

UPFRONT FEES: FINANCING TOOL, OR FRAUD?

It is impossible to say how many individuals have paid upfront fees for nothing! Few people like to publicize their errors in judgment. No one is eager to admit being duped, or to being someone whose *exuberance* overwhelmed his or her business sense.

Identifying a reliable funding source is difficult. It is more difficult when funding options are limited. For commercial borrowers—the lack of *clear* rules is a game changer.

DIY: A Downward Spiral for Serious Business

Talk to someone who has lost money in up front fees and the common sense warning signs seem rather obvious. They responded with cash to one or more of the following: Pressure to act immediately. Our location must be kept quiet. We work with only the best institutions. Statements like: “Funding guaranteed.” Others recall a series of unconnected, unsupported statements—all very positive, of course. All represent fraud at work.

In commercial funding, individuals are often left to their own devices. Fraud hurts business, and slows business growth, but unclear state guidelines may simply muddy the issues. Under funded government agencies, moreover, cannot possibly track and stop every case of fraud. The environment for abuse is made more fertile by ignorance.

A borrower’s knowledge of his own business may be excellent. But, when discussions turn to finance, experience provides the prudence. As Dr. James Walter of the Wharton School said about finance, it’s a “skill of deciding what is, and what is not, relevant.” Such wisdom is learned, not acquired.

As a funding advisor myself on biofuels & green development projects, my job is to match trustworthiness and integrity of the borrower and/or innovator with the businessperson and/or investor’s honorable objectives. Of course, trust and integrity are not easy characteristics to identify, but they must be identified, and *long* before funder and client meet. Why? Because trust and reliability are the glue in the financial negotiations.

Some of the pressure in discussions can be reduced, as we do, by working directly with investors and conduits focused on alternative energy. Even so the process remains the same.

Based on my experience, I have noted five powerful tests borrowers can use to root out fraudulent fees. Beside saving time and frustration—these will keep you away from uncertainty. Here are some good questions regarding up front fees.

- 1) What is the fee for? Vague insinuations that “our accountants” and “the attorneys” demand their payment upfront (almost always “to perform due diligence”) are common. Ask: ‘Who gets the money?’ The odds are you, are talking to a recipient of some or all the funds on the phone. (You’ll hear: “If you can’t handle the deposit, we’ll have to release the funding to another project.” Sure.)

- 2) Of the number of deals you have reviewed (how many projects have collected fees on that did not fund?) What percentage has received the funding they requested?
- 3) What documents do you provide that outline and expressly describe the value this fee adds to my business?
- 4) Will you provide me a receipt of funds with a full description of the payment and consideration?
- 5) Will you provide me with a bank officer, attorney, accountant or other such representative of your good standing?

Of course, funding entities have expenses, we all do. But their expenses cannot be put entirely on the back of business people trying to secure capital to start businesses which create jobs, etc. etc. without getting some specific benefit—funding.

Do It Right: Investment Funding A Powerful Tool

There are reputable funding sources available. Many are direct to informed investors and conduits, mentioned earlier, who review and sometimes pre-negotiate for investors. Most of these charge no upfront fees. Some will, however, expect the prospect to have money to assist in the transaction. Why?

The business-financing concept is simple. Generally, an investor's money is stimulating the success of a project. The investor has every obligation to reduce his risk and get a return on the investment. He has zero obligation to take over all of the borrowers risk.

We often hear the argument that 'the borrower has put his money into their project.' Investors are sensitive to this argument. But, they are in business. It is often up to the advisor in the transaction, such as my company, to negotiate the even ground that protects both parties and allows the negotiation and documentation to continue through to funding.

Bluntly, if the borrower has money sitting in the project, it only proves he knows how to spend money, not that he knows how to make it. If a borrower runs out of money, business rationale says he needs to be able to get what he needs (whatever it takes) to bring the project to fruition. The investor may require some further money as a symbol of the borrowers belief in the next steps to get the funding, such as an attorney's escrow, or a line or letter of credit.

Typically project-funding payments are released upon certain conditions—based on the term sheet and letter of commitment from a lender. Escrow is often used, to "hold" funds in good faith for the transaction, protecting the parties' money and interests until certain specific conditions are met.

By contrast, some banks have done a disservice to many business people. These banks support the notion that if a project looks good on paper and shows value it deserves funding. Because of that logic nearly 1/3 of the bio diesel facilities in the U.S. were closed down from 2008-2010. And also why whole blocks of large and small city business districts went dark—

and not only Detroit! Why? Because lending banks funded concepts, sometimes based on real estate values, without grasping the underlying business.

Investors watch how borrowers act. They know that, in reality, many businesses simply fail to see and address the actual risks. By the same token, investors know that downturns provide lower-cost entry to extraordinary returns—for the right opportunity.

In summary, upfront fees are a screening device. For the borrower, they should be viewed as a hurdle, but not a roadblock to business success. Where a reasonable fee will help achieve the borrower objective, no one will protest.

The trick is to determine which fees will provide you a good deal, and those that will leave you with a good deal less.

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