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MIKE PHIPPS FINANCE ACL (364 314)

fresh ideas...

Loan Conditions, Reviews and Refinancing.
It Doesn't Need to be a Nightmare!

We have talked in the past about our view that we are moving into a tighter credit environment in which bank lending guidelines will become stricter. We also talked about challenges existing borrowers are having with annual business loan reviews and extended interest only periods. I am less than delighted to announce that for once our predications have come to fruition. Daily feedback from borrowers suggests that times are indeed becoming challenging both for new borrowers and for existing operators.

To be frank some of the concerns raised with us are of the borrower's own making and reflect a lack of understanding of the terms and conditions of the loan. In many cases we have been able to offer guidance around a better understanding of loan condition compliance and offer borrowers a few helpful tips to manage their bank relationship better. For our own clients we offer to manage the relationship on behalf of the borrower which can reduce the stress levels somewhat. A problem shared is a problem halved so to speak.

Here's what we know for sure. The majority of business loan borrowers are going to be subjected to an annual review of their facilities. The borrower's ongoing capacity to meet their obligations and the value of the bank's security are usually inextricably linked to the performance of the business. As such it should come as no surprise that the bank will seek copies of your most recent financial statements. By most recent we mean very recent, not your tax returns lodged 12 months ago. This may well mean that you need your accountant to prepare end of financial year financial statements even if you don't intend to lodge your returns for months. I hear people say what an impost this is. I say that if you have got to the end of the financial year without preparing draft financial statements as part of pre June tax planning you need to take a serious look at how you are managing your financial affairs. I suspect your lender will take the same view. Nothing strikes fear into the heart of your bank manager like disorganised financial reporting and the possibility of ensuing dramas with tax planning and provisioning!

A word of caution on simply dropping your financial statements on your bank manager's desk. Going concern businesses such as management rights and motels are bought, sold and valued on adjusted net profits. Your tax returns will seek to minimise that profit as best and as legally as you can. It's important to ensure that your lender appreciates the difference and assesses your annual review in a balanced manner. Comparing an unadjusted set of financials designed to minimise your tax with the P and L you bought on and valued on can be a recipe for disaster if not managed and presented appropriately. Again, we do this for our clients if they wish.

Your lender will almost certainly ask for some supporting information when conducting the annual review. An up to date statement of assets and liabilities is a definite and in most cases so is confirmation that all your tax obligations are up to date. We believe in getting on the front foot and also providing your bank with any good news stories that will assist in keeping the lender in a state of happiness. If you have an agreement top up, lease extension, units coming into your letting pool, new accommodation contract or wonderful Trip Advisor reviews tell your lender.

And now, onto another challenge. It may be that your loan is not coming up for review but for expiry. This is a much more serious matter than the annual review of a loan and we have previously written about the potential perils of short term finance. Some lenders, in order to offer lower interest rates, make relatively short term funding commitments to their clients. The Letter of Offer says loan term 3 years. Many borrowers wrongly assume this is the interest only period and the loan will automatically roll on. Not so. If the loan term is 3 years then all bets are off after that period. In essence you reapply for your loan and there is no obligation on the bank to extend the loan term. It is imperative that you have your loan term expiry diarised and ensure you have all necessary information in front of your bank in time for them to reapprove the loan, revalue the business and other security and issue a new Letter of Offer. These days that's no less than a month prior to the loan expiry date. If you miss the expiry date the bank can, at its discretion, extend the loan term to give you time to get yourself organised but it's not a good look and best avoided.

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Regardless of loan review and/or expiry triggers more and more banks are taking the option of revaluing security more regularly. Remember, your bank retains the right to revalue as and when they see fit and it's at your cost. Again, get on the front foot with an adjusted P and L for sale purposes and some recent market sales evidence and potentially save yourself thousands.

So, what's the end game here? Frankly we make money when people borrow and use our services. That includes refinancing so I guess we should be big fans of that strategy. Not necessarily. All things being equal you have likely developed a relationship with your bank, met your obligations and built trust and some rapport. There's value in that relationship and like a marriage it's worth working at, even if there are occasional rocky patches from time to time. However, when the time is right it's certainly worth at least taking a look at the competitive landscape to see what else is on offer and to ensure your lender is looking after you. In my mind the time to do this is at annual review or loan expiry. Your bank will review you and I think you have every right to review the bank. You have gone to the trouble of preparing what amounts to a loan application (or we have done it for you) and in many cases you have an up to date valuation. It takes little extra effort to use this data to see what other lenders might offer and to compare your existing arrangements. At the very least you will be equipped with some bargaining power and at the other extreme you will have options if your current lender drops the ball. Our end to end process manages all this for our clients fee free (shameless plug !)

Right now, the single biggest motivator for people moving banks is the imposition of P and I loan repayments at the end of interest only periods. There are numerous reasons why borrowers like interest only and just as many reasons why lenders don't. We have developed strategies for negotiating extended interest only terms or at least reducing the burden of full P and I repayments and we are happy to share these with clients.

A word of warning. Debt service tests are becoming ever more stringent and the hurdle you met 3 years ago may well be a leap too high in todays closely regulated financial environment. If you are asking for interest only finance, you need to have a good reason. Preserving cash flow for good wine, fast cars and fun times resonates with me but will almost certainly leave your bank manager less than excited. There are any number of perfectly good financial reasons to use interest only finance so best to use one of those instead.

Finally, and just to clarify because I know the managing director will ask. No, I don't advocate taking a look at the competition to see what's on offer if your marriage is getting a bit rocky. In my case that could prove fatal!

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