A Few Lending Rules to Note for this Year

By Steve Mariani

By now everyone should know that some of the most recent changes to SBA SOP's include a much lower down payment requirement, 10% now vs 25% in the past. This adjustment opens a lot more businesses to many more buyers and what we're seeing may surprise you. Specializing in the larger goodwill transactions exposes us to many high net worth individuals and the issue and concerns that come with them. How much of their personal real estate must we attach liens to and what amounts of stocks and bonds might have to be pledged to secure the financing is what consistently comes to mind. Today we answer those questions and more as we describe a few must know rules before applying for financing anywhere.

Let's start with the first rule that very few are aware of and no one wants you to know. The first rule relates to real estate equity. The actual rule states: **SBA does not require a lender to collateralize a loan with real estate to meet the "fully secured" definition when the equity in the real estate is less than 25% of the property's fair market value.**

The words to note in the above rule are "does not require". Meaning that a lender can and do place liens on many borrower's property's when they have little to no equity value left in them. This is an optional rule that MANY lenders choose to ignore. This rule also can apply to commercial, rentals and investment properties of the borrower. Knowing that most borrowers will not be aware of this rule or push a lender to utilize it, many high net worth borrowers just choose an alternative financing option or make other decisions instead of purchasing a business. Some just allow the lender to place those liens thinking that it must be an SBA rule with no options. Now you can inform them of the actual rule and possibly save a deal, and maybe a property or two.

The next is not an actual rule but something that is consistently asked of us and you should also know this answer. Does my spouse have to sign on this loan? There is no rule that demands a spouse to sign anything except the PFS (if they are married). The Personal Financial Statement MUST be completed jointly according to the SBA. The spouse's assets are considered for collateral purposes when they've acquired them together. If the spouse is a key member of the management team moving forward and an integral part of the business plan or becoming an officer of the new company, then yes, they will be asked to sign on the loan. Another reason a lender might request the spouse to sign is if he/she supports the household with their salary and income level. If the lender is counting on a spouse's salary to support the borrower, they will be asked to guaranty the loan.

Aside from the few reasons stated above, the spouse should be left out of the financing package and off as a guarantor on the loan.

These 2 rules are the first things we address with each of our high net worth borrowers. We want them to know there are avenues of protecting assets that do comply with SBA rules. We explore each home value to determine the most appropriate amount when assisting with a borrower's financial statement and prior to lender submission. It becomes all about knowing the answers before the questions are asked.

Once we determine the borrower's eligibility and collateral position, we then turn toward the business eligibility. Many want to know if they can purchase a business and leave the current management in place. The actual rules states that 1) anyone owning any shares of stock must leave the operation upon closing. They are permitted to work for the new owner as a consultant for a period not to exceed 1 year. 2) The SBA cannot be used to purchase a "Passive Business". This means the buyer(s) must have a plan to operate the business that their buying and it cannot be run absentee. Typically, lenders want to see a plan showing that the borrower lives within 45 minutes of the target or will be living within 45 minutes of the target post-closing. Keeping important staff like managers, etc. becomes a bit of a challenge as the SBA is looking for anyone considered a "key" employee. Wording here becomes more important than you might be aware of based on today's rules. Lenders are advised to watch for "key employees" and determine how important they are to the success of the operation. If they are shown to be very important, the SBA advises lenders to have them guaranty the loan to confirm they stay with the company. A policy that is not what many high net worth borrowers wish to hear or address. This is where every word submitted to a direct lender must be read and addressed if necessary, BEFORE application submission.

The last rule I'd like to bring to your attention today is something we only see a few times a year but when we do, it needs to be addressed immediately. You should know by now, if you've closed even one SBA loan, that a business valuation will be required for each transaction to support the purchase price. I support and understand this rule but what if the valuation company does not and the valuation comes in a bit lower then the actual selling price? In our offices we know the rule that states: **Any amount in excess of the appraisal may not be financed with the SBA guaranteed loan.**

Keeping in mind that the loan amount requested is typically much lower then the selling price due to the injection of down payment monies and seller notes (if any) that both affect and reduce the loan amount and, in most cases, below the appraisal values. This is also an optional rule that allows the lender to demand the selling price of the business be adjusted lower to meet the valuation. There is a similar rule which applies to commercial real estate, but we will not get into that today, just know it exists.

Today I've outlined a few of the rules which consistently come up on larger goodwill transactions and our hope is that this helps you close more deals. Also note that this is just a few of the many rules which apply to those larger deals and if for any specific answers on these or any other SBA rules, please contact us at Askdiamond@easysba.com. A no cost, no obligation email solution to answer your SBA questions.

Diamond Financial specializes in these larger, goodwill type transactions and we are always happy to share the information that makes them happen. Call us and experience the power of the experts.

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Diamond Financial Services, Since 1996