Magnusson Balfour
COMMERCIAL & BUSINESS BROKERS

Newsletter

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Financing Businesses

By Scott Balfour

One of the biggest challenges to buyers acquiring and sellers selling a business is obtaining financing. One reason it is so challenging is that there is no universal set of underwriting guidelines as there is in other types of lending:

For credit cards you simply apply, then based on the credit score from the credit agencies and your income level, a card will be issued w/ a pre-set rate and limit.

For larger purchases like an automobile, lending is based on your credit score, the value of the car and perhaps on your current employment income.

For a residence lending is based on the appraisal of the home, credit score/history, and ratios based on your employment income and debt.

For Investment Real Estate lending is usually based on a percentage (75 to 80) of the buildings appraised value, and the cash flow from the building. It assumes a good credit history of the purchaser, but is not dependent on the employment income of the buyer.

For a businesses it is more complicated. Some of these factors are: The assets of the business; are they furniture fixtures and equipment, inventory, rolling stock, receivables, etc.? Whether business is trending, up or down. The credit history of the buyer. The amount of goodwill. The work experience of the buyer. The financials of the business being purchased. The structure of the sale; stock or just assets. Does the business lease or include real estate? Is their a business plan? What industry is the business in, etc.? Add to that, that each lender has its own in-house set of guidelines. Even banks using programs like the SBA all have their individual set of rules.

Bank

Ok, enough about the problems.... how do you get financing for small businesses?

The first thing a purchaser should do is to assemble: a copy of their credit report, complete a detailed personal financial statement, dust off and revise their résumé, and collect their last three years tax returns.

The sellers should assemble: a list of Furniture Fixtures and Equipment, get the financial statements of the business, the last three tax returns for the business along with a year to date income statement.

Create a description and history of the business, its markets, employees, roles, venders, customers, processes, etc.

Now here is where it gets interesting. ***The ultimate financing will be based on a combination of the strengths and weaknesses of both the purchaser and the business.*** This is why without knowing both sides, there is no simple answer to "What is typical financing for a business".

Now let's look through this pile of assembled papers. Let's start getting answers to some basic questions:

DOWN PAYMENT: How much cash is available from the purchaser? What assets of the purchaser can quickly be converted to cash? What assets could be pledged for security? Are there any 'angle' investors, family friends, etc? Now knowing how much down payment is available lets look at what is required. What is the price of the business? What are the assets of the business? Itemize them into broad categories like, inventory, equipment, machinery, receivables, real estate, goodwill. Lenders often require a pre set downpayment % that varies with each individual category. After this is all said and done if you have between 20% and 50% for a down payment, proceed.

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Real Estate

Looking For a *Good Deal*?

As Commercial Real Estate Brokers investors often ask us; “ Do you have any *good deals*?” I sometimes feel that I’m supposed to answer with, “Yes, there is among all the available properties on the market this one, special, undiscovered, diamond in the rough that is an unbelievable *good deal*.”

Let me state before I go on that yes, there are a lot of *good deals* on the market. The challenge comes in determining what is a *good deal* for an individual investor. What’s good for one might be totally innappropriate for another. Let’s look at some questions for consideration.

Cash Flow – Are you looking for an existing positive cash flow from an established building? If so, leased properties might make the most sense.

Real Estate Investment...A Balancing Act

Appreciation- Are you less concerned w/cash flow but you want the property value to increase at an accelerated rate? If so, the old expression of *getting in the way of the bull dozer might apply*. A property on the outskirts of current development might work.

Liquidity- You must ask yourself, do you need the option to sell quickly if an emergency arrives, or can you hold on for the long run? Unique properties might hold the most potential for return, but it might take a time to capitalize on them or sell quickly should the need arise.

Time- Are you looking to invest money but not time? An occupied condo, or triple net commercial lease might work. Or are you willing to add time and value to a project in seeking higher returns? Perhaps land for development or rehabs?

Risk vs. Yield – As in other investments, a steady certainty will most likely yield less than a volitile unknown.

Use- Do you intend to use the property? If so, perhaps non-financial issues come into play. Aesthetics or image, location as to proximity to transportation or your clients, cost of aquisition as well as cost to operate.

Looking for the *best deal* in real estate? We at Magnusson Balfour would like to help find the *best deal* for **you!**

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If not, it still could happen, but you are outside of the normal box, and it won’t be easy.

CASH FLOW: What is the constant and predicted cash flow of the business? Subtract what you as owner feel you need to take home as a reasonable salary. Take the remainder multiply it by 75%. This will put you in the ballpark for what is referred to as ‘available for debt service’. Take the available for debt service number, apply prevailing interest rates; appropriate term for the loan or loans. Do the calculations. You will then have an amount that can possibly be financed.

If the amount for possible financing and the available down payment is greater than the businesses purchase price, you’re good to go. Not every bank will be interested in lending for a variety of reasons. Shop around. Financing may have to come from a variety of sources, including possibly the seller. In a future article we will go further into ‘sources of financing’. But at least for now you have a good starting point.

So in summary, business financing is based on the interplay of the 4 C’s. **C**redit of purchaser, **C**haracter of purchaser (résumé) **C**ollateral, and **C**ash Flow of the business.

We at Magnusson Balfour take great pride in our ability to match ‘buyers, businesses, and banks.’ Do let us know if we can help you.