NCEO | NATIONAL CENTER FOR EMPLOYEE OWNERSHIP

New 2018 Law Makes SBA ESOP Financing Easier

On August 13, 2018, the Main Street Employee Ownership Act (MSEOA) became law when President Trump signed the John S. McCain National Defense Authorization Act (see section 862, starting on page 262 of the PDF). (As incorporated into the defense act, the provisions are no longer literally called the Main Street Employee Ownership Act, but we use that term here for ease of reference.) The new law encourages the creation of ESOPs and worker cooperatives by facilitating transactions via loans supported by the Small Business Administration (SBA). It also directs the SBA's outreach infrastructure to encourage business owners to consider employee ownership.

Under prior law the SBA could make loans to help finance ESOPs, but the loans were subject to several requirements that made them impractical in most situations. The MSEOA eliminates five obstacles that were challenges under the old law.

1. **Before the MSEOA: The loan had to be made directly to the ESOP trust.**

   Now: SBA-backed loans can now be made to the company to reloan to the ESOP, as long as the transaction financed by the loan results in the trust owning at least 51% of the business. The loan from the company to the trust does not need to be on the same terms as the loan from the lender to the company. If the seller retains some ownership in the business following the transaction, she or he will be required to provide a personal guarantee for the loan.

2. **Before the MSEOA: The seller could not retain any role in the management or governance of the company following the**

transaction.
Now: The seller can retain a role in the company as "an officer, director, or key employee of the small business concern when a qualified employee trust or cooperative has acquired 100 percent of ownership of the small business concern."

3. **Before the MSEOA: There had to be a 10% equity investment in a business transaction loan.** Now: The law gives the SBA the discretion to waive the requirement for a 10% equity investment to accompany a business transaction loan.
4. **Before the MSEOA: The loan had to go directly through the SBA itself, a long and cumbersome process compared to the much easier approach of working with SBA preferred lenders.**
Now: ESOP companies can work with banks under the preferred lender program, which provides SBA guarantees for loans up to $5 million (additional funding from other sources can be added).
5. **Before the MSEOA: SBA-backed financing could only be used to directly fund the transaction.** Now: SBA-backed loans can also be used for transaction costs.

In addition, the program provides that Small Business Investment Companies (SBICs) can make loans to ESOPs. SBICs receive two dollars in government-guaranteed debt for every dollar raised in equity, up to a limit of $150 million (see the SBA's SBIC overview for details). SBICs typically would provide unsecured debt in ESOP transactions.

Finally, the MSEOA requires the SBA to coordinate with investment funds licensed through the SBA's Small Business Investment Company program and intermediary lenders through the SBA's Microloan Program to promote employee ownership as an area to consider for investment and lending. It also directs Small Business Development Centers to provide outreach and training on ESOPs, and it directs the SBA to set an interagency task force to develop further recommendations for promoting employee ownership.
It will be sometime in 2019 before the law becomes fully effective because the SBA first has to develop regulations and guidelines under the Act.

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