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# Long-Awaited Changes to the SBA 7(a) Loan Program for Change of Ownership Financing Now in Effect

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A long-anticipated change to the U.S. Small Business Administration's (SBA) 7(a) Loan Program went into effect on May 11, 2023. This change will allow borrowers to use 7(a) loan proceeds to purchase a portion of a business or finance a partial change of ownership when, historically, 7(a) loan proceeds could only be used to purchase 100% of a business.

The 7(a) Loan Program provides support to small businesses through access to capital. Through this program, SBA-approved lenders make direct loans to qualified borrowers and receive a guarantee of that loan from the SBA. Guarantees are generally between 50% to 75% of the loan amount, but can be up to 90%.

One of the primary uses of 7(a) loan proceeds has been to provide funding for changes of ownership to preserve the existence of small businesses. While fairly accessible, there are certain eligibility thresholds that a business must meet to qualify for these loans. In addition to the standard eligibility requirements, the rules governing the use of loan proceeds towards a change of ownership are provided by the SBA Standard Operating Procedures (SOP) 50 10 6, and Title 13 of the Code of Federal Regulations (CFR), sections 120.202 and 120.130.

Historically, the SBA only permitted the use of 7(a) loan proceeds to finance a complete change of ownership. Whether it was accomplished through an equity purchase or asset purchase, the change in ownership needed to result in the purchaser(s) owning 100% of the business after the transaction closed (with limited exceptions to permit the acquisition of a controlling interest in a business through an employee stock ownership plan (ESOP) or equivalent trust). With the upcoming change to the rule, borrowers will have more options available to them under the 7(a) Loan Program.

The SBA is revising 13 CFR Sections 120.202 and 120.130 to permit 7(a) loan proceeds to be used by a borrower to purchase a portion of a business or an owner's interest in a business, or to purchase some of the interests of multiple owners, in addition to a complete change of ownership. A corresponding change to the SOP is expected to be forthcoming.

As part of this revision, the SBA has indicated that they intend to permit seller(s) to remain as an owner, officer, director or key employee and remain involved in the day-to-day operations of the business. This is a departure from the current regulations that only permit a seller to remain as an officer, director or key employee of the business for a period not to exceed 12 months (except in circumstances where the purchaser is an ESOP).

The SBA has also indicated it is reviewing potential changes to the equity injection requirements, however, those requirements remain unchanged at this time. New owners are required to inject at least 10% of the total project costs. Existing owners purchasing another owner's interest may be exempt from the 10% equity requirement if:

- They have been actively participating in the business operations and have held the same or increasing ownership interest in the business for the past 24 months.
- The business balance sheets for the most recent completed fiscal year and current quarter reflect a debt-to-worth ratio of no greater than 9:1 before the change in ownership. In the event either of these conditions are not satisfied, the equity injection remains at 10% of the project costs.

One last item of note, the SBA does not lend to individuals. Any partial change of ownership will require the business to be the borrower or co-borrower with the person(s) acquiring the partial ownership interest. The SBA will be providing further information through the formal issuance of the next generation of the SOP and through its lender outreach programs.

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