The SBA Reverts Back to Stricter Lending Standards

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Effective June 1, 2025, Standard Operating Procedure (SOP) 50 10 8 introduced several significant changes to the U.S. Small Business Administration's (SBA) lending program. One main area of focus on this latest version of the SOP is underwriting standards. The SBA has reintroduced the underwriting standards that lenders were accustomed to pre-2021. This stems from some lackluster statistics that the SBA saw as recently as last year. For fiscal year 2024, the SBA 7a program saw negative cash flow. This was the first year of negative cash flow for the program in over a decade. According to current SBA officials, one key reason for this negative cash flow was the substantial rise in defaults from underqualified buyers. The "do what you do" philosophy that the SBA permitted SBA lenders to use during the Biden administration has been eliminated in full as part of the latest SOP. This philosophy allowed SBA lenders to use their respective internal commercial lending practices when SBA guidance was not explicitly clear on applicable procedures. This is no longer allowed with the new SOP, and stricter underwriting requirements are back in place.

Moving forward, the SBA is effectively requiring all loans to be collateralized. Any SBA loan of $50,000 or more will require collateral, significantly down from the threshold of $500,000. The SBA has also returned to a 10% equity injection threshold on any transaction involving a startup business or change of ownership. The highly popular use of seller notes will also be impacted under the scope of the new equity injection requirements. Under the new SOP, only full standby seller notes that carry the entire term of an SBA 7a loan can qualify as part of the equity injection, but only up to 50% of the required equity injection amount. Notes with principal or interest payments, and even partial standby notes, do not fall within the SBA's scope to satisfy some, or all, of an equity injection requirement.

The SBA's franchise directory was also brought back to assist SBA lenders. The directory confirms if a

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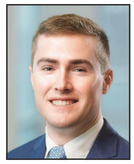

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given franchise and business model is preapproved by the SBA. For the preapproved franchises, SBA review of franchise due diligence is no longer necessary. For franchises and business models that don't appear in the directory, ineligibility is possible, but if not, a thorough review of franchise, license and management agreements, as applicable, must be handled by SBA lenders. To further improve efficiency of the due diligence review process for franchise lending, a franchise will get added to the franchise directory upon submission of a signed master agreement with a lender and the SBA. By getting this agreement submitted and approved, every SBA borrower applying for financing in connection with a given franchise will not need to obtain and provide a franchise addendum to the SBA. The franchise addendum is no longer required for any borrower using SBA lending.

Overall, the latest changes in the SOP have likely reduced the volume of SBA-eligible borrowers that lenders have been accustomed to for the last several years. While reduced volume is not something that any lender wants to hear, the stricter underwriting and eligibility requirements will reduce headaches for lenders that came from the substantial rise in defaults.

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