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A Valentine's Day Gift from the SBA - After Just Six Weeks, the SBA Modifies its Franchise Review Process

In an alert from late December of last year, we informed you of a change in the process that the Small Business Administration (SBA) implemented in its process for determining whether, from the SBA's perspective, franchisees are independent, small businesses and thus qualified to receive SBA-assisted financing. These changes went into effect on January 1, 2017. The SBA has now notified its employees, SBA lenders, and other parties of a temporary change to this process. These changes went into effect yesterday, on February 14, 2017, and are in place until further notice.

Beginning immediately, rather than requiring use of the SBA's standardized (non-negotiable) franchise agreement addendum in all cases, a lender may do one of two things: (1) it can submit as part of its loan package to the SBA the standardized SBA franchise agreement addendum (which the SBA has slightly modified); or (2) this is the new option—if the franchisor has a 2015 or 2016 form of SBA addendum that was negotiated and approved by the SBA, the lender can submit that negotiated SBA addendum along with a standardized certification form signed by the franchisor. If the franchisor does not have a 2015 or 2016 form of negotiated SBA addendum, this second option is not available, and the lender must submit the current form of standardized SBA franchise agreement addendum, as signed by the franchisor and franchisee.

As mentioned above, along with this change to the franchise review process, the SBA has also modified the standardized SBA franchise agreement addendum. The revisions are largely technical, but a few are worth summarizing briefly. First, the SBA will allow the form addendum to be modified to address types of agreements other than just franchise agreements (for instance, license agreements) and to change the terminology of the

parties to the addendum to match the agreement being signed (for instance, licensee/licensor). Second, if the franchisee owns the real estate where the franchised location is to operate, the new form of addendum requires that if the franchisor has, at the time financing is sought, recorded any restrictive covenants against the real estate, such covenants must be removed in order to qualify for SBA-assisted financing. Finally, the addendum clarifies that for temporary personnel franchises, the temporary employees must be employed by the franchisee.

If you are a franchisor and you receive a request from an SBA lender, we recommend you confirm that the lender has followed the correct process. It has been our experience over the past six weeks that even lenders from large, national banks have been using outdated forms and processes in connection with the rollout of the SBA's new process at the beginning of this year. With such fast-changing implementation, questions are sure to arise.

February 2017

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