

Changes to Bank Credit Facility Terms: Company Considerations

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Whilst many customers of the banks have been in a position to negotiate the commercial terms with their bank manager directly over the years it is increasingly the case that certain key legal terms of the loan documents are being amended as a matter of course.

In this note we are aiming to give you a brief explanation of the key changes being made to terms of loan agreements.

Cost of funds

As a consequence of well publicised difficulties in the wholesale funding market (by which banks lend to each other), the cost of providing a loan has risen for most banks. This was often reflected in a customer's loan agreement by reference to the lender's base rate, on top of which a borrower obviously is charged a margin. In response to this increased cost, lenders are seeking to move many facilities from a base rate method of calculating interest to the LIBOR ("London Inter Bank Offered Rate") method. This requires quite a number of largely mechanical changes to existing agreements, which assuming the commercial principle is accepted, should be largely non contentious. The LIBOR method of calculating interest does however bring with it a slightly less flexible regime and borrowers should ensure they are clear as to what these will entail and that their anticipated operating of the facilities will be able to accommodate this different regime.

Margin

In very simple terms the credit crunch has reduced the amount of money lenders have to lend. If a lender has less money to lend and there is greater appetite for its loans, the return it will look to make will increase, hence the strong likelihood that when extending or renegotiating existing facilities, a lender will be looking for an increase in

its margin. As has always been the case, this is squarely a matter for negotiation.

Valuations

In a rising market, a clause which was commonly not focused on is the ability of a lender to initiate an investigation or instruct the preparation of a report (eg. a valuation) to ascertain the financial position of the borrower. As the property market has decreased, it is increasingly the case that lenders are utilising their right to revalue the assets secured to them. This is a cost which is usually borne by the borrower.

A borrower may want to consider the possibility of discussing with a lender the prospect of restricting this ability to ensure that the cost of a valuation (or report) would only be for the borrower's account where an event of default (or other breach of the terms of the loan agreement) has occurred or indeed that the valuation or report proves that it has occurred.

Summary

The banking market has certainly been through a traumatic period. One clear consequence is that, certainly in the short to medium term, the cost of borrowing is going to increase. When considering funding options, a borrower, as has always been the case, needs to consider both what the cost of borrowing is and what is the likely relationship going to be with individual lenders. Certain changes, such as the likely switch to the LIBOR method of calculating interest are quite possibly not going to be negotiable for some time, the margin being charged still should be.

Should you require further information or would like to discuss any of the matters raised in this note please do not hesitate to contact a member of the Burness banking team.

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