

SBA can issue a lease guarantee only when "there exists a reasonable expectation that the small business concern, in behalf of which the guarantee is issued, will perform the covenants and conditions of the lease." In other words, we are not to take undue risks.

The legislation also requires that the SBA share of the fee for the lease guarantee protection cannot exceed $2\frac{1}{2}$ percent per annum of the minimum annual guaranteed rental.

As a result of this legislation, the rates established from actuarial studies in effect limit SBA to direct lease guarantee protection for periods of 15 years or longer, since the higher risks in the early years of a lease require a larger premium.

To underwrite leases for a shorter period—5 to 15 years—SBA must participate with a private insurance company, with SBA as reinsurer.

The legislation also provides that the program must be self-sustaining—the fees or premiums that SBA charges must cover the costs of the program.

Some of the basic conditions under which the lease guarantee program operates are:

There must be a lessor-lessee relationship; that is, there must be a bona fide lease involved.

The lessee applicant must show that it cannot obtain the lease without a guarantee and that it was unable to obtain a lease guarantee from a private source upon reasonable terms meeting the requirements of the applicant.

SBA seeks the widest possible participation with private insurance companies in this program. In such participations, leases may be guaranteed for a minimum of 5 years up to a maximum of 20 years, with SBA as reinsurer.

Premiums are calculated as a percentage of total minimum rent guaranteed and range from 6.5 percent for a 5-year lease to 2.1 percent for a 20-year lease.

Premiums are payable in advance, and there is no refund provision.

The lessee must pay 3 months' rent in advance, to be held in escrow, repayable with 4-percent interest at lease termination unless used to pay rent defaults.

In case of default, the landlord must satisfy certain requirements, such as prompt notification of default to insurers, before he can make a claim. He must also look to the escrow first to satisfy default rentals.

If private participation is not available, SBA may make direct lease guarantees. However, as I have mentioned, the legislative limitation of 2.5 percent on the SBA share of the risk prohibits our guaranteeing directly leases with terms of less than 15 years.

Since this is a self-sustaining insurance program, it became necessary to develop rate levels and premiums which would support the risks and exposures anticipated. Various actuarial studies have been completed. In these studies, expected rates of default are determined by analysis of key business characteristics, the influence of general economic conditions, and months' rent lost in default. Basic risks are related to management experience, financial structure, location factors, normal economic fluctuations, and the risk of depression and recession.

A uniform rate for all leases of the same terms was established. The gross premium includes a "load factor" of 20 percent to cover administrative costs and a fair profit to the participating company.