Reasons to Avoid an Earnout When Selling Your Mortgage Business

When selling your mortgage brokerage, structuring the deal can be as important as finding the right buyer. One option often proposed by buyers is an earnout, where part of the sale price is contingent on the business hitting specific performance targets after the sale. While earnouts can seem appealing at first, offering the potential for a higher payout, they come with significant risks and complications that sellers need to carefully consider. Here are key reasons to avoid an earnout when selling your mortgage business.

1. Loss of Control Over Business Operations

Once you sell your mortgage business, you'll no longer have direct control over how it operates, yet your future payout will depend on its performance. The new owner's management style, decisions, or strategic direction could impact the business negatively, jeopardizing your ability to meet earnout targets. Without control, you could see the business underperform, leaving you with a lower payout than anticipated.

2. Disputes Over Financial Metrics

Earnouts often depend on specific financial metrics, such as revenue growth, profit margins, or deal volume. Disagreements between the buyer and seller about how these metrics are calculated can lead to conflicts, delayed payments, or reduced payouts. Misalignment on reporting practices or accounting methods may create friction and uncertainty, leaving you in a prolonged negotiation over what you're owed.

3. Extended Financial Risk Exposure

Earnouts tie your future payout to the success of the business over an extended period, often 1-3 years post-sale. This leaves you financially exposed to risks outside your control, such as market downturns, rising interest rates, or changes in the mortgage industry. If the business underperforms due to external factors, your total earnings from the sale could fall significantly short of expectations.

4. Complexity and Uncertainty

Earnouts add complexity to the sale process, both during negotiations and after the deal closes. The terms of an earnout need to be clearly defined in the contract, including how performance will be measured and verified. This complexity can lead to disputes or prolonged post-sale involvement, which is counterproductive if your goal is to exit the business cleanly and move on.

5. Potential for Lower Upfront Payment

Buyers may use the earnout structure as a way to offer a lower upfront payment, transferring the risk to you. While they promise a higher total payout based on future performance, you could end up with less cash in hand at closing. A deal that provides a lower upfront payment and relies heavily on an earnout increases your financial risk and reduces immediate liquidity.

Conclusion

While earnouts may offer the allure of a higher payout, they introduce significant risks, uncertainties, and potential disputes. For mortgage business owners seeking a clean exit and a guaranteed financial return, it’s often better to negotiate for a higher upfront payment rather than relying on future performance. A straightforward sale offers clarity, finality, and peace of mind, allowing you to move forward without lingering obligations or risks tied to the business's future success.