divestiture of all ownership interest and severance of any relationship with the Small Business Applicant (and any associated Eligible Passive Concern) in any capacity, including being an employee (paid or unpaid).

5. Employee Stock Ownership Plans (ESOPs) and 401(k) Accounts: When an ESOP or 401(k) owns 20% or more of a Small Business Applicant, the Plan or Account cannot guarantee the loan. The Plan or Account must meet all applicable IRS eligibility requirements. In addition, the following loan conditions must be met:

a) The owner(s) of a 401(k) must provide his or her full unconditional personal guaranty regardless of the individual ownership interest in the applicant concern. This guaranty must be a secured guaranty if required by SBA's existing collateral policies.

b) The members of the ESOP are not required to personally guarantee the debt, but all owners of the Small Business Applicant who hold an ownership interest of 20% or more outside the ESOP are subject to SBA's personal guaranty requirements.

c) The application cannot be structured as an EPC/OC. (13 CFR §120.111(a)(6)) (SBA regulations require each 20% or more owner of the EPC and each 20% or more owner of the OC to guarantee the loan, and the regulation does not provide for an exception.)

C. Real Estate and Business Appraisal Requirements

The regulations governing appraisal requirements are set forth at 13 CFR §120.160(b):

1. Commercial Real Estate

SBA requires a real estate appraisal if the SBA-guaranteed loan is greater than $250,000 AND is collateralized by commercial real property.

a) For all loans greater than $250,000, secured by commercial real property, federally regulated lenders must obtain an appraisal by a state licensed or certified appraiser and otherwise follow their primary regulator's FIRREA requirements for real estate appraisals. Appraisals must be in compliance with the Uniform Standards of Professional Appraisal Practice (USPAP). Additionally, SBA requires that completed appraisals be dated within 12 months of the application for guaranty, and that federally-regulated lenders comply with the provisions set forth in paragraphs 3 and 4 below with regard to other fixed assets and the additional appraisal requirements for changes of ownership. **No Exemption is granted under the Interagency Appraisal and Evaluation Guidelines dated December 2, 2010 for Transactions Insured or Guaranteed by a US Government Agency. (www.fdic.gov/news/news/financial/2010/fil10082a.pdf).**

b) For all loans greater than $250,000, secured by commercial real property, SBA Supervised Lenders must follow the appraisal requirements provided below.

c) The SBA or the lender may require an appraisal of real property by a State licensed or certified appraiser in connection with a loan for $250,000 or less, if such appraisal is necessary for appropriate evaluation of creditworthiness.

d) The appraiser must be:

i. independent and have no appearance of a conflict of interest (such as a direct or indirect financial or other interest in the property or transaction); and

ii. either State-licensed or State-certified with the following exception: when the commercial property's estimated value is over $1,000,000, the appraiser must be State-certified.

e) In order for the appraiser to identify the scope of work appropriately, the appraisal must identify the lender as the client and/or an intended user of the appraisal, as those terms are defined in USPAP. **The lender may not use an appraisal prepared for the seller or the applicant**. The cost may be passed on to the Small Business Applicant.

f) The appraisal must be an "Appraisal Report" prepared in compliance with USPAP.

g) If the loan will be used to finance new construction or the substantial renovation of an existing building, the appraisal must estimate what the market value will be at completion of construction. ("Substantial" means rehabilitation expenses of more than one-third of the purchase price or fair market value at the time of the application.) After construction is completed, lender must obtain a statement from the appraiser, general contractor, project architect, or construction management firm that the building was built with only minor deviations (if any) from the plans and specifications upon which the original estimate of value was based. If the lender cannot obtain such a statement, then the lender may not close the loan without SBA's prior written permission.

h) If the SBA guaranteed loan was used to cover the construction period, the lender must notify the appropriate SBA CLSC of any deviation(s) and work with the SBA CLSC to determine an appropriate course of action, including the securing of additional collateral. The lender's notification to SBA must provide a sufficient understanding of the reasons for the differences in values between the estimated and actual values as well as a recommendation as to a remedy to offset the difference in values such as additional equity or additional collateral. If additional collateral is being required, the lender must identify both the fair market and liquidation values of the additional collateral. If the lender is unable to obtain a statement that the building was built with only minor deviations (if any) from the plans and specifications upon which the original estimate of value was based, but is able to obtain a new appraisal demonstrating that the market value meets or exceeds the original estimate of value, then no additional action on the part of the lender is necessary.

i) If the loan will be used to acquire an existing building that does not require construction, the appraiser should estimate market value on an as-is basis. If the appraiser estimates the value other than on an as-is basis, the narrative must include an explanation of why the as-is basis was not used.

j) When valuing the collateral, the lender must not include the contributory value of any rental income or the value of any intangible assets contained in the appraisal.

Comment [D10]: SOP 50 10 5 (H) updated USPAP guidance with the removal of the terms self-contained and summary appraisal reports.

Comment [D11]: SOP 50 10 5 (H) provides additional qualified sources for post construction review.

k) An appraisal may be submitted as part of the loan application to assist with the underwriting or as part of the loan closing. In no case may the lender rely on an appraisal that was prepared more than 12 months prior to the date of the application.

i. If the lender is going to require the appraisal at closing, the loan application must include an estimate of the value of the real estate and the estimate must be identified in the loan authorization with the requirement for an appraisal that supports the estimated value at time of closing.

ii. If at time of closing the appraisal:

(a) Comes in at 90% or more of the estimated value, the lender may close the loan but must include a written explanation as to why the appraisal is less than the estimated value in the loan file; or

(b) Comes in at less than 90% of estimated value, the lender may not close the loan without SBA's prior written permission (see exception below for PLP lenders). The lender's justification to SBA must provide a sufficient understanding of the reasons for the differences in values between the estimated and actual values as well as a recommendation as to a remedy to offset the difference in values such as additional equity or additional collateral. If additional collateral is being required, the lender must identify both the fair market and liquidation values of the additional collateral.

iii. Exception for PLP Lenders:

PLP lenders are permitted to close a loan when the appraisal is less than 90% of the estimated value but the lender must include a written justification as part of its file that may be reviewed by SBA at time of guaranty purchase or when SBA is reviewing the lender. The justification must include a thorough analysis by the lender of the reasons for the appraisal being low and an explanation as to what steps the lender took to offset the risk to SBA from the low appraisal such as additional equity or additional collateral.

2. Non-commercial real estate or real estate securing a personal guaranty

SBA has no specific appraisal requirements for non-commercial real estate (such as a residence) or real estate (commercial or non-commercial) taken as collateral to secure a personal guaranty.

3. Other Fixed Assets

If the valuation of fixed assets is greater than their depreciated value (net book value), an independent appraisal by a qualified individual must be obtained by the lender to support the higher valuation. A valuation of the fixed assets provided as part of a business valuation will not meet these requirements, except as part of a going concern appraisal as described in paragraph 5.e) below.

4. Additional Appraisal Requirements for all Changes of Ownership

For businesses that have been transferred within 36 months prior to the date of the loan application and the loan amount is more than $250,000, SBA requires:

a) An appraisal of the business real estate that meets the appraisal requirements above; and

b) Either a "review" of the appraisal by another appraiser selected directly by the lender or a site visit by a senior member of the lender's staff. The lender must document the file and include the date of the visit and a description of the items reviewed on site.

5. Business Appraisal Requirements – Change of Ownership

Comment [D12]: SOP 50 10 5 (H) for change of Ownership, provides revised requirements regarding the professional qualifications necessary to perform business appraisals (formerly valuations) for special purpose property.

Determining the value of a business (not including real estate which is separately valued through a real estate appraisal) is the key component to the analysis of any loan application for a change of ownership. An accurate business appraisal is required because the change in ownership will result in new debt unrelated to business operations and potentially the creation of intangible assets. A business appraisal assists the buyer in making a determination that the seller's asking price is supported by an independent qualified source.

a) Non-Special Purpose Properties

i. If the amount being financed (including any 7(a), 504, seller, or other financing) minus the appraised value of real estate and/or equipment being financed is $250,000 or less, the lender may perform its own valuation of the business being sold, unless the lender's internal policies and procedures require an independent business appraisal from a qualified source.

ii. If the amount being financed (including any 7(a), 504, seller, or other financing) minus the appraised value of real estate and/or equipment is greater than $250,000 or if there is a close relationship between the buyer and seller (for example, transactions between family members or business partners), the lender must obtain an independent business appraisal from a qualified source.

iii. A "qualified source" is an individual who regularly receives compensation for business appraisals and is accredited by one of the following recognized organizations:

(a) Accredited Senior Appraiser (ASA) accredited through the American Society of Appraisers;

(b) Certified Business Appraiser (CBA) accredited through the Institute of Business Appraisers;

(c) Accredited in Business Valuation (ABV) accredited through the American Institute of Certified Public Accountants;

(d) Certified Valuation Analyst (CVA) accredited through the National Association of Certified Valuation Analysts; and

(e) Accredited Valuation Analyst (AVA) accredited through the National Association of Certified Valuation Analysts.

(f) Accredited Business Certified Appraiser (ABCA) accredited through the International Society of Business Analysts.

b) **Special Purpose Properties** (A “Special Purpose Property” is a limited-market property with a unique physical design, special construction materials, or a layout that restricts its utility to the specific use for which it was built.)

i. If the amount being financed (including any 7(a), 504, seller, or other financing) minus the appraised value of real estate and/or equipment being financed is $250,000 or less, the lender may perform its own valuation of the business being sold, unless the lender’s internal policies and procedures require an independent business appraisal from a qualified source.

ii. When the loan financing any portion of the acquisition of a business is over $250,000 or if there is a close relationship between the buyer and seller (for example, transactions between family members or business partners) and the business operates from a Special Purpose Property, the lender must obtain an independent appraisal performed by a Certified General Real Property Appraiser.

iii. The appraisal must allocate separate values to the individual components of the transaction including land, building, equipment and intangible assets.

iv. The Certified General Real Property Appraiser must have completed no less than four going concern appraisals of equivalent special use property as the property being appraised, within the last 36 months, as identified in the qualifications portion of the Appraisal Report.

v. Each appraisal assignment under this section must be undertaken with a specific instruction for the Certified General Real Property Appraiser to conduct the appraisal in compliance with current USPAP guidelines.

c) In order for the individual performing the business appraisal to identify the scope of work appropriately, the business appraisal must be requested by and prepared for the lender. The scope of work should identify whether the transaction is an asset purchase or stock purchase and be specific enough for the individual performing the business appraisal to know what is included in the sale (including any assumed debt). The business appraisal must include the individual’s opinion of value, the qualifications of the individual performing the appraisal and their signature certifying to the information contained in the appraisal. The lender may not use a business appraisal prepared for the applicant or the seller. The cost of the appraisal may be passed on to the Small Business Applicant.

d) If the application will be submitted to the LGPC, the business appraisal must be submitted as part of the loan application. (See Chapter 6, of this Subpart.)

e) If the application will be submitted under delegated authority, the business appraisal may be obtained and reviewed after the issuance of an SBA loan number and prior to closing. If the lender is processing the application under delegated authority and requests the business appraisal after issuance of an SBA loan number, the credit memorandum must include an estimate of the value of the business. The credit memorandum must be updated after receipt of the business appraisal to include a comparison of the loan amount and the business appraisal.

f) Any amount in excess of the business appraisal may not be financed with the SBA guaranteed loan.

g) Lender Verification of Business Appraisal Financial Data

Lender must obtain a copy of the financial information relied upon by the individual who performed the business appraisal and verify that information against the seller's IRS transcripts to ensure the accuracy of the information.

D. <u>CAPLine Collateral Requirements</u>

1. The CAPLines programs listed below have specific collateral requirements as follows:

a) For Working Capital CAPLines:

i. If the lender will disburse the line based on a borrowing base certificate, the lender must obtain a first lien on the applicant's working/trading assets (i.e., accounts receivable, inventory).

ii. If the lender will not use a borrowing base certificate to disburse the line, the lender must assume full utilization of the revolving line of credit and secure the line with sufficient collateral to ensure there is a 1:1 collateral ratio. Lender must obtain a first lien position on the working/trading assets (accounts receivable and inventory) financed with the line. If the working/trading assets are insufficient to provide a 1:1 collateral ratio, the lender also must take additional collateral to ensure there is a 1:1 collateral ratio. If business assets do not fully secure the loan, the lender must take available equity in personal real estate owned by the principals as collateral to ensure there is a 1:1 collateral ratio. (See Chapter 7, Paragraph IV.H.4 of this subpart for further guidance.)

b) For Builder's CAPLines:

i. SBA will accept no less than a second lien position on the property being constructed or renovated if the purpose of the first lien was to acquire the property. If the property is part of a subdivision where the prime lender for the subdivision holds a first lien OR serves as partial collateral for a loan secured by more than one parcel of real estate, the first lienholder must provide a "release clause" for transfer of clear title to any eventual buyer of individual parcels upon receipt of a pre-established payment.

ii. Do not take a second lien position if the first lienholder requires that the entire loan be paid in full before any property is released. Where Lender/SBA is in a second position, the total amount necessary to release the first and second liens may not exceed 80% of the fair market value (selling price) of the completed project.