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Business Lending News

SBA CLARIFIES AFFILIATIONS FOR SBA ELIGIBILITY ... IT'S ALL ABOUT CONTROL, CONTROL, CONTROL!

A new [SBA Rule](#) effective July 27 clarifies what constitutes "control" in determining small business and franchise affiliations for SBA loan program eligibility. In many ways, the new rule helps open the door to SBA lending for small business owners and franchisees.

For Small Business Loans

SBA has clarified and amended sections of the previous rule in defining ownership, management, and identification of interest for SBA loan eligibility. As in the previous rule, it doesn't matter whether the control is exercised, it simply needs to exist as defined.

Affiliation Based on Ownership. The new rule has increased the definition of "control" from one party having control over 50% of voting equity to more than 50%, allowing more businesses to be eligible for SBA loans. If it were only that easy! SBA now clarifies terms of control as:

- Voting equity of concern:
 - The principal having more than 50% of voting equity in another business is determined as an affiliate
 - If no one person has majority voting equity, then SBA has determined control to be held by the company president, chairman of the board, chief executive officer (CEO) or other officers, managing members, partners or directors who control company management
 - A minority shareholder who can prevent or block a quorum will be deemed "in control"

Affiliation Based on Management. SBA has kept the principles of affiliation for common management in the previous rule. In the new rule, SBA has modified the language to clarify that management agreements are included in the types of managers and management subject to consideration under the new regulation.

Affiliation Based on Identity of Interest. SBA has clarified that there's an affiliation by identity of interests when close relatives have "identical or substantially, identical business or economic interests (such as where the close relatives operate concerns in the same or similar industry in the same geographic area)." As a lender, you need to discuss in your credit memo whether the applicant with a family member operating in the same industry constitutes an affiliation or whether the two businesses are separate.

Affiliation arising under stock options, convertible securities and agreements to merge. We see this rarely. Under the new rule, SBA didn't change the existing principles regarding these affiliations.

We wouldn't be JRB if we didn't give a simplified example of what you might come across: The NAIC code for a small business grocery is \$32 million over three years' average sales. So let's say grocery store owner Mr. Smith owns six small stores. As a lender, you must consider the three-year average income of all six stores. An average total over \$32 million will exceed SBA's eligibility requirement. Now let's say Mr. Smith owns just one store with \$16 million in aggregate

sales over three years. He also has controlling interest as defined by SBA in his cousin, Mrs. Smith's produce business - an affiliate relationship. This could possibly push Mr. Smith out of SBA eligibility for his grocery store loan. As a lender you need to review the companies' combined three year average sales. A total exceeding \$32 million pushes Mr. Smith out of eligibility. Under \$32 million? Green light to proceed.

As a lender, it's now more important than ever for you to have and review all entity documentation during the eligibility phase of an application since SBA has clearly outlined the need for review of Bylaws and Operating Agreements in determining an affiliation.

NOTE: As small business affiliation is a complex issue; this new rule may not be the last statement we hear. We would anticipate further clarification as time goes on.

For Franchise Loans: 'Affiliate' Clarification

The new rule has made SBA eligibility for franchise loans a lot easier. To not be defined as an "affiliate," a potential franchisee must simply: 1) have the right to profit from its efforts and; 2) bear the risk of loss commensurate with ownership.

Significantly, SBA has changed its review to only that of the pending franchisee (licensee)/ franchisor agreement. SBA will no longer consider the franchisee's other affiliate relationships with the franchisor. So if an applicant already owns several franchises, it's no longer required for lenders to review all of the borrower's franchise agreements to determine SBA eligibility. Only the one agreement under the lender's consideration is relevant.

It's all so easy, right? It can be. At JRB, we can help you navigate the waters of eligibility for SBA small business loan programs. [Contact JRB!](#)

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