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SBA 7(a) Loans – Planning for Liquidation

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Lenders enjoy some discretion with respect to the servicing and liquidation of SBA 7(a) loans. However, various technical requirements imposed on lenders can provide the Small Business Administration a basis to deny or limit its guarantee obligations. Extra time and effort spent at the outset of a loan default can strengthen the lender's likelihood of full recovery on the SBA's loan guaranty and limit the expense of litigating with the SBA if it denies all or part of its guaranty obligations.

The Decision to Accelerate

Lenders with non-SBA loan portfolios are given the discretion – subject to acting in a commercially reasonable manner – to determine whether a 7(a) loan should be accelerated based on their internal policies and procedures for similarly sized non-SBA loans. However, even though the lender has discretion, the SBA does not always defer to the lender's decisions. For example, a post-default site visit must be conducted in a timely manner – 60 days – following an uncured payment default, whether or not the lender intends to accelerate. If the lender's failure to accelerate and place the loan in liquidation status adversely affects the collateral or ability to recover on the loan, the SBA can challenge its guaranty obligation.

In the interest of justifying the commercial reasonableness of the lender's decisions (and decision-making process), the post-default site visit should be well documented and contain explanations of the lender's conclusions. Gut feelings or an unexplained decision to take a wait-and-see approach can put the guaranty unnecessarily at risk if collateral is lost or loses value in the

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The firm's banking lawyers provide experienced counsel in connection with all aspects of commercial loans. Chaired by **Scott W. Foley**, the firm's **Banking & Financial Services Group** represents regional and community banks, credit unions, finance companies, pension funds, and other financial institutions in Maryland and throughout the Mid Atlantic.

The banking group advises financial institutions in commercial lending transactions; it also advocates for financial institutions in commercial loan workouts, restructurings, and bankruptcy proceedings. Because the group has extensive experience in the origination of loans and in workout situations, it is prepared to provide efficient representation at every stage in the commercial lending process. With decades of experience in the banking industry, Mr. Foley and the firm's other seasoned banking attorneys appreciate the potential hazards facing clients in the commercial loan process, and strive to protect lenders' interests throughout the lifecycle of the loan.

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interim. Accounts receivable should be sampled and verified. If collateral valuations do not support a full or substantial recovery, additional assessment and strategies as to unencumbered assets of the loan obligors may be warranted.

Lenders should conduct the site visit with an eye towards developing a liquidation strategy and plan. Even if the lender ultimately decides that the best strategy is to work with the borrower and keep the loan in regular servicing, the work done at the initial post-default site visit can make the transition to liquidation ultimately more manageable if things do not work out. The lender can often obtain more and better quality information when the borrower is still cooperative and eager to comply with requests. That may not be the case in the future when the borrower knows the business is failing and is dealing with multiple creditors and more dire problems.

Developing a Liquidation Plan

Although not technically required by the SBA in all loans, a liquidation plan is a must. The liquidation plan is a key document the SBA will look to in order to see if the lender acted prudently in liquidating the loan collateral and whether there is a basis for a repair (i.e., the amount needed to compensate the SBA for loss due to improper closing, servicing, or liquidation).

Like the post-default site-visit report, a liquidation plan should include supporting documentation and analysis justifying the lender's conclusions regarding the value of loan collateral and its plan to timely and cost-effectively liquidate (or abandon) such collateral. The liquidation plan should also include an assessment of any non-collateral sources of repayment (i.e., unencumbered assets of obligors) and an analysis of any workout alternatives.

The level of detail included in the liquidation plan, and whether to obtain legal counsel's assistance in preparing the plan, is a decision for each lender based on the nature and extent of any perceived servicing or collateral deficiencies, the amount of the loan and past experiences. The SBA's policy is to not reimburse lenders for legal fees incurred in connection with routine loan servicing or liquidation duties; however, if there is a large guaranty request at stake and complex issues that could negatively impact the value or availability of collateral, early consultation of counsel could prove invaluable. Counsel may be able to provide strategies to address and correct loan deficiencies about which the lender might not be aware. In a relatively straightforward collateral liquidation or low-dollar loan, it often makes sense for a lender to handle the liquidation analysis and planning in house while following the SBA's guidelines.

Conclusion

In order to protect the SBA's guaranty obligations on 7(a) loans, lenders should approach borrower defaults and its subsequent decision-making process with care. In the face of significant losses on the underlying loan, the SBA may challenge the lender's decisions concerning liquidation. Additional time and effort in the liquidation planning process could save lenders trouble (and money) when it comes time to demand payment on the SBA guaranty.

For more information about this or other banking law matters, please contact Scott W. Foley, Chair of the Shapiro Sher Banking & Financial Services Group, at swf@shapirosher.com.