

## **CRACKING THE CODE: HOW RECENT SBA CHANGES TO SMALL BUSINESS ELIGIBILITY RESHAPES LENDING LANDSCAPE**

SBA Releases Changes on Franchise Directory & Definition of Affiliates for SBA 7(a) and CDC/504 Loan Programs

By Laurie Satel, Managing Attorney | July 18, 2023

### **Important Change: SBA Updates Franchise Directory and Lender Requirements**

As of May 11, 2023, the Small Business Administration (SBA) released SBA Procedural Notice No. 5000-84667 which has implemented a significant change regarding franchise standards and lender requirements. The requirements replace all text at SOP 50 10 6, Part 2, Section A, Ch.1, Para D. 4-6 and are applicable to Business Loans, Disaster Loans and Surety Bond Guarantee Programs and will take effect August 1, 2023.

The SBA will no longer publish the SBA Franchise Directory, and SBA lenders are no longer obligated to enter a franchise identifier number into E-Tran. Instead, SBA lenders now bear the responsibility of ensuring that loan applicants meet the necessary loan program requirements.

This change shifts the onus onto SBA lenders to verify and confirm that loan applicants comply with the appropriate program criteria. The SBA Franchise Directory, previously relied upon by lenders, is no longer in use. Moving forward, lenders must independently assess and ensure that loan applicants meet the necessary standards and qualifications based upon the SBA's definition of Affiliation.

### **Understanding Affiliation: SBA's Definition of Small Business and Affiliated Entities**

According to the Small Business Act, a small business concern is defined as an independently owned and operated entity that is not dominant in its field of operation. The Small Business Administration (SBA) further interprets this definition to include the consideration of affiliated entities in certain cases, which are businesses owned by the applicant or an owner of the applicant.

In determining the size of the applicant, the SBA may require the inclusion of these affiliated entities. This means that the SBA takes into account the combined resources, revenues, and employee count of both the applicant and the affiliated entities. This consideration is crucial in assessing whether a business meets the criteria to be classified as a small business.

Understanding the concept of affiliation and its impact on determining the size of a business is essential for navigating SBA programs and eligibility requirements. Lenders should verify NAICS codes to verify if the affiliate operates in the same 3-digit NAICS subsector as the applicant.

#### Affiliation Triggers:

1. When the Applicant owns more than 50 percent of another business, the Applicant and the other business are considered affiliated.
2. When a business owns more than 50 percent of an Applicant, the owning business is affiliated with the Applicant. If the owning business also owns more than 50 percent of another business operating in the same 3-digit NAICS subsector as the Applicant, all three entities (owning business, other business, and Applicant) are affiliated.
3. When an individual owns more than 50 percent of the Applicant and also owns more than 50 percent of another business operating in the same 3-digit NAICS subsector as the Applicant, the Applicant and the individual's other business entity are affiliated.
4. If an owner of 20 percent or more of the Applicant is a business operating in the same 3-digit NAICS subsector, the Applicant and the owner are affiliated.
5. If an owner of 20 percent or more of the Applicant also owns more than 50 percent of another business operating in the same 3-digit NAICS subsector, the Applicant and the owner's other business entity are affiliated.
6. Ownership interests of spouses and minor children are combined when determining the amount of ownership interest.
7. When determining the percentage of ownership an individual has in a business, the SBA considers the pro rata ownership of entities. For example, if an individual owns a percentage of the Applicant and also owns 100 percent of another entity, the SBA considers the individual's total ownership percentage in the Applicant to be the combined amount.

## Affiliation Based on Stock Options, Convertible Securities, and Agreements to Merge:

Stock options, convertible securities, and agreements to merge are treated as if they have already been exercised and have a present effect on ownership. The SBA considers these options, securities, and agreements as though the rights granted have been utilized.

1. Agreements to open or continue negotiations for a potential merger or stock sale at a later date are not considered “agreements in principle” and do not have present effect.
2. Options, convertible securities, and agreements subject to conditions precedent that are incapable of fulfillment, speculative, unenforceable, or highly improbable are not given present effect.
3. Divesting ownership interest solely to avoid affiliation is not recognized by the SBA.
4. When determining the size of a concern, the SBA considers the receipts, employees, or alternate size standard of the concern in question and includes all domestic and foreign affiliates, regardless of profit status.
5. An Economic Partnership and its Operating Companies are treated as a single entity.
6. For exceptions to affiliation, refer to § 121.103(b) of the SBA regulations.

Stay informed, adapt to the changes, and rely on Satel Law for expert advice to navigate the evolving landscape of SBA loan requirements. Together, we can navigate these modifications and achieve your lending objectives effectively.

***For more further information please contact our experienced attorneys at 813.563.0636, or email [sba@satellawfirm.com](mailto:sba@satellawfirm.com)***

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