Bank credit squeeze hurting small businesses

Jirsch Sutherland Partner Trent Devine

More lenders are tightening the credit screws on small businesses – and it's set to have dire consequences for many owners who rely on home equity to fund their operations.

In a trend reflecting the concerns of Jirsch Sutherland Partner Trent Devine in October last year, more lenders are now placing tough restrictions on the use of residential property equity by reining in loan-to-value ratios to as low as 40 per cent and toughening document checks. ASX-listed Adelaide Bank is the latest lending institution to toughen terms for small-business borrowers. In March, ING also began banning borrowers from using their homes as security for business loans.

With the credit squeeze the result of the damning Hayne Royal Commission fallout, Trent says many small businesses are now struggling to expand, hire new staff and purchase essential equipment.

"I said last year that businesses that used home equity for business borrowings were at risk, and that's certainly proving to be the case," he says. "That's because we now have an environment where credit is increasingly hard to come by. Property prices are also falling, which means the levels of equity with which to finance or prop up a business are falling. At the same time, many business owners are also facing mortgage stress caused by flat wages growth, rising living costs, and growing levels of underemployment."

Struggling to grow

ASBFE Ombudsman Kate Carnell

With 80 per cent of Australian small businesses utilising home equity as a basis for their growth at some point during their operational cycle, Australian Small Business and Family Enterprise Ombudsman Kate Carnell says the current difficulties around obtaining credit are creating significant challenges.

“At the moment it’s almost impossible for a small business who needs a loan to get one,” Ms Carnell told JS Matters. “For a business that doesn’t have significant equity in bricks and mortar, it’s incredibly difficult to get any loan. That means the capacity to grow a business and to employ people is greatly reduced. It’s not going to get better unless there’s significant change in the way that both ATSIC and APRA manage the rules that they’re setting for serviceability. The view that property values are going to continue to go down for a little while is also making it worse, there’s no doubt.”

For small businesses needing a loan, she says the difficulties lie around the key issue of serviceability.

“The dilemma is that banks are assessing small businesses in the same way they are for consumers,” she explains. “The reason they’re doing that is because they’re risk-averse. Because small business loans are often secured against property, they’re being intermingled with the requirements for consumers around mortgages, which is making it almost impossible for businesses to pick up a loan because they can’t meet those requirements.”

Ms Carnell says that a failure to amend lending requirements for small businesses will create wide-spread consequences.

“The Reserve Bank has made the point that if this continues it will start slowing the economy further,” she says. “Because if small businesses aren’t growing and employing, then the economy slows. It’s pretty much that simple. It’s quite a broad-based problem. If businesses don’t grow, then at the end of the day they’ll start to flounder. This is really serious.”

Equally concerned over small business lending, the Council of Financial Regulators has said it will closely monitor lending to small business and also urged banks to maintain the supply of credit to the sector. In its second quarterly statement, the council noted that new lending to small business has slowed noticeably over the past year, with the situation being complicated by the dependence on residential property as loan collateral. Roughly half the $220 billion of small business loans currently outstanding are secured against houses and apartments.

“For many small businesses, personal and business finances are intermingled. As a consequence, the higher standards that lenders apply to personal borrowing are affecting some small business loan applications,” the Council’s statement said. “[We] will continue to monitor developments closely and stressed the importance of lenders supplying credit to small and medium-sized businesses.”

In the absence of lending policy changes, Trent Devine also fears that the plight of Australian small businesses will only become more difficult.

“Because the practice of using homes to finance new small businesses is extremely common in Australia, failure to make finance more accessible once again will see many face the possibility of insolvency,” he says.

“I think you’d find the majority of people with a start-up small business would use capital from their homes to start out, which obviously is a concern when things turn for the worse. Borrowing from home equity to start a business has always happened, and with the huge price increases of recent years, struggling businesses have been able to lean on that equity. Now, with price drops and the current credit squeeze, the resulting difficulties can easily flow on to bottom lines.”