What your banker will never tell you

UNDERSTANDING THE MINDSET OF BANKERS AND WHAT THEY CAN AND CAN'T DO IS CRUCIAL FOR DEVELOPERS SEEKING TO FINANCE ASSETS AND NEW PROJECTS, WRITES DEVELOPMENT FINANCE PARTNERS' CO-FOUNDER AND DIRECTOR **MATTHEW ROYAL.**

It's not often you have the opportunity to get inside the head of your banker (scary place, right?). But let me bravely take you there.

Although I've never been a fan of horror movies, in meetings with new clients I hear a new horror story every week. In most cases, scenarios follow a similar plot: the client is the innocent victim and their bank or banker is the evil villain. Of course, the story would be different if told from the banker's perspective!

I'd like to bring some balance to the story. As a property banker, investor and advisor, I understand the realities of life from each of these perspectives. Let's start with the banker. The first thing you need to know is the banker or the bank is not your friend or your joint-venture partner who shares risks and profits. Many of our new clients learn this the hard way even after many, many years of being loyal to one bank.

An inconvenient truth, as the film title so famously put it, is that borrowers often become very complacent – and probably a bit lazy – when it comes to one of most crucially important parts of their business: financing assets and new developments. Talk to seasoned property developers or investors, and even most experienced bankers, and they will tell you that banking relationships are fair-weather based. If it's fine and sunny, it's all smiles. However, if it's dark and stormy, the smiles quickly turn to tears.

SPREAD YOUR RISK

The old saying 'don't put all your eggs in one basket' is true when it comes to banking. Never, ever, ever have all your fixed assets, cash/savings, business trading accounts and transactional accounts with the one bank. There's an important reason for this. Once the bank has an 'all monies' position it can go into 'cash lock-up' mode on you (don't you love the terms bankers use?).

Speaking of banking lingo, it is important to understand that bankers have great incentives to secure what we call 'share of wallet'. That simply means they cross-sell as many products and secure as much of your total banking requirements as possible. This greatly increases the banker's loan portfolio profitability, reduces risk, decreases competition from other banks, gives them greater control over you and lets them monitor your overall liquidity. In short, you are at their mercy.

This is where it gets scary. Suppose there is an event which triggers a review of your facilities (whether it be a scheduled review or otherwise) and the bank determines you are outside of 'arrangements' or 'loan covenants'. It will then – depending on the breach – do one or some of the following:

- ask you to reduce your facility limits with them
- apply the cash you have on deposit to debt reduction

- freeze your trading accounts and credit cards
- apply net free cash in your rental proceeds accounts to debt reduction
- request that you refinance, increase your interest rate margins or apply a default rate
- charge you additional fees
- instruct very expensive specialist due diligence reports
- apply 100 per cent of net sale proceeds of stock/assets to debt reduction
- formally cross-securitise all your assets
- apply caveats to your personal assets over which they do not have security, courtesy of rights afforded to them per your personal guarantees
- withdraw all finance approvals yet to be drawn down
- encourage or force you to dramatically reduce your overheads, including staff
- withdraw any undrawn loan approvals.

Property developers are likely to be put in a position where they have to sell down their most liquid profitable assets – at values less than market to quickly reduce debt, thereby rapidly eroding their net equity and ability to reduce debt through their core business over the medium term. You can imagine the flow-on effects to the rest of your business, projects, forward cash-flow and ability to deliver your development pipeline!

HEED THE WARNINGS

Once things start going bad it can be a very slippery slope to ruin. You might say “that will never to happen to me”, but I am here to tell you that most borrowers who have suffered such a fate never believed that it would happen to them either.

Don’t say you were never warned. I have had clients who had forced on them every one of the above recovery actions. These clients are understandably very frustrated and angry, and cannot begin to understand why their bank is acting so unreasonably and uncommercially – potentially even creating heavy losses for itself!

Unfortunately, for borrowers and their often-frustrated bankers, the banks’ modern-day post-global financial crisis loans management policies are highly automated and robotic. The days of old-school relationship banking are long gone. The banks’ computerised credit risk grading models reduce your credit worthiness down to standardised numeric ratings, which largely decide your future with a bank. As a result, the influence and discretionary decision-making authority of our local banking relationship manager has been largely reduced to zero.

With rare exceptions, your banker is authorised to approve virtually nothing and say no to virtually everything. If you don’t believe me, ask your banker whether they would agree with that statement or not. So, more often than not, the banker is really not the evil villain in the story, after all. They are simply forced to work within the boundaries of the bank’s lending guidelines and loans management policy.

Fortunately, there is some good news. The way that bankers and their approving credit managers choose to apply their bank’s lending guidelines and loans management policy is highly negotiable under the right circumstances.

So what are those circumstances, I hear you say? Read on to discover how DFP negotiates positive outcomes and realigns the interests of all stakeholders.

HOW DEVELOPMENT FINANCE PARTNERS CAN HELP

You now have a better understanding of bankers. They may not be evil villains, but they are not your friend either. So under which circumstances will a bank/banker consider negotiating favourable outcomes with a customer whose credit position is deemed to have deteriorated and needs to be exited from the bank? More importantly, how does the poor helpless victim (i.e. the customer/borrower/guarantor) effectively communicate their position, needs, objectives, concerns and what support they require?

You will note I have referred separately to the banker and the bank at which he or she is employed; there is good reason for this. It is important to make this distinction because we are not negotiating and communicating with a faceless institution. We are dealing with different personality types and authority levels, all with varying individual agendas and objectives.

Having had the benefit of several years of experience working as a manager within a property finance unit of a bank and other major financial institutions, I understand the absolute importance of knowing how to manage different personalities within a bank (not to mention the internal politics at play!).

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Like all things in life, you can't go wrong if you focus on getting the basic principles right. While every situation is different, at DFP we adopt a similar approach when developing a workout strategy and negotiating favourable outcomes for our clients with their bankers and banks. Following are the key actions.

1. Confessional time

The first step in the process is what we like to call confessional time. This is where we spend as much time as necessary drawing out the good, the bad and the ugly. Sometimes this is called discovery, diagnosis or due diligence. Regardless of what you call it, it is vital that we obtain full disclosure of all of the facts of the background events leading up to the current less-than-perfect state of affairs.

We often find that our clients are presenting as battle weary after years of GFC-induced stress and pressure. Their decision-making is usually highly reactive and focused on trying to put out one fire after the next. There is no clear strategy other than survival. The quality of decisions made in this environment is, as you can imagine, less than perfect and likely to lead to the client taking progressively higher risks to try to recover their position.

2. Developing an agreed strategy and objectives

Having established a detailed understanding of what we are working with – and putting aside all emotion, biases, conspiracy theories, blame and emotional baggage – we can get on with focusing on the client's real objectives. The aim is to advise them of what is achievable and what is required to reach that agreed set of objectives.

The most critical element of any successful workout strategy is to ensure the interests of all key stakeholders are thoroughly considered and aligned towards the successful attainment of the agreed objectives. Once we have established an achievable set of objectives and strategy, especially after a sustained period of operating in survival mode, our clients often gain a renewed sense of determination and focus.

3. Turning plans into reality

Working backwards from the agreed set of objectives, we work with the client to allocate the various sub-projects and tasks, and set a budget and timeline. This forms the basis of an accountable framework upon which we can report to various stakeholders, including the bank/s, shareholders, directors and other creditors.

An essential element of any workout is to develop a strategy which achieves the objectives of all stakeholders in order to achieve an overall greatly improved position for our client. The trick is to understand the real objectives of your banker/bank. Depending on the depth and extent of the borrower's credit impairment, the banker/bank's

objectives may be more different than you understand. For example, the banker/bank's objectives, if we are dealing with mild to moderate interest arrears, are very different than those of the borrower who has a mild to moderate LVR default on an expired loan which has failed to sell despite genuine efforts to do so.

Communicating the agreed strategy and seeking the required support from the key stakeholders within the context of the abovementioned accountable framework is the next critical step towards success. An important safety warning is required at this point! Prepare, prepare, prepare ... and deliver.

A common source of frustration for a banker is when their client promises certain things will happen and they do not eventuate. Such a scenario quickly erodes the relationship and, in many cases, this has already happened a number of times prior to DFP being engaged. In the post-GFC world, this type of frustration has become a daily occurrence which has resulted in bankers and their credit managers becoming increasingly sceptical. So the presentation of any workout strategy must be heavily evidence-based in order for it to be credible, bankable, supportable and defensible.

Why is reasonable evidence so important to your banker and his or her credit manager? Well, simply put, by providing reasonable evidence to support the basis of our workout strategy (requests), we are providing our clients' banker/s (whose careers and credibility are at stake) with the confidence they need to justify and defend their decision to support our proposal.

Apart from being evidence-based, the key elements of a workout proposal must be:

- realistic
- transparent
- milestone-driven
- confidence-delivering, with the deliverable track record of the project control group providing stakeholders with the confidence that they are capable of successfully completing each of the tasks
- heavily success driven and highly accountable in the engagement of the project control group
- rigorous, containing regular reporting intervals tracking actuals to forecasts
- presented and negotiated by a suitably qualified professional adviser such as DFP
- based on conservative high and low forecasts.

It has been my experience that regular, no-nonsense, transparent and independent reporting builds valuable goodwill, relationships, trust and ongoing co-operation with the banker/bank. The process of a workout is often a fluid and dynamic process resulting in the need for minor variations and the agreed objectives to be reasonably renegotiated with the banker/bank.

The elements I've described will support this process to occur all the way until the final settlement of the matter has been resolved. By adopting this pragmatic and disciplined approach to debt workouts, DFP has added tremendous value to our clients and their banks. Practically, this approach has been used to great effect as can be seen in the following case study - http://www.dfpartners.com.au/medowie-woolworths/

Please feel free to contact me at mroyal@dfpartners.com.au or any of the DFP team members http://www.dfpartners.com.au/team/ if you would like to discuss our debt advisory workout service in more detail. And, remember, we have the experience to know what your banker will never tell you. ●

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DEVELOPMENT FINANCE PARTNERS is Australia's leading industry expert in funding and partnering property developments, providing a complete end-to-end solution. DFP has a unique combination of specialist knowledge and practical experience, with the directors collectively facilitating more than $1 billion in funding packages.