8.3 Borrowing and leasing

- *What type of finance do you need?*
- *Sources of finance*
- *How much can I borrow?*
- *The loan proposal*
- *Lending requirements*

When your business needs finance it is important to plan your approach to potential lenders prior to making the appointment to present your application. The reason for this is that a well-prepared application will stand a much better chance of being successful.

Many businesses fail to plan for finance, or use the wrong finance options in their business (such as using an overdraft to buy new capital equipment). Planning for finance is important because it lowers the risk to the lender and allows you to ensure that as a business owner, you can adequately manage and appropriately utilise the finance you obtain. Make it work for your business, not against you! The key considerations should be:

- Can the business afford to make the principal and interest repayment on time every time?
- Has the bank enough security to recover the debt if the business cannot make the repayments?
- What is the track record of the business with lenders?

These will be the most important considerations from a lender's perspective, and especially the track record of the business. The business banking manager will look at the past relationship they (or other financial institutions) have had with your business and whether you have been able to keep on track with loans in the past. This will then determine to a large extent the confidence the lender can have in the financial projections you have made in your application.

What type of finance do you need?

Begin by determining the type of finance required. There are three main types:

- property finance
- working capital finance
- plant and equipment finance

As a general rule, short-term finance should be used to cover short-term assets and expenses such as stock, debtors or overheads; medium-term finance should be used to acquire medium-term assets such as plant, equipment, furniture and fittings, and motor vehicles; and long-term finance should be used to acquire long-term assets such as property.

Note that different borrowing facilities have different taxation consequences. The principal component of hire purchase payments is GST taxable, and leasing payments are wholly GST taxable. The structure of other loan facilities may affect the timing and amount of interest and depreciation deductions. You should check with your accountant.

Sources of finance

Once you have determined the product(s) you are looking for, the next step is to find out who has those products on the best terms. The major sources of finance are as follows:

- Major trading banks offer a full range of borrowing options.
- Merchant banks are focused mainly on large transactions.
- Finance companies offer a good range of commercial plant and equipment products and working capital facilities.
- Building societies, credit unions and friendly societies have a limited range of commercial products, but are competitive for personal lending.
- Your accountant may be able to arrange business finance on your behalf.
- Finance brokers will arrange finance for you on a commission basis. This type of finance has become very popular in recent years due to the emergence of mortgage originators, who now undertake about one-third of all property-linked lending in Australia.

How much can I borrow?

The amount you can borrow will depend on your borrowing track record, your ability to service the loan repayments, and the amount and quality of the assets and guarantees being offered as security.

Assets will score a higher lending valuation ration (LVR) if the bank can easily identify and sell them in the event of repayment default. The table will give you an approximate idea of the LVR attached to different asset classes by lenders.

Asset class	Lending valuation ratio (LVR)
Property	60-75%
Plant & equipment	20-100%
Debtors	20-75%
Stock	20-50%

The loan proposal

A lender will want to know in detail what you require finance for, as well as the terms and facilities you require. A lender will also want details of your business and industry, your legal structure, recent financial statements, and the security offered against the loan.

Lending requirements

This includes:

> the amount of the loan required, and the facility type

> the term of the loan

> what the loan will be used for

> who the money will be paid to at settlement

> where the repayment funds will come from—income streams from business growth, increasing sales revenue, greater production capacity or reduced costs

> the security offered for the loan—typically assets

> the current values of those assets, and details of any independent valuation

> details of any contract for the purchase with the loan funds of any plant and equipment, property or business, including the settlement date

Business details

This includes:

> a description of your business

> your history

> your products and services

> the major trends in your industry

> the location, size and potential growth of your market

> your major competitors, their location, size, capabilities, strengths and weaknesses

> an analysis of your relative competitive strength

> your assets and intellectual property

> the owners and other members of your management team, with an honest assessment of your strengths and weaknesses

> your key staff

> your key customers

> your key suppliers

> your legal structure, especially the borrowing entity, and your ACN (Australian Company Number) or ABN (Australian Business Number), together with supporting documents such as partnership agreements, company incorporation documents or trust deeds

> the names and financial position of the individuals who will provide personal guarantees for the loan

> your accountant, solicitor and current banker

Financial statements

This includes:

> financial statements for the last three years

> cash flow projections for the next twelve months

> details of current borrowings

Security offered

This includes any real estate, plant and equipment or other assets put up as security for the loan, and any personal guarantees offered.