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## Financing the Acquisition or Expansion of a Small Business through the SBA 7A Program

By [Harlan Friedman](#)

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Recently a prospective client visited our office and was inquiring about the financing of an upcoming business acquisition. I immediately inquired whether the business opportunity that he was contemplating also came with real estate or was it only the purchase of a business opportunity consisting of good will, Furniture Fixtures and Equipment (FFE), work in progress. and, the client/customer list.

He immediately responded that it was only a business acquisition along with two five year lease options.

As a commercial financial broker I immediately realized the scene was set for a typical SBA 7A loan. Typical is probably not the best word because each 7A loan is very different, the only similarities are that the loan is SBA Guaranteed, and that the SBA will require a loan to be collateralized to the fullest extent possible.

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For those readers that are not familiar with the SBA 7A program I offer following basic information. The Small Business Administration (SBA) guarantee a business loan for a prospective purchaser of a business acquisition. The difference between this SBA Program and others is that it is the only program that will allow for the purchase of a business with accompanying real estate.

Most business that is sold fewer than two million dollars is sold without real estate. The business is usually situated in a leased facility. SBA does not require that the business have a lease agreement in place for the length of term of the SBA loan, or at the very least additional option periods to cover the length of the term.

Many prospective borrowers are under the impression that the SBA actually funds their loan. This statement is obviously not true. The SBA only guarantees the loan should the loan go into default, the SBA guarantee protects the bank not the borrower. The true funder of the loan is the bank that approves the loan. Therefore each financial institution needs to feel very comfortable with the requested loan submission.

The rest of this article will share the questions and responses that I share with my clients. It is my hope that other people can learn from these experiences.

The first question I'm usually asked is that I've heard that the SBA takes "forever" to close transactions. I respond that a professional prepared submission package should fund between 45 and 60 days from submission to the underwriter, I believe the reason for this closing time frame is the preparation that goes into packaging the loan.

A properly prepared package should answer the following inquiries by the review underwriter.

Does the business in question have a positive cash flow that is supported by historical documentation? This is answered by including the appropriate financial statements and tax returns. Can the business support additional debt?

Is the individual that is attempting to secure the loan qualified to run the business? This is answered by the inclusion of his current resume, as well as any supporting documentation.

Does the prospective purchaser have marketing and business plan to demonstrate knowledge of the business as well as their plans for repayment and future growth?

What are the projected revenues for the new business?

What is the current financial situation of the borrower?

If a buyer of a business just walks into their local bank, and does not have an individual who knows and understands the process the loan will default. But a professionally prepared package answers all the asked questions that an underwriter needs to have handled and thus makes

time frame for approval and ultimately closing much faster.

Another question revolves around the experience of the new buyer of business. Many new buyers believe that because the borrower has agreed in the purchase agreement to train them in running the newly acquired business, that this should satisfy the lender. As a matter of practical application most sellers do in deed offer training for a minimal period of time, usually no more than three months. Most sellers are more than willing to extend the training time on a continuing consulting basis if needed.

I respond with pretend for a moment that you are the lender, would you lend your hard earned money to an individual who has little or no experience running this particular business. Many new clients are so excited about the idea of running their own business after so many years of being an employee that they exaggerate their own abilities. This question causes the individual to take a hard look at their self, and the potential for successfully running the new venture.

After we dispense of the experience question, I usually ask for their financial history and current situation. This request always causes the following inquiry. Why should my past financial condition other than the fact that I have accumulated a proper down payment matter to the bank? Again I ask them to put on their lender's hat, and ask themselves would they lend their money to an individual who has no experience making money over the years.

The lenders want to feel very comfortable that the new owner will be successful, and they can only judge by the borrowers' historical trend evidenced by their financial statements, bank accounts and tax returns then project forward.

Another consistent question revolves around collateral. Most borrowers assume that the assets of the business will cover the collateral requirement of the lender. They tend to believe that the business assets should be valued for collateral purposes at their fair market value.

Nothing is further from the truth. The lender will treat all collateral as if it was liquidated at an auction and therefore they discount it at least 50% more.

The follow up question then becomes, If the business assets secured by a UCC 1 filing statement (the Uniform Commercial Code filing statement) allows the bank in the event of default to take immediate ownership of the business assets and liquidate them to recoup their investment) for is not enough security for the loan, what must I do to pledge my home?

This is a more difficult one to handle, but I basically ask them for a moment to imagine that they are the banker/Preferred Lender Provider (PLP) and they lend money completely unsecured other than just the assets of the business.

In conclusion in the proper circumstances there is no better way to fund the purchase of a business.

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