Capital when you need it most...

Of Cowboys and Lenders...

BY W. SCOTT MCCULLUM

"Financing a construction firm may involve yellow iron, but more frequently requires an iron stomach."

Few industries ride the peaks and valleys of economic life quite like construction. Whether it's living and dying with the whims of government funded projects, the ebbs and flows of corporate capital expenditures or the emotional ups and downs of housing starts, hearing construction CFOs tell tales of on again off again lending relationships is unsettling at best. But one of these tales might hold an opportunity to learn, identify and enlighten your approach for funding your company in these interesting times.

A Shocking Development

In 2017, one of the largest self-performing infrastructure construction entities in the country, focused on heavy civil construction was at a crossroads. With more than a 50-year history of building public sector projects such as waste treatment facilities, civic centers, energy production plants and numerous federal works projects throughout the western US, the company possessed strong operating results that pointed to a bright future. A future that involved a shift in business model to adapt to a changing marketplace.

Imagine their surprise when their long-time regional bank decided to end their relationship. Adding to the frustration where the reasons. Despite the long-standing history of positive performance and leadership through the economic cycles, the bank "just couldn't get comfortable" with their shift in business model. "Just couldn't get comfortable"... years of business relationship gone with abstract reasoning as though they were describing how they slept last night or the need for a memory foam mattress. And after meeting with other financial institutions, it became apparent that the best approach was to just meet the bank's payoff request and move on.

While these other financiers were all very interested, the process moved at a snail's pace. Days turned to weeks and then to months. Initial information required evaluate the finance opportunity was very straightforward but over time began to accumulate by the pound. And before they knew it, they were up against a deadline to pay off their old bank or be held in default. Imagine, years of solid performance in a long-time relationship followed by an abrupt and abstract request to leave then put in a corner against default.

While a painful and downright shocking experience for the CFO and senior management team, the solution was found by partnering with an experienced construction industry lender.

"The days where your relationship with the people at the bank determined the longevity of relationship are now rapidly being replaced with "governance models" driven from "capital allocation" measures."

One that could establish future funding capacity and flexibility that could meet the needs of their business shift. One that could move quickly and even leverage their knowledge of the industry to offer financing at higher advance rates on invoice amounts or provide a longer tenor for used and remanufactured assets.

Why does this kind of thing happen?

Banks are under unprecedented levels of regulation. The days where your relationship with the people at the bank determined the longevity of relationship are now rapidly being replaced with "governance models" driven from "capital allocation" measures. Leverage ratios and cash flow coverage may define who you are more than your management team, value proposition or your performance. And in a post financial crisis world, this is the new normal. Because of this, at any point your lending relationship could be closer to some magic threshold of risk than you know—and potentially closer than your banker knows. This stricter governance of bank risk has many banks only looking for a certain credit profile. You might even say, the ones that simply don't need or want to borrow at all are their best prospects. Unfortunately, these trends just do not meet the needs of a dynamic construction industry environment.

Further complicating matters are the disappearance of the "industrial finance company". GE Capital, among countless others, were staples of the capital structure for construction firms of all sizes. But these companies, again for reasons of regulation and risk, are likely gone forever—leaving a multi-billion dollar financial hole in the marketplace. Construction CFOs may be missing the out-of-the-box source of capital that offers additional flexibility.

Success with Financing.

There are a few fundamental actions to take when capitalizing your construction firm. First, construction industry expertise is critical. The key to the real-life solution from the previous story was finding a lender with deep understanding of the construction marketplace. From the bidding process, bonding requirements, cash flow spikes and equipment needs, it's crucial that the lender understand how capital is used in a construction environment. The Risk Management Association, the "bible" of most commercial credit professionals, points to construction as being one of the most leveraged industries with among the lowest cash flow coverage and highest histories of default. A lender who doesn't truly understand the industry can be easily scared by these high level statistical "bad apples" and how they might "spoil the bunch", where an experienced construction lender can mitigate and structure financing to meet your needs while protecting their investment.

Second, diversification is key. Even if your revolver bank is pleased with company performance, if they hold all your equipment debt you can very quickly bump up against leverage levels, debt hold levels or other covenant issues. Having a trusted partner to handle equipment and project lending that can act a complement to your senior lending relationship can be critical for success. . Often these equipment lenders can add additional value in more flexible structures that maximize cash flow or preserve capital in a way your revolver bank may not—even if your revolver bank understands construction.

Finally, you might just need a cowboy. A lender that can get out-of-the-box and take on the project or equipment need that most lenders would run from.

"These lenders are real dealmakers and while they may be fewer in number than in years past...there are a few out there that are committed to construction and built to stand the test of time."

A lender that can work around dips in performance or soft collateral. These cowboys might be able to take on risk that others are incapable of because their regulatory environment simply doesn't allow it. These lenders are real dealmakers and while they may be fewer in number than in years past...there are a few out there that are committed to construction and built to stand the test of time.

What's Next?

With growth opportunities rising for construction companies of all kinds, now may be the time to evaluate alternatives and listen to new approaches. Although the economic environment feels favorable to most, those of us that have been through the ups and downs know this won't last forever. Is your company prepared for what's next?

CG Commercial Finance

CG Commercial Finance offers mid-sized and large construction firms more than just competitive equipment financing. With transactions typically in the $500,000 - $100,000,000 range, CG is an out-of-the-box complement to bank groups for financing assets and larger complex projects. CG offers solutions for the growth, expansion, recapitalization, and efficiency for businesses throughout the United States and internationally.

W. Scott McCullum is CEO of CG Commercial Finance. Learn more about CG by going to www.cgcommercialfiannce.com.