Low Cost Loans: A Matter of Timing

Many Banks Are Wary of Contractor Loans, Laying Down a Solid Foundation Can Make the Difference

Wall and ceiling contractors in search of a loan may find a widespread resistance by banks, but laying a solid foundation with the right type of bank can mean adequate credit at lowest cost, according to lending specialists at Chicago’s Continental Bank.

During a presentation at a conference on the construction industry sponsored by F.W. Dodge and the McGraw-Hill Conference and Seminar Group, three members of Continental Bank’s construction and engineering division outlined for specialty contractors the availability of bank credit, types of loans, and methods of lowering the cost of financing.

Drew E. Waitley, Continental vice president and head of the construction and engineering division, pointed out that an estimated 48 percent of commercial banks have policies against making contractor loans.

The reasons for these banks’ reluctance to make loans to contractors are based, he continued, on the high-risk nature of the industry, the scarcity of collateral, the refusal of finance companies to refinance contractor loans, and poor understanding by bank lenders of contractors’ financial statements.

For these reasons, Waitley advised contractors to find a bank that is interested in handling contractors, and that also has a large enough legal lending limit to handle the credit needs of a contractor. They should also have the scope to service the business, including an international capability if the contractor is performing overseas work.

Jon E. Vance, second vice president, discussing the various types of credit available, explained that banks offer short-term credit in the form of bid check loans and operating loans.

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Longer-term credit, extending beyond one year, is available for equipment purchases, he continued, but lease arrangements are an important alternative method of financing equipment.

The borrower’s costs are expressed in terms of the prime rate, a certain increment above prime, or a percentage of prime, Vance noted. The rate can float daily or be fixed until the note matures, and the total cost to the contractor can be a rate plus balances that the contractor must keep on deposit at the bank, or “all in rate,” meaning without balance requirements.

Generally, Vance said, “short-term credit is cheaper than long-term, and unsecured loans are typically cheaper than secured. The marketability of collateral, if taken, is also a pricing determinant along with parent company or personal guarantees.”

However, he added, the true pricing decision by the bank is based on the amount of risk involved in extending credit and the likelihood of repayment.

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Anthony J. Turek, vice president, says bankers’ confidence in repayment is affected by the manner in which contractors present their companies to lenders over a period. “There must be a mutual feeling of trust and integrity,” he said. This can be developed through frequent meetings between the contractor and bank lenders, where frank and open discussions are held, noting both the good and the bad, and, if mistakes are made, how management plans to correct them.

In addition, bankers require financial reports, Turek said, including an audited annual report. Interim financial reports should be submitted at least quarterly, and Turek recommended including contract status reports with the statements.

The contract status reports, he said, are fundamental to understanding the financial condition of a company, because they show what is occurring in jobs in progress and also provide an opportunity for management to demonstrate successful performance.