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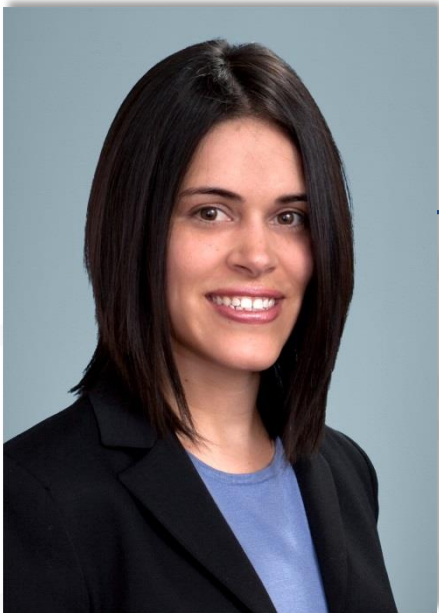
# **Before It Leaves the Bank: Closing Errors That Can Cost You Your Guaranty**

Mid-America Lenders Conference

April 8 – 10, 2019

# Instructors

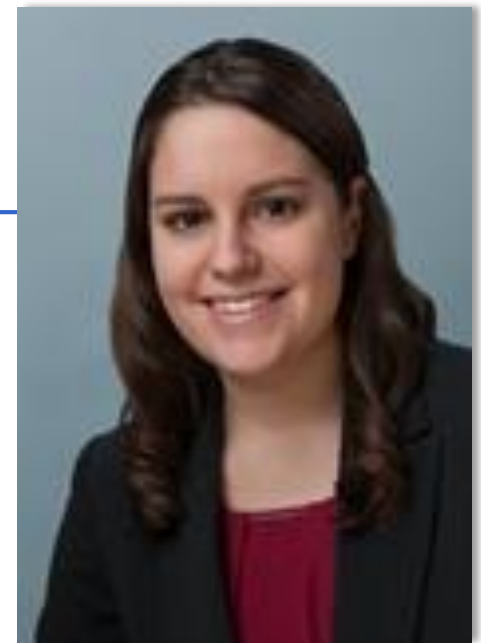
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Partner, Starfield & Smith, PC

Jessica Conn's areas of practice focus on government guaranteed lending, commercial lending, banking, real estate and commercial law.



**Katherine Tohanczyn**

Associate, Starfield & Smith, PC

Katherine has closed hundreds of government guaranteed loans nationwide and has assisted numerous of lenders in guaranteed purchase appeals to the SBA.

# AGENDA

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- ❑ Four Pillars of a Guaranty Purchase Review – How closing issues can come back later
- ❑ Possible Outcomes
- ❑ Common Closing Errors that Lead to a Repair or Denial
- ❑ SOP 50 10 5(K) Highlights

# The Four “Pillars” of a Guaranty Purchase Review

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- ❑ **Origination:** Determine that the loan was originated in accordance with regulations and Standard Operating Procedures in place at the time of origination. Eligibility is key.
- ❑ **Closing:** Evaluate whether the loan was closed in accordance with the Loan Authorization. Collateral is key.
- ❑ **Servicing:** Evaluate whether the servicing of the loan was in accordance with the loan documents, regulations, and prudent lending practices – and whether those actions caused harm to the Agency. Modifications and releases.
- ❑ **Liquidation:** Evaluate whether the liquidation and collection on the defaulted loan was prudent and followed program guidelines. Site visits, environmental reports, and appraisals.

# Possible Outcomes

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- ❑ **Purchase:** Purchase request is complete, there is no harm to the Agency, and meets all criteria for honoring the payment in full. A decision to fund is reached within the 45-day Brand Promise.
- ❑ **Repair:** A decision is reached to honor the guaranty, but not in the full amount, due to a material deficiency during origination, closing, servicing, and/or liquidation.
- ❑ **Denial:** A decision is reached to deny the guaranty in full. This must have headquarter's concurrence.
- ❑ **Cancel/Terminate:** Based on the facts of the case, the lender chooses to cancel or terminate the guaranty.
- ❑ **Withdrawal:** Lender needs more time to collect documents and provide additional information, therefore withdraws the request. The guaranty is still in full effect and the purchase request can be made anytime thereafter.

# Common Closing Errors

## ❑ Lien and Collateral Issues that Result in Missed Recoveries

- Failure to obtain required lien position
- Failure to properly perfect security interest
  - ❑ PMSI Issues
- Generally a Repair



# Common Closing Errors

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## □ Equity Injection

- Missing or unsupported verification of required equity injection (includes verification of source in some cases)
- Denial in early default



# Common Closing Errors

## ❑ Unauthorized Use of Proceeds

- Proceeds disbursed for purpose(s) inconsistent with the loan authorization or subsequent modifications without a business justification.
- Often a repair, but could be a denial if early default and improper use of proceeds caused the failure of the business)

## ❑ Disbursement Documentation

- What is needed?
- Leasehold Improvement
- Reimbursement to Borrowers
- Working Capital





# Franchise Agreements

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- FTC Definition of Franchise
  - Right to operate business associated with trademark
  - Significant degree of control
  - Franchisee makes a required payment
- Franchise Directory
  - Eligible under SBA's affiliation rules and other eligibility criteria
  - Franchise Identifier Code
- SBA Form 2642 v. Negotiated Addendum



# Common Closing Errors

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## ❑ **Verification of Financial Information**

- Missing or unsupported documentation of verification of borrower financial information with IRS when financial information was relied on in lender's credit analysis
- Denial in early default



# Common Closing Errors

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- ❑ Debt Refinance - Documentation
  - Notes, security agreements or other documentation evidencing debt
- ❑ Credit Cards
  - Credit card statement(s)
  - Certification
- ❑ Collateral
  - When is the same collateral required?



# Change of Ownership

- ❑ Must be COMPLETE
  - Seller may not remain as an officer, director, owner or key employee of the business
    - ❑ EXCEPT ESOP
- ❑ Entity must be co-borrower
- ❑ EPC/OC Partner Buyout
- ❑ 4506 on Sellers
- ❑ Valuations/Appraisals



"We're buying the company, the brand, the building ...  
but mostly we're buying the golden eggs."

## Review Documentation Carefully!

# SOP 50 10 5(K) Highlights

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- ❑ Personal liquidity consideration
- ❑ Applicant agreements and affiliation
- ❑ Illegal Industry
- ❑ Term for leasehold improvements
- ❑ SBA Form 159

# Questions

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