**Buying a Business**

*This information will help you better understand the role of a Business Buyer Advocate.*

# The Business Buy-Sell Financing Maze

Unless the seller prefers to finance a huge portion of the purchase price versus getting up to 90% in cash at closing the odds are the buyer will use a bank loan to finance the deal. I have long been a proponent that SBA business acquisition loans are win-win-win as they benefit the buyer, seller, and bank. In my market, 80% of my client deals are $2-5 million and what I address here covers deals up to about $7 million, it is the most common financing structure. Simply put, without the SBA program bankers would make fewer loans (and make less money), sellers would finance a larger part of the deal, and buyers would buy smaller businesses with the same amount of cash out-of-pocket.

That said, nothing is perfect so let's review some business acquisition loan basics, SBA loan policies, and their caveats. Keep in mind, this is nothing more than an overview, as I see it. It is not a definitive guide to bank loans. For that, talk to bankers.

**The basics**

There are two types of bank loans for acquisitions, conventional and SBA guaranteed. As I say in my book *Buying a Business That Makes You Rich*, when talking about financing the acquisition of a business always put the adjectives mature, profitable, and fairly priced in front of the word business. Losers are tough to finance with a bank. Here are some basics:

- Conventional loans usually require 25% of the price in cash from the buyer. SBA loans always require 25% buyer equity, which may include a subordinated seller note (more on this later).
- Conventional loans are more collateral based (what the bank can sell if the loan goes bad).
- The SBA doesn't make loans; they guarantee a portion of the loan to the bank. All types of loans go through the banks standard underwriting. If an SBA loan, then the SBA policies are "laid on top of" the banks underwriting.
- SBA acquisition loans go up to $5 million, so a deal close to $7 million is possible (a larger deal means more buyer equity or seller financing).

Story: In 2016 a buyer went to four banks. Three banks came back with very similar offers, all using the SBA program. The fourth, also using the SBA program, insisted the seller finance 50% more than he was (see the third bullet above). This bank was immediately eliminated.

**Policies**

The vast majority of loans on deals under $7 million will use the SBA program, so here are some of the guidelines:

- There are three main advantages – there's a 10-year amortization (gentle on the cash flow), the bank becomes a cash flow lender (don't need hard collateral), the buyer can get in for a very low cash out-of-pocket down payment, often 10-12%.
- The 25% buyer equity can be a combination of buyer cash and a fully subordinated seller note for two years.
- No prepayment penalties.
- A working capital line of credit can be part of the package (I used to not like SBA lines of credit but the new rules make them quite attractive).
- "Extra" funds plus bank/SBA fees can be rolled into the loan (and paid over 10 years).

Story: A couple recent clients received a package including their funds for acquisition, bank costs, a working capital line of credit, and extra funds (to pay closing costs, have extra cash, etc.). Remember, the more the banker lends the more she gets paid.

**Caveats (Gotchas)**

Here are some things to be aware of:

- The buyer must buy 100% of the company.
- The fees are higher, about 3%. But they are amortized over 10 years.
- The seller can't stay on for longer than one year (in writing).
- The buyer will pledge their home equity. This means buyers with a lot of home equity are discriminated against, versus buyers with little to no home equity. I have only seen a couple instances where the buyer didn't pledge home equity, but the bank was covered by large investment portfolios.
- The paperwork and never ending questions will drive the buyer and seller nuts.

- The seller will probably get 85-90% in cash but receive no payments for two years. Their subordinated note is considered buyer equity. Actually, not a bad trade off versus getting about 50% in cash, as in the "old" days.

Story: Over the years the founder/seller gave small amounts of shares to 10 employees, about 15% of the shares total. Given the rule about sellers not working at the company for more than one year post-close, this was an issue. These employees were needed and wanted their jobs. So, a week before closing the founder/seller bought back the shares from the employees so he now was selling 100% and no jobs were at risk.

**Conclusion**

Want to buy a business? You have a myriad of financing options including all cash (from you and as rare as can be), 100% seller financing (extremely rare), a combination of your cash and a seller note (rare), a conventional bank loan (not common), or an SBA guaranteed bank loan (extremely common). While most buyers want the seller to have skin in the game with a small seller note I have recently had a couple deals where the buyer put in enough cash to pay off the seller 100% at closing. In one case the buyer knew the seller and wanted him totally out. He didn't want payments to the seller, having to share financial information (if the seller was a lender), or have the seller feel (as a lender) he could visit the business at any time. Lots of options but the financing maze usually exits with the buyer putting in 10-15%, the seller financing 10-15% and the bank financing 75% with a SBA guaranteed loan.

This was originally written for and published on their blog by IBA in Bellevue, WA

**John Martinka**

PO Box 3085
Kirkland, WA 98083
425-576-1814
john@johnmartinkacom
martinkaconsulting.com
Blog: johnmartinka.com
@johnmartinka