



# **SOP 50 10 5 (J) Updates**

Wednesday, November 8, 2017

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Office of Financial Assistance  
Office of Financial Operations/SLPC  
Office of General Counsel

# UPCOMING EVENTS/RESOURCES

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## ❑ **SOP 50 10 5(J) Webinar – Corporate Governance**

- ❑ Wednesday, December 6, 2017 – 2:30pm Eastern
- ❑ <http://ems7.intellor.com/login/714251>

## ❑ **SBA 504 Connect Call with Lenders**

- ❑ Tuesday, December 12, 2017 - 3pm Eastern

## ❑ **CDC Online**

- ❑ [SBA Info Notice 5000-17011](#)
- ❑ [Webinar/Resources](#)

## ❑ **IRS Form 4506T**

- ❑ [SBA Info Notice 5000-17010](#)
- ❑ Revised [IRS Form 4506-T](#) (July 2017)

## ❑ **[SBA Franchise Directory](#)**

# SOP 50 10 5 (J) Updates

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## *HOT TOPICS*

- ❑ **EPC/OC Deal Structure**
- ❑ **Change of Ownership Deal Structure**
- ❑ **Environmental Updates**
- ❑ **Historic Property Review by OGC**
- ❑ **Historic Rehabilitation Tax Credits and Deal Structure Example**

# SOP 50 10 5 (J) Updates

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## *CLOSING ISSUES*

- Intercreditor Agreements**
- Malpractice Insurance**
- Liens**
- Lien Instruments**
- Interim Lender Documents Recording**
- Designated Attorney Hardship Waiver Update**

# EPC/OC – 504 Deal Structure Issues

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- ▶ 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.

# EPC/OC – 504 Deal Structure Issues

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Subpart C, Chapter 2, III. C. 5. d) v.

- ▶ The rent or lease payments cannot exceed the amount necessary to make the loan payment(s) to the SBA and Third Party Lender, and an additional amount to cover the EPC's direct expenses of holding the property, such as routine maintenance, insurance and property taxes. Lease payments may not include amounts for accelerated payments on the Third Party Lender loan.

# EPC/OC – 504 Deal Structure Issues

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## **Excess rent not acceptable examples:**

OC is paying excess rent in the amount of \$220,000 and using those funds to purchase other property for the EPC.

- ▶ OC is paying excess rent in the amount of \$75,000 to amortize the first mortgage faster.
- ▶ OC is paying excess rent to make payments on additional financing obtained on the subject property.
- ▶ Excess rents acceptable: The only acceptable solution to existing excess rents is to submit an amended lease that clearly reflects that no excess rent will be paid.

## **Technical default not acceptable example:**

- ▶ Existing 504 financed Project is currently leased 80% to an unrelated third party tenant when applicant applies for a new 504.
- ▶ Acceptable: OC currently occupies 100% of existing 504 Project and needs to expand. They will occupy 100% of the new property and will maintain eligible occupancy level at the existing facility.



# Change of Ownership – 504 Deal Structure Issues

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- ▶ 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

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## **Businesses Engaged in Illegal Activity**

- No 504 loans or renting space to businesses engaged in illegal activities – subject to seizure

## **Religious business eligibility – [Form 1971](#)**

- Submit to SLPC with application

## **Update on non-U.S. Citizen eligibility**

## **CAIVRS update**

## **Prior Loss to Government – Pre-application check**

# Environmental Updates

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## Significant Changes:

- ▶ 1 year shelf life for Phase I Reports (*for SBA's purposes*)
  - ▶ (Parties may still wish to comply with EPA's regulatory guidelines to avoid jeopardizing legal and regulatory protections)
- ▶ SBA recognition of state equivalent “No Further Action” and “Closure” letters and procedures
  - ▶ The “No Further Action” mitigating factor for disbursement in the presence of contamination now reads as follows:

“No Further Action”. If a CDC obtains a “no further action letter” or “closure letter” from a Governmental Entity (*or state equivalent of a “no further action letter” or “closure letter”*) stating that no further Remediation or monitoring of Contamination previously found is required, approval or disbursement may be considered. *A state equivalent of a closure letter includes a written determination from a licensed professional in those jurisdictions that delegate authority to such professionals for site closures.*

*(Emphasis added)*

# Environmental Updates

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## Significant Changes, Continued:

- ▶ Prohibition on CDCs entering into any agreements that alter the terms of SBA's template reliance letter.
- ▶ In addition to adding this prohibition, SBA simultaneously modified the template Reliance Letter to waive time limitations on liability. This was done because we discovered that some environmental firms were placing these time limitations on liability within the reports themselves. For example, one large environmental firm was placing a 180 day limitation on liability in the "Terms and Conditions" section of the their environmental reports.

# Environmental Updates

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## Other Changes:

- ▶ Dry Cleaning Facility (including historical use at the property)
  - ▶ The SOP was modified to require Phase II testing for “*any Property with on-site dry cleaners, whether currently in operation or operated historically at the site, that did, do or likely used chlorinated and/or petroleum-based solvents*” (in addition to a Phase I which would be required due to the NAICS code match). Additionally, SBA requires that any soil and groundwater contamination and soil vapor intrusion be addressed.
- ▶ Gas Station Loans (Appendix 5)
  - ▶ SBA now requires that Phase I reports for gas station loans “*include documentation supporting the Environmental Professional’s determination of compliance with all regulatory requirements, if any, pertaining to tank and equipment testing.*”

# Environmental Updates

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## Other Changes, Continued:

- ▶ **Record Search with Risk Assessment (RSRA)**
  - ▶ The “look back” period for the historical records component of RSRA was amended to ensure that Environmental Professionals are choosing historical records that identify property back to the property’s first developed use, or back to 1940, whichever is earlier. Additionally, SBA clarified that the underlying database reports relied upon must be included in the RSRA.
- ▶ **Reliance Letter - Formatting Changes**
  - ▶ The format of the template Reliance Letter was modified make it clear that for 504 loans, the CDC is the lender for the purposes of this letter.
- ▶ **Reliance Letter - Phase I Addendums**
  - ▶ The Phase I section was amended to include not only Phase I reports, but also “any addendum(s) thereto”

# Environmental Updates

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## Other Changes, Continued:

- ▶ Release of Rights to Indemnification from SBA/CDC
  - ▶ SBA added a new paragraph to the SOP that previously existed only in Appendix 5 (Gas Station Loans). This paragraph is designed to protect both SBA and CDCs from lawsuits, which can occur if SBA or a CDC foreclose upon a property where such covenants “run with the land.”

“I. Release of Rights to Indemnification from SBA/CDC:

If any Person has a right to indemnification from subsequent owners of the Property (e.g., SBA/CDC after acquiring Property through foreclosure or other means), then they must execute either the SBA Indemnification Agreement or another document in which they waive all known and unknown rights and release all claims and causes of action whether now or hereafter in existence against SBA and CDC related to Contamination at the Property including the right to indemnification. CDCs must submit all waiver and release documents to the SBA center processing the loan for review and approval by SBA counsel, along with a copy of the title report, the document providing for indemnification, and the purchase and sale documents, if any. PCLP CDCs must also submit the waiver and release to the SBA for review and approval prior to a request that SBA fund the loan. The document containing the waiver and release must be recorded.”

# Environmental Updates

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## Other Changes, Continued:

- ▶ Changes to Mitigating Factors
  - ▶ “Minimal Contamination *with Minimal Remediation.*”
  - ▶ “Other factor(s)” – SBA clarified when the SBA Environmental Committee considers the existence of environmental insurance to be persuasive when evaluating disbursement under this factor. Brownfield agreements were also added as another example of an “Other Factor” that can be considered.
  - ▶ Reminder: Requests for exceptions to SBA’s environmental policies and procedures go *directly* to [EnvironmentalAppeals@sba.gov](mailto:EnvironmentalAppeals@sba.gov) – don’t send them to the SLPC. Additionally, *always* provide justification for not wanting to follow an Environmental Professional’s recommendations. E-mails to the committee can now be up to 15 MB (with attachments).

# Environmental Updates

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## Other Changes, Continued:

### **Appendix 4 – NAICS Codes of Environmentally Sensitive Industries**

- ▶ SBA added the following NAICS codes:
  - 484 -TRUCKING (*if service bays, truck washing, or fuel tanks present*)
  - 713990 - OTHER RECREATIONAL INDUSTRIES (*indoor and outdoor shooting ranges only*)

### **Appendix 5 – Requirements Pertaining to Gas Station Loans**

- ▶ SBA updated this appendix for clarity

# Environmental Updates

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## Other Changes, Continued:

- ▶ SBA modified the following NAICS codes (*new language in italics*):

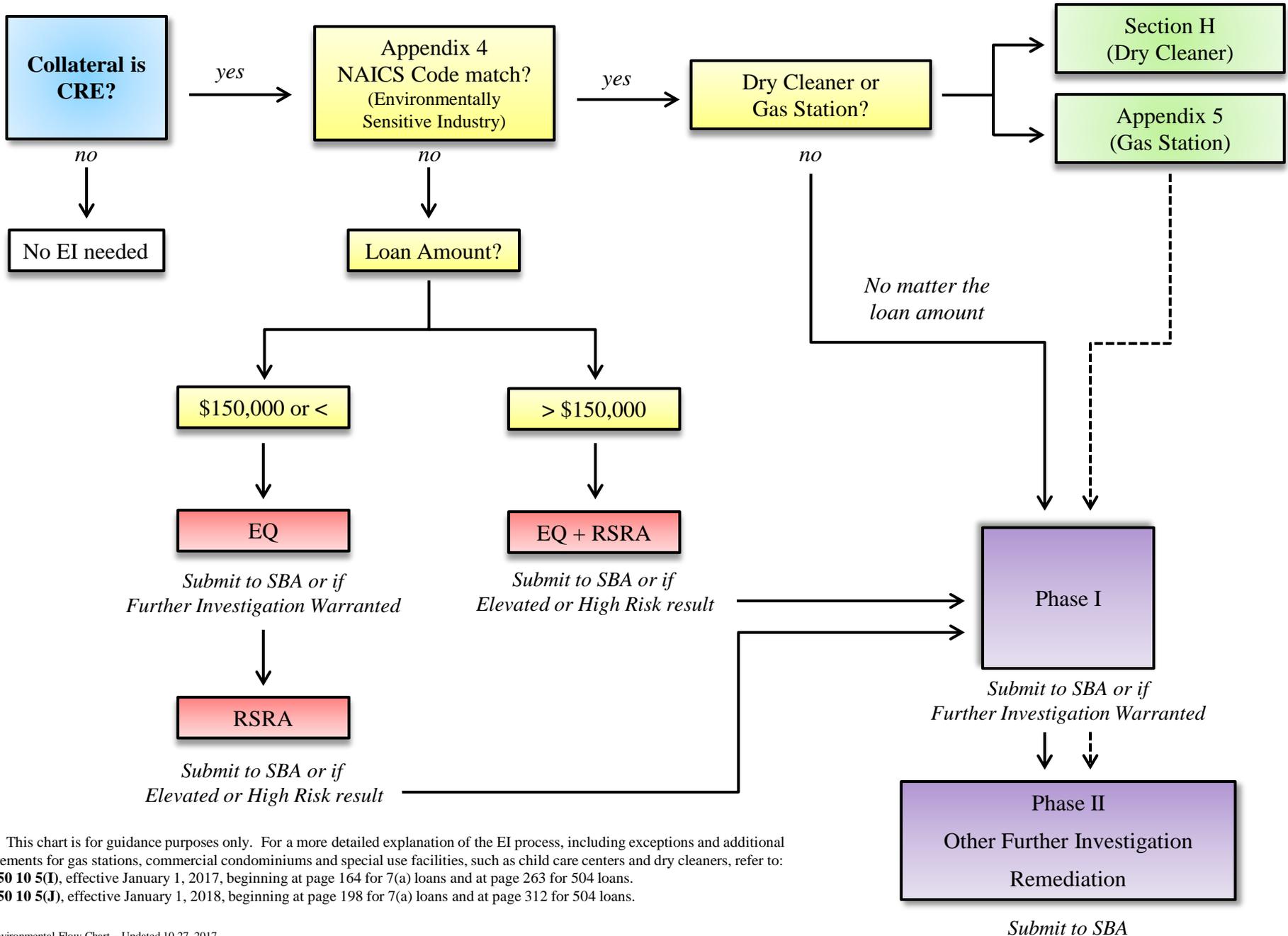
316 – LEATHER & ALLIED PRODUCT MANUFACTURING  
*(not required if assembly only)*

326 – PLASTICS & RUBBER PRODUCTS MANUFACTURING  
*(not required if assembly only)*

332 – FABRICATED METAL PRODUCT MANUFACTURING  
*(not required if assembly only)*

8122 – DEATH CARE SERVICES  
*(unless no embalming or cremation at the Property)*

# SBA Environmental Flow Chart



**Note:** This chart is for guidance purposes only. For a more detailed explanation of the EI process, including exceptions and additional requirements for gas stations, commercial condominiums and special use facilities, such as child care centers and dry cleaners, refer to: **SOP 50 10 5(I)**, effective January 1, 2017, beginning at page 164 for 7(a) loans and at page 263 for 504 loans. **SOP 50 10 5(J)**, effective January 1, 2018, beginning at page 198 for 7(a) loans and at page 312 for 504 loans.

# SOP 50 10 5 (J) Updates

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## Updates on Historic Properties Review

- Section 106 of the National Historic Preservation Act mandates Federal agencies undergo a review all federally funded projects impacting sites listed or eligible to be listed on the National Register of Historic Places (“NRHP”).
- The CDC (on PCLP loans) and SLPC (on non-PCLP loans) must consult with local SBA counsel for further guidance.
- If there is no potential to cause effect on historic properties, there are no further obligations under Section 106. (example purchase/no renovation/no changes)
- If SBA finds no adverse effect and the SHPO agrees or does not object within 30 days, the Agency can proceed with the approval of the loan.
- If SBA Counsel finds an adverse effect on the historic nature of the property, SBA must consult with the State Historic Preservation Officer (SHPO) to attempt to resolve the issue.

# SOP 50 10 5 (J) Updates

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## Historic Properties Review Resources

- ❑ Guide for Assessing Potential Historic Properties

<https://www.nps.gov/nr/publications/bulletins/pdfs/nrb22.pdf>

- ❑ National Register of Historic Places webinar site

<https://www.nps.gov/nr/faq.htm#nr>

# Letter from State Historic Preservation Authority

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Thank you for your email of (Date), concerning a SBA 504 loan for the proposed renovation of the interior of the above referenced building. As you know the building is located within the National Register-listed Downtown Historic District (GF0042). Given your description of the proposed undertaking, we have determined that the 504 loan will not affect the historic district.

The above comments are made pursuant to Section 106 of the National Historic Preservation Act and the Advisory Council on Historic Preservation's Regulations for Compliance with Section 106 codified at 36 CFR Part 800.

Thank you for your cooperation and consideration. If you have questions concerning the above comment, contact XXXX at XXXX or XXXX . In all future communication concerning this project, please cite the above referenced tracking number.



# Letter from State Historic Preservation Authority

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Thank you for your July 21, 2016, email asking us to comment on the effect of a Small Business Administration Loan for the above-referenced undertaking. We have reviewed our files on the property and determined that, while it is the National Register-listed Carolina Cadillac Building (GF0694), the proposed renovations will not affect the property. This is due to the prior removal of the architectural elements on the interior.

The above comments are made pursuant to Section 106 of the National Historic Preservation Act and the Advisory Council on Historic Preservation's Regulations for Compliance with Section 106 codified at 36 CFR Part 800.

Thank you for your cooperation and consideration. If you have questions concerning the above comment, contact XXXX, at XXXX or. In all future communication concerning this project, please cite the above referenced tracking number.



# SOP 50 10 5 (J) Updates

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## Historic Rehabilitation Tax Credits

IRS regulations (IRC § 50), property owner eligible may lease the property, and transfer the historic rehabilitation tax credits, to another party.(the “Tax Credit Investor”).

SBA may participate in Projects involving such tax credits under the following conditions:

- Borrower/owner of the property leases to the Tax Credit Investor who then simultaneously subleased back to the Borrower. The term of the sublease must be equal to the term of the lease.
- Copies of the lease and the sublease must be submitted with the 504 application. The executed copies of both leases must be submitted to District Counsel for legal review prior to closing.
- SBA’s lien on the Project Property must not be subordinate to the lease between the Borrower and the Tax Credit Investor.
- The loan may not be structured as an EPC/OC loan.
- The structure of these transactions may vary case-by-case. CDCs and the SLPC should consult with District Counsel for additional guidance.
- SBA may also participate in projects where the Borrower transfers State rehabilitation tax credits if such projects satisfy all applicable State requirements and the other requirements set forth in SOP 50 10 5 (J).

# Historic Rehabilitation Tax Credits - Example

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- ▶ Borrower proposes to buy a historic building (certified as on the National Registry) for \$1,000,000 and invest another \$1,000,000 in rehabilitating the structure.
- ▶ For a certified historic rehabilitation, the Borrower can generate a tax credit of 20% of the cost of the rehabilitation or \$200,000, in this example.
- ▶ The Borrower can make what the IRS calls a “Pass-Through Election” on the property (or sell the tax credits) by agreeing to lease it to another party and treat the lessee as having incurred the costs of rehabilitation.

# Historic Rehabilitation Tax Credits

## **Project Property**

Eligible for Historic Rehabilitation Tax Credits

Mortgage or Deed of Trust to CDC/SBA recorded



Leased to

**Tax Credit Investor**

And **simultaneously**



Subleased to

**SBA Borrower**

# SOP 50 10 5 (J) Updates

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## ❑ Intercreditor Agreements

Chapter 1, IV.A.8. (p.258)

CDCs must not enter into **any Intercreditor agreement** with the Third Party Lender other than that Third Party Lender Agreement (SBA Form 2287) without the prior written consent of SBA.

# SOP 50 10 5 (J) Updates

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## ❑ Malpractice Insurance

Subpart C, Chapter 5, I.D.5.

**d) Malpractice Insurance - if required by state law.**

# SOP 50 10 5 (J) Updates

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## ❑ **Liens** - Subpart C, Chapter 3, I.B.4.

- ▶ Lien position on real estate is generally evidenced by a title insurance policy. If the title insurance policy contains a clause **requiring arbitration** or a clause allowing either party to demand arbitration in the case of a dispute, an endorsement to the policy must be obtained deleting that condition. If the policy requires that both parties agree to arbitration, no endorsement is necessary.



# SOP 50 10 5 (J) Updates

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## ❑ Lien Instruments

Subpart C, Chapter 6 II.B.3.

CDCs may use their own forms for the lien instruments on Project Property and secondary collateral. Those forms must be either state bar-approved forms or approved by SBA Counsel prior to submission. The lien instruments on real estate must contain a due-on-sale clause. **Please note: The SBA Forms 928 and 930 are expired and must not be used.**

# SOP 50 10 5 (J) Updates

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## ❑ Interim Lender Documents Recording Cancellation

Subpart C, Chapter 6, III.B.9.

Ensure that all **recorded interim lender documents** are cancelled of record at the place of recordation **within 90 days after funding.**

# SOP 50 10 5 (J) Updates

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## Updated guidance for designated attorneys – pp. 69–70

- ❑ Revised the guidance for designated attorneys to request hardship waivers of the professional malpractice insurance requirements.
- ❑ Applicants may request a hardship exemption from the General Counsel, or designee, with respect to the policy limits or the deductible. Policy limit reductions to \$500,000/\$1,000,000 will only be granted to sole practitioners and small firms of three or fewer attorneys, while deductible requirement waivers will only be granted to larger firms with a demonstrated, strong financial history.
- ❑ Counsel will consider several factors in determining whether to include the waiver, including but not limited to the quality, number and dollar value of the 504 closings completed during the past 12 months.
- ❑ If approved, a hardship waiver will have a duration of one year.

# SBA Contacts – OCA/OFA and OFPO

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# SBA Contacts - OGC

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