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UFT
COMMERCIAL FINANCE, LLC

Cashless Seller-Finance™;

An Innovative Solution Using the Enhancement CPC™

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A New Breed of Seller-Finance

Whether you have spent years building a business, amassing assets, and accumulating wealth in your personal estate or you are driving a company that has a need to divest itself of some long-term assets in order to lighten balance sheet load, there comes a time when selling a business or some of your assets just makes sense. The trick is to assure that you or your firm have the economic freedom, time, and flexibility to successfully plan for a divestiture. That means being able to find the right buyers at the right time with both the means and skills to act. This assures that you not only get your price, but do so while benefiting strategically from the sale.

For a seller that has the financial strength and balance sheet available, sponsoring a buyer-of-choice so that it can qualify for attractive acquisition funding could be a great option. This type of sponsorship isn't a traditional form of seller-finance, requiring a seller to take a note back from the buyer, agree to an earn-out, surrender control of its asset without collecting the full sale price, or give a personal guarantee to a third party lender subject to terms the seller doesn't control and that could result in the seller's curing an unexpected buyer default. This new breed of seller-finance brings with it a load of seller benefits, including a front-loaded cash purchase payment, a premium price upon sale, current returns during the finance period, and better controls to guard against buyer default. For the right seller, the use of the Enhancement CPC as the newest tool in a "Cashless Seller-Finance™" transaction makes sense.

Enhancement CPCs for Investment

The Enhancement CPC™ is a new type of security that represents a fractional beneficial ownership in a credit enhancement facility supporting a specific project or transaction. Using an Enhancement CPC, an investor is able to engage in "Cashless Investments™" with a view to creating a yield enhancement for a select portion of its broader investment portfolio. A Cashless Investment strategy enables an investor to acquire investment exposure in virtually any pre-qualified investment, project or business opportunity without investing or spending its cash-on-hand or loading its balance sheet with direct debt or conventional leverage. Instead, the investor causes the issuance and delivery of a specially-formatted standby letter of credit to a dedicated trust account as purchase consideration for the Enhancement CPC linked to the target investment. The Enhancement CPC brings with it the investment exposure that the investor seeks, a direct collateral position on the underlying project or assets, and a yield stream derived from any combination of enhancement fees, revenue participation, earnings interest, or asset appreciation participation, dependent on the nature of the project being undertaken or assets being acquired. That yield translates into a true source of portfolio yield enhancement that is additive to the performance of the underlying portfolio assets that the investor pledged to cause the issuance of its letter or credit as the purchase consideration for the Enhancement CPC.

"When you overlay this basic construct in a seller-finance transaction ..., a very compelling picture evolves that could prove invaluable to a qualified asset owner when considering the best route to a successful sale."

Fundamentally, the first question that arises when an investor is learning about making Cashless Investments™ using an Enhancement CPC™ is 'Where does the money come from to fuel the investment if I don't contribute my cash?'. This is a very good question and goes to the need for an investor to understand the basics of gaining investment exposure using Enhancement CPCs[1]. Once this is understood, the benefits of using this tool to power a seller-finance alternative will become apparent. In most cases, before a project or business becomes eligible for investment using an Enhancement CPC, the business or the project sponsor will have first enrolled in a membership-based Capital Cooperative™. Cooperative Membership prequalifies the business or project to independently apply to the Cooperative for a commitment and allocation of funding for the member's project or business.

The Cooperative has been established for, among other things, providing cost-effective funding to its members who benefit from certain economies of scale resultant from the Cooperative's volume-based capital framework. The Cooperative relies on the highly targeted credit enhancement afforded through the operation of the Enhancement CPC to insulate against project or business-related risks that could arise in the event of a catastrophic project or investment default by one of its member firms. With this in mind, it has built its funding protocols around making capital available expressly to projects, businesses, or transactions that have this type of tailored underlying protection to guard against default. When an Enhancement CPC is purchased by an investor, the letter of credit that is delivered as purchase consideration for that Enhancement CPC is positioned in a dedicated trust where it will sit for the duration of the transaction as risk mitigation for the Cooperative's benefit related to a particular member's project or business. That letter of credit can be drawn only under very narrow circumstances by the Cooperative's trustee, consisting primarily of a default by the member in the payment of its costs of funding.

When you overlay this basic construct in a seller-finance transaction in which the Cooperative will provide funding to a buyer in reliance in part on the seller's purchase of an Enhancement CPC by delivery of a letter of credit, a very compelling picture evolves that could prove invaluable to a qualified asset owner when considering the best route to a successful sale.

Seller Sponsorship of a Buyer

Applying the Enhancement CPC to the sale of an asset – regardless of the asset's nature – is a coordinated process between the buy- and sell-side of virtually any contemplated transaction. First, the seller will qualify as a "Participating Lender" with UFT Commercial. To do so, the seller will demonstrate that it possesses sufficient financial standing and strength to be admitted as a potential participant to purchase an Enhancement CPC. Generally, the eligibility threshold for Enhancement CPC participation is one in which the seller is both the equivalent of an "Accredited Investor" under the Securities and Exchange Commission Act of 1933 and "Qualified Purchaser" under the SEC's 1940 Act.

[1] See, UFT Commercial Finance Publication P-0808.MCP, *"Master Credit Participations; The Un-Securitization"* and Form 0808.UEC, *"Understanding the Enhancement CPC"*.

"...the seller has the luxury of choosing the buyer that he believes is best-suited and most likely to succeed with the asset, rather than simply choosing the buyer that can pay the best price."

In practical terms, true capability to participate in an Enhancement CPC™ series in support of the sale of one of its assets, either directly or through an affiliated entity, boils down to the seller's ability to deliver one or more conforming letters of credit; the aggregate face value of which is equal to either the full sale price of the asset or some lesser amount that represents the maximum amount that the seller is willing to sponsor for the benefit of the asset buyer.

For the sake of comparison, in a conventional asset sale transaction, candidate buyers will already have all purchase proceeds available *without* need of any support from the seller. These buyers' self-sufficiency means the seller will be competing head-to-head with other sellers of similar assets in hopes of attracting one of those capable buyers. Under those circumstances, there are only a few ways the seller can differentiate itself, such as offering better sales terms or a lower price. Also, there is always a risk of fostering a "buyer's market" if there are more assets available for purchase than there are independently qualified buyers in a given market segment.

The seller's prequalification to offer asset purchase financing will immediately broaden its field of potential buyers to include those that may not have all of their funding accounted for. With the buyer's need established, the seller is able to step in to provide a solution that both positions its asset for sale and the related Enhancement CPC for purchase in support of the buyer.

Cashless Seller-Finance™ is a meaningful solution for buyers that are not only looking for an asset to buy, but are simultaneously searching out a finance source that makes the transaction possible. By embedding a credit enhancement of the buyer's asset purchase transaction in the core terms of sale, the seller is able to offer its asset coupled with a reliable source of funding for the winning bidder. This strategy virtually guarantees that if a buyer qualifies as a member of the Capital Cooperative™, it will have the financing necessary to complete the asset purchase transaction as contemplated.

The seller's credit enhancement of the buyer's purchase essentially positions the seller as the "bank" for the buyer and radically differentiates the assets that the seller has offered for sale from most other similar assets in the marketplace — they come pre-packaged with purchase funding. The seller can set credit enhancement terms and pricing that reward it for a willingness to accept continuing passive exposure to both the asset and buyer. This includes designing purchase terms that actively guard against the prospect of buyer default, such as the establishment of reserves, performance bonds, and other risk mitigants that best prevent the seller's credit enhancement (letter of credit) from being drawn or called upon should the buyer face any unforeseen difficulties or disruptions.

Positioning an asset sale in this way expands the field of potential buyers for the seller's asset, which, in turn, will increase competition in the bidding process, ultimately driving the asset sale price to a premium while also better assuring a successful sale. That added competition tends to mean that, when it matters most to a seller – such as in the sale of a business -- the seller has the luxury of choosing the buyer that he believes is best-suited and most likely to succeed with the asset, rather than simply choosing the buyer that can pay the best price.

For example, often times, the "most-likely-to-succeed" buyer of an operating business might be comprised of the business's existing management team. Unfortunately, members of management may be the best qualified to *operate* the business, but the least qualified to raise capital to *buy* the business. Then, if they succeed in raising capital, the cost of the financing orchestrated at the hands of an investor that may not have management's or the seller's best interests at heart could eventually cause the buyer's default. Can we say "loan to own", anyone?

By using the Enhancement CPC as a targeted credit enhancement vehicle, the seller can better control both its and the business's destiny even after the sale. Particularly, the seller can:

"... the incorporation of the Enhancement CPC™ into the fabric of an asset sale transaction is all about providing mutually beneficial options to buyer and seller -- options that the seller may not realize are available and that the buyer may only dream of having."

(a) agree reasonable and realistic terms with management so that the threat of management-buyer default is minimized,

(b) receive full payment of the sale price at closing from the buyer,

(c) get paid a premium on the sale price in consideration of credit enhancement support,

(d) generate returns on continuing business operations as a source of portfolio yield enhancement,

(e) benefit from a new tool for balance sheet management that can exchange a long-term asset for cash-on-hand and trade a contingent balance sheet obligation (the letter of credit) for the purchase of an independently issued, yield-bearing security;

(f) have peace of mind knowing that there is business continuity and the business's customers and employees are in good hands,

(g) have the option to exit the seller-finance transaction early by reselling the Enhancement CPC™ as secured by the asset; and

(h) dependent upon the circumstances, enjoy beneficial tax treatment upon sale.

Overall, the incorporation of the Enhancement CPC into the fabric of an asset sale transaction is all about providing mutually beneficial options to buyer and seller – options that the seller may not realize are available and that the buyer may only dream of having.

Qualifying a Buyer with the Cooperative

The execution of a seller-finance transaction utilizing the Enhancement CPC is indeed a coordinated effort between buyer and seller. Whereas, the seller is doing its part to provide an underlying credit enhanced foundation upon which the buyer can rely, the buyer needs to be able to meet certain minimum eligibility criteria in its own right in order to qualify and enroll in the Capital Cooperative™ so that it can access capital.

Once a buyer and the seller have agreed sale terms, the buyer will submit an enrollment application to the Cooperative. The Cooperative screens the buyer and its principals with anti-money laundering, know-your-customer, and background checks as well as a commercial evaluation of the buyer's track record. This assures that the Cooperative agrees with the seller's assessment that this particular buyer is sufficiently qualified to operate the asset once purchased and has the means and plan in place to successfully service the Cooperative's funding.

The Cooperative puts a high priority on this process when enrolling a new member, regardless of whether for a seller-finance transaction or otherwise, because the Cooperative's economic interests are fundamentally aligned with the good performance of each of its members. Simply put, if the member is successful in meeting its obligations, the Cooperative financially benefits. If the member is unsuccessful and the buyer defaults in servicing the Cooperative's allocation of capital, the Cooperative's trustee draws on the letter of credit to be made whole as to the principal amount allocated, but the Cooperative will have lost virtually all economic benefits of the transaction while incurring significant opportunity cost. It is for these commercial reasons that the Cooperative is actively incentivized to best assure a seller-finance transaction is prudent and likely to succeed. The buyer (its member) must be qualified, the sales terms reasonable and financially supportable, and both the seller and buyer in agreement that the asset can and will cover financing costs incurred by the buyer throughout the lifecycle of the transaction.

Understanding the Structure

Once the purchase terms are agreed between buyer and seller and the purchase transaction has been reviewed, qualified, and approved for funding, the transaction components can be positioned to put the Cashless Seller-Finance transaction in motion.

First, a credit enhancement agreement will be entered between UFT Commercial and the Capital Cooperative™. This agreement will contain, among other things, a reflection of the commercial terms and conditions of the purchase agreement between the buyer and seller as to (i) the consideration payable to the seller for its credit support and (ii) a call for the buyer to enter a security agreement with UFT Commercial to agree the terms of pledge of the asset as collateral for the credit enhancement. These two core components — the credit enhancement agreement and the related security agreement — constitute the "credit" that will be fractionalized into Enhancement CPCs™ for the seller's acquisition.

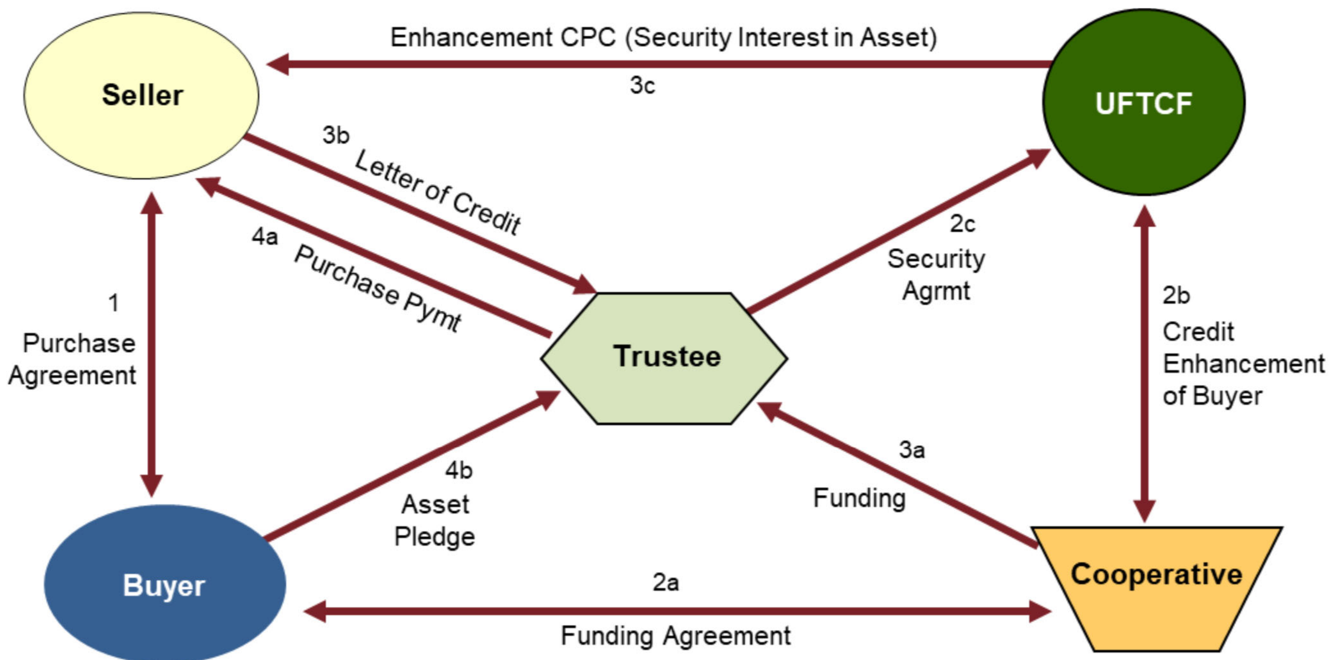
As seen in Figure 1 immediately below, the deposit of the agreed amount of funding for the asset purchase and the seller's letter of credit (to both credit enhance the buyer's asset purchase and acquire the Enhancement CPC) will both be deposited to a dedicated trust account established by the Capital Cooperative for the transaction. UFT Commercial will cause the issuance of the Enhancement CPC™ that is secured by the asset upon the recording of its sale to the buyer.

It's at this stage that the seller will receive its purchase payment and the title to the asset will transfer to the buyer. This officially closes the transaction.

Thereafter and through the term of the seller-finance transaction, the buyer will make its scheduled payments to the trustee, which will be processed and then disbursed to the seller as yield on the Enhancement CPC. Payments of yield will continue until such time as the seller-finance facility is retired by repayment of the funding amount allocated by the Capital Cooperative to the buyer.

It is important to note that one of the less obvious benefits of the seller's purchase of the Enhancement CPC and engagement in a Cashless Seller-Finance transaction is that at any time during the term of the credit enhancement (which is also the term of the Enhancement CPC), the seller may elect to resell its Enhancement CPC to any other qualified Participating Lender. If the buyer's transaction has been performing to plan and the yield streams on the Enhancement CPC paid consistently, the seller may even garner a premium upon sale.

Figure 1



"The introduction of an Enhancement CPC-linked seller-finance structure is a true win-win for both buyer and seller."

Bringing a Range of Options Home for Buyer and Seller

"Seller-Finance" of the kind described in this paper has an array of applications in the marketplace; all of which provide mutually advantageous benefits to both buyer and seller. For a seller that has the means to support this structure with its balance sheet, the opportunity for additional financial gains are clear. Likewise, for the fortunate buyer that both fits the bill for the seller and qualifies for independently sourced, asset-specific funding from the Cooperative, financing terms can be negotiated that are potentially better and more flexible than that buyer could garner almost anywhere else in the open market.

The introduction of an Enhancement CPC-linked seller-finance structure is a true win-win for both buyer and seller. It manifests a transaction dynamic that readily aligns the interests of parties that customarily stand on opposite sides of a transaction and between which a natural tension exists. That alignment fosters a cooperative longer term and "big-picture" view of a well-architected asset sale from both the buyer's and seller's perspectives.

Resultant from the seller's willingness to lend credit support to the buyer for the purchase, it is reasonable for the seller to expect more operationally-qualified candidate buyers to knock on its door to compete for the asset. That expanded field of potential buyers results in a natural competition that will drive a potential premium on sale price as well as a willingness on the buyer's part to pay an attractive on-going yield to compensate the seller for its support that makes the Cooperative's offer of funding possible. Additionally, since the seller is essentially trading asset ownership for a priority security interest in the asset when making the sale, the seller gets these benefits while maintaining a virtually "risk neutral" position.

Understanding the Risks

While the seller owned its asset, it carried the risk of that asset's performance in its capacity as "operator". Now, in this type of seller-finance transaction, the seller is secured by its previously owned asset and, again, will carry the risk of that asset's performance in its capacity as "investor" or "secured party" in the related Enhancement CPC™. Same asset, same risk — different context.

As the investor in the Enhancement CPC and the source of credit enhancement that permits the buyer to access independently-sourced funding for the purchase of the asset, who better to understand the risk of the asset *not* being able to support the buyer's obligation than the former owner/operator of the asset? Provided the seller takes the time to choose a well-suited buyer – not just necessarily the one that offers the most money or the best yield in consideration of the seller's credit enhancement – and designs a transaction that is realistic with regard to credit enhancement terms that can be supported by the asset's historical performance levels or by the value-add that may come along with the buyer, the seller's risk can be well-managed and the risk of buyer default can be significantly mitigated.

Barring a catastrophic unremedied buyer default that results in the seller's letter of credit being drawn and unreimbursed by the buyer, under this structure, the seller will have:

(i) most likely sold its asset more readily;

(ii) add only a contingent liability on its balance sheet as to its credit enhancement of the buyer and the buyer's operation of the asset;

(iii) negotiated and been paid a premium purchase price for the asset in consideration of its credit enhancement of the transaction

"Within the context of an Enhancement CPC-linked seller-finance structure, there is an inherent mutual interest of the parties to see the transaction succeed."

and a competitive bidding process among many potential buyers;

(iv) received a lump-sum cash payment of the purchase price at closing that was equal to or exceeded the amount of credit enhancement support provided;

(v) purchased the Enhancement CPC™ as an on-balance-sheet security that is secured directly by the asset sold; and

(vi) received yield payments, whether fixed or performance-based, for the full term of the Enhancement CPC resultant from the operation of the asset.

In the interests of a balanced understanding of the transaction, in a worst-case scenario, if the buyer fails in servicing its obligations under the seller-finance transaction, the seller's letter of credit that is credit enhancing the buyer's purchase will be acted against by the Cooperative and drawn for cash up to its full face value. If the buyer is unable to reimburse the seller for the amount drawn, the seller will take its asset back and be free to sell it once again.

In assessing risks and costs, however, it is important to note that during the life of the transaction -- prior to any buyer default — the seller will have had free-use of all cash purchase proceeds paid to it on the original date of sale through the actual date of final default following the letter of credit draw. It also will have received agreed yield payments on the Enhancement CPC in consideration of its credit support. Both of these factors can be expected to significantly offset expenses incurred in the seller's engagement in what would only then be considered a failed sales transaction, making the downside risk of engaging in a Cashless Seller-Finance™ trade both limited and readily quantifiable.

An Enlightened Mutual Interest

Within the context of an Enhancement CPC-linked seller-finance structure, there is an inherent mutual interest of the parties to see the transaction succeed. The seller doesn't want to see the buyer fail, have its letter of credit drawn, and the asset come back onto its balance sheet. Likewise, the buyer wants to perform on its obligation and eventually own the asset outright — fully unencumbered and without the payment of on-going finance costs. Both parties are interested in establishing pricing and terms that they believe increase confidence that the buyer's obligations can be well-managed and consistently met during the term of the seller-finance transaction.

Therefore, the seller, who may normally only be focused on extracting best-possible price from a buyer in a traditional sales transaction, becomes interested in setting terms that are more fair and equitable and won't create circumstances that could induce a buyer default, putting the seller's credit enhancement at risk. For the buyer, this well-constructed seller-finance strategy takes the uncertainty of finding sufficient investor capital off the table when buying the asset. This allows the buyer to negotiate with greater confidence with a view to offering best-supportable-purchase-price to the seller.

An asset sale transaction structure that incentivizes negotiations between buyer and seller to legitimately put the mutual long-term interests of each of the parties on par largely doesn't exist. The battle to extract maximum value from the other party is a

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hallmark of this oldest form of zero-sum trading, buy-sell marketplace.

However, Cashless Seller-Finance as now made possible using the tools and methods described should influence the motivations and strategic thinking of both buyer and seller in this type of transaction. It enables the elevation of a simple and well-orchestrated asset sale so that it can take on an economically impactful set of benefits for both sides of the trade. A refreshed look at a transaction counterparty through this collaborative economic lens can help to de-prioritize what are probably the top two typical drivers of the interaction between buyer and seller. Those being, the desire for one party to prevail over the other and, simply put, the desire for each party to achieve what they deem "best possible price" as such would be quantified in vastly different ways dependent upon that particular party's perspective.

The utilization of the Enhancement CPC in seller-finance causes a harmonization between buyer and seller that alters the expected transaction dynamic when compared to traditional deal negotiations of this type. The post-asset-sale transaction period that exists in any Cashless Seller-Finance trade forces the parties to look beyond the immediate outcome of negotiations to a strategic alignment of long-term objectives end expectations related to the good performance of the asset. That alignment helps to convert what are naturally opposing objectives of the parties into an unusual partnership of buyer and seller. With that partnership comes both tangible and intangible benefits that would not be likely, or, for that matter, otherwise possible in the context of a customary asset sale transaction.

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