ARRANGING BORROWING FACILITIES

ARE YOU THINKING OF ARRANGING NEW BORROWING FACILITIES OR NEED TO RENEW EXISTING ONES? **DOMINIC BENNETT** OF CHRISTIES GOES OVER THE PROCEDURES YOU NEED TO FOLLOW.

Sooner or later, a treasurer gets involved in arranging new borrowing facilities or renewing existing facilities that are expiring. Many treasurers will either have never been through the process before or perhaps have been involved only in a junior role in negotiating facilities in the distant past. The purpose of this article is to pass on some practical experience gained in renewing borrowing facilities over the past few months. Since both your business and the financial markets are constantly evolving, it is worthwhile going back to some basic questions when looking at renewing or setting up facilities.

WHAT LEVEL OF FACILITIES DO I NEED? Assuming there is no doubt that you do wish to establish some facilities, your first question might be, how much? If you already have facilities, do you simply need to renew the same amount, do you need to increase them or could you reduce them? To answer these questions you will naturally look at past usage and future plans. Clearly, such forecasts as cashflow projections and business plans will indicate what your expected funding needs might be over the next few years. These should be used as a guide to the absolute minimum level of facilities you should be considering, you should then add a safety margin of additional facilities to provide headroom to cover unexpected developments. Past usage should also be looked at as it may reveal seasonal peaks of borrowing that could affect how you tailor the facilities. On the other hand, you might find that, historically, your company has used only a very small percentage of its available facilities. In this case, it could be difficult to persuade your banks to renew facilities that are under-utilised and your Board to pay the resulting facility and commitment fees.

HOW LONG DO I NEED FACILITIES TO BE IN PLACE? Traditionally, committed facilities have tended to be long term, with five years being a common period. The treasurer should, however, be prepared to consider a much shorter period if there are strategic reasons for doing so. For example, you might consider current margins to be historically high and expect them to reduce in a couple of years time. In this case, you would want to keep the facility relatively short in the expectation that margins will be lower when the facility is due for its next renewal. Similarly, if the company had recently experienced poor trading results, it would not want to bear the cost of these in terms of a high margin for more than a couple of years. Again, the best strategy might be to arrange a facility for a relatively short period such as two years, in the expectation that when the facility is renewed the company is able to demonstrate stronger financial performance and benefit from it with a finer margin.

If issues like these are not a consideration, most treasurers are likely to seek longer term facilities – typically in the five to seven years range – so that they have the comfort of knowing the funds are available and to minimise the time and cost involved in future years in renewing the facilities. You should aim to spread the maturity of facilities so only a small proportion mature in any one year. This helps to even out the effects of fluctuations in margin levels from year to year and to limit the risk of being unable to raise the required funding if the markets or the company hit a bad patch.

HOW DO I WANT MY FACILITIES STRUCTURED? The structuring of your facilities as bilateral, syndicated or club is likely to be influenced by what facilities you already have and your existing banking relationships. Bilateral facilities arguably result in stronger relationships with the individual banks, as you will negotiate with and borrow from each bank directly. On the other hand, setting up and maintaining a series of bilateral facilities is more time-consuming than managing a syndicated or club arrangement. You might find it is easier to raise the facilities you require through syndication, as the status of the lead bank will be instrumental in encouraging other banks to join the syndicate. One drawback of a syndicated loan is that you may have little or no control over who is a syndicate member and whether the members can sell or transfer their portion of the loan. A club arrangement can help here, as it restricts the rights of banks to sell or transfer their part of the loan.

Two other issues can be considered under this heading:

- **Whether the facilities are committed, uncommitted or a mix of the two.** Generally, treasurers take the prudent view that the

bulk of their facilities should be committed so that they are definitely available when needed. The cost of this assurance is, of course, the commitment fee that is payable.
- **How the funds can be drawn, for example, by way of money market borrowings and/or bills.** In practice, most companies are able to borrow by both means and treasurers should be aware of the advantages and disadvantages of each form of borrowing. Money market borrowings require shorter notice and can be more flexible in terms of amount. Bill discounting is usually cheaper but is less flexible, in that you are normally required to give notice on the day before the utilisation date and that sufficient bills have to be lodged with the bank. In addition, there may be a minimum face value for each bill, which will affect the exact amounts that can be borrowed in this way.

It is standard practice to be able to borrow by means of money market drawings in sterling, dollars, euro, and any other currency freely convertible and transferable into sterling.

PRICING. Pricing is dependent upon market conditions at the time of setting up the facility and also on the credit status of the borrower, which may have changed since the last facility was arranged. As a result, it is difficult to be definitive about pricing in the current environment, except to say that margins are higher now than five years ago and a borrower looking to renew an expiring five-year facility can expect margins to be at least double the previous level. Commitment fees are typically half of the margin and are calculated on the undrawn portion of the facility on a daily basis and charged every three-months. You can also expect to pay 0.10% of the facility amount as a facility fee on signing.

COVENANTS. Covenants are designed to protect the banks and to ensure they obtain key financial information through the compliance reporting process. There are a number of standard covenants that are commonly found in loan documentation, relating, for example, to the borrower not granting security over its assets to third parties ('negative pledge'), promptly notifying the bank of the occurrence of any event of default and providing financial statements within a given time period after the period end.

Other covenants may be tailored more specifically to the company and can give scope for negotiation with the bank. Typically, these are financial covenants relating to maintaining a stated minimum level of consolidated net tangible worth, ensuring that consolidated net borrowings do not exceed a specified percentage of net worth and that consolidated profits before interest and tax are equal to or exceed a given multiple of consolidated net finance charges ('interest cover').

It is essential that the company recognises the underlying risks both in its business and in the markets that could impact on its ability to comply with these financial covenants. For example, could net worth be significantly reduced as a result of adverse exchange rate movements affecting the exposed foreign currency denominated net assets in the balance sheet? Or could a rise in interest rates push the cost of floating rate long-term debt up to the point where the interest cover covenant could be breached? One benefit of negotiating such financial covenants is that it focuses attention on these risks and the actions necessary to manage them.

MANAGING THE PROCESS. The primary relationship the company has with the bank is through the relationship officer. The more the firm can do to provide the relationship officer with relevant information about itself, the easier will be the process of establishing or renewing borrowing facilities. To this end, it is helpful to prepare an information pack that can be presented to the relationship officer, and which can subsequently be used within the bank in proposing a new facility to the bank's credit committee. The information pack should include information about the company, for example:

- actual profit and loss information for the past two years and projections for the proposed period of the facility;
- balance sheet and cashflow information for the same periods;
- assumptions on which these financial projections are based;
- a copy of the most recent audited financial statements;
- where the relationship is new, group structure and organisation charts;
- information about any significant strategic changes in the group, such as acquisitions, divestments, factory closures, capital expenditure or new products;
- any outstanding or potential litigation; and
- other relevant information, such as cost reduction programmes or redundancy schemes.

The pack should also include details of the facility the company wishes to establish. This is usually set out in a term sheet defining the outline terms and conditions for the proposed facility. Most treasurers will wish to ensure that these terms and conditions are the same for all their facilities, as variations usually involve additional time and expense in terms of legal fees, negotiation, monitoring and covenant compliance and reporting.

The banks, for their part, normally prefer to be on the same footing as other banks so that they are not disadvantaged from the point of view of security or competitiveness. A well-prepared and presented information pack will smooth the process of getting the facility approved.

Two other aspects to the process should also be considered:

- Do you need external advisers to help with preparing the information pack and bank negotiations? The treasurer who has little or no experience of setting up facilities, or who has resource constraints, may wish to employ advisers who have a wide knowledge of the current market, the banks' information requirements, pricing and so on. A little bit of money spent on advice can be amply repaid if it results in finer pricing on a five-year facility.
- Do you need to use external lawyers to draft and review loan documentation and manage the process of getting board resolutions passed by the borrower and guarantor group companies, or can this be done by your in-house lawyers?

Establishing and renewing borrowing facilities can be a time-consuming and challenging process that is made easier by advance planning and well chosen advice. Whatever approach you take, your ultimate goal is to obtain the facilities you need, at a reasonable price and with acceptable covenants. The satisfaction comes from successfully achieving all three.

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