

# Fixed Asset Financing



- Differences with working capital
  - Implications for firms
  - Implications for lenders
- Financial instruments used
- Fixed asset debt sources
- Fixed asset financing gaps
- Cambridge Biotech case

# Fixed Asset vs. Working Capital



- Larger and longer term investments than working capital
  - Need for long-term financing
- “Irreversible” decisions: cannot be corrected in the short term (one-year) working capital cycle
- Greater impact on firm’s profits and losses
  - Detailed Net Present Value analysis by firms
- Pose much higher risk for lenders
  - More thorough due diligence
  - Higher underwriting standards: lower LTV, higher DSCR
  - Stricter financial covenants
  - Loan participations and guarantees to reduce risk

# Fixed Asset Financing Instruments



- Term loan: medium-term for equipment & some real estate
- Leasehold improvement loan: investments in leased space; collateral challenge
- Real estate mortgage loan
- Corporate bonds-public or private sale; can vary maturity to lower interest rate
- Leasing-commonly use for equipment
  - My lower costs vs. acquisition with debt
  - More financial flexibility (no financial covenants)
  - No appreciation upside
  - Potential tax benefits-deduction of full lease payment

# Debt Financing Sources



- Commercial and savings banks, credit unions
- Finance companies-especially for equipment leasing
- Tax-exempt bonds, especially for manufacturers, non-profit facilities
- SBA 504 program

50% bank loan (senior)

40% SBA debenture  
(junior)

10% firm  
equity

# SBA 504 Program



- SBA provides subordinate loan for small business fixed asset investments under a 50/40/10 structure
- SBA loan (“debenture”) originated by SBA-licensed certified development corporations (CDCs)
  - \$5 to 5.5 million max ; up to 20 year amortization;
  - 4 Michigan based CDCs; Michigan Certified Development Corporation the largest
- U.S. FY2015 : 5,787 SBA 504 loans totaling 4.3 billion
- Michigan: 259 SBA 504 loans totaling \$143.6 million in FY2013

# Fixed Asset Financing Gaps



- Asset cost exceeds collateral value
  - Weak real estate markets=> Detroit
  - Industrial or specialized properties
- High equity requirement (low LTV) may exceed the firm's ability to supply equity
- Availability of long-term and/or fixed rate debt

# Approaches to Fixed Asset Financing Gaps



- **Detroit Development Fund (Invest Detroit )**

<http://investdetroit.com/managed-funds/detroit-investment-fund/>

- Second position on assets
- Combined junior and senior LTV of 90%
- Terms up to 7 years; amortization up to 15 years
- Urban Retail Fund finance tenant and leasehold improvements

- **Michigan Business Growth Fund (MEDC) Collateral Support Program**

<http://www.michiganbusiness.org/grow/access-capital/#section1>

- Cash deposit with bank to provide additional loan collateral
- Up to 49.9% of loan and \$5 million maximum
- Origination and annual fee of 1 to 3%

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