

Lending changes

How to work with lenders in the current credit environment **Interviewed by Meredyth McKenzie**

The current credit environment has changed drastically from what it has been in past years. Credit is tighter than ever, making it more and more difficult to obtain loans. Lenders are risk adverse regarding whom they lend to, although recently there has been some improvement in lenders' attitudes.

"Lenders are looking very closely at their customers and potential borrowers," says Paul R. Anderson, the director of assurance services with GBQ Partners LLC. "They're asking a lot more questions about borrowers' financial situations and their outlooks going forward. Most of this is driven by banks' risk aversion and wanting to avoid potential losses."

Smart Business spoke with Anderson about how to work with lenders in this credit environment and what new loans are available to borrowers.

What should you understand about working with lenders in this credit environment?

The first is to understand that the environment is not like it was a few years ago, when credit was easier to obtain. You need to have a greater degree of patience for the process. The bank is also going to go through a lot more due diligence on its part, so you have to be prepared for many more questions and be willing to provide a lot more information. You need to be willing to work with the lender to help them be prepared to answer the questions they will receive as the loan moves through the approval process.

What new loans are available to businesses?

One new loan that has become more prevalent in Central Ohio is an asset-based loan. The lender will agree to advance funds based on specific assets owned by the company, primarily accounts receivable and inventory. The total amount that can be borrowed is determined based on applying the advance rate, which is a percentage usually between 40 to 70 percent, to the amount of qualifying accounts receivable and inventory. Both the advance rate and what are qualifying accounts receivable and inventory are specified in the loan agreement.



Paul R. Anderson
Director of assurance services
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The lender will require periodic verification of these assets, since the loan is tied directly to these balances and accounts. One of the bank's internal auditors or sometimes a third-party auditor will perform certain tests to verify the accuracy and completeness of the qualifying accounts receivable and inventory.

This type of loan is generally used for manufacturing companies but can also be used for service companies with a sizeable amount of accounts receivable. We're seeing this loan being used more as an alternative, as businesses are being challenged on servicing more traditional lines of credit, financing or term notes.

What are the benefits and risks of asset-based loans?

The primary benefit is that these loans are usually granted to companies that might not receive other financing. There is also less concern about the company's operating results, since most of the focus is on the change in assets that determine the loan value.

The disadvantage is that the loan is tied to just those account balances. So if the company's need for working capital or permanent financing is greater than what might be advanced under an asset

based loan arrangement, it may be difficult to obtain that additional financing. These loans are also tightly structured under a strict formula, based on certain criteria of qualifying accounts. For example, if a certain portion of accounts receivable is more than 90 days old, the entire account may be excluded from qualifying. There's no ability to negotiate or change that. If an account kicks past 90 days old, the company is going to lose the benefit of that account in its collateral base.

What should you expect during an asset verification audit, and how can you prepare for this?

It's the same as preparing for a mini year-end audit. You need to communicate with the auditor when he or she contacts you about the records that are needed. You need to be organized and have those records available when they arrive.

Provide the auditor with a place to work on-site and be available while he or she is there to quickly answer any questions that may arise. The worst thing is to be tied up in meetings during the verification, and the auditor can't get to you to get questions answered. Try to schedule it away from your normal monthly close, so you're not busy with that project. The verification usually takes between two to four days to complete for an average size company.

Where do you see the credit environment heading in the future, and how can you prepare for this?

Hopefully we'll return to a more stable lending environment, so the economy can begin to grow and fully recover. I do not expect the pendulum to swing all the way back to before, where lenders were very aggressive. But surely they're going to have to become more aggressive than in the past year.

Companies will also need to obtain working capital in order to grow, and not all companies will be able to self-generate this money. These companies will be looking to lenders to help provide them with that working capital to fund their growth. <<

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