

Changes Underway for SBA 7(a) and 504 Loan Programs

By Nathan Hill

Changes are coming to the Small Business Administration's (SBA) 7(a) Loan Program and 504 Loan Program. In recent weeks, the SBA released two final rules that are set to become effective in May 2023. The SBA's goal is to "aid, counsel, assist and protect the interests of small business concerns in order to preserve free competitive enterprise and to maintain and strengthen the overall economy of our nation." One of the ways the SBA accomplishes this goal is through its 7(a) and 504 Loan Programs, which provides SBA-guaranteed financial assistance to small businesses. Some of the changes include:

- **The Affiliation Rule:** To qualify for an SBA loan program, a small business must meet certain size requirements because in order to receive an SBA loan, there must be a "small business concern." The Affiliation Rule, through SBA regulations, is used to determine whether a business qualifies as small. Under the traditional rule, entities would be affiliated if "one controls or has the power to control the other, or a third party or parties controls or has the power to control both." 13 C.F.R. § 121.103(a)(1). Under the new rules, affiliation will no longer be found based on common management, identity of interest, and franchise agreements – opening the door for more businesses to possibly be eligible for an SBA loan program. While the Affiliation Rule is changing, it is still imperative for SBA Lenders to perform eligibility analyses for all applicants and business structures.
- **Partial Changes in Ownership:** Under the current rules, SBA 7(a) loan proceeds cannot be used to purchase a portion of a business or a portion of another owner's interest. The new rule will change that and allow a borrower to purchase a portion of a business or a portion of another owner's interest in a business. This change could help provide employees a path to ownership, assist a co-owner in buying out a partner, and create the possibility of equity rollovers with the use of an SBA 7(a) loan.
- **Streamlined Lending Criteria:** The SBA is required to determine the creditworthiness and reasonable assurance of repayment of a borrower. Traditionally, this was accomplished through an analysis of nine specific factors. Now, the SBA simply "must use appropriate and prudent generally acceptable commercial credit analysis processes and procedures consistent with those used for their similarly sized, non-SBA guaranteed commercial loans." By simplifying the underwriting requirements, SBA loans may be better able to provide small businesses access to capital, especially those businesses owned by underserved communities.
- **Ending the Small Business Lending Companies (SBLC) Moratorium:** For the past 40 years, the SBA has not issued licenses to non-bank lenders. Now, non-banks may apply for a new license rather than having to buy one of the existing 13 non-bank licenses. The SBA, seeing that certain markets contain gaps and continue to struggle to obtain financing on non-predatory terms, is implementing the rule change to help bridge the small business financing gap. This rule change could open the door for fintech companies and nonprofit lending organizations to become licensed SBA lenders. The new rule will create Community Advantage ("CA") SBLCs. Under the CA program, "community-based, mission-focused lenders meet the credit, management, and technical assistance needs of small businesses in underserved markets." Under the new rule, all current CAs will be grandfathered in and licensed as Community Advantage SBLCs. The

SBA has yet to release the lending limits, capital requirements, and other requirements for these CA SBLCs.

- **Reduce the Requirement of Hazard Insurance:** Currently, SBA 7(a) and 504 loans require hazard insurance on all collateral regardless of loan size. Under the new rule, hazard insurance will be required for loans greater than \$500,000. For loans of \$500,000 or less, SBA Lenders must follow the hazard insurance policies and procedures they have established and implemented for their similarly sized, non-SBA-guaranteed commercial loans. This rule removes what was considered to be a burdensome requirement for the smallest of businesses who might not be getting the largest SBA loan.

While the final rules contain more changes, this is just a brief highlight of changes coming to the small business and SBA world. Further, while the rule changes are now final, the SBA will be releasing a lot of clarification and guidance in the coming weeks, so it is not entirely clear how these rules will play out in practice. Roetzel attorneys are available to assist in understanding the impacts of these SBA changes to your business.

If you have any questions about this topic, please contact one of the listed Roetzel attorneys.

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