Declining property values put cash flow at risk

Mark Fenton-Jones

Financiers are warning small businesses to look for alternative sources of cash funding if declines in property values cause cash flow to dry up.

Many small businesses secure loans against property, but a waning property market could put them at risk. Owners, particularly of start-ups, often secure finance using the value of their homes, but the tepid sector may cost businesses vital funding.

National auction clearance rates are not available, but state snapshots give an indication of market conditions. According to the Real Estate Institute of Victoria, for the fifth weekend in a row, demand was subdued at auctions in Melbourne last weekend. The clearance rate was 59 per cent from the 829 auctions reported last weekend, compared with the same weekend last year, where 990 auctions were held and 72 per cent cleared.

"The slowdown in the property market will affect business cash flow if a loan is secured by a property's value," says Rob Lamers, chief executive of Oxford Funding, a subsidiary of Bendigo and Adelaide Bank. "Now that auction clearance rates have dropped, a property may undergo a revaluation that results in reduced credit."

A property previously valued at $1 million would typically attract 80 per cent funding credit, which means the business could borrow $800,000. A revaluation of that property to $900,000 would mean a business could borrow $720,000, a significant reduction of $80,000.

Such reductions in cash flow can have a big impact on daily business, as Best Management Group chairman David Catterall has noticed over the past three years.

Catterall, whose private management company specialises in hotels and resorts, says cash-flow pressures can halt spending on plant and equipment, followed by repairs and maintenance.

"Inventories are run down. Staff training and travel gets canned. Then the more desperate practices emerge: getting staff to bring their own tools or computers to work, deferring payments to suppliers and staff, disputing payments or having a go at legal action on an old outstanding matter, however flimsy."

Alternative forms of financing have been heavily promoted in recent years.

Lamers, whose company provides factoring and invoice discounting services, says securing loans against property may not be the most appropriate long-term solution, as credit will not increase as the business grows.

Restricted bank lending has also lifted business for fellow factoring service Bibby Financial Services.

It says half its clients are new to debtor finance as they seek other forms of lending to deal with rising interest rates and withdrawal of the government's stimulus support.

The big banks say they have not seen any major deterioration in the amounts small businesses can borrow caused by lower property values. But banks say they also focus on a credit facility supported by cash flow, not solely the property value, when making a decision to lend.

Australian Financial Review Sat 4 June 2011