

The new SBA rules and their effects on your transactions!

These matter to you on so many levels, please read.

Building success through the sharing of information

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If you include SBA financing in your transactions, then you must have heard about the many changes going into effect on August 1st of 2023 in SOP 50-10-7. Many posts are promoting these changes as beneficial to our industry, but today I will explain the good, the bad, and the ugly about these changes and what they can mean to every American taxpayer. Note that this information is as of today, and much of this may change prior to the actual release date of August 1st, 2023.

Let us begin by outlining a few of the major changes in case you have not read these yourself.

- 1) Partial changes of ownership now allowed. (Current rules state it must be a 100% change of ownership)
- 2) Seller note contributions toward downpayment can be on standby for only 24 months. (Not the entire life of the loan)
- 3) Seller notes can now contribute 100% of the down payment amount. (Previous maximum was 50% of D/P)
- 4) Seller's may stay on as "Key" employees moving forward. (Now is only 12 months allowed and cannot be "Key")
- 5) Franchise eligibility approval is now left up to the lender to determine. (SBA Franchise registry has been removed)
- 6) Personal liquidity rules and limits removed. (Liquidity limits were in place)
- 7) Business affiliation changes from 20% to 50%

Once this SBA memo was released on May 9th, I began speaking with lenders around the country to better understand their initial thoughts and how we should expect underwriting policies to be adjusted. It initially appeared that these rules, although

extremely aggressive, provided lenders with additional avenues to assist our clients to secure acquisition financing. What I missed in these first memos was the granting of 3 FINTECH licenses to unregulated websites. The SBA was now going to allow algorithm-based lending, as was done for PPP loans in the past. The premise is to provide lower served communities the access to start-up capital loans ranging from 25K to 100K with very little criteria, and no personal interviews or communication. Congress has heard testimony from community banks that typically provide this type of loan, but buyers must qualify for them. The local community banks go on to explain how they work for many months with potential start-ups to help create business plans, compile projections, and provide valuable advice through the first years of operation, to ensure success. This level of advice and guidance is critical to the repayment ability of our borrowers and greatly decreases our defaults on this type of financing.

About FINTECH lending, (and yes, I had to Google it at first) a description that I found is as follows:

Fintech lending uses digital technology to enable lenders to issue loans through websites or mobile applications.

Many FINTECH lenders appeared during the PPP loan years to assist small business expedite their assistance loans. The issue here is that the FINTECH lenders produced significantly higher PPP loan fraud and default levels and had little to no oversight or regulation at all. These are not federal registered banks and do not have to abide by federal banking laws or regulations or oversight. The concern that many SBA lenders have today, is that these FINTECH lenders will create historical levels of default never experienced in the SBA's 70-year history. If the percentages come remotely close to the PPP default levels, then in just one year the entire program is expected to exhaust all funds available to provide guarantees for our acquisition loan requests.

A few highlights and positive changes in the new rules that do affect our industry. Now sellers can provide 24 months of seller financing on stand-by, and this can now be included as down payment. Prior to this change, a seller that was holding a seller note that contributed toward a buyer's down payment must have had to be on full stand-by for the entire life of the loan. This is a more palatable repayment term, and I would expect many more sellers to be open to agreeing to assist buyers with their down monies. The lenders I have spoken to seem to embrace and accept this rule and allow this structure to be included as of today.

Seller staying on as a key employee is another rule lenders may embrace. Something SBA said they would never allow in the past but now appears to be a possibility. Here is why these matter to our industry. Just think about all those businesses that require a specialty license, such as Electrical contracting, Construction, Plumbing and HVAC to name just a few. If the seller is now allowed to remain indefinitely with this business as a key employee, then it appears that they can hold the license moving forward. This has not been accepted by our lenders and does not take effect until August 1, 2023. Something to watch as we move forward as it can have a significant effect on your specialty listing options.

Allowing seller notes to contribute the entire down payment may take effect in August, but lender feedback is that most lenders will not approve a loan without some level of buyer injection. We are again monitoring this rule to see if A) if this takes effect, and B) what and how lenders will approach this. We expect there to be certain exceptions under lender policies to allow no down payment acquisitions for specific case scenarios.

Personal liquidity test removal is a substantial change for our firm, and maybe for yours also. The current rule in place only allows a borrower to retain a certain level of "Liquidity" post-closing, and if their liquidity is too great, they can become completely ineligible for SBA financing. The removal of this requirement now would allow any level of high-net-worth individual to secure financing for an acquisition. This level of buyer is typically looking for the larger size businesses and can now become financeable under the 7a program.

The bottom line for most brokers and Americans to understand about these changes is the exposure and increased chances for defaults. You may view the current SBA rules in place today as too strict, but I can assure you that if these new rules are implemented, that the SBA program itself will be in jeopardy. Based on the expected defaults, if these become law, we can all be picking up the tab and funding the SBA 7a program either through your taxpayer dollars (SBA has not been government supplemented since 2001) or the performing SBA small business loans will be costing much more to secure.

If you would like to learn more specifics and view the actual congressional hearings, please use the links below to view session part I and/or session part II. These are highly informative views from lenders, NAGGL and independent SBA providers presenting to the congressional small business committee. I have also included direct links to the SBA informational notices that were sent out on May 9th if you would like to read specific verbiage.

As we understand the lender interpretations, and the effects on business acquisitions, I will be sharing with the industry to keep you informed through future newsletters and webinars, so stay tuned.

To increase your success, direct your buyers to one of our highly trained SBA managers for their pre-qualification letter (at NO COST) and we will be happy to assist in the screening and closing of your transaction. We guarantee a **YES** or **NO** answer within 3 days of file submission. Try us and see the difference that personalized service, along with top level advice and lending sources, can make. We do not pay fees; we increase your commissions!

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[Full Committee Hearing: "Examining the SBA's Changes to the 7\(a\) Lending Program Part I" - YouTube](#)

[Full Committee Hearing - "Examining the SBA's Changes to the 7\(a\) Lending Program Part II" - YouTube](#)

[SBA Information Notice 5000-847027](#)

[Procedural Notice 5000-846607 - Implementation of the Final Rule on Affiliation and Lending Criteria \(sba.gov\)](#)