

MOUNTAIN WEST SMALL BUSINESS FINANCE MASTERS IN 504 LENDING

■ Affiliation



TODAY'S PRESENTER:

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3 TAKEAWAYS:

- You don't need to be an affiliation expert, that's what we're here for.
 - If you have a concern, contact us early (size standard (is the applicant too big?), franchise/management agreements, etc.)
- Most businesses are not too big
- If we ask for it, it's because we need it

MOST COMMON QUESTION: HOW DO YOU CALCULATE THE 504 SIZE STANDARD?

- Applicant Net Worth:
 - OC (applicant), EPC, and all affiliates must have a tangible net worth of \$15 MM or less at the time of application
- Applicant Revenue
 - OC (applicant), EPC, and all affiliates must have 2-year average Net Profit After Taxes of \$5 MM or less at the time of application

MOST COMMON QUESTION: HOW DO YOU CALCULATE THE 504 SIZE STANDARD?

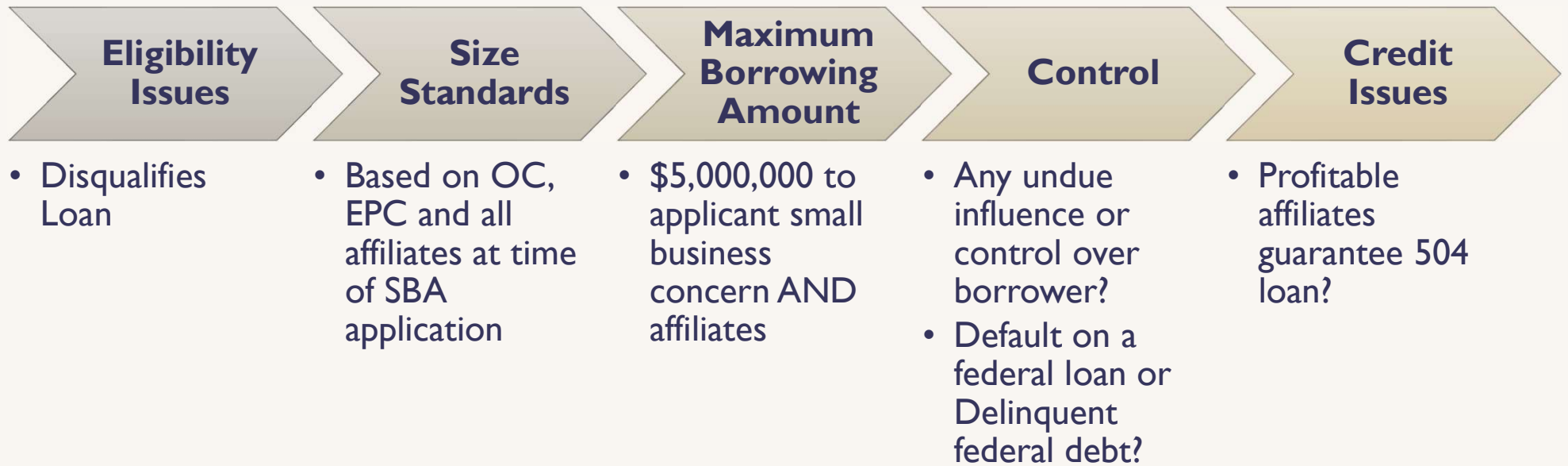
- Let's crunch some numbers!



CHECK OUT THIS 18 AFFILIATE BANGER

Entity	Association	Overridden	Tangible Net Worth (000)	Profit Last Year (000)	2 Years Ago (000)
[REDACTED] ...	EPC		(\$108)	\$155	\$137
[REDACTED] LLC	Primary OC		\$3,792	(\$1,077)	\$277
[REDACTED] ...	Operating Company		\$3,200	\$3,471	\$1,558
[REDACTED] REAL ESTATE HOLDINGS,...	Affiliate	✓			
[REDACTED] LLC	Affiliate	✓			
[REDACTED] LLC	Affiliate	✓			
[REDACTED] LLC	Affiliate		\$32	\$63	\$1,283
[REDACTED] LLC	Affiliate	✓	\$97	\$150	(\$68)
[REDACTED] L.L.C.	Affiliate	✓	\$219	\$187	(\$60)
[REDACTED] LLC	Affiliate	✓	\$241	(\$8)	(\$60)
[REDACTED] LLC	Affiliate	✓	\$6	\$30	\$27
[REDACTED] ...	Affiliate	✓	\$2,627	\$963	\$854
[REDACTED] LLC	Affiliate	✓	\$395	\$69	\$196
[REDACTED] ...	Affiliate	✓	\$2,086	\$1,168	(\$806)
[REDACTED] LLC	Affiliate	✓	\$848	\$110	(\$584)
[REDACTED] ...	Affiliate	✓			
[REDACTED] LLC	Affiliate	✓			
[REDACTED] LLC	Affiliate	✓	\$214	\$89	\$50
Average Profit (000):			\$13,649	\$5,370	\$2,803
					\$4,087

WHY DO WE CARE?



ASSOCIATE – CFR §120.10 DEFINITION

An Associate of a small business is:

- Officer, director, owner of more than 20% of equity, or key employee of small business
- Any entity in which one or more individuals above owns or controls at least 20%
- Any individual or entity in control of or controlled by small business

Duration of Associate relationship:

- 6 months before loan application date to SBA
- Continues as long as loan is outstanding

3 Reasons We Care About Associates?

- Prior Arrest, convictions – Form 1244, Section XIX or Form 912's
- Personal guarantees
- Prior Loss to Government and Delinquent Federal Debt

AFFILIATION MISCONCEPTION

- Many (if not most) lenders approach issue of affiliation by determining owners of 20% or more of Applicant business (“Principals”) and then assuming that all other businesses owned by those Principals must be an “Affiliate”
- This is not always accurate
- This also confuses issue of Associate versus Affiliate
- Affiliation is all about **CONTROL** or **POWER TO CONTROL**
- Continues to be **SLPC HOT BUTTON ISSUE**

AFFILIATION FOR BUSINESS LOAN PROGRAMS

Control

- Affiliation exists when one individual or entity controls or has power to control another, **OR**
- A third party(ies) controls or has power to control **both**
- Does not matter whether control is exercised, so long as power to control exists

Factors considered

- Ownership
- Stock options, convertible securities, agreements to merge
- Management
- Identity of Interest
- Franchise and License Agreements

AFFILIATION BASED ON –

1. Ownership

- More than 50% voting control
 - If none, control rests with Board, President, CEO, etc. per organizational docs
 - Be mindful of potential Negative Control by minority owner

2. Stock Options, etc.

- Assumed to have “present effect”

3. Management

- Common controlling management – individuals or entities
- Also extends to common controlling boards of directors
- Control through management agreement creates affiliation – i.e. third-party hotel management companies

MANAGEMENT AGREEMENT REVIEW

- Management company has sole discretion over business operations with minimal oversight of decision-making by Applicant business → AFFILIATED
- To avoid affiliation, management agreement must include Applicant business having “meaningful oversight” over management company’s activities, including –
 - Approve annual operating budget
 - Approve any capital expenditures or operating expenses over a significant dollar threshold
 - Have control over the bank accounts
 - Have oversight over the employees operating the business (who must be employees of the Applicant business)
- SBA review/approval
 - For non-PCLP loans, CDC submits management agreement to SLPC for pre-application review/approval
 - For PCLP loans – CDC reviews management agreement for affiliation and documents file

TRIVIA BREAK!!!

- Rap star Calvin Broadus Jr. is more commonly known by what name?
- Snoop Dogg
- Also acceptable, Snoop Doggy Dogg, or Snoop Lion



AFFILIATION BASED ON –

4. Identity of Interest

- Affiliation arises when there is an identity of interest between “close relatives” with “identical or substantially identical business or economic interests”
- “Such as where the close relatives operate concerns in the same or similar industry in same geographic area”
- “Close Relative” – a spouse, a parent, a child or sibling; or spouse of any such person (13 CFR 120.10)
- May rebut determination with evidence showing interests are separate

AFFILIATION – IDENTITY OF INTEREST

- Presumption of affiliation
 - SBA presumes that affiliation arises between two firms that are controlled by close relatives
 - No common ownership or management is required for SBA to have this presumption
- There must be control
 - The presumption does not arise if one or both family members does not have control of his/her respective firm
- There must be a business connection – the presumption only arises if the family-owned businesses –
 - are in the same industry, and
 - are in the same geographic area, and
 - have some established business relationship with each other (i.e. buy and sell goods and/or services, subcontracts or joint ventures, shares or provides loans, resources, equipment, locations or employees)

AFFILIATION – REBUTTING IDENTITY OF INTEREST

- Demonstrate at least one of the family members does not control his/her respective firm – collect Organizational Documents
- Establish an estrangement between close family members
- Businesses are not in same line of work
- Businesses are in different geographic locations
- Establish a clear line of fracture between the businesses
 - Do not conduct business with each other
 - Do not share personnel, office space, back office functions, etc.

AFFILIATION BASED ON –

5. Franchise/License Agreements

- Generally do not create affiliation, provided applicant franchisee/licensee has right to profit from its efforts and bears risk of loss commensurate with ownership
- Reviews limited to applicant concern only
- Use SBA's new Franchise Directory at <https://www.sba.gov/sba-franchise-directory>

AFFILIATION “HOT BUTTON ISSUES”

- Disclose ALL “Potential” affiliates and why/why not affiliated
- Source of possible affiliates
 - PTR schedules B, C, D, E, F, etc. and Forms K-1s
 - Personal Financial Statement – be careful about undisclosed Trusts
- For ALL potential entities, determine CONTROL
 - If control exists, entity is an **AFFILIATE**
 - If no control exists, entity is a **RELATED NON-AFFILIATE**
- Disclose Affiliates in CDC Credit Memo
 - “Management Control” chart of CDC Credit Memo’s management analysis section
 - Exhibit 10 of Loan Application Package
- **HOT BUTTON for SLPC and OCRM Reviews**

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MOUNTAIN WEST SMALL BUSINESS FINANCE MASTERS IN 504 LENDING

Please join us for our next Masters in 504 Lending Session

- August 25th at 11:00am
- Topic:
- Please invite all of those in your offices who have any present or potential future, role in 504 lending to attend

THANK YOU

