No Respect:
Why Charge-Offs are Still Assets

BY BRETT BOEHM

Brett Boehm of TBF Financial thinks charged-off loans or leases don't get the respect they deserve. He explains how the process of selling charged-off assets can generate revenue from almost nothing.

BRETT BOEHM
Principal/Director,
Business Development,
TBF Financial, LLC

Charged-off commercial paper is the Rodney Dangerfield of your balance sheet: It gets no respect. However, a growing number of lenders are treating their charged-off commercial paper as an asset — and gaining steady returns from selling it.

Few lenders want to have anything to do with their charged-off loans or leases. This is understandable. Often, charge-offs are associated with the failure that led to their non-payment. There's also a good chance acrimony was involved in collection attempts. Time and resources were spent on the collection process, and it failed.

So there they sit, as a line item or beside an asterisk on the balance sheet, doing nothing to improve the bottom line. If they elicit any reaction from a lender, it's often a sigh or a frown — or both.

But when lenders start treating their charge-offs as assets, many discover one of the easiest ways to convert them into cash and profits is to sell them. Quite simply, the sale proceeds represent found money and found profits. Those who treat their charged-off commercial paper as an asset and formulate a regular plan for selling it are adding an integral part to their company's business plan — one that generates revenue from this written-off asset.

I know this firsthand because TBF Financial serves many of the largest companies in the $650 billion equipment finance sector by purchasing their portfolios of small-ticket leases and loans that were uncollected and charged off. Among the first to offer this service when it was founded in 1998, TBF has now streamlined and perfected a simple, easy process that pays sellers cash upfront for accepted pools of charge-offs.

An Easy Asset to Sell

Viewing your charged-off debt as an asset rather than a liability is the first step toward transforming it into cash. Once charge-offs are viewed as assets, lenders find that selling is a very easy process. Here's how it often works, from start to finish:

1) The lender's or lessor's due diligence effort consists of preparing an electronic spreadsheet with minimal information for any charged-off assets for sale. The buyer of the charged-off asset will use this information to perform due diligence on the accounts and develop an offering price for the portfolio. If the price is acceptable to the seller, the transaction will be closed with purchase/sale agreement. The entire transaction, from the time the buyer receives the seller's spreadsheet until closing, can take no more than one to two weeks depending on the portfolio's size.
2) If the parties have a forward flow arrangement, no due diligence will be required after the first transaction. The parties will agree on a price for subsequent transactions, and the purchase/sale agreement for the first sale will provide the terms for all subsequent sales. The only document required for each new sale under such an arrangement will be a bill of sale. At the time of each sale, the seller will simply email the buyer a spreadsheet of the accounts it wishes to sell. The buyer will then pay for the charged-off assets by overnighting a check or making a wire transfer of the purchase funds.
3) Upon the first sale, the parties will agree on how the backup documents will be made available to the buyer. Today, most of the documents are stored electronically, and the buyer is either given limited access to the seller's database or the seller burns the data to a CD or DVD.

When lenders start treating their charge-offs as assets, many discover one of the easiest ways to convert them into cash and profits is to sell them.

The Case for Selling Your Charged-Off Assets

There are many other significant benefits to selling charged-off assets. And, frankly, there are no liabilities. In today's challenging economic climate, many commercial lenders and lessors are finding themselves under increased pressure to explore every possible source of revenue to enhance their bottom line. It's hardly surprising, then, that selling charged-off assets is materializing as exactly that hidden resource.

Selling charged-off assets is the easiest way to convert them into revenue and improve cash-flow. Any lender that is seeking ways to improve its bottom line can benefit from the immediate boost gained from selling charged-off leases or written-off loans. Once sellers complete their initial sale of charged-off assets, they often see how easy it is to realize cash, and they are likely to start a proactive arrangement where they automatically sell their charged-off assets, usually monthly or quarterly. The regular revenue from the sales becomes a positive line item in companies' budgets that they can count on going forward.

Since these assets have been charged off the seller's ledger as having no value, the purchase price is a "recovery" for accounting purposes; therefore, the total purchase price goes directly to the seller's bottom line as profit. While many equipment finance companies will do end-of-the-year charged-off assets sales to increase annual profits, an increasing number of lenders and lessors are finding that selling charge-offs throughout the fiscal year provides a steady stream of revenue. For revenue generation, there's never a better time to sell than the present because charged-off assets don't appreciate with age.

This strategy of selling charged-off assets as soon as they have been determined uncollectible has the added benefit of removing them from the path that assigns them to a collection agency — a path with its own expenses and risks. Companies that sell their charged-off assets have learned that the purchase price for these assets is more than they are likely to recover by using collection agencies. This allows the sellers to reduce their collections process expenses while generating revenues from an immediate sale of the charged-off asset. Even if the seller decides to wait until after the collection process is complete, there is still plenty of potential to boost profits by selling the charged-off asset at that point.

Another reason some companies are selling charged-off assets is because they are uncomfortable with the uncertainty of using collection agencies. Because of the nature of their legal relationship with the lender or lessor, collection agencies are acting on behalf of, and representing, the owners of the charged-off asset; this means that everything and anything the agencies must do to collect ultimately reflects on the account owners.

Let's face it: Collections is a business that can get ugly. These days, collection agencies are being more closely monitored, and some are being charged with violations of the law by regulatory authorities for use of illegal collection tactics. The last thing any commercial lender or equipment finance company needs or wants is to be associated with or responsible for any illegal actions taken by the collection agencies they have hired.

Unlike collection agencies, which are essentially agents of the lessor or lender and working under the lessor or lender's name, the buyer of charged-off assets acts on its own behalf as the title holder to the account. The sale of the portfolio to the buyer is an arms' length transaction without recourse, so the seller is totally out of the picture going forward.

As added insurance against any such association, buyers of charged-off assets will agree to not resell the asset. With this assurance, the sellers do not have to be concerned that any possible secondary or tertiary buyer of the charged-off asset will do anything that will reflect negatively on the seller.

Therefore, by avoiding the collections process altogether, the seller of a charged-off asset gets the best of both worlds: complete disassociation from the bad debt, while still getting to apply the proceeds of the sale to the bottom line as profit — which has the biggest impact of all.

One final critical distinction between collection agencies and buyers of charged-off assets is worth noting: Unlike collection agencies, which are often motivated to pick only the low-hanging fruit from the accounts they are given, commercial debt buyers are experts at reaching higher by identifying collectible accounts and successfully collecting on them. Because of their expertise at recognizing value, they are able to offer substantial prices for the non-performing accounts they buy — and do so at the point of sale.

Since these assets have been charged off the seller's ledger as having no value, the purchase price is a "recovery" for accounting purposes; therefore, the total purchase price goes directly to the seller's bottom line as profit.

Changed Perceptions About Charged-Off Assets

As mentioned earlier, a critical first step for many commercial lenders or lessors is working through the negative perception they have toward the charged-off paper on their balance sheets. Once they view their charged-off assets as just that — *assets* — potential sellers can see firsthand how the process works by having their charged-off assets evaluated.

It never hurts to get an estimate on their value. Knowing the cash value a buyer will pay for a charged-off asset is the first step toward deciding how to deal with it. Buyers are more than willing to provide potential sellers with an estimate.

The bottom line is we need to give charged-off assets the respect they deserve. Yes, they are most certainly an unconventional "asset," but establishing a solid plan for liquidation yields significant benefits. Remember, the purchase price a buyer pays is a "recovery" and therefore the total purchase price goes directly to the seller's bottom line as a profit. In today's tight market, what commercial lender or lessor can afford to pass up revenue generated, almost literally, from nothing? m

BRETT BOEHM is the principal/director of business development for TBF Financial, LLC. A 1998 graduate of The John Marshall School of Law and an attorney licensed in the state of Illinois, Boehm has been with the company since its inception. Deerfield, IL-based TBF has been a buyer of distressed equipment leases and other forms of commercial obligations since its inception in 1998.