



## PACKAGE YOUR ASSETS TO RAISE FINANCING

“Money mek di mare gallop”; so says a popular Jamaican proverb. Whether in boom times or periods of recession available financing is the life blood of a business. Businesses will require financing for long term or capital projects and also for short term operations or working capital. These financing needs may be met through debt creation or equity investments.

### Nature of Equity Financing

Equity investment in a business is the residual value of the assets minus the liabilities of the business. It is the source of financing for which there is usually no immediate obligation to repay or make any payments on the amount received as investment. Equity investors are the real risk takers of the business; there is a very direct relationship between the rate of return on their investment and the performance of the business. The Companies Act provides that these investors may only be paid dividends where the company reports distributable profit in the financial year.

### Debt Financing

The other alternative source of financing is debt financing. The cost to a business for debt financing is likely to be cheaper than equity financing because the loan providers tend to be taking less risk in relation to the business than the equity investors. Loans may be obtained from bank or money market sources, and may be secured or unsecured.

In this article, we explore some of the assets that may be used to obtain secured debt financing, as well as, the general characteristics of some common types of security that a borrower may grant to his lender.

### Types of Assets that may be used as Security

Typically some of the asset types that may appear on the balance sheet of a company are as follow: land and buildings, plant and machinery, motor vehicles, inventory, cash and bank account, accounts receivables, investments, and key man insurance policies.

All of these assets can be used as security to obtain loans from banks and/or money markets.

Banks will usually offer standard loan products/services, and in some cases may facilitate negotiations with a view to offering custom designed products/services. The most important consideration for a lender is that the collateral used to secure the loan is of adequate value to cover the maximum value of the loan, and also that the lender can readily be put in a position to liquidate the security and use the proceeds to cover the loan. Accordingly collateral will generally be viewed by lenders as superior where it is adequate and liquid, which in turn may reduce the cost of borrowing to the lender.

Some types of security instruments that may be used include: mortgage, debenture, guarantee, assignment, factoring agreement, pledge, hypothecation, lease financing and commercial paper. In this article we look briefly at mortgage, guarantee, assignment and lease financing.

## Mortgage

Many of us are familiar with mortgages. This is an instrument which has the effect of granting a lender title/ownership rights to property belonging to the borrower by way of security until the loan has been repaid. The important feature of a mortgage is that ownership rights are transferred from borrower to lender, subject to the borrower's right to redeem the ownership interest in the property on repayment of the loan.

Mortgages may be granted in respect of any kind of asset, whether tangible or intangible. The mortgage may also be fixed on a specific asset and the borrower loses the right to sell or transfer the asset without the consent of the lender, or it may be a floating mortgage over a shifting pool of assets which will continue to be used in the borrower's business, for example, stocks-in-trade.

## Guarantees

A borrower may provide security for its loan by using guarantees. The guarantor is a third party to the loan contract who agrees with the lender that if the lender provides financing to the borrower, the guarantor/surety guarantees repayment of that loan. The liability of the guarantor does not arise until the borrower has defaulted on its loan repayment. Additionally, amortization of the loan or other events which causes the loan balance to be reduced will also result in a reduction of the liability of the guarantor.

It is quite common for related companies to guarantee loans taken by other companies in the group. For example, a parent company would often issue a guarantee in respect of a loan taken by its subsidiary. An individual majority shareholder of a company may also issue a guarantee in respect of the company of which he is a member.

## Assignments

A borrower may, as security for a loan, assign the benefits to which he is entitled under certain contracts. The type of benefit which a lender would usually be interested in is the right to receive money payments.

Accordingly, a borrower who is expecting future cash flows, for example, from the collection of receivables, proceeds of insurance, proceeds of negotiable certificates of deposit, may exploit that source of income for securing financing that is needed in the present.

## Lease Financing

Lease financing generally refers to situations where the buyer would have the lender purchase the asset in which he is interested, for example, motor vehicle or commercial equipment. That asset would be reflected on accounting records as an asset of the lender. The "borrower" would then acquire the right to use the asset while making lease payments to the lender. The "lender" may subsequently acquire ownership rights in the asset. These types of arrangements are sometimes referred to as "off balance sheet financing".

## Conclusion

As is often said, weathering this global recession requires that businesses be efficient, creative, and maximize the value of all assets held by them. Businesses should package their assets in the most attractive way possible in order to raise financing in an era when that commodity is scarce. Lenders will certainly need to ensure that they

take all the necessary steps to perfect the security taken over the assets of their borrowers.

Andrea Scarlett-Lozer is an Associate at Myers, Fletcher & Gordon, Attorneys-at-law. She is a member of the Commercial and Intellectual Property Departments and can be contacted at [andrea.scarlett@mfg.com,jm](mailto:andrea.scarlett@mfg.com,jm) or via [www.myersfletcher.com](http://www.myersfletcher.com).