

Feeling the Credit Freeze During Tough Times

By Michael Kaplan

During this time of economic struggles, many people and businesses turn to their lines of credit to provide them with the flexibility to weather this economic storm. Individuals and businesses alike rely on their lines of credit to pay for bills while they wait for cash to come in whether from customers or their jobs. Generally speaking, this is a good tactic to buy them some time, especially considering the reduced interest rates that we see in today's economic climate. However, as the banking industry continues to struggle with foreclosures and the risk inherent in their real estate portfolios, banks have turned to freezing the use of lines of credit lately based on the additional risk the customer exhibits.

You may not be able to rely on your home equity line of credit to provide you with assistance in paying your bills. Most banks are re-evaluating their outstanding loans and determining what their risk factors are to the banks. The banks are not looking at any of their customers other assets or their customers' ability to pay back the line; rather they are focusing solely on the debt to equity ratio their customers exhibit in their residences. The only security the banks have on the lines of credit they issue are the residences, therefore when the ratios change, the customer is deemed to be a higher risk to the bank. An example of this is when an individual owns a residence that was worth \$1,000,000 three months ago and has a first mortgage on it of \$750,000 and equity line of \$50,000. Now the property is worth \$900,000 and the debt-to-equity ratio has changed and the outstanding loans are closer to the value of the resi-

dence. The risk at this point is extremely high for the bank since the equity in the property is eroding. Like in this situation, the banks have recently been issuing letters to their customers notifying them that they are freezing their lines of credit and will not be able to use them unless they either pay down some of their outstanding debt or the value of the property increases. In recent days, the letters customers have received from the banks freezing their lines of credit have taken them by surprise. Make sure you plan ahead and have cash available if you see that property values are decreasing rapidly and that your equity in your residence is eroding.

Banks have also been taking a harder look at the lines of credit they have outstanding with businesses. Banks are focusing more effort on strengthening their balance sheets and reducing their risk. When this occurs, struggling businesses are normally the ones to suffer. If businesses don't have enough of their own capital, they tend to rely heavily on lines of credit they receive from banks. However, since the credit crisis began banks have been increasing their restrictions and requirements of their customers. They have requested financial information more frequently, so they can assess the viability of their customers to pay back the outstanding debt, as well as, the customers ability to continue their business. Most companies that have strong relationships with their lending institutions will not suffer the same scrutiny, as would a new customer of the bank, but will be requested to provide financial information. The banks will continue to review the financial information provided and assess their risk. The loans that are collateralized by equipment or inventory are less risky to

banks then those that are collateralized by accounts receivable. The accounts receivable aging report has continued to be a focus of the bank's scrutiny. Recently, banks have tended to freeze lines of credit for those customers that exhibit higher risk for the banks. Those customers that have high accounts receivable aging balances, especially those that are in the over 90 days outstanding column normally result in higher risk. The likelihood of collecting those receivables continues to decrease, thereby increasing the overall risk for the bank's customer to have the ability to pay the outstanding debt. Businesses should make sure that they continue to put a high emphasis on collecting all receivables, especially the older ones, so that they will look stronger in the eyes of their lending institution.

When faced with the situation of the bank freezing your line of credit, try to contact your banker. Try to discuss with them a plan to resolve the issue, so you can resume using your line of credit. The more information you share with them, the more they may be able to help. Another option is if you anticipate having a need to use your line of credit in the future, you may want to draw it down and put it in a money market account. Even though you will be paying interest on it, you will earn interest on it and have it available when you need it. Banks are less likely to call loans than to freeze the line of credit as long as you are paying the loan based on the agreed-upon terms.

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