SELLING BUSINESS NOTES FOR QUICKER CASH

In about 85 percent of all business sales, sellers accept a cash down payment and a promissory note to pay the balance in installments. The note is personally guaranteed by the buyer, and it is secured by the business and its assets in case the buyer defaults. Providing owner financing allows sellers to cater to a broader pool of potential buyers.

However, many sellers don't want to be in the lending business and would prefer not to hold business notes. The good news is: they don't have to. If you created a business note to unload your company, you can sell the note to someone else. This way you can get instant cash out of the business, instead of waiting to receive periodic payments in the future. You can use the cash for a variety of purposes, including: capitalizing on other investment opportunities, paying off debts, funding college tuition and making major purchases.

How Selling Business Notes Works

Business notes are purchased at a discount—like all notes sold on the secondary market—to make them attractive to potential buyers. Without a discount, there is no incentive for investors to incur the risk of waiting three to five years or even longer to recoup their money. Historically, more than 90 percent of new business owners fail within the first five years. Therefore, there's considerable risk attached to the purchase of any business note.

You may receive less than the full balance of your note when you sell it. However, the total cash you receive from the down payment and the sale of the note will usually be about the same as you would have received from an all-cash sale of your business. That's because all-cash buyers can insist on a much lower selling price.

The amount of money you'll actually receive for your note depends on a number of factors. But as a general rule, for a full purchase, you can expect to be paid 50 to 80 percent of the balance of the note. More specifically, the amount of cash your note can be sold for will be determined by three general components: the current economic environment, the terms of the note (payment amount, interest rate, length of payback, etc.) and the degree of risk or probability that the note holder will lose his/her money.

Criteria for Purchasing Notes

Certain guidelines must be met in order for a business note to be purchased. Naturally, first-position liens are eligible. Here are some other elements investors like to see:

- The business is in a profitable position, with evidence of operating cash flow.
- The buyer has good credit, which generally means a FICO score of at least 625.
- The buyer put down at least 30 percent of the purchase price in cash, which signifies that he/she is truly committed and able to weather down cycles.
- The principal owners have made a personal guarantee on the note.
- The note has been "seasoned," meaning the buyer has made payments for at least two months. This shows that the buyer is happy with the purchase.
- The note should have a minimum face value of $15,000.00.

Structuring the Sale

There are a number of ways to structure the sale of your business note. You can sell the entire note, or only part of it. The most common way to sell a note is through a "partial purchase," which involves selling only a certain number of the remaining payments on your note.

Note buyers can purchase any number of the remaining payments in a variety of ways. For example, let's say you have a note with a balance of $80,000 payable in 240 monthly installments. If you need just $20,000 now, for whatever reason, the note buyer would calculate how many payments would need to be purchased to provide you with that specific amount of cash. Exactly which payments would be purchased would depend on your personal financial situation. You could sell:

- A certain number of the beginning payments on the note. (The note buyer might purchase the first 60 payments, and then you would receive the final 180 payments.)
- A certain number of the final payments on the note. (The buyer could purchase the final 180 payments, passing the first 60 payments through to you.)
- A certain percentage of each of the remaining 240 payments on the note. Perhaps 50 percent of each of the 240 installment payments could be purchased. (You would receive one half of each of the 240 payments.)

So which option in the above example would be best for you? It would depend on your current financial needs and future concerns. All of the alternatives would provide you with an immediate $20,000 cash payment. However, you might choose the first option if you need $20,000 today and require a future monthly cash flow beginning in five years. You might choose the second scenario if you needed $20,000 now and a monthly payment for the next five years until you start receiving your retirement benefits. Or you might choose the third option if you need $20,000 today and also want/need the monthly 50 percent payment for the next 20 years.

The Purchase Process

To purchase a business note, buyers will need to take an assignment of the security instrument (UCC-1 Financing Statement) and receive an endorsement of the promissory note.) But before getting to that stage, they will do the necessary due diligence and closely examine all aspects of the sales transaction of your business. The note buyers will handle all the paperwork for the purchase, from verifying all aspects of the deal and preparing/having recorded all of the necessary documents to make the change.

The note purchasing process takes an average four weeks to complete. If the sale of your business and the creation of the note was "typical," then you should have your money within four weeks.