

# **SBA Changes affecting your deals!**

## **Utilizing current market conditions to close transactions!**

Building success through the sharing of information

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If you've been following along with all the SBA lending changes in 2023 and your head is already spinning, you may want to skip this newsletter altogether. Today I will discuss 3 rules that have changed since August 1<sup>st</sup>, and methods of utilizing them to help you close additional transactions. The information contained in this letter is our understanding and interpretation and as of this the date of this writing. I have compiled these structures and comments by interviewing some of our most aggressive, high volume SBA lenders. We must understand how their credit teams are interpreting and implementing these changes as we move forward with transactions.

By now you've probably heard all about the "Partial ownership transfers" included in the new rules that allow a partial business sale. The day after the announcement of this rule change many lenders were quick to begin advertising it as they understood its possible effects on broker transactions. This happened long before they truly understood how this would, or could, be implemented. The initial rule change allowed for the ownership percentages to be determined post-closing, and anyone owning under 20% would be exempt from SBA loan guarantees. The reality hit them almost 2 months later when the SBA also referred to the 6-month look back rule. This long-standing rule states that the lender must look back 6 months on the selling entity to determine ownership levels at that time, and any owner that held 20% or more of the stock, **MUST** now fully guarantee the new loan for the buyer. We all recognize that the chances of this happening are slim to none, why would a seller agree to this. Now for the upside of this rule, and ways to use it to your transaction's advantage. The first thing to understand is that if there are multiple sellers, with different levels of ownership, what amount of stock did each hold 6 months prior and who would be required to sign on the loan today. Most transactions have only one seller that holds 100% of the stock and this is no advantage to them unless specific circumstances are in place. Let's consider a specialty license business such as HVAC, Plumbing, Electrical, etc. that does require a licensed owner. Understanding that most business listings

take up to 9 months to close from the initial listing date, what if the seller has an employee with the license that he provides a 5% ownership level soon after the listing agreement is executed? After 6 months of ownership, this employee could now become a partner with the new buyer, and not be required to guarantee the loan. The buyer, in this scenario, can purchase 95% of the stock from the majority stockholder and avoid any license related concerns on the lending side, while retaining a valued and key employee. Minority sellers can now also have an opportunity to remain with the business post-closing, if desired. The bottom line is that although this rule is not as originally thought, there still may be advantages to understanding it in detail and we believe it will make specific transactions easier to finance.

Another rule clarification that can greatly assist on your larger transactions is the removal of the personal liquidity requirements. Prior to this rule change, any excess liquidity that a buyer might have over the actual loan amount would have to be injected into the project or this buyer became ineligible. This buyer now remains eligible for an SBA backed loan without having to inject all excess funds and without requiring the pledging of those funds for collateral. Higher net worth clients now become eligible buyers and by utilizing the correct lender, can also protect their excess cash.

Earn outs have been ineligible to be included in SBA transactions for the last many years. You may have come across my alternative labeled “forgivable seller notes”, which can accomplish the same result. These seller promissory notes have been accepted by many lenders over the years, while others have adamantly stated these are ineligible to be included quoting the “changing of the purchase price post-closing” rule. The forgivable seller notes accomplish the two major concerns that SBA had with earnouts. The first was that the SBA issued down payment minimums that were based off the selling price and earnouts were being removed from the projects and considered outside transactions. The second was that any amounts related to earnouts were not included in the SBA required business valuations. My solution to address both concerns was to create a “forgivable seller note” which accomplished the same goals as an earnout but complied with both the SBA items. It was now included in the purchase price and business valuations. These notes have now been officially allowed under SBA current rules as the clarification states that as long as the forgivable portion is to the benefit of the buyer, these notes can now be included in our transactions.

We are all seeing a tightening in lending criteria these days with many lenders pulling back. Understanding these rules and changes as we move forward has never been more important to closing your transactions. Although you and I may be working harder these days for the same volume levels, utilizing all available structuring options is more important than ever. Be aware of the bait and switch that takes place during tighter market conditions and stay updated on your lenders' current lending criteria, we do.

To increase your success and closing rate, direct your buyers to one of our highly trained SBA managers for their pre-qualification letter (at NO COST) and we will be happy to assist in the screening and closing of your transaction. We guarantee a **YES** or **NO** answer within 3 days of file submission. Try us and see the difference that personalized service, along with top level advice and lending sources, can make. We do not pay fees; we increase your commissions!

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