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Business Lending News

A CAUTIONARY CAIVRS TALE: SEE POSSIBLE RED FLAGS? DIG A LITTLE DEEPER. CONTACT SBA!

Since SOP 50 10 5 (D) became effective in October 2011, lenders are required to perform CAIVRS searches for all SBA loan applications. As you know, the Credit Alert Verification Reporting System (CAIVRS) is a database run by the U.S. Department of Urban Development (HUD). A CAIVRS search tells you if one or more of the parties to a federal/government-guaranteed loan - SBA loan, FEMA loan, or student loan - has ever defaulted.

As part of your due diligence, you search CAIVRS using the information on all parties the borrower provided on Form 1919. Before we go on, it's important to note that about 95% of applications get no hits on CAIVRS. So under normal circumstances, it's OK to proceed.

But Be Forewarned: Cautionary Tales. Let's say that after a clean CAIVRS search you go through the time and expense of environmental reports, collateral evaluations and the details involved in loan processing. And lo, SBA denies the loan. It happens. There's something lurking in the background that didn't show up on CAIVRS. Or let's say a party to a loan answers Form 1919 in the honest belief he has no past defaults and one turns up on SBA's radar that did not get reported to CAIVRS.

How were you to know? Sometimes clues on the application tell you to take a closer look at all parties to the loan and other details before you proceed. First, a couple of hypothetical cases:

Tale #1: The Hidden Default. A few years back two partners got an SBA loan for $1 million to start a small business. Midway into development, they decided against the venture, and a 3rd party offered to purchase the note. The parties agreed to an Offer in Compromise of $600,000, which SBA approved.

Here's the rub: Although SBA approved the Offer in Compromise, the loan balance is technically still out there. Fast forward 10 years. The partner to the old loan enters into a new agreement with another partner and they apply for an SBA loan. The new partner doesn't know any of the background. And the old partner believes his old loan is paid off. Here's the deal: SBA's database is more robust than CAIVRS. It picks up the old loan - and the $400,000 balance - while processing the new loan. In cases like this, if the delinquent federal debt or prior loss to the government is fully satisfied, i.e., if the balance can be paid off, the application can be processed. Yet in this case, the party to the old loan can't afford to pay the outstanding $400,000 balance, so the new loan can't proceed. The partners are out of luck. And the lender is out time, resources, and money. See SOP 50 10 5 (I), Subpart B, Chapter 2, page 95, q.viii.

Tale #2: The 'Forgotten' Default. Here, a husband and wife are parties to an SBA loan and the lender is proceeding. Then CAIVRS finds a default on the husband. He'd had a bevy of student loans and honestly forgot about one. The balance is small, so he pays it off and the loan proceeds. Phew! Yet it's always possible that a party to a loan didn't tell the truth on Form 1919. So even though he pays off the balance after getting caught, there's a question of character.

How are you to know? How to head off problems? Our thoughts: If you have even an inkling of a red flag on an application, it's important to dig deeper before going on. Begin with the interview. Ask probing questions of all parties to the loan. Someone might have answered falsely on Form 1919 in all innocence. If so, you can take immediate action to clear things up. Or the borrower might see one of the principals in a new light and re-evaluate.
Also, while CAIVRS is a good resource, in rare circumstances delinquent federal loans or prior losses might not be picked up. This can come about when there is an anomaly such as an Offer in Compromise related to a prior loss that's hanging around in the background. Acknowledging that this could happen, it's a good idea to check out other resources including credit reports. Or consult your SBA District Office for further guidance.

A tale well told? We hope so. Better to take early action than expend valuable resources and have your loan come back and bite you.

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