



## What Franchisees Can Expect from the New SBA Policy

The Small Business Administration (SBA) recently published [SBA Notice 5000-1399](#), relating to the issuance of [SOP 50 10 5\(l\)](#). **The new SOP includes revised franchise procedures intended to provide a more streamlined process and faster turnaround time relating to loans made to franchised businesses that were historically ineligible for SBA-guaranteed loans if the franchisor was deemed to be an “affiliate” of the borrower-franchisee.**

The SOP outlines changes in how the SBA will determine “size eligibility based on affiliation for franchised businesses.” Under this provision, the SBA will not generally consider restraints imposed on a franchisee by its franchise or license agreement to decide whether the franchisor is affiliated with an applicant franchisee or licensee, as long as the applicant franchisee has the right to profit from its efforts, and bears the risk of loss commensurate with ownership. Instead, the SBA will only consider the franchise or license agreements of the borrower-applicant.

- Under the new provisions, which took effect January 1, 2017 and affect both the 7(a) and 504 programs, the SBA has subsequently discontinued its registry of pre-approved unaffiliated franchisors and lists of ineligible-affiliated-franchisors. Now, for every individual loan, franchisors and borrower franchisees simply sign a mandatory, two-page Addendum to the Franchise Agreement, to satisfy the SBA that the franchisor and franchisee are not affiliated.
- The new SBA Addendum will prevail over any conflicting term(s) in the franchise agreement. This primarily affects areas of undue control by the franchisor over the franchisee in the areas of: covenants, employee hiring, change of ownership, and forced sale of assets.
- These changes are good news for borrowers. With this new “one and done” addendum and additional changes to franchise agreements, franchisees can look forward to a more streamlined transaction, as well

as less strict franchisor limitations on partial transfers, franchisee liability after a sale and how the real estate is used.

The amendment remains in effect until the loan is paid in full or SBA no longer has an interest in it. The language is set-in-stone and borrowers must still meet all other bank/lender and SBA loan eligibility requirements. Lenders must identify the specific franchise involved and submit the signed amendment at the time of application with the SBA. Failure to comply may result in a denial of liability on the guaranty.

In the past, franchisors had wider limits on their right to first refusal in the case of a partial transfer. According to the new amendment, those limits are reduced to only instances where the partial transfer is to an existing owner or the family members of an existing owner or principal. Franchisors can't block a transfer by "unreasonably" withholding consent, and post-sale the selling franchisee cannot be held liable for the new franchisee's obligations.

Also within the new agreement, if you own the franchised property, your franchisor cannot restrict how you use the real estate. However, if your business restricts patrons based on non-capacity issues such as gender, it will not be eligible for SBA financing. Although franchisors can't force you to sell the property to them when the franchise agreement is terminated or expires, they can require a lease be put in place at market rate.

Master franchises and borrowers whom the SBA deem dominant in or having too much control over their industries, are not eligible for SBA financing. Franchisees operating or looking to operate multiple franchises within a specific geographic area under an area development rights agreement, may be eligible.

Please refer to [SBA Notice 5000-1399](#) and [SOP 50 10 5\(I\)](#) for more information. Please consult with your lawyer to determine how these changes will affect your individual situation. Questions can also be emailed to the SBA at [FranchiseFY2017@sba.gov](mailto:FranchiseFY2017@sba.gov).

If you are in the market for hotel financing, contact Rushi Shah at [312-640-7430](tel:312-640-7430) or [rshah@conloncapital.com](mailto:rshah@conloncapital.com) to compare SBA and other debt options. Conlon Capital specializes in CMBS and other short and long-term non-recourse lending products for loan sizes \$5 million and higher.