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The Pitfalls of Refinancing Your Business

Most business owners and managers don't actively look to refinance their business. Changing lenders takes a significant amount of time and money. And unless the rates charged by a new lender are considerably lower, the costs to change are usually greater than the savings realized through cheaper borrowing rates.

Yet in most cases, managers have little choice. Their current lender has issues with the loan and informs the customer that it may be in the company's best interest to find another lender. This could be due to a number of reasons:

1. The company is losing money;

2. The company has violated one or more of its covenants under its lending agreement;

3. Due to changing economic conditions, the lender has determined that the industry the company is in has become a "high risk" industry with a greater risk of business failure; or

4. Similar to 3, the lender determines its loan portfolio is concentrated heavily in the customer's industry and so in order to diversify its risk profile, it needs to terminate some loan agreements in that industry.

A lender may not explicitly tell a customer that they want them to leave. There are many telltale signs that a lender may wish to terminate a loan agreement. These include:

1. A revision or renewal of the current loan agreement on a short term basis and with it, the requisite renewal fee;

2. Reducing the amount a customer can borrow through stricter margin requirements;

3. An increase in the interest rates and fees on the loans involved; or

4. An increase in the reporting (for example from monthly to weekly) with respect to the margin requirements or (from quarterly to monthly) with respect to the covenant requirements.

Eventually, if the customer doesn't get the message, the lender may move the loan into its "special loans" division. An outside consultant may be retained on behalf of the lender (but at the customer's expense) to assist in the monitoring process.

Once a loan is in special loans, the lender may determine that not enough progress is being made on refinancing. It may then demand repayment of the loan. For operating loans which are demand in nature, this means the lender is usually within its rights to demand repayment of the loan within 10 days of mailing of a registered letter. For other types of loans, the time period for repayment may be greater and will depend on the terms and conditions set out in the loan agreement. Nevertheless if the notice period expires without repayment, the lender usually has the right to appoint a receiver and either:

1. Assume control of the business and sell the business and its assets as a going concern; or

2. Suspend operations and liquidate the assets.

The objective of course is to avoid special loan situations because not only do they take up a lot of management's time but they can also be expensive. It's a catch-22 because these are usually the situations where management can least afford to be spending their time on areas other than managing their business. Yet if they don't deal with the financing issues at hand, they may not have a business to manage.

It is circumstances like these when an outside advisor can add a great deal of value. Given their expertise in similar situations, the right advisor can inform managers of the rights they have under the loan agreement. They can act as the communicator with the lender, informing the lender of the progress the company is making in obtaining new financing and steps taken on the operational side of things to improve company performance.

Most advisors should endeavour to provide a win-win solution for both parties involved. Lenders don't want a situation where a receiver is engaged to realize on its security. Loan proceeds are always less in these situations versus when a company can refinance on its own. And in the latter case, the company's goodwill and reputation remains untarnished, providing it a greater chance to succeed in its turnaround strategy.

Most importantly, an effective advisor can assess the business and determine what alternative sources of financing are right for the company. Perhaps circumstances have changed and the business no longer qualifies for a standard Schedule A Bank Loan. An advisor can save managers a lot of time and energy determining what type of financing the company is qualified for and which lenders would be a perfect fit.

Aries Advisory Group Ltd. has a great deal of experience in "lender fatigue", loan refinancing and special loan situations. Please review our website at www.ariesag.com and contact us at info@ariesag.com to see how we can help you should one of these situations arise in your company. Time is the most valuable resource a manager has. Let us manage the lender and refinancing process for you so you can spend your time where it should be spent – on managing your business.