(2) You make a follow-on investment, in which case the new securities may be redeemed in less than one year, but no earlier than the redemption date associated with your earliest Financing of the concern.

(b) The redemption price must be either:

(1) A fixed amount that is no higher than the price you paid for the securities; or

(2) An amount that cannot be fixed or determined before the time of redemption. In this case, the redemption price must be based on:

(i) A reasonable formula that reflects the performance of the concern (such as one based on earnings or book value); or

(ii) The fair market value of the concern at the time of redemption, as determined by a professional appraisal performed under an agreement acceptable to both parties.

(c) Any method for determining the redemption price must be agreed upon no later than the date of the first (or only) closing of the Financing.

[61 FR 3189, Jan. 31, 1996, as amended at 64 FR 52646, Sept. 30, 1999; 69 FR 8098, Feb. 23, 2004]

§ 107.855 Interest rate ceiling and limitations on fees charged to Small Businesses ("Cost of Money").

''Cost of Money'' means the interest and other consideration that you receive from a Small Business. Subject to lower ceilings prescribed by local law, the Cost of Money to the Small Business must not exceed the ceiling determined under this section.

(a) *Financings to which the Cost of Money rules apply*. This section applies to all Loans and Debt Securities. As required by § 107.800(b), you must include as Debt Securities any equity interests with redemption provisions that do not meet the restrictions in § 107.850.

(b) *When to determine the Cost of Money ceiling for a Financing*. You may determine your Cost of Money ceiling for a particular Financing as of the date you issue a Commitment or as of the date of the first closing of the Financing. Once determined, the Cost of Money ceiling remains fixed for the duration of the Financing.

(c) *How to determine the Cost of Money ceiling for a Financing*. At a minimum, you may use a Cost of Money ceiling of 19 percent for a Loan and 14 percent for a Debt Security. To determine whether you may charge more, do the following:

(1) Choose a base rate for your Cost of Money computation. The base rate may be either the Debenture Rate currently in effect plus the applicable Charge determined under § 107.1130(d)(1), or your own ''Cost of Capital'' as determined under paragraph (d) of this section.

(2) For a Loan, add 11 percentage points to the base rate; for a Debt Security, add 6 percentage points. In either case, round the sum down to the nearest eighth of one percent.

(3) If the result is more than 19 percent (for a Loan) or 14 percent (for a Debt Security), you may use it as your Cost of Money ceiling.

(4) If two or more Licensees participate in the same Financing of a Small Business, the base rate used in this paragraph (c) is the highest of the following:

(i) The current Debenture Rate plus the applicable Charge determined under § 107.1130(d)(1);

(ii) The Cost of Capital of the lead Licensee; or

(iii) The weighted average of the Cost of Capital for all Licensees participating in the Financing.

(d) *How to determine your Cost of Capital*. ''Cost of Capital'' is an optional computation of the weighted average interest rate you pay on your ''qualified borrowings''. ''Qualified borrowings'' means your Debentures together with your borrowings at or below the usual interest rate charged by banks in your locality on the date your loan was made.

(1) For any fiscal year, you may compute your Cost of Capital:

(i) As of the first day of your fiscal year, to remain in effect for the entire year; or

(ii) As of the first day of every fiscal quarter during the fiscal year, to remain in effect for the duration of the quarter.

(2) For each qualified borrowing outstanding at your last fiscal year or fiscal quarter end, multiply the ending principal balance (net of related

unamortized fees) by the number of days during the past four fiscal quarters that the borrowing was outstanding, and divide the result by 365.

(3) Add together the amounts computed for all borrowings under paragraph (d)(2) of this section. The result is your weighted average borrowings.

(4) For all qualified borrowings outstanding at your last fiscal year or fiscal quarter end, determine the aggregate interest expense for the past four fiscal quarters, excluding amortization of loan fees. For the purposes of this paragraph (d)(4):

(i) Interest expense on Debentures includes the 1 percent Charge paid by a Licensee under § 107.1130(d)(1); and

(ii) Section 301(d) Licensees with outstanding subsidized Debentures are presumed to have paid interest at the rate stated on the face of such Debentures, without regard to any subsidy paid by SBA.

(5) Divide the interest expense from paragraph (d)(4) of this section by the weighted average borrowings from paragraph (d)(3) of this section, and multiply by 100. The result is your Cost of Capital, which you may use to compute a Cost of Money ceiling under paragraph (c) of this section.

(e) *SBA review of Cost of Capital computation*. You must keep your Cost of Capital computations in a separate file available for SBA's review.

(1) A computation that is kept in such a file and is audited by your independent public accountant is considered correct unless SBA demonstrates otherwise.

(2) If a computation is not kept in such a file or is unaudited, you must prove its accuracy to SBA's satisfaction.

(f) *Charges included in the Cost of Money*. The Cost of Money includes all interest, points, discounts, fees, royalties, profit participation, and any other consideration you receive from a Small Business, except for the specific exclusions in paragraph (g) of this section. For equity interests subject to the Cost of Money rules (see paragraph (a) of this section), you must include:

(1) The portion of the fixed redemption price that exceeds your original cost.

(2) Any amount of a redemption that is paid out of accounts other than the Small Business's capital accounts (capital, paid-in surplus, or retained earnings of a corporation; or partners' capital of a partnership).

(g) *Charges excluded from the Cost of Money*. You may exclude from the Cost of Money:

(1) Discount on the loan portion of a Debt Security, if such discount exists solely as the result of the allocation of value to detachable stock purchase warrants in accordance with generally accepted accounting principles.

(2) Closing fees, application fees, and expense reimbursements, each as permitted under § 107.860.

(3) Reasonable prepayment penalties permitted under § 107.830(d)(3).

(4) Out-of-pocket conveyance and/or recordation fees and taxes.

(5) Reasonable closing costs.

(6) Fees for management services as permitted under § 107.900.

(7) Reasonable and necessary out-of-pocket expenses you incur to monitor the Financing.

(8) Board of director fees not in excess of those paid to other outside directors, if your board representation meets the requirements of § 107.730(e).

(9) A reasonable fee for arranging financing for a Small Business from a source that is neither a Licensee nor an Associate of yours. The Small Business must agree in writing to pay such a fee before you arrange the financing.

(10) A one-time ''bonus'' that satisfies the requirements in paragraph (i) of this section.

(11) The difference between the contractual interest rate of the Financing and a default rate of interest permitted as follows:

(i) If a Small Business is in default, you may charge a default rate of interest as much as 7 percentage points higher than the contractual rate until the default is cured.

(ii) For this purpose, ''default'' means either failure to pay an amount when due or failure to provide information required under the Financing documents.

(12) Royalty payments based on improvement in the performance of the Small Business after the date of the Financing.

(13) Gains realized on the disposition of Equity Securities issued by the Small Business.

(h) *How to evaluate compliance with the Cost of Money ceiling*. You must determine whether a Financing is within the Cost of Money ceiling based on its discounted cash flows, as follows:

(1) Beginning with the date of the first disbursement (''period zero''), identify your cash inflows and cash outflows for each period of the Financing. The appropriate period to use (such as years, quarters, or months) depends on how you have structured the disbursements and payments.

(2) Discount the cash flows back to the first disbursement date using the Cost of Money ceiling from paragraph (d) of this section as the discount rate.

(3) If the result is zero or less, the Financing is within the Cost of Money ceiling; if it is greater than zero, the Financing exceeds the Cost of Money ceiling.

[61 FR 3189, Jan. 31, 1996, as amended at 63 FR 5867, Feb. 5, 1998; 64 FR 52646, Sept. 30, 1999; 65 FR 69432, Nov. 17, 2000]

§ 107.860 Financing fees and expense reimbursements a Licensee may receive from a Small Business.

You may collect Financing fees and receive expense reimbursements from a Small Business only as permitted under this § 107.860.

(a) *Application fee*. You may collect a nonrefundable application fee from a Small Business to review its Financing application. The application fee may be collected at the same time as the closing fee under paragraph (c) or (d) of this section, or earlier. The fee must be:

(1) No more than 1 percent of the amount of Financing requested (or, if two or more Licensees participate in the Financing, their combined application fees are no more than 1 percent of the total Financing requested); and

(2) Agreed to in writing by the Financing applicant.

(b) *SBA review of application fees*. For any fiscal year, if the number of application fees you collect is more than twice the number of Financings closed, SBA in its sole discretion may determine that you are engaged in activities not contemplated by the Act, in violation of § 107.500.

(c) *Closing fee—Loans*. You may charge a closing fee on a Loan if:

(1) The fee is no more than 2 percent of the Financing amount (or, if two or more Licensees participate in the Financing, their combined closing fees are no more than 2 percent of the total Financing amount); and

(2) You charge the fee no earlier than the date of the first disbursement.

(d) *Closing fee—Debt or Equity Financings*. You may charge a Closing Fee on a Debt Security or Equity Security Financing if:

(1) The fee is no more than 4 percent of the Financing amount (or, if two or more Licensees participate in the Financing, their combined closing fees are no more than 4 percent of the total Financing amount); and

(2) You charge the fee no earlier than the date of the first disbursement.

(e) *Limitation on dual fees*. If another Licensee or an Associate of yours collects a transaction fee under § 107.900(e) in connection with your Financing of a Small Business, the sum of the transaction fee and your application and closing fees cannot exceed the maximum application and closing fees permitted under this § 107.860.

(f) *Expense reimbursements*. You may charge a Small Business for the reasonable out-of-pocket expenses, other than Management Expenses, that you incur to process its Financing application. If SBA determines that any of your reimbursed expenses are unreasonable or are Management Expenses, SBA will require you to include such amounts in the Cost of Money or refund them to the Small Business.

(g) *Breakup fee*. If a Small Business accepts your Commitment and then fails to close the Financing because it has accepted funds from another source, you may charge a ''breakup fee'' equal to the closing fee that you would have been permitted to charge under paragraph (c) or (d) of this section.

[61 FR 3189, Jan. 31, 1996; 61 FR 41496, Aug. 9, 1996]