

Doron F. Eghbali Closely Held Business Law

What is Asset-Based Lending?

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Recently, business owners have heard a lot about asset-based lending. However, it is very important to understand how to qualify for it, what the terms are and what the benefits and drawbacks are.

In fact, amid the frozen credit market and the need of businesses with plummeting credit rating, insufficient track record or patience to get funding to sustain or hopefully grow, businesses and lenders alike have been carefully considering asset-based lending.

Since asset-based lenders focus on collateral and not credit worthiness, most traditional lenders used to shy away from that. However, this is changing.

DEFINITION

Asset-based lending is when business owners put up their equipment, inventory, accounts receivable, patents and other liquid assets as collateral in exchange for cash.

1. QUALIFICATION

Liquidity

Asset-based lenders want to turn their collateral into cash easily, if need be. For instance, restaurants, retailers and other businesses that collect credit card payments are popular.

In addition, such lenders are receptive to the following types of collateral:

- Patents
- Real Estate
- Heavy Equipment Used in Manufacturing and Farming

2. TERMS

- **Relatively Higher Rates:** Asset-based loans have usually higher interest rates than traditional bank loans. However, such loans, have relatively lower rates than credit card arrangements.
- **More Liquidity Lower Rate:** In fact, the more liquid the collateral is, the lower the interest rate is. This is because asset-based lending focuses on the value of the collateral and its liquidity rather than the credit worthiness of the business or individual business owners.

- **Only 60% or 80% of Collateral for Cash:** Most lenders only give cash up to 60% of collateral value if the collateral is hard assets. If collateral is more liquid such as accounts receivables, then lenders might grant loans as high as 80% of collateral value.

3. BENEFITS

- **Easier to Obtain with Less than Optimal Credit:** One of the most important benefits of asset-based lending is businesses can obtain cash easily and more quickly without worrying about their credit worthiness as individuals or businesses.
- **Easier Terms Tailored for a Particular Business:** Most lenders have divisions specialized in particular sectors. These divisions have a better understanding of a business. For instance, they might craft the terms of the loan to accommodate a borrower and offer collections division and payment processing.

4. DANGERS

- **Higher Rates:** As previously noted, asset-based loans have relatively higher rates.
- **Secured Loans:** Such loans are secured. So, if you miss your payments your collateral will be legally seized.
- **CAVEAT:** More traditional loans offer relatively better terms in case of missed payments or default.

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