



SBA Information Notice

TO: All SBA Employees

CONTROL NO.: 5000-1096

SUBJECT: SOP 50 10 5(A) policy regarding the financing of goodwill

EFFECTIVE: 2/27/2009

Background:

SBA Information Notice 5000-1092 issued February 6, 2009, announced the publication of the first update to SOP 50 10(5). The first update to the SOP is known as SOP 50 10 5(A) and will be effective March 1, 2009.

As part of the update, the section on the financing of business acquisitions was modified. Among the changes was new guidance on the amount of goodwill that may be financed with the proceeds of a 7(a) loan. Previously, SOP 50 10(5) stated the following regarding the financing of goodwill:

The lender should explore seller-financing with a subordinate lien to the SBA-guaranteed loan on the business assets. The amount of seller-financing that should be considered is the amount being borrowed by the buyer to finance the acquisition of intangible assets such as goodwill.

As the number of 7(a) loans being used for business acquisition has increased, SBA determined that more specific guidance on the financing of goodwill was appropriate and added the following to SOP 50 10 5(A):

Goodwill:

- (1) If the purchase price of the business includes goodwill (or “blue sky”), the lender should explore seller-financing with a subordinate lien to the SBA-guaranteed loan.
- (2) The lender may finance a limited amount of goodwill. In no event may the amount of goodwill financed by an SBA guaranteed loan exceed 50% of the loan amount up to a maximum of \$250,000.
- (3) If any of the loan proceeds will be used to finance goodwill, the amount must be specifically identified in the Use of Proceeds section of the Authorization.

We have received comments on this issue from lenders and business brokers. Business brokers have commented that this will have a significant negative impact on their business. They are concerned that many sellers do not want to finance a portion of the sale to the new owner as was recommended in the previous versions of SOP 50 10. The comments from lenders are on both sides of the issue. Several lenders stated that they do not finance goodwill on a conventional basis. These lenders believe that goodwill is the riskiest asset on a small business borrower’s books and do not believe that an SBA guaranteed loan should be used to finance goodwill. Other lenders stated that SBA financing of goodwill is the only financing available in the present credit market and that limiting the amount of goodwill that can be financed using a 7(a) loan to \$250,000 will effectively stop business

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SBA Form 1353.2 (12-93) MS Word Edition; previous editions obsolete
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acquisitions. Some lenders suggested that many newly unemployed individuals are considering the purchase of a business and that it is appropriate for SBA, in its role of financing those businesses that cannot access conventional loans, to provide guarantees on loans to these individuals when seller financing is not available.

SBA began collecting data on business acquisitions approximately 4 years ago. But, as SBA did not expressly address the financing of goodwill in the SOP, the data does not include how much of the business acquisition was goodwill or whether the goodwill portion was financed by the seller or by the buyer with non-SBA guaranteed funds. Thus, the initial performance data of these loans is inadequate to draw conclusions on the overall performance of loans with a substantial amount of goodwill.

Because SBA does not have data specifically identifying goodwill in business acquisitions and because the Agency has been told there are limited options for those borrowers wishing to finance a business acquisition involving a substantial amount of goodwill, SBA has decided that it will review loan applications that do not meet the guidance in the SOP.

Option for SBA Review

For loan applications where the request for 7(a) financing of goodwill exceeds the limits set in SOP 50 10 5(A) because the buyer and/or the seller are unable to finance the amount of goodwill that exceeds the SOP limit, the lender may submit the application to the [Standard 7a Loan Guaranty Processing Center \(LGPC\)](#) for SBA's consideration.

The submission must include:

1. a completed Form 4;
2. a completed Form 4-I including the lender's internal credit memo;
3. a completed Form 159(7a) where required;
4. a detailed explanation as to the circumstances that prevent the seller and/or buyer from meeting the SOP requirements for the financing of the balance of the goodwill;
5. a business valuation as required in SOP 50 10 5(A), Subpart B, Chapter 4, Paragraph II.C. to include the name and address of the individual performing the business valuation;
6. any appraisals used to establish the value of real estate and/or equipment;
7. the name and address of any broker involved in the transaction and the fee charged for their services; and
8. any other information that the LGPC needs to finish processing a specific application.

This process will be in place through August 31st, 2009. At that time, SBA will provide further guidance on this issue. During this six month period, SBA will collect information from the applications submitted to the LGPC and analyze the types of businesses and transaction structures submitted.

Definition of Goodwill

“Goodwill” is created when an existing business is acquired and the acquiring entity pays more for the business than the book value of the business’s assets. Simply put, “goodwill” is the premium the seller is requiring as part of the purchase price (and the buyer is willing to pay) for an established business in the marketplace as compared to that same buyer starting a new business. By paying a premium for an established business, the buyer is relying on the existing business’s established market share to continue due to such reasons as an established customer base, a premium location, etc. (Customer lists and non-compete agreements are documents that the seller may provide to support the goodwill the seller is requesting.)

For SBA purposes, the amount of goodwill resulting from a change of ownership is determined as follows:

1. Asset purchase:

Selling Price minus the sum of the book value of all assets being purchased = goodwill.

(If the lender has obtained an appraisal for any real estate or machinery and equipment being acquired, the appraised value may be substituted for the book value for these assets. If the business being sold has intangibles such as licenses or patents on its balance sheet, the book value must be used for these assets. Intangibles that do not have an existing book value may not be subtracted from the selling price.)

2. Stock purchase:

Selling Price minus (the sum of the book value of all assets being purchased minus the sum of all liabilities that are being assumed) = goodwill.

(If the lender has obtained an appraisal for any real estate or machinery and equipment being acquired, the appraised value may be substituted for the book value for these assets. If the business being sold has intangibles such as licenses or patents on its balance sheet, the book value must be used for these assets. Intangibles that do not have an existing book value may not be subtracted from the selling price.)

Additional Information

Lenders and other interested parties may continue to send suggestions concerning the SOP to SBA at SOP50-10Modernization@sba.gov. This e-mail box is set up to receive only.

Questions regarding SOP 50 10 5(A) should be directed to the lender relations specialist in the local SBA field office.

Grady B. Hedgespeth
Director, Office of Financial Assistance