



*Office of Financial Assistance  
Updates*

---

**SOP 50 10 5 (J)**  
**October 23, 2017**

# UPCOMING EVENTS/WEBINARS

---

## SOP 50 10 5 (J) Webinars

Nov. 8<sup>th</sup> 2:30 – 4:00 p.m. ET

Dec. 6<sup>th</sup> 2:30 – 4:00 p.m. ET

## SBA Connect Call

December 12<sup>th</sup> 2:30 – 4:00 p.m. ET



# ETRAN Updates

---

## SOP 50 10 5 (J) – Chapter 4

- Certified Development Companies use the 504 ETRAN system to submit all 504 loan applications.
- CDCs may choose to either use a vendor solution that integrates with the Capital Access Financial System (CAFS) loan platform or manually use the ETRAN web screens to submit all 504 loan applications and all attachments (including SBA Form 159(504)) electronically via E-Tran to the SLPC.
- Documents greater than 250MB must be separated into multiple documents. The system does not support uploads greater than 250MB.
- Detailed guidance on the ETRAN submission process can be found in the 504 ETRAN User Guide for Submitting Loan Applications, posted on SBA's website.

# SOP 50 10 5 (J) Updates

---

## Case-by-case Exceptions

Now included in the SOP, Case-by-case exceptions regarding Area of Operations no longer go through District offices. They are only submitted to SLPC. All other conditions of 13 CFR 120.839 apply.

## Management waivers

for rural CDCs may be with another CDC anywhere in the region or in an adjacent state.

# SOP 50 10 5 (J) Updates

---

## ❑ Special Purpose Property Updates

Effective January 1, 2018, SBA require 15% for the first special purpose property project to a small business borrower, and 20% equity injection for each subsequent special purpose property project to the same borrower.

If the borrower had a prior special purpose property funded prior to January 1, 2018 with a 15% equity injection, then their subsequent 504 loan requests for special purpose properties will require 20% equity injection.

# SOP 50 10 5 (J) Updates

---

## ❑ **Limit on Energy Public Policy Projects**

Energy Public Policy Projects (EPP) are now limited to no more than \$16.5 million in the aggregate per borrower

If a small business borrower already has more than \$16.5 million in 504 EPP loans funded prior to January 1, 2018, they are ineligible for further 504 loan applications under this public policy. If the small business borrower has not reached the maximum of \$16.5 million, it does not mean that each project is automatically eligible.

Also, SLPC may recommend that a borrower be eligible for less than \$16.5 million in EPP loans based on their underwriting analysis.

# SOP 50 10 5 (J) Updates

- 
- ❑ **New business definition - redefined “start date” of a new business as the date the small business begins generating revenue.**

“P. New Business is a business that has been in operations for 2 years or less at the time the loan is approved. A business that has been in operation for more than 2 years at the time the loan is approved may be considered a New Business if it is a change of ownership that will result in new, unproven ownership/management and increased debt unrelated to business operations. If there is a change of ownership, the CDC must review the management and level of debt and make a determination whether an additional borrower’s contribution of 5% is necessary. Operations are deemed to begin when the business begins generating revenue from its intended operations.”



# SOP 50 10 5 (J) Updates

---

- ❑ **Passive business update (13 CFR § 120.110(c))**
  - Owner occupancy required
  - Developers ineligible
  - Leasing entire facilities ineligible
  - Leasing land ineligible
  - Management agreements – must be reviewed
  - Residential leasing ineligible



# SOP 50 10 5 (J) Updates

---

## ❑ 504 Refinance Program Updates

CDCs had concerns that the nomenclature in the last policy update of the 504 Debt Refinance was confused.

SBA has removed the terms “Other Secured Debt” and “Business Operating Expenses”. We will only be using our previously defined terms of “Qualified Debt” and “Eligible Business Expenses”.

The cap on Eligible Business was reduced from 25% to 20%.

# SOP 50 10 5 (J) Updates

---

## ❑ **Borrower guarantees <5% when appropriate**

On August 20, 2017 SBA announced, and effective September 20, 2017, SBA now may, when appropriate, require guarantees from borrowers with less than 5% ownership.

This has now been incorporated into SOP 50 10 5 (J).

# SOP 50 10 5 (J) Updates

---

SBA has updated SOP 50 10 5 (J) to incorporate this change which went into effect 9/20/17.

- ❑ **Consumer cooperatives are eligible**

Consumer Cooperatives are now eligible for 504 financing.

- ❑ **Heavy mobile equipment eligibility**

SBA clarified that heavy duty mobile equipment with an existing useful life of 10 years is eligible for 504 financing.

## EPC/OC – 504 Deal Structure Issues

---

- ▶ Two main issues with existing SBA 504 EPC/OC financing that prevent the approval of new financing:
  - ▶ Ineligible excess rent: To correct the issue the CDC needs to provide an amended executed lease between the EPC and OC that clearly reflects that no excess rent will be paid.
  - ▶ Technical default occupancy: If the OC no longer meets the occupancy of the existing SBA financed building the issue must be addressed. The building could be sold or refinanced and the SBA loan paid in full thus eliminating the default.
-

# Change of Ownership – 504 Deal Structure Issues

---

- ▶ Change of Ownership Example under SOP 50 10 5 (J):
- ▶ Two owners 10% and 90%. The 10% owner wants to own 100% of the entity owning the eligible fixed asset.
- ▶ Purchase contract \$900,000 for the 90% owner's interest in the entity that owns a \$1,000,000 building owned free and clear.
- ▶ Purchaser can use their equity towards the injection but cannot receive any of the project funds. Structure could look as follows:
  - ▶ TPL: \$500,000
  - ▶ SBA: \$400,000
  - ▶ Borrower Contribution: \$100,000 (equity in the property).

# SOP 50 10 5 (J) Updates

---

## ❑ 912 update

- Form 912 - signed and dated within 90 days of application
- If “Yes” response - include details on event. A “Yes” response required even when the individual believes the record is sealed, expunged or otherwise unavailable.
- Misdemeanors - not submitted unless crime against a child. CDC reviews court’s disposition of cases and retains supporting documentation.
- Form 258 - Original Fingerprint Cards must be submitted.
- Divestiture - An Individual may not reduce ownership within 6 months prior to application to avoid completing Form 912 unless it is complete divestiture.
- 912 Decision Appeals - may be submitted to OCA with adequate documentation and severance of any relationship with the Applicant and associated Eligible Passive Concern, including being an employee (paid, unpaid, or contractor)

# **New Franchise Procedures**

---

# SOP 50 10 5 (J) Updates

---

- ❑ **Franchise Updates**
  - **Appendix 9 – SBA Addendum to Franchise Agreement – SBA Form 2462**
  - **Appendix 10 – Annual Franchisor Certification – SBA Form 2464**
  
- ❑ **Management Agreements**



# New Procedures

---

- ▶ New Procedures are not effective until January 1, 2018.
- ▶ SBA is currently accepting new brands for review/ placement on the Directory now.
- ▶ Prior to January 1, 2018, SBA will be issuing all new SBA franchise Identifier Codes for the brands on the Directory

# Benefits to Lenders/CDCs

---

- ▶ Lenders and CDCs will no longer have to review franchise agreement and other collateral documentation for affiliation between the franchisor and franchisee or eligibility of the franchise.
- ▶ Lenders and CDCs can rely on the Directory for determinations of affiliation and eligibility, eliminating inconsistent decisions and backlogs
- ▶ CDCs will no longer have to undergo a pre-application franchise review by the SLPC as the center will no longer review franchise documents.



# SBA Franchise Directory

---

- ▶ SBA has created the SBA Franchise Directory which includes all franchise and other brands reviewed by SBA that are eligible for SBA financial assistance.
- ▶ The Directory will:
  - ▶ Be maintained on SBA's website at <https://www.sba.gov/for-lenders>.
  - ▶ Determine if a brand meets the FTC definition of a franchise
  - ▶ Determine if the business model for the brand is eligible under SBA regulations.
  - ▶ Provide an SBA Franchise Identifier Code if the brand meets the FTC definition
  - ▶ Determine if an addendum is needed, and if so whether the franchisor will use the SBA Addendum (SBA Form 2462) or has an SBA Negotiated Addendum.

# FTC

---

- ▶ While a relationship established under a license, jobber, dealer or similar agreement is not generally described as a “franchise” relationship, if such relationship meets the Federal Trade Commission’s definition of a franchise, it is treated by SBA as a franchise for purposes of affiliation determinations in accordance with 13 CFR 121.301 (f) (5)

# FTC Definition

---

- ▶ The FTC definition of a “franchise” states as follows: Franchise means any continuing commercial relationship or arrangement, whatever it may be called in which the terms of the offer or contract specify, or the franchise seller (franchisor) promises or represents, orally or in writing, that:
  1. The Franchisee will obtain the right to operate a business that is identified or associated with the franchisor’s trademark, or to offer, sell or distribute goods, services, or commodities that are identified or associated with the franchisor’s trademark;

# FTC Definition

---

2. The franchisor will exert or has authority to exert a significant degree of control over the franchisee's method of operation, or provide significant assistance in the franchisee's method of operation; and

3. As a condition of obtaining or commencing operation of the franchise, the franchisee makes a required payment or commits to make a required payment to the franchisor or its affiliate.

An Agreement must meet all three of the above elements of the FTC definition in order to be considered a "franchise"



# FTC Exemptions

---

- ▶ Fuel Agreements
  - ▶ Although exempt from the FTC disclosure requirements, all agreements and relationships that are covered by the Petroleum Marketing Practices Act (PMPA), 15 U.S.C. 2801 (e.g. gas stations, dealer/jobber agreements), are included within the FTC definition of a “franchise”

# Dealer Agreements with New Car Manufacturers

---

- ▶ SBA is no longer excluding dealer agreements with new car manufacturers from affiliation determinations. Therefore, applicants that are or will be operating under a dealer agreement with a new car manufacturer that meets the FTC definition are subject to the new procedures.



# Use of the Directory

---

- ▶ For applications involving a franchise or similar relationship that meets the FTC definition of a franchise, the CDC must check the Directory to determine if it includes the Applicant's brand
  - ▶ If the Applicant's brand is on the Directory, the CDC may proceed with submitting the application to the SLPC or approving under its PCLP authority
  - ▶ If the Applicant's brand is not on the Directory, the CDC cannot process the application or approve the loan under its PCLP Authority and must follow the process to add a brand to the Directory.

# Multiple Agreements

---

- ▶ When an Applicant operates under multiple agreements (i.e. multiple product lines), CDCs only need to check the Directory for the brands or agreements that are “critical” to the Applicant’s business operation. If the applicant operates under multiple brands that are critical to its business operation, the CDC must check the Directory for all of those brands.
- ▶ SBA considers an agreement to be “critical” if the agreement (or the products, services or trademarks covered by it) accounts, individually or together with other agreements of the applicant, for more than 50% of the applicant’s revenues.

# Procedure to Add Brands to the Directory

---

- ▶ Franchisor must submit the following to [franchise@sba.gov](mailto:franchise@sba.gov)
  - ▶ Franchise Disclosure Document (FDD) if applicable
  - ▶ Agreement
  - ▶ All other documents the franchisor requires the franchisee to sign

# Review Process

---

- ▶ If the franchisor agrees to use SBA Form 2462 (SBA Standard Addendum) SBA will only conduct an eligibility review and will not review of affiliation.
- ▶ If the franchisor elects not to use the SBA Form 2462, SBA will work with the franchisor to resolve any affiliation issues, including through the use of an SBA Negotiated Addendum, if necessary.

# Review Process

---

- ▶ Upon completion of SBA's review and a determination by SBA that the brand is eligible, SBA will list the brand on the Directory, along with an indication of the type of Addendum being used, if necessary, and will assign an SBA Franchise Identifier Code.
- ▶ If SBA determines that the brand does not meet the FTC definition of a franchise, SBA will list the brand on the Directory but will indicate that it is not a franchise and SBA will not assign an SBA Franchise Identifier Code

# Franchisor Certification

---

- ▶ For those franchises listed on the Directory that either do not need an addendum or are using an SBA Negotiated Addendum, in order to remain on the directory with the no addendum or a SBA Negotiated Addendum, the franchisor must submit to SBA each year the Annual Franchisor Certification (SBA Form 2464). If Franchisor cannot certify as required or would like to change its addendum, the Franchisor will follow procedures to add a brand to the Directory.
  - ▶ The Franchisor Certification is no longer required on a loan by loan basis if using an SBA Negotiated Addendum.

# Issues that Result in Affiliation

---

## Transfer or Change of Ownership

- ▶ Franchisor has the option or right of first refusal (ROFR) to purchase an interest in the franchise and become a partial owner of the Franchisee.
- ▶ Franchisor's consent to the sale or transfer of any interest in the franchise (full or partial) is based on the Franchisor's "sole discretion" or the agreement is silent on the standard for consent.
- ▶ Franchisee remains liable for the actions of the transferee after transfer of the franchise

# Affiliation

---

## Sale of Assets

- ▶ Franchisor or an appraiser selected by the Franchisor solely controls the valuation of assets when the Franchisor has the option or ROFR to purchase assets, including real estate, upon default or termination of agreement.
- ▶ Franchisor has the right to force the Franchisee to sell the Franchisee's real estate upon default or termination of agreement.



# Affiliation

---

## Covenants or Use Restrictions

- ▶ Franchisor has recorded or has the right to record against the Franchisee's real estate any restrictive covenants, branding covenants or environmental use restrictions (e.g., restricting the use of the property upon sale).
- ▶ If there are any restrictions recorded against the franchisee's real estate, they must be removed before the loan can be approved/closed.

# Affiliation

---

## Control of Employees

- ▶ Franchisor has the authority to directly control (hire, fire or schedule) Franchisee's employees.
- ▶ For temporary personnel franchises, Franchisor (not the Franchisee) employs the temporary employees.

# Procedure to Submit Franchise Application

---

- ▶ For non-PCLP loans, if the applicant's brand meets the FTC definition of a franchise, CDC must identify the name of the franchise and the SBA Franchise Identifier Code when entering the application into E-Tran. **No other franchise documentation must be submitted to the SLPC with the application.** The SLPC will confirm that the brand is listed on the Directory.

# Procedure

---

- ▶ For PCLP loans, if the applicant's brand meets the FTC definition of a franchise, CDC must document in its file that the applicant's brand is on the Directory and identify the name of the franchise and SBA Franchise Identifier Code when entering the application into E-Tran.
- ▶ *If the applicant's brand is not on the Directory and the PCLP-CDC determines the brand does not meet the FTC definition and proceeds with approving the loan under its PCLP authority, SBA will review this decision at time of loan closing and the PCLP-CDC bears the risk of an incorrect determination and the loan not being able to be closed.*

# Procedure

---

- ▶ When an Applicant operates under multiple brands, the CDC must enter the name of the franchise and the SBA Franchise Identifier Code for the brand that generates the largest amount of the Applicant's revenue in E-Tran.
- ▶ The CDC must identify all other brands and their SBA Franchise Identifier Codes (if applicable) in the CDC's credit memorandum.
- ▶ For non-PCLP loans, the SLPC will confirm that all brands critical to the Applicant's business operation are on the Directory.
- ▶ PCLP CDCs must document in their file that all brands critical to the Applicant's business operation are on the Directory, and will be required to submit that documentation for SBA's review prior to closing.

# Procedure

---

- ▶ If the applicant franchisee has multiple locations and each location operates under a separate franchise agreement, each location (i.e., each agreement) must have its own SBA Form 2462 or an SBA Negotiated Addendum, if applicable.
- ▶ If the applicant applies for further assistance under an agreement that already has an executed addendum, CDC will not need to obtain a new addendum in connection with the subsequent application for financial assistance.

# Procedure

---

- ▶ For all 504 loans, prior to closing, the CDC must obtain a copy of the executed franchise agreement, the executed SBA Form 2462 or SBA Negotiated Addendum (if applicable), and any other document the franchisor requires the franchisee to sign.
- ▶ The CDC will upload the executed franchise agreement, the executed SBA Form 2462 or SBA Negotiated Addendum and any other document the franchisor requires the franchisee to sign, into ETRAN prior to submitting the closing package to SBA Counsel

# Franchisor Applicant

---

- ▶ A Franchisor's relationship with its franchisees under a franchise agreement must be considered when making a size determination for an applicant franchisor.
- ▶ If affiliation is found based on the franchise agreement, the Franchisor may execute a global addendum to resolve any affiliation issues.
- ▶ If the applicant is a franchisor, to request a determination of affiliation and, if necessary, obtain a franchisor global addendum, please contact [franchise@sba.gov](mailto:franchise@sba.gov)



# Development Agreement

---

- ▶ Ineligible Franchise Development Agreements contain the following:
  - ▶ Provide the developer with a geographic area with which to establish additional franchise units which are owned and operated by other franchisees.
  - ▶ Developer's income is derived from the royalty payments from each franchisee in the developer's geographic territory.

SBA has determined these to be passive and therefore an applicant operating under this type of Development Agreement is not eligible for SBA financing.

# Development Agreements

---

- ▶ If an applicant franchisee has an affiliate that operates under an ineligible Franchise Development Agreement, the applicant franchisee may be eligible for SBA financial assistance, provided that the applicant and its affiliates are small and no SBA loan proceeds are used for the benefit of the ineligible affiliate franchise developer.

# Area Development Rights

---

- ▶ An applicant franchisee that is or will be operating under a franchise agreement that provides the franchisee with the right to develop additional units that the franchisee or its affiliates own and operate within its territory (“area development rights” or “Multi-Unit Franchise Agreement”), however, may be eligible provided that the applicant and its affiliate franchise units is small.

# Management Agreements

---

- ▶ Businesses that have entered into a management agreement with a third party that gives the management company sole discretion to manage the operations of the business, including control over the employees, the finances and the bank accounts of the business, with no involvement by the owner(s) of the Applicant business, are considered passive, are not eligible.

# Management Agreements

---

- ▶ Management agreements that give the management company sole discretion over the business operations with minimal oversight of the decision-making by the Applicant business, while not passive, create affiliation between the management company and the Applicant business.
- ▶ SBA has determined, however, that affiliation is not created between the Applicant business and the management company if the management agreement includes meaningful oversight by the Applicant business over the management company's activities.
  - ▶ “Meaningful oversight” by the Applicant business means involvement in the decisions made concerning the operation of the business, which include a management agreement that provides for the Applicant business to do all of the following: approve the annual operating budget, approve any capital expenditures or operating expenses over a significant dollar threshold, have control over the bank accounts, and have oversight over the employees operating the business (who must be employees of the Applicant business).

# Process for Review of Management Agreements

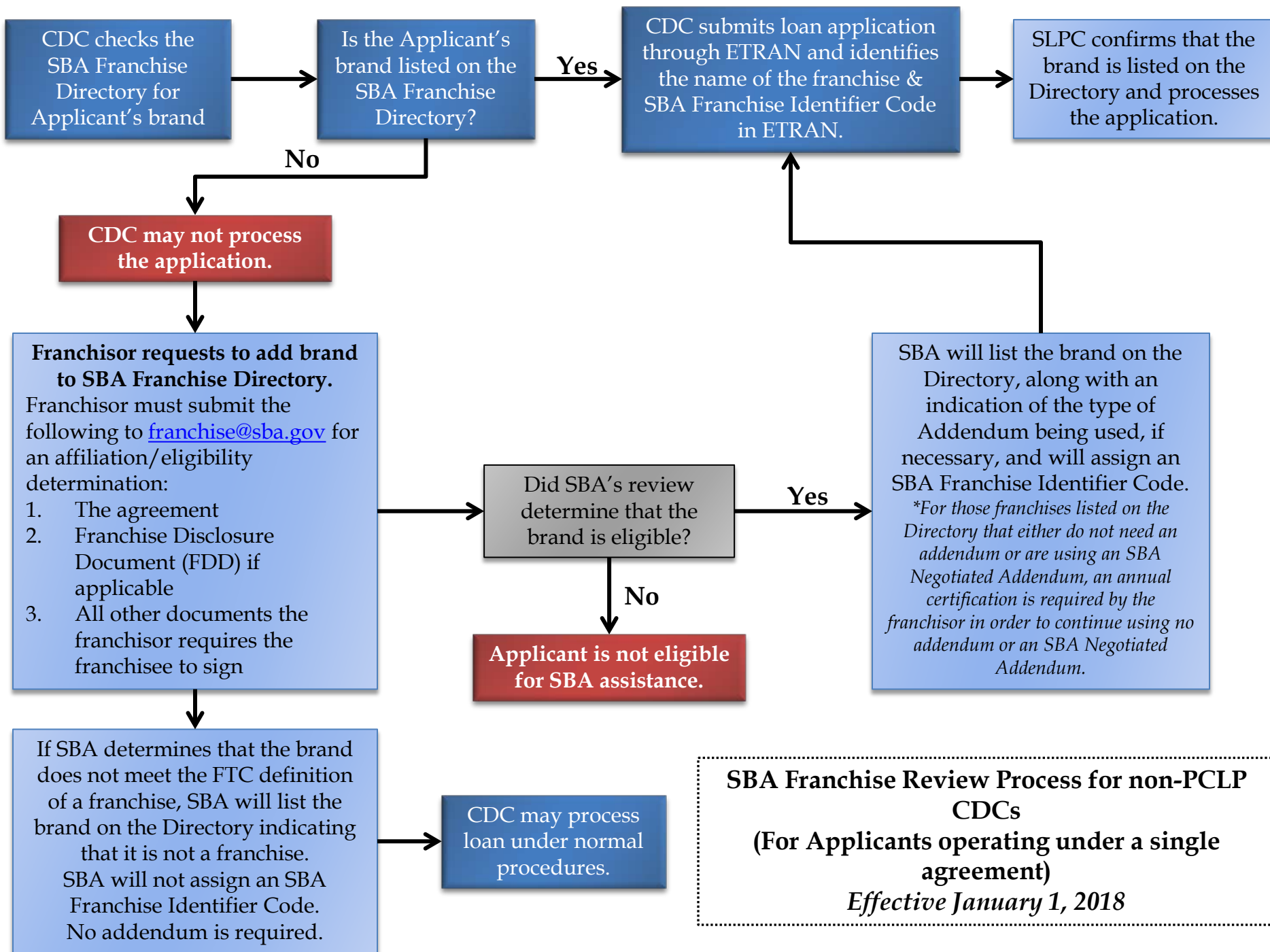
---

- ▶ If the applicant will be using a management agreement, CDC must submit the management agreement to the SLPC (pre-applicant), to determine if it creates affiliation between the Applicant and the management company.
- ▶ If a PCLP CDC is processing the loan under its delegated authority, PCLP CDC must review the management agreement to determine if it creates affiliation between the Applicant and management company.

# Questions on SBA Franchise Policy

---

- ▶ Questions on SBA's Franchise Policy should be directed to [franchise@sba.gov](mailto:franchise@sba.gov).
- ▶ Franchisors that would like to appeal SBA's decision not to place them on the Directory may do so by forwarding a copy of the decision, along with an explanation of how the determination is perceived to be inconsistent with this SOP, to [franchise@sba.gov](mailto:franchise@sba.gov). Franchise appeals will be reviewed by the SBA Franchise Committee comprised of OFA and OGC personnel.
- ▶ Certain issues involving businesses that may be engaged in promoting religion, that may have activities of a prurient nature, that involve any activity that is illegal under federal, state, or local law (such as a marijuana dispensary), or that appear to cater to one gender may be referred to the Associate General Counsel for Litigation for a decision.





## SBA Contacts

---

**Dianna Seaborn**  
Director, OFA  
[dianna.seaborn@sba.gov](mailto:dianna.seaborn@sba.gov)

**Steve Olear**  
Attorney, OGC  
[Stephen.olear@sba.gov](mailto:Stephen.olear@sba.gov)

**Linda Reilly**  
Chief, 504 Loan Program  
[linda.reilly@sba.gov](mailto:linda.reilly@sba.gov)

**Babak Hosseini**  
Finance and Loan Specialist  
[babak.hosseini@sba.gov](mailto:babak.hosseini@sba.gov)

**Hien Nguyen**  
Director, SLPC  
[hien.nguyen@sba.gov](mailto:hien.nguyen@sba.gov)

