

BUYING A BUSINESS: THE FUNDING OPTIONS

LIKE A TYPICAL PROPERTY DEAL, FUNDING IS KEY TO ENSURING SUCCESS IN ANY TRANSACTION AND THIS APPLIES EQUALLY TO SALE AND PURCHASE OF A REAL ESTATE BUSINESS. MANY DEALS FAIL AT THIS STAGE DUE TO INAPPROPRIATE OR INCOMPLETE FUNDING BEING ARRANGED. STORY BY CRAIG WEST.

I have written previously about preparing businesses for sale and ensuring the structure and due diligence documentation are in place to make the sale as easy as possible for the purchaser. Of course, funding the purchase is always going to be an important issue and if done correctly the funding cannot only ensure the transaction is able to proceed but assist the business to be profitable and efficient under the future owners.

Funders in this space have a list of requirements which need to be met. With all the upheaval in the finance area in the last two years these requirements are now quite stringent – nothing though that would prohibit you from obtaining finance to purchase a good business with a good management plan.

In most cases, the purchasing funding solution will be a combination of equity and debt (and possibly several types of debt) and it is important to get good advice around the structuring of this funding to minimise the cost of funding, maximise your flexibility around repayment terms and security and ensure that the funding is not just obtained “at any cost” and severely penalises or inhibits the business going forward.

A few key issues in preparing the funding submission; (again, refer back to my previous article on preparing your business for sale as much of the work is very similar) funders are looking for clear and concise documentation both historical and also future – business plan, sales and marketing plan, cash flow projections etc are all part of the assessment criteria for most funders.

John Encina of Macquarie Commercial Finance (specialist business finance brokers who we work with regularly for clients) has kindly provided a list of some current lending criteria for the purchase of a real estate business:

Borrowing Ratio: Typically up to 60% of the value of the rent roll. Lenders will not lend against goodwill. Lenders will lend up to 100% of the purchase price if supporting security is provided.

Loan Terms: 15 years typically with first 2 years interest then principal and interest over remaining term

Facility: Most lenders will use a Commercial Bill product

Interest Rate: Typically the Bank Bill Rate plus a margin of 2.20% to 3.50% depending on the strength of the deal. Currently approximately 7.70% to 9.00%.

Security: Fixed and Floating charge over

the company that owns the rent roll plus directors’ guarantees.

Interest Cover: Lenders typically looking for an interest cover (net profit plus other income/total interest cost) of minimum two times.

As you can see, nothing too arduous or impossible here – but preparation is the key and a good broker can make a real difference in the outcome of your funding application.

In terms of structuring, whilst we understand the banks need security we do need to protect our overall position and other assets outside the business. In the event that something does go wrong in the future we do not want to lose everything as a result of this one particular deal.

Some other options are also worth pursuing. Vendor finance is still common and provides easier access to funding, though it does carry risk for both parties – security generally ranks well behind the primary lender/bank etc and if something goes wrong it is often difficult for the vendor to recover funds in the final wash up.

Recently, I have seen businesses funded with some newer products based around a commission funding model though this is unlikely to provide enough funds to purchase the entire business.

Employee share style plans, which we have used with our clients for several years primarily to attract and retain key people within real estate businesses can also be utilised to fund the purchase – either partially or in some cases a full purchase over an extended period of time.

Shareholder loans are also still popular whether it be the principal injecting their own cash/savings or personally borrowed funds or a less involved silent investor injecting needed capital to fund the purchase. A key issue here is to ensure the shareholder takes some security over the business in the same way that any other funder would – then in the event of something going wrong their investment is protected and they have a reasonable chance of being repaid.



Craig West is a strategic accountant who has built a specialist advisory practice focused on small business owners. Craig has written three books educating SMEs on employee incentives, succession planning and

asset protection and has recently been invited to undertake a PhD in Business Succession Planning. www.successionplus.com.au



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