

MERGERS & ACQUISITIONS Alert

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New SBA Guidelines Improve Ability to Finance Business Acquisitions

Many of our small business clients are still having difficulty finding acceptable financing for their business needs. One alternative is loans that are backed by the U.S. Small Business Administration (SBA). Although SBA loans often require more documentation (i.e., more paper), such loans can offer attractive terms such as longer amortization periods and lower interest rates. Another advantage is that SBA loans may be utilized to acquire another business. And, even better, effective October 1, 2009, some of the SBA rules governing business acquisition loans will be liberalized in favor of borrowers.

The biggest change involves financing intangible assets - often called "goodwill." Under the old SBA guidelines, lenders were prohibited from financing more than \$250,000 of goodwill. This imposed a significant limitation against using SBA financing to acquire a business - given that a significant amount of the value of many modern businesses is derived from intangible assets such as client/customer lists, patents, copyrights, trademarks, agreements not to compete and goodwill.

Under the new SBA guidelines, there is no technical limit on the amount of intangible assets that can be financed. If the value of the intangible assets purchased exceeds \$500,000, the borrower and the seller must provide an equity injection of at least 25% of the purchase price of the business. However, the SBA guidelines provide that the seller and purchaser may agree how much "equity" each will provide - with seller financing counting towards the required equity amount. Most SBA lenders currently require borrowers to provide capital equal to at least 10% of the total purchase price. The remainder can come from seller financing. When seller financing is combined with a working capital loan from the lender, this structure can result in a much lower equity requirement than a traditional loan.

One caveat to using seller financing to fund an equity injection: the SBA guidelines require that no payments of principal or interest be paid to the seller for a period of two years. Although interest can accrue during this two year period, some sellers may be unwilling to defer payment for two years. One possible solution is to utilize two seller promissory notes. One promissory note would represent the seller's "equity" contribution (up to 15% of the purchase price) and would not be payable for two years. The second note would represent the balance of the seller financing and could be payable immediately.

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The reader should consult legal counsel to determine how laws apply to specific facts and situations.

Finally, in any business acquisition loan, the borrower must still meet other SBA requirements, including:

- qualifying as a small business pursuant to SBA standards;
- the borrower must purchase 100% of the business;
- the seller cannot remain as an officer, director, stockholder or key employee;
- an analysis must be performed by the lender confirming that the change of ownership will benefit the business (not just the buyer or seller);
- the maximum loan amount is currently \$2,000,000; and
- any owner of at least 20% of the business must personally guaranty the loan.



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