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Financing the Future: Navigating New Trends and Challenges in Franchisee Approvals and Lending

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Financing the Future: Navigating New Trends and Challenges in Franchisee Approvals and Lending

Access to capital is a cornerstone of franchise growth, but the franchise lending landscape is evolving rapidly. This white paper will explore current developments in franchisee lending, including the return of the SBA Franchise Directory, shifting underwriting standards, and the pros and cons of targeting select high-wealth and sophisticated franchisee applicants versus the broader spectrum of mainstream franchisee applicants.

Regulatory Backdrop: SBA Rules, Regulations, Recent Changes

It is important to understand that rules can shift. When change occurs, the market typically reacts quickly but not in unison and often reacts before developing a nuanced understanding of the changes. Even when the change is clearly laid out, lenders' application in real time can vary, which can affect timing and structure.

Several recent changes to the SBA financing process deserve particular attention. First, eligibility depending on ownership requirements, including citizenship and operational control structure, has become more central to the analysis for SBA financing. This applies to multi-member entities, and investor-backed ownership structures.

The SBA Franchise Directory is now the formal determining authority for franchise eligibility. If a brand is not listed here, the SBA financing route is closed regardless of a potential borrower's liquidity and financial strength.

Next, greater enforcement around global cash flow analysis reflects expansion of lender analysis of potential borrowers beyond business level projections, as personal debt service coverage expectations have become more prominent in underwriting.

Similarly, an increased emphasis on post-closing liquidity (financial reserves after an equity injection), has become a more often-used underwriting requirement. Lenders want to see that potential borrowers are not only sufficiently capitalized up front, but will have a financial buffer after closing, as well.

Application of the Credit Elsewhere Requirement shows the SBA tightening their analysis on potential borrowers as well. Borrower access to readily accessible liquidity through other avenues means SBA financing may not even be the proper vehicle for their transaction.

This is why it is imperative to understand financing and SBA eligibility early - often before a franchise agreement is signed. Prospects need to know if they are bankable, and what the SBA and the lender will require, so everyone avoids late-stage surprises.

Simply put: SBA rules are not an afterthought. They directly influence who is eligible, how deals with eligible recipients must be structured, and how quickly a lender can move.

SBA Directory as Exclusive Authority

For years, the Franchise Registry, maintained by FRANData, served as a widely used reference point for lenders when evaluating franchise eligibility. It provided comfort around control provisions and affiliation concerns, and it was not the SBA itself making the determination. As mentioned above, though, it is essential to monitor changes. There is no better example than the shifting landscape of the Franchise Registry.

On June 1st, 2025, the SBA formalized the re-introduction of the SBA Franchise Directory as the final authority on franchise eligibility for SBA financing. If a brand is not listed in the Directory, lenders cannot move forward for that concept, regardless of how strong the borrower or concept may be.

The SBA has rolled this out with greater direct oversight. Brands must submit documentation directly to the SBA for review, including franchise agreements, governing documents, and related control provisions. The SBA reviews issues such as affiliation, ownership control, transfer rights, and management authority. Once approved, the brand is listed publicly in the Directory, which is updated regularly and searchable by lenders.

This change comes with several practical implications. First, the importance of franchise agreements and authority provisions are amplified and now directly impact SBA financing eligibility. Next, the Directory is now a non-starter as it relates to brand development. An emerging concept that has not yet applied for listing cannot access the SBA channel for its candidates in the meantime. This added friction can be mitigated through careful drafting and planning.

Now that eligibility is determined directly by the SBA, the process is streamlined with less ambiguity, with the Directory serving as a gatekeeper. So, practitioners advising on system development should approach Directory listing as a foundational piece of system development, not a cherry on top or an afterthought.

ROBS Program

From an SBA financing perspective, the Rollover as Business Startup (ROBS) can be a very effective capitalization tool when structured correctly.

A properly structured ROBS transaction can help alleviate both insufficient equity injection during the ramp-up period, and limited post-closing liquidity, both of which are common challenges in financing, often making the difference in SBA underwriting.

In situations when a borrower is leaving traditional employment to launch the business, lenders focus closely on how personal financial obligations will be supported during the ramp up period. When structured properly, the business can compensate the owner in a manner consistent with program guidelines, which provides stability similar to outside income from a lender's perspective. That financial support during the early stages often gives lenders greater confidence in the borrower's ability to navigate startup volatility.

ROBS, as it's used in franchising today, was pioneered Len Fischer, the Founder and Chairman of Benetrends Financial. He established the model within franchising, and earlier this year the International Franchise Association recognized him for his impact on franchise financing.

Transactions of this nature require careful structuring and diligent ongoing compliance. They include continuing plan administration, IRS reporting requirements, and other annual upkeep.

Structural Decisions Fueling Financing Eligibility

Entity structure is commonly associated with tax treatment in the early stages of business formation and development. Most prospective franchisees default to LLCs or S Corporations. However, structure matters more than many people realize in the SBA world, and C Corporations should receive more consideration than they typically receive.

C Corporations come into the conversation primarily in the context of structure and compliance. For structure, C Corporations are essential to the previously discussed ROBS transactions. ROBS require C Corporations, which have downstream effects on ownership, governance, and capital flow to the business. Business structure is not a decision prospective borrowers should blindly choose.

Beyond ROBS, lenders and the SBA look closely at ownership structure, control provisions, and how equity is held. The entity type can impact eligibility, affiliation considerations, and how the deal is underwritten. For example, an entity structured efficiently for tax purposes may introduce complications in the lending context that a different structure would have avoided, and structural adjustments made after the fact take time, cost money, and can introduce delays that affect transaction timing in ways that may be difficult to recover from.

What we see in practice is that entity decisions are often made early for tax or operational reasons, without fully considering financing implications. In today's environment, that sequencing can create avoidable friction. The key takeaway is simple: entity structure should be aligned with the financing strategy from the beginning, not adjusted after the fact. Franchise counsel and business advisors should operate with this in mind, beginning with the initial formation discussion.

Item 7: Why Going Low Hurts the Lending Process

Item 7 of the Franchise Disclosure Document outlines the estimated initial investment required to establish a franchise. This is understandably one of the most important Items disclosed in an FDD from a financing perspective.

When Item 7 ranges are positioned aggressively low (as is common), it can create real challenges in the lending process. This is the case because lenders do not underwrite to best case scenarios. They underwrite to realistic and often conservative assumptions. When startup costs are shown at the low end of what is truly achievable, lenders tend to build in their own contingency. That often results in higher total projected costs than the candidate expected, which can create injection shortfalls, liquidity gaps, or debt service issues.

We also see situations where tenant improvement allowances are backed out of the buildout cost in Item 7. While that may reflect a potential landlord credit, it can misrepresent the actual capital required. In many markets, tenant improvement allowances are minimal or nonexistent, and lenders underwrite based on total project exposure, not assumed offsets.

Through a lender's lens, Item 7 may also serve as an assessment of franchisor cost discipline. Ideally, actual startup costs should fall squarely within the Item 7 range provided. When costs fall outside the estimated range of initial investment – whether above or below – lenders begin questioning whether the franchisor has a strong enough grasp of their costs and whether their projections can be relied upon elsewhere. This can permeate to other aspects of the relationship.

In today's environment, realistic and supportable ranges strengthen credibility and build lender confidence. So, counsel and advisors should emphasize that the ranges in Item 7 should be reasonable and supported by data to reduce any potential friction arising from costs falling outside their estimates.

Net Worth Requirements for Candidates

For many years, net worth has been a focal point in franchise development discussions. It is often one of the first metrics referenced when evaluating candidate strength. This makes sense – a candidate's financials should, in theory, strongly indicate the caliber of borrower they will be.

However, from a lender's perspective, net worth alone does not determine approval. What lenders focus on more heavily is personal debt service coverage ratio (DCR). Simply put, DCR inquires into whether the borrower has sufficient income and liquidity to support their personal obligations *alongside* the new business debt. This inquiry includes review of income sources, housing obligations, any installment payments, other debt, and total household financial commitments.

Net worth can be somewhat subjective as a catch-all metric. Certain assets may appear strong on paper but are weaker in practice because they are not readily accessible or do not directly contribute to servicing debt. Likewise, some liabilities may not materially impact true serviceability.

As a result, a candidate may meet a stated net worth benchmark yet still fall short from a debt coverage standpoint. On the other hand, a candidate with a more modest net worth, but who carries minimal debt and has strong recurring income, may be a strong candidate. In sum, it is important to understand that, in underwriting, demonstrated personal debt service capacity carries more weight than simply meeting a number to exceed a net worth threshold.

Credit Elsewhere Requirement from the SBA

The Credit Elsewhere Requirement is one of the most misunderstood components of SBA lending. At its core, the SBA requires lenders to determine that the borrower cannot obtain comparable credit on reasonable terms *without* the SBA guaranty. In other words, lenders must evaluate liquid assets and other resources that are reasonably available to a borrower in order to support the project. If they are deemed to have enough access to fund their project without SBA assistance, they should use that capital instead.

This seems like a simple inquiry, but there is more to it than appears on the surface. The key issue is whether capital is readily accessible and reasonably expected to be deployed into the business. If liquidity is *available* and *unrestricted*, lenders must consider it as part of the Credit Elsewhere analysis. That evaluation can materially influence eligibility, structure, and whether SBA financing is appropriate.

As has been emphasized earlier, this requirement means that candidates should assess their resources early in their development process. The retirement funds previously considered untouchable may suddenly factor into this determination. Conducting this review early will go a long way in preparing for how lenders may treat those assets in determining SBA eligibility.

Multi-Unit Financing

When we talk about multi-unit financing, we have to be clear about what we mean. Opening two storefronts at once is very different from buying multiple territories in a non-storefront model. These details matter, as underwriting considerations differ materially depending on the model being financed and conflating them can lead to underpreparation.

In traditional brick and mortar concepts, financing multiple locations at the same time significantly increases capital exposure and operational complexity. Lenders are underwriting the combined project cost, total debt service, lease obligations, construction timelines, and ramp up risk across more than one unit. Also, under evaluation is whether the borrower has the operational and personnel infrastructure to support simultaneous openings, including:

- Oversight of construction and buildout
- Hiring and training capacity
- Management depth beyond the owner
- Systems in place to supervise multiple locations at once

These factors are very different from those considered when financing multiple territories in a mobile or service-based model without storefront buildout. In those cases, there is typically no real estate exposure and no tenant improvement risk. Underwriting focuses more on working capital, marketing ramp up, and personal debt service coverage rather than construction risk.

This is certainly not the first section where the main takeaway is that details and understanding the concept, and how the SBA will evaluate it, matters. Candidates considering multi-unit brick and mortar opportunities should understand how that opportunity will be evaluated before agreeing to a multi-unit agreement. Mobile or service-based models should do the same. Similarly, franchisors structuring their development program should understand how their model is treated, and how that may change candidate qualifications.

The Case for Prequalifying Before Discovery Day

Discovery Day is a meaningful milestone. It requires time, travel, emotional investment, and operational resources from the franchisor. When candidates attend without first being financially vetted, it often leads to late-stage fallout that could have been avoided. So, financial qualification

should not follow emotional commitment. It should be moved up the order of operations to precede it.

Prequalifying candidates goes a long way in avoiding the potential emotional investment leading up to the late-stage fallout. Prequalifying should answer a few fundamental questions upfront:

- Is the candidate bankable under current lending standards?
- Do they have sufficient liquidity and equity injections?
- Do they meet personal DCR expectations?
- If SBA is not viable, do they have the capital to write a check?

This by no means requires a completed loan application or full review. Once again, this process is centered around an honest, early assessment to set expectations before the emotional commitment really sticks.

When these questions are addressed early, Discovery Day audiences will be candidates who are financially viable. That improves close rates, protects brand credibility, and reduces friction later in the process. For franchisors that want to build brand credibility, protecting candidates from late-stage failure will go a long way.

The Case for Using a Financing Consultant

For many candidates, commercial financing, especially when pursuing an SBA loan, is something they have never gone through before. It is a specialized form of commercial lending with its own regulatory framework, underwriting standards, and structural requirements. Even sophisticated borrowers are often surprised by how nuanced the process can be.

While the SBA provides the framework, each lender operates within the SBA framework differently. Credit culture, risk tolerance, interpretation of policy, preferred industries, comfort with startups, and appetite for multi-unit transactions can vary meaningfully from bank to bank. What one lender may decline, another may view differently. The difference between approval and rejection can simply come down to the right or wrong profile fit.

This is where experience becomes critical. A financing consultant who has worked in SBA lending for decades and has maintained longstanding relationships across multiple lenders understands not just the written program rules, but the lenders' practical application of those rules. They know which institutions are active, what profiles they prefer, how to position a file, and how to structure a transaction before it is submitted.

While more relationships can help, this is not about quantity over quality approach or the ability to send a potential deal to more lenders. It is about structuring the deal properly and matching it with the right lender the first time. Working with a financing consultant who operates in business lending every day, across cycles and regulatory shifts, can materially improve efficiency, reduce friction, and increase the probability of approval.

Post Closing Liquidity Requirements

Very often, post-closing liquidity is closely tied to personal debt service stability. As mentioned earlier, lenders are not only evaluating whether the business can operate during ramp up but are also assessing whether the borrower can continue to meet personal debt service obligations after the transaction closes. That includes mortgages, installment debt, revolving credit, and overall household obligations. This makes sense - assessing concurrent demands on a finite pool of resources, and their interaction in ways that become visible under stress, is understandably important in the big picture.

If a borrower deploys nearly all available capital into the project and is left with minimal reserves, the personal debt service coverage profile can weaken quickly during the early months of operations. Lenders want to see that sufficient liquidity remains after closing to support both business variability and personal obligations.

This directly impacts how candidates should approach early capitalization. There is clearly a line to walk between overcapitalizing to where a borrower will not be able to support the business and their personal obligations and preserving liquidity to balance those expenses. In practice, post-closing liquidity is not simply a reserve requirement. Counsel and advisors need to communicate to their clients that it is a buffer that protects personal debt service during the most volatile stage of the business.

Importance of a Well-Structured Business Plan

In today's lending environment, the business plan is not a formality. It is a critical underwriting document. A well-structured and concise business plan that aligns with SBA and lender requirements ties together the core elements above, including realistic Item 7 assumptions, thoughtful capital structure, personal debt service capacity, post-closing liquidity, and ramp up planning. With this in mind, it may be the most important tool to control the narrative as the borrower seeks SBA funding.

A well-constructed business plan can help on multiple fronts. First, it can show the lender's grasp on their concept and the realities of the investment. Lenders rely on clear and supportable assumptions – not the all-too-common best-case projections. They look for figures that reflect real startup costs, reasonable revenue build, and sufficient liquidity to support both business variability and personal obligations. In multi-unit situations, they also want to understand management depth and operational infrastructure.

When the business plan is structured properly, it demonstrates preparation. It shows that the borrower understands the capital requirements, the ramp up period, and the financial obligations involved. That clarity goes a long way in building lender confidence. In many cases, the difference between a deal that moves smoothly through underwriting and one that stalls comes down to how clearly the business plan and financial model presents risk, structure, and financial realism.

Conclusion

In sum, timing is the unifying theme in navigating SBA financing. Early engagement with financing considerations reduces friction, protects candidates from avoidable failure, and improves

outcomes for franchisors and lenders alike. Conversely, late engagement increases potential friction points and increases the risk of disappointing outcomes for potential candidates. The franchise development process has long been designed around the candidate's operational and cultural fit with a brand; financing deserves the same integration into that process.

Practitioners would be well-served to emphasize assessing the financial considerations early and honestly, which will lead to supportable investment considerations that will build lender confidence in the candidate and produce better outcomes for the candidates and systems at large.