



## Funding Small Business Ownership Transfers

Using Small Business Administration (SBA) Financing Strategies



**CORNERSTONE**  
WEALTH MANAGEMENT GROUP

About 80 percent of U.S. business owners say they want to pass their family business on to the next generation, but research shows that only 33 percent are successful in the transfer (Chief Executive Magazine). Sometimes, the transfer of the business and resulting financial challenges doom the company to failure. A loan facilitated by the Small Business Administration (SBA) may allow business owners to sell their business and leave a healthy company to the next generation.

At Cornerstone Wealth Management Group, our team works closely with business owners to use SBA loans to facilitate ownership transfers. Working closely with entrepreneurs, we clarify common misconceptions regarding SBA loans, review the SBA loan process, and help facilitate a transaction that maximizes the value our clients receive. In this paper, we'll review the use of Small Business Administration financing strategies to fund ownership transfers.

## IS YOUR BUSINESS YOUR LARGEST ASSET?

The entrepreneurs and business owners we work with typically have most of their wealth concentrated in their businesses. This presents an undesirable risk to their wealth plan and their ability to pursue financial freedom.

A 2014 survey by CNBC reported that more than 70% of small business owners' wealth is invested in their businesses. Another study from the American Family Business Institute revealed that 20% of owners have over 80% of wealth tied up in their businesses. This lack of diversification subjects a business owner's wealth to unnecessary risk.

As business owners approach retirement, their desire for financial risk typically decreases. Experts recommend that no more than 25% of a family's net worth should be tied up in any one asset as retirement nears. A business owner may also seek to reduce their regulatory, legal, or business risk as they prepare for retirement. Many are weary of running their firm and want to enjoy their time in retirement free from business concerns.

## WITHDRAWING CASH FROM YOUR BUSINESS

Because the economy has rebounded and led to healthier businesses, many aging business owners are now receptive to considering an exit strategy to help fund their retirement. Many need cash from their business to retire with true financial freedom, yet their heirs don't have the assets to purchase the firm.

Often, business owners consider selling their business to family members, co-owners, competitors, investors, or an existing management team. Some business owners worry that their children or heirs will leverage their homes or cash out retirement savings to fund the purchase. Other owners seek to sell off business assets to fund their exit. However, financial strain as a result of the purchase can cause undue stress on the new owners and the health of the business alike. One often overlooked solution for withdrawing assets from a business is funding an ownership transfer with SBA Financing.

Using a third party source of funds, such as an SBA loan, can allow the business owner to receive their equity from the company without requiring the business itself to liquidate assets. The SBA's 7(a) lending program is designed to provide small businesses with financial assistance to cover a variety of business needs.

## ABOUT THE SMALL BUSINESS ADMINISTRATION

The SBA was created in 1953 to help support entrepreneurs and small business owners. The agency's mission is to strengthen the nation's economy by supporting small businesses. The SBA does not actually make loans, instead, they oversee lending through a network of banks and credit union partners. With offices in every state, the SBA has been growing steadily to increase access to capital for small businesses since the decline of credit availability in 2008.



## THE SBA LOAN GUARANTEE PROGRAM

The SBA's 7(a) government-guaranteed lending program is designed to make capital available to small businesses and entrepreneurs who may otherwise face difficulty securing a loan. The agency provides a guarantee to the lender of up to 75% of 7(a) loans over \$150,000. The program facilitates loans of up to \$5 million through bank and non-bank partners. The 7(a) lending program has grown from \$1 billion in loans in 1984 to \$23.5 billion in 2015.

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## SBA LOAN BENEFITS

Working with an experienced SBA lender as a partner can help better leverage the financing of an acquisition or partial buy-out of a business. Loan rates are often lower than available through commercial lenders and SBA financed transactions have other unique benefits including:

- Can be used to transfer a business to a family member
- Available for first-time business buyers
- Suitable for small to mid-sized businesses
- Often used to pay multiples of 4 to 6 or greater
- Flexible deal structures



While SBA loans are one option available to help fund the transfer of a small business, they are not the only option. Business owners seeking to transfer their business to family members, business partners, key employees, or shareholders should understand the advantages, risks, and costs associated with SBA Financing strategies prior to making any financial decision.

## USES OF LOAN PROCEEDS

While the terms of SBA loans are negotiated between the borrower and SBA-approved lender, in general, there is a maximum loan amount of \$5 million. Unlike commercial loans that are amortized over five to seven years, SBA loans are normally for ten year terms. For loans greater than \$150,000 with a maturity of one year or shorter, there is a 0.25 percent fee of the guaranteed portion of the loan. For loans with maturities of more than a year, the fee is 3 percent of the guaranteed portion between \$150,000 and \$700,000, and 3.5 percent on the portion over \$700,000. There is an additional fee of 0.25 percent on any guaranteed portion of more than \$1 million.

## ABOUT SBA 7(A) LOANS

The proceeds of a 7(a) loan may be used to assist in the acquisition, operation, or expansion of an existing business including:

- To provide long-term working capital
- Short-term working capital needs
- Revolving funds
- For equipment, machinery, furniture, fixtures, supplies or materials
- To purchase real estate, including land and buildings
- To construct a new building or renovate an existing building
- To establish a new business or assist in the acquisition, operation or expansion of an existing business
- To refinance existing business debt, under certain conditions

SBA loans cannot be used in the following circumstances:

- To refinance existing debt where the lender is in a position to sustain a loss and SBA would take over that loss through refinancing
- To permit the reimbursement of funds owed to any owner, including any equity injection or injection of capital to continue the business until the SBA-backed loan is disbursed
- To repay delinquent state or federal withholding taxes or other funds that should be held in trust or escrow

## 7(A) LOAN REPAYMENT TERMS

SBA programs typically offer maximum loan terms of seven years for business transfers. However, actual loan maturities are based on the ability to repay and the purpose of the loan proceeds. Most loans are repaid with fixed-rate monthly payments of principal and interest.

## COLLATERAL

SBA loans are generally secured by both business and personal assets until the recovery value equals the loan amount. Personal guarantees are usually required from all owners of 20 percent or more of the equity of the business and lenders may require personal guarantees of owners with less than 20 percent ownership.

## THE BENEFITS OF AN EXPERIENCED SBA PARTNER

Most entrepreneurs are only going to sell one business during their lifetime. Sellers can benefit from a representative looking out for their best interest and guiding them through the process.

Often, sellers are cashing in on their life's work and plan to rely on the sale value for the rest of their lives. For this reason, it's important to maximize the value they receive for their business and avoid unnecessary costs. Meanwhile, employees and family members may still depend on the continuity of the business, so it's desirable to leave the business healthy and positioned for future growth.

Transactions facilitated by SBA loans can offer various advantages, but also present common mistakes to avoid. By working with an experienced team, business owners can increase the value they receive for their business, decrease the time it takes to secure a loan, and avoid unnecessary costs and complications.



## DO YOU HAVE TRUE WEALTH?

Many of the business owners we work with are thankful for their careers but long for true financial freedom to pursue their greatest passions. We understand that as a business owner, you may seek true wealth by both withdrawing cash from your business as well as leaving a thriving firm to your heirs.

If your business is your largest asset, you may benefit from diversifying your wealth to reduce overall risk. By transferring ownership of your business, you may obtain more balance in both your wealth and your life. To learn more about whether an SBA financed ownership transfer may be appropriate for your unique situation, contact us today.

## ABOUT SCOTT FORD

Scott Ford is Founder and CEO of Cornerstone Wealth Management Group, an independent Registered Investment Advisory firm serving entrepreneurs, business owners, executives, and their families. The firm specializes in business liquidity strategies and SBA financing. It is Scott's mission to help his clients pursue financial freedom and live a balanced and fulfilled life.

Scott is a registered principal at LPL Financial and a Registered Financial Consultant (RFC). He is ranked in the top one percent of all LPL Registered financial advisors based on annual production. He was recognized as one of the 20 Rising Stars of Wealth Management by Private Asset Management Magazine in 2008 based upon assets managed of \$1 million or more per client. Since 2005, Scott has been an active financial technical analyst and is currently a Chartered Market Technician (CMT) candidate.



Clients often choose to work with Scott because of his experience with the challenges business owners and executives face as well as his firm's disciplined process. His personal and proactive approach is designed to bring clarity and simplicity to the complex issues of financial management. For over 20 years, he has been helping his clients define and pursue their own unique version of "True Wealth."

Scott is the author of three books: *Financial Jiu-Jitsu: A Fighter's Guide to Conquering Your Finances*, *The Widow's Wealth Map: Six Steps to Beginning Again*, and the New York Times Bestseller, *The Sustainable Edge: Fifteen Minutes a Week to a Richer Entrepreneurial Life*.

He and his wife, Angie, reside in Hagerstown and have two wonderful children as well as a dog and a cat. In addition to spending time with his family, Scott is a voracious reader and enjoys woodworking, Brazilian Jiu-Jitsu, golf, hunting, permaculture and beekeeping; basically anything outdoors.

19833 Leitersburg Pike, Suite 1  
Hagerstown, MD 21742  
Local: (301) 739-8505  
Toll-Free: (866) 485-8505  
Fax: (301) 739-8513



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WEALTH MANAGEMENT GROUP