More SBA changes as of November 15th

5 major effects on business acquisitions (good and bad)

Building success through the sharing of information

By Steve Mariani
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As changes continue to trickle down from SBA leadership, today I will describe what I believe to be the top 5 adjustments that every intermediary in America needs to be aware of before considering acquisition financing for your clients. Although this “Updated SOP” becomes rule on November 15th, it includes a few controversial items that may change the initial structures of your listing. Today’s writing is the current understanding and interpretation by many of the top volume lenders in our market. Please note that these may change or be adjusted as SBA leadership clarifications are published.

The first change that I feel is important to every larger goodwill transaction, is the official acceptance of my “Forgivable Seller Note” structure. This has been widely controversial for the last 15 years with some lenders accepting it and others not. It’s official and listed as “Seller rebates” in the new SOP’s. This rule now allows the seller to hold a note contingent upon the business meeting certain criteria. If the criteria is not met, then portions of the note are forgiven or rebated to the buyer. This type of note can be tied to company performance, employee retention, customer retention or concentration, and other similar possible fluctuations that can affect the overall future success of the business. This has always been an alternative to the ineligible Earn-out clause that used to be included in many transactions.

The hot topic amongst everyone in the industry is the clarification of the “Partial Buyout” rule which allows a buyer to purchase less than 100% of a business. The issue and concern with this rule were regarding a 6-month lookback period which then demanded the seller to guarantee the new loan if they owned 20% or greater at that time. This rule has been updated and clarified to truly allow “Post closing percentage of ownership” to be used when determining who guarantees the loan. Meaning that as long as your seller retains an ownership level below 20%, he should not be required to sign. This seller is also now allowed to remain as a key employee moving forward and this opens many possibilities. I believe that on a licensed required business we can now leave a seller with a 1% ownership interest, and they may hold any license deemed necessary to operate. With any level of ownership, the seller is not required to exit the business within 12 months and can remain indefinitely. The seller must exit within 12 months if they no longer retain any ownership level. In my opinion, (note that I have NOT completed one as of yet) this can affect many HVAC, Plumbing, Electrical, etc. type transactions.

If your transactions typically include business and real estate combined, then this current release may present a problem for your buyers and may adjust the entire structure and cash flow of your deal. The previous rule surrounding commercial real estate (CRE) when included in a business transaction was that if 51% of loan proceeds were allocated to the CRE purchase, then the entire loan can have a maximum maturity of 25 years. This has now changed and currently stated that 51% of the purchase price must be CRE to receive a 25-year loan. Prior to this SOP release, if the CRE was less than 51% then the lender must blend the term and average out the classifications of proceeds. Today it demands that on any acquisition that includes CRE under 51%, the maximum loan maturity can only be 10 years. This now removes the option to blend and extend the term when including real estate. This will greatly diminish cash flow coverage ratios and may cause structure adjustments such as purchasing the real estate at a future date. Purchasing the CRE alone would then secure a 25-year term and be independent of the business financing, when applying for a s or leasing the building on a more permanent basis.

On a positive note, SBA will be waiving borrower SBA fees on loans under $1million and reducing them on loans over $1 million. This is a big savings and incentive to assist with initial closing costs. There are no changes or reductions on SBA fees for loans greater than $2M.

The final item for today’s letter is again on a positive note. SBA no longer requires a lender to place a lien on non-business assets such as personal homes when the SBA loan amount is $500k and below. This rule appears to be optional to lenders and does still allow internal policy to place liens on buyer assets, something we plan to monitor moving forward.

At Diamond Financial, our mission is to provide the latest lender interpretations of the latest rules and how you can work best within them. We hope today's letter was informative and please feel free to share with anyone that you believe can benefit from it. We are dedicated to the success of the intermediary.

Diamond Financial is always here to answer any SBA questions you might have on any transaction in your pipeline. Many industry experts around the country count on our advice and guidance for transaction financing options and structures. We're here for the industry and to help you close loans to increase your commissions. Reach out to us anytime and learn how our expertise can help you.

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