

If you are serious about buying a business, you will bump into seller financing within your first few offers. It is not fringe anymore. Across lower middle market and main street deals, seller notes are common because they bridge valuation gaps, reduce cash at close, and align the seller with the future of the company. I have used seller financing to win competitive processes I would have otherwise lost, and I have seen deals fall apart when buyers treated it as an afterthought. The difference comes down to structure, timing, and credibility.

This guide breaks down how seller financing actually works in the trenches, where the pitfalls hide, and how to turn a seller note from a reluctant concession into a shared advantage. It draws on patterns I see repeatedly in Business Acquisition Training cohorts and in real transactions across service, light manufacturing, ecommerce, and recurring revenue businesses.

## **What seller financing is, and what it is not**

Seller financing is a loan from the seller to the buyer, usually documented as a promissory note. It funds a portion of the purchase price at close. The buyer makes payments over time, typically with interest, sometimes with performance-based features like earnouts or contingent payments if revenue or EBITDA hits certain thresholds. A true seller note is senior only to equity, not to bank debt. That ranking matters because it dictates who gets paid first if things go sideways.

What it is not: a blank check for buyers short on cash or a backdoor earnout dressed up as debt. If a seller senses you are using a note to cover sloppy analysis or to avoid risking your own capital, you will lose credibility. Likewise, if a seller expects a bank-like risk profile and interest rate while also agreeing to full subordination and payment deferrals, the math and incentives will clash. Successful seller financing acknowledges that risk and reward must balance across term, interest, security, and covenants.

## **Why sellers accept it**

Sellers agree to finance part of their exit for several reasons, rarely just one. Taxes drive a lot of behavior. When a seller receives payments over time rather than a lump sum, they may benefit from installment sale treatment under current U.S. tax law, spreading recognition of gain and possibly smoothing brackets. Cash flow matters too. In many smaller companies, the buyer cannot reasonably service senior debt and also pay the full price in cash without strangling operations. A seller who wants a deal to close at a fair value often finds that a note bridges the affordability gap.

Human factors loom larger than spreadsheets. I have watched owners of 30-year family businesses prioritize a buyer who promised continuity for the workforce and local presence, even with a slightly lower cash component. The seller note becomes a signal of trust and a continuing connection to the business. That trust, however, is not blind. Sellers often demand security, personal guarantees, or performance covenants to protect their position.

## **How seller financing strengthens your offer**

When you are buying a business in a competitive process, one lever you control is structure. If you build a seller note thoughtfully, you can:

- Increase total consideration without increasing cash at close.
- Share risk sensibly by tying payments to realistic performance.
- Reduce bank leverage, improving debt service coverage and closing probability.

I once watched two nearly identical bids on a commercial HVAC company. Offer A was cash heavy, funded by a senior loan that left the company stretched. Offer B had a smaller bank loan, a moderate seller note at 7 percent interest amortizing over five years with a one-year interest-only period, plus a short earnout tied to maintenance contract retention. The seller picked Offer B even though the day-one cash was lower by about 8 percent, because the structure made survival and eventual full payment more likely.

## Common structures that work in practice

The market tolerates multiple flavors of seller financing. The right choice depends on cash flow resilience, seasonality, customer concentration, and the buyer's capital stack.

Straight amortizing note. Clean and predictable. Interest at a fixed rate, principal paid monthly or quarterly over three to seven years. This suits steady, nonseasonal businesses with durable demand like B2B services or property maintenance. If you are using SBA 7(a) debt in the U.S., be mindful of the agency's subordination requirements and payment standby periods.

Interest-only then amortizing. [Business Acquisition](#) For businesses that need a ramp after transition, such as ecommerce brands investing in inventory turns or agencies integrating account management, an initial interest-only period helps preserve cash. I have seen 6 to 12 months work well. Past a year, sellers start to worry they are just holding risk without seeing progress.

Performance kicker. A base amortization schedule with a small contingent bonus tied to net revenue retention, customer count, or gross profit margin. The base note handles the bulk of repayment, while the kicker recognizes intangible value and smooths egos when valuation is contested.

Unitranche with a seller strip. In rarer cases where a private credit fund provides a unitranche facility, the seller might still hold a subordinated strip. The interest rate then needs to adjust upward to reflect deeper subordination, but beware of choking free cash flow.

Hybrid of seller note plus equity rollover. Some sellers prefer to reinvest a slice of proceeds back into the business rather than a heavier note. If the seller is genuinely keen to stay invested, this can reduce fixed obligations and align incentives. It is not a substitute for a seller note when the buyer needs payment deferral to bridge value.

## Terms that move the needle

If you want a seller to say yes quickly, address these terms early and precisely. Vague language breeds mistrust.

Interest rate. I see a typical band of 6 to 10 percent in the lower middle market, with the midpoint around 7 to 8 percent for five-year paper when bank debt is senior. If the note is fully subordinated and on standby for a period, expect a lower cash pay and possibly a PIK (paid in kind) feature where interest accrues without cash outlay. Be explicit about compounding.

Amortization and deferral. Payment schedules should match the business's cash generation. If the company's monthly EBITDA is lumpy, quarterly payments soften shocks. A deferral or interest-only window is sensible if it bridges a known investment like equipment upgrades or CRM migration. Avoid deferrals that last so long that principal barely moves before maturity.



Security and guarantees. Sellers will ask for security against business assets. Senior lenders typically require the seller to subordinate to their lien. If the seller requests a personal guarantee from the buyer, you have leverage to narrow scope, cap exposure, or make it springing based on covenant breaches.

Covenants. Two to four clear covenants beats a tangled web. Keep them focused on actions that directly affect payment risk: maximum additional debt, distributions above a threshold, asset sales outside the ordinary course, and minimum cash balances. Overbearing covenants drain goodwill and flexibility.

Standby provisions and SBA quirks. If you use SBA financing, seller debt often must be on full standby for 24 months or more, meaning no principal or interest payments during that period. You can still accrue interest. Plan for the balloon that forms and model cash flows under multiple interest rate scenarios so you do not surprise yourself later.



Prepayment rights. Give the buyer the right to prepay without penalty after a short no-call period, or with a modest declining premium. Sellers appreciate a fair shot at early cash, and buyers appreciate optionality if the business outperforms.

## **Modeling cash flow with real numbers**

Handshakes do not service debt. Detailing cash flows is what calms nerves on both sides. Here is a simplified pattern I use when evaluating affordability of seller financing:

Start with normalized EBITDA. Deduct a realistic owner compensation for your replacement role if it is not already baked in. Subtract a working capital buffer based on seasonality. Layer in senior debt service with required DSCR headroom, typically targeting 1.5x in most businesses and 1.75x if volatile. Whatever remains is the cushion from which seller note payments must come. Leave at least 10 to 20 percent of revenue as operating buffer in low margin businesses and a dollar amount equal to two months of fixed overhead in higher margin, project-based businesses.

An example helps. Assume a residential plumbing business with \$1.4 million EBITDA on \$6 million revenue. After setting aside \$150,000 of working capital and modeling a senior loan with \$700,000 annual debt service, you might have \$500,000 of free cash available. A five-year seller note of \$1.5 million at 8 percent would require roughly \$380,000 in year one if fully amortizing. That is tight but feasible if churn is low and add-on services are sticky. If the business has weather shocks each winter, you might instead structure quarterly payments with a nine-month interest-only period after closing to bridge the slow season.

## **Addressing the fear behind the numbers**

Sellers usually do not say, "I fear you will default." They say, "I need to protect what I built." Respect that. Bring a crisp operating plan for the first year. Show your budget for upgrades and hires and when they hit. Outline the transition: who tells key accounts, how field teams get paid under your ownership, who signs paychecks during the first payroll. The more practical detail you share, the less the seller will worry that payments will dry up.

I have sat at kitchen tables where the seller's spouse asked more pointed questions than any banker. They want to know whether the business will retain its character. When they hear you intend to keep the office manager who has run payroll for 15 years and add a dispatcher to cut overtime, they can picture continuity. That opens space to negotiate a seller note on fair terms.

## Negotiating without poisoning the well

Negotiating a seller note is like tuning a guitar, not hammering a nail. Small adjustments travel through the instrument. Here is a compact sequence that keeps momentum and trust.

- Anchor early with rationale. When you deliver your initial offer, state in plain language why a seller note helps close and sustain the deal. Tie it to specific cash flow patterns and lender requirements rather than vague "industry norms."
- Trade, do not take. If you ask for a longer interest-only period, offer a modest rate step-up after the deferral or add a covenant that eases the seller's concern. If the seller wants a higher rate, counter with a shorter term or more manageable security.
- Use third-party constraints constructively. Senior lenders and SBA rules restrict payments and security. Frame these as guardrails that protect the whole capital stack, not as a cudgel. When the seller understands the requirements, they tend to focus on feasible adjustments, not impossible ones.
- Document clarity quickly. Follow every negotiation call with a one-page term sheet update. Ambiguity kills deals more than bad terms do.

That sequence reduces drama. The key is to keep the why and the how connected so you are not haggling over isolated numbers.

## Where seller financing goes wrong

Most blowups trace back to three root causes: mismatched expectations, unrealistic cash flow, or sloppy documentation. I will offer a few telltale signs.

If the seller wants an interest rate near private credit levels while insisting on equal or senior priority to the bank, you have a structural mismatch. Educate kindly, with examples. When someone holds out for an 11 percent note that is not subordinated, a bank will almost certainly walk.

If your model relies on aggressive synergies to make payments, pause. Cutting three heads in month one, raising prices 10 percent across the board, and switching vendors at once is a plan for churn. Load realistic ramp timing. Leave room for a bad month and a surprise tax bill.

If the note is documented as debt but behaves like an earnout tied to net income after buyer-selected adjustments, litigation risk rises. Earnouts are fine when they are clearly earnouts. Seller notes should have fixed schedules and objective triggers for any contingency.

Finally, communication after close matters. A seller who financed a chunk of your deal is still a stakeholder. I have seen defaults avoided because the buyer called the seller early about a problem and negotiated a temporary

deferral. I have also seen relationships sour when the seller learned of a miss after payments were late. Share a brief monthly summary for the first year. It signals respect.

## **Using seller financing with SBA and bank debt**

If you are buying a business in the U.S. with SBA 7(a) funds, expect specific rules. The SBA typically requires seller notes to be on full standby for a period, often two years, which means no payments can be made on the note, though interest may accrue. The SBA also looks at total combined leverage. If your structure pushes DSCR below the lender's threshold, the file will stall. I coach buyers to design two versions of the note in their term sheet: one configured for SBA standby and one for conventional bank financing. That way, you do not have to renegotiate the concept if your lender changes.

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Conventional banks vary more. Some allow a modest current pay to the seller if DSCR is strong. Others require full subordination with a cash flow sweep that prioritizes principal reduction on the bank line. Early conversations with lenders clarify the feasible band of terms. Loop the seller into those constraints with a simple diagram: bank first, then seller, then equity. Savvy sellers get it and will shift to negotiating rate and term within that reality.

## **Practical ways to build seller confidence**

Trust is a currency in these deals. You earn it in practical ways.

Show your work. Bring a sensitivity table that answers what happens if revenue drops 10 percent or gross margin compresses 2 points. Then point to how the seller note still gets paid because the amortization schedule flexes or your discretionary spend adjusts.

Offer a small personal guarantee that burns off. If you can tolerate some personal exposure, a capped guarantee that reduces after timely payments can bridge gaps without wrecking your sleep. Sellers read it as skin in the game.

Propose a standby interest reserve. Deposit a few months of seller interest into a separate account at close, only accessible for note payments. It is a tangible signal and often cheaper than bumping the interest rate.

Invite the seller into a specific post-close role. Not as a meddling shadow owner, but as a paid advisor for a set number of hours per month for the first six months. You get access to tribal knowledge. They get assurance that critical handoffs will not be fumbled.

## **Integrating seller financing into your acquisition process**

The mechanics of a good acquisition process help seller financing land smoothly. In Business Acquisition Training programs, we teach buyers to bake structure into the narrative from the first serious conversation. Do not pitch it as a last-minute fix during credit committee week.



The steps look like this. You qualify the business and the seller's motivations. You frame your buying philosophy, explaining that you prefer to fund a portion of the price through a seller note to keep leverage moderate and alignment strong. Your initial non-binding indication of interest includes a clear range for the note, rate, and term. During confirmatory diligence, you test the cash flow under stress and update the terms promptly, with rationale. The purchase agreement and the promissory note are drafted in parallel, not as an afterthought. You finalize subordination and intercreditor agreements with your lender early, so there are no day 29 surprises on a 30-day timeline.

When those pieces are in place, seller financing becomes a normal part of the story rather than a special request.

## **Case sketches from the field**

A specialty landscaping company with \$900,000 EBITDA had lumpy spring cash needs. We structured a \$1.2 million seller note at 7.5 percent with quarterly payments and a six-month interest-only start. The senior bank line flexed for seasonal inventory. The seller initially wanted monthly payments but accepted quarterly once we showed payroll and fuel spikes in April and May. Two years in, the buyer prepaid half the note after landing a municipal contract.

A niche B2B SaaS tool at \$2.2 million ARR and 85 percent gross margin had unstable churn after a UI overhaul. We avoided a heavy note and chose a smaller \$600,000 seller note with a 6 percent rate, then layered a 24-month earnout tied to net dollar retention above 100 percent. The seller preferred an earnout upside to a larger fixed note because he trusted the product roadmap. The buyer kept fixed obligations modest while aligning on growth.

A commercial cleaning firm with two founder-operators needed a careful handoff. We negotiated a \$1 million note at 8 percent with a personal guarantee from the buyer capped at \$300,000, burning down by \$100,000 per year

upon timely payments. That limited lifetime exposure for the buyer while giving the sellers psychological comfort. The note included a covenant not to divert accounts to new entities, with a clear definition tied to customer IDs, not vague language. Everyone slept better.

## **Edge cases and judgment calls**

Some situations do not fit templates. If the seller is moving out of state and does not want any ongoing tie, you might need to sweeten rate or shorten term to secure even a modest note. If the business relies on a single whale customer, do not make the seller note contingent on revenue from that customer alone. Instead, use a broader gross profit threshold to avoid a single-point failure in the contract.

If the seller is carrying a large note and also wants to keep the real estate with a lease, be careful about stacked fixed charges. In that case, negotiate a rent schedule that flexes in the first year so that a miss does not simultaneously trigger a lease default and a note default.

If a private equity buyer is in the mix with all-cash, you can still compete if the seller values continuity. Offer a modest equity rollover avenue for the seller so their note plus rollover presents a psychological upside that a clean exit lacks. Not every seller wants that, but many do once they see the math and feel your plan.

## **Legal documentation that actually protects people**

Your attorney will draft the promissory note, security agreement, and subordination or intercreditor agreement. Push for clarity over cleverness. Define defaults plainly: missed payments beyond a grace period, breach of key covenants, insolvency events. Outline cure rights and notice mechanics by email and certified mail. Specify jurisdiction consistent with the purchase agreement. If there is a collateral package for the seller, list UCC filings and any exceptions that senior lenders require. If a personal guarantee exists, cap it, define burn-off conditions, and limit it to the note, not to all obligations under the purchase agreement, unless you intend that.

Coordinate signatures so that the purchase agreement, bill of sale, note, and subordination documents all flow in one closing set. A stray filing or a missing consent can haunt you years later when you try to refinance.

## **Your operating plan is the real collateral**

Sellers sign notes because they believe you will run the business competently. That belief is not built in a pitch deck. It is assembled from the questions you ask, the diligence you prioritize, and the respect you show for frontline work. When you can walk the floor and ask about cycle time, scrap rate, or first-call resolution without faking it, sellers notice. When you own the messy parts, like a 30-day AR bulge or a creaky CRM, and explain how you will fix them without breaking morale, your seller financing ask stops feeling like a risk transfer and starts looking like a smart bridge.

One buyer I coached brought a simple 90-day plan to the close meeting. It had five moves: stabilize vendor terms, add a part-time controller, migrate payroll, launch a retention check-in with top 20 customers, and stand up weekly cash forecasts. The seller read it quietly and said yes to a longer interest-only period he had resisted for weeks. Words matter. But a grounded plan matters more.

## **The long game: using seller financing to scale acquisitions**

If you intend to buy more than one business, your reputation follows you. Treat seller notes as sacred obligations. Pay early when you can. Share honest updates. When you inevitably run into a rough patch, ask for a temporary

modification with data and a path to resume payments. A handful of positive references from sellers who carried paper for you is worth more than a glossy pitch deck when you chase your next acquisition.

Seller financing is not a gimmick. Done right, it is a disciplined tool that closes gaps the bank cannot, accelerates deals you might otherwise lose, and keeps stakeholders aligned through the choppy early months of ownership. It rewards buyers who understand cash flow at a granular level and who negotiate with empathy and precision. With practice, it becomes a standard part of your Buying a Business toolkit, not a special exception you deploy only when capital is tight.