time of the proposed rule that adequate service includes other factors in addition to the number of loan approvals, including adequate servicing of loans. Thus, in the proposed rule, SBA indicated that any CDC seeking to expand will have to show that it has a history of adequate experience and expertise in both loan packaging and servicing, and that the existing CDCs in the proposed area of expansion have not been adequately packaging or servicing loans.

In the proposed rule, SBA solicited comments and recommendations regarding the factors that should be included in a determination of whether the existing CDCs are adequately servicing an Area of Operations. SBA asked commenters to particularly focus on how to incorporate a servicing component into its approach.

SBA received 35 comments in response to its solicitation. Only two opposed the policy proposed by SBA. The remainder supported SBA's efforts to assure availability of 504 financing everywhere in the country by establishing limited competition. Most of the comments discussed various factors which the commenter believed should be incorporated into SBA's decision making process upon receipt of an application for extension of one CDC into another's Area of Operations. Among the comments received was a proposal submitted by the industry's trade association, as well as many recommendations from individual CDCs and financial institutions.

As a result of the comments received, SBA has determined to amend its proposed rule in several respects. The proposed rule provided that SBA would consider an Area of Operations inadequately served if the existing CDCs in the Area of Operation have not averaged, over the last two fiscal years, sufficient loan approvals for the population in the CDCs' Area of Operation, as set by SBA in an annual program announcement. All of the comments which were addressed to the issue were concerned about the annual development of a standard. Commenters expressed the opinion that annually revisiting the standard would create a ''moving target'' for the industry to achieve and introduce uncertainty and instability into the industry. Most indicated support for a reviewable standard consistent with national performance levels.

Most comments were opposed to judging performance solely on the number of loan approvals based upon population levels as suggested by SBA in the proposed rule (along with a servicing component). The comment submitted by the industry's trade association did utilize the number of loan approvals per million of general population (and a servicing component) as the criterion for determining that the CDCs in an Area of Operations are adequately serving the area. However, many individual CDCs presented numerous other elements which they recommended be considered as part of the performance level ''formula''. In addition to the number of loan approvals per population of the Area of Operation, the various factors included: The number of small businesses in the Area of Operations; the number of deals closed, rather than approved (showing that the deals are ''real'' and the CDC is capable of following through); the density of small businesses in the Area of Operation; the character of the Area of Operations (urban, suburban, or rural); the types of small businesses; the economic conditions prevailing in the Area of Operations; amount loaned per small business population; jobs created/retained; servicing record and capabilities; currency rate; loss rates; other services provided to small businesses (technical and financial assistance); relationship with the local SBA office; ties to the local community and its resources; and knowledge of the area and its economic and business climate. In short, solely looking at loan approval volume is an inadequate measure of a CDC's service to the community.

Several commenters pointed out potential problems that could result from basing CDC performance solely on ''packaging'' and loan approval volume.

SBA agrees with several commenters that level of activity is probably an accurate barometer of past and future performance. However, SBA has determined that loan approval volume based upon general population alone should not be the sole determination of whether an area is being adequately served.

Based upon the comments received, SBA has decided to amend its proposed rule to delete the reference to any one factor determining that an Area of Operations is being inadequately served. Rather, SBA has determined that loan approval volume should be utilized only as a benchmark upon which to support the application of a CDC to expand into an Area of Operation which it presently does not serve. If the loan approval volume of the existing CDCs in the area does not reach the benchmark figure, the applying CDC will be able to proceed with its application.

The application to expand must be in writing to the SBA District Office serving the geographic area in which the CDC proposes to expand. It must demonstrate to the satisfaction of SBA that the CDC is capable of providing the additional territory the full range of services expected of a CDC, including the ability to process, close, service, and, if authorized, liquidate 504 loans. The existing CDC or CDCs in the expansion area will then have at least 30 days in which to respond to the District Office. The ''burden of proof'' shall be upon the existing CDC or CDCs to explain why the SBA should not grant the application for extension. In its deliberations, the SBA District Office may, in its discretion, consider any factor presented to it, but SBA will

consider particularly relevant information concerning the various factors suggested in the comments to the proposed rule and previously set forth in this preamble. The SBA District Office shall submit its recommendation within 30 days of the end of the comment period to the AA/FA for a final decision within 30 days of receipt of the District Office's recommendation.

Seven comments cautioned that expansion should be permitted only into contiguous areas, referencing the problems experienced by the banking industry when interstate banking was first permitted. These commenters suggested that ''leapfrogging'' financial institutions may not know their new markets, leading to potential loan losses and damage to the program. Two other commenters were concerned with ''cherry picking'' of valuable markets to the detriment of markets where business potential was less.

These are both matters which SBA will consider very carefully. The expanding CDC's application must specify the exact territory into which it proposes to expand. SBA will compare the loan approval volume of the existing CDC or CDCs in that exact territory to the benchmark figure. The expanding CDC will not be able to use an existing CDC's loan approval volume for its entire Area of Operations (presumably lower) to justify expansion into a smaller, valuable market, which is being adequately served by the existing CDC or CDCs. If the more valuable market is not being adequately served, then the expanding CDC is justified in attempting to expand into it. SBA will at all times maintain its focus on the ultimate customers, the small businesses which both SBA and the CDC industry serve. If small businesses in a ''prime'' area are not being adequately served, the existing CDC or CDCs will not be supported by SBA in any argument that the area is being ''cherry picked''. If a CDC is concerned about potential expansion into its territory, SBA believes, as do many of the commenters, that competition will cause that CDC to better serve its community.

Although sensitive to the advantages resulting from regional experience and knowledge, SBA has determined not to limit applications for expansion to contiguous areas. SBA will, however, require that an expanding CDC have a local presence in a non-contiguous territory. As part of its application, the expanding CDC must indicate how it intends to provide that local presence, and must agree to have a local presence in place before submitting any 504 loans for approval.

Finally, the comments presented to SBA several suggestions which it has considered for establishing the benchmark figure. SBA recognizes that each number suggested by any of the commenters was somewhat arbitrary. Several comments presented data on loan approval volume in the country or in specific regions. Based on the figures provided by the industry trade association in its comment, total loan approvals for FY 1993 were 2,388 resulting in an average loans per million of general population of 5.37. In FY 1994 and 1995, the corresponding figures were 3,685 (8.29 loans per million) and 4,398 (9.89 per million). The industry trade association suggested that an average of 5 loans per million of general population, for the previous two years, or 2, whichever is greater, be the standard. (In the proposed rule, the standard would have been absolute and determined that a CDC was not adequately serving its Area of Operation.)

SBA prefers to set a higher target. Unlike the performance standard in § 120.828, failure to attain the standard will not disqualify a CDC in any way or cause it to be subject to decertification. So long as a CDC provides 2 loan approvals per year, it will continue as an active CDC if it so chooses. The standard in § 120.835 is merely a benchmark to determine whether another CDC may be able to expand into the CDC's Area of Operations in order to compete with the CDC in order to better serve the small business community.

Therefore, SBA has adopted the suggestions contained in the comment of an individual CDC and has established in this final rule the benchmark standard of one approved loan per 100,000 of general population averaged over the last year 2 years. Both the industry and SBA expect the number of loans approved to grow sharply over the next several years. As discussed earlier in this preamble, the industry prefers and SBA agrees that the benchmark remain constant and not change on an annual basis so that CDCs will know that they have a constant ''target'' to attain. SBA does not want to establish a benchmark which is already outdated. The industry average is nearly 10 loan approvals per million (or one per 100,000). By adopting the comment of 1 per 100,000, SBA feels it has established a figure which may remain in effect for the foreseeable future and is already exceeded by a majority of the industry. Further, the benchmark applies to a total loan volume of all CDCs existing in an Area of Operations, not each individual CDC.

SBA will continue to work with the industry to refine the benchmark. One or more of the factors discussed previously may supplement or ultimately replace loan approvals per 100,000 of general population (such as small business population, job creation/retention, loans closed, or dollar amount of loan volume).

§ 120.838. In the proposed rule, SBA determined that all existing, temporary expansions of Areas of Operations would expire automatically 6 months after the effective date of these regulations, unless a CDC applies for permanent expansion into that Area before the expiration date. SBA believed that CDCs will best serve the small business community by making a permanent commitment to an Area of Operations. SBA received several comments in support of this provision and none in opposition. Therefore, SBA adopts the proposed provision without change in this final rule.

§ 120.839. In the proposed rule, SBA provided for a CDC, upon showing good cause, to apply to SBA to make an individual loan for a Project outside its Area of Operations in an area not being adequately served by other CDCs. The SBA also proposed to permit an applicant small business to write to the AA/FA to request the assistance of a CDC not currently serving the area. SBA added this provision to give a small business more flexibility if it had a concern about the ability of a particular CDC to provide service.

SBA received 12 comments concerning this proposal, none of which opposed the provision. Several supported the provision as proposed. Others concurred that case-by-case extensions can help to assure access to 504 financing, but should be limited to specific situations. Others felt that the proposed regulations were too vague and permitted too much discretion on the part of decision-makers. Most commenters favored more explicit directions and alternatives.

SBA has determined to adopt, in most part, the suggestions of the industry trade association in its comment. Provided that the applicant CDC can demonstrate that it can adequately service the loan, a CDC may apply to make an individual loan outside its Area of Operations if (1) the applicant CDC has previously assisted the business to obtain a 504 loan, (2) the applicant small business or CDC can document in writing to the AA/FA specific circumstances that would prevent the existing CDC or CDCs serving the area from assisting the business adequately, or (3) the existing CDC or CDCs serving the area agree to

permit the applicant CDC to make the loan. SBA has deleted from its proposed rule the reference to an area not adequately served by other CDCs. As discussed previously with respect to § 120.835, this final rule does not establish a standard of performance, but only a benchmark. Thus, it would not be possible to establish that an area is inadequately served without going through the entire process set forth in § 120.835, which is not SBA's intent in this section. Further, the focus in this section is on the particular Project in question and that is covered sufficiently by the situation (2) as recommended by the industry trade association. The second circumstance in SBA's proposed rule, Borrower initiation of the request, is also subsumed into situation (2) in this final rule.

§ 120.840. SBA received one comment regarding this section, pointing out that the section set forth only basic eligibility standards for a CDC to become an Accredited Lender, which standards did not refer to servicing or portfolio quality in any way. SBA concurs with the comment and has amended the section to include additional eligibility requirements, including that an applicant must have been a CDC for a minimum of 12 months.

§ 120.845. SBA received two comments regarding this section. One comment pointed out that the proposed language appeared to suggest that SBA approved Premier Certified Lender loans in the same manner as any other 504 loan. SBA has adopted the language of the comment, clarifying that SBA's final approval is limited to eligibility of the guarantee. The other comment requested SBA to include in the regulation the specific amounts and payment schedule of contributions to the loss reserve. SBA has concluded that this is not necessary. The schedule is in the statute and will be expounded upon in SBA's SOP, to which PCLPs will have access. Therefore, SBA declines to adopt this comment.

§ 120.862. This section sets forth community development and public policy goals, the achievement of any one of which causes a Project to be eligible for 504 financing if a CDC's overall portfolio of 504 loans, including the subject loan, meets or exceeds the CDC's Job Opportunity average. Also, qualifying under a public policy goal makes a Project subject to an increased amount of funding. One comment pointed out that assisting businesses in Labor Surplus Areas had been a community development goal in the current regulation, but had been included as a public policy goal. Another comment pointed out that there must be a written revitalization plan in order to invoke revitalizing a business district as a public policy goal. A third comment pointed out that the rule should include assisting businesses located in areas affected by Federal budget reduction, not just businesses affected by such matters. SBA concurs in all three comments and has made the revisions in this final rule. A fourth comment contended that assisting manufacturing firms was a public policy goal, not a community development goal. However, assisting manufacturing firms has always been a community development goal in SBA's regulations, and SBA declines to change this long-standing placement.

§ 120.871. Both the 7(a) and 504 loan programs limit the amount of the rentable property which can be leased to a third-party, whether the loan or Project involves new construction or an existing building. Currently, there are minor differences between the programs in the amount of space permitted to be leased. The 504 limitation is currently set forth in a regulation, while the 7(a) limitations are set forth in an SOP. Several commenters noted the differences between the programs and suggested that the proposed regulation be made applicable to all SBA business loan programs. SBA concurs with the comments and has moved §§ 120.871 and 120.872 from Part H to Part A as §§ 120.131 and 120.132.

§ 120.880. SBA received five comments pointing out that the size standard for 504 eligibility set forth in the proposed rule omitted the word ''tangible'' to modify net worth. SBA concurs and adds the word ''tangible'' in this final rule.

§ 120.881. This section sets forth types of Projects ineligible only for 504 loans (as opposed to 7(a) loans). In the current regulation, a Project is ineligible, if the relocation of any of the operations of the small business will cause a substantial increase in unemployment in any area of the country or a net reduction of one-third or more in the workforce of the relocating small business. In the proposed rule, SBA attempted to limit the effect to distressed areas rather than the entire country by creating a defined term. As discussed earlier, commenters pointed out that SBA's proposed definition may have been unworkable. Therefore, SBA has dropped the proposed change and returned the relocation limitation to the language in the current regulation.

One commenter pointed out that speculative projects are ineligible in all business loan programs, not just 504. SBA concurs and has moved § 120.881(c) to § 120.110(s).

§ 120.882. In the current regulations, costs incurred by a Borrower in anticipation of receiving a 504 loan are not eligible to be included in Project costs unless the applicant has filed a written notices with the CDC and SBA within 60 days of incurring the expense and SBA gives written approval. As a result, CDCs and SBA receive notices from many potential borrowers considering 504 financing who desire to maximize potential financing. Many of these businesses never actually apply or their applications are denied. In those cases, the written notices are a useless paperwork burden on SBA, the CDC and the applicant. Therefore, SBA proposed in § 120.882(a)(2) to eliminate the requirement for written notice and allow as an eligible Project cost any expense incurred toward a Project within six months of receipt by SBA of a complete loan application.

SBA received 16 comments opposing the 6 month limit. Commenters pointed out that in actual practice the time it takes to reach the point of application is often far greater than 6 months. In many metropolitan areas, the zoning use permits, building permits, and other clearances can take 9 to 12 months. Often engineering plans and architectural drawings may need to be completed or redone, and lengthy environmental studies may be required. In states like Minnesota with long winters, the delay between site preparations and construction may span more than 6 months.

The intent of the proposed rule was to alleviate unnecessary paperwork. It was not intended to limit eligible costs. Therefore, SBA increases the limit in this final rule to 9 months and adopts a comment suggesting a waiver of the limit by the SBA District Office for good cause, which waiver should not be unreasonably withheld.

§ 120.883. This section sets forth eligible administrative costs which may be paid with the proceeds of the 504 loan, thereby allowing the small business to borrow the cost of the item so that it does not have to be paid out of the Borrower's own resources. One of the permitted costs is the CDC processing fee. Seven commenters pointed out that in streamlining the language of the regulation, SBA had deleted language in the current regulation describing at what point in time the fee is considered earned and may be collected. SBA agrees that this is important information for Borrowers to know and adds the requested language in this final rule.

Another grouping of costs traditionally allowed by SBA to be paid out of the proceeds of the 504 loan are closing costs. Currently, SBA interprets closing costs to include fees of professionals, such as engineers and attorneys, involved in the Project (see § 120.961(a)).

Typically, many of the legal services required to close the 504 financing are provided by the CDC's counsel, who is usually experienced in closing 504 loans and thus, is able to do so cost effectively. Sometimes, a Borrower will also retain an attorney. Under the current regulations, the CDC may charge the Borrower up to $2,500 to reimburse the CDC for the legal expenses resulting from services performed by the CDC counsel relating to the 504 financing. The Borrower must pay the legal fees of Borrower's counsel, if retained. If CDC counsel desires to charge the CDC more than $2,500, the CDC may only do so if SBA approves the higher fee, in which case, the CDC must pay the difference to the CDC counsel and may not be reimbursed by the Borrower. The CDC collects the fee (up to $2,500) at closing and forwards it to the closing attorney.

The $2,500 figure in the current regulation has engendered much debate within the industry. Many CDCs feel the figure establishes a minimum base for attorney fees and is, therefore, anti-competitive. On the other hand, during the past year, SBA has conducted several expedited closing training sessions for CDC counsel. Many attorneys feel that the figure establishes a ceiling for attorney services and is, therefore, anti-competitive. There appears to be a wide range of fees charged by CDC counsel for closing services.

Most CDCs try to minimize counsel fees to reduce costs to the Borrower. One of the ways is for the CDC to use in-house counsel. Another way is to use in-house paralegals and staff to prepare the closing documents, close the loan, and present a completed loan closing package after closing to outside counsel solely for review and legal opinion. However, the current regulations allow a CDC to charge the Borrower only for the legal bill of outside CDC counsel. A CDC that retains its own counsel in-house or employs paralegals and other staff to prepare and close the loan cannot recover its costs for providing that service.

In the proposed regulation, SBA omitted reference to any legal fee amount in either § 120.883(d) or § 120.961(a). Whether it is viewed as a ceiling or a base, the $2,500 reference certainly appears to have had an effect on legal fees charged. SBA believes legal fees should be determined by the competitive market. There is no reason for SBA to influence the market rate by referring to a specific fee level in its regulation.

SBA received 15 comments concerning legal fees from the industry. All but one strongly objected to the deletion of the $2,500 reference from the regulations. In addition, several comments requested SBA to allow CDCs to recover the staff and in-house counsel costs of closing a loan.

SBA concurs with the comments recommending that CDCs be allowed to charge the Borrower for the in-house costs of preparing the loan documents and closing the loan. Since both the CDCs and SBA desire to reduce the level of legal fees incurred by the Borrowers, it is self-defeating to require CDCs to utilize outside counsel in order to recover legal costs. Allowing the CDC to recover in-house costs from the Borrower will still result in a savings to the Borrower because the costs of CDC staff and in-house counsel are less than outside counsel. Therefore, proposed rule § 120.961(a) (which is § 120.971(a)(2)) in this final rule has been amended to allow the CDC to charge the Borrower an amount sufficient to reimburse it for reasonable legal expenses of outside counsel, and in-house counsel and staff related to closing the 504 financing.

Despite the near unanimous opposition to the deletion of the $2,500 reference, SBA declines to amend either § 120.883(d) or § 120.971(a)(2) (§ 120.961(a) in the proposed rule). None of the comments presented any persuasive arguments to cause SBA to change its convictions. Many of the comments referred to the $2,500 reference as a ''cap'' which kept legal fees to the Borrower in line. Whether it functioned more to inhibit or increase fees is open for discussion. But exceeding the ''cap'' certainly did not affect the Borrower. If SBA approved, the CDC paid the attorney without reimbursement. Thus, if the reference functioned as a ''cap'', it did so to benefit the CDC, not the Borrower.

As more attorneys become designated to perform expedited 504 loan closings, as more attorneys become familiar with the 504 closing process (because of the expected large increase in loan volume), and as additional CDCs use in-house counsel or paralegal staff to prepare documents and close loans, SBA expects competitive pressures to limit increases in legal fees. In any event, SBA does not belong in the business of setting or suggesting legal fees. That is a function of the competitive market.

The comment process caused SBA to review carefully the whole issue of legal fees as treated in the 504 program compared to commercial lending generally. A number of comments present information concerning CDC efforts to reduce Borrowers' legal costs. SBA has previously interpreted legal fees to be eligible costs, either as Project costs or administrative costs. Most of the legal fees for which a Borrower is responsible are eligible Project costs directly attributable and essential to the Project.

Legal fees associated with the closing of the 504 loan are not eligible as Project costs. They are not directly attributable and essential to the Project. If they are eligible at all, they would have to be eligible administrative costs.

All of the eligible administrative costs in § 120.883, with the exception of legal fees, are fees imposed upon the Borrower by the financing process itself over which the Borrower has no control. All are defined by regulation or other government entities (recording fees, for example). The only variable cost is legal fees.

Closing legal fees are not usually financed by commercial loan proceeds. Closing legal fees are current costs. Why should they be financed over 20 years? Legal fees are not usually financed over time. SBA suspects that if claims are true that closing legal fees have been maintained at an artificially high level, it is because the fees have been able to be financed over a lengthy period of time and have been ''hidden'' in the Debenture. SBA has concluded that closing legal fees should not be eligible administrative costs for 504 loans. CDCs and Borrowers will now have a real incentive to reduce fees. Therefore, in this final rule, SBA has eliminated legal fees from the eligible administrative costs for 504 loans in § 120.883(d).

Finally, several commenters recommended that the specific fees for the items in § 120.883 be identified. SBA concurs. These fees have been set forth with specific numbers in § 120.971.

§ 120.891. This section of the proposed rule required the interim lender to certify to the amount of the interim loan disbursed and the CDC to certify that the Project was completed in accordance with the plans and specifications. Three comments noted that the wording of the first requirement implied that the interim lender must certify to much more than just the amount disbursed. SBA concurs that the language could be misleading. In this final rule, SBA clarifies that the interim lender must certify only the amount disbursed.

§ 120.892. This sections deals with certifications to SBA by the CDC, interim lender, and Borrower that there has been no adverse change in the ability of the Borrower to repay the 504 loan. For over 15 years the standard phrase used was ''unremedied substantial adverse change.'' In the proposed rule, SBA substituted ''adverse change,'' believing that if there were insubstantial adverse changes or remedied changes, it did not affect whether the Borrower could repay the loan. However, after receiving seven comments requesting a return to the familiar language, SBA amends the three subsections of § 120.892 to insert in this final rule ''unremedied substantial adverse change.''

§ 120.911. The current regulations state that the Borrower's contribution to the permanent financing may be land or cash. The regulations have never permitted the value of buildings or other structures on the land to be counted toward the Borrower's contribution. SBA did not propose any change in this section in the proposed rule.

However, SBA received 10 comments suggesting that SBA consider including the value of site improvements such as buildings on contributed property if the Project is for the purpose of renovating the building or constructing an addition to the building. According to the comments, older buildings that need renovation are often not financed under the 504 program due to this restriction. SBA sees no reason why it should not agree to these suggestions. Whatever the original purpose of the restriction may have been, it appears to have no logical reason, credit or otherwise, for continuing it. Therefore, SBA adopts the comments in this final rule and allows Borrowers to contribute the value of buildings, structures and other site improvements which will be part of the Project Property, previously acquired by the Borrower or CDC.

§ 120.921. As a result of comments received, two subsections have been added to § 120.921. First, § 120.923(b) in the proposed rule has become § 120.921(d). The language of the proposed rule has been changed to clarify that a Third-Party lienholder must subordinate to the CDC/SBA lien any future advance in excess of the outstanding principal balance and accrued interest of the Third-Party Loan at the time of such advance. The new § 120.921(e) prohibits a Third-Party lender from escalating the rate of interest upon default to an amount greater than the maximum rate in § 120.921(b).

§ 120.930. SBA received five comments pointing out that the language was confusing. In the proposed rule, SBA attempted to indicate what happens if the cost of the completed Project is less than the Debenture amount. Since five commenters all felt the language was confusing, SBA returns in this final rule to the language in the present regulation.

§ 120.938. This section defines when SBA will look to the CDC for recourse in the event it defaults on a Debenture. SBA received 6 comments contending that negligence is too high a standard. SBA examined the Debenture which CDCs sign. The language in the Debenture includes fraud, negligence, or misrepresentation. Therefore, SBA has adopted the language in the Debenture.

§ 120.961(b). SBA received 4 comments contending that the referral fee which a CDC may charge a Third-Party lender is excessive. However, none of the comments presented any reasons or support for such assertions. Therefore, SBA declines to change the proposed rule. However, commenters did point out an error in the section in that the fee applies to the Third-Party loan, not the 504 loan. In addition, SBA refers to the fee in the final rule as a referral fee, rather than a finder's fee. SBA further indicates in this final rule that a CDC receiving such a fee must comply with the regulations under Part 103 of this chapter.

§ 120.971. In this final rule, SBA has consolidated into this section the fees which were previously set forth in § 120.883, so that a Borrower may find in one section all allowable fees to which it may be subject.

Compliance With Executive Orders 12612, 12778, and 12866, the Regulatory Flexibility Act (5 U.S.C. 601, et seq.), and the Paperwork Reduction Act (44 U.S.C. Ch. 35)

SBA certifies that this final rule involves internal administrative procedures and does not constitute a significant rule within the meaning of Executive Order 12866 and does not have a significant economic impact on a substantial number of small entities within the meaning of the Regulatory Flexibility Act, 5 U.S.C. 601, et seq. It is not likely to have an annual economic effect of $100 million or more, result in a major increase in costs or prices, or have a significant adverse effect on competition or the United States economy.

For purposes of the Paperwork Reduction Act, 44 U.S.C. Ch. 35, SBA certifies that this final rule contains no new reporting or record keeping requirements.

For purposes of Executive Order 12612, SBA certifies that this rule has no federalism implications warranting the preparation of a Federalism Assessment.

For purposes of Executive Order 12778, SBA certifies that this rule is drafted, to the extent practicable, in accordance with the standards set forth in Section 2 of that Order.

List of Subjects

13 CFR Part 108

Equal employment opportunity, Loan programs-business, Reporting and recordkeeping requirements, Small businesses.

13 CFR Part 116

Coastal Zone, Flood insurance, Flood plains, Lead poisoning, Small businesses, Veterans.

13 CFR Part 120

Loan programs-business, Reporting and recordkeeping requirements, Small businesses.

13 CFR Part 122

Community development, Employee benefit plans, Energy conservation, Environmental protection, Exports, Individuals with disabilities, Loan programs-business, Loan programs-energy, Loan programs-veterans, Microloans, Reporting and recordkeeping requirements, Small businesses, Solar energy, Trusts and trustees, Veterans.

13 CFR Part 131

Loan programs-business, Small businesses.

Accordingly, pursuant to the authority set forth in sections 5(b)(1) and (b)(6) of the Small Business Act, 15 U.S.C. 634(b)(6) and 636(a) and (h), SBA hereby amends Chapter I of Title 13, Code of Federal Regulations (CFR), as follows:

1. Part 120 is revised to read as follows:

PART 120—BUSINESS LOANS

General Descriptions of SBA'S Business Loan Programs

Sec.

Definitions

Authority: 15 U.S.C 634(b)(6) and 636(a) and (h).

General Descriptions of SBA's Business Loan Programs

§ 120.1 Which loan programs does this part cover?

This Part regulates SBA's financial assistance to small businesses under its general business loan programs (''7(a) loans'') authorized by section 7(a) of the Small Business Act (''the Act''), 15 U.S.C. 636(a), its microloan demonstration loan program (''Microloans'') authorized by section 7(m) of the Act, 15 U.S.C. 636(m), and its development company program (''504 loans'') authorized by Title V of the Small Business Investment Act, 15 U.S.C. 695 to 697f (''Title V''). These three programs constitute the business loan programs of the SBA.

§ 120.2 Descriptions of the business loan programs.

(a) *7(a) loans.* (1) 7(a) loans provide financing for general business purposes and may be:

(i) A direct loan by SBA;

(ii) An immediate participation loan by a Lender and SBA; or

(iii) A guaranteed loan (deferred participation) by which SBA guarantees a portion of a loan made by a Lender.

(2) A guaranteed loan is initiated by a Lender agreeing to make an SBA guaranteed loan to a small business and applying to SBA for SBA's guarantee under a blanket guarantee agreement (participation agreement) between SBA and the Lender. If SBA agrees to guarantee (authorizes) a portion of the loan, the Lender funds and services the loan. If the small business defaults on the loan, SBA's guarantee requires SBA to purchase its portion of the outstanding balance, upon demand by the Lender and subject to specific conditions. Regulations specific to 7(a) loans are found in subpart B of this part.

(b) *Microloans.* SBA makes loans and loan guarantees to non-profit Intermediaries that make short-term loans up to $25,000 to eligible small businesses for general business purposes, except payment of personal debts. SBA also makes grants to Intermediaries for use in providing management assistance and counseling to small businesses. Regulations specific to these loans are found in subpart G of this part.

(c) *504 loans.* Projects involving 504 loans require long-term fixed-asset financing for small businesses. A Certified Development Company (CDC) provides the final portion of this financing with a 504 loan made from the proceeds of a Debenture issued by the CDC, guaranteed 100 percent by SBA (with the full faith and credit of the United States), and sold to investors. The regulations specific to these loans are found in subpart H of this part.

§ 120.3 Pilot programs.

The Administrator of SBA may from time to time suspend, modify, or waive rules for a limited period of time to test new programs or ideas. The Administrator shall publish a document in the Federal Register explaining the reasons for these actions.

Subpart A—Policies Applying to All Business Loans

Definitions

§ 120.10 Definitions.

The following terms have the same meaning wherever they are used in this part. Defined terms are capitalized wherever they appear.

Associate. (1) An Associate of a Lender or CDC is:

(i) An officer, director, key employee, or holder of 20 percent or more of the value of the Lender's or CDC's stock or debt instruments, or an agent involved in the loan process;

(ii) Any entity in which one or more individuals referred to in paragraphs (1)(i) of this definition or a Close Relative of any such individual owns or controls at least 20 percent.

(2) An Associate of a small business is:

(i) An officer, director, owner of more than 20 percent of the equity, or key employee of the small business;

(ii) Any entity in which one or more individuals referred to in paragraphs (2)(i) of this definition owns or controls at least 20 percent; and

(iii) Any individual or entity in control of or controlled by the small business (except a Small Business Investment Company (''SBIC'') licensed by SBA).

(3) For purposes of this definition, the time during which an Associate relationship exists commences six months before the following dates and continues as long as the certification, participation agreement, or loan is outstanding:

(i) For a CDC, the date of certification by SBA;

(ii) For a Lender, the date of application for a loan guarantee on behalf of an applicant; or

(iii) For a small business, the date of the loan application to SBA, the CDC, the Intermediary, or the Lender.

Authorization is SBA's written agreement providing the terms and conditions under which SBA will make or guarantee business loans. It is not a contract to make a loan.

Borrower is the obligor of an SBA business loan.

Certified Development Company (''CDC'') is an entity authorized by SBA to deliver 504 financing to small businesses.

Close Relative is a spouse; a parent; or a child or sibling, or the spouse of any such person.

Eligible Passive Company is a small entity or trust which does not engage in regular and continuous business activity, which leases real or personal property to an Operating Company for use in the Operating Company's business, and which complies with the conditions set forth in § 120.111.

Intermediary is the entity in the Microloan program that receives SBA financial assistance and makes loans to small businesses in amounts up to $25,000.

Lender is an institution that has executed a participation agreement with SBA under the guaranteed loan program.

Loan Instruments are the Authorization, note, instruments of hypothecation, and all other agreements and documents related to a loan.

Operating Company is an eligible small business actively involved in conducting business operations now or about to be located on real property owned by an Eligible Passive Company, or using or about to use in its business operations personal property owned by an Eligible Passive Company.

Preference is any arrangement giving a Lender or a CDC a preferred position compared to SBA relating to the making, servicing, or liquidation of a business loan with respect to such things as repayment, collateral, guarantees, control, maintenance of a compensating balance, purchase of a Certificate of deposit or acceptance of a separate or companion loan, without SBA's consent.

Rural Area is a political subdivision or unincorporated area in a non-metropolitan county (as defined by the Department of Agriculture), or, if in a metropolitan county, any such subdivision or area with a resident population under 20,000 which is designated by SBA as rural.

Service Provider is an entity that contracts with a Lender or CDC to perform management, marketing, legal or other services.

Subpart A—Policies Applying to All Business Loans

Eligibility Requirements

§ 120.100 What are the basic eligibility requirements for all applicants for SBA business loans?

To be eligible for an SBA business loan, a small business applicant must:

(a) Be an operating business (except for loans to Eligible Passive Companies);

(b) Be organized for profit;

(c) Be located in the United States;

(d) Be small under the size requirements of Part 121 of this chapter (including affiliates). See subpart H of this part for the size standards of Part 121 of this chapter which apply only to 504 loans; and

(e) Be able to demonstrate a need for the desired credit.

§ 120.101 Credit not available elsewhere.

SBA provides business loan assistance only to applicants for whom the desired credit is not otherwise available on reasonable terms from non-Federal sources. SBA requires the Lender or CDC to certify or otherwise show that the desired credit is unavailable to the applicant on reasonable terms and conditions from non-Federal sources without SBA assistance, taking into consideration the prevailing rates and terms in the community in or near where the applicant conducts business, for similar purposes and periods of time. Submission of an application to SBA by a Lender or CDC constitutes certification by the Lender or CDC that it has examined the availability of credit to the applicant, has based its certification upon that examination, and has substantiation in its file to support the certification.

§ 120.102 Funds not available from alternative sources, including personal resources of principals.

(a) An applicant for a business loan must show that the desired funds are not available from the personal resources of any owner of 20 percent or more of the equity of the applicant. SBA will require the use of personal resources from any such owner as an injection to reduce the SBA funded portion of the total financing package (*i.e.,* any SBA loans and any other financing, including loans from any other source) when that owner's liquid assets exceed the amounts specified in paragraphs (a)(1) through (3) of this section. When the total financing package:

(1) Is $250,000 or less, each 20 percent owner of the applicant must inject any personal liquid assets which are in excess of two times the total financing package or $100,000, whichever is greater;

(2) Is between $250,001 and $500,000, each 20 percent owner of the applicant must inject any personal liquid assets which are in excess of one and one-half times the total financing package or $500,000, whichever is greater;

(3) Exceeds $500,000, each 20 percent owner of the applicant must inject any personal liquid assets which are in excess of one times the total financing package or $750,000, whichever is greater.

(b) Any liquid assets in excess of the applicable amount set forth in paragraph (a) of this section must be used to reduce the SBA portion of the total financing package. These funds must be injected prior to the disbursement of the proceeds of any SBA financing.

(c) For purposes of this section, liquid assets means cash or cash equivalent, including savings accounts, CDs, stocks, bonds, or other similar assets. Equity in real estate holdings and other fixed assets are not to be considered liquid assets.

§ 120.103 Are farm enterprises eligible?

Federal financial assistance to agricultural enterprises is generally made by the United States Department of Agriculture (USDA), but may be made by SBA under the terms of a Memorandum of Understanding between SBA and USDA. Farm-related businesses which are not agricultural enterprises are eligible businesses under SBA's business loan programs.

§ 120.104 Are businesses financed by SBICs eligible?

SBA may make or guarantee loans to a business financed by an SBIC if SBA's collateral position will be superior to that of the SBIC. SBA may also make or guarantee a loan to an otherwise eligible small business which temporarily is owned or controlled by an SBIC under the regulations in part 107 of this chapter. SBA neither guarantees SBIC loans nor makes loans jointly with SBICs.

§ 120.105 Special consideration for veterans.

SBA will give special consideration to a small business owned by a veteran or, if the veteran chooses not to apply, to a business owned or controlled by one of the veteran's dependents. If the veteran is deceased or permanently disabled, SBA will give special consideration to one survivor or dependent. SBA will process the application of a business owned or controlled by a veteran or dependent promptly, resolve close questions in the applicant's favor, and pay particular attention to maximum loan maturity. For SBA loans, a veteran is a person honorably discharged from active military service.

Ineligible Businesses and Eligible Passive Companies

§ 120.110 What businesses are ineligible for SBA business loans?

The following types of businesses are ineligible:

(a) Non-profit businesses (for-profit subsidiaries are eligible);

(b) Financial businesses primarily engaged in the business of lending, such as banks, finance companies, and factors (pawn shops, although engaged in lending, may qualify in some circumstances);

(c) Passive businesses owned by developers and landlords that do not actively use or occupy the assets acquired or improved with the loan proceeds (except Eligible Passive Companies under § 120.111);

(d) Life insurance companies;
(e) Businesses located in a foreign country (businesses in the U.S. owned by aliens may qualify);
(f) Pyramid sale distribution plans;
(g) Businesses deriving more than one-third of gross annual revenue from legal gambling activities;
(h) Businesses engaged in any illegal activity;
(i) Private clubs and businesses which limit the number of memberships for reasons other than capacity;
(j) Government-owned entities (except for businesses owned or controlled by a Native American tribe);
(k) Businesses principally engaged in teaching, instructing, counseling or indoctrinating religion or religious beliefs, whether in a religious or secular setting;
(l) Consumer and marketing cooperatives (producer cooperatives are eligible);
(m) Loan packagers earning more than one third of their gross annual revenue from packaging SBA loans;
(n) Businesses with an Associate who is incarcerated, on probation, on parole, or has been indicted for a felony or a crime of moral turpitude;
(o) Businesses in which the Lender or CDC, or any of its Associates owns an equity interest;
(p) Businesses which:
(1) Present live performances of a prurient sexual nature; or
(2) Derive directly or indirectly more than *de minimis* gross revenue through the sale of products or services, or the presentation of any depictions or displays, of a prurient sexual nature;
(q) Unless waived by SBA for good cause, businesses that have previously defaulted on a Federal loan or Federally assisted financing, resulting in the Federal government or any of its agencies or Departments sustaining a loss in any of its programs, and businesses owned or controlled by an applicant or any of its Associates which previously owned, operated, or controlled a business which defaulted on a Federal loan (or guaranteed a loan which was defaulted) and caused the Federal government or any of its agencies or Departments to sustain a loss in any of its programs. For purposes of this section, a compromise agreement shall also be considered a loss;
(r) Businesses primarily engaged in political or lobbying activities; and
(s) Speculative businesses (such as oil wildcatting).

§ 120.111 What conditions must an Eligible Passive Company satisfy?

An Eligible Passive Company must use loan proceeds to acquire or lease, and/or improve or renovate real or personal property (including eligible refinancing) that it leases to an Operating Company for the conduct of the Operating Company's business. Any ownership structure or legal form may qualify as an Eligible Passive Company.

(a) Conditions that apply to all legal forms:

(1) The Operating Company must be an eligible small business, and the proposed use of the proceeds must be an eligible use if the Operating Company were obtaining the financing directly;

(2) The Eligible Passive Company (with the exception of a trust) and the Operating Company each must be small under the appropriate size standards in part 121 of this chapter;

(3) The lease between the Eligible Passive Company and the Operating Company must be in writing and must be subordinated to SBA's mortgage, trust deed lien, or security interest on the property. Also, the Eligible Passive Company (as landlord) must furnish as collateral for the loan an assignment of all rents paid under the lease;

(4) The lease between the Eligible Passive Company of the Operating Company, including options to renew exercisable solely by the Operating Company, must have a remaining term at least equal to the term of the loan;

(5) The Operating Company must be a guarantor or a co-borrower (with the Eligible Passive Company) of the loan (in a 7(a) loan including working capital, the Operating Company must be a co-borrower); and

(6) Each holder of an ownership interest constituting at least 20 percent of the Eligible Passive Company and the Operating Company must guarantee the loan (the trustee shall execute the guarantee on behalf of any trust).

(b) *Additional conditions that apply to trusts.* The eligibility status of the trustor will determine trust eligibility. All donors to the trust will be deemed to have trustor status for eligibility purposes. A trust qualifying as an Eligible Passive Company may engage in other activities as authorized by its trust agreement. The trustee must warrant and certify that the trust will not be revoked or substantially amended for the term of the loan without the consent of SBA. The trustor must guarantee the loan. For purposes of this section, the trustee shall certify to SBA that:

(1) The trustee has authority to act;

(2) The trust is not regarded as a grantor trust for tax purposes;

(3) The trust has the authority to borrow funds, pledge trust assets, and lease the property to the Operating Company;

(4) The trustee has provided accurate, pertinent language from the trust agreement confirming the above; and

(5) The trustee has provided and will continue to provide SBA with a true and complete list of all trustors and donors.

Uses of Proceeds

§ 120.120 What are eligible uses of proceeds?

A small business must use an SBA business loan for sound business purposes. The uses of proceeds are prescribed in each loan's Authorization.

(a) A Borrower may use loan proceeds from any SBA loan to:

(1) Acquire land (by purchase or lease);

(2) Improve a site (e.g., grading, streets, parking lots, landscaping), including up to 5 percent for community improvements such as curbs and sidewalks;

(3) Purchase one or more existing buildings;

(4) Convert, expand or renovate one or more existing buildings;

(5) Construct one or more new buildings; and/or

(6) Acquire (by purchase or lease) and install fixed assets (for a 504 loan, these assets must have a useful life of at least 10 years and be at a fixed location, although short-term financing for equipment, furniture, and furnishings may be permitted where essential to and a minor portion of the 504 Project).

(b) A Borrower may also use 7(a) and microloan proceeds for:

(1) Inventory;

(2) Supplies;

(3) Raw materials; and

(4) Working capital (if the Operating Company is a co-Borrower with an Eligible Passive Company, part of the loan proceeds may be applied for working capital if used for that purpose only by the Operating Company).

(c) A Borrower may use 7(a) loan proceeds for refinancing certain outstanding debts.

§ 120.130 Restrictions on uses of proceeds.

SBA will not authorize nor may a Borrower use loan proceeds for the following purposes (including the replacement of funds used for any such purpose):

(a) Payments, distributions or loans to Associates of the applicant (except for ordinary compensation for services rendered);

(b) Refinancing a debt owed to a Small Business Investment Company (''SBIC'');

(c) Floor plan financing or other revolving line credit, except under § 120.390;

(d) Investments in real or personal property acquired and held primarily for sale, lease, or investment (except for a loan to an Eligible Passive Company or to a small contractor under § 120.310);

(e) A purpose which does not benefit the small business; or

(f) Any use restricted by §§ 120.201 through 120.203 and 120.884 (specific to 7(a) loans and 504 loans respectively).

§ 120.131 Leasing part of new construction or existing building to another business.

(a) If the SBA business loan involves the construction of a new building, a Borrower may lease up to 33% of the square footage of rentable property (total square footage of all buildings or facilities used for business operations) for a short term to any third party if reasonable growth projections show that the Borrower will need additional space within three years and will use all of the additional space within ten years. If the Borrower is an Eligible Passive Company leasing 100 percent of the Project space to an Operating Company, the Operating Company may sublease up to 33 percent to a third party under the same conditions.

(b) If the SBA business loan involves the acquisition, renovation, or reconstruction of an existing building, the Borrower (or Operating Company, if the Borrower is an Eligible Passive Company) must occupy at least 51 percent of the Rentable Property. The balance of the Rentable Property may be leased out to any third party, if the loan proceeds were not used to remodel or convert the space to be leased out. (For 504 loans, *see also* § 120.871.)

Ethical Requirements

§ 120.140 What ethical requirements apply to participants?

Lenders, Intermediaries, CDCs, and Associate Development Companies (''ADCs'') (in this section, collectively referred to as ''Participants''), must act ethically and exhibit good character. Ethical indiscretion of an Associate of a Participant or a member of a CDC will be attributed to the Participant. A Participant must promptly notify SBA if it obtains information concerning the unethical behavior of an Associate. The following are examples of such unethical behavior. A Participant may not:

(a) Self-deal;

(b) Have a real or apparent conflict of interest with a small business with which it is dealing (including any of its Associates or an Associate's Close Relatives) or SBA;

(c) Own an equity interest in a business that has received or is applying to receive SBA financing (during the term of the loan or within 6 months prior to the loan application);

(d) Be incarcerated, on parole, or on probation;

(e) Knowingly misrepresent or make a false statement to SBA;

(f) Engage in conduct reflecting a lack of business integrity or honesty;

(g) Be a convicted felon, or have an adverse final civil judgment (in a case involving fraud, breach of trust, or other conduct) that would cause the public to question the Participant's business integrity, taking into consideration such factors as the magnitude, repetition, harm caused, and remoteness in time of the activity or activities in question;

(h) Accept funding from any source that restricts, prioritizes, or conditions the types of small businesses that the Participant may assist under an SBA program or that imposes any conditions or requirements upon recipients of SBA assistance inconsistent with SBA's loan programs or regulations;

(i) Fail to disclose to SBA all relationships between the small business and its Associates (including Close Relatives of Associates), the Participant, and/or the lenders financing the Project of which it is aware or should be aware;

(j) Fail to disclose to SBA whether the loan will:

(1) Reduce the exposure of a Participant or an Associate of a Participant in a position to sustain a loss;

(2) Directly or indirectly finance the purchase of real estate, personal property or services (including insurance) from the Participant or an Associate of the Participant;

(3) Repay or refinance a debt due a Participant or an Associate of a Participant; or

(4) Require the small business, or an Associate (including Close Relatives of Associates), to invest in the Participant (except for institutions which require an investment from all members as a condition of membership, such as a Production Credit Association);

(k) Issue a real estate forward commitment to a builder or developer; or

(l) Engage in any activity which taints its objective judgment in evaluating the loan.

Credit Criteria for SBA Loans

§ 120.150 What are SBA's lending criteria?

The applicant (including an Operating Company) must be creditworthy. Loans must be so sound as to reasonably assure repayment. SBA will consider:

(a) Character, reputation, and credit history of the applicant (and the Operating Company, if applicable), its Associates, and guarantors;

(b) Experience and depth of management;

(c) Strength of the business;

(d) Past earnings, projected cash flow, and future prospects;

(e) Ability to repay the loan with earnings from the business;

(f) Sufficient invested equity to operate on a sound financial basis;

(g) Potential for long-term success;

(h) Nature and value of collateral (although inadequate collateral will not be the sole reason for denial of a loan request); and

(i) The effect any affiliates (as defined in part 121 of this chapter) may have on the ultimate repayment ability of the applicant.

§ 120.151 What is the statutory limit for total loans to a Borrower?

The aggregate amount of the SBA portions of all loans to a single Borrower, including the Borrower's affiliates as defined in part 121 of this chapter, may not exceed a guarantee amount of $750,000, except as otherwise authorized by statute for a specific loan program. The amount of any loan received by an Eligible Passive Company applies to the loan limit of both the Eligible Passive Company and the Operating Company.

§ 120.160 Loan conditions.

The following requirements are normally required by SBA for all business loans:

(a) *Personal guarantees.* Holders of at least a 20 percent ownership interest generally must guarantee the loan. SBA, in its discretion, consulting with the Participating Lender, may require other appropriate individuals to guarantee the loan as well, except SBA will not require personal guarantees from those owning less than 5% ownership.

(b) *Appraisals.* SBA may require professional appraisals of the applicant's and principals' assets, a survey, or a feasibility study.

(c) *Hazard Insurance.* SBA requires hazard insurance on all collateral.

(d) *Taxes.* The applicant may not use any of the proceeds to pay past-due Federal and state payroll taxes.

Requirements Imposed Under Other Laws and Orders

§ 120.170 Flood insurance.

Under the Flood Disaster Protection Act of 1973 (Sec. 205(b) of Pub. L. 93–234; 87 Stat. 983 (42 U.S.C. 4000 *et seq.*)), a loan recipient must obtain flood insurance if any building (including

mobile homes), machinery, or equipment acquired, installed, improved, constructed, or renovated with the proceeds of SBA financial assistance is located in a special flood hazard area. The requirement applies also to any inventory (business loan program), fixtures or furnishings contained or to be contained in the building. Mobile homes on a foundation are buildings. SBA, Lenders, CDCs, and Intermediaries must notify Borrowers that flood insurance must be maintained.

§ 120.171 Compliance with child support obligations.

Any holder of 50% or more of the ownership interest in the recipient of an SBA loan must certify that he or she is not more than 60 days delinquent on any obligation to pay child support arising under:

(a) An administrative order;

(b) A court order;

(c) A repayment agreement between the holder and a custodial parent; or

(d) A repayment agreement between the holder and a State agency providing child support enforcement services.

§ 120.172 Flood-plain and wetlands management.

(a) All loans must conform to requirements of Executive Orders 11988, ''Flood Plain Management'' (3 CFR, 1977 Comp., p. 117) and 11990, ''Protection of Wetlands'' (3 CFR, 1977 Comp., p. 121). Lenders, Intermediaries, CDCs, and SBA must comply with requirements applicable to them. Applicants must show:

(1) Whether the location for which financial assistance is proposed is in a floodplain or wetland;

(2) If it is in a floodplain, that the assistance is in compliance with local land use plans; and

(3) That any necessary construction or use permits will be issued.

(b) Generally, there is an 8-step decision making process with respect to:

(1) Construction or acquisition of anything, other than a building;

(2) Repair and restoration equal to more than 50% of the market value of a building; or

(3) Replacement of destroyed structures.

(c) SBA may determine for the following types of actions, on a case-by-case basis, that the full 8-step process is not warranted and that only the first step (determining if a proposed action is in the base floodplain) need be completed:

(1) Actions located outside the base floodplain;

(2) Repairs, other than to buildings, that are less than 50% of the market value;

(3) Replacement of building contents, materials, and equipment;

(4) Hazard mitigation measures;

(5) Working capital loans; or

(6) SBA loan assistance of $1,500,000 or less.

§ 120.173 Lead-based paint.

If loan proceeds are for the construction or rehabilitation of a residential structure, lead-based paint may not be used on any interior surface, or on any exterior surface that is readily accessible to children under the age of seven years.

§ 120.174 Earthquake hazards.

When loan proceeds are used to construct a new building or an addition to an existing building, the construction must conform with the ''National Earthquake Hazards Reduction Program (''NEHRP'') Recommended Provisions for the Development of Seismic Regulations for New Buildings'' (which can be obtained from the Federal Emergency Management Agency, Publications Office, Washington, D.C.) or a code identified by SBA as being substantially equivalent.

§ 120.175 Coastal barrier islands.

SBA and Intermediaries may not make or guarantee any loan within the Coastal Barrier Resource System.

§ 120.176 Compliance with other laws.

All SBA loans are subject to all applicable laws, including (without limitation) the civil rights laws (*see* Parts 112, 113, 117 and 136 of this chapter), prohibiting discrimination on the grounds of race, color, national origin, religion, sex, marital status, disability or age. SBA requests agreements or evidence to support or document compliance with these laws, including reports required by applicable statutes or the regulations in this chapter.

Enforceability Despite Rule Changes

§ 120.180 Are rules enforceable if they are changed later?

Regulations and contractual provisions in effect at the time of a transaction govern an SBA loan financing transaction, notwithstanding subsequent rule or contract changes. SBA may conduct an enforcement action regarding any violation of provisions of regulations or contracts applicable at the time, but no longer in effect or in use.

Loan Applications

120.190 Where does an applicant apply for a loan?

An applicant for a business loan should apply to:

(a) A Lender for a guaranteed or immediate participation loan;

(b) A CDC for a 504 loan;

(c) An Intermediary for a Microloan; or

(d) SBA for a direct loan.

§ 120.191 The contents of a business loan application.

For most business loans, SBA requires that an application for a business loan contain, among other things, a description of the history and nature of the business, the amount and purpose of the loan, the collateral offered for the loan, current financial statements, historical financial statements (or tax returns if appropriate) for the past three years, IRS tax verification, and a business plan, when applicable. Personal histories and financial statements will be required from principals of the applicant (and the Operating Company, if applicable).

§ 120.192 Approval or denial.

Applicants receive notice of approval or denial by the Lender, CDC, Intermediary, or SBA, as appropriate. Notice of denial will include the reasons. If a loan is approved, an Authorization will be issued.

§ 120.193 Reconsideration after denial.

An applicant or recipient of a business loan may request reconsideration of a denied loan or loan modification request within 6 months of denial. Applicants denied due to a size determination can appeal that determination under part 121 of this chapter. All others must be submitted to the office that denied the original request. To prevail, the applicant must demonstrate that it has overcome all legitimate reasons for denial. Six months after denial, a new application is required. If the reconsideration is denied, a second and final reconsideration may be considered by the Associate Administrator for Financial Assistance (AA/FA), whose decision is final.

Computerized SBA Forms

§ 120.194 Use of computer forms.

Any Applicant or Participant may use computer generated SBA application forms, closing forms, and other forms designated by SBA if the forms are exact reproductions of SBA forms.

Reporting of Fees

§ 120.195 Disclosure of fees.

An Applicant for a business loan must identify to SBA the name of each Agent as defined in part 103 of this chapter that helped the applicant obtain the loan, describing the services performed, and disclosing the amount of each fee paid or to be paid by the applicant to the Agent in conjunction with the performance of those services.

Subpart B—Policies Specific to 7(a) Loans

Bonding Requirements

§ 120.200 What bonding requirements exist during construction?

On 7(a) loans which finance construction, the Borrower must supply a 100 percent payment and performance bond and builder's risk insurance, unless waived by SBA.

Limitations on Use of Proceeds

§ 120.201 Refinancing unsecured or undersecured loans.

A Borrower may not use 7(a) loan proceeds to pay any creditor in a position to sustain a loss causing a shift to SBA of all or part of a potential loss from an existing debt.

§ 120.202 Restrictions on loans for changes in ownership.

A Borrower may not use 7(a) loan proceeds to purchase a portion of a business or a portion of another owner's interest. One or more current owners may use loan proceeds to purchase the entire interest of another current owner, or a Borrower can purchase ownership of an entire business.

Maturities; Interest Rates; Loan and Guarantee Amounts

§ 120.210 What percentage of a loan may SBA guarantee?

SBA's guarantee percentage must not exceed the applicable percentage established in section 7(a) of the Act. The maximum allowable guarantee percentage on a loan will be determined by the loan amount. As of October 12, 1995, the percentages are: Loans of $100,000 or less may receive a maximum guarantee of 80 percent. All other loans may receive a maximum guarantee of 75 percent, not to exceed $750,000, unless otherwise authorized by SBA.

§ 120.211 What limits are there on the amounts of direct loans?

(a) The statutory limit for direct loans made under the authority of section 7(a)(1)-(19) of the Small Business Act is $350,000. SBA has established an administrative limit of $150,000 for direct loans. The AA/FA may authorize acceptance of an application up to the statutory limit.

(b) The statutory limit for direct loans made under the authority of section 7(a)(20) is $750,000. SBA has established an administrative limit of $150,000. The Associate Administrator for Minority Enterprise Development may authorize the acceptance of an application that exceeds the administrative limit.

(c) The statutory limit on SBA's portion of an immediate participation loan is $350,000. The administrative limit is the lesser of 75 percent of the loan or $150,000. The AA/FA may authorize exceptions to the administrative limit up to $350,000.

§ 120.212 What limits are there on loan maturities?

The term of a loan shall be:

(a) The shortest appropriate term, depending upon the Borrower's ability to repay;

(b) Ten years or less, unless it finances or refinances real estate or equipment with a useful life exceeding ten years; and

(c) A maximum of 25 years, including extensions. (A portion of a loan used to acquire or improve real property may have a term of 25 years plus an additional period needed to complete the construction or improvements.)

§ 120.213 What fixed interest rates may a Lender charge?

(a) *Fixed Rates for Guaranteed Loans.* A loan may have a reasonable fixed interest rate. SBA periodically publishes the maximum allowable rate in the Federal Register.

(b) *Direct loans.* A statutory formula based on the cost of money to the Federal government determines the interest rate on direct loans. SBA publishes the rate periodically in the Federal Register.

§ 120.214 What conditions apply for variable interest rates?

A Lender may use a variable rate of interest, upon SBA's approval. SBA's maximum allowable rates apply only to the initial rate on the date SBA received the loan application. SBA shall approve the use of a variable interest rate under the following conditions:

(a) *Frequency.* The first change may occur on the first calendar day of the month following initial disbursement, using the base rate (see paragraph (c) of this section) in effect on the first business day of the month. After that, changes may occur no more often than monthly.

(b) *Range of fluctuation.* The amount of fluctuation shall be equal to the movement in the base rate. The difference between the initial rate and the ceiling rate may be no greater than the difference between the initial rate and the floor rate.

(c) *Base rate.* The base rate shall be the prime rate in effect on the first business day of the month, printed in a national financial newspaper published each business day, or the SBA Optional Peg Rate which SBA publishes quarterly in the Federal Register.

(d) *Maturities under 7 years.* For loans with maturities under seven years, the maximum interest rate shall not exceed two and one-quarter (2 1/4) percentage points over the base rate.

(e) *Maturities of 7 years or more.* For loans with maturities of seven or more years, the maximum interest rate shall not exceed two and three-quarters (2 3/4) percentage points over the base rate.

(f) *Amortization.* Initial amortization of principal and interest may be recomputed and reassessed as interest rates fluctuate, as directed by SBA. With prior approval of SBA, the Lender may use certain other amortization methods, except that SBA does not allow balloon payments.

§ 120.215 What interest rates apply to smaller loans?

For a loan over $25,000 but not exceeding $50,000, the interest rate may be one percent more than the maximum interest rate described above. For a variable rate loan of $25,000 or less, the maximum interest rate described above may be increased by two percentage points.

Fees for Guaranteed Loans

§ 120.220 Fees that Lender pays SBA.

(a) The Lender pays a guarantee fee to SBA for each loan as follows:

Guaranteed portion of loan	Fee measured as percentage of guaranteed portion	When payable	Lender may get fee from borrower	When SBA refunds fee from borrower
12 Months or less	25%	With Guarantee Application.	When SBA Approves Loan.	If Application Withdrawn or Denied.[1]

Guaranteed portion of loan	Fee measured as percentage of guaranteed portion	When payable	Lender may get fee from borrower	When SBA refunds fee from borrower
More Than 12 months and Total Guaranteed Portion Is $80,000 or Less.	2.0% of Guaranteed Portion	Within 90 days of SBA Approval.	After First Disbursement.	If Loan Cancelled and Never Disbursed.
More Than 12 Months and Amount of Guaranteed Portion of Loan That Is $250,000 or Less.	3%	Within 90 Days of SBA Approval.	After First Disbursement.	If Loan Cancelled and Never Disbursed.
More Than 12 Months and Amount of Guaranteed Portion of Loan Between $250,000 and $500,000.	3.0% of 1st $250,000 plus 3.5% of balance.	Within 90 Days of SBA Approval.	After First Disbursement.	If Loan Cancelled and Never Disbursed.
More Than 12 Months and Amount of Guaranteed Portion of Loan Exceeding $500,000.	3.0% of 1st $250,000 plus 3.5% of next $250,000 plus 3.875% of the Amount Exceeding $500,000.	Within 90 Days of SBA Approval.	After First Disbursement.	If Loan Cancelled and Never Disbursed.

[1] Also, if SBA substantially changes the Lender's loan terms and approves the loan, but the modified terms are unacceptable to the Borrower or Lender. (The Lender must request refund in writing within 30 calendar days of the approval).

(b) If the guarantee fee is not paid, SBA may terminate the guarantee. The Borrower may use working capital loan proceeds to reimburse the Lender for the guarantee fee. Acceptance of the guarantee fee by SBA shall not waive any right of SBA arising from the Lender's misconduct or violation of any provision of this part, the guarantee agreement, the Authorization, or other loan documents.

(c) The Lender shall also pay SBA an annual service fee equal to 0.5 percent of the outstanding balance of the guaranteed portion of each loan. The service fee cannot be charged to the Borrower. SBA may institute a late fee charge for delinquent payments of the annual service fee to cover administrative costs associated with collecting delinquent fees.

§ 120.221 Fees which the Lender may collect from a loan applicant.

(a) *Service and packaging fees.* The Lender may charge an applicant reasonable fees (customary for similar Lenders in the geographic area where the loan is being made) for packaging and other services. The Lender must advise the applicant in writing that the applicant is not required to obtain or pay for unwanted services. The applicant is responsible for deciding whether fees are reasonable. SBA may review these fees at any time. Lender must refund any such fee considered unreasonable by SBA.

(b) *Extraordinary servicing.* Subject to prior written SBA approval, if all or part of a loan will have extraordinary servicing needs, the Lender may charge the applicant a service fee not to exceed 2 percent per year on the outstanding balance of the part requiring special servicing.

(c) *Out-of-pocket expenses.* The Lender may collect from the applicant necessary out-of-pocket expenses such as filing or recording fees.

(d) *Late payment fee.* The Lender may charge the Borrower a late payment fee not to exceed 5 percent of the regular loan payment.

(e) *No prepayment fee.* The Lender may not charge a fee for full or partial prepayment of a loan.

§ 120.222 Fees which the Lender or Associate may not collect from the Borrower or share with third parties.

The Lender or its Associate may not:

(a) Require the applicant or Borrower to pay the Lender, an Associate, or any party designated by either, any fees or charges for goods or services, including insurance, as a condition for obtaining an SBA guaranteed loan (unless permitted by this part);

(b) Charge an applicant any commitment, bonus, broker, commission, referral or similar fee;

(c) Charge points or add-on interest;

(d) Share any premium received from the sale of an SBA guaranteed loan in the secondary market with a Service Provider, packager, or other loan-referral source; or

(e) Charge the Borrower for legal services, unless they are hourly charges for requested services actually rendered.

Subpart C—Special Purpose Loans

§ 120.300 Statutory authority.

Congress has authorized several special purpose programs in various subsections of section 7(a) of the Act. Generally, 7(a) loan policies, eligibility requirements and credit criteria enumerated in Subpart B of this part apply to these programs. The sections of this subpart prescribe the special conditions applying to each special purpose program. As with other business loans, special purpose loans are available only to the extent funded by annual appropriations.

Disabled Assistance Loan Program (DAL)

§ 120.310 What assistance is available for the disabled?

Section 7(a)(10) of the Act authorizes SBA to guarantee or make direct loans to the disabled. SBA distinguishes two kinds of assistance:

(a) *DAL–1.* DAL–1 Financial Assistance is available to non-profit public or private organizations for disabled individuals that employ such individuals; or

(b) *DAL–2.* DAL–2 Financial Assistance is available to:

(1) Small businesses wholly owned by disabled individuals; and

(2) Disabled individuals to establish, acquire, or operate a small business.

§ 120.311 Definitions.

(a) *Organization for the disabled* means one which:

(1) Is organized under federal or state law to operate in the interest of disabled individuals;

(2) Is non-profit;

(3) Employs disabled individuals for seventy-five percent of the time needed to produce commodities or services for sale; and

(4) Complies with occupational and safety standards prescribed by the Department of Labor.

(b) *Disabled individual* means a person who has a permanent physical, mental or emotional impairment, defect, ailment, disease or disability which limits the type of employment for which the person would otherwise be qualified.

§ 120.312 DAL–1 use of proceeds and other program conditions.

(a) DAL–1 applicants must submit appropriate documents to establish program eligibility.

(b) Generally, applicants may use loan proceeds for any 7(a) loan purposes. Loan proceeds may not be used:

(1) To purchase or construct facilities if construction grants and mortgage assistance are available from another Federal source; or

(2) For supportive services (expenses incurred by a DAL–1 organization to subsidize wages of low producers, health and rehabilitation services, management, training, education, and housing of disabled workers).

(c) SBA does not consider a DAL–1 organization to have a conflict of interest if one or more of its Associates is an Associate of the Lender.

§ 120.313 DAL–2 use of proceeds and other program conditions.

(a) The DAL–2 loan proceeds may be used for any 7(a) loan purposes.

(b) An applicant may use DAL–2 loan proceeds to acquire an eligible small business without complying with the change of ownership conditions in § 120.202.

(c) A DAL–2 applicant must submit evidence from a physician, psychiatrist, or other qualified professional as to the permanent nature of the disability and the limitation it places on the applicant.

§ 120.314 Resolving doubts about creditworthiness.

For the purpose of the DAL Program, SBA shall resolve doubts concerning the creditworthiness of an applicant in favor of the applicant. However, the applicant must present satisfactory evidence of repayment ability. Personal guarantees of Associates are not required for purposes of DAL–1 financial assistance.

§ 120.315 Interest rate and loan limit.

The interest rate on direct DAL loans is three percent. There is an administrative limit of $150,000 on a direct DAL loan.

Businesses Owned by Low Income Individuals

§ 120.320 Policy.

Section 7(a)(11) of the Act authorizes SBA to guarantee or make direct loans to establish, preserve or strengthen small business concerns:

(a) Located in an area having high unemployment according to the Department of Labor;

(b) Located in an area in which a high percentage of individuals have a low income inadequate to satisfy basic family needs; and

(c) More than 50 percent owned by low income individuals.

Energy Conservation

§ 120.330 Who is eligible for an energy conservation loan?

SBA may make or guarantee loans to assist a small business to design, engineer, manufacture, distribute, market, install, or service energy devices or techniques designed to conserve the Nation's energy resources.

§ 120.331 What devices or techniques are eligible for a loan?

Eligible energy conservation devices or techniques include:

(a) Solar thermal equipment;

(b) Photovoltaic cells and related equipment;

(c) A product or service which increases the energy efficiency of existing equipment, methods of operation or systems which use fossil fuels, and which is on the Energy Conservation Measures list of the Secretary of Energy;

(d) Equipment producing energy from wood, biological waste, grain or other biomass energy sources;

(e) Equipment for cogeneration of energy, district heating or production of energy from industrial waste;

(f) Hydroelectric power equipment;

(g) Wind energy conversion equipment; and

(h) Engineering, architectural, consulting, or other professional services necessary or appropriate for any of the devices or techniques in paragraphs (a) through (g) of this section.

§ 120.332 What are the eligible uses of proceeds?

(a) *Acquire property.* The Borrower may use the loan proceeds to acquire land necessary for imminent plant construction, buildings, machinery, equipment, furniture, fixtures, facilities, supplies, and material needed to accomplish any of the eligible program purposes in § 120.330.

(b) *Research and development.* Up to 30% of loan proceeds may be used for research and development:

(1) Of an existing product or service; or

(2) A new product or service.

(c) *Working capital.* The Borrower may use proceeds for working capital for entering or expanding in the energy conservation market.

§ 120.333 Are there any special credit criteria?

In addition to regular credit evaluation criteria, SBA shall weigh the greater risk associated with energy projects. SBA shall consider such factors as quality of the product or service, technical qualifications of the applicant's management, sales projections, and financial status.

Export Working Capital Program (EWCP)

§ 120.340 What is the Export Working Capital Program?

Under the EWCP, SBA guarantees short-term working capital loans made by participating lenders to exporters (section 7(a)(14) of the Act). Loan maturities may be for up to three years with annual renewals. Proceeds can be used only to finance export transactions. Loans can be for single or multiple export transactions. An export transaction is the production and payment associated with a sale of goods or services to a foreign buyer.

§ 120.341 Who is eligible?

In addition to the eligibility criteria applicable to all 7(a) loans, an applicant must be in business for one full year at the time of application, but not necessarily in the exporting business. SBA may waive this requirement if the applicant has sufficient export trade experience or other managerial experience.

§ 120.342 What are eligible uses of proceeds?

Loan proceeds may be used:

(a) To acquire inventory;

(b) To pay the manufacturing costs of goods for export;

(c) To purchase goods or services for export;

(d) To support standby letters of credit;

(e) For pre-shipment working capital; and

(f) For post-shipment foreign accounts receivable financing.

§ 120.343 Collateral.

A Borrower must give SBA a first security interest sufficient to cover 100 percent of the EWCP loan amount (such as insured accounts receivable or letters of credit). Collateral must be located in the United States, its territories or possessions.

§ 120.344 Unique requirements of the EWCP.

(a) An applicant must submit cash flow projections to support the need for the loan and the ability to repay. After the loan is made, the loan recipient must submit continual progress reports.

(b) SBA does not limit the amount of extraordinary servicing fees, as referenced in § 120.221(b), under the EWCP.

(c) SBA does not prescribe the interest rates for the EWCP, but will monitor these rates for reasonableness.

International Trade Loans

§ 120.345 Policy.

Section 7(a)(16) of the Act authorizes SBA to guarantee loans to small businesses that are:

(a) Engaged or preparing to engage in international trade; or

(b) Adversely affected by import competition.

§ 120.346 Eligibility.

(a) An applicant must establish that:

(1) The loan proceeds will significantly expand an existing export market or develop new export markets; or

(2) The applicant business is adversely affected by import competition; and

(3) Upgrading facilities or equipment will improve the applicant's competitive position.

(b) The applicant must have a business plan reasonably supporting its projected export sales.

§ 120.347 Use of proceeds.

The Borrower may use loan proceeds to acquire, construct, renovate, modernize, improve, or expand facilities and equipment to be used in the United States to produce goods or services involved in international trade, and to develop and penetrate foreign markets.

§ 120.348 Amount of guarantee.

SBA can guarantee up to $1,250,000 for a combination of fixed-asset financing and working capital, supplies and EWCP assistance. The fixed-asset portion of the loan cannot exceed $1,000,000 and the non-fixed-asset portion cannot exceed $750,000.

Qualified Employee Trusts (ESOP)

§ 120.350 Policy.

Section 7(a)(15) of the Act authorizes SBA to guarantee a loan to a qualified employee trust (''ESOP'') to:

(a) Help finance the growth of its employer's small business; or

(b) Purchase ownership or voting control of the employer.

§ 120.351 Definitions.

All terms specific to ESOPs have the same definition for purposes of this section as in the Internal Revenue Service (IRS) Code (title 26 of the United States Code) or regulations (26 CFR chapter I).

§ 120.352 Use of proceeds.

Loan proceeds may be used for two purposes.

(a) *Qualified employer securities.* A qualified employee trust may relend loan proceeds to the employer by purchasing qualified employer securities. The small business concern may use these funds for any general 7(a) purpose.

(b) *Control of employer.* A qualified employee trust may use loan proceeds to purchase a controlling interest (51 percent) in the employer. Ownership and control must vest in the trust by the time the loan is repaid.

§ 120.353 Eligibility.

SBA may assist a qualified employee trust (or equivalent trust) that meets the requirements and conditions for an ESOP prescribed in all applicable IRS, Treasury and Department of Labor (DOL) regulations. In addition, the following conditions apply:

(a) The small business must provide the funds needed by the trust to repay the loan; and

(b) The small business must provide adequate collateral.

§ 120.354 Creditworthiness.

In determining repayment ability, SBA shall not consider the personal assets of the employee-owners of the trust. SBA shall consider the earnings history and projected future earnings of the employer small business. SBA may consider the business and management experience of the employee-owners.

Veterans Loan Program

§ 120.360 Which veterans are eligible?

SBA may guarantee or make direct loans to a small business 51 percent owned by one or more of the following eligible veterans:

(a) Vietnam-era veterans who served for a period of more than 180 days between August 5, 1964, and May 7, 1975, and were discharged other than dishonorably;

(b) Disabled veterans of any era with a minimum compensable disability of 30 percent; or

(c) A veteran of any era who was discharged for disability.

§ 120.361 Other conditions of eligibility.

(a) Management and daily operations of the business must be directed by one or more of the veteran owners whose veteran status was used to qualify for the loan.

(b) This direct loan program is available only if private sector financing and guaranteed loans are not available.

(c) A veteran may qualify only once for this program on a direct loan basis.

Pollution Control Program

§ 120.370 Policy.

Section 7(a)(12) of the Act authorizes SBA to guarantee loans up to $1,000,000 to an eligible small business to plan, design or install a pollution control facility. An applicant must meet the eligibility requirements for 7(a) loans.

Loans to Participants in the 8(a) Program

§ 120.375 Policy.

Section 7(a)(20) of the Act authorizes SBA to provide direct (unilaterally or together with Lenders) or guaranteed loans to firms participating in the 8(a) Program.

§ 120.376 Special requirements.

The following special conditions apply (otherwise, 7(a) loan eligibility criteria apply):

(a) The Associate Administrator of Minority Enterprise Development (''MED'') may waive the direct loan administrative ceiling of $150,000, and raise it to $750,000.

(b) The SBA portion of a guaranteed loan must not exceed $750,000.

(c) The interest rate on a guaranteed loan shall be the same as on 7(a) guaranteed business loans. The interest rate on a direct loan shall be one percent less than on a regular direct loan.

(d) For a direct loan or SBA's portion of an immediate participation loan, SBA shall subordinate its security interest on all collateral to other debt of the applicant.

§ 120.377 Use of proceeds.

The loan proceeds shall not be used for debt refinancing. Only a manufacturing concern may use loan proceeds for working capital.

Defense Economic Transition Assistance

§ 120.380 Program.

Section 7(a)(21) of the Act authorizes SBA to guarantee loans to help eligible small businesses transition from defense to civilian markets, or eligible individuals adversely impacted by base closures or defense cutbacks to acquire or open and operate a small business.

§ 120.381 Eligibility.

(a) *Eligible small businesses.* A small business is eligible if it has been detrimentally impacted by the closure (or substantial reduction) of a Department of Defense installation, or the termination (or substantial reduction) of a Department of Defense Program on which the small business was a prime contractor, subcontractor, or supplier at any tier.

(b) *Eligible individual.* An eligible individual, for purposes of this program, includes the following persons involuntarily separated from their position or voluntarily terminated under a program offering inducements to encourage early retirement:

(1) A member of the Armed Forces of the United States (honorably discharged);

(2) A civilian employee of the Department of Defense; or

(3) An employee of a prime contractor, sub-contractor, or supplier at any tier of a Department of Defense program.

(c) *Defense loan and technical assistance (DELTA).* The DELTA program provides financial and technical assistance to defense dependent small businesses which have been adversely affected by defense reductions. The goal of the program is to assist these businesses to diversify into the commercial market while remaining part of the defense industrial base. Complete information on eligibility and other rules is available from each SBA district office.

§ 120.382 Repayment ability.

SBA shall resolve reasonable doubts concerning the small business' proposed business plan for transition to non-defense-related markets in favor of the loan applicant in determining the sound value of the proposed loan.

§ 120.383 Restrictions on loan processing.

Since greater risk may be associated with a loan to an applicant under this program, a Certified Lender or Preferred Lender shall not make a defense economic assistance loan under the PLP or CLP programs.

CapLines Program

§ 120.390 Revolving credit.

(a) CapLines finances eligible small businesses' short-term, revolving and non-revolving working-capital needs. SBA regulations governing the 7(a) loan program govern business loans made under this program. Under CapLines, SBA generally can guarantee up to $750,000.

(b) CapLines proceeds can be used to finance the cyclical, recurring, or other identifiable short-term operating capital needs of small businesses. Proceeds can be used to create current assets or used to provide financing against the current assets that already exist.

Builders Loan Program

§ 120.391 What is the Builders Loan Program?

Under section 7(a)(9) of the Act, SBA may make or guarantee loans to finance small general contractors to construct or rehabilitate residential or commercial property for resale. This program provides an exception under specified conditions to the general rule against financing investment property. ''Construct'' and ''rehabilitate'' mean only work done on-site to the structure, utility connections and landscaping.

§ 120.392 Who may apply?

A construction contractor or home-builder with a past history of profitable construction or rehabilitation projects of comparable type and size may apply. An applicant may subcontract the work. Subcontracts in excess of $25,000 may require 100 percent payment and performance bonds.

§ 120.393 Are there special application requirements?

(a) An applicant must submit documentation from:

(1) A mortgage lender indicating that permanent mortgage money is available to qualified purchasers to buy such properties;

(2) A real estate broker indicating that a market exists for the proposed building and that it will be compatible with its neighborhood; and

(3) An architect, appraiser or engineer agreeing to make inspections and certifications to support interim disbursements.

(b) The Borrower may substitute a letter from a qualified Lender for one or more of the letters.

§ 120.394 What are the eligible uses of proceeds?

A Borrower must use the loan proceeds solely to acquire, construct or substantially rehabilitate an individual residential or commercial building for sale. ''Substantial'' means rehabilitation expenses of more than one-third of the purchase price or fair market value at the time of the application. A Borrower may use up to 20 percent of the proceeds to acquire land, and up to 5 percent for community improvements such as curbs and sidewalks.

§ 120.395 What is SBA's collateral position?

SBA will require a lien on the building which must be in no less than a second position.

§ 120.396 What is the term of the loan?

The loan must not exceed sixty (60) months plus the estimated time to complete construction or rehabilitation.

§ 120.397 Are there any special restrictions?

The borrower must not use loan proceeds to purchase vacant land for possible future construction or to operate or hold rental property for future rehabilitation. SBA may allow rental of the property only if the rental will improve the ability to sell the property. The sale must be a legitimate change of ownership.

Subpart D—Lenders

§ 120.400 Loan Guarantee Agreements.

SBA may enter into a Loan Guarantee Agreement with a Lender to make deferred participation (guaranteed) loans. Such an agreement does not obligate SBA to participate in any specific proposed loan that a Lender may submit. The existence of a Loan Guarantee Agreement does not limit SBA's rights to deny a specific loan or establish general policies. *See also* §§ 120.441(b) and 120.451(d) concerning Supplemental Guarantee Agreements.

Participation Criteria

§ 120.410 Requirements for all participating Lenders.

A Lender must:

(a) Have a continuing ability to evaluate, process, close, disburse, service and liquidate small business loans;

(b) Be open to the public for the making of such loans (not be a financing subsidiary, engaged primarily in financing the operations of an affiliate);

(c) Have continuing good character and reputation, and otherwise meet and maintain the ethical requirements of § 120.140; and

(d) Be supervised and examined by a State or Federal regulatory authority, satisfactory to SBA.

§ 120.411 Preferences.

An agreement to participate under the Act may not establish any Preferences in favor of the Lender.

§ 120.412 Other services Lenders may provide Borrowers.

Subject to § 120.140 Lenders, their Associates or the designees of either may provide services to and contract for goods with a Borrower only after full disbursement of the loan to the small business or to an account not controlled by the Lender, its Associate, or the designee. A Lender, an Associate, or a designee providing such services must do so under a written contract with the small business, based on time and hourly charges, and must maintain time and billing records for examination by SBA. Fees cannot exceed those charged by established professional consultants providing similar services. *See also* § 120.195.

§ 120.413 Advertisement of relationship with SBA.

A Lender may refer in its advertising to its participation with SBA. The advertising may not:

(a) State or imply that the Lender, or any of its Borrowers, has or will receive preferential treatment from SBA;

(b) Be false or misleading; or
(c) Make use of SBA's seal.

Pledging Notes or Transferring Unguaranteed Portion

§ 120.420 Financings by Nondepository Lenders.

(a) A Small Business Lending Company regulated by SBA or a Business and Industrial Development Company (''Nondepository Lender'') may pledge the notes evidencing SBA guaranteed loans or sell the unguaranteed portions of such loans if SBA, notwithstanding the provisions of § 120.453(c), in its sole discretion, gives its prior written consent. The Lender must be secure financially and have a history of compliance with SBA's regulations and any other applicable state or Federal statutory and regulatory requirements.

(b) The Nondepository Lender, SBA, and any third party involved in the transaction, as determined by SBA in its sole discretion, must enter into a written agreement satisfactory to SBA acknowledging SBA's interest as guarantor of the subject loans and accepting that all relevant third parties agree to recognize and uphold those interests under the Act, this part, and the contractual provisions of SBA's Loan Guarantee Agreement. In any such agreement, the parties must agree to the following conditions:

(1) The Nondepository Lender, SBA, or a third party custodian agreeable to SBA, will hold all pertinent Loan Instruments, and the Nondepository Lender will continue to service the loans after the pledge or transfer is made; and

(2) The Nondepository Lender must retain an economic risk in and bear the ultimate risk of loss on the unguaranteed portions. This must be demonstrated to SBA's satisfaction by establishing a sufficient reserve fund at the time of sale of the unguaranteed portions and, in the case of pledging notes, by retaining all of the economic interest in the unguaranteed portion of any loan which a note evidences.

(c) The Nondepository Lender may not use SBA guaranteed loans or the collateral supporting such loans as collateral for any borrowing not related to financing of the guaranteed or unguaranteed portion of SBA loans.

Miscellaneous Provisions

§ 120.430 SBA access to Lender files.

A Lender must allow SBA's authorized representatives, during normal business hours, access to its files to review, inspect and copy all records and documents relating to SBA guaranteed loans.

§ 120.431 Suspension or revocation of eligibility to participate.

SBA may suspend or revoke the eligibility of a Lender to participate in the 7(a) program because of a violation of SBA regulations, a breach of any agreement with SBA, a change of circumstance resulting in the Lender's inability to meet operational requirements, or a failure to engage in prudent lending practices. Proceedings for such purposes will be conducted in accordance with the provisions of part 134 of this chapter. A suspension or revocation will not invalidate a guarantee previously provided by SBA.

Certified Lenders Program (CLP)

§ 120.440 What is the Certified Lenders Program?

Under the Certified Lenders Program (CLP), designated Lenders process, close, service, and may liquidate, SBA guaranteed loans. SBA gives priority to applications and servicing actions submitted by Lenders under this program, and attempts to respond within three days of submission to SBA. All other rules in this part 120 relating to the operations of Lenders apply to CLP Lenders.

§ 120.441 How does a Lender become a CLP Lender?

(a) An SBA field office may nominate a Lender or a Lender may request a field office to consider it for CLP status. SBA district directors may approve and renew a Lender's CLP status. The district director will consider whether the Lender:

(1) Has the ability to process, close, service and liquidate loans;

(2) Has a satisfactory performance history with SBA, including the submission of complete and accurate loan guarantee application packages;

(3) Has an acceptable SBA purchase rate; and

(4) Has shown the ability to work well with the local SBA office.

(b) If the district director does not approve a request for CLP status, the Lender may appeal to the AA/FA, whose decision will be final. If SBA grants CLP status, it applies only in the field office that processed the CLP designation. A CLP Lender must execute a Supplemental Guarantee Agreement that will specify a term not to exceed two years.

§ 120.442 Suspension or revocation of CLP status.

The AA/FA may suspend or revoke CLP status upon written notice providing the reasons at least 10 business days prior to the effective date of the suspension or revocation. Reasons for suspension or revocation may include a loan performance record unacceptable to SBA, failure to make the required number of loans under the expedited procedures, or violations of applicable statutes, regulations or published SBA policies and procedures. A CLP Lender may appeal the suspension or revocation made under this section under procedures found in part 134 of this chapter. The action of the AA/FA remains in effect pending resolution of the appeal.

Preferred Lenders Program (PLP)

§ 120.450 What is the Preferred Lenders Program?

Under the Preferred Lenders Program (PLP), designated Lenders process, close, service, and liquidate SBA guaranteed loans with reduced requirements for documentation to and prior approval by SBA.

§ 120.451 How does a Lender become a PLP Lender?

(a) An SBA field office serving the area in which a Lender's office is located can nominate the Lender, or a Lender can request a field office to consider it for PLP status. The SBA field office will forward its recommendation to an SBA centralized loan processing center which will submit its recommendation and supporting documentation to the AA/FA for final decision.

(b) In making its decision, SBA considers whether the Lender:

(1) Has the required ability to process, close, service and liquidate loans;

(2) Has the ability to develop and analyze complete loan packages; and

(3) Has a satisfactory performance history with SBA.

(c) If the Lender is approved, the AA/FA will designate the area in which it can make PLP loans.

(d) Before it can operate as a PLP Lender, the approved Lender must execute a Supplemental Guarantee Agreement, which will specify a term not to exceed two years.

(e) When a PLP's Supplemental Guarantee Agreement expires, SBA may recertify it as a PLP Lender for an additional term not to exceed two years. Prior to recertification, SBA will review a PLP Lender's loans, policies and procedures. The recertification decision of the AA/FA is final.

(f) A PLP Lender may request an expansion of the territory in which it can process PLP loans by submitting its request to a loan processing center. The center will obtain the recommendation of each SBA office in the area into which the PLP Lender would like to expand its PLP operations. The center

will forward the recommendations to the AA/FA for final decision. If a PLP Lender is not a CLP Lender in a territory into which it seeks to expand its PLP status, it automatically obtains CLP status in that territory when it is granted PLP status for the territory.

§ 120.452 What are the requirements of PLP loan processing?

(a) Subparts A and B of this part govern the making of PLP loans, except for the following:

(1) Certain types of businesses, loans, and loan programs are not eligible for PLP, as detailed in published SBA policy and procedures.

(2) A Lender may not make a PLP business loan which reduces its existing credit exposure for any Borrower, except in cases where an interim loan(s) has been made for other than real estate construction purposes to the Borrower which was approved by the Lender within 90 days of receipt of the issuance fo a subsequent PLP loan number.

(3) SBA will not guarantee more than the specified statutory percentage of any PLP loan.

(b) A PLP Lender notifies SBA of its approval of a PLP loan by submitting to SBA's loan processing center appropriate documentation signed by two of the PLP's authorized representatives. SBA will attach the SBA guarantee and notify the PLP Lender of the SBA loan number (if it does not identify a problem with eligibility, and funds are available).

(c) The PLP Lender is responsible for all PLP loan decisions regarding eligibility (including size) and creditworthiness. The PLP Lender is also responsible for confirming that all PLP loan closing decisions are correct, and that it has complied with all requirements of law and SBA regulations.

§ 120.453 What are the requirements of a PLP Lender in servicing and liquidating SBA guaranteed loans?

The PLP Lender must service and liquidate its SBA guaranteed loan portfolio (including its non-PLP loans) using generally accepted commercial banking standards employed by prudent lenders. The PLP Lender must liquidate any defaulted SBA guaranteed loan in its portfolio unless SBA advises in writing that SBA will liquidate the loan. The PLP Lender must submit a liquidation plan to SBA prior to commencing liquidation action. The PLP Lender may take any necessary servicing action, or liquidation action consistent with a plan, for any SBA guaranteed loan in its portfolio, except it may not:

(a) Take any action that confers a Preference on the Lender;

(b) Accept a compromise settlement without prior written SBA consent; and

(c) Sell or pledge more than 90 percent of a PLP loan.

§ 120.454 PLP performance review.

SBA may review the performance of a PLP Lender. SBA may charge the PLP Lender a fee to cover the costs of this review.

§ 120.455 Suspension or revocation of PLP status.

The AA/FA may suspend or revoke PLP status upon written notice providing the reasons at least 10 business days prior to the effective date of the suspension or revocation. Reasons for suspension or revocation may include loan performance unacceptable to SBA, failure to make the required number of loans under the expedited procedures, or violations of applicable statutes, regulations or published SBA policies and procedures. A PLP Lender may appeal the suspension or revocation made under this section under procedures found in part 134 of this chapter. The action of the AA/FA remains in effect pending resolution of the appeal.

Small Business Lending Companies (SBLC)

§ 120.470 What is an SBLC?

A Small Business Lending Company (SBLC) is a nondepository lending institution licensed by SBA. SBA supervises, examines, and regulates SBLCs. An SBLC is subject to all applicable SBA regulations, including those governing Lenders. SBA has imposed a moritorium on licensing new SBLC's since January, 1982.

(a) An SBLC may only make:

(1) Loans under section 7(a) (except section 7(a)(13)) of the Act in participation with SBA; and/or

(2) SBA guaranteed loans to micro-Lenders in the SBA Microloan program (see subpart G of this part). Such loans are subject to the same conditions as guaranteed loans made to SBA-designated microlenders by SBA participating Lenders.

(b) In addition to complying with §§ 120.400 through 120.413, an SBLC must meet the following requirements:

(1) *Business structure.* It must be a corporation (profit or non-profit).

(2) *Written agreement.* It must sign a written agreement with SBA.

(3) *Capital structure.* It must have unencumbered paid-in capital and paid-in surplus of at least $1,000,000, or ten percent of the aggregate of its share of all outstanding loans, whichever is more.

(4) *Capital impairment.* It must avoid capital impairment at all times. Impairment exists if the retained earnings deficit of an SBLC exceeds 50 percent of combined paid-in capital and paid-in-surplus, excluding treasury stock. An SBLC must give SBA prompt written notice of any capital impairment within 30 calendar days of the month-end financial report that first reflects the impairment. Until the impairment is cured, an SBLC may not present any loans to SBA for guarantee.

(5) *Issuance of securities.* Without prior written SBA approval, it must not issue any securities (including stock options and debt securities) except stock dividends and common stock issued for cash or direct obligations of, or obligations fully guaranteed as to principal and interest by, the United States.

(6) *Voluntary capital reduction.* Without prior written SBA approval, it must not voluntarily reduce its capital, or purchase and hold more than 2 percent of any class or combination of classes of its stock.

(7) *Reserves for losses.* It must maintain a reserve in the amount of anticipated losses on loans and receivables.

(8) *Internal control.* It must adopt a plan designed to safeguard its funds and other assets, to assure the reliability of its personnel, and to maintain the accuracy of its financial data.

(9) *Dual control.* It must maintain dual control over disbursement of funds and withdrawal of securities. An SBLC may disburse funds only by checks or wire transfers authorized by signatures of two or more officers covered by the SBLC's fidelity bond, except that checks in an amount of $1,000 or less may be signed by one bonded officer. There must be two or more bonded officers, or one bonded officer and a bonded employee to open safe deposit boxes or withdraw securities from safekeeping. The SBLC shall furnish to each depository bank, custodian, or entity providing safe deposit boxes a certified copy of the resolution implementing these control procedures.

(10) *Fidelity insurance.* It must maintain a Brokers Blanket Bond, Standard Form 14, or Finance Companies Blanket Bond, Standard Form 15, or such other form of coverage as SBA may approve, in a minimum amount of $500,000 executed by a surety holding a certificate of authority from the Secretary of the Treasury pursuant to 31 U.S.C. 9304–9308.

(11) *Common control.* It must not control, be controlled by, or be under common control with, another SBLC. Without prior written SBA approval, an

Associate of one SBLC shall not be an Associate of another SBLC or of any entity which directly or indirectly controls or is under common control with another SBLC.

(12) *Management.* An SBLC must employ full time professional management.

(13) *Borrowed funds.* Without SBA's prior written approval, it must not be capitalized with borrowed funds. Shareholders owning 10 percent or more of any class of its stock shall not use borrowed funds to purchase the stock unless the net worth of the shareholders is at least twice the amount borrowed or unless the shareholders receive SBA's prior written approval for a lower ratio.

§ 120.471 Records.

Each SBLC must comply with the following requirements concerning records:

(a) *Maintenance of Records.* It must maintain accurate and current financial records, including books of account, minutes of stockholder, directors, and executive committee meetings, and all documents and supporting materials relating to the SBLC's transactions at its principal business office. Securities held by a custodian pursuant to a written agreement shall be exempt from this requirement.

(b) *Preservation of records.* (1) It must preserve in a manner permitting immediate retrieval the following documentation for the financial statements required by § 120.472 (and of the accompanying certified public accountant's opinion), for the following specified periods:

(i) Preserve permanently:

(A) All general and subsidiary ledgers (or other records) reflecting asset, liability, capital stock and surplus, income, and expense accounts;

(B) All general and special journals (or other records forming the basis for entries in such ledgers); and

(C) The corporate charter, bylaws, application for determination of eligibility to participate with SBA, and all minutes books, capital stock certificates or stubs, stock ledgers, and stock transfer registers;

(ii) Preserve for at least 6 years following final disposition of the related loan:

(A) All applications for financing;

(B) Lending, participation, and escrow agreements;

(C) Financing instruments; and

(D) All other documents and supporting material relating to such loans, including correspondence.

(2) Records and other documents referred to in this section may be preserved electronically if the original is available for retrieval within a reasonable period.

§ 120.472 Reports to SBA.

An SBLC must submit the following to the AA/FA:

(a) An audited financial statement prepared by a certified public accountant within three months after the close of each fiscal year, and interim financial reports when requested by SBA;

(b) A report of any legal or administrative proceeding, by or against the SBLC, or against an officer, director, or employee of the SBLC for an alleged breach of official duty, within 10 days after initiating or learning of the proceeding, as well as notification of the terms of any settlement or final judgment (in addition to any reporting under applicable SBA Forms);

(c) Copies of any report furnished to its stockholders (including any prospectus, letter, or other publication concerning the financial operations of the SBLC);

(d) A summary of any changes in the SBLC's organization or financing, such as:

(1) Any change in its name, address or telephone number;

(2) Any change in its charter, bylaws, or its officers or directors (to be accompanied by a statement of personal history on an approved SBA form);

(3) Any changes in capitalization (including those identified in § 120.470);

(4) Any changes affecting the eligibility of the SBLC to continue to participate as an SBLC; and

(5) Notice of a pledge of stock within 30 calendar days of the transaction if 10 percent or more of the stock is pledged by any person (or group of persons acting in concert) as collateral for indebtedness, and such pledge does not involve a transfer for which prior written approval of SBA is required under § 120.473;

(e) Such other reports as SBA may require from time to time by written directive.

§ 120.473 Change of ownership or control.

(a) Any change of ownership or control without prior written approval of SBA is prohibited. An SBLC must request approval of any such change from the AA/FA. Pending the approval, the SBLC may not register the proposed new owners on its transfer books nor permit them to participate in any manner in the conduct of the SBLC's affairs. Change of ownership or control includes:

(1) Any transfer of 10 percent or more of any class of the SBLC's stock, and any agreement providing for such transfer;

(2) Any transfer that could result in the beneficial ownership by any person or group of persons acting in concert of 10 percent or more of any class of its stock, and any agreement providing for such transfer;

(3) Any merger, consolidation, or reorganization; or

(4) Any other transaction or agreement that transfers control of the SBLC.

(b) If transfer of ownership or control is subject to the approval of any State or Federal chartering, licensing, or other regulatory authority, copies of any documents filed with such authority must, at the same time, be transmitted to the AA/FA.

§ 120.474 Prohibited financing.

An SBLC may not make a loan to a small business that has received financing (or a commitment for financing) from an SBIC that is an Associate of the SBLC.

§ 120.475 Audits.

Every SBLC is subject to periodic audits by SBA's Office of Inspector General, Auditing Division, and the cost of such audits will be assessed against the SBLC, except for the first audit. Fees are structured based on the SBLC's assets as of the date of the latest audited financial statement submitted to SBA before the audit. The fee schedule is set forth in SBA's Standard Operating Procedures manual.

§ 120.476 Suspension or revocation.

SBA may revoke or suspend an SBLC for a violation of law, these regulations, or any agreement with SBA. An appeal can be made following the procedures set forth in part 134 of this chapter.

Subpart E—Loan Administration

§ 120.500 General.

This subpart outlines the general loan administration policies applicable to loan servicing and liquidation.

Servicing

§ 120.510 Servicing direct and immediate participation loans.

SBA services the direct loans that it makes. Generally, the Lender services immediate participation loans that it makes and in which SBA participates.

§ 120.511 Servicing guaranteed loans.

The Lender services guaranteed loans, holds the Loan Instruments and receives the Borrower's payments of principal and interest.

§ 120.512 Who services the loan after SBA honors its guarantee?

Generally, after SBA honors its guarantee, the Lender must continue to hold the Loan Instruments and service and liquidate the loan. The Lender must execute a Certificate of Interest showing SBA's percentage of the loan, and must submit a liquidation plan to SBA for each loan to be liquidated. If SBA elects to service or liquidate the loan, the Lender must assign the Loan Instruments to SBA.

§ 120.513 What servicing actions require the prior written consent of SBA?

Except as otherwise provided in a Supplemental Guarantee Agreement with the Lender, SBA must give its prior written consent before the Lender takes any of the following actions:

(a) Alters substantially the terms or conditions of any Loan Instrument (for example, any increase in the principal amount or change in the interest rate, or action conferring a Preference on the Lender);

(b) Releases collateral having a cumulative value in excess of 20 percent of the original loan amount;

(c) Accelerates the maturity of the note;

(d) Sues upon any Loan Instrument;

(e) Compromises or waives any claim against any Borrower, guarantor, obligor or standby creditor arising out of any Loan Instrument; or

(f) Increases the amount of any prior lien held by the Lender on the collateral securing the loan.

SBA'S Purchase of a Guaranteed Portion

§ 120.520 When does SBA honor its guarantee?

(a) SBA, in its sole discretion, may purchase a guaranteed portion of a loan at any time. A Lender may demand in writing that SBA honor its guarantee if the Borrower is in default on any installment for more than 60 calendar days (or less if SBA agrees) and the default has not been cured. If a Borrower cures a default before a Lender requests purchase by SBA, the Lender's right to request purchase on that default lapses.

(b) Purchase by SBA of the guaranteed portion does not waive any of SBA's rights to recover money paid on the guarantee, based upon the Lender's negligence, misconduct, or violation of this part, including those actions listed in § 120.524(a), the Loan Guarantee Agreement or the Loan Instruments.

§ 120.521 What interest rate applies after SBA purchases its guaranteed portion?

When SBA purchases the guaranteed portion of a fixed interest rate loan, the rate of interest remains as stated in the note. On loans with a fluctuating interest rate, the interest rate that the Borrower owes will be at the rate in effect at the time of the earliest uncured payment default, or the rate in effect at the time of purchase (where no default has occurred).

§ 120.522 How much accrued interest does SBA pay to the Lender or Registered Holder when SBA purchases the guaranteed portion?

(a) *Rate of interest.* If SBA purchases the guaranteed portion from a Lender or from a Registered Holder (if sold in the Secondary Market), it will pay accrued interest at:

(1) The rate in the note if it is a fixed rate loan; or

(2) The rate in effect on the date of the earliest uncured payment default, or of SBA's purchase (if there has been no default).

(b) *Payment to Lender.* If the Lender submits a complete purchase request to SBA within 120 days of the earliest uncured payment default, SBA will pay accrued interest to the Lender from the last interest paid-to-date up to the date of payment. If the Lender requests SBA to purchase after 120 days from the date of the earliest uncured payment default date, SBA will pay only 120 days of interest. For LowDoc loans, the interest paid to the Lender will be governed by the Supplemental Guarantee Agreement.

(c) *Payment to Registered Holder.* SBA will pay a Registered Holder all accrued interest up to the date of payment.

(d) *Extension of the 120 day period.* Before the 120 days expire, the SBA field office may extend the period if the Lender and SBA agree that the Borrower can cure the default within a reasonable and definite period of time or that the benefits from doing so otherwise will exceed the costs of SBA paying additional interest. If the 120 days have passed, only the AA/FA or designee can extend the period.

§ 120.523 What is the ''earliest uncured payment default''?

The earliest uncured payment default is the date of the earliest failure by a Borrower to pay a regular installment of principal and/or interest when due. Payments made by the Borrower before a Lender makes its request to SBA to purchase are applied to the earliest uncured payment default. If the installment is paid in full, the earliest uncured payment default date will advance to the next unpaid installment date. If a Borrower makes any payment after the Lender makes its request to SBA to purchase, the earliest uncured payment default date does not change because the Lender has already exercised its right to request purchase.

§ 120.524 When is SBA released from liability on its guarantee?

(a) SBA is released from liability on a loan guarantee (in whole or in part, within SBA's exclusive discretion), if any of the events below occur:

(1) The Lender has failed to comply materially with any of the provisions of these regulations, the Loan Guarantee Agreement, or the Authorization;

(2) The Lender has failed to make, close, service, or liquidate a loan in a prudent manner;

(3) The Lender's improper action or inaction has placed SBA at risk;

(4) The Lender has failed to disclose a material fact to SBA regarding a guaranteed loan in a timely manner;

(5) The Lender has misrepresented a material fact to SBA regarding a guaranteed loan;

(6) SBA has received a written request from the Lender to terminate the guarantee;

(7) The Lender has not paid the guarantee fee within the period required under SBA rules and regulations;

(8) The Lender has failed to request that SBA purchase a guarantee within 120 days after maturity of the loan;

(9) The Lender has failed to use required SBA forms or exact electronic copies; or

(10) The Borrower has paid the loan in full.

(b) If SBA determines, after purchasing its guaranteed portion of a loan, that any of the events set forth in paragraph (a) of this section occurred in connection with that loan, SBA is entitled to recover any money paid on the guarantee plus interest from the Lender responsible for those events.

(c) If the Lender's loan documentation indicates that one or more of the events in paragraph (a) of this section may have occurred, SBA may undertake such investigation as it deems necessary to determine whether to honor or deny the guarantee, and may withhold a decision on whether to honor the guarantee until the completion of such investigation.

(d) Any information provided to SBA prior to Lender's request for SBA to honor its guarantee shall not prejudice SBA's right to deny liability for a guarantee if one or more of the events listed in paragraph (a) of this section occur.

(e) Unless SBA provides written notice to the contrary, the Lender remains responsible for all loan servicing ad liquidation actions until SBA honors its guarantee in full.

Deferment, Extension of Maturity and Loan Moratorium

§ 120.530 Deferment of payment.

SBA may agree to defer payments on a business loan for a stated period of time, and use such other methods as it considers necessary and appropriate to help in the successful operation of the Borrower. This policy applies to all business loan programs, including 504 loans.

§ 120.531 Extension of maturity.

SBA may agree to extend the maturity of a loan for up to 10 years beyond its original maturity if the extension will aid in the orderly repayment of the loan.

§ 120.532 What is a loan Moratorium?

SBA may assume a Borrower's obligation to repay principal and interest on a loan by agreeing to make the payments to the Lender on behalf of the Borrower under terms and conditions set by SBA. This relief is called a ''Moratorium.'' Complete information concerning this program may be obtained from local SBA offices.

Liquidation of Collateral

§ 120.540 What are SBA's policies concerning liquidation of collateral?

(a) *Liquidation policy.* SBA or the Lender may liquidate collateral securing a loan if the loan is in default or there is no reasonable prospect that the loan can be repaid within a reasonable period.

(b) *Sale and conversion of loans.* Without the consent of the Borrower, SBA may:

(1) Sell a direct loan;

(2) Convert a guaranteed or immediate participation loan to a direct loan; or

(3) Convert an immediate participation loan to a guaranteed loan or a loan owned solely by the Lender.

(c) *Disposal of collateral and assets acquired through foreclosure or conveyance.* SBA or the Lender may sell real and personal property (including contracts and claims) pledged to secure a loan that is in default in accordance with the provisions of the related security instrument (*see* § 120.550 for Homestead Protection for Farmers).

(1) *Competitive bids or negotiated sales.* Generally, SBA will offer loan collateral and acquired assets for public sale through competitive bids at auctions or sealed bid sales. The Lender may use negotiated sales if consistent with its usual practice for similar non-SBA assets.

(2) *Lease of acquired property.* Normally, neither SBA nor a Lender will rent or lease acquired property or grant options to purchase. SBA and the Lender will consider proposals for a lease if it appears a property cannot be sold advantageously and the lease may be terminated on reasonable notice upon receipt of a favorable purchase offer.

(d) *Recoveries and security interests shared.* SBA and the Lender will share pro rata (in accordance with their respective interests in a loan) all loan payments or recoveries, all reasonable expenses (including advances for the care, preservation, and maintenance of collateral securing the loan and the payment of senior lienholders), and any security interest or guarantee (excluding SBA's guarantee) which the Lender or SBA may hold or receive in connection with a loan.

(e) *Guarantors.* Guarantors of financial assistance have no rights of contribution against SBA on an SBA guaranteed or direct loan. SBA is not deemed to be a co-guarantor with any other guarantors.

Homestead Protection for Farmers

§ 120.550 What is homestead protection for farmers?

SBA may lease to a farmer-Borrower the farm residence occupied by the Borrower and a reasonable amount of adjoining property (no more than 10 acres and seven farm buildings), if they were acquired by SBA as a result of a defaulted farm loan made or guaranteed by SBA (*see* the Consolidated Farm and Rural Development Act, 7 U.S.C. 1921, for qualifying loan purposes).

§ 120.551 Who is eligible for homestead protection?

SBA must notify the Borrower in possession of the availability of these homestead protection rights within 30 days after SBA acquires the property. A farmer-Borrower must:

(a) Apply for the homestead occupancy to the SBA field office which serviced the loan within 90 days after SBA acquires the property;

(b) Provide evidence that the farm produces farm income reasonable for the area and economic conditions;

(c) Show that at least 60 percent of the Borrower and spouse's gross annual income came from farm or ranch operations in at least any two out of the last six calendar years;

(d) Have resided on the property during the previous six years; and

(e) Be personally liable for the debt.

§ 120.552 Lease.

If approved, the applicant must personally occupy the residence during the term of the lease and pay a reasonable rent to SBA. The lease will be for a period of at least 3 years, but no more than 5 years. A lease of less than 5 years may be renewed, but not beyond 5 years from the original lease date. During or at the end of the lease period, the lessee has a right of first refusal to reacquire the homestead property under terms and conditions no less favorable than those offered to any other purchaser.

§ 120.553 Appeal.

If the application is denied, the Borrower may appeal the decision to the AA/FA. Until the conclusion of any appeal, the Borrower may retain possession of the homestead property.

§ 120.554 Conflict of laws.

In the event of a conflict between the homestead provisions at §§ 120.550 through 120.553 of this part, and any state law relating to the right of a Borrower to designate for separate sale or to redeem part or all of the real property securing a loan foreclosed by the Lender, state law shall prevail.

Subpart F—Secondary Market

Fiscal and Transfer Agent (FTA)

§ 120.600 Definitions.

(a) *Certificate* is the document the FTA issues representing a beneficial fractional interest in a Pool (Pool Certificate), or an undivided interest in the entire guaranteed portion of an individual 7(a) guaranteed loan (Individual Certificate).

(b) *Current* means that no repayment from a Borrower to a Lender is over 29 days late measured from the due date of the payment on the records of the FTA's central registry (Pools) or the entity servicing the loan (individual guaranteed portion).

(c) *FTA* is the SBA's fiscal and transfer agent.

(d) *Note Rate* is the interest rate on the Borrower's note.

(e) *Net Rate* is the interest rate on an individual guaranteed portion of a loan in a Pool.

(f) *Pool* is an aggregation of SBA guaranteed portions of loans made by Lenders.

(g) *Pool Assembler* is a financial institution that:

(1) Organizes and packages a Pool by acquiring the SBA guaranteed portions of loans from Lenders;

(2) Resells fractional interests in the Pool to Registered Holders; and

(3) Directs the FTA to issue Certificates.

(h) *Pool Rate* is the interest rate on a Pool Certificate.

(i) *Registered Holder* is the Certificate owner listed in FTA's records.

(j) *SBA's Secondary Market Program Guide* is an issuance from SBA which

describes the characteristics of Secondary Market transactions.

§ 120.601 SBA Secondary Market.

The SBA secondary market (''Secondary Market'') consists of the sale of Certificates, representing either the entire guaranteed portion of an individual 7(a) guaranteed loan or an undivided interest in a Pool consisting of the SBA guaranteed portions of a number of 7(a) guaranteed loans. By the terms of such Certificate, SBA guarantees a Registered Holder timely payment of principal and interest from the loan or loans underlying the Certificate. Transactions involving interests in Pools or the sale of individual guaranteed portions of loans are governed by the contracts entered into by the parties, SBA's Secondary Market Program Guide, and this subpart. See sections 5 (f), (g), and (h) of the Small Business Act (15 U.S.C. 634 (f), (g) and (h)).

Certificates

§ 120.610 Form and terms of Certificates.

(a) *General form and content.* Each Certificate must be registered with the FTA. SBA must approve the terms of the Certificate.

(b) *Face amount of Pool Certificate.* The face amount of a Pool Certificate cannot be less than a minimum amount as specified in the Program Guide, and the dollar amount of Certificates must be in increments which SBA will specify in the Program Guide (except for one Certificate in each Pool). SBA may change these requirements based upon an analysis of market conditions and program experience, and will publish any such change in the Federal Register.

(c) *Basis of payment for Pool Certificates.* Principal installments and interest payments are based on the unpaid principal balance of the portion of the Pool represented by a Pool Certificate. All prepayments on loans in the Pool must be passed through to the appropriate Registered Holders with the regularly scheduled payments to such Holders.

(d) *Basis of payment for Individual Certificates.* Principal installments and interest payments are based on the unpaid principal balance of the SBA guaranteed portion of the loan supporting an Individual Certificate. The Certificate must provide for a pass through to the Registered Holder of payments which the FTA receives from a Lender or any entity servicing the loan, less applicable fees.

(e) *Interest rate on Pool Certificate.* The interest rate on a Pool Certificate must be equal to the lowest Net Rate on any individual guaranteed portion of a loan in the Pool.

§ 120.611 Pools backing Pool Certificates.

(a) *Pool characteristics.* As set forth in the Program Guide, each Pool must have:

(1) A minimum number of guaranteed portions of loans;

(2) A minimum aggregate principal balance of the guaranteed portions;

(3) A maximum percentage of the Pool which an individual guaranteed portion may constitute;

(4) A maximum allowable difference between the highest and lowest note interest rates;

(5) A maximum allowable difference between the remaining terms to maturity of the loans in the Pool; and

(6) A minimum weighted average maturity at Pool formation.

(b) *Adjustment of Pool characteristics.* SBA may adjust the Pool characteristics periodically based upon program experience and market conditions.

§ 120.612 Loans eligible to back Certificates.

(a) Pool Certificates are backed by the SBA guaranteed portions of loans comprising the Pool. An Individual Certificate is backed by the SBA guaranteed portion of a single loan. Any such loan must:

(1) Be current as of the date the Pool is formed or the individual guaranteed portion of a loan is initially sold in the Secondary Market;

(2) Be guaranteed under the Act; and

(3) Meet such other standards as SBA may determine to be necessary for the successful operation of the Secondary Market program.

(b) The loans that back a Pool must meet the SBA requirements in effect at the time the Pool is formed.

§ 120.613 Secondary Participation Guarantee Agreement.

When a Lender wants to sell the guaranteed portion of a loan, it enters into a Secondary Participation Guarantee Agreement (''SPGA'') with SBA and the prospective purchaser. The terms of sale between the Lender and the purchaser cannot require the Lender or SBA to repurchase the guaranteed portion of the loan except in accordance with the terms of the SPGA. Before execution of the SPGA, the Lender must:

(a) Submit to FTA a copy of the proposed SPGA, the note, and such other documents as SBA may require;

(b) Disburse to the Borrower the full amount of the loan; and

(c) Pay SBA all guarantee fees relevant to the loan in full.

The SBA Guarantee of a Certificate

§ 120.620 SBA guarantee of a Pool Certificate.

(a) *Extent of Guarantee.* SBA guarantees to a Registered Holder the timely payment of principal and interest installments and any prepayment or other recovery of principal to which the Registered Holder is entitled. If the Borrower of a loan in a Pool backing the Certificates does not make a required installment payment, SBA, through the FTA, will make advances to maintain the schedule of interest and principal payments to the Registered Holders.

(b) *SBA guarantee backed by full faith and credit.* SBA's guarantee of the Pool Certificate is backed by the full faith and credit of the United States.

§ 120.621 SBA guarantee of an Individual Certificate.

(a) *Extent of SBA guarantee.* With respect to Individual Certificates, SBA guarantees to purchase from the Registered Holder the guaranteed portion of the loan for an amount equal to the unpaid principal and accrued interest due as of the date of SBA's purchase, less deductions for applicable fees. Unlike the SBA guarantee with respect to pooled loans, SBA does not guarantee timely payment on Individual Certificates.

(b) *What triggers the SBA guarantee.* SBA's guarantee to the Registered Holder may be called upon when:

(1) The Borrower remains in uncured default for 60 days on payments of principal or interest due on the note;

(2) The Lender fails to send to the FTA on a timely basis payments it received from the Borrower; or

(3) The FTA fails to send to the Registered Holder on a timely basis any payments it has received from the Lender.

(c) *Full faith and credit.* SBA's guarantee to the Registered Holder is backed by the full faith and credit of the United States.

Pool Assemblers

§ 120.630 Qualifications to be a Pool Assembler.

(a) *Application to become Pool Assembler.* The application to become a Pool Assembler is available from the AA/FA. In order to qualify as a Pool Assembler, an entity must send the application to the AA/FA, with an application fee, and certify that it:

(1) Is regulated by the appropriate agency as defined in section 3(a)(34)(G) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(34)(G));

(2) Meets all financial and other applicable requirements of its regulatory

authority and the Government Securities Act of 1986, as amended (Pub. L. 99–571, 100 Stat. 3208);

(3) Has the financial capability to assemble acceptable and eligible guaranteed loan portions in sufficient quantity to support the issuance of Pool Certificates; and

(4) Is in good standing with SBA (as the AA/FA determines), the Office of the Comptroller of the Currency (''OCC'') if it is a national bank, the Federal Deposit Insurance Corporation if it is a bank not regulated by the OCC, or the National Association of Securities Dealers if it is a member.

(b) *Approval by SBA.* An entity may not submit Pool applications to the FTA until SBA has approved the application to become a Pool Assembler.

(c) *Conduct of business by Pool Assembler.* An entity continues to qualify as a Pool Assembler so long as it:

(1) Meets the eligibility standards in paragraph (a) of this section;

(2) Conducts its business in accordance with SBA regulations and accepted securities or banking industry practices, ethics, and standards; and

(3) Maintains its books and records in accordance with generally accepted accounting principles or in accordance with the guidelines of the regulatory body governing its activities.

§ 120.631 Suspension or termination of Pool Assembler.

(a) *Suspension or termination.* The AA/FA may suspend a Pool Assembler from operating in the Secondary Market for up to 18 months or terminate its status as a Pool Assembler, if the Pool Assembler (and/or its Associates):

(1) Does not comply with any of the requirements in § 120.630 (a) and (c);

(2) Has been indicted or otherwise formally charged with, or convicted of, a misdemeanor or felony;

(3) Has received an adverse civil judgment that it has committed a breach of trust or a violation of a law or regulation protecting the integrity of business transactions or relationships;

(4) Has not formed a Pool for at least three years; or

(5) Is under investigation by its regulating authority for activities which may affect its fitness to participate in the Secondary Market.

(b) *Suspension procedures.* The AA/FA shall notify a Pool Assembler by certified mail, return receipt requested, of the decision to suspend and the reasons therefore at least 10 business days prior to the effective date of the suspension. The Pool Assembler may appeal the suspension made under this section pursuant to the procedures set forth in part 134 of this chapter. The action of the AA/FA shall remain in effect pending resolution of the appeal.

(c) *Notice of termination.* In order to terminate a Pool Assembler, the AA/FA must issue an order to show cause why the SBA should not terminate the Pool Assembler's participation in the Secondary Market. The Pool Assembler may appeal the termination made under this section pursuant to procedures set forth in part 134 of this chapter. The action of the AA/FA shall remain in effect pending resolution of the appeal.

Miscellaneous Provisions

§ 120.640 Administration of the Pool and Individual Certificates.

(a) *FTA responsibility.* The FTA has the responsibility to administer each Pool or Individual Certificate. It shall maintain a registry of Registered Holders and other information as SBA requires.

(b) *Self-liquidating.* Each Pool or individual guaranteed portion of a loan in the Secondary Market is self-liquidating because of Borrower payments or prepayments, redemption by SBA, and/or payments by SBA or the Lender after default by the Borrower. Substitution of the guaranteed portions of existing loans for defaulted loans is not permitted.

(c) *SBA's right to subrogation.* If SBA pays a claim under a guarantee with respect to a Certificate issued under this subpart, it must be subrogated fully to the rights satisfied by such payment.

(d) *SBA ownership rights not limited.* No Federal, State or local law can preclude or limit the exercise by SBA of its ownership rights in the portions of loans constituting the Pool against which the Certificates are issued.

§ 120.641 Disclosure to purchasers.

(a) *Information to purchaser.* Prior to any sale, the Pool Assembler, Registered Holder of an Individual Certificate, or any subsequent seller must disclose to the purchaser, verbally or in writing, information on the terms, conditions, and yield as described in the SBA Secondary Market Program Guide.

(b) *Information on transfer document.* The seller must provide the same information described in paragraph (a) of this section in writing on the transfer document when the seller submits it to the FTA. After the sale of an Individual Certificate, the FTA will provide the disclosure information in writing to the purchaser.

(c) *Information in prospectus.* If the Registered Holder is a trust, investment Pool, mutual fund or other security, it must disclose the information in paragraph (a) of this section to investors through a prospectus and other promotional material if an Individual Certificate or Pool Certificate is placed into or used as the backing for the investment vehicle.

§ 120.642 Requirements before the FTA issues Pool Certificates.

Before the FTA issues any Pool Certificate, the Pool Assembler must deliver to it the following documents:

(a) A properly completed Pool application form;

(b) Either:

(1) Individual Certificates evidencing the guaranteed portions comprising the Pool; or

(2) An executed SPGA and related documentation for the loans whose guaranteed portions are to be part of the Pool; and

(c) Any other documentation which SBA may require.

§ 120.643 Requirements before the FTA issues Individual Certificates.

(a) *FTA issuance of initial Certificate.* Before the FTA can issue the Individual Certificate for a guaranteed portion of a loan, the original seller must provide the following documents to the FTA:

(1) An executed SPGA;

(2) A copy of the note representing the guaranteed loan; and

(3) Any other documentation which SBA may require.

(b) Review of documentation. SBA may review or require the FTA to review any documentation before the FTA issues a Certificate.

§ 120.644 Transfers of Certificates.

(a) *General rule.* Certificates are transferable. Transfers in the Secondary Market must comply with Article 8 of the Uniform Commercial Code of the State of New York. The seller must use the detached form of assignment (SBA Form 1088), unless the seller and purchaser choose to use another form which the SBA approves. The FTA may refuse to issue a Certificate until it is satisfied that the documents of transfer are complete.

(b) *Transfer on FTA records.* In order for the transfer of a Certificate to be effective the FTA must reflect it on its records.

(c) *Contents of letter of transmittal accompanying the transfer of Certificates.* (1) A letter of transmittal must accompany each Certificate which a Registered Holder submits to the FTA for transfer. The Registered Holder must supply the following information in the letter:

(i) Pool number, if applicable;

(ii) Certificate number;

(iii) Name of purchaser of Certificate;

(iv) Address and tax identification number of the purchaser;

(v) Name and telephone number of the person handling or facilitating the transfer;

(vi) Instructions for the delivery of the new Certificate.

(2) The Registered Holder must also send the fee which the FTA charges for this service. The FTA will supply fee information to the Registered Holder.

(d) *Lender cannot purchase guaranteed portion of loan it made.* The Lender (or its Associate) that made a 7(a) guaranteed loan cannot purchase the guaranteed portion of that loan in the Secondary Market. If a Lender does purchase the guaranteed portion of one of its own loans, it shall not have the unconditional guarantee of SBA.

§ 120.645 Redemption of Certificates.

(a) *Redemption of Individual Certificate.* The prepayment of the underlying loan or a default on such loan will trigger the redemption of the Certificate by FTA/SBA in accordance with the procedures prescribed in the SPGA.

(b) *Redemption of Pool Certificate.* The FTA and SBA may redeem a Pool Certificate because of prepayment or default of all loans in a Pool.

§ 120.650 Registration duties of FTA in Secondary Market.

The FTA registers all Certificates. This means it issues, transfers title to, and redeems them. All financial transactions relating to a guaranteed portion of a loan flow through the FTA. In fulfilling its obligation to keep the central registry current, the FTA may, with SBA's approval, obtain any necessary information from the parties involved in the Secondary Market.

§ 120.651 Claim to FTA by Registered Holder to replace Certificate.

(a) To replace a Certificate because of loss, theft, destruction, mutilation, or defacement, the Registered Holder must:

(1) Give the FTA information about the Certificate and the facts relating to the claim;

(2) File an indemnity bond acceptable to SBA and the FTA with a surety to protect the interests of SBA and the FTA;

(3) Pay the FTA its fee to replace a Certificate; and

(4) Use an affidavit of loss (form available from the FTA) to report:

(i) The name and address of the Registered Holder (and the name and capacity of any representative actually filing the claim);

(ii) The Certificate by Pool number, if applicable;

(iii) The Certificate number;

(iv) The original principal amount;

(v) The name in which the Certificate was registered;

(vi) Any assignment, endorsement or other writing on the Certificate; and

(vii) A statement of the circumstances of the theft or loss.

(b) When the FTA receives notice of the theft or loss, it will stop any transfer of the Certificate. The Registered Holder must send to the FTA all available portions of a mutilated or defaced Certificate. When the Registered Holder completes these steps, the FTA will replace the Certificate.

§ 120.652 FTA fees.

The FTA may charge reasonable servicing fees, transfer fees, and other fees as the SBA and FTA may negotiate under contract.

Suspension or Revocation of Participant in Secondary Market

§ 120.660 Suspension or revocation.

(a) *Suspension or revocation of Lender, broker, dealer, or Registered Holder for violation of Secondary Market rules and regulations.* The AA/FA may suspend or revoke the privilege of a Lender, broker, dealer, or Registered Holder to sell, purchase, broker, or deal in loans or Certificates for:

(1) Committing a serious violation, in SBA's discretion, of:

(i) The regulations governing the Secondary Market; or

(ii) Any provisions in the contracts entered into by the parties, including SBA Forms 1085, 1086, 1088 and 1454; or

(2) Knowingly submitting false or fraudulent information to the SBA or FTA.

(b) *Additional rules for suspension or revocation of broker or dealer.* In addition to acting under paragraph (a) of this section, the AA/FA may suspend or revoke the privilege of any broker or dealer to sell or otherwise deal in Certificates in the Secondary Market if:

(1) Its supervisory agency has revoked or suspended the broker or dealer from engaging in the securities business, or is investigating the firm or broker for a practice which SBA considers, in its sole discretion, to be relevant to the broker's or dealer's fitness to participate in the Secondary Market;

(2) The broker or dealer has been indicted or otherwise formally charged with a misdemeanor or felony which bears on its fitness to participate in the Secondary Market; or

(3) A civil judgment is entered holding that the broker or dealer has committed a breach of trust or a violation of any law or regulation protecting the integrity of business transactions or relationships.

(c) *Notice to suspend or revoke.* The AA/FA shall notify the affected party in writing, providing the reasons therefore, at least 10 business days prior to the effective date of the suspension or revocation. The affected party may appeal the suspension or revocation made under this section pursuant to the procedures set forth in part 134 of this chapter. The action of the AA/FA will remain in effect pending resolution of the appeal. Revocation will last a minimum of five years.

Subpart G—Microloan Demonstration Program

§ 120.700 What is the Microloan Program?

The Microloan Demonstration Program assists women, low income individuals, minority entrepreneurs, and other small businesses which need small amounts of financial assistance. Under this program, SBA makes direct and guaranteed loans to Intermediaries (as defined below) who use the proceeds to make loans to eligible borrowers. SBA may also make grants under the program to Intermediaries and other qualified nonprofit entities to be used for marketing, management, and technical assistance to the program's target population.

§ 120.701 Definitions.

(a) *Deposit account* is a demand, time, savings, passbook, or similar account maintained with an insured depository institution (not including an account evidenced by a Certificate of Deposit).

(b) *Economically Distressed Area* is a county or equivalent division of local government of a state in which, according to the most recent available data from the United States Bureau of the Census, 40 percent or more of the residents have an annual income that is at or below the poverty level.

(c) *Grant* is a Federal award of money, or property in lieu of money (including cooperative agreements) to an eligible grantee that must account for its use. The term does not include the provision of technical assistance, revenue sharing, loans, loan guarantees, interest subsidies, insurance, direct appropriations, or any fellowship or other lump sum award.

(d) *Insured depository institution* has the same meaning as in section 3(c) of the Federal Deposit Insurance Act, 12 U.S.C. 1813(c).

(e) *Intermediary* is an entity participating in the Microloan Demonstration Program which makes and services Microloans to eligible small businesses and which provides

marketing, management, and technical assistance to its borrowers. It may be:

(1) A private, nonprofit community development corporation or other entity;

(2) A consortium of private, nonprofit community development corporations or other entities;

(3) A quasi-governmental economic development entity, other than a state, county, municipal government or any agency thereof; or

(4) An agency of or a nonprofit entity established by a Native American Tribal Government.

(f) *Microloan* is a short-term, fixed interest rate loan of not more than $25,000 made by an Intermediary to an eligible small business.

(g) *Non-Federal sources* are sources of funds other than the Federal Government and may include indirect costs or in-kind contributions paid for under non-Federal programs. Community Block Development Grants are considered non-Federal sources.

(h) *Specialized Intermediary* is an Intermediary which maintains a portfolio of Microloans averaging $7,500 or less.

§ 120.702 Are there limitations on who can be an Intermediary or on where an Intermediary may operate?

(a) *Prior experience requirement.* To be eligible to be an Intermediary, an organization must:

(1) Have made and serviced short-term fixed rate loans of not more than $25,000 to newly established or growing small businesses for at least one year; and

(2) Have at least one year of experience providing technical assistance to its borrowers.

(b) *Limitation to one state.* An Intermediary may not operate in more than one state unless the AA/FA determines that it would be in the best interests of the small business community for it to operate across state lines.

§ 120.703 How does an organization apply to become an Intermediary?

(a) *Application Process.* Organizations interested in becoming Intermediaries should contact SBA for information on the application process.

(b) *Documentation in support of application.* The application must include a detailed narrative statement describing:

(1) The types of businesses assisted in the past and those the applicant intends to assist with Microloans;

(2) The average size of the loans made in the past and the average size of intended Microloans;

(3) The extent to which the applicant will make Microloans to small businesses in rural areas;

(4) The geographic area in which the applicant intends to operate, including a description of the economic and demographic conditions existing in the intended area of operations;

(5) The availability and cost of obtaining credit for small businesses in the area;

(6) The applicant's experience and qualifications in providing marketing, management, and technical assistance to small businesses; and

(7) Any plan to use other technical assistance resources (such as counselors from the Service Corps of Retired Executives) to help Microloan borrowers.

§ 120.704 How are applications evaluated?

(a) *Evaluation criteria.* In selecting Intermediaries, SBA will attempt to insure that Microloans are available to small businesses in all industries and particularly to small businesses located in urban and rural areas.

(b) *Preference for organizations which make very small loans.* In selecting Intermediaries, SBA will give priority to applicants which maintain a portfolio of loans averaging $7,500 or less.

(c) *Consideration of quasi-governmental organizations.* Generally, SBA will consider applications by quasi-governmental organizations only when it determines that program services for a particular geographic area would be best provided by such organization.

§ 120.705 What is a Specialized Intermediary?

At the end of an Intermediary's first year of participation in the program, SBA will determine whether it qualifies as a Specialized Intermediary. An Intermediary qualifies as a Specialized Intermediary if it maintains a portfolio of Microloans averaging $7,500 or less. Specialized Intermediaries qualify for more favorable interest rates on SBA loans. If, after the first year, an Intermediary qualifies as a Specialized Intermediary, the special interest rate is applied retroactively to SBA loans made to the Intermediary. After the first year SBA will determine an Intermediary's qualifications as a Specialized Intermediary annually, based on its lending practices during the term of its participation in the program. Specialized Intermediaries also qualify for a greater amount of technical assistance grant funding.

§ 120.706 What are the terms and conditions of an Intermediary SBA loan?

(a) *Loan Amount.* An Intermediary may not borrow more than $750,000 in the first year of participation in the program. In subsequent years, the Intermediary's obligations to SBA may not exceed an aggregate of $2.5 million, subject to statutory limitations on the total amount of funds available per state.

(b) *Repayment terms.* During the first year of the loan, an Intermediary is not required to make any payments, but interest accrues from the date that SBA disburses the loan proceeds to the Intermediary. After that, SBA will determine the periodic payments. The loan must be repaid within 10 years.

(c) *Interest rate.* The interest rate is equal to the rate applicable to five-year obligations of the United States Treasury, adjusted to the nearest one-eighth percent, less 1.25 percent. However, the interest rate for Specialized Intermediaries is equal to the rate applicable to five-year obligations of the United States Treasury, adjusted to the nearest one-eighth percent, less two percent.

(d) *Collateral.* As security for repayment of the SBA loan, an Intermediary must pledge to SBA a first lien position in the MRF (described below), LLRF (described below), and all notes receivable from Microloans.

(e) *Default.* If for any reason an Intermediary is unable to make payment to SBA when due, SBA may accelerate maturity of the loan and demand payment in full. In this event, or if an Intermediary violates this part or the terms of its loan agreement, it must surrender possession of all collateral described in paragraph (d) of this section to SBA. The Intermediary is not obligated to pay SBA any loss or deficiency which may remain after liquidation of the collateral unless the loss was caused by fraud, negligence, violation of any of the ethical requirements of § 120.140, or violation of any other provision of this part.

(f) *Fees.* SBA does not charge Intermediaries any fees for loans under this Program. An Intermediary may, however, pay minimal closing costs to third parties, such as filing and recording fees.

§ 120.707 What conditions apply to loans by Intermediaries to Microloan Borrowers?

(a) *General.* An Intermediary may make Microloans to any small business eligible to receive financial assistance under this part. Proceeds from Microloans may be used only for working capital and acquisition of materials, supplies, furniture, fixtures,

and equipment. SBA does not review Microloans for creditworthiness.

(b) *Amount and maturity.* Generally, Intermediaries should not make a Microloan of more than $10,000 to any borrower. An Intermediary may not make a Microloan of more than $15,000 unless the borrower demonstrates that it is unable to obtain credit elsewhere at comparable interest rates and that it has good prospects for success. An Intermediary may not make a loan of more than $25,000, and no borrower may owe an Intermediary more than $25,000 at any one time. Each Microloan must be repaid within six years.

(c) *Interest rate.* The maximum interest rate that can be charged a Microloan borrower is:

(1) On loans of more than $7,500, the interest rate charged on the SBA loan to the Intermediary, plus 7.75 percentage points; and

(2) On loans of $7,500 or less, the interest rate charged on the SBA loan to the Intermediary, plus 8.5 percentage points.

§ 120.708 What is the Intermediary's financial contribution?

The Intermediary must contribute from non-Federal sources an amount equal to 15 percent of any loan that it receives from SBA. The contribution may not be borrowed. For purposes of this program, Community Development Block Grants are considered non-Federal sources.

§ 120.709 What is the Microloan Revolving Fund?

The Microloan Revolving Fund (''MRF'') is an interest-bearing Deposit Account into which an Intermediary must deposit the proceeds from SBA loans, its contributions from non-Federal sources, and payments from its Microloan borrowers. An Intermediary may only withdraw from this account the money needed to establish the Loan Loss Reserve Fund (§ 120.710), proceeds for each Microloan it makes, and any payments to be made to SBA.

§ 120.710 What is the Loan Loss Reserve Fund?

(a) *General.* The Loan Loss Reserve Fund (''LLRF'') is an interest-bearing Deposit Account which an Intermediary must establish to pay any shortage in the MRF caused by delinquencies or losses on Microloans. An Intermediary must maintain the LLRF until it has repaid all obligations it owes SBA.

(b) *Level of Loan Loss Reserve Fund in first year.* In an Intermediary's first year, the balance on deposit in the LLRF must equal not less than 15 percent of the total outstanding balance of all notes receivable owed by its Microloan borrowers.

(c) *Level of Loan Loss Reserve Fund in subsequent years.* In all subsequent years, an Intermediary must maintain a balance on deposit in the LLRF at a level which, at a minimum, reflects its loss experience as determined by SBA. However, the maximum amount required in the LLRF will not exceed 15 percent of the total outstanding balance owed by an Intermediary's Microloan borrowers.

§ 120.711 What rules govern Intermediaries?

Intermediaries must operate in accordance with applicable statutes, regulations, policy notices, SBA's Standard Operating Procedures (SOPs), and the information in the application.

§ 120.712 How does an Intermediary get a grant to assist Microloan Borrowers?

(a) *General.* An Intermediary is eligible to receive grant funding from SBA of not more than 25 percent of the outstanding balance of all SBA loans to the Intermediary. The Intermediary must contribute, solely from non-Federal sources, an amount equal to 25 percent of the grant. Contributions may be made in cash or in kind.

(b) *Limitations on grant funds.* An Intermediary may not borrow its contribution. It may only use grant funds to provide Microloan borrowers with marketing, management, and technical assistance, except that:

(1) Up to 15 percent of the grant funds may be used to provide information and technical assistance to prospective Microloan borrowers; and

(2) Grant monies may be used to attend training required by SBA. Intermediaries may not enter into third party contracts for the provision of technical assistance to program clients.

(c) *Exception to contribution requirement.* Intermediaries which make at least 50 percent of their loans to small businesses located in or owned by residents of Economically Distressed Areas are not subject to the contribution requirement in paragraph (a) of this section.

(d) *Intermediaries eligible to receive additional grant monies.* An Intermediary may receive an additional SBA grant equal to five percent of the outstanding balance of all loans received from SBA (with no obligation to contribute additional matching funds) if:

(1) The Intermediary makes at least 25 percent of its loans to small businesses located in or owned by residents of an Economically Distressed Area; or

(2) The Intermediary is a Specialized Intermediary.

(e) SBA will determine an Intermediary's eligibility for all grants under this section separately for each loanmaking office or site.

§ 120.713 Does SBA provide technical assistance to Intermediaries?

SBA may procure technical assistance for an Intermediary to improve its knowledge, skill, and understanding of microlending by awarding a grant to a more experienced Intermediary. SBA may also obtain such assistance for prospective Intermediaries in areas of the country that are either not served or underserved by an existing Intermediary.

§ 120.714 How does a non-Intermediary get a grant?

(a) *Grant procedure for non-Intermediaries.* Any nonprofit entity that is not an Intermediary may apply to SBA for a grant to provide marketing, management and technical assistance to low-income individuals for the purpose of assisting them in obtaining private sector financing in amounts of $25,000 or less. To qualify, it must submit information regarding its ability to provide this assistance. If approved, the grant agreement will establish the terms and conditions for the grant.

(b) *Number and amounts of grants.* In each year of the Microloan Program, SBA may make no more than 25 grants to non-Intermediaries for terms of up to five years. A grant may not exceed $125,000.

(c) *Contribution by nonprofit entity.* The nonprofit entity must contribute an amount equal to 20 percent of the grant. The contribution from the nonprofit entity must come solely from non-Federal sources, and may include direct costs or in-kind contributions paid for under non-Federal programs.

§ 120.715 Does SBA guarantee any loans an Intermediary obtains from another source?

(a) SBA may guarantee not less than 90 percent of no more than 10 loans by for-profit or nonprofit entities (or an alliance of such entities) to Intermediaries located in urban areas and no more than 10 loans by such entities to Intermediaries located in Rural Areas (as defined in § 120.10).

(b) Any loan guaranteed by SBA under this section will have a term of 10 years. If an Intermediary receives such a loan, it will not need to repay any principal or interest during the first year, although the interest will accrue. During the second through fifth years, the Intermediary will pay interest only. During the sixth through tenth years, it will pay interest and fully amortize the principal.

(c) The interest rate on any loan under this section shall be calculated as described in § 120.706.

Subpart H—Development Company Loan Program (504)

§ 120.800 What is the purpose of the 504 program?

As authorized by Congress, SBA has established this program to foster economic development, create or preserve job opportunities, and stimulate growth, expansion, and modernization of small businesses.
§ 120.801 How is a 504 Project financed?

(a) A small business may apply for 504 financing through the CDC serving the area in which the 504 Project is located. SBA issues an Authorization if it agrees to guarantee part of the funding for a Project.

(b) Usually, a Project requires interim financing from an interim lender (often the same lender that later provides a portion of the permanent financing).

(c) Generally, permanent financing of the Project consists of:

(1) A contribution by the small business in an amount of at least 10 percent of the Project costs;

(2) A loan made with the proceeds of a CDC Debenture for up to 40 percent of the Project costs and certain administrative costs, collateralized by a second lien on the Project Property; and

(3) A private sector loan comprising the balance of the financing, collateralized by a first lien on the Project property.

(d) The Debenture is guaranteed 100 percent by SBA (with the full faith and credit of the United States), and sold to Underwriters who form Debenture Pools. Investors purchase interests in Debenture Pools and receive Certificates representing ownership of all or part of a Debenture Pool. SBA and CDCs use various agents to facilitate the sale and service of the Certificates and the orderly flow of funds among the parties.

§ 120.802 Definitions.

The following terms have the same meaning wherever they are used in this subpart. Defined terms are capitalized wherever they appear.

Area of Operations is a geographic area in which a CDC conducts its activities.

Associate Development Company (ADC) is an entity approved by SBA to assist CDCs to deliver 504 financing.

Central Servicing Agent (CSA) is an entity that receives and disburses funds among the various parties involved in 504 financing under a master servicing agent agreement with SBA.

Certificate is a document issued by SBA or its agent representing ownership of all or part of a Debenture Pool.

Debenture is an obligation issued by a CDC and guaranteed 100 percent by SBA, the proceeds of which are used to fund a 504 loan.

Debenture Pool is an aggregation of Debentures.

Investor is an owner of a beneficial interest in a Debenture Pool.

Job Opportunity is a full time (or equivalent) permanent job created within two years of receipt of 504 funds, or retained in the community because of a 504 loan.

Net Debenture Proceeds are the portion of Debenture proceeds that finance eligible Project costs (excluding administrative costs).

Project is the purchase or lease, and/or improvement or renovation of long-term fixed assets by a small business, with 504 financing, for use in its business operations.

Project Property is one or more long-term fixed assets, such as land, buildings, machinery, and equipment, acquired or improved by a small business, with 504 financing, for use in its business operations.

Third Party Loan is a loan from a commercial or private lender, investor, or Federal (non-SBA), State or local government source as part of the Project financing.

Underwriter is an entity approved by SBA to form Debenture Pools and arrange for the sale of Certificates.

Certification Procedures To Become a CDC

§ 120.810 Applications for certification as a CDC.

(a) Applicants for certification as a CDC must apply to the SBA District Office serving a proposed Area of Operations. An applicant must demonstrate that it satisfies the certification and operating criteria in §§ 120.820 through 120.829, as well as:

(1) The need for 504 services (if there is already a CDC in the Area of Operations, the applicant must justify the need for another and present a plan to avoid duplication or overlap);

(2) A budget, approved by its Board of Directors; and

(3) A plan to meet CDC operating requirements (without specializing in a particular industry).

(b) The AA/FA, with the recommendation of each District Office in the applicant's proposed Area of Operations, shall make the certification decision.

§ 120.811 Public notice of CDC certification application.

(a) As part of the application process, the applicant must publish a notice in a general circulation newspaper in the proposed Area of Operations, including the name and location of the proposed CDC, its purpose and Area of Operations, and the names and addresses of its officers and directors. The applicant shall send a copy of the notice to SBA. The notice shall provide the public at least 30 days to submit written comments to the District Office. The SBA shall consider the comments in making its decision on the application.

(b) CDCs serving the proposed Area of Operations shall be directly notified and given at least 30 days to comment.

§ 120.812 Probationary period for newly certified CDCs.

(a) Newly certified CDCs will be on probation for a period of two years, at the end of which the CDC must petition for:

(1) Permanent CDC status;

(2) A single, one-year extension of probation; or

(3) ADC status.

(b) SBA will consider failure to file a petition before the end of the probationary period as a withdrawal from the 504 program. If the CDC elects ADC status or withdrawal, it must transfer all funded and/or approved loans to another CDC, SBA, or another servicer approved by SBA.

Requirements for CDC Certification and Operation

§ 120.820 CDC non-profit status.

A CDC must be a non-profit corporation (or limited liability company) in good standing. (For-profit CDCs certified by SBA prior to January 1, 1987 may retain their certifications.) An SBIC may not become a CDC.

§ 120.821 CDC Area of Operations.

A CDC must have a designated Area of Operations, specified by the CDC and approved by SBA. There can be only one statewide CDC in each state, which must foster economic development throughout the state and provide 504 assistance to areas not adequately served by other CDCs.

§ 120.822 CDC membership.

A CDC must have at least 25 members (or stockholders for for-profit CDCs approved prior to January 1, 1987). No person or entity may own or control more than 10 percent of the CDC's voting membership (or stock). Members must be representative of and provide evidence of active support in the Area

of Operations. Members must be from each of the following groups:

(a) Government organizations responsible for economic development in the Area of Operations and acceptable to SBA;

(b) Financial institutions that provide commercial long-term fixed asset financing in the Area of Operations;

(c) Community organizations dedicated to economic development in the Area of Operations such as chambers of commerce, foundations, trade associations, colleges, or universities; and

(d) Businesses in the Area of Operations.

§ 120.823 CDC Board of Directors.

The CDC must have a Board of Directors chosen from the membership by the members, and representing at least three of the four membership groups. No single group shall control. The Board members must be responsible officials of the organizations they represent, and at least one must possess commercial lending experience. The Board must meet at least quarterly and shall be responsible for CDC staff decisions and actions. A quorum shall require at least 5 Directors. If there is a vote on loan approval or servicing actions, at least one Board member with commercial loan experience approved by SBA must be present and vote. As an alternative, the Board may obtain the recommendation of another person approved by SBA and possessing commercial lending experience.

§ 120.824 Professional management and staff.

A CDC must have full-time professional management, including an Executive Director (or the equivalent) managing daily operations. It must also have a full-time professional staff qualified by training and experience to market the 504 Program, package and process loan applications, close loans, service the loan portfolio, and sustain a sufficient level of service and activity in the Area of Operations.

(a) *Contracting out to third parties.* CDCs may obtain, under contract, marketing, packaging, processing, and servicing services from qualified Lender Service Providers, as that term is defined in part 103 of this chapter, located in the Area of Operations, subject to SBA's prior written approval. CDCs may contract for outside legal and accounting services without SBA approval. Compensation under all such contracts must be reasonable and customary for similar services in the Area of Operations. SBA may audit the contracts.

(b) *Contracting out to other CDCs.* CDCs may contract with other CDCs for specific services, subject to SBA's prior written approval.

§ 120.825 Financial ability to operate.

A CDC must be able to sustain its operations continuously, with reliable sources of funds (such as income from services rendered and contributions from government or other sponsors).

§ 120.826 Basic requirements for operating a CDC.

A CDC must operate in accordance with applicable statutes, regulations, policy notices, SBA's SOPs, and the information in its application. It must supply to SBA current and accurate information about all certification and operational requirements, and maintain the records and submit the reports required by SBA.

§ 120.827 Services a CDC provides to small businesses.

(a) A CDC must operate in and adequately service its Area of Operations. It must market the 504 program, package and process 504 loan applications, and close and service 504 loans. A CDC's loan portfolio must be diversified by business sector.

(b) A CDC may provide small businesses with financial and technical assistance, or may help small businesses obtain such assistance from other sources, including preparing, closing, and servicing loans under contract with Lenders in SBA's 7(a) program.

(c) A CDC also may loan amounts to the Borrower equal to the value of all or part of the Borrower's contribution to a Project in the form of cash or land, including site improvements, previously acquired by the CDC.

§ 120.828 Minimum level of CDC lending activity.

A CDC must provide at least two 504 loan approvals each full fiscal year.

§ 120.829 Job Opportunity average a CDC must maintain.

(a) A CDC's portfolio must reflect an average of one Job Opportunity per $35,000 of 504 loan funding. The AA/FA may permit a CDC to average up to one per $45,000 for good cause in:

(1) Alaska;

(2) Hawaii;

(3) State-designated urban or rural jobs and enterprise zones;

(4) Empowerment Zones and Enterprise Communities; and

(5) Labor Surplus Areas listed in the Department of Labor's publication ''Area Trends.''

(b) A CDC must indicate in its annual report the Job Opportunities actually or estimated to be provided by each Project.

(c) If a CDC does not maintain the required average, it may retain its certification if it justifies to SBA's satisfaction its failure to do so in its annual report and shows how it intends to attain the required average.

§ 120.830 Reports a CDC must submit.

A CDC must submit the following reports to SBA:

(a) An annual report within 90 days after the end of the CDC's fiscal year, and such interim reports as SBA may require;

(b) Resumes for all new Associates and staff;

(c) Reports of involvement in any legal proceeding;

(d) Changes in organizational status;

(e) Changes in any condition that affects its eligibility to continue to participate in the 504 program; and

(f) Quarterly service reports on each loan in its portfolio which is 60 days or more past due (and interim reports upon request by SBA).

Extending a CDC'S Area of Operations

§ 120.835 Application to extend an Area of Operations.

SBA may expand a CDC's Area of Operations if the proposed Area of Operation is not being adequately served by existing CDC(s) and the expanding CDC is well-qualified to serve it. A CDC seeking to expand its Area of Operations must apply in writing to the SBA District Office serving the geographic area in which the CDC proposes to expand.

(a) A CDC may submit an application to expand its Area of Operations if the existing CDCs serving the area have not averaged, over the last two years, at least one loan approval per 100,000 of general population in the Area of Operation. The one loan per 100,000 population requirement applies only to the area proposed for expansion, not the entire Area of Operations of the existing CDC or CDCs serving the expanded area.

Example to paragraph (a) of this section. CDC A averages 0.8 loans per 100,000 of general population state-wide, but 1.2 loans per 100,000 in city X. CDC B seeks to expand its Area of Operations only into city X. CDC B's application will be denied without further review because CDC A meets the 1 loan per 100,000 population requirement in the proposed expanded Area of Operation.

(b) The application to expand must demonstrate to the satisfaction of SBA the expanding CDC's ability to provide full service to small businesses in the expanded territory, including processing, closing, servicing, and, if authorized, liquidating 504 loans. The

expanding CDC must also demonstrate in its application that it will have a local presence and representation in the expanded Area of Operations before submitting any 504 loans for approval.

§ 120.836 Public notice and opportunity for response.

SBA will notify all CDCs servicing the proposed area of expansion, allowing at least 30 days for the existing CDCs to respond to the District Office. The expanding CDC also must publish a notice in a general circulation newspaper in the proposed area of expansion, advising of its intent to expand and giving the public at least 30 days to comment to SBA. The burden of proof in opposing the application will be upon the existing CDC or CDCs to show why SBA should not grant the application for extension.

§ 120.837 SBA decision on application for extension.

(a) The SBA District Office may consider any factor presented to it concerning the proposed area of expansion, the expanding CDC and its Area of Operations, and the existing CDC or CDCs serving the area, including the following: number of loan approvals per 100,000 of general population; number of loan approvals per 100,000 of small businesses; the density of small businesses; jobs created and retained; the number of 504 loan closings; the average 504 loan amount; urban, suburban, or rural character of the expanding area; the mix of small businesses; the prevailing economic conditions; servicing record and capabilities; currency rates; loss rates; other services provided to small businesses (technical and financial assistance); relationship with the local SBA office; and ties to and knowledge of the local community and its resources.

(b) The SBA District Office will submit a recommendation, with any supporting materials, within 30 days of the end of the comment period to the AA/FA, who will make the final decision within 30 days of his or her receipt of the District Office's recommendation. In making its decision, SBA will consider all information submitted to it, as well as the currency of the expanding CDC's portfolio, including the default rate.

§ 120.838 Expiration of existing, temporary expansions.

All existing, temporary expansions of Areas of Operation shall expire 6 months after March 1, 1996, unless a CDC applies for permanent expansion before the expiration date.

§ 120.839 Case-by-case extensions.

(a) A CDC may apply to make an individual loan for a Project outside its Area of Operations to the District Office serving the area in which the Project will be located if:

(1) The applicant CDC has previously assisted the business to obtain a 504 loan;

(2) The applicant small business or CDC can document in writing to the AA/FA specific circumstances that would prevent the existing CDC or CDCs serving the area from assisting the business adequately; and

(3) The existing CDC or CDCs serving the area agree to permit the applicant CDC to make the loan.

(b) The applicant CDC must demonstrate that it adequately can service the loan.

(c) The AA/FA may approve the request for good cause shown.

Accredited Lenders Program (ALP)

§ 120.840 Accredited Lenders Program.

The SBA may designate a CDC as an Accredited Lender. SBA will provide an Accredited Lender with expedited loan processing or servicing action.

(a) *Applications.* CDCs may apply to the SBA field office with which it is most active. The SBA office will send its recommendation and the application to the AA/FA for final decision.

(b) *Eligibility.* In order to be eligible to receive Accredited Lender status, a CDC must have been an active participant in the 504 loan program for not less than the preceding 12 months. In evaluating an application to be an Accredited Lender, SBA will consider all relevant factors, including:

(1) The CDC's ability to work with the local SBA office;

(2) The quality of past performance; and

(3) The quality of the loan portfolio, including the default rate.

(c) *Term of designation.* CDCs will be designated as ALPs for a two year period, and are eligible to renew the designation for additional two year periods.

(d) *Suspension and revocation.* The AA/FA may suspend or revoke ALP designation upon written notice stating the reasons therefore at least 10 business days prior to the effective date of the suspension or revocation. Reasons for suspension or revocation may include loan performance unacceptable to SBA or violations of applicable statutes, regulations or published SBA policies and procedures. An ALP may appeal the suspension or revocation made under this section pursuant to the procedures set forth in part 134 of this chapter. The action of the AA/FA shall remain in effect pending resolution of the appeal.

Premier Certified Lenders Program

§ 120.845 Premier Certified Lenders Program.

The SBA has established a pilot program to designate a number of CDCs as Premier Certified Lenders (''PCLPs''), which will be able to process, approve, close and service 504 loans.

(a) *Characteristics.* Loans processed through the PCL Program will be subject to the same loan terms and conditions as other 504 loans, but final approval by SBA will be limited to eligibility of the guarantee.

(b) *Applications.* A CDC may obtain information concerning this program from SBA's Office of Pilot Operations in Washington, D.C. A CDC may apply to the SBA field office with which it is most active. The SBA office will send the application with a recommendation to the AA/FA for final decision.

(c) *Eligibility.* SBA will consider the CDC's ability to work with the local SBA office and the quality of past performance.

(d) *Loss reserve.* A PCLP must establish a loss reserve for its financings under this program, secured by its segregated assets in favor of SBA, in the amount of the PCLP's historic loss rate or 10 percent of its exposure under the PCLP program, whichever is greater. The PCLP must contribute to the loss reserve for each such financing at the times and in the amounts established by law.

(e) *Review.* The SBA shall review a PCLP's financings at least annually.

(f) *Suspension and revocation.* The AA/FA may suspend or revoke PCLP designation upon written notice stating the reasons therefore at least 10 business days prior to the effective date of the suspension or revocation. Reasons for suspension or revocation may include loan performance unacceptable to SBA, failure to meet loss reserve or eligibility criteria, or violations of applicable statutes, regulations or published SBA policies and procedures. A PCLP may appeal the suspension or revocation made under this section pursuant to the procedures set forth in part 134 of this chapter. The action of the AA/FA shall remain in effect pending resolution of the appeal.

(g) *Program period.* On October 1, 1997, the PCLP pilot program ends.

Associate Development Companies (ADCs)

§ 120.850 ADC functions.

(a) An ADC must support local economic development efforts. An ADC

may package, close, and service loans for a CDC under a written contract approved by SBA. Such contracts must meet Service Provider criteria, and specify the rights and responsibilities of the parties (including payment terms). The CDC remains solely responsible to SBA for the processing, closing, and servicing of the loan. It may not charge the Borrower a higher fee because it is using the ADC's services.

(b) An ADC must operate in accordance with statutes, regulations, policy notices, SBA's Standard Operating Procedures (SOPs), and the information in its application. It must supply to SBA current and accurate information about all certification and operational requirements, and maintain the records required by SBA.

§ 120.851 ADC eligibility and operating requirements.

(a) An ADC must demonstrate to SBA and maintain the following:

(1) Adequate management ability;

(2) A Board of Directors meeting at least quarterly and chosen from the membership by the members;

(3) A professional staff, including at least one qualified full-time professional with small business lending experience available during regular business hours; and

(4) A budget or financial statements showing the financial capability and funding to sustain continuing operations.

(b) An ADC may contract out for staff services only if SBA gives prior approval. The contract, subject to SBA audit, may not be self-serving, and compensation must be reasonable and customary.

§ 120.852 Suspension and revocation of ADCs.

SBA may require corrective action, or the AA/FA may suspend or revoke ADC status upon written notice stating the reasons therefore at least 10 business days prior to the effective date of the suspension or revocation. Reasons for suspension or revocation may include violations of applicable statutes, regulations or published SBA policies and procedures. An ADC may appeal the suspension or revocation made under this section pursuant to the procedures set forth in part 134 of this chapter. The action of the AA/FA shall remain in effect pending resolution of the appeal.

Ethical Requirements

§ 120.855 CDC and ADC ethical requirements.

CDCs, ADCs and their Associates must act ethically and exhibit good character. They must meet all of the ethical requirements of § 120.140. In addition, they are subject to the following:

(a) Any benefit flowing to an Associate or his or her employer from activities as an Associate must be merely incidental (this requirement does not prevent an Associate or an Associate's employer from engaging in a business relationship with the CDC and/or the Borrower in the regular course of business, including providing interim financing or Third-Party loans); and

(b) Unless waived by SBA for good cause, an Associate may not be an officer, director, or manager of more than one CDC or ADC (except that the membership or Board of Directors of a broader-based CDC may include a member or director of a local CDC within its Area of Operations).

Project Economic Development Goals

§ 120.860 Required objectives.

A Project must achieve at least one of the economic development objectives set forth in § 120.861 or § 120.862.

§ 120.861 Job creation or retention.

A Project must create or retain one Job Opportunity for every $35,000 guaranteed by SBA.

§ 120.862 Other economic development objectives.

A Project that achieves any of the following community development or public policy goals is eligible if the CDC's overall portfolio of 504 loans, including the subject loan, meets or exceeds the CDC's required Job Opportunity average. Loan applications must indicate how the Project will meet the specified economic development objective.

(a) Community Development goals:

(1) Improving, diversifying or stabilizing the economy of the locality;

(2) Stimulating other business development;

(3) Bringing new income into the community;

(4) Assisting manufacturing firms (Standard Industrial Classification Manual (SIC) Codes 20–49); or

(5) Assisting businesses in Labor Surplus Areas as defined by the Department of Labor.

(b) Public Policy goals:

(1) Revitalizing a business district of a community with a written revitalization or redevelopment plan;

(2) Expanding exports;

(3) Expanding Minority Enterprise development (*See* § 124.103(b) of this chapter);

(4) Aiding rural development;

(5) Increasing productivity and competitiveness (retooling, robotics, modernization, competition with imports);

(6) Modernizing or upgrading facilities to meet health, safety, and environmental requirements; or

(7) Assisting businesses affected by Federal budget reductions, including base closings, either because of the loss of Federal contracts or the reduction in revenues due to a decreased Federal presence.

Leasing Policies Specific to 504 Loans

§ 120.870 Leasing Project Property.

(a) A Borrower may use the proceeds of a 504 loan to acquire, construct, or modify buildings and improvements, and/or to purchase and install machinery and equipment located on land leased to the Borrower by the CDC or an unrelated lessor if:

(1) The remaining term of the lease, including options to renew, exercisable solely by the lessee, equals or exceeds the term of the Debenture, or, in the case of machinery or equipment, equals or exceeds the useful life of the property or the term of the Debenture, whichever is lesser;

(2) The Borrower assigns its interest in the lease to the CDC with right of reassignment to SBA; and

(3) The 504 loan is secured by a recorded lien against the leasehold estate and other collateral as necessary.

(b) If a CDC leases property to a small business, the rent paid by the small business during the term of the Debenture must be enough to pay principal and interest on all debt incurred by the CDC to finance the Project, and all related expenses. The rent also may include a reasonable return on the CDC's investment.

§ 120.871 Leasing part of an existing building to another business.

(a) The costs of interior finishing of space to be leased out to another business are not eligible Project costs.

(b) Third-party loan proceeds used to renovate the leased space do not count towards the 504 first mortgage requirement or the Borrower's contribution.

Loan-Making Policies Specific to 504 Loans

§ 120.880 Basic eligibility requirements.

In addition to the eligibility requirements specified in subpart A, to be an eligible Borrower for a 504 loan, a small business must:

(a) Use the Project Property (except that an Eligible Passive Company may lease to an Operating Company); and

(b) Together with its affiliates, meet one of the following size standards:

(1) It does not have a tangible net worth in excess of $6 million, and does not have an average net income after Federal income taxes (excluding any carry-over losses) for the preceding two years in excess of $2 million; or

(2) It meets the size standards in Part 121 of this chapter for the industry in which it is primarily engaged.

§ 120.881 Ineligible Projects for 504 loans.

In addition to the ineligible businesses and uses of proceeds specified in subpart A of this part, the following Projects are ineligible for 504 financing:

(a) Relocation of any of the operations of a small business which will cause a net reduction of one-third or more in the workforce of a relocating small business or a substantial increase in unemployment in any area of the country, unless the CDC can justify the loan because:

(1) The relocation is for key economic reasons and crucial to the continued existence, economic wellbeing, and/or competitiveness of the applicant; and

(2) The economic development benefits to the applicant and the receiving community outweigh the negative impact on the community from which the applicant is moving; and

(b) Projects in foreign countries (loans financing real or personal property located outside the United States or its possessions).

§ 120.882 Eligible Project costs for 504 loans.

Eligible Project costs which may be paid with the proceeds of 504 loans are:

(a) Costs directly attributable to the Project including expenditures incurred by the Borrower (with its own funds or from a loan):

(1) To acquire land used in the Project prior to applying to SBA for the 504 loan; or

(2) For any other expense toward a Project within nine months prior to receipt by SBA of a complete loan application, unless the time limit is extended or waived by SBA for good cause;

(b) In Projects involving construction, a contingency reserve for cost overruns not to exceed 10 percent of construction cost;

(c) Professional fees directly attributable and essential to the Project, such as title insurance, architecture, engineering, accounting, environmental studies, and legal fees (other than legal fees associated with the closing); and

(d) Repayment of interim financing including points, fees and interest.

§ 120.883 Eligible administrative costs for 504 loans.

The following costs and fees are not part of Project costs but may be paid with the proceeds of the 504 loan and the Debenture (see § 120.971):

(a) SBA guarantee fee;

(b) Funding fee (to cover the cost of a public issuance of securities and the Trustee);

(c) CDC processing fee;

(d) Closing costs, other than legal fees; and

(e) Underwriters fee.

§ 120.884 Ineligible costs for 504 loans.

Costs not directly attributable and necessary for the Project may not be paid with proceeds of the 504 loan. These include, but are not limited to, the following:

(a) Debt refinancing (other than interim financing).

(b) Third-Party Loan fees (commitment, broker, finders, origination, processing fees of permanent financing).

(c) Ancillary business expenses, such as:

(1) Working capital;

(2) Counseling or management services fees;

(3) Incorporation/organization costs;

(4) Franchise fees; and

(5) Advertising.

(d) Fixed-asset Project components, such as:

(1) Short-term equipment, furniture, and furnishings (unless essential to and a minor portion of the Project);

(2) Automobiles, trucks, and airplanes; and

(3) Construction equipment (except for heavy duty construction equipment integral to a business' operations and meeting the IRS definition of capital equipment).

(e) Closing legal fees.

Interim Financing

§ 120.890 Source of interim financing.

A Project may use interim financing for all Project costs except the Borrower's contribution. Any source (including a CDC) may supply interim financing provided:

(a) The financing is not derived from any SBA program, directly or indirectly;

(b) The terms and conditions of the financing are acceptable to SBA;

(c) The source is not the Borrower or an Associate of the Borrower; and

(d) The source has the experience and qualifications to monitor properly all Project construction and progress payments. (If the source lacks such experience or qualifications, SBA may require the interim loan to be managed by a third party such as a bank or professional construction manager.)

§ 120.891 Certifications of disbursement and completion.

Before the Debenture is issued, the interim lender must certify the amount disbursed. The CDC must certify that the Project was completed in accordance with the final plans and specifications (except as provided in § 120.961).

§ 120.892 Certifications of no adverse change.

Following completion of the Project, the following certifications must be made before the 504 loan closing:

(a) The interim lender must certify to the CDC that it has no knowledge of any unremedied substantial adverse change in the condition of the small business since the application to the interim lender;

(b) The Borrower (or Operating Company) must certify to the CDC that there has been no unremedied substantial adverse change in its financial condition or its ability to repay the 504 loan since the date of application, and must furnish interim financial statements, current within 90 days of closing; and

(c) The CDC must issue an opinion to the best of its knowledge that there has been no unremedied substantial adverse change in the Borrower's (or Operating Company's) ability to repay the 504 loan since its submission of the loan application to SBA.

Permanent Financing

§ 120.900 What are the sources of permanent financing?

Permanent financing for each Project must come from three sources: the Borrower's contribution, Third-Party Loans, and the 504 loan. Typically, the Borrower contributes 10 percent of the permanent financing, Third-Party Loans 50 percent and the 504 loan 40 percent.

The Borrower's Contribution

§ 120.910 How much must the Borrower contribute?

The Borrower must contribute to the Project cash (or property acceptable to SBA obtained with the cash) or land (that is part of the Project Property) valued at 10 percent or more of the Project cost (exclusive of administrative cost). The source of the contribution may be a CDC or any other source except an SBA business loan program (*see* § 120.913 for SBIC exception).

§ 120.911 Land contributions.

The Borrower's contribution may be land (including buildings, structures and other site improvements which will be part of the Project Property)

previously acquired by the Borrower or the CDC.

§ 120.912 Borrowed contributions.

The Borrower may borrow its cash contribution from the CDC or a third party. If any of the contribution is borrowed, the interest rate must be reasonable. If the loan is secured by any of the Project assets, the loan must be subordinate to the liens securing the 504 Loan, and the loan may not be repaid at a faster rate than the 504 Loan unless SBA gives prior written approval. A third party lender may not receive voting rights, stock options, or any other actual or potential voting interest in the small business.

§ 120.913 May an SBIC provide the contribution?

Subject to part 107 of this chapter, SBIC's may provide financing for all or part of the Borrower's contribution to the project. SBA shall consider SBIC funds to be derived from federal sources if the SBIC has leverage (as defined in part 107 of this chapter). If the SBIC does not have leverage, the investment will be considered to be from private funds. SBIC financing must be subordinated to the 504 loan and may not be repaid at a faster rate than the Debenture.

Third Party Loans

§ 120.920 The first lien position.

The Borrower must obtain one or more Third Party Loans totaling at least as much as the 504 loan. Third Party Loans usually have the first lien position. They cannot be guaranteed by SBA.

§ 120.921 Terms of Third Party loans.

(a) Maturity. A Third Party Loan must have a term of at least 7 years when the 504 loan is for a term of 10 years and 10 years when the 504 loan is for 20 years. If there is more than one Third Party Loan, an overall loan maturity must be calculated, taking into account the maturities and amounts of each loan. If there is a balloon payment, it must be justified in the loan report and clearly identified in the Loan Authorization.

(b) *Interest rates.* Interest rates must be reasonable. SBA must establish and publish in the Federal Register a maximum interest rate for any Third Party Loan from commercial financial institutions. The rate shall remain in effect until changed.

(c) *Other terms.* The Third Party Loan must not have any early call feature or contain any demand provisions unless the loan is in default. By participating, a Third Party Loan lender waives, as to the CDC/SBA financing, any provision in its deed of trust, or mortgage, or other documents prohibiting further encumbrances or subordinate debt. In the event of default, the Third Party Lender must give the CDC and SBA written notice of default within 30 days of the event of default and at least 60 days prior to foreclosure.

(d) *Subordination.* A Third-Party Loan lienholder must subordinate to the CDC/SBA lien any future advance in excess of the outstanding principal balance and accrued interest of the Third Party Loan at the time of such advance except expenditures for collection, maintenance, and protection of the Third Party Loan lienholder's lien position.

(e) *Escalation upon default.* A Third-Party Lender may not escalate the rate of interest upon default to an amount greater than the maximum rate set forth in paragraph (b) of this section.

§ 120.922 Pre-existing debt on the Project Property.

In addition to its share of Project cost, a Third-Party Loan may include consolidation of existing debt on the Project Property. The consolidation must not improve the lien position of the Lender on the pre-existing debt, unless the debt is a previous Third-Party Loan.

§ 120.923 What are the policies on subordination?

(a) Financing provided by the seller of Project Property must be subordinate to the 504 loan. SBA may waive the subordination requirement if the property is classified as ''other real estate owned'' by a national bank or other Federally regulated lender and SBA considers the property to be of sufficient value to support the 504 loan.

(b) A Borrower is eligible for a 504 loan even if part of the Project financing is tax-exempt. SBA's lien position must not be subordinate to loans made from the proceeds of the tax-exempt obligation.

§ 120.924 Prepayment of subordinate financing.

The Borrower must not prepay any Project financing subordinate to the 504 loan without SBA's prior written consent.

§ 120.925 Preferences.

No Third Party Lender shall establish a Preference.

§ 120.926 Referral fee.

The CDC may receive a referral fee from the Third Party Lender if the CDC secured the lender for the Borrower under a written contract. The Borrower cannot pay this fee. If a CDC charges a referral fee, the CDC will be construed as a Referral Agent under part 103 of this chapter.

504 Loans and Debentures

§ 120.930 Amount.

(a) Generally, a 504 loan may not exceed 40 percent of total Project cost plus 100 percent of eligible administrative costs. For good cause shown, SBA may authorize an increase in the percentage of Project costs covered up to 50 percent. No more than 50 percent of eligible Project costs can be from Federal sources, whether received directly or indirectly through an intermediary.

(b) Generally, the minimum 504 loan must be $50,000, although, upon good cause shown, SBA may permit a 504 loan as small as $25,000. The amount of the Debenture must equal the amount of the 504 Loan plus administrative costs.

(c) Upon completion of the Project, the Debenture amount will be reduced by the amount that the unused contingency reserve exceeds 2 percent of the anticipated Debenture.

§ 120.931 504 lending limits.

The outstanding balance of all SBA financial assistance to a Borrower and its affiliates under the 504 program covered by this Part must not exceed $750,000 ($1,000,000 if one or more of the public policy goals enumerated in § 120.862(b) applies to the Project).

§ 120.932 Interest rate.

The interest rate of the 504 Loan and the Debenture which funds it is set by the SBA and approved by the Secretary of the Treasury.

§ 120.933 Maturity.

The term of a 504 Loan and the Debenture which funds it shall be either 10 or 20 years.

§ 120.934 Collateral.

The CDC/SBA takes a junior lien position (usually a second lien) on the Project collateral. In rare circumstances, collateral other than the Project collateral may be accepted by SBA. Sometimes secondary collateral is required. All collateral must be insured against such hazards and risks as SBA may require, with provisions for notice to SBA and the CDC in the event of impending lapse of coverage.

§ 120.935 Deposit.

At the time of application for a 504 loan, the CDC may require a deposit from the Borrower of $2,500 or 1 percent of the Net Debenture Proceeds, whichever is less. The deposit may be

applied to the loan processing fee if the application is accepted, but must be refunded if the application is denied. If the small business withdraws its application, the CDC may deduct from the deposit reasonable costs incurred in packaging and processing the application.

§ 120.936 Subordination to CDC.

SBA, in its sole discretion, may permit subordination of the Debenture to any other obligation of the CDC, except debt incurred by the CDC to obtain funds to loan to the Borrower for the Borrower's required contribution to the Project financing.

§ 120.937 Assumption.

A 504 loan may be assumed with SBA's prior written approval. § 120.938 Default.

(a) Upon occurrence of an event of default specified in the 504 note which requires automatic acceleration, the note becomes due and payable. Upon occurrence of an event of default which does not require automatic acceleration, SBA may forbear acceleration of the note and attempt to resolve the default. If the default is not cured subsequently, the note shall be accelerated. In either case, upon acceleration of the note, the Debenture which funded it is also due immediately, and SBA must honor its guarantee of the Debenture. SBA shall not reimburse the investor for any premium paid.

(b) If a CDC defaults on a Debenture, SBA generally shall limit its recovery to the payments made by the small business to the CDC on the loan made from the Debenture proceeds, and the collateral securing the defaulted loan. However, SBA will look to the CDC for the entire amount of the Debenture in the case of fraud, negligence, or misrepresentation by the CDC.

§ 120.939 Borrower prohibition.

Neither a Borrower nor an Associate of the Borrower may purchase an interest in a Debenture Pool in which the Debenture that funded its 504 loan has been placed.

§ 120.940 Prepayment of the 504 loan or Debenture.

The Borrower may prepay its 504 loan, if it pays the entire principal balance, unpaid interest, any unpaid fees, and any prepayment premium established in the note. If the Borrower prepays, the CDC must prepay the corresponding Debenture with interest and premium. If one of the Debentures in a Debenture Pool is prepaid, the Investors in that Debenture Pool must be paid pro rata, and SBA's guarantee on the entire Debenture Pool must be proportionately reduced. If the entire Debenture Pool is paid off, SBA may call all Certificates backed by the Pool for redemption.

§ 120.941 Certificates.

(a) The face value of a Certificate must be at least $25,000. Certificates are issued in registered form and transferred only by entry on the central registry maintained by the Trustee. SBA guarantees the timely payment of principal and interest on the Certificates.

(b) Before the sale of a Certificate, the seller, or the broker or dealer acting as the seller's agent, must disclose to the purchaser the terms, conditions, yield, and premium and other characteristics not guaranteed by SBA.

Debenture Sales and Service Agents

§ 120.950 SBA and CDC must appoint agents.

SBA and the CDC must appoint the following agents to facilitate the sale and service of the Certificates and disbursement of the proceeds.

§ 120.951 Selling agent.

The CDC, with SBA approval, shall appoint a Selling Agent to select underwriters, negotiate the terms and conditions of Debenture offerings with the underwriters, and direct and coordinate Debenture sales.

§ 120.952 Fiscal agent.

SBA shall appoint a Fiscal Agent to assess the financial markets, minimize the cost of sales, arrange for the production of the Offering Circular, Debenture Certificates, and other required documents, and monitor the performance of the Trustee and the underwriters.

§ 120.953 Trustee.

SBA must appoint a Trustee to:

(a) Issue Certificates;

(b) Transfer the Certificates upon resale in the secondary market;

(c) Maintain physical possession of the Debentures for SBA and the Certificate holders;

(d) Establish and maintain a central registry of:

(1) Debenture Pools, including the CDC obligors and the interest rate payable on the Debentures in each Pool;

(2) Certificates issued or transferred, including the Debenture Pool backing the Certificate, name and address of the purchaser, price paid, the interest rate on the Certificate, and fees or charges assessed by the transferror; and

(3) Brokers and dealers in Certificates, and the commissions, fees or discounts granted to the brokers and dealers;

(e) Receive semi-annual Debenture payments and prepayments;

(f) Make regularly scheduled and prepayment payments to Investors; and

(g) Assure before any resale of a Debenture or Certificate is recorded in the registry that the seller has provided the purchaser a written disclosure statement approved by SBA.

§ 120.954 Central Servicing Agent.

(a) SBA has entered into a Master Servicing Agreement designating a Central Servicing Agent (CSA) to support the orderly flow of funds among Borrowers, CDCs, and SBA. The CDC and Borrower must enter into an individual Servicing Agent Agreement with the CSA for each 504 loan, constituting acceptance by the CDC and the Borrower of the terms of the Master Servicing Agreement.

(b) The CSA has established a master reserve account. All funds related to the 504 loans and Debentures flow through the master reserve account under the provisions of the Master Servicing Agreement. The master reserve account will be funded by a guarantee fee, a funding fee to be published from time to time in the Federal Register, and by principal and interest payments of 504 loans. At SBA's direction, the CSA may use funds in the master reserve account to defray program expenses. In the event a Borrower defaults and its 504 note is accelerated, SBA shall add funds under its guarantee to ensure the full and timely payment of the Debenture which funded the 504 loan. At SBA's direction, the CSA must pay to the CDC servicing each loan the interest accruing in the master reserve account on loan payments made by each Borrower between the date of receipt of each monthly payment and the date of disbursement to investors. The CSA may disburse such interest periodically to CDCs on a pro rata basis. SBA may use interest accruals in the master reserve account earned prior to October 1991 (not previously distributed to the CDCs) for the costs of 504 program administration.

§ 120.955 Agent bonds and records.

(a) Each agent (in §§ 120.951 through 120.954) must provide a fidelity bond or insurance in such amount as necessary to fully protect the interest of the government.

(b) SBA must have access at the agent's place of business to all books, records and other documents relating to Debenture activities.

§ 120.956 Suspension or revocation of brokers and dealers.

The AA/FA may suspend or revoke the privilege of any broker or dealer to

participate in the sale or marketing of Debentures and Certificates for actions or conduct bearing negatively on the broker's fitness to participate in the securities market. SBA must give the broker or dealer written notice, stating the reasons therefore, at least 10 business days prior to the effective date of the suspension or revocation. A broker or dealer may appeal the suspension or revocation made under this section pursuant to the procedures set forth in part 134 of this chapter. The action of the AA/FA will remain in effect pending resolution of the appeal. SBA may suspend or revoke the opportunity for a hearing under part 134 of this chapter.

Closings

§ 120.960 Responsibility for closing.

The CDC is responsible for the 504 Loan closing. The Debenture closing is the joint responsibility of the CDC and SBA.

§ 120.961 Construction escrow accounts.

The CSA, title company, CDC attorney, or bank may hold Debenture proceeds in escrow to complete Project components such as landscaping and parking lots, and acquire machinery and equipment if the component or acquisition is a minor portion of the total Project and has been contracted for completion or delivery at a specified price and specific future date. The escrow agent must disburse funds upon approval by the CDC and the SBA, supported by invoices and payable jointly to the small business and the designated contractor.

Servicing and Fees

§ 120.970 Servicing of 504 loans and Debentures.

The CDC must service the 504 loan in accordance with the Loan Authorization, these regulations, SBA policies and procedures, and prudent lending standards until paid in full, including review of the small business's financial statements, tax filings, insurance, and security filings. In doing so, CDCs must comply with the provisions of § 120.513. In addition, CDCs must comply with the servicing requirements set forth in SBA's SOP. CDCs must report promptly to SBA any adverse trend, condition or information relevant to a Borrower. Upon request by a CDC, SBA may agree to defer a Borrower's monthly payment. SBA may negotiate agreements with CDCs to liquidate loans.

§ 120.971 Allowable fees paid by Borrower.

(a) *CDC fees.* CDCs may charge the following fees to the Borrower:

(1) *Processing fee.* The CDC may charge up to 1.5 percent of the net Debenture proceeds to process the financing. Two-thirds of this fee will be considered earned and may be collected by the CDC when the Authorization for the Debenture is issued by SBA. The portion of the processing fee paid by the Borrower may be reimbursed from the Debenture proceeds;

(2) *Closing fee.* The CDC may charge a fee to cover an amount sufficient to reimburse it for reasonable legal expenses of in-house or outside legal counsel. The CDC may also charge a fee to cover reasonable miscellaneous closing costs. Closing costs, other than legal fees, may be funded out of the Debenture proceeds;

(3) *Servicing fee.* The CDC will charge a monthly servicing fee of not less than 0.5 percent per annum nor more than 2 percent per annum on the unpaid balance of the loan as determined at five-year anniversary intervals. A servicing fee in excess of 1.5 percent in a Rural Area and 1 percent everywhere else requires SBA's prior written approval, based on evidence of substantial need. The servicing fee may be paid only from loan payments received. The fees may be accrued without interest and collected from the CSA when the payments are made;

(4) *Late fees.* Loan payments received after the 15th of each month may be subject to a late payment fee of 5 percent of the late payment or $100, whichever is greater. These fees will be collected by the CSA on behalf of the CDC; and

(5) *Assumption fee.* Upon SBA's written approval, a CDC may charge an assumption fee not to exceed 1 percent of the outstanding principal balance of the loan being assumed.

(b) *CSA fees.* The CSA may charge an initiation fee on each loan and a monthly servicing fee under the terms of the Master Servicing Agreement.

(c) *Other agent fees.* Agent fees and charges necessary to market and service Debentures and Certificates may be assessed to the Borrower or the investor. The fees must be approved by SBA and published periodically in the Federal Register.

(d) *SBA fees.* (1) SBA charges a 0.5 percent guarantee fee on the Debenture.

(2) For those loans approved after October 1, 1995, SBA charges a fee of 0.125 per annum on the unpaid principal balance of the loan as determined at five-year anniversary intervals.

(e) *Miscellaneous fees.* A funding fee not to exceed 0.25 percent of the Debenture may be charged to cover costs incurred by the trustee, fiscal agent, transfer agent.

§ 120.972 Oversight and evaluation of CDCs and ADCs.

SBA may conduct an operational review of a CDC or ADC. The SBA Office of Inspector General may conduct, supervise or coordinate audits pursuant to the Inspector General Act. The CDC or ADC must cooperate and make its staff, records, and facilities available.

CDC Transfer, Suspension and Revocation

§ 120.980 Transfer of CDC to ADC status.

SBA shall transfer to ADC status any CDC that fails to meet the activity level required by SBA, on average over two consecutive fiscal years. SBA shall notify the CDC in writing of the action and of the opportunity for a hearing pursuant to part 134 of this chapter at least 10 business days prior to the transfer. During the pendency of a hearing, SBA's action will remain in effect.

§ 120.981 Voluntary transfer and surrender of CDC certification.

A CDC may not transfer its certification or withdraw from the 504 program without SBA's consent. The CDC must provide a plan to SBA to transfer its portfolio. The portfolio may only be transferred with SBA's written consent. If a CDC desires to withdraw from the 504 program, it must forfeit its portfolio to SBA. SBA may conduct an audit of the transferring or withdrawing CDC.

§ 120.982 Correcting CDC servicing deficiencies.

SBA may require corrective action, including the transfer of existing or pending financings to another CDC in good standing. SBA must notify the CDC in writing of any servicing, reporting or collection deficiencies and the corrective actions to be taken. SBA may instruct the CSA to withhold service and late fees and may assess the CDC up to $250 per day for expenses incurred by SBA to correct the deficiencies. If non-compliance continues for 90 days, SBA may take the fees as compensation for its efforts to obtain compliance.

§ 120.983 Transfer of CDC servicing to SBA or another CDC.

If a CDC fails to correct servicing deficiencies, or is unable or unwilling to service its portfolio, SBA may assume the servicing or require the transfer of all or part of the CDC's portfolio to

another CDC within or adjoining the deficient CDC's Area of Operations. If there is no suitable CDC, SBA may approve a transfer to another entity. Future service fees from transferred loans will be paid to the transferee. In addition, the CDC's processing authority will be temporarily suspended.

§ 120.984 Suspension or revocation of CDC certification.

(a) *Suspend or revoke.* The AA/FA may suspend or revoke the CDC's certification if a CDC:

(1) Violates a statute, an SBA regulation, or the terms of a Debenture, authorization, or agreement with SBA;

(2) Makes a material false statement, knowingly misrepresents, or fails to state a material fact;

(3) Fails to maintain good character;

(4) Fails to operate according to prudent lending standards;

(5) Fails to correct servicing, collection, reporting, or other deficiencies; or

(6) Is unable or unwilling to operate in accordance with the requirements of this part.

(b) *Transfer portfolio.* Upon suspension or revocation, the CDC must transfer its remaining portfolio and any 504 applications or financings in process to another CDC designated or approved by SBA. If a pending 504 financing is completed after a transfer, any deposit must also be transferred. Any fees must be apportioned by SBA between the two CDCs in proportion to services performed.

(c) *Provide written notice.* SBA must give written notice to the CDC at least 10 business days prior to the effective date of a suspension or revocation, informing the CDC of the opportunity for a hearing pursuant to part 134 of this chapter.

Enforceability of 501, 502 and 503 Loans and Other Laws

§ 120.990 501, 502, and 503 loans.

SBA has discontinued loan programs for 501, 502, and 503 loans. Outstanding loans remain under these programs, and Borrowers, CDCs, and SBA must comply with the terms and conditions of the corresponding notes and Debentures, and the regulations in this part in effect when the obligations were undertaken or last in effect, if applicable.

§ 120.991 Effect of other laws.

No State or local law may preclude or limit SBA's exercise of its rights with respect to notes, guarantees, Debentures and Debenture Pools, or of its enforcement rights to foreclose on collateral.

PARTS 108, 116, 122, and 131—[REMOVED]

2. Parts 108, 116, 122, and 131 are removed.

Dated: January 22, 1996.

John T. Spotila,

Acting Administrator.

[FR Doc. 96–1432 Filed 1–30–96; 8:45 am]

BILLING CODE 8025–01–P

13 CFR Part 115

Surety Bond Guarantee

AGENCY: Small Business Administration (SBA).

ACTION: Final rule.

SUMMARY: This final rule revises the regulations found at 13 CFR Part 115, governing the Surety Bond Guarantee (SBG) Program. It eliminates inconsistencies, clarifies procedures, accommodates program experience and industry changes, and provides for more efficient program operation. It also clarifies and shortens regulations where appropriate, eliminates redundant provisions, consolidates and reorganizes sections, and clarifies ambiguous language.

EFFECTIVE DATE: This final rule is effective March 1, 1996.

FOR FURTHER INFORMATION CONTACT: Barbara Brannan, Office of Surety Guarantees, (202) 205–6540.

SUPPLEMENTARY INFORMATION: In response to a Memorandum from President Clinton for all federal agencies to simplify their regulations, SBA published a proposed rule on November 27, 1995, to revise the regulations governing the Surety Bond Guarantee Program. See 60 FR 58263 (November 27, 1995). The public was afforded a thirty-day period in which to submit comments on the proposed rule to SBA. During that period, SBA received 12 comment letters. After giving careful consideration to the concerns raised in those letters, SBA is today finalizing the proposed rule with certain modifications discussed below.

General Comments

Those comment letters that addressed the proposed renumbering and reorganization of Part 115 commended the rewrite for its clarity and comprehensibility. Those aspects of the proposed rule are being finalized as proposed. In this final rule, SBA has continued its effort to simplify Part 115 by creating smaller sections out of the largest proposed section (§ 115.60). Subsequent sections (§§ 115.61 through 115.64) have been renumbered to accommodate this change.

Definitions—Contract, etc.

All three of the comments received on the proposed change to the definition of ''contract'' objected to the exclusion of maintenance agreements covering defective materials. Under the proposal, a maintenance agreement covering defective workmanship would be considered a contract, but a maintenance agreement covering defective materials would not. It was argued in the comments that the typical maintenance agreement in use today covers both defective workmanship and defective materials. On reconsideration, SBA agrees that the definition of contract should permit coverage of defective materials since that accords with standard practice in the industry today. The definition is finalized accordingly. The final version also clarifies that maintenance agreements of longer than two years duration can be considered contracts if they meet the requirements set forth in the definition.

A new defined term has also been added to the final rule: ''final bond''. The term means a performance bond and/or a payment bond. This is one of several non-substantive changes SBA is making in the final rule to make the regulations clearer.

Eligibility of Payment Bonds

Proposed § 115.12(b) would have allowed payment bonds to be guaranteed by SBA only if performance bonds were issued at the same time. As four comment letters pointed out, recent amendments to the Miller Act eliminate the bonding requirement for federal contracts of less than $100,000, but allow for certain alternatives to protect subcontractors and suppliers against non-payment by the general contractor. As one alternative, the contracting officer may require a payment bond on the contract. Under SBA's proposed change to § 115.12(b), contractors in the SBG Program would have been unable to bid on those small public contracts that require payment bonds only.

Given the recent Miller Act changes, SBA agrees that payment bonds should not automatically be considered ineligible for guaranteed bonding when no performance bond is issued. The final version of § 115.12(b), therefore, does not restrict the eligibility of payment bonds. However, SBA does not intend to guarantee payment bonds that are essentially forfeiture bonds. If a payment bond allows the claimant to receive the full amount of the bond from the surety regardless of the amount of the damage or loss the claimant has