Do You Pari Passu?

It's a question that could lead to the financing answer that works best for you or your company.

"Pari passu" is Latin for "equal rate" and, while it is the type of loan arrangement with which many banks and lenders might not be overly familiar, it could open the door to opportunity to those willing to pursue it when seeking a favorable mortgage.

Generally speaking, credit remains tight for most businesses in the United States today, with the issue for many lenders being lack of available capital (customer creditworthiness). Many companies experienced losses or downturns in profitability during 2009, and, as a result, obtaining financing is much more challenging now. This is due to the fact that companies are unable to meet the cash flows and ratio requirements that many lenders currently seek based upon their 2009 financial statements. Additionally, further compounding the lending problem is the fact that banks do not want to be overexposed to certain industries that they deem risky.

We recently worked through such a scenario and found a surprising answer to a client's mortgage dilemma: the *pari passu* option through the Small Business Administration (SBA).

Here's how it worked.

For many mid-sized businesses, SBA loan programs never used to be practical. However, as a result of the current economic downturn, the Obama administration has raised many of the loan limits and eliminated the fees that SBA normally charges, making the SBA a viable solution to businesses who never may have considered SBA in the past.

In this particular case, a domestic automobile dealership client sought to refinance its $4 million mortgage. Initially banks were approached about a conventional commercial mortgage but, after experiencing a challenging 2009 and being deemed to operate in a risky industry, banks were unwilling to provide this dealership with a conventional mortgage.

We next inquired about an SBA mortgage. The SBA's most popular loan programs are the 7 (a) and the 504. The 7(a) program offers mortgages on original owner-occupied real estate purchases up to $5 million but, since our client was refinancing, their option had to be a 504 program loan. Unfortunately, the 504 loan program has a maximum #2 million loan, of which the SBA guarantees the first $1.5 million for refinancing existing debt.. So at first glance our client had reached another dead end as this did not meet their $4 million mortgage requirement.

This is where *pari passu* came in – banks are allowed to *pari passu* mortgage debt with the SBA. In this kind of arrangement, the SBA assumes a maximum risk of $1.5 million of the first $2 million of the mortgage under the 504 program. The bank then assumes the remainder of the risk and, while both parties have a first lien position on the property, the bank's mortgage is not in a second position to the SBA. In this scenario, the bank mitigates almost half of its risk, making the mortgage more attractive from a risk-tolerance point of view. With the elimination of the SBA fees, this type of mortgage became even more attractive to our client from a cost perspective.

The *pari passu* option is not often discussed or even well-known in banking circles; in fact, of the eight banks our client approached, only one was even vaguely aware of the concept. What's more, most lenders – even many SBA lenders – are not yet aware of the *pari passu* arrangement. However, one lender who *was* experienced with these types of transactions was able to put the deal together.

The moral of the story is to keep all options open and cast a wide net when reviewing financing options, as not all banks are created equal. You just may find that the *pari passu* option is one that works best for your mortgage loan.

Please contact your local Auto Team America member today for additional information!

Cash Flow

With sales still lackluster at many stores, having enough cash on hand to meet obligations remains a management challenge. The first step in strong cash-flow management is maintaining an organized system for cash accounts. It's also important to maintain a tight collection policy and to properly account for inventory.

Getting cash to flow
Although the U.S. economy shows signs of healing, many dealerships continue to bite the bullet as they look for ways to meet payroll demands, finance floor plans and make a profit. With sales still lackluster at many stores, having enough cash on hand to meet obligations remains a management challenge.

Banking on management
The first step in strong cash-flow management is maintaining an organized system for cash accounts. Keep at least two bank accounts — one for general funds and one for payroll — and have your accounting department reconcile them monthly when bank statements are received.

Small daily overages and shortages aren't uncommon. To maintain an organized system for managing cash, set aside any discovered variances in cash deposits each day in a separate general ledger account. Review and reconcile this account monthly too.

Depending on your dealership, a large percentage of cash can come in through contracts-in-transit. You should maintain only one general ledger account for these transactions. Any division of this account allows for additional, unnecessary entries and greater room for error.

Claiming cash promptly
To free up cash, process a sale as soon as possible after it's completed. Collect all contract balances within five days and investigate all credit balances. Time lags can tie up a large amount of cash. You can determine the average time it takes for funds to be received and when floor plan payments are due. To convert paper to cash sooner, submit paper to financing companies several times daily.

Maintaining a tight collection policy can help free up cash and save you money in the long run. Your computer system probably lets you print summary receivable reports so you can thoroughly review account aging.

Keep in mind that the "true worth" of accounts receivable worsens as time passes. According to a study by the U.S. Department of Commerce, for example, receivables legitimately considered current are worth 100 cents per dollar. But those same receivables are worth only 67 cents per dollar when more than 90 days old — and only 43 cents per dollar after one year.

You can keep an eye on receivables through a few simple activities. Exception reports can print out all receivables more than 30 or 60 days old. Generate these reports weekly for department managers to review and clear. Each dealership should maintain an updated list of the 20 oldest receivable balances, indicating the customers' names, amounts owed and current collection status.

Additionally, institute a credit policy that authorizes a maximum of two or three people to approve credit limits for commercial accounts, establishes clear credit restrictions and sets up an aggressive collection program.

Last, hire a top-notch warranty administrator. Aim for a three- to five-day time span between submitting a claim and getting paid.

Accounting for the goods
A dealership's inventory of excess new and used vehicles can slow cash flow to a trickle. Assign someone to reconcile and verify your monthly floor-plan statement for new vehicle inventory. Pay attention to discrepancies between the date that vehicles are delivered and the date interest starts to accrue.

Also verify that payoff dates are accurate. And limit the number of managers who order inventory. Target vehicles more than 90 days old for speedy sales.

For used vehicles, determine if your inventory is too large based on current demand. Then take action to convert the excess to cash. Reduce the selling price, provide extra incentives to salespeople to sell used vehicles and offer promotional items to potential buyers. Send your no-sellers to the auction house for rapid disposal.

For parts inventory, dispose of items older than three years. Computer software programs can highlight excess parts inventory over current needs and help reduce obsolescence through automatic tracking.

Managing with a purpose
Through strong management, you can improve your dealership's flow of cash. If you start with the basics, such as separating general funds from payroll, processing sales quickly and tightening your collection policy, you'll be on the road to improved cash flow.

Please contact your local Auto Team America member for additional information.

TAX TIP — SMALL BUSINESS HEALTH CARE TAX CREDIT

The new health reform law gives a tax credit to certain small employers that provide health care coverage to their employees, effective with tax years beginning in 2010. The new law, the Patient Protection and Affordable Care Act, was passed by Congress and was signed by President Obama on March 23, 2010.

Small employers that provide health care coverage to their employees and that meet certain requirements ("qualified employers") generally are eligible for a Federal income tax credit for health insurance premiums they pay for certain employees. In order to be a qualified employer, (1) the employer must have fewer than 25 full-time equivalent employees ("FTEs") for the tax year, (2) the average annual wages of its employees for the year must be less than $50,000 per FTE, and (3) the employer must pay the premiums under a "qualifying arrangement".

An organization exempt under Code Section 501(c) may qualify for the credit. . However, special rules apply in calculating the credit for a tax-exempt qualified employer.

Only premiums paid by the employer under an arrangement meeting certain requirements (a "qualifying arrangement") are counted in calculating the credit. Under a qualifying arrangement, the employer pays premiums for each employee enrolled in health care coverage offered by the employer in an amount equal to a uniform percentage (not less than 50 percent) of the premium cost of the coverage

If an employer pays only a portion of the premiums for the coverage provided to employees under the arrangement (with employees paying the rest), the amount of premiums counted in calculating the credit is only the portion paid by the employer. For purposes of the credit (including the 50-percent requirement), any premium paid pursuant to a salary reduction arrangement under a section 125 cafeteria plan is not treated as paid by the employer.

For tax years beginning in 2010 through 2013, the maximum credit is 35 % of the employer's premium expenses that count towards the credit. The credit increases to 50% in the year 2014.

The credit phases out gradually where eligible employees exceed 10 or if the average annual wages exceed $25,000.

The credit offsets an employer's actual liability for the year and any unused credit amount can be carried back one year and forward 20 years. However, an unused credit amount can not be carried back to a year before the effective date of the credit. Thus, any unused credit amount for the year beginning in 2010 can only be carried forward.

You should consult with your ATA representative in evaluating whether you would qualify for the credit and how to calculate the credit amount.