More Options Available to Secure Capital from Banks and Specialty Finance Companies than Ever, but Be Prepared

By Peter A. Salinas

There have not been so many financial services firms offering lines of credit focused in the deep subprime and buy here-pay here marketplace in many years. Though there is increased competition among capital providers, businesses seeking capital today should be prepared to have their operations compared to the best retailers in the industry in order to get the best rates if any capital at all.

While national banks and major financial institutions have taken a larger role once again after pulling back during the Great Recession, they are pretty quiet about their participation in the deep subprime markets and declined to participate in this article. Others, however, welcome the opportunity to discuss the marketplace and their value-proposition and still others with a brand new programs want to introduce themselves.

Mark VanGeison, president of Spartan Financial Partners, a line of credit (LOC) provider to the buy here-pay here industry, has a large and growing portfolio of buy here-pay here retailers who use their receivables as collateral for capital. Spartan also purchases bulk receivables as well.

Spartan, based in Spartanburg, S.C., is affiliated with American Credit Acceptance, LLC, an indirect automotive finance company with more than $1 billion in assets.

As a firm that both buy notes and offers LOCs, VanGeison can talk to the value of both capital acquisition methods, though for this article he focused on the LOCs.

It’s really up to the dealer as to what best suits his or her needs,” VanGeison said. “While contract purchasers also look for repeat business and long term relationships, the transactions are shorter term, quicker infusions of capital.”

For it’s LOCs Spartan looks for either seasoned dealers who have been in business for at least two to three years or start-up dealers whose principals have a solid operating background in buy here-pay here. Spartan’s typical partner is looking to grow and needs $1 million to $10 million, though in some circumstances Spartan will provide smaller LOCs. Length of the financial arrangement is generally 12 to 24 months.

“Lines of credit backed by receivables are a process that requires the dealers to personally back the loan and submit to a detailed due diligence process as to policies and procedures as well as regular audits.”

David Fricke, an executive vice president, with Texas Capital Bank said his firm has been a national player in providing buy here-pay here dealers with LOCs and are pursuing dealer relationships in every state in the country.

“We’re looking for dealers in business at least three years and have done so profitably,” Fricke said. “They typically have a $4 million principal-only portfolio and are looking for lines of credit of at least $2 million. We prefer to do three year deals.”

Fricke, who has been involved in this business for 20 years and with Texas Capital for 10 years, said Texas Capital has always taken a conservative approach to its lending practices and that has served the company well.

“Our goal has been to be in this space long-term and despite upheaval in the marketplace over the years, we have continued to do what we do and served our partners well.”

He said the dealers Texas Capital likes to do business with, and this is true of most everyone providing LOCs to dealers, are low-leveraged, well-run operations with consistent receivables performance. This means the operation has a sophisticated dealer management system and well-trained, capable managers, excellent underwriting and collections processes.

“It’s important for the dealer to take an
active role in the operation and membership in a Twenty Group and state and national associations is a plus with us as well,” Fricke said.

Fricke said the upside of LOCs versus other types of capital is the relationship with the financial provider in terms of providing insight into the marketplace, longer terms and, typically, lower costs as well.

“The downside,” Fricke said, “can be penalties for terminating the financial arrangement early, regular auditing of the portfolio for delinquencies and charge offs and personal liability in the event of a default.”

The marketplace has more firms providing capital to BHHP, and now Lease Here-Pay Here dealers, than it has for many years, including some new players. One such firm new to this industry is Advantage Funding (www.advantagefund.com), based in Lake Success, N.Y.

Edward Kaye, its president and CEO, said his firm, a subsidiary of the general Japanese trading conglomerate, Marubeni America Corp., has long been a player in financing ground transportation in the U.S., including commercial coaches, limousines, ambulances, taxi cabs, and vocational trucks such as tow trucks and specialty trucks. Marubeni also has significant automotive finance related holdings in the U.S. and abroad. Advantage Funding spent the past year investigating the BHHP model and, importantly the LHPH business model to see if it could find a way to provide capital to these retailers.

There are just a few capital providers who will provide lines of credit to LHPH dealers, not necessarily because it’s a less-effective or less-profitable business model, but more because it’s less understood and less commonplace.

“We were introduced to this industry by LHPH Inc., which provides training and support to lease here-pay here dealers,” Kaye said. “Because so much of the financing we provide in ground transportation involves leasing we were very comfortable with the leasing model.”

Kaye said after investigating the industry for a year, he believes his capital model is unique to the marketplace but not complicated and certainly not new.

“What we do is finance the acquisition cost plus a small dealer mark up of the vehicle for transportation and reconditioning,” Kaye said. “We charge an interest rate, far lower than the consumer is typically charged, and are paid monthly. We can work with both the sale or lease models.”

This business model, Kaye noted, has been around a long time and is easy to understand.

“If a customer defaults on the note,” Kaye said, “the dealer must pay us in full within 30 days of the date of default. If a repossession occurs and the dealer wants to recondition the vehicle and put it back in inventory, we will finance it again, but the advance will be determined at the fair market value, not acquisition cost.”

Advantage rates will currently range from 9-12 percent depending on the dealer. The firm looks for at least five years in business, a strong balance sheet, proven success, strong personal credit and a personal guarantee of the dealer principal.

“We also require a ‘seat’ on the portfolio management system or DMS,” Kaye said.

The advantage of this program is the dealer can finance the vehicle for the life of the loan versus 60-90 days paying interest only with a floorplanner, Kaye said. The dealer can also choose the duration of the financing. It can be for just a year or for as long as the contract with the consumer is active.

“We’ve been experiencing great feedback from dealers and look forward to rolling this program out to the industry over the next two years,” he added.

Another company offering a brand new real-estate backed line of credit is Westlake Financial’s, Advanced Lending & Portfolio Solutions (ALPS), division based in Los Angeles, according to Todd Laruffa, ALPS’ director.

Following the 2008-2009 housing bubble and subsequent Great Recession, many dealers, both franchise and independent, and particularly independent dealers found themselves without bank-based lines of credit. Many dealers were left unable to renew their LOCs despite solid business practices and financial success.

Laruffa said that is why Westlake and ALPS have created this new “real estate-backed” Westlake-ALPS Line of Credit, in which dealers will be able to secure an LOC backed by either commercial or residential real estate or even a combination of both.

“The credit facility will be based on the appraised value of the collateral and how much leverage is available,” Laruffa said. “It’s open to both franchise and independent dealers, but franchise dealers are far more likely to have an existing credit facility in place.”

Credit facilities will be considered on real estate that still has an outstanding mortgage.

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"We will take each situation on a case-by-case basis," Laruffa said, "but given that the dealer is not over leveraged, has a solid credit rating and a clean background, rates should be very competitive making this an attractive offer for car dealers who own or nearly own valuable real estate."

ALPS will require two years of federal tax returns, a pro forma on the company’s future plans and what the money will be used for, Laruffa said.

"This program is literally just being rolled out nationally," he said. "However, we have the capital in place and the program requirements and conditions are all set. Dealers should expect no more than a two-to-three week process."

Texas Capital’s Fricke said new players in capital provision to the deep subprime and buy here-pay here markets are not unusual, but many it tends to be cyclical.

"We saw a lot of players come and go and it’s been that way since the 1980s," Fricke said. "We saw many exit during economic downturns in 2008, 2001 and 1997. It seems that over time, interest comes back because there is such a need out there and because of the strong returns that can be realized."

Legal and regulatory compliance has been come a very hot topic for dealers, but the question is with a wider regulatory eye being cast on the industry, does it make it a riskier investment for the capital providers?

VanGeison said his firm’s affiliation with American Credit Acceptance provides Spartan access to five full time legal professionals and they work with the industry-related law firm of Hudson Cook, LLP on a regular basis. Deal jacket audits are performed regularly on Spartan’s clients.

"It’s not that compliance makes this market any less attractive, but it does make us focus even harder on our due diligence to make sure our partners are focused on compliance as well."

VanGeison said there are plenty of dealers out there doing everything they can to be compliant with local, state and federal laws and regulations, and it’s Spartan’s job to find them and partner with them.

Though new to this segment of the marketplace, Kaye said Advantage’s due diligence in examining the industry and developing a program to meet its needs ensures that it will be a player for many years.

"We have been around a long time serving clients with financial services and we know how cultivate and maintain those relationships," Kaye said. "Working with dealers to ensure compliance, accounting and other aspects are top notch is something we will focus on intently, especially with LHPH Inc. as an associate."

Fricke makes an important final point about capital and the buy here-pay here industry.

"Since the Great Recession there has been a lot of capital sitting on the sidelines and over the past 18 months or so, much of that has found a way back into the economy," he said. "This industry is no different. There is a lot more capital available, but in our marketplace there are roughly the same amount of opportunities, perhaps even less as we lost dealers in 2008-2010. What that means for dealers is more competition, perhaps better rates. That’s good for them, and competition is good for us as well."

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