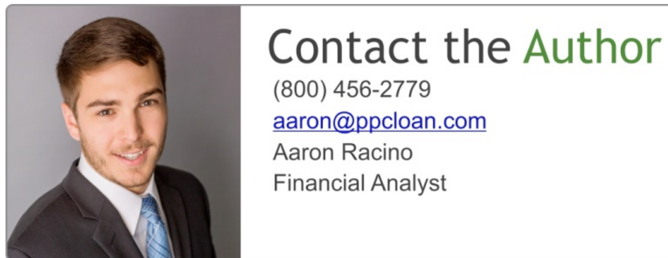
PPCLOAN™
Allstate Agency Value Index

Third Quarter 2016 Allstate Agency Value Index Editorial

Being the creator and author of the Allstate Agency Value Index has afforded me the opportunity to write countless articles and to travel on behalf of PPCLOAN to speak to both Allstate Management and the Agency force. In the process, I have learned of the issues often faced at loan closing, such as the restrictive covenant.

So, this quarter I have asked Aaron Racino to share his expertise in the area of seller financing. If you would like to discuss financing with Aaron he can be reached at aaron@ppcloan.com or toll free at 800-456-2779.

Paul Clarke
President of PPCLOAN



The Good, The Bad, and The Ugly: Seller Financing

This editorial is part one of a two part series. This part will discuss the ins and outs of seller financing and the second section will focus on an analytical view of how these acquisitions are structured in real world transactions. In today's market where the demand for Allstate agencies seems to be ever-growing, values have been holding strong and seller financing has become a common part of selling an agency. The following editorial will discuss the various aspects of seller financing as they relate to the classic western film The Good, the Bad, and the Ugly starring Clint Eastwood.

The Good

Seller financing the sale of an agency is attractive for a variety of different reasons, with the primary being that the seller acts as the bank. Without having a bank involved, the seller has significantly more leverage and is better able to dictate the terms of the loan, sell for a premium purchase price, and choose an approved buyer of their liking regardless of their ability to secure traditional financing.

Another common perk of seller financing is the steady stream of loan payments that the seller receives on a monthly basis. This is particularly attractive for agents that are retiring as they might benefit from a monthly annuity-like payment rather than a one-time lump sum. These payments can act to replace their existing income and be used to cover personal living expenses well into retirement. The seller can structure the loan with things such as interest rate, repayment term, and amount financed in a variety of different ways in order to achieve the desired size of the monthly payments.

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The buyer and seller have the flexibility to structure the deal however they see fit and are able to negotiate things like the interest rate, loan term, down payment, and purchase price to achieve an ideal loan structure that may be outside of what conventional lenders may be willing or able to do. For example, banks may have limitations on the duration of a loan term and they may be less likely to negotiate interest rate due to underwriting guidelines. Additionally, traditional lenders may be more selective of who they lend money to which is due largely to the creditworthiness of a potential borrower.

The Bad

Although there are attractive aspects to seller financing the sale of a business, there are reasons to be slightly hesitant. When sellers are lending someone money to purchase their business, they are often times placing a lot of trust on the buyer to repay the debt. Banks do this every day when they are making all types of loans but two of the major differences are that banks are well diversified among hundreds of loans and they are also experts in assessing risk.

Underwriting a financing transaction is one of the most crucial steps to ensure that you are lending money to someone that is likely to repay their obligation. All banks have their own underwriting guidelines and procedures in place to make sure that they make good quality loans. In a seller financing transaction, it is the sole responsibility of the seller to make sure that they are loaning money to an individual that is likely to repay them. Sellers often forgo this step altogether and this puts them in jeopardy of lending money to someone who may have a history of not repaying debt or financial adversity which may ultimately lead to loan default.

Additionally, when a seller enters into a contract to finance the sale of their agency themselves, they are committing the proceeds from the sale to be repaid over time and are reliant on the agency to continue to perform so that they can be repaid. One problem with agreeing to loan somebody money over a long period of time is that you lose the ability to "cash out" and take the lump sum amount to use for other investments or opportunities. This tradeoff is called opportunity cost; meaning that you lose the opportunity to invest your money elsewhere and earn a higher rate of return because your funds are committed to a different investment. If your funds are locked up in a seller note, you are unable to invest in another business venture, invest in the stock market, or pursue other opportunities.

The investment of a seller note may often times be rewarding but, as many financial experts will tell you, it is critical to diversify your investments. Diversification plays such a large role in investment portfolios because it helps spread the risk of loss among many assets so even if you are losing money in one investment, it may be offset by several different profitable ones. In the case of seller financing, all of the funds are dependent on one investment and the risk for loss is much greater than a well-diversified retirement portfolio.

The Ugly

Without a doubt the biggest drawback to seller financing 100% of the sale of a business is that the seller is taking all of the risk. In the event that the buyer of the agency defaults on the loan, for any variety of reasons, the seller is the one who suffers the consequences and bears the expense to legally pursue a default judgment.

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One major risk of lending money to an Allstate agent is the possibility of Allstate terminating their contract. This can happen for a number of reasons and can occur suddenly which will often leave lenders (traditional banks and sellers alike) scrambling to collect as much money as possible to minimize their loss. Loan default may also be the result of things such as declining revenue, increased expenses, or the agent simply walking away.

Simply put, the chance of a loan default is at the forefront of everyone's mind when they make a loan whether it is for $100 or $1,000,000. For many agents, their most valuable asset is their agency and they rely on the proceeds from the sale to live off of during retirement. Although an individual that is retiring may find seller financing to be attractive, they are also the ones who most heavily rely on the proceeds from the sale and stand the most to lose in the event of a loan default because they are left without much of a retirement strategy. In any case, defaults can be extremely costly to any lender that is owed money and puts them in danger of taking a substantial loss.

Any Last Words?

So is seller financing the sale of your agency better than using a bank? Unfortunately, it's hard to say either way with confidence but it is certainly more risky. Every person may have different preferences and every acquisition is unique so it is important to weigh The Good, the Bad, and the Ugly characteristics to determine what is best for you. In the next editorial we will take a look at the last 100 outside buyer Allstate acquisitions that PPCLOAN has financed to gain insight into how sellers are structuring these deals in the real world. We find that there may be a middle ground between minimizing risk and maximizing the reward.

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