Fixed Asset Financing

- Differences with working capital
  - Implications or 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 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%