

Practical Solutions:

OBTAINING FINANCING: HOW TO SATISFY A BANK'S CONCERNS

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Great changes have taken place over the past ten (10) years in the leasing industry with the result that there are far fewer independent leasing companies in the market with gross receivables of 25M to 75M. Larger broker firms exist in the sub-25M market that carry some of their own paper for a period of time before discounting it to a larger company and larger leasing companies that are a subsidiary of a bank or insurance company exist. But the company that had 25-50 people working for it including, a small sales force and collection department is gone. Gone in part because larger companies, with access to less expensive money, could offer cheaper rates and gone because the administrative expense of documenting and collecting small ticket leases became too expensive. Overall, this expense and the more competitive rates of larger companies made small ticket leasing companies less attractive to local banks as an attractive borrower for the local bank. To remain competitive, therefore, a small ticket lessor must be mindful of a bank's concerns and endeavor to keep the perspective of these lending institutions in focus.

Banks always analyze a loan to a borrower in terms of the liquidation value of the account should the borrower encounter a situation making repayment of the loan difficult. To liquidate a loan made to a leasing company, a bank has to consider more factors than in an ordinary loan situation where the borrower controls all of its own assets. First of all,

there may be many underlying or sub-borrowers who are lessees. These lessees will normally be paying the leasing company their monthly payments, but in a work-out scenario, the bank has to contact these lessees in order for them to make their payments directly to the bank. If the lessees refuse and the bank has to hire a reposessor to try and pick-up the equipment, the bank will likely be forced to utilize agencies in many different locations to pick up equipment from lessees who could be spread out in geographical areas that are probably unfamiliar to the bank. Since the bank was not involved in the credit analysis of the lessees, the bank may not understand the lessee's business or his cash flow. Mistakes may be made in attempting collections when an account is not following a traditional pay history.

On the other hand, today's lending market bears witness to a huge volume of unsecured business loans where there is no collateral at all. In spite of a bank's potential difficulties in collecting from a leasing company's accounts, the equipment still provides leverage in trying to make a lessee pay. There are advantages in collecting a loan from a leasing company, including the ability to attach the receivables of the leasing company, which can consist of hundreds of payments from lessees. Another key advantage is the ability to sell the equipment collateralizing the lease for some recovery from a non-paying lessee, which is more than can be recovered from a non-paying unsecured borrower.

Additionally, it is unlikely for all of the lessees of a leasing company to stop paying, therefore, some delinquency can be anticipated and factored into the rates that a leasing company charges. From the standpoint of a return, leasing companies can command a higher rate than traditional loans in any event because a lease only finances a percentage of the equipment value and the residual makes up the difference.

In today's lending environment, which includes many new Internet and telecommunications businesses, leasing is a form of collateralized lending that should be preferred to straight, unsecured loans with no collateral. Lenders should be encouraged to look at leasing as a form of asset-based lending, not unsecured lending. Lessors should suggest that lenders should try to picture the risk as a function of whether or not the business operates or generates income without the piece of equipment that is being leased. In other words, financing a lease is a means to insure that the business will be able to produce its staple product that will eventually be turned into cash.

Once lenders understand what leasing companies do, it becomes easier to tailor a small leasing company's profile and operations so that the collateral issue aside, leasing companies can be viewed more attractively to banks. As stated previously, a bank's primary concern when extending credit to any borrower, is getting paid back via liquidation. It makes practical sense, therefore, for a leasing company courting a bank (to lend it money) to concentrate its available funds with a small number of high balance deals rather than a greater number of small balance ones. This will make a bank more secure in knowing that it will be easier to inspect and/or liquidate fewer items of collateral but with the potential for a greater recovery. Along those same lines, a leasing company that leases to customers in a closer geographical area will find a bank more willing to lend it money than a leasing company that leases to customers across the country, because to a bank's way of thinking, this increases the risk due to the difficulty in liquidating the collateral. Equipment that has a high resale value and not just expensive to buy is going to spark a bank's interest more than a leasing company that primarily leases computers or telecommunications equipment, which banks tend to view

as an unsecured loan rather than a lease. If there were additional collateral that the leasing company puts forth or requires from its lessees in the ordinary course, that also would influence a bank favorably.

Ideally, banks like to know that they can get repaid through liquidating their collateral if a borrower is no longer able to pay. The more practical a leasing company can be by providing adequate measures of recovery through larger deals closer to home, or obtaining additional collateral and less administrative burden if a bank does have to take over collecting payments, the more likely the bank will make a loan to the leasing company.

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