Abigail: I'm here with Ross Magnuson, Market President of Heritage Bank and we're going to be talking about your partnership buy-in program. First, I'd like to know what questions you would ask prospects looking to form a partnership buy-in agreement.

Ross: The first questions that I would typically start with is - what's the process that their business goes through in accepting or looking at new partners. We want to know what their criteria is, what they're looking for. It helps us get a good feel for when they're going to be adding new partners, what type of a partnership buy-in they're looking at. Because there's different areas that they can buy into the partnership or buy into the business. If they have multiple businesses, maybe they just buy into certain areas of that business. And then whether they own real estate or not, if they buy into the real estate entity also.

So, we start by finding out what their process is for buying into the partnership. Then when we get into that and understand that a little bit better, then we start talking and asking about how do they buy into it? So, understand how they become partners and then how do they buy in? Does the individual have to come up with a loan themselves? Does the business carry it? Is there a combination of the two? Do they become a full partner if they haven't paid off? So, we really try to find out how the funding happens.

Abigail: That kind of goes into our next question about how do new partners finance their partnership buy-in agreements.

Ross: There's really a few ways of doing it, or really just a couple of ways. One of them is they have enough cash to do it. So, they've saved up. They're able to put a hundred or $200,000, or whatever that dollar amount is into buying in. So, if they have the cash to do that, whether they get that from a family member, they saved up for cash is one way. If they don't, then it's borrowing the money. And then it's how do they borrow? Do they go out themselves and get a loan for it? Will the business carry them for it? And that's where we become involved. If they're looking at the loan, we want to do the loan for them, with the business guaranteeing it, working on the structure for the payment that fits, their draws that they'll be getting from the partnership.

Abigail: Okay. So what would the process look like for a partnership buyout?

Ross: So, the process for a partnership buyout is a lot different than a partner buying in. So, the process for buying a partnership out is where let's say you and I are in business together, and I'm going to buy you out of the business. What I'm really doing is I'm buying your interest in the business. So, if it's just the two of us, I'm going to buy you out. So now I have a decision whether or not I personally want to buy you out, or if I want to have the business buy you out. And then the business has the debt, but I have 100% ownership of the business. So, it becomes more of a business loan and a business structure, depending on what the business collateral is, whether it's real estate, it's equipment, whatever it might be. It could be the accounts receivable. So, it becomes a business loan to the business with the individual guaranteeing the buyout. If there's really, you and I are the only two partners to it.

If there's multiple partners that are involved, it is still that same decision. The business can take over the debt if there's four or five partners and they're buying out one or two of them. Then they can still take that out as a business debt, where again, the business takes the debt on. They make the payments through the operating cash flow of the business entity. So that's buying out another partner. Typically, we see it being a business type of loan at that point in time.

So, the difference between that and a partnership buy-in is the partnership buy-in is structured where the loan is to the individual. So, I'm becoming a new partner. I'm buying into the partnership. I am getting the loan myself - individually. And then what we do is we ask that the business guarantees it because if they don't make payments, they really don't want us to be an owner in that business. So, one is the buyout, buying a partner out - really is a business type of debt. And the way we look at it where the other one is an individual loan to the individual that is buying into that partnership. That make sense?

Abigail: Yeah. And that kind of answered my question about the structure for the loans as well.

Ross: And the buyout part of it, where the structure of that, again, we structure depending on what the purpose of that is. If they have real estate, we can structure it on a real estate term loan where it's maybe the payments are structured longer so they can get maybe a 15 or a 20-year amortization. If it is more of short-term assets that we're taking for it, we would structure it based on the equipment or the accounts receivable, something that's a short-term asset. And that might end up being a five or a seven-year type buyout, 10-year at the very most. So, a little different structure there too.

Abigail: So, what is the partnership buy-in formula?

Ross: Oh boy, it's a great question because they're all different. So, they all have different types. Really, it's based upon the cash flow of the business. It's based on the equity that they're buying into. It's based on the number of partners that the partnership has. If you have a partnership, for instance, that has $2 million worth of equity, and it's just you and I in, and we decide, okay, it's worth $2 million. If I'm going to buy you out, I got to come up with a million dollars. Because that's what the buyout is. If you've got 10 partners that are buying into it, or you've got nine and you're adding a 10th, then that buy-in becomes a lot less because there's more people buying into that same piece of the pie. So, I might have $200,000 to buy in to something that's worth a lot more because there's more partners that are buying in.

So, trying to figure out what that formula is depends on the equity of the business, the cash flow of the business, how many partners are involved in it. There might be some blue sky for future earnings that are all calculated in. So, I can't honestly say that there is one partnership buy-in formula that's used. There's a lot of different formulas, depending on all of that different stuff I've mentioned. So, they all have different ways of wanting to calculate it or needing to calculate it. So, sorry, no straight answer, an easy one on that one. It's just the way it is.

Abigail: Yeah.

Ross: It makes sense, though, doesn't it?

Abigail: Yeah, for sure.

Ross: Okay. Good.

Abigail: So, do Heritage Bank business relationship managers have knowledge in how to structure a partnership buy-in?

Ross: Yes. Yes. I believe that we do have the structure, that they know how to buy in, because when it really comes right down to it, it's a term loan. So, they're familiar with the structure of a term loan. It just comes down to making sure that we understand how much it is, what they need to cash flow. We don't want to set up the business or the individual up for failure. So, if it's a large amount, we set it up on a three-year payment term and they don't have the ability to pay for it, it's not going to work out. So, it's more understanding what the cash flow is to work around the structure.

When it really comes down to it, it's a payment over a set term, whether it's five years, seven years, 10 years, if we have to stretch that out far enough. That works with the cash flow for both the business and the individual because the business is ultimately making the distribution to the partners to make those payments, whether the distributions come quarterly, semi-annually, or even annually. If they become annually, then we do talk with them about making interest payments quarterly or monthly on it to keep those costs down on the payments. So, it really, like I say, a lot of it depends on the cash flow of the business when we figure out the structure of it, but they understand the structure in general.

Abigail: Yeah. So, what are some of the partnership buyout alternatives?

Ross: Alternatives such as how they could finance it or alternatives for what options are out there?

Abigail: A little bit of both. Like what are the other options to a partnership buyout? What are the ways in which you could do it?

Ross: Ways in which we do it, again, like we talked a little bit earlier about structuring it for different types of payments. If the partnership is buying into it, it's really hard to come up with a lot of different options because typically they're not pledging real estate as collateral for the business or any long-term assets where we can say we'll finance that over 20 years for them. Usually it's seven or 10 years, depending on the cash flow of the business.

The alternate ways of doing that, though, is that we could take, if they have a home or if they have equity in their home, we could take their home as collateral. And then we could stretch that payment out longer for them. Becomes a personal loan to them on their real estate, their house. Again, we could put that out over 15 or 20 years to lower that cash flow for it. But ultimately, we want to do is make sure that that individual – um we help people succeed financially. That's our ultimate goal that we want to. So, the quicker that we can make sure it works for them cash flow to pay that debt off, eventually they have stronger cash flow coming into them individually. So, there are some alternatives for it, but it really depends on what the collateral is.

Abigail: Does Heritage Bank require the partnership or firm to have an updated partnership agreement?

Ross: Yes. Yeah, we do require making sure that they have a partnership agreement because we need to know if that partner leaves whatever firm they're with or the business that they're with, if they leave, we need to know what the payout terms are on that. If there's still debt that's paid on, we expect our debt to be paid first. And then the rest would go back to the partner that they're paying off or basically buying out of it. So, we do want to know what the terms are in the partnership agreements, how that's structured, how that's handled, how they allow people into it. So yes, we do require and make sure that the partnership agreement also names who the current partners are and what their titles are. We want to know who the managing partner is for that entity. We need to know who can sign for loans for the entity. We need to know that they require them to guarantee the debt that they have. So, there are a number of things we do take a look at in those agreements.

Abigail: Is there any minimum or maximum dollar amount that Heritage Bank will finance?

Ross: Working with the partnership buyouts, there really isn't a minimum or maximum. I would say that the minimum or max amount that we finance is based on the cash flow of the business to repay the debt and to make sure that the partner that's buying in isn't getting strapped too much and that it's a fair buy-in. Most of them that we see are fair and equitable buy-ins to them. We haven't seen anywhere - where the buy-in is so high the partnership can't afford to make the distributions to the partners to support the debt that they're getting. So, it really is - as much as anything contingent on the cash flow of the business to support the debt and the buy-in for it. It could be if the business can't afford it to pay any draws on it, really then there shouldn't be anything for buying into it or should be very minimal for it.

Abigail: And then does Heritage Bank finance a partner that the firm has already internally financed?

Ross: Yes. If the firm is already carrying a loan on their books for a partner to buy in, we would pay off that debt with the firm and then the individual would have the debt with the bank, very similar to what they would have for buying into the business. But if it is something that's on their books, yes, we would finance that for them using the same methods and options that we have for any type of new partner buying in.

Abigail: Then my last question is what are the benefits of financing your partnership buy-in with Heritage bank?

Ross: Well, the benefits for the partner that's buying in is the partner really feels like they are a full partner. They've paid the firm for their buy-in. They have the personal debt for it. So, they really feel like they are a full partner at the time of buying in. The firm's not carrying them. So, they don't feel like, "Well, I really haven't bought in because they're still carrying the debt for me."

The benefit for the business is it doesn't impact their cash flow. It's not debt that they're carrying where they have to get their payments over time. They maybe have to borrow money through their operating line to cover it. They get all that money upfront, and they can distribute it or use it to operate the business, or maybe pay out to the other partners, are current owners. Those are the biggest benefits that we see other than because we're nice and you want to do business with us. But it doesn't materially impact the business at that time from a cash flow crunch. They get some money that they can put into the business however they want, whether they want to grow it or they need it for operating, or growth is really a big one for them.

Abigail: Perfect. Do you have any last comments you would like to be added to the content?

Ross: I think you've come up with a lot of good questions here and content for it. It's just understanding that we can help those businesses. I can't emphasize enough that we just want to make sure that the individual that we're financing is able to afford the payments on this. We can't strap them so much that it affects their own way of living, their own lifestyle for it. So, we really do take a look at making sure that we underwrite the business just as much as we do the individual.