KAFROUNI
LAWYERS

Guide

Vendor Finance

A simple guide for buyers and sellers of businesses.

Disclaimer

What is vendor finance?

Vendor finance occurs when the seller is prepared to fund part of the purchase price payable by a buyer for their business. Normally, the seller will agree to allow the buyer to pay part of the purchase price on completion with the balance payable afterwards as agreed. The business is actually transferred to the buyer on completion.

Vendor finance is not an "installment sale"?

Though often confused with it, vendor finance is different to an installment sale where the seller retains ownership of the business until such time as the whole of the purchase price is paid. An installment sale has many difficulties for a buyer and a seller. For the buyer, whilst they are in control of the business, they are not the owner of the business and may experience difficulties dealing with the lessor under the lease and other suppliers and creditors of the business. For the seller, they will still retain risk, including to their reputation, whilst they are not in control of the business.

When is vendor finance an option?

Sellers are often prepared to provide vendor finance when the money market is tight, such as it is now. When buyers are having difficulty borrowing money from the banks to buy businesses, vendor finance is an option that facilitates the sale and allows the seller to achieve a satisfactory price, even though a part will be paid after completion.

Is vendor finance something new?

Vendor finance is not new. It has been around since at least the 1870 and 1880 in Australia, predominantly used in land sales at that time. Its popularity and use goes through cycles depending on economic conditions.

Is vendor finance a good thing for a buyer of a business?

For the buyer, vendor finance is not unlike borrowing money from a bank. In effect, the buyer is borrowing the balance not paid for the business on completion from the seller in accordance with the terms agreed. Vendor finance can be desirable because:

- it solves the difficulties of obtaining finance from a bank;
- buyers and sellers can make their own arrangements without the involvement of a bank; and
- it is relatively quick and easy.

What are the usual terms that must be agreed?

When providing vendor finance, specific terms have to be agreed and documents. Some of the usual terms to consider are:

- how much is to be borrowed by way of vendor finance (e.g $100,000);
- what interest is to be charged (e.g 10% per annum);
- over what period is to be repaid (e.g. 2 years);
- in what amounts and frequency is it to be repaid (e.g. $4,500 per month);
- what "security" must be provided to the seller to ensure payment is made (e.g mortgage over house or charge over company);

- what regular management and financial reports will be provided to the seller over the term to support the buyer's ongoing capacity to pay (e.g. quarterly profit and loss or BAS Statements).
- what will happen if the buyer misses a payment (e.g. the full amount will become outstanding, the buyer can be sued and any security taken can be enforced);
- who pays for the legal costs associated with it (e.g. the buyer)

Is vendor finance a good thing for a seller of a business?

For a seller, vendor finance may provide the solution allowing the sale of the business at a price satisfactory to the seller. When providing it, the seller must:

- ensure that the amount of vendor finance provided is not so much that it reduces the emotional commitment to a business that otherwise would be achieved when a buyer is putting up all the money (or borrowing it from a bank);
- be very careful not to mislead or deceive the buyer in any way concerning the business giving a buyer an argument later not to pay some or all of the balance;
- take all precautions to secure the balance monies due against the assets of the buyer.

What security should a seller obtain from a buyer?

As the seller will transfer the business to the buyer prior to receiving the full sale price, the seller will normally take "security" over the business or some other asset of the buyer. This gives the seller the ability to "take" something of value from the buyer if they fail to meet their obligations; just like a bank would take a mortgage over a house for a home loan.

The seller's security could be in the form of a bill of sale over the business assets, charge over a company or mortgage over the lease or other freehold property. That way, if the buyer does not meet its obligations the seller should be able to take possession of the business personally or through a receiver and manager and re-sell it. Also, if the purchaser is a company, the seller will usually also require the directors of the purchaser to guarantee the debt of the company.

What legal documents are required for vendor finance?

The terms upon which vendor finance is provided by the seller is normally contained in the business sale contract itself or a separate vendor finance agreement. This will depend on the specific circumstances of the sale and the extent of the terms agreed. In addition, there will be separate documents for every type of security taken by the seller. Normally the seller's lawyers will prepare the documents.

Why are these documents important?

The recording of the arrangement properly in writing, by a lawyer, will minimise any misunderstanding between the buyer and the seller. It will also mean that the seller can sue the buyer for a failure to meet their obligations and enforce any security taken.

How much do these legal documents cost?

Depending on how the terms are to be documented and what security is being taken, the cost will usually range from $1,500 to $4,000.

Who normally pays these costs?

Normally the costs of completing the documents relating to the vendor finance are charged to the buyer. This is not unlike borrowing money from a bank where the buyer has to pay the costs. This means that the buyer will pay the seller's lawyer's fees for preparing the documents in addition to their own lawyer's fees for review.

Before deciding on vendor finance, what advice should be sought?

Buyers and sellers of businesses must obtain legal advice on their risks and obligations regarding vendor finance. There are many risks, some of which have been highlighted, that must be understood and balanced with the benefit of vendor finance.

An accountant and/or financial advisor will help a buyer or seller appreciate the financial and tax (GST) consequences of vendor finance including for the buyer, their capacity to repay the financed amount over the agreed time.

Provided vendor finance is an option, your business broker will advise on how best to promote this option to get a suitable buyer.

What to do next: If you would like more information on dealing with vendor finance, or for all queries regarding business sales and assistance, call Joe Kafrouni or Rob Montes on (07) 3354 8888 or joe@klaw.com.au or rob@klaw.com.au.

