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Underwriting Guidelines for Factors and Asset-Based Lenders

The Second in a Four Part Series Focusing on Underwriting Guidelines Used by Asset-Based Lenders and Factors in Relation to Accounts Receivable, Equipment, Inventory and Real Estate

Part 2: Equipment

When seeking equipment financing with an asset-based lender it is important to understand the focus of the lenders' due diligence so you can be better prepared to answer their questions and get your deal funded quickly.

As Brokers, many of you are involved in seeking equipment financing for your clients in addition to other types of financing. Leasing is one common form of equipment financing. For example, a company may utilize a sale-leaseback where the business basically sells some of their equipment to a leasing company for a lump sum amount of cash. The leasing company then leases the equipment back to the company for a monthly "lease" payment.

However, in an asset-based lending relationship, equipment is financed by the lender doing a term loan based on a percentage of the appraised value of the equipment. This loan is then "amortized", typically over 3-4 years, by monthly payments of principal and interest. Generally, asset-based lenders will only make equipment term loans in conjunction with a revolving Line of Credit based on accounts receivable and inventory. Therefore, if your client needs both a Line of Credit and a loan on their equipment, an asset-based lender can be a good choice.

When you are assessing the terms of a potential equipment loan for your client, pay special attention to: (a) what advance rate the asset-based lender is using vs. the appraised value of the equipment; (b) what type of appraisal the lender is willing to accept, i.e. Fair Market Value; Orderly Liquidation Value or Forced Liquidation Value; (c) how long the loan amortization period is; and (d) the overall cost of the loan. For asset-based lenders, these proposal items are decided prior to funding after a review of a number of items. Therefore, your understanding of the information that an asset-based lender will review during their due diligence will help you get the best deal for your client and close more deals for yourself.

Information Required by an Asset-Based Lender Assessing an Equipment Loan:

- Detailed Equipment List and/or Appraisal- Asset based lenders will look for very detailed equipment lists and/or former appraisals. Ideally the equipment description will include model number, year built, condition and overall description. Typically it is unwise to get an appraisal yourself as lenders have lists of "approved" appraisers they will use. However, if you feel it is necessary to get an appraisal, make sure its from a reputable and licensed appraiser and that it includes both the Forced Liquidation Value (what the equipment would bring at an auction after expenses) and the Orderly Liquidation Value (what the equipment would bring at an orderly sale over a period of time—usually 3-6 months).

- Rolling Stock and Quasi "Fixtures"- Asset-based lenders want to know where their equipment is and, therefore, are not as aggressive in making loans against company vehicles and other drivable equipment. Conversely, equipment that is very difficult to move can also be a concern for asset-based lenders. Very large, "fixture" type equipment can be prohibitively expensive to move resulting in little or no recovery to the lender if an auction is required. Thus any extremes in relation to the location and the mobility of the equipment can have a bearing on the eligibility and/or advance rate for equipment.

- Equipment Age and Condition- Obviously, the age and condition of equipment will have an effect on the appraisal value and, thus, on the amount of the loan an asset-based lender will make. Note, however, that the effect of age varies among types of equipment. For example, the useful life of a computer or copying machine will be far less than a printing press. Therefore, if the majority of a company's equipment is old relative to its useful life, it may have a very low appraised value or it may be considered ineligible for financing altogether.

- List of Leased Items- When an equipment loan is considered, any leased equipment is the collateral of other lenders and thus the leased items will need to be noted for the asset-based lender. Often, leased items will not be included on a company's financial statement and might easily be missed. Therefore, your client must specifically note any leased equipment on their equipment list and/or appraisal.

- Application Items- As financing broker, you probably have your own application used to obtain information on a prospect. Below are a few items you may want to include on your application as this information will be required by an asset-based lender considering equipment financing:

    - Landlord Name, Contact Information and Monthly Rent Amount- If a client is renting the facility where the equipment is located, the asset-based lender will need this information to negotiate a landlord's agreement. In a liquidation scenario, this agreement will grant the asset-based lender access to the facility where the equipment is located and time to sell the equipment. In return, the agreement will assure the landlord that the asset-based lender will pay rent during this liquidation period.
    - Tax Information- When asking about taxes, don't just check payroll taxes. Many states have a personal property taxes on company equipment. These taxes will take a priority over a secured lender's lien on equipment and will result in the lender not doing the loan if the taxes are not current.
    - Hazardous Materials Involved?- If hazardous materials are used in the operation of the equipment, there might be large expenses associated with the removal of these materials if the asset based lender needs to liquidate the equipment. These expenses might well exceed any value the equipment might otherwise have so it's a good question to ask your prospect if this is a potential issue.

Conclusion- Asset-based lenders look at a variety of criteria when deciding what equipment they will loan against and at what advance rate, amortization schedule, and cost. Obviously, these criteria also affect your commission from the funding source. So have your client prepare information outlined above and you will see a quicker turnaround on your applications and a higher closing percentage.

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- Beyond commissions, SPECTRUM also offers you a bonus each time you fund a deal as well as year end bonuses based on the volume of invoices purchased.
- As your client grows with SPECTRUM, your commission also grows!
- **For more specifics please call or e-mail Jeff Colquette at 952-876-8229 or jeff.colquette@spectrumcommercial.com**.

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SPECTRUM continues to assist banks and brokers by financing $25,000 - $4,000,000 credits that have suffered a setback, credits in transition and new companies that are currently outside the bank's parameters. SPECTRUM can provide the financing bridge for these struggling businesses until they return to stable and profitable operations.

SPECTRUM Programs:
As the source for working capital for non-bankable credits, SPECTRUM's product lines remain a strong fit to address the many issues encountered by struggling businesses.

- **Accounts Receivable Financing** --For those smaller and/or severely financially stressed companies, this program may be the best fit.
- **Asset-Based Lines of Credit** --For the larger non-bankable credits with relatively stronger performance, better internal controls and more experienced management. This program focuses on financing receivables, inventory, equipment and R.E.
- **Structured Asset-Based Line of Credit** --SPECTRUM also offers a unique product for those credits needing to leverage various collateral classes but who lack the required financial performance and internal controls necessary to qualify for our typical Asset-Based Line of Credit. This program is basically a hybrid program combining an **Accounts Receivable Financing** accommodation for the A/R with an **Asset-Based Line** on inventory and/or equipment and/or real estate.

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