Recent SBA's Rule Changes Make Exit Possible For More Owners

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Editor's Note:

In the past few issues of this newsletter we argued that the primary benefit of planning your business exit well before your target departure date is that you need time to close the gap between what your business is worth today and the purchase price that will yield a secure retirement. We will return to that discussion in our next issue when we begin a series of articles about actions you can take today to increase the value of your company.

For this issue, we asked Robert Heffner, a BEI Member and President of Rocky Mountain Capital LLC, an SBA lending expert specializing in business acquisitions to explain how recent changes to Small Business Administration's 7(A) loan program affect owners of small and mid-sized companies.

These changes are recent and may not last forever so owners who may have delayed planning their exits because they believe that no buyer can acquire the financing necessary to purchase their companies should think again. If you and your company are otherwise ready for transition—your value drivers are in place and fully operational, and you have closed the gap between what your business is worth and the amount you need to retire—read on.

For owners seeking good news about credit availability the search is a bit like looking for a needle in a haystack. One needle for owners of companies with purchase prices between $400,000 and $4 million are recent changes to the Small Business Administration's 7(A) loan program.

Under new rules, any amount of goodwill (up to the overall lending limit of $2 million) may be financed so long as there is at least 25 percent equity provided in any combination of borrower down payment and seller stand-by financing.

In addition, the SBA has temporarily increased its guarantee from 75 percent to 90 percent of loan amount, and has waived the guarantee fee charged to borrowers (formerly, about 2.6% of loan amount). These temporary provisions are expected to continue through the end of 2010.

Congress is also expected to raise the overall loan limit to $5 million (with up to a 90 percent guarantee), perhaps before July of 2010.

What does this mean?

In a nutshell, the new rules make acquisition financing easier for borrowers, provide clarity and additional security for lenders, and significantly increase availability of SBA financing at a time when it is needed more than ever.

For Owners

Under the old limits, only $250,000 of intangibles (such as goodwill) could be financed. Because many growing and profitable companies have a large percentage of goodwill in their purchase prices, this $250,000 limit made it all but impossible for buyers of these companies to secure SBA financing. Now, even if owners attribute a large portion of their business value to intangibles, it's much more likely that buyers can finance up to 70 percent of the purchase price, with the SBA guarantee. Different considerations apply to sales to a third party and transfers to insiders (using the two-phase method used by many BEI advisors), so check with a SBA lending expert before determining how these new rules may affect your exit plan.

For Lenders

Many banks do not work with buyers seeking to finance an acquisition for a variety of reasons, but a major one is that goodwill has no collateral value. With the SBA now guaranteeing 90 percent of the loan amount (including amounts attributed to goodwill) expect banks to re-evaluate their participation in these loan programs.

Through another regulatory change, so long as combined buyer equity and seller standby exceeds 25 percent, banks are not required to submit loans involving more than $500,000 of intangibles for a separate SBA approval. As a result, the loan approval process for loans meeting this equity threshold has decreased from 6 to 7 weeks to 2 to 3 weeks.

If you believe that your business is one that could attract a buyer under these new limits, remember that banks who do make these loans focus on the:

- Management skill of buyer;
- Credit history of buyer; and
- Historical company cash flow and positive cash flow trends that indicate the company can pay off the loan.

For Borrowers

As mentioned above, changes to the SBA's 7(A) program have increased the pool of potential buyers/ borrowers for companies in the $400,000 to $4,000,000 range. The SBA has lowered another barrier to borrowers by waiving its guarantee fee to the borrower of 2.6 percent of the loan amount.

The Crystal Ball

It's expected (though not known for certain) that Congress will soon raise the 7A loan limit to $5 million and the loan guarantee amount to 90 percent. Keep in mind that if the limits are raised, banks will not necessarily lend $5 million for acquisitions based solely on cash flow. Bankers are cautious by nature and they will be especially cautious in this new, bigger arena. On the larger loans, we can expect most banks to require collateral (such as real estate) to support a designated percentage (possibly 50 percent) of the loan amount.

The World of SBA Loans

Like every other Government program, SBA loans involve a significant number of regulatory requirements. Getting a project through a bank's loan committee is a bit like storming a walled city. You must know which wall to storm, how to clear it on your first try, and preferably have someone on your team who works for you, rather than for the bank.