

Financing transactions from \$3MM to \$8MM is different in 2024!

With so many rule and lender changes, here's the best way to assure an approval.

Building success through the sharing of information

By Steve Mariani

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With so many SBA rule changes, credit underwriting economy concerns, and lender discussions about blacklisting certain industries, today's \$8MM transaction has a few more hurdles than just a year ago. On a positive note, we now have more avenues to close the gap between SBA's max of \$5MM and the actual selling price of the business, if it's higher. We're seeing more of these size transactions every day here in our offices and today I'll describe how we've creatively structured a few of them, along with ways we've overcome some of the hurdles.

What we're learning about the current market conditions in 2024 is that many lenders are preparing for the "perceived" financial crash. Most believe the other shoe will be dropping sometime soon and they're trying to anticipate which industries should be on their watch list in the coming months. Depending upon the actual lenders' aggressiveness over the last 3 years, they will already have a list of industries that have defaulted internally on in-house portfolio loans, and this is where their list begins. It only takes a loan or two in any one industry to cause a lender to tighten credit criteria and increase coverage ratios, or even ban an industry entirely. After 30 years in this business, I have seen the handwriting many times before and I have learned to ask specific questions upfront when lender tightening begins. Remaining current on each lender guideline and credit adjustment is critical to staying on a transaction timeline.

What this means is that if the lender keeps you completely in the loop on credit terms and internal policy changes, we should not be wasting any valuable time exposing the wrong lender to the wrong transaction. The problem happens most times when you aren't kept in the loop and the lender representative (BDO) is more focused on possible volume over actual volume and is not considering any of the parties involved.

Understand that many will spend weeks on a transaction just trying to fit that square peg into—well, you know, it just doesn't work.

Specific lenders all have specific boxes and exposing a \$5MM loan request to a lender than has a goodwill cap of \$1.5MM is not only counterproductive but adds much frustration to all parties included in the deal. The larger transactions are typically accompanied by a sophisticated buyer with goals and timelines which need to be met. The seller usually follows the guidance of their trusted intermediary and is utilizing the resources provided by them. Likewise, most buyers will consider lending resources also provided by the advisor with the hopes of making this a smooth transaction. This is where the level of talent and expertise of your lending partner should become an incredibly valuable asset to your team advising on eligibility during the entire process.

Structuring an \$8.5 MM transaction had very few options last year at this time. Most were having the seller hold a substantial seller's note to bridge the gap between the selling price and the maximum financing available. All that changed with the partial buyout rule coming into play. Today we are structuring that same transaction using a few methods to not only protect the seller, but also provide a feasible, cost effective, avenue for all parties to benefit. Here's a possible structure for this transaction in today's market. We first determine if the business has any amount of hard assets. In this scenario we understand that the business has trucks, trailers and a few other assets that equal an amount of \$1.5MM. We will typically remove trucks and trailers from transactions to benefit the buyer in the future as an SBA lender must hold all titles by rule (a hinderance to the buyer). This could be considered by an outside leasing firm that wishes to create an ongoing relationship with this business and a possible benefit to both parties. After removing the vehicles and securing the \$1.5MM in a lease, we focus on the remaining needed funding of \$7.0MM. The buyer is required by SBA to inject no less than \$850K but could inject more. \$1,275MM or 15% of the project would be preferable. This would now leave the gap of financing at \$725K – If the seller were to retain a 10% ownership level, then this would reduce the project by another \$850K, enough to complete the transaction with no seller note included. Seller/partner can be bought out in the future through generated cash flow or financing at a pre-determined point in the future.

The second example includes a plumbing contractor where our buyer was not able to secure the required license prior to the closing, an SBA rule for funding. The state demanded one year of in-state operations before they would allow this buyer to sit for the license exam. This seller is of retirement age and has held the license for many years but did not wish to provide any seller financing to complete the transaction. We utilized the partial buyout rule and structured a 95% stock buyout of the seller's corporation leaving the seller with a 5% ownership level. Based on the current SBA rules this seller can hold the license and not guarantee this loan as his ownership remained under 20% post transaction. The next step was to include a clause in their partnership agreement that stated the 95% owner would purchase the remaining shares within 24 months at a predetermined price from the minority owner.

These are just two examples of utilizing a combination of the new rules, old rules and lenders willing to follow them. If you would like my structuring assistance on any of your larger loan requests, I am always available to this community. You can reach out directly to me at Stevem@easysba.com or my direct dial at 919.376.2922.

I 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.

Steve Mariani

Owner, Diamond Financial Services

(888) 238-0952

Let's get Started!