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Business Lending News

SOME GUIDANCE FROM THE SBA: WHEN AND HOW SHOULD LENDERS PROTECT COLLATERAL?

In our still tough economic environment, we know many lenders are struggling with issues regarding protecting collateral in a variety of situations. Since the SBA has no hard-and-fast written rules for these situations, many of you are asking what the SBA's expectations are. We took your concerns, and some sample scenarios, to the SBA's National Guaranty Purchase Center in Herndon.

Here's a recap of the guidance we received:

Q: What are lenders expected to do to protect collateral when the loan isn't technically in default? Are lenders allowed to place their loans into default and initiate foreclosure if the borrower/principal is delinquent in property taxes, but the loan is current? Many of our clients expressed concern that the longer the tax delinquency, the less equity there may be in the property, especially if the property ends up in a forced sale.

A: This is a problem for all parties! The loan may be current, but the borrowers clearly have a problem. It's time to look under the rocks! The SBA expects the lender to visit the business to determine the real extent of the problem, because typically the loan has other issues besides the tax delinquency. If the situation warrants, lenders may call a default if the borrower can't/won't pay the outstanding taxes, and/or if the situation can't be resolved with a deferment or extension of maturity, or if a reasonable workout isn't possible or prudent.

If there are no other material issues, the SBA has had lenders advance the property taxes with the borrower repaying on a very short timetable. Of course this could become a habit and bad habits are hard to break. Bottom line: the SBA leaves it to the lender to do a comprehensive evaluation to determine the extent of the financial risk and the situation causing the non-payment to come up with a reasonable remedy.

Q: To insure or not to insure in "maybe" situations?

A: Better safe than sorry! The SBA expects lenders to use reason and common sense in protecting collateral. If the SBA has a reasonable expectation of tangible recovery value from its equity position, then lenders are expected to protect collateral with whatever the hazard requires. So if the property is in a flood plain, the SBA would expect flood insurance. Even if flood risk seems minimal in some flood plain areas, if the lender chooses not to cover and there's flood damage, the SBA would question that decision and measure the net effect of the "harm" in terms of diminished return on the collateral due to the damage.

Lenders don't need SBA approval to order any coverage. In fact, the SBA participates in any reasonable expense. Yet importantly, the analysis and credit memo must clearly and convincingly support the release decision as it will be reviewed at time of purchase and especially if there's a death that bears on the full repayment of the loan. The SBA sees the tax situation as similar to life and property insurance non-payment, which also would require lenders to evaluate each situation.

So it's not always clear sailing. At J.R. Bruno & Associates, we've helped hundreds of lenders buck the rapids of a tough economy and borrower struggles. Call us if you need assistance in evaluating your institution's borrower SOS. We'll help you navigate the waters!

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