



Guidelines for Acquisition Financing

Eligibility and qualification for bank financing of a business acquisition is subject to the credit standards of the Bank. It is always best to consult a lending professional at on questions and further detail.

1. Loan Size

Typical borrower down payment is 10-20%; typical seller financing is 10% to 15%. Bank loan, then, is typically 65% to 75% of total costs (selling price, plus working capital, plus loan fees and costs). This is primarily dependent on the type of business.

a. **Maximum Transaction Size:** Financing is rarely practical for transactions with a sale price exceeding \$6 million; most transactions are priced at \$4 million and below.

b. **Minimum Transaction Size:** \$50,000

2. Trends in Gross Revenues and EBIDA: downward trends in EBIDA, continuing downward through the current year interim statements, are not acceptable for financing. This is true regardless of the absolute level of adjusted net earnings (Seller Discretionary Earnings or EBIDA), or the multiple of net earnings in relation to debt service: it is the trend which is disqualifying. Downward gross revenue trends are usually disqualifying, unless EBIDA is stable or increasing at the same time (usually indicating shift to lower volume but higher-margin business).

Comment: A dip in gross or net revenues for a year or two can sometimes be tolerated when the trend has flattened or has been reversed for a full calendar or fiscal year (usually at least 9 months' flat or improving trend must be shown, and for such a partial-year recovery, approval will be contingent on reviewing yearend statements prior to closing). Banks typically underwrite on the basis of the calendar or fiscal year period for which tax returns are filed, not on the basis of 12-month trailing periods, or projections.

3. Change of Ownership Considerations:

a. Exiting owners must exit completely. A selling owner cannot retain any ownership after the transaction, and may not be an officer, director or consultant of the business for longer than 12 months after the sale.

b. **Will not finance a partial change of ownership.** If one or more partners are buying out another partner or partners, the transaction must result in 100% ownership by the purchasing owners. An existing owner cannot be financed to purchase the partial ownership interest of another partner (for example, with 3 partners, one partner may not buy out a single other partner.) An outside party (someone not currently an owner) cannot purchase anything less than 100% ownership (for example, if there are partners, must buy out all the partners).

c. **Business real estate involved in a business purchase cannot be financed separately from the loan,** unless the lender is given a shared (pari passu) lien position with the real estate lender.



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d. A **leasehold business**, as of closing date, must have a lease term plus extensions equal to the term of the loan (usually, 10 years)--or else be able to demonstrate that location is not a critical factor, and that equivalent space at equivalent rent is readily available in the local market.

e. **Landlords** must be willing to sign a “landlord’s consent,” allowing lender to enter the premises to seize collateral in event of a default.

5. Requirements for principals (20% or greater shareholders; officers, directors):

a. All principals must 100% personally guarantee the loan—no exceptions.

b. If the loan is not 100% secured by hard assets of the business (real estate and FFE only) at bank liquidation value of the assets, then principals may require a pledge of personal assets (typically real estate and significant financial assets), up to the point that the loan is 100% secured (This is ONLY for loans \$350,000 and above). If all available resources are pledged and loan is still not fully secured, collateral shortfall in itself is not a reason for decline.

c. Principals must be active owner-managers, not passive investors.

d. Principals must have significant, related-industry ownership/general management experience, with strong preference for same-industry experience in independent business (as opposed to nonrelated industry, or corporate middle management).

e. Principals must have good credit history (generally, at least a 650 FICO score) with no bankruptcies in last 7 years. Judgments, defaults, and frequent delinquencies may disqualify.

f. Principals must be of good character: all arrests for other than minor traffic violations must be disclosed; more than 3 misdemeanors or any felony may be disqualifying.

g. Principals (at minimum, those who will be active managers) must be US citizens or resident aliens with a green card.

6. Equity Injection (down payment).

a. **Buyer Equity** - Banks typically require at least 20% of total project costs to be injected by the borrower. (Total project costs = purchase price, plus loan fees, plus required working capital). Usually, up to half that requirement (10% of total costs) can come in the form of seller take-back financing that is on full standby, receiving no payments of principal or interest for the term of the note, or until that note is paid off.

b. **Seller Financing** - Banks will generally also require at least 10% of costs to be financed by the seller (including, not in addition to, any “standby note” such as the above.) Exception: when the borrower is a current key employee or manager of the business being acquired, seller financing may not be required.

c. **Intangibles**- If the purchase price of the business includes \$500,000 or more of intangibles (goodwill, patents, non-competes, trade name, customer list, etc the bank may requires that there must be combined buyer and seller equity equal to at least 25% of the purchase price. “Seller equity” is defined, for this purpose, as any seller take-back financing for which payments are deferred for at least 2 years. When real estate is transferred along with the business this 25% equity rule applies to the real estate also

7. Ineligible Businesses



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- a. Non-profit business (for profit subsidiaries are eligible)
- b. Businesses engaged in lending (banks, finance & investment companies, factors, others whose “stock in trade is money.”
Note: exceptions for certain kinds of companies, such as check cashing & pawn shops, when >50% of revenues are from services or activities other than finance.
- c. Life insurance companies.
- d. Businesses with >1/3 of revenues from SBA loan packaging.
- e. Borrower plus all affiliates exceeding size standard determinations (each must meet own standard; all total meet the group’s main industry standard)
- f. Businesses/Private Clubs that limit membership for reasons other than capacity
- g. Businesses located in a Foreign Country
- h. Businesses that derive >1/3 gross annual revenue from gambling, or whose main purpose is gambling (such as a casino) regardless of revenue proportions
- i. Businesses engaged in illegal activity
- j. Government-owned entities (except Tribally controlled)
- k. Landlords, businesses primarily engaged in renting space (“passive companies”).
- l. Businesses primarily engaged in promoting, instructing, indoctrinating religion.
- m. Businesses primarily engaged in political or lobbying activities
- n. Consumer and marketing cooperatives (producer cooperatives are eligible)
- o. Speculative businesses (traders speculating on gain in asset values—such as commodity or stock investors; inherently risky “speculative” businesses such as oil wildcatting, research and development; “spec home” construction).
- p. Businesses primarily sexual in nature
- q. Pyramid sales plans and multilevel marketing companies
- r. Business in which the Lender applying for guarantee, or any employee or associate of Lender, owns an equity interest.
- s. Business with Franchise/Licensee/Dealer/Jobber agreement that does not meet SBA standards (imposes “unacceptable control,” thereby renders the business effectively an affiliate or subsidiary of the franchisor or licensor).
- t. Franchise developers (master franchisees): considered passive & speculative

8. Ineligible Uses of Funds

- a. Payments, distributions or loans to principals:
- b. Business relocations that cause unemployment; financial hardship to leaseholder; or nullify labor agreement
- c. Investments in real or personal property acquired and primarily held for sale, lease or investment (including remodeling of rental space)
- d. Illegal Activities
- e. Refinancing debt owed to an SBIC
- f. Payment of delinquent payroll taxes (income taxes eligible, but a credit issue)
- g. Use of funds for refinancing is allowed, but subject to numerous restrictions— consult with a Bank lending professional on any proposed refinance.

9. Ineligible Personal Guarantors / Principals (20% or more owner/shareholder)



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- a. Principal is on probation, parole or pending criminal charges, or has a legal history demonstrating poor character or “moral turpitude.”
- b. Principal has caused a prior loss to the government: -defaulted student loans -delinquency on trust fund taxes (Soc.Sec, Medicare, UI, Work Comp) -loss, whether through settlement or otherwise, to any federal agency
- c. Conflict of interest: principal is a high government or military official,

BONUS: Pros and Cons of Different Loan Types

| Source of Funding | Pros | Cons |
|--|--|---|
| Rollovers for Business Startups (ROBS) | <ul style="list-style-type: none"> No debt or interest cost because the money is yours No taxes or penalties for early withdrawal Setting up a ROBS is fast | <ul style="list-style-type: none"> Setup fee and ongoing fees are charged Risking your nest egg |
| SBA Loans | <ul style="list-style-type: none"> Low interest rates and long repayment terms Down payment as low as 10 % | <ul style="list-style-type: none"> Guarantee fee is charged More paperwork and slower application process Great credit score needed to qualify, 680+ |
| Conventional Bank Loans | <ul style="list-style-type: none"> Low interest rates | <ul style="list-style-type: none"> Requires 20-30% down payment and collateral Great credit score needed to qualify, 680+ |
| Seller Financing | <ul style="list-style-type: none"> Seller has continued stake in business success Low interest rate Can negotiate terms with seller | <ul style="list-style-type: none"> Not available for all deals Usually only covers a portion of the purchase price, so must be combined with other financing |
| Home Equity Loans and Lines of Credit | <ul style="list-style-type: none"> Competitive interest rates | <ul style="list-style-type: none"> Reduces equity in your home Require strong credit score, 650+ |
| Family and Friend Loans | <ul style="list-style-type: none"> Convenient Often inexpensive (low rates, flexible lender) | <ul style="list-style-type: none"> Can create tension if business fails |



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