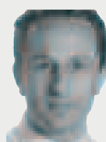
Ask the experts: How low can you go?

Many companies have been refinancing recently. Is this the moment to refinance? How cheap can rates go? What is the optimum term? What does 'cheap' mean for your long-term relationship and does history have any lessons?



Matthew Hurn, Group Treasurer, Dixons Group plc

Banks have been telling corporates "there has never been such a good time to raise finance" for the past two years though margins have continued to fall.

Interestingly at the moment, bank debt is extremely cheap compared to current CDs levels as banks look for assets and in many cases participate in facilities with larger amounts hoping to leverage further auxiliary business.

While rates may fall further, the risk of rates rising must outweigh the potential benefits that they may fall further.

The big question for me is what will drive rates higher and how quickly will they rise? In other words how can I protect myself from the event risk?

Whilst a large corporate failure is not obviously pending, the pain of lower margins is already being felt among smaller banks with some temporarily exiting the lending market or London altogether.

My concern would be whether this ultimately bodes well for corporates and leads to the classic debate of transactional versus relationship banking. Banks exiting the marketplace might limit the total coverage and specialisms that multinationals require in some of the foreign operations.

Those advocates of transaction banking may think they have never had it so good but how long can it last? Offering the CFO large reductions in funding costs may win you friends but the next time you need to refinance in five years time, you may be the bearer of bad news. Personally, I want my banks to achieve an acceptable return on equity to ensure that they will then be willing to put their balance sheets up for any potential large funded M&A deal.

Refinancing now does make sense and where there is money on the table my advice would be to take it though maybe not all of it. The old adage "there is no such thing as a free lunch" may hold truer now than in the past. Treasurers, who write 'large cheques' in respect of bank fees, will now need to make sure they are splitting those fees and feeding the hungry mouths appropriately.

Those corporates not ready to refinance should certainly consider hedging the re-financing risk but maybe that's another question?

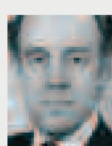
The view from the banker
Francis Burkitt, Managing Director, Corporate Finance, Cazenove

I'm advising my clients – corporate borrowers – that we are probably at the bottom of the market, so that if they are at all inclined to refinance, they should get on with it. Having said that, I don't think that margins will rise in the first half of this year, and probably not in the second either. It's just that because I don't think margins have further to fall, I see no reason in delaying a refinancing.

Other relevant aspects include commitment fees, which on 5-year deals seem to have settled at 35-40% of the margin; repeating MAC clauses, which any borrower with a CP programme should be able to remove; and financial covenants, which seem to have relaxed less than margins have, but where some movement still seems possible.

A final aspect is the accounting treatment of the front-end fees on the existing facility that is being replaced. If these are being amortised, they may have to be expensed when the new deal is signed, or perhaps the amortisation can continue.

This partly depends on whether new money is being raised, or whether there is just a change in the terms. Some companies aim for a particular treatment, and others are indifferent, but this point is worth watching out for.



Arthur Burgess, former treasurer British Gas and a member of the ACT Editorial and Publications Committee

Some three thousand years ago the author of Ecclesiastes, probably an old man, wrote that 'what has been will be again, what has been done will be done again; there is nothing new under the sun.' Those of us who were tasked with arranging funding a decade or two ago are finding the current situation rather familiar.

In the late 1980s the London market benefited from a flood of Japanese bank liquidity which drove spreads to unprecedentedly low levels. I was in the privileged position of being able to pick and choose from an almost limitless array of banks whose head offices far away regarded a triple-A company with the word 'British' in its title as effectively government risk even if they were privatised.

In a world of virtually unending would-be lenders and not actually needing to borrow at all, it became a question of expectation management. Recognition of the need for local lending officers to show their superiors some return while not paying for unnecessary facilities meant explaining that while grateful for their support, the time was not yet quite ripe - a delicate path to tread. It is not very exciting to be seen as one of the hundred-odd closest relationship banks. Yet we knew that we would eventually see days when such facilities would be required.

When the economic miracle in Japan ran into choppy waters at the end of the 1980s and the early '90s the surplus liquidity in London dried up and the market corrected. There was also a reduction in the banks' capital base due to the huge increases in loan provision. The introduction of BIS capital adequacy requirements at the same time obliged the banks to review their approach to lending and sharply curtail the least profitable activities. This reduced the potential pool of resources available for lending with the greatest impact being on uncommitted lines. Spreads tightened dramatically.

Shrewd treasurers should recognise that 'the best is the enemy of the good' and decide at what level they would be comfortable in defending their decision and tie up the key banks they want to have in their financing group. Account officers will have the kudos of getting their deals done, even if not at the rate they would like; corporates will have the comfort of committed financing on acceptable terms. Don't expect that a change will necessarily be incremental – rates could fall off a cliff.