How Advisors Are Using Financing To Build Their Ideal Businesses

THE LIVE OAK REPORT
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Like many advisors, you’ve probably thought a lot about how you can build your business. Is it enough to bring in a few new clients? Or do you want to make a leap and buy another practice? Do you want to bring in a partner with a book of his or her own—or do you want to buy out a partner whom you’ve outgrown?

Business transitions—acquisitions, successions, and expansions—are on the rise in the industry. One important reason is the new access to capital, as evidenced by the rapid growth in advisor borrowing. At Live Oak Bank, we have lent more than $350 million to advisors since we financed our first transaction in 2013.

One important thing we have learned during the years we have been working with advisors is how little hard information is available on advisors’ borrowing activity. So we decided to dig through our own loan portfolio and share some insights on the kinds of loans advisors are taking. In addition, we spoke with some advisors about how they used financing to build their businesses.

Access to capital is one of the foundations of American business success. With this Report, we hope to help advisors understand more about what their peers are doing, and use that knowledge and insight to inform their own ambitions and plans.

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**OUR SURVEY SAMPLE**

Live Oak examined 276 loans in our own portfolio, analyzing them for purpose, amount, and portion of overall transaction. All loans in the study were for at least $350,000, the minimum loan when Live Oak began its Investment Advisory loan program in 2012. (The minimum was lowered to $75,000 in 2015.) Names and affiliations were scrubbed from the data. We separated external acquisitions—when an RIA (registered investment advisor) bought another RIA, or an advisor affiliated with one broker-dealer acquired a practice affiliated with another broker-dealer—from internal acquisitions, in which the acquisition took place within a single broker-dealer’s ranks. We differentiated both of these types of transactions from internal succession, which we define as a next-generation advisor buying out a senior principal owner.
WHY ADVISORS BORROW

Small business owners often bemoan the difficulty of getting credit, and financial advisors are no exception. Most banks are hesitant to lend to a business whose assets are primarily intellectual—the advisors’ ability to attract and serve clients. Live Oak has changed that scenario through our cash-flow lending model. Even without tangible assets most of our borrowers tend to be highly qualified. The average annual revenues of the borrowers we surveyed is $600 thousand and the average assets under management are $210 million. In addition, the average loan size is $1.2 million.

Since Live Oak Bank began its loan program in 2012, roughly two-thirds of its loans have gone to advisors who are engaging in an acquisition or an internal succession, a number that reflects the wave of transitions going through the independent advisor industry as Baby Boomers retire. Since 2011, 10,000 Baby Boomers have been celebrating their 65th birthday every day, and that age wave will continue until 2030, according to the Pew Research Center. It’s not just the clients who are headed to the beach.

LIVE OAK BANK LOANS BY THE NUMBERS

66% Of Loans Are For Acquisition & Succession. But the majority of these acquirers are not financing a textbook succession. Among advisors who are acquiring a practice, only 28% say that they are borrowing in order to execute an internal succession plan. The majority are buying out other advisors, whether within their network (46% of acquisitions), or, less often, outside of it (26%), a number that includes RIAs who buy other RIAs. These numbers bear witness to the continued lack of internal succession planning among most independent advisors.
NOW IS A GOOD TIME TO PLAN

The internal successions tend to be the largest deals, however, with an average purchase price of $2,343,148 and an average loan size of $1,710,029. (The difference usually takes the form of a seller note.) External acquisitions rank second, with an average purchase price of $1,681,861 and an average loan size of $1,148,729. Internal acquisitions’ average purchase price is far lower: $916,108, with an average loan size of $757,144.

Succession Planning Facts

The average age of financial advisors in most channels is above 50. (According to a 2014 report from Cerulli Associates)

It typically takes several years to identify and groom an internal successor.

It usually takes at least 18–24 months to find an external buyer, negotiate a deal, and execute the transition.

As of 2012, 63% of advisors had no succession plan. (According to a report from the Aite Group)
Refinancing is a relatively new loan category for Live Oak Bank but it already comprises 9% of our loans. Advisors are realizing that they can improve the terms of their loans. In most cases, they pay a lower rate of interest with Live Oak financing and extend the loan’s duration to further improve their cash flow. Advisors are trading in old loans from broker-dealers and custodians—with full cooperation from the previous lenders, who are then able to redeploy their capital.

Breakaway and tuck-in loans remain a substantial portion of the Live Oak loan portfolio, at 7% and 3% respectively. In these cases advisors borrow capital to float a new firm or bring in a new partner. The average loan size for breakaways and tuck-ins is $766,901.

Working Capital loans make up 7% of Live Oak loans, and provide advisors with funds that may be used for a variety of purposes, such as starting up a branch office, renovations and new equipment, and more. The average loan size is $785,480—but the median loan is far smaller, at $450,000.

Commercial Real Estate loans are available to advisors who want to build, expand or buy an office. They are a small part of the overall Investment Advisory loan portfolio, but can fund an interesting personal-finance strategy for advisors—buying their firm’s office and collecting the rent as part of their future retirement income stream. The average real estate loan is $1,344,167. These loans have a 25-year term, unlike the standard Live Oak business-purpose loan, which in most cases amortizes over 10 years.
CONCLUSION: USE THE POWER OF CAPITAL

With a Live Oak loan, financial advisors can transform their practice into a well-capitalized business with a growing balance sheet. Building the firm doesn’t require digging into your pocket or dispersing equity. A loan, on generous terms, can help you structure your business for lasting success.

Information gathered and presented by the Live Oak Bank Investment Advisory Lending Team. For further detailed insight contact our team at 910-550-2261.

CASE STUDIES: TWO ADVISOR’S STORIES

Ross Lawrence
Hoffman Financial Resources

Ross Lawrence is the embodiment of successful succession. He joined his firm, Hoffman Financial Resources, a Nevada, Missouri hybrid RIA affiliated with LPL, in 2011. Still in his twenties, he bought out his senior partner, Greg Hoffman, on January 1, 2016. For Lawrence, 75% of the business purchase was covered by a Live Oak loan, and the remainder took the form of a seller note. Both seller and buyer continue to work at the firm—Hoffman, who’s still in his fifties, is committed to implementing a successful transition for his clients.

“I’m doing a lot of planning,” Lawrence says of his $117 million AUM firm. Right now, he’s focused on the transition rather than on bringing in a lot of new clients. But Lawrence hopes to grow through acquisition in the future—backed by the power of Live Oak acquisition financing.
Private Ocean was founded in 2009, when Friedman & Associates merged with Salient Wealth Management to form a leading San Francisco Bay Area RIA. Since then, the firm has grown to more than $1 billion in assets under management. Greg Friedman, founder of Friedman & Associates and president of Private Ocean, wanted to consolidate ownership and buy out a senior partner who was ready to reduce his active engagement with the firm. As a long-time leader in the financial planning community, Friedman had plenty of options, including bringing in new partners or private equity. He chose a Live Oak loan instead.

“The Live Oak loan offered good terms, and it also offered qualitative benefits,” Friedman said. “I was able to consolidate ownership in a way that made both me and my partner happy. He no longer has to concern himself with the ongoing ups and downs of the business. From our point of view, we got superior loan terms and the flexibility to prepay if we choose.” Borrowing money, rather than selling a piece of the firm to a new partner or a consolidator, gives Friedman more power to chart the future of his business—and continue to grow.

Just as important to Friedman was the improvement in his ability to attract and retain talent. The Bay Area has a thriving RIA community and talent is at a premium. “We now have equity to share, which makes us a more attractive employer and acquirer. There is no outside owner to cloud the waters—a reason I didn’t want to work with a consolidator—which makes it easier to sign on.

We were concerned about losing our top advisors to firms that would allow them to buy in and become an equity player. Best-practices firms are doing that, and we wanted to as well.”

Friedman may not be finished borrowing. He is eyeing some acquisitions now. “We expect to close an acquisition this year. We don’t need to borrow but we are in talks with a second firm we’d like to acquire next year, and for that one we may decide to borrow again. That’s when we might return to Live Oak.”