GLOBAL PACIFIC

GLOBAL UPDATE

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How to get funding in a credit crunch

In this issue I'd like to talk about the availability of finance and how I can help you obtain it.

My September 09 GLOBAL VIEW traced the history of the current global credit crunch – to see that issue click here

Since then the availability of loans has if anything got steadily worse. Finance companies here have all but vanished or ceased lending, bank lending criteria is tougher, and many of the types of loans available two or three years ago have disappeared.

But there is money around. Here are some observations about the availability of funds – both debt and equity - for property and business. Call or email me if you'd like more detail.

Bank Finance

Banks are toughening their credit criteria, have fewer funds available to lend and are favouring existing clients. At the same time they are reviewing those existing facilities to seek additional guarantees, covenants, cross collateralisation of securities, GSA security, reduced loan ratios and generally tighter conditions.

Banks are notorious for cross collateralising all assets owned and this can lead to problems in a downturn. For example, on the sale of an asset the equity released being retained by the bank to bring other assets owned within new guidelines they require. We're constantly being approached by clients to finance acquisitions outside the applicant's normal banking channels or to refinance existing assets elsewhere.

Having said this we do have good contacts in the banks and are arranging bank loans by providing detailed proposals that enable the bank to better understand your property or business, and your ability to service the debt and repay the loan.

It's quite simple really, in an environment where money is tight, the more you do to pre-empt the credit department's questions – yes that includes knowing what their criteria are – the less work and time everyone has to spend on the assessment the more likely the loan will be approved.

Residential loans

Banks like residential lending which is favourable to their government imposed lending requirements. However they still favour the run-of-the-mill lending to salaried borrowers with a reasonable deposit and a house in a recognised geographical location. Loans outside their comfort zone are hard to obtain, and those where debt servicing is difficult to show, almost impossible.

Non-bank residential lenders are far fewer than two or three years ago and many of these are now seeking similar credit criteria to the banks. Gone are the days of the easy lo-doc loans.

Many non-bank lenders are restricted by their insurers as to the size of loan and the geographical location of the property. We do however have access to lenders with interest rates comparable to the banks that are not restricted to the amount they will lend on houses.

Solicitor nominee, contributory mortgage, and trustee lenders are also a good source of finance for residential property. The secret is knowing which one has the funds at the time you want them.

Finance for residential construction loans has been difficult to raise, but we have access to financiers who will lend on these - typically 80% of final valuation or 70% for spec builders. They may not need a pre-sale but will want an indication from a bank or another lender they will re-finance when the project is completed.

We also have access to short term bridging loans on residential property with an exit strategy in 6 months to a year.

Commercial loans

For some time now the overriding criteria on the availability and cost of finance for commercial and industrial property has been the strength of the tenants and leases. Nothing has changed except with so many vacancies around now – see Herald article on city CBD vacancies here – the reliance on good tenancies has become even greater.

There are a number of lenders of commercial finance including banks, solicitor nominee, contributory mortgage, and trustee lenders.

One speciality product I reported on in my September GLOBAL UPDATE worth repeating has the following characteristics:

- Stand alone product - no collateral security required.
- Will lend on commercial property (and residential properties - investment or owner occupied).
- Up to 66% of lower of purchase price or valuation.
- Loan size from $200,000 - $5,000,000.
- Terms from 6 months - 3 years.
- Interest rate 7% - 11% (depending on risk profile) with interest only or flexible principle repayment terms.
- Debt servicing cover on secured property should be greater than 1.3 times rental income
- Clean credit required.
- Available for properties located nationwide - preference for main cities and major provincial centres.

There's also a new breed of lender emerging from the finance company ashes that will look at short term bridging "asset" loans of 6 months to a year where debt servicing is less important than a clear exit strategy. Many are private lenders.

These loans are assessed on a case by case basis and the security taken - and pricing - is a function of the risk they perceive. A proper proposal is essential. Like the banks the less work and time everyone has to spend on the assessment the more likely the loan will be approved.

Farm lending

Specialty farm lenders have always assessed a proposal from a debt servicing point of view. The valuation of the farm land and improvements are irrelevant and loan to valuation ratios are an end result rather than a starting point. With a dairy farm, for example, the first figure put in the spreadsheet is the current milk fat solids price.

With banks and other multiple asset lenders, this has not always been the case and the valuation of the farm land and improvements had taken a more prominent role. In those days more farms were being bought and sold so the lender was more comfortable about being able to exit from a non-performing loan. Not so now.

But the money is there for the right proposal. I have spoken to farm lenders who are flush with funds and are eager to get them out.

Bare land, coastal and rural properties

These are tough to finance. They do not generate revenue for debt servicing and are usually secondary assets that are the first to be offered for sale in tough times. Rodney Dickens produces an excellent Property Insights report which covers this subject. For an example on the Northland coastal section market click here and to subscribe click here

But even here there are ways of raising finance and avoiding forced sales that would be difficult to achieve and end up with the financier and the borrower in stalemate - or both losing out badly.

Business lending

This is the area which has suffered the most from the demise of the finance companies. If you're looking to raise finance for a new business in leased premises - with no record of previous profitable accounts – good luck.

The most common method of arranging funds for small businesses is to provide collateral security by way of property – usually residential. Banks are still in this market but you need to be aware that this cross collateralisation type of lending can lead to problems. As mentioned above, banks are looking for all means at their disposal to grab more security and reduce loans.

There are also lenders who specialise in "factoring" debtors to provide much needed working capital. Factoring can be defined as converting current credit sales into cash before their due date. The most common form here is non-disclosed debtor finance where the business can factor their invoices without the customer knowing. Invoices must be business to business, no consumer invoices, with a reasonable spread of debtors. Advance 70% - 90% of invoice value.

There are also financiers who provide single invoice discounting where the lender simply purchases one or more current invoices and pays up to 90% of the invoice value in cash. Pricing is more expensive than above and depends on the time until the customer pays, but has the advantage of being a more flexible arrangement.

Plant and machinery lending will be the subject my next GLOBAL UPDATE, but suffice to say there are specialty lenders in this area who don't need collateral property security and are flush with funds looking for new business. I'll get back to you on this.

Development finance

This has been almost impossible to get – certainly without presales - and mezzanine finance from traditional sources has effectively disappeared.

But now we have lenders who look at projects on a case by case basis. For example, one has indicated they will offer up to $5 million secured by first mortgage. Another feels happy behind a bank as long as the developer has contributed sufficient cash themselves and there is a clear exit.

Again these loans are assessed on a case by case basis and the security taken - and pricing - is a function of the risk they perceive. So if you've got a development project that needs funding it's worth giving me a call.

Private investors

I've mentioned above private investors who will look at bridging loans but there's another group who will look at taking a share in an investment or project or a loan/equity position which gives the investor a return plus part ownership of the asset.

In the current economic climate it's been hard to sell assets to repay loans as cashed up investors have been sitting on their hands waiting to see how the economy developed and whether bargains were going to appear.

But the reality is in the past few years many of the projects and businesses that were funded would never have got off the ground had it not been for the global phenomenon of easy credit and low interest rates. It's now becoming apparent the majority of investment "opportunities" that are appearing now, fall into this category and are of no interest once the details are revealed.

Maybe it's the realisation of this, or simply New Zealanders finally returning to work after the summer break, but I'm now getting people phoning me with cash in their pockets looking for these types of opportunities in both property and business.

Most are looking for something they can be fully hands on and add value to – especially in the property sector. Others are happy to take more of a back seat – say for a business investment a position on the board.

There are no set rules. I've got people interested only in large ventures, only in property, or only in businesses. So if you've got an interesting project or business you can't finance and feel might suit this type of funding, email or call me on my mobile 021 902 004.

Cheers

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