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Business Lending News

REFINANCING SBA LOANS CHAPTER 1:
REFINANCING DEBT AS RELATED TO SBA'S 'CREDIT ELSEWHERE TEST'

As promised, we're taking a look at the thorny issue of refinancing SBA loans. First up: Refinancing existing debt as related to the "Credit Elsewhere Test." In a previous eBulletin, we discussed that the language defining Credit Elsewhere calls for clarification:

What it doesn't mean: that the borrower has been turned down by several lenders, i.e., that they can't get credit from any other source.

What it means: To meet the "Credit Elsewhere Test," SBA loan eligibility is measured according to the applicant's needs, not the lender's: Do the borrower's needs exceed the lender's commercial lending policy? If so, the loan meets SBA's Credit Elsewhere Test. Effective October 1, 2015, qualifying areas may be a combination of factors including the borrower's need for a longer term and/or a larger loan amount than the lender's legal loan limit/policy; that the borrower has insufficient collateral; and /or that the business is a start-up.

So what about debt refinancing? Here's the tricky question. If the borrower already has a loan, doesn't that mean credit was available elsewhere? So how does the SBA justify guaranteeing loans that refinance existing debt? There's a lot to this. If your institution is considering refinancing existing SBA loans, complete details are in SOP 50 10 5 (H) Lender and Development Company Loan Programs, effective May 1, 2015. Refinancing is covered in Chapter 3. Subpart B; E. Policies Regarding Debt Refinancing, pgs. 112-117. Here's a brief overview of some key components:

The Key. First off, the original loan must have been SBA eligible or must now be eligible, and the proposed loan needs to provide the borrower with a substantial benefit. Additionally the loan must be treated as a debt of the business, and proceeds from the original loan must have been used by the business for a business purpose. And importantly, lenders may refinance existing SBA 7 (a) debt that SBA determines isn't "on reasonable terms." Written justification must be provided as to why the current loan isn't on reasonable terms. Unreasonable terms include but aren't limited to:

- loans involving a demand note or balloon note; or the current maturity isn't appropriate for the original purpose
- interest rate exceeds SBA's maximum
- debt being refinanced is on a revolving credit line or a credit card
- loan with an inappropriate maturity, e.g., loan with a three-year term that financed equipment with a 15-year useful life
- loan is over collateralized
- line of credit lender is unwilling to renew

Other debt SBA considers "not on reasonable terms" involves refinancing seller debt when there's a change of ownership. We'll address this issue in a separate eBulletin. Stay tuned for Refinancing SBA Loans: Chapter 2!

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