DeVoe CapitalWorks™ Case Study

Partial Equity Buy-In Lending Program

***CapitalWorks** provides understanding and access to capital and lending solutions to RIAs. With many options available today, we seek to help RIAs understand the various options and how capital and lending can be transformational. To help you better understand how our process works, we teamed with one of DeVoe CapitalWorks' Marketing Partners to share a real-time example of capital in motion.*

Live Oak Bank, a participating lender in *CapitalWorks*, may be best known for acquisition financing. In addition, the Bank often partners with firms to create long-term succession and growth strategies. Thinking long-term allows advisors and their firms to create flexible, multi-step strategies for smooth transitions.

Background

Live Oak's partial equity buy-in lending program exemplifies this long-term approach. This program, developed by Live Oak Bank in response to a growing wave of aging firm founders, enables first-generation advisors (G1) to gradually transition equity to the next gen (G2) in tranches with a final buyout at the time of the selling owner's retirement. The aim is an affordable and manageable path toward an eventual total buyout of the firm by the G2.

Recently, working through DeVoe CapitalWorks, Live Oak applied its partial equity buy-in lending program to assist 'Cascade Wealth Management,' a pseudonym for the actual Pacific Northwest RIA.

Cascade has advised high net worth individuals in the Pacific Northwest for over two decades. By 2020, the firm served 155 clients with $1 billion in assets under management generating $4.1 million in recurring revenue. The independently appraised value of the business was over $10 million.

Live Oak Bank's work with this Cascade Wealth Management provides a useful illustration of the mechanics, value, and potential applications of this innovative lending program.

The Business Goal

Cascade's shares were largely concentrated in the hands of its founder (over 80%). With an eye toward retiring in the years ahead, he wanted to gradually transition his equity in the firm to a new generation of owners. The founder aimed to reduce his ownership share in the firm to approximately 20% over the next five years and be completely divested within seven years.

The Solution

To further its G2 transition, Cascade implemented a first tranche buy-in utilizing the Live Oak program. Two G2 long-time team members, already minority owners, were the initial loan beneficiaries.

Live Oak Partial Equity Buy-In Lending Requirements

- Minimum loan size: $250,000, with a typical term of seven to 10 years
- Loan made to the individual borrower and underwritten on personal cash flow with proforma distributions based on historical figures
- Borrower requirements:
  - Minimum one-year employment tenure with the firm
  - Personal credit score of 700 or more
  - Debt to income ratio under 50% before taking on the equity buy-in loan
  - Cash injection required is 10% or 50% of personal liquidity; if 10% is not available
- Advisory firm requirements:
  - Stabilized debt service coverage ratio of at least 1.5x
  - Must provide a corporate guarantee

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Each G2 purchased another 3.3% share of the firm from its founder with the new financing. The purchases dropped the founder's ownership share in the firm from 83.6% down to 77.0% and roughly doubled the shares of the two purchasing minority owners.

Because of their existing shares in the firm, neither of the new purchasers had to put additional cash down. To make the buy-in even more affordable, shares were sold at a 22% discount relative to appraised value.

While terms are typically seven years for partial equity buy-in loans, in this case, the borrowers requested and were granted a 10-year payback period. Both wanted some extra "breathing room" because they planned to purchase additional equity in the near term. In exchange for the longer term, the borrowers each pledged their residences.

Win / Win for All Parties

By applying Live Oak Bank's partial equity buy-in program, G2 was able to: i) acquire additional equity from the principal owner (G1), ii) structure the note in such a way that cash outlay was eliminated, and duration met their expectations, and iii) the internal succession plan was created to migrate G1's ownership from 80% to eventually 20%. This 'seamless transition' of the RIA's ownership was seamless to the clients and staff, all thanks to a creative approach structured by Live Oak Bank.

Why DeVoe CapitalWorks

We've identified the capital providers who focus on the wealth management industry, continue to monitor the new players and solutions, and then connect it all back to the needs of a given advisor. You will get connected to a funding source quickly so you can stay focused on serving your clients.

Getting Started

For more information or to begin the process, call us at **415-813-5066** or send an email to: **info@devoe-co.com**.