Should Australian businesses start worrying now about the cost of debt?

There has been a lot of discussion recently about an impending increase in the cost of debt for Australian individuals and businesses.

Both monetary (low interest rates) and fiscal (recently passed tax cuts) policies in recent years have been designed to encourage spending. These strategies were introduced to keep the economy ticking over during the period of transition away from the resources boom. They have also resulted in record levels of household debt and the well-publicised property boom particularly in the eastern seaboard cities.

But what happens when the economy experiences a significant rise in the cost of debt? Are Australian policy makers ready for the impact? Will tightly leveraged businesses find themselves on the brink of insolvency? What's the likely impact on the Australian economy and consumer spending?

Cost and availability of debt

It's been widely reported that more stringent bank lending regulations are likely to impact the lending practices of the major banks. Some of the issues raised include:

- Will LVR's become tighter?
- Will bank credit departments take a more rigid and risk-averse position when assessing loan applications?
- Will lending rates increase as a result of new risk assessment criteria?
- Will the number of approved new loan applications decline?

Another consideration is how the major banks will compete for capital in circumstances where the US economy is showing signs of long-term improvement and the Fed is lifting interest rates. Will international capital flood back to the US making it less available for the Australian banks to secure?

We're already seeing the emergence of second and third tier banks and other non-bank lenders in the market. The traditional domain of such lenders is "riskier" or less secure loans, which the majors can't fund. But with higher risk comes higher rates of interest. In some of our recent assignments, we've come across non-bank lenders with effective rates of interest in excess of 40% p.a. Unfortunately for the business community, these are becoming more common.

Interest-only loans converting to Principal and Interest

Along with the property boom came a burgeoning property investor market. A lot of property investors took up interest-only loans to minimise cash flow drains on their negatively-geared property investments. These interest-only facilities have a limited term and convert to principal and interest at their expiry.

It's expected that $360 billion of loans will convert over the next 3 years. With the well-publicised low wages growth, it would seem that the only way for households to continue their current spending habits is to either sell their investment and payout their loans or borrow more.

Australian businesses should prepare now for a cost of debt increase and changing consumer spending

Compared to household debt, business lending rates are low. But where businesses are supported by a significant level of debt, it's important that management prepare for an increase in debt costs to avoid any negative impact on their operations.

Furthermore, not only should businesses carefully consider the impacts on their cost of borrowing, they should also prepare for the effect on their revenues if consumer habits change. Industries such as retail, tourism, luxury goods and hospitality are particularly at risk.

The biggest danger here is that while the Government and RBA use various monetary and fiscal policies to maintain steady growth in our economy, the banking regulatory framework and international market conditions may very well dictate the cost of borrowing in Australia despite the policies implemented.

The cost of debt may increase sooner than the Australia policy makers and economy are ready for, which means we as an economy, will not be prepared for the outcome.

How BRI Ferrier can help

We can assess your current situation and advise on a path forward to minimise further risk.

Early intervention is often the key for a successful restructure of your business. BRI Ferrier will develop and implement a restructuring strategy that is in the best interest of all stakeholders.

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Our broad experience and industry resources equips us to assist in the most complex situations. Contact us to find out how we can support you.

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