Don't Just Say No
Give unsuitable lending prospects a soft landing

By Ben Van Zee

Lending in today's over-regulated and over-stressed environment is rarely simple or straightforward. Consider this scenario: A well-established company has been doing business with their bank for years with many established accounts in addition to a $900,000 line of credit. But the company hit a rough patch and after sustained losses, the bank needed to pull back on their line of credit. What's a banker to do?

One option is to simply tell the client the news about the lowered line of credit and hope it doesn't cost the bank the account (and associated fees). Instead, this banker contacted a factoring company to partner on the deal. The bank carved out the receivables they were comfortable with and pared back their line of credit to $650,000, while the factoring company provided $250,000. The client still had the working capital they needed, and the bank saved the relationship and the fee income. Fast forward eighteen months: the client is back on their feet and ready to go back to the bank for all their borrowing. Because the bank had stayed in the game and provided a solution instead of just saying no, the bank still had a good relationship with them and was able to win in a competitive lending environment.

It happens nearly every day – the phone rings with a customer or prospect looking for a loan, but their situation doesn't quite fit your risk profile. Maybe they're a startup or in a turnaround situation. The stakes are even higher when they are a current customer with deposit accounts. As a banker, you have several alternatives to turning them away: non-bank owned factoring companies, asset based lenders, equipment financiers, and real estate lenders. Determining which is the right fit means asking two key questions to understand the situation.

First question: What's their collateral?

If their collateral is primarily commercial accounts receivable, as in a service business or a staffing or trucking company, your best option is to refer them to a factoring company or an asset based lender.

If the prospect doesn't have a stellar credit history or has operational problems, factoring, or purchasing accounts receivable, is best. This is because factoring companies do not rely on the creditworthiness of the borrower, but instead on the creditworthiness of the borrower's customers. In addition, with factoring:

- Cash is generated at the time of sale, which is important to business owners who need to improve their cash flow.
- There are no loan covenants.
- Factoring companies typically are willing to keep growing the credit facility as the receivables grow.
- Factoring companies will consider higher-risk clients such as storied credits, start-ups, businesses in the early stages of a turnaround, or companies working in out-of-favor industries.

If a client needs to also rely on inventory as collateral, an asset based lender might be the best bet, if the client has a better financial history or performance. Asset based lending:

- Is based on a formulaic structure with advance rates against current assets such as accounts receivable and inventory.
- Requires a financially stronger client than factoring.
- Allows companies such as manufacturers or distributors to monetize their inventory assets in addition to their accounts receivable.

Some asset based lenders also lend against real estate and equipment, but they will not give as high an advance rate on those asset classes as specialized equipment lenders or real estate lenders.

The Many Benefits of the Regulatory Feedback Initiative

By Craig Foss

Ever wonder who the best regulator is? There are only two ways to find out: You can spend considerable resources (time, money, and headaches included) changing charters, going through exam cycles and exit meetings, or you can simply request a customized Regulatory Feedback Initiative (RFI) survey and see what your peers who are already dealing with them have to say. And did we mention this second option is FREE to members of the Minnesota Bankers Association?

Over the last year and throughout the foreseeable future, banks all over the state are going to be dealing with regulators attempting to interpret and enforce hundreds of new statutory provisions and regulations. While the regulators should be working together to apply these changes consistently, we know from experience this doesn't always happen seamlessly. This is where the RFI comes in. Bankers just like you can complete an anonymous survey regarding recent exam experiences. Then, when you receive your first day letter request from your examiner, contact us to request a customized report that lets you see what others' experiences have been like. This can give you great insight into examiner hot topics and give you a head start at putting the shine on those areas in your bank.

The benefits of the RFI surveys don't stop there. As the surveys are collected, it gives us the ability to periodically pull our own reports and see what bankers are reporting across a broad spectrum. We can than take this information and look for areas where many individual bankers may be struggling with the same issues and raise these concerns directly with regulatory officials. We can also use the information to determine if additional educational programming is needed. All of this allows us to better meet your needs.

If you have not yet taken the survey at all or you just received an exam report and you need to complete another one, please contact Terry Tiller at terryt@minnbankers.com. You can also find more information about the surveys and the reports to help you prepare for your next exam by going to the Regulatory Feedback Initiative page under the Legal/Compliance tab on our website, www.minnbankers.com. And remember, it's a lot easier to achieve strong examination results by using our free, anonymous survey reports than changing bank charters every few years. ■

Getting the Most From RFI

- Request a custom report as soon as you know the examiners are coming
- Fill out the anonymous survey about your experiences when the exam is over
- Encourage peers to take the surveys so the data remains up to date and dynamic

If a client has only inventory as collateral, with very little in terms of accounts receivable assets, inventory finance companies are an option. These are helpful for clients who need to monetize their inventory assets. Retailers are one example. Inventory finance companies are also a good fit for importers who require financing to pay global suppliers who won't give them terms.

If a client is relying on equipment as collateral, equipment lenders are a good source of financing. Compared to other lenders, equipment lenders and lessors typically extend a higher advance rate against a specific piece of equipment. They are extremely knowledgeable about the values of all different types of equipment and can leverage their expertise to say yes to an out-of-favor asset, where a bank might have to say no. They also understand the tax benefits of the myriad of equipment financing structures and sometimes offer more financing options than traditional lenders.

If a client is relying on real estate as collateral, real estate lenders or hard money lenders are often the way to go. These are generally local companies that understand the local real estate dynamics, will do their own valuations, and will lend against a wide variety of real estate assets. Some specialize in construction finance. They are typically more open to different types of situations, whether it's a foreclosure the client wants to flip, an odd piece of land, a short term event that needs bridge financing, or an unusual ownership structure. They are fairly nimble outfits and can typically move fast.

Second question: How much working capital do they need to achieve their goals?

If you see that the client's situation requires a lot of working capital, recommending several lenders might be the answer. Each type of lender will offer different advance rates against different asset classes. For instance, an asset based lender might advance 85% against A/R, 50% on inventory, 30% against the value of machinery, and 20% against the value of real estate. But, if that client were to create their own financing path and go to both a factoring company and an equipment finance company, they might get 90% against their A/R and 60% against the value of their equipment. So while that's more work, the end result would be more cash in their account. The borrower should assess how much cash they'll get out of each scenario before they decide.

Recommending a blend of providers is appropriate when a client needs more money than they could get from any one individual lender – it's the benefit of working with several specialists rather than one generalist.

What's in it for you? Extending relationships.

Advising prospects of all the available options means you can keep lines of communication open and maintain existing relationships even if the company's current situation isn't bankable. Gauge how much runway is needed and keep in touch. Ask how they're doing as they progress on their path back to bankability, and chances are, you'll be the bank they look to. ■

Ben Van Zee
President
Commonwealth Capital, LLC
ben@commonwealthmn.com
www.CommonwealthMN.com

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14985 60th Street North | Stillwater, MN 55082
Phone: 651-439-2951 | AJ-Law.com