10 Things You Need To Know About Your Next Factoring Contract

A guide to the questions you should ask before signing your next factoring contract

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Introduction

The freight trucking industry is a cash-intensive business and factoring has evolved into a complex web of providers, some of whom are honest and well-meaning professionals that will work hard to assist you in obtaining the cash flow necessary for ongoing operations. You can also find less reputable providers that will say and do most anything to get you to sign a contract that they would prefer you not read prior to signing.

This guide is designed to help you ask informed questions of your factor BEFORE you sign the contract. At a minimum this guide can help you avoid the frustration and headaches that come with things not being as you thought they were. This guide can potentially save you not only frustration and headaches but also thousands of dollars that can surely be put to better use elsewhere in your company.

This information guide is provided to share an opinion and should not be interpreted as legal advice in any form. Every contract is unique and we encourage you to seek appropriate legal representation with any contract you sign.
Evaluating Freight Factoring Agreements

We call out that the right freight factoring agreement can be a smart cash management strategy because the wrong factoring agreement can create its own set of issues.

We see a lot of factoring agreements pass our desk from virtually every competitor out there and the number of wrong deals is surprising.

We strive to educate anyone that calls us on the process and what to look for in any agreement, ours or anyone else’s.

We put this guide together based on our experience of mistakes that we see repeatedly, we often ask questions about how these terms are put together in an existing agreement and too often the answer is “I don’t know”.

If you are considering signing an agreement, extending an agreement or factoring for the first time we recommend asking these questions. These are not the only questions you should ask but these are some of the details that may turn out to be significant down the road.

We would love to answer these questions for you about our agreements as well. We strive for transparency in all of our dealings and encourage you to compare our deal with any other proposals you have.

Now, on to the questions...
1. **Term & Renewal – What is the length of time you will be bound by the contract and how will it renew?**

Three to six month terms are best but one year contracts are not uncommon. Scrutinize terms longer than 6 months and use longer term contracts as negotiating points on other terms.

Ensure you understand the renewal provisions once the term of the contract expires; many contracts have auto-renew provisions that require you to provide advance notice of your intent to not renew. Failing to get in front of an auto-renew provision can lock you into an additional term.

2. **Reserves – How much is held in deposit and when can you recover it?**

Most factoring companies will hold back a ‘reserve’ that is the funds remaining after an invoice and the factoring fees have been paid. Some of these funds will be held in deposit to guard against bad debt; these funds are often not released to you until the account is closed. Look at the amount of money that can be held in deposit, this is your money that you will not have access to until the account is closed.

Remaining reserves above those held in deposit will be returned on a periodic basis with two to four weeks being typical. This is your money that is being held back so a shorter reserve holding period is better.
3. Funding vs. Getting Cash – When the timing of cash flow is important you need to know the difference

Funding an invoice is the process of presenting an invoice to your factoring company. Many factoring companies will claim same day funding or 24 hour funding but that does not necessarily mean you will have cash within 24 hours. It is not uncommon for funds to take 48 hours or more to actually appear in your account.

The processing of submitted invoices should occur within the same day up to a cutoff window, anything submitted after this cutoff will process the following day. You should therefore look for a cutoff window that is as late in the day as possible, ideally a minimum of 2:00PM EST.

ACH deposits will typically take 24 hours to clear and your factor may charge fees from $0 to $20 for an ACH deposit. Wire transfers will clear within an hour or two and you should expect fees from $20 to $50 for a wire transfer. Understand your options and recognize that these could change over time, you may not typically need the speed of a wire transfer but it is good to know what it would cost before you need it.

4. Online Account Access – Now a commodity feature

Not long ago online access was a unique benefit, today it should be a pass/fail criteria. Factoring companies that can’t provide online 24 hour access to your account may be lacking critical infrastructure to properly support your business. Keep asking questions.
5. **Contract Minimums – Paying for not using available credit**

Some contracts have minimum volume requirements to maintain an active account status, effectively requiring you to submit a minimum amount of invoices within a set period. Failure to meet these volume requirements may incur a fee.

Similarly, minimum account fees may be charged regardless of the volume that you factor. Minimum factoring volume and minimum account fees may or may not be linked in your contract; that is you could incur minimum account maintenance fees AND fees for not meeting minimum volume requirements.

6. **Hidden Fees – The devil is in the details**

A contract can contain fees for almost anything you could think of and while many of these may be small ancillary fees that can certainly add up over time.

Beware of getting ‘nickled and dimed’ from these fees by looking for them and understanding when they apply and what you can do to avoid them. Common fees include invoice processing fees, ACH or wire transfer fees, credit check fees, minimum factor fees and numerous others.

These fees can be lucrative for factoring companies and costly to you so read your contract carefully and don’t hesitate to question anything that you don’t fully understand.
7. **Advance – Understanding the obvious**

Most factoring companies will tell you that they advance a certain % and charge a certain percentage but it may not be clear if the charge is included in the advance % or not.

An example is a company that advertises a 90% advance and charge 3% but on first funding a trucking company may find that the fee is taken out of the advance and so the net proceeds are actually 87%. Don’t assume that a 90% advance implies that you will receive 90%, seems obvious but it may not be.

8. **Up Front Fees and Exit Fees – They can get you coming and going**

Account setup fees are common to offset the expense of initial credit checks, UCC searches, due diligence fees and filing fees. These fees can range from $200 to over $1,000 per account but can often be deducted from first funding to reduce out of pocket expenses. These fees should not be incurred unless you are guaranteed funding.

You may see an application fee which is typically non-refundable and should be avoided; this is pure profit for the factor and should be avoided.

Many contracts may provide for exit fees to close UCC fillings and manage open invoices. These fees can again range from $200 to over $1,000 but may be waived for customers in good standing at the time the contract terminates.
9. **Contract Termination – Getting out**

You should enter into a contract with a clear understanding of how you can exit that same contract. How much notice do you need to provide before you can close the account or the account renews?

Knowing how hard it will be to exit and how difficult your factor may make it for you to exit can be tough to figure out. Look for specifics in your contract and also be very wary of any verbal promises along the lines of ‘that is something in all our contracts, we never enforce that’.

10. **Recourse vs. Non Recourse – Not always what it seems**

There are few things more misunderstood in factoring than recourse. Too many people falsely believe that a non-recourse contract eliminates the possibility of them being liable for an invoice that does not pay on time.

True non-recourse contracts are typically expensive and contain restrictions on who you can factor and strict condition under which non-recourse applies. Typically, non-recourse applies when the invoice payor is insolvent and goes out of business which is not likely. Slow pay or no-pay will typically get recourse.

If you believe that you need a non-recourse contract study it carefully and seek legal counsel to ensure that you understand the terms and conditions when recourse applies and when it does not.
5 Star Factoring Agreement Audit

To further help you maximize your cash flow with factoring 5 Star has developed a 10-minute Factoring Agreement Audit which we conduct over the phone with you and one of our account reps.

What we accomplish in the fast-paced zero-nonsense session is:

- Establish a baseline for current market rates based on the number of trucks you are running
- Identify the Big 3 gotcha’s that you need to understand, and how to ask about them to get information that is useful for comparison
- You will walk away with a punch-list of evaluation criteria that will put your knowledge ahead of 95% of all others who are negotiating a factoring agreement

Please be assured that this consultation will not be a thinly disguised sales pitch. There is no charge for the call, but please be advised that the call must be strictly limited to 10 minutes. The consult will typically take place within three working days of your call.

To secure a time for this call please email info@5StarFreightFactoring.com or call 1-888-785-4491.