Practical Solutions

Obtaining Financing: How to Satisfy a Bank's Concerns

By Anthony L. Lamm

GREAT CHANGES have taken place over the past 10 years in the leasing industry, resulting in far fewer independent leasing companies with gross receivables of $25 million to $75 million. Larger broker firms exist in the sub-$25M market, which 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 also exist. But the company that had 25 to 50 people working for it, including a small sales force and collection department, is gone.

These companies are gone, in part, because larger companies, with access to less expensive money, could offer cheaper rates, and gone too 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.

Analyzing the Liquidation Value

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 sub- or underlying borrowers who are lessees. These lessees will normally be paying the leasing company their monthly payments, but in a workout 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 repossessor to try and pickup the equipment, the bank will likely be forced to use 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 or her 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.

Advantages of Collecting a Loan

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 nonpaying lessee, which is more than can be recovered from a nonpaying 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 re-turn, leasing companies can command a higher rate than traditional loans, 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 encour-

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'Earnings Credits'

viding additional information that may tend to "confuse the lessee" or "detract attention from" the required disclosures. Accordingly, the court held that the disclosure that Turner sought "is not only not required under the CLA but also is arguably *forbidden* by it." The court concluded: "At best, the inclusion in a CLA-governed lease of a lengthy explanation of GMAC's banking relationship with Chase and the likelihood that GMAC will earn earnings credits *would be technical and confusing* and would 'detract attention from' required disclosure....How a lessor profits from money in its possession is simply irrelevant under the CLA so long as the cost to the consumer of the lease is clear."

In the aftermath of *Turner*, lessors cannot afford to be complacent in anticipating newer, even more inventive theories of liability that the plaintiff's bar may seek to impose in class action proceedings. For this reason, lessors must constantly evaluate how their current business practices are reflected in their lease disclosure forms and procedures. ■

Upcoming Seminars

EAEL Fall Expo and Legal Forum '99: Sept. 27, Secaucus Crowne Plaza, Secaucus, N.J. *Sponsor:* Eastern Association of Equipment Lessors, 600 Mamaroneck Ave., 4th floor, Harrison, N.Y. 10528-1632. Telephone: (914) 381-5830; fax: (914) 381-5829.

Municipal Leasing Forum: Oct. 6-8, Regal Knickerbocker Hotel, Chicago. *Sponsor:* Equipment Leasing Association of America, 1300 N. 17th St., Suite 1010, Arlington, Va. 22209-3803. Telephone: (703) 527-8655.

38th Annual Convention-Equipment Leasing Association: Oct. 31 - Nov. 3, Riverside Hilton, New Orleans. *Sponsor:* Euromoney Lease Training, 50 Broad St., Suite 1937, New York, N.Y. 10004. Telephone: (212) 361-3499.

Law & Basic Documentation: Nov. 8-9, Atlanta. $950. *Sponsor:* Euromoney Lease Training.

Accounting for Leases: Nov. 11-12, Chicago. $950. *Sponsor:* Equipment Leasing Association of America.

Emerged and Emerging New Uniform Commercial Code: Nov. 11-13, New York Hilton. $795. *Sponsor:* American Law Institute-American Bar Association Committee on Continuing Profession Education, 4025 Chestnut St., Philadelphia, Pa. 19104-3099. Telephone: (800) CLE-NEWS; fax: (215) 243-1664.

Asset-Backed Commercial Paper Conference: Nov. 15-16, Crowne Plaza Hotel, New York. $1,999. *Sponsor:* IBC USA Conferences Inc., 225 Turnpike Rd., Southborough, Mass. 01772-1249. Telephone: (508) 481-6400; fax: (508) 481-7911.

IBC's Risk Securitization: Nov. 15-16, DoubleTree Guest Suites, New York. $1,999. *Sponsor:* IBC USA Conferences Inc.

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aged to look at leasing as a form of asset-based lending, not unsecured lending. Lessors should suggest that lenders 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 ensure that the business will be able to produce its staple product, which 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 by 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.

Location, Location, Location

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 is 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 re-quires 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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