TONY'S VIEW COVID-19 #6 SUPPLEMENT

Input to your Strategy for Adapting to Challenges

Feel free to pass on to friends and clients wanting independent economic commentary

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My Aim

To help Kiwis make better decisions for their businesses, investments, home purchases, and people by writing about the economy in an easy to understand manner.

At the Coalface – Banking

Last Wednesday I sent a survey request to 100 bankers and financiers on my subscription list and received 33 well written, detailed descriptions of how banks and non-bank lenders are handling the current Covid-19 crisis, and early assessments of lending rule changes. In contrast with real estate agents in last week's survey noting low levels of activity, bankers are being run off their feet. Staff are working long hours directly assisting clients or supporting those staff who do. Most systems seem up to handling the rush of client enquiries regarding mortgage deferrals and special three-year business finance.

Bank liquidity and funding are viewed as excellent. But both household and business customers are having to be educated that the government's special assistance packages are not free and interest still accrues. There are some particular business sectors seen as under, or set to come under, trying periods with regard to additional debt availability and sustainability of current debt – largely accommodation, hospitality, retail property, property development, and farming (reflecting a continuation of banks for two years reducing their agricultural sector exposures, especially dairy.)

Businesses

Banks have taken supporting existing clients as their number one priority and pulled back to varying degrees on willingness to consider and accept new-to-bank clients and new funding requests from existing clients outside the Business Finance Guarantee Scheme (BFGS). Existing financing discussions with commercial property customers have been placed on hold in light of rental income flow interruptions and worsened tenant outlooks. Banks now have little to no appetite for new property developments.

They want clients to make contact to discuss financing options and rearrangements earlier rather than later when the mindset will have shifted away from all hands to the pump helping those in need to handling the fallout from the recession.

Very high authority has been given to staff to shift repayments to interest-only with quick turnaround on such requests.

Businesses are being asked to project cash flows over the next 60 days of most intense weakness, then think what they will look like after that and project again with a focus on preserving cash and calculating debt serviceability. Businesses are making immediate decisions regarding laying people off and slashing other expenses at a speed never seen before. But banks are advising them to act with integrity and continue paying suppliers in a timely manner.

Businesses are being told they can't now make income projections for the coming year based on their returns over 2018 and 2019 as the economic circumstances have changed too radically. Banks have not it seems changed their debt servicing metrics. It is more currently that business customers do not have the liquidity needed to support a normal attitude toward borrowing and servicing.

Most businesses are choosing not to apply to access the BFGS if they don't seriously need the money at the moment, preferring to wait until the lockdown ends and they can start to get a better feel for what the new "normal" will be for the coming 12-18 months. For those that are, their bankers are suggesting they treat the funds as working capital taken on with a view to helping finance their restart pending the recovery of normal debtor collections. Some firms are accelerating efficiency agendas with increased take-up of self-service channels and platforms, and regrets they did not do it sooner as the benefits are accruing very rapidly. Some banks suggest when you call to discuss going forward, to have your accountant on the call as well.

Accommodation, hospitality, and retail property are the sectors banks largely consider of highest credit risk currently, but with concerns also evident about property development with regards to falling asset values, capital needing to be injected to lower debt ratios, and end-buyer demand dropping off hitting residential property developments in particular.

Banks are concerned about more rural loans. For the past two years banks have been retreating from rural lending, looking to cut risks and starting to have deeper conversations with many farmers regarding sustainable debt levels. Now the drought, shipping, and meat processing interruptions are layering more pressures on top. Expectations are firm that banks will be writing off more farm sector debt over the coming couple of years than anticipated and that appetite for fresh lending will decline again. (Ed. note. Therefore, if our primary sector is going to lead us out of recession it may need fresh investor capital to do so.)

The motor vehicle finance sector traditionally suffers badly during a recession, and the intensity of this period of economic weakness is expected to prove very challenging for lenders with large exposures to this sector. In fact, all asset-based finance businesses (heavy machinery, trucks etc.) are expected to go through a trying period as cash flows dry up at the same time as asset-backing of loans worsens. This has happened to this sector many times before.

No lender is willing to advance funds to a business if they believe that such action would simply delay the inevitable. In other words, rejection of a funding request can be confirmation to a business that they are not viewed as viable on an ongoing basis in their current form. Once made aware of the stringent conditions of the BFGS many businesses are backing off pursuing debt assistance through that vehicle.

Bankers anticipate that once businesses and householders in need have decided to make use of the assistance schemes, six months from now tougher decisions will need to be made regarding business and mortgage viability in light of income losses. Many clients are expected to face big structural challenges down the track and working through these will occupy considerable bank resources between 6-18 months' time. Throughout and after that period a general tightening of lending criteria compared with recent years is anticipated. But respondents stressed that banks do remain open for business with good funding in place.

Mortgages

Most banks aren't accepting mortgage applications with less than 20% deposit, and for calculating debt-servicing ability current virus-constrained income levels are being used, not expected income levels in the future when things are expected to be better. In some cases, anticipated bonuses, overtime, commissions are not being considered for income projection and therefore debt-servicing ability purposes. In other words, ability to get a mortgage has been cut for anyone out of work clearly, but also anyone experiencing an income drop or reliant on other than base wages and salaries.

Although the newspapers have highlighted high numbers of people taking mortgage holidays, most people making enquiries decide not to make a deferral when they realise interest will still accrue. Many thought the government was going to pay their mortgage for them. Similarly, many businesses are not making use of the BFGS once they realise the 80% guarantee from the government is given to the bank, not the borrower, and obligation to repay does not shift.

Non-bank mortgage providers are seeing an increased number of new clients who have had promised but not written down finance from a bank withdrawn. But actual mortgage preapprovals are being honoured.

Many property owners working with their brokers are seeking some mortgage deferral, most going to interest-only once they understand that what is on offer is a mortgage deferral, not a cost-free holiday. Banks are processing interest-only changes quickly, but full mortgage deferral applications are taking longer. Applications for new finance have largely dried up. Some banks are offering only three months deferral with a review in three months.

Banks lacked loan application processing staff before the virus shock and lockdown and still appear to lack sufficient staff to handle enquiries. That may explain why banks no longer appear to have interest in refinancing mortgages from other banks at the moment. It's just not a priority.

Some banks have straight out stated to brokers that they are taking no new clients at the moment. Not all however.

An extra pushback by banks is being made on minimum deposit sizes for investment apartment purchases, changing in some cases from 30% deposit to a minimum 45%.

Mortgagors are wary of taking repayment holidays because of the extra interest which will accrue and because some banks are not extending the mortgage term but instead raising planned repayments for when the holiday period ends.

A number of mortgage broker groups have been told by their banks that they are exercising the clause which says the borrowers are clients of the bank and not the brokers, and they are dealing directly with the customer now. That is not the case for all brokers however, some of whom officially in their contracts "own" the customer.

Supplements 1 - 5 can be found here
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