



## Guidelines for using SBA 7(a) loan for Acquisition Financing

Eligibility and qualification for financing of a business acquisition is subject both to SBA rules (since most credit unions/banks prefer lending for business acquisition with an SBA guarantee), and to the credit standards of the credit union themselves. The screening criteria below include both SBA rules and typical banking standards. It is always best to consult an SBA lending professional on questions of eligibility and qualification.

### 1. Loan Size

Typical borrower down payment is 10%, seller financing is an additional 10% to 15% and the Bank loan is typically 75% to 80% of total costs (selling price, plus working capital, plus loan fees and costs).

*A seller note can count toward the buyer's down payment only if it is on full standby (no principal or interest payments) for the life of the SBA loan. Standby seller notes, other standby debt and minority investor equity together can cover no more than half of the required down payment. Ask your banker for more information about this option.*

In practical terms, SBA financing can play a significant role in deals with selling price up to \$5 million depending on down payment available from buyer, seller's willingness to finance a larger-than-normal percentage of the transaction; and availability of other types of financing (such as equipment leasing and current-asset financing).

- **Maximum Transaction Size:** given the above considerations, SBA financing is rarely practical for transactions with a sale price exceeding \$6 million; most SBA-financed transactions are at \$4 million and below.
- **Minimum Transaction Size:** SBA specifies no minimum loan size. Most lenders active in acquisition finance find loan sizes under \$100,000 to be uneconomic.
- **Maximum and Minimum EBIDAT:** following the above, at typical multiples companies with EBIDAT under \$150K or over \$2 million are likely to be too small or too large respectively.

*(Note: EBIDAT is Earnings Before Interest, Depreciation, Amortization and Taxes (if C Corp))*

**Total SBA Exposure:** SBA's "total exposure" to any one borrower plus any affiliates is currently 75% of the maximum loan amount of \$5 Million or \$3.75 Million guaranteed portion. The guaranteed portion of any outstanding SBA debt of the borrower and all affiliates must be subtracted from the total exposure limit, to determine how much additional SBA guarantee can be available to support lending to the company

### 2. Trends in Gross Revenues and EBIDAT

Downward trends in EBIDAT, continuing downward through the current year interim statements, are not acceptable for financing. This is true regardless of the level of adjusted net earnings (Sellers Discretionary Earnings or EBIDAT), or the multiple of net earnings in relation to debt service: it is the trend which is disqualifying. Downward gross revenue trends are usually disqualifying, unless EBIDAT is stable or increasing at the same time (usually indicating shift to lower volume but higher-margin business).

A dip in gross or net revenues for a year or two can sometimes be tolerated (COVID 19 pandemic) when the trend has flattened or has been reversed for a full calendar or fiscal year (usually at least 9 months' flat or improving trend must be shown, and for such a partial-year recovery, approval will be contingent on reviewing yearend

statements prior to closing). Credit Unions typically underwrite based on the calendar or fiscal year period for which tax returns are filed.

Under SBA SOP 50 10 8.1, debt service coverage must be met with historical earnings (the last fiscal year or a two-year average), not projections. The minimum is 1.25 times for most acquisitions and 1.15 times when an existing business expands by acquiring another business.

### 3. Business Size Standards

Borrowing business, taken together with all affiliates must meet either SBA's size standard for its industry (NAICS code) or SBA's alternative size standard, which requires both:

- The maximum tangible net worth may not exceed \$15 million.
- The average net income after Federal income taxes (excluding any carry-over losses) for the 2 full fiscal years before the application date may not exceed \$5.0 million.

Affiliation: SBA considers a business to be an "Affiliate" when:

- One person or group controls both businesses (generally 50% or more ownership, or the power to control), the businesses share common management, or close relatives own businesses in the same or a similar industry
  - Ie. Gesa Sandwich Shop and Gesa Teriyaki (Affiliate Example)
- Ownership interests of spouses and minor children must be combined when determining amount of ownership interest.

NOTE: in a business asset purchase, the applicant or borrowing company is the entity purchasing the assets; in a business stock purchase by individuals, the applicant or borrowing company is the company whose stock is being acquired.

### 4. Change of Ownership Considerations

For a complete change of ownership, the exiting owners must exit completely. The seller may not remain as an officer, director, stockholder, or employee of the Applicant. If a short transitional period is needed, the small business may contract with the seller as a consultant (1099 not W-2) for a period not to exceed 24 months including any extensions.

SBA allows partial changes of ownership. Talk with your banker for details on this program. At least one original owner must stay in the business and personally guarantee the loan.

- Business valuation: an independent business valuation, ordered by the credit union, is required for every change of ownership. Any part of the purchase price above the appraised value must be paid with buyer equity, and total debt cannot exceed the appraised value.
- Quality of Earnings report: required, and ordered by the credit union, when the business purchase price is \$3 million or more (excluding owner-occupied real estate).
- Loan term: the business acquisition portion of the loan is limited to 10 years. If the loan also finances real estate, a blended term may apply.

**Business real estate involved in a business purchase cannot be financed separately from the SBA-guaranteed loan unless** the SBA lender is given a shared (pari passu) lien position with the real estate lender.

*Exception: Can use an SBA 504 loan for real estate, together with an SBA guaranteed (7a) loan for the business acquisition.*

**Lease Terms:** When the Borrower is operating in leased space and when a substantial portion of the loan proceeds will be used for leasehold improvements, or a substantial portion of the collateral consists of leasehold improvements, fixtures, machinery, or equipment that is attached to leased real estate the lease including renewal options exercisable only by the Borrower, should equal or exceed the term of the loan.

This rule is flexible for loans where leasehold improvements, fixed machinery or the business is not dependent on a specific location to conduct business. Ie Roofing Company vs Restaurant.

**Landlords** must be willing to sign a "landlord's consent," allowing lender to enter the premises to seize collateral in event of a default.

## 5. Requirements for principals (20% or greater shareholders; officers, directors)

- All owners of 20% or more must personally guarantee the SBA-guaranteed loan—no exceptions. If spouses each own 5% or more and together own 20% or more, both must guarantee. A trust that owns any part of the business, and the person who created the trust, must also guarantee.
- If the SBA loan is not 100% secured by hard assets of the business (real estate and FFE only) at liquidation value of the assets, then principals may require a pledge of personal assets (typically real estate and significant financial assets), up to the point that the loan is 100% secured (This applies to loans over \$50,000; personal real estate is pledged when it has at least 25% equity). If all available resources are pledged and loan is still not fully secured, collateral shortfall is not a reason for decline.
  - Life Insurance may be needed through if it's a single owner and there is a collateral shortfall.
  - **Liquidation Value:** Real Estate- 85%, Land- 50%, New Equipment-75%, Used Equipment- 50%/80%, A/R, Inventory and Furniture & Fixtures- 10%
- Principals must be active owner-managers, not passive investors.
- Principals must have related-industry ownership/general management experience, with strong preference for same-industry experience in independent business
- Principals must have good credit history (generally, at least a 640 FICO score) with no bankruptcies in last 7 years. Judgments, defaults, and frequent delinquencies may disqualify.
- Businesses with an Associate who is incarcerated, on probation, on parole, or is under indictment for a felony or any crime involving or relating to financial misconduct or a false statement.
- 100% of the business's direct and indirect owners must be U.S. citizens or U.S. nationals whose principal residence is in the U.S. Since March 1, 2026, lawful permanent residents (green card holders) may not own any part of an SBA-financed business.

## 6. Equity Injection (down payment).

SBA requires buyer equity of at least 10% of total project costs, and it cannot be reduced for an initial acquisition. Up to half of it may come from "limited sources": a seller note on full standby, other standby debt, or equity from minority investors who own less than 20% and have no control

- **Buyer Equity** - Banks typically require at least 10% of total project costs to be injected by the borrower. (Total project costs = purchase price, plus loan fees, plus required working capital).
- Seller debt may not be considered as part of the equity injection unless it is on full standby (no principal or interest payments) for the life of the 7(a) loan. Seller debt that is not on full standby is counted in debt service coverage, amortized over no more than 10 years.
- **Seller Financing** - Banks would like to see some amount to be financed by the seller (including, not in addition to, any "standby note" such as the above.)

## 7. Ineligible Businesses

- Non-profit businesses (for-profit subsidiaries may be eligible).
- Financial businesses primarily engaged in the business of lending, such as banks, finance companies, and factors (pawn shops, although engaged in lending, may qualify in some circumstances).
- Passive businesses owned by developers and landlords that do not actively use or occupy the assets acquired or improved with the loan proceeds.
- Life insurance carriers.
- Businesses located in a foreign country.
- Businesses using pyramid or multilevel sales distribution plans.
- Small businesses that obtain more than one-third of their annual gross revenue for the prior year, including rental income, from legal gambling activities.
  - C-Store/Gas Station/Bar- Lottery/Pull Tab Commissions are removed from the cash flow.
- Businesses that are engaged in any activity that is illegal under federal, state, or local law.
- Businesses that restrict patronage for any reason other than capacity or that have discriminatory hiring practices.
- Government-Owned Entities, except for businesses owned or controlled by a Native American tribe.
- Businesses with an Associate who is incarcerated, on probation, on parole, or is under indictment for a felony or any crime involving or relating to financial misconduct or a false statement.
- Businesses that present live performances of a prurient sexual nature or that derive more than de minimis gross revenue, directly or indirectly, through the sale of products, services or the presentation of any depictions or displays of a prurient sexual nature.
- Prior Loss to the Government or Delinquent Federal Debt
- Businesses primarily engaged in political or lobbying activities.
- Search-fund structures and businesses where investors who do not guarantee the loan have control.
- Businesses with any direct or indirect owner who is not a U.S. citizen or U.S. national.

## 8. Ineligible Uses of Funds

- Payments, distributions, or loans to principals: NO CASH OUT to PRINCIPALS
- Business relocations that cause unemployment; financial hardship to leaseholder; or nullify labor agreement
- Investments in real or personal property acquired and primarily held for sale, lease, or investment (including remodeling of rental space)
- Illegal Activities
- Refinancing debt owed to an SBIC
- Payment of delinquent payroll taxes (income taxes eligible, but a credit issue)

## 9. Ineligible Personal Guarantors / Principals (20% or more owner/shareholder)

- The principal is on parole or incarcerated.
- Principal has caused a prior loss to the government: defaulted student loans, delinquency on trust fund taxes (Social Security, Medicare, UI, Work Comp), whether through settlement or otherwise, to any federal agency
- Conflict of interest: principal is a high government or military official, or an employee of SBA.

*Other SBA Items may be needed or can change at any time. Make sure to talk to your SBA Relationship Manager for more information*

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SBA requirements described here reflect SBA SOP 50 10 8.1, effective for loans issued an SBA loan number on or after October 1, 2026.

*All loans are subject to underwriting and credit approval.*

*Oral agreements or oral commitments to loan money, extend credit, or to forbear from enforcing repayment of a debt are not enforceable under Washington law.*