LEASING, FINANCING AND YOUR BUSINESS

BY KEN HURWITZ

I thought it would be a good idea to reflect back on 2014 and share some of my most frequently asked questions.

WHY IS MY BANK NOT INTERESTED IN MY BUSINESS?

Well it may not be quite that bad, but pretty much any business has some form of banking relationship, even if it's just for deposits. A bank will look at your business and hang a number on it they feel comfortable with lending. The number is the total amount of credit they are prepared to offer, and it could be a combination of loans, operating lines or other purchasing lines of credit, credit cards, and secured lending. As soon as you hit that number you will be capped.

It is no secret your bank will always be your lowest cost of funds, and this is for two reasons: first, the cost of funds for a deposit taking institution these days is less than 1%, maybe even less than 0.5%, and that's pretty tough to beat. For a bank to put out rates a couple of points over prime, their profit margin is still very good, and when you are the lowest cost in your industry you can pick and choose who and where you put your dollars.

Secondly, a bank will have you secured in more ways than you probably realize. I cannot tell you how often I tell one of my customers that even though they have no debt and all of their equipment was paid in cash, their bank still has a first charge against everything via a GSA (General Security Agreement). A GSA provides a lender a security interest in a specified asset or property that is pledged as collateral. In the event that the borrower defaults, the pledged collateral can be seized and sold. It is presented and signed when an account is opened and gives the bank a first charge against all current and *future* assets.

As an asset-based lender, I come across this often when I close a deal by taking a piece of equipment as collateral in lieu of a deposit. I inform my client I need a waiver from their bank. I almost always get "but I paid for it in cash, I didn't use my bank to finance it." Regardless of how banks secure you or your company, they will ensure to always be in an equity position, meaning the security is always more than the value of the credit provided and/or offered.

When it comes to small business loans, in my world of equipment loans, banks will first look at the size of the transaction and whether it fits the equity box of the company. Specifically, they will look at the company's total net, or essentially cash left within the company. A bank will think the transaction fits if the net worth is twice the amount of the transaction. However, in the manufacturing industry this type of evaluation is problematic since equipment is inherently very expensive and usually purchased when an opportunity for growth comes along.

The reality is a bank has a surplus of cheap money and lots of potential investments, there is an excess demand for their services and therefore they can pick the most secure and risk-free investments.

WHY AREN'T YOUR RATES IDENTICAL TO MY BANK?

When banks look at a potential transaction they evaluate their exit strategy. For example, let's take a mortgage. Most institutions will not lend more than 70-75% of the purchase price, but when they do it will be at very cheap rates, maybe 3% or 4%. In the event of a default the property is sold and the bank gets all its money back because they are in a full equity position, the amount lent is less than the total value of the asset so they are only out the time it takes to get the property sold.

A private non-bank leasing company gets its money from a number of different places, but it is not a deposit taking institution and therefore has a higher cost of funds. The typical leasing company will focus on assets where they have expertise. A leasing company will look at the $100,000 transaction and will expect the company to have retained earnings of $100,000. Also, a new piece of equipment will automatically depreciate the moment it is installed. Those two factors equate to a transaction that is riskier than a bank would accept and therefore they will not be priced identically.

CAN YOU QUOTE ME A RATE?

Getting a quote for financing is as simple as looking up lending rates on a website; it is the approval that actually counts. The only way for any business to get a meaningful quote is once an approval has been issued or after enough information has changed hands that whoever is evaluating the transaction can make a qualified statement. I totally understand everyone wants to ensure they are getting the best deal at the lowest possible cost, but shopping for financing is as important as sourcing the right equipment. And the same care should be taken to find the right source with expertise and understanding of the industry. CM

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