



Buyer Sources of Funds

Written by Peter Busacca

When qualifying for a bank loan to purchase a company, either through a commercial banker or through SBA-guaranteed loans, the lender will ask you to document your sources of funds for the purchase.

Sources of Funds:

- 1) Cash or near-cash equivalents,
- 2) Equity in real estate, and
- 3) Conversion of retirement funds.

Cash: Usually, "Cash" includes money in savings accounts and the conversion of stocks, bonds or other financial instruments into cash.

Real Estate: If you own real estate, it is likely that you will be asked to pledge that real estate as security for commercial or SBA loan. The bank will charge you for an appraisal of the current fair market value of the real estate. They will ask you for documentation on the current outstanding balance on any remaining loans that are secured by the property. The difference between the current market value and the balance owed is called "paper equity" and banks can provide Home Equity Line of Credit (HELOC) loans up to 90% of the paper equity amount.

Retirement Funds: Conversion of retirement funds requires a financial agent such as Guidant Financial Services (GFS) or BeneTrends to facilitate the process. Under certain conditions ERISA law enables you to become the administrator of a self-directed 401(k). Generally this requires creating a subchapter C corporation owned by both you and by your newly created 401(k). The funds from your IRA or 401(k) can then be made available to the new corporation for business purposes, such as the purchase of an existing business. This can be done without incurring the steep penalties usually incurred in cashing out your retirement funds. As long as you use those converted funds for legitimate business expenses, there is no penalty. There are some restrictions on what kind of companies can be purchased, and the folks at GFS or BeneTrends can advise you on these issues.

If you would like to find out more about converting retirement funds, we can refer you to GFS and to BeneTrends. Both are very experienced in this area. Both firms will require that you engage a lawyer experienced in these kinds of transactions. Let us know if we can help with introductions to any of these groups.

The sum of these three sources of funds – cash, HELOC and retirement funds - is your down-payment amount.

Pre-Qualification: To obtain a bank loan, you will need to identify your sources of funds. You'll be asked to provide documentation that proves the funds are available in the amounts you state. You will also be asked to provide personal



Washington Brokers and Business Intermediaries

Buyer Sources of Funds

Written by Peter Busacca

financial statements including a pro forma income statement and balance sheet. The banks will be happy to provide you with basic forms.

Qualification: Once a business has been selected, Washington BBI will provide you with financial and other information from the Seller. This information is needed for your decision process, but the bank will also need copies of certain information so that they can qualify the business for a loan.

So what documentation will the bank need from the seller? This varies somewhat by bank and by the seller's industry, but this generally includes several years of income statements, balance sheets, tax filings, and asset inventories. In addition, most banks prefer to see a business valuation that was performed by an independent business valuator.

Business valuations cost from \$2,500 to over \$5,000. If a significant amount of capital equipment is involved in the business's operations, then a separate equipment appraisal may also be needed. Equipment appraisals cost about the same as business valuations.

Washington BBI does not conduct business valuations for our clients, although we will perform valuations for others. It is never in our client's best interest to have their own broker perform the valuation. Valuations will only be respected if they are done by an independent, objective and accredited business valuator. We're accredited, but if we are involved in the purchase or sale, then we won't be viewed as independent or objective. If you need a business valuation performed, we know several accredited valuers in the area that can do a fine job for you.

Summary: Obtaining a bank loan is best done using a two-step approach. First, work with several bankers to become pre-qualified for a business loan. This is done by providing three documents: Sources of Funds, Income Statement, and a Balance Sheet. Once you have selected a company to purchase, then the second step is to provide the banker with the documentation they need to support a funding decision for that specific selling firm in their specific industry.

Washington BBI will coach you through the entire purchase and funding process. We have relationships with key loan officers at several commercial banks in the area, and we are happy to make introductions. We can also refer you to financial services firms if you wish to use your retirement funds.