



10 September 2020

Hon Josh Frydenberg MP
Treasurer
Parliament of Australia
Canberra ACT 2600

Dear Treasurer,

Banks – Covid pandemic LVR and ICR breaches of covenant and deferral of interest

I am writing to seek your assistance in requesting the banks to agree to the following:

- a moratorium on breaches of covenant of Loan to Value Ratios (LVR) until 1 January 2022
- a moratorium on banks changing pre-Covid LVR's until 1 January 2022
- a moratorium on breaches of covenant of Interest Cover Ratios (ICR) until 1 January 2022
- enabling a business to defer capitalised interest until 1 January 2022 and then for that interest to be amortised over the life of the loan

Otherwise sound profitable businesses have endured a significant downturn as a result of the Covid pandemic. Our members' fear that due to Government imposed trading restrictions, they may be in breach of various bank covenants. The pandemic has also severely inhibited their capacity to repay capitalised interest. This means that they are at the risk of losing their business and the jobs they provide. As we come out of this pandemic, there are still diverse segments who are most at risk, e.g. Victoria, accommodation sector, border towns and CBD businesses.

Loan to Value Ratio (LVR)

The example below illustrates a breach of an LVR covenant of 50% where the bank revalues a business from \$10M to \$9M as a result of the pandemic and changed trading conditions. In this example, the owner would have to either find another \$1M to satisfy the covenant, or sell the business at a reduced amount to its pre-Covid value.

	Pre Covid	Post Covid
Business value	10,000,000	9,000,000
Loan	5,000,000	5,000,000
LVR (Debt%)	50%	56%

Interest Cover Ratio (ICR)

The example below illustrates a business that has a "2x ICR". That is, the owner has entered a covenant with the bank that EBITDA of the business must be "two times" the interest paid. If the ratio falls below "2x ICR", the business is in breach of the bank covenant and the bank is able to seek repayment of the loan that may force a sale of the business.

	Pre Covid	Post Covid
Loan	5,000,000	5,000,000
Interest 2.5%	2.5%	2.5%
Interest paid	125,000	125,000
EBITDA	1,000,000	200,000
Interest Cover Ratio	8.00	1.60

Deferral of interest

The example below illustrates a loan of \$5,000,000 with a term of 10 years remaining. The banks have generally provided an option where interest and principal can be deferred until 31 December 2020. This option has been taken up by many hoteliers, especially for example in Victoria who have endured a long and extended lock down. Come 1 January 2021, the banks will be expecting that the agreed repayments of principal and interest will recommence (in the example below that would include interest of \$10,416.67 per month). Given that businesses should be hopefully back on track, that is reasonable.

In the example below there will be deferred interest of \$93,750. Our members are concerned that banks may seek that interest to be repaid in full in January 2021. Such a scenario will be beyond the means of many businesses. Therefore, we request the banks confirm the option enabling a business to defer capitalised interest until 1 January 2022 and then for that interest to be amortised over the life of the loan.

	Amount
Loan	5,000,000
Interest rate 2.5%	2.5%
Interest due per month and deferred	10,416.67
Months interest deferred (March to December 2020)	9
Total interest deferred	93,750
Period of loan remaining 10 years (months)	120
Amortised amount per month added to repayments	781
New total interest due per month	11,198

Conclusion

The AHA believes these moratoriums and assurances would provide a reasonable period of somewhat normal trading to allow businesses to recover, such that they would no longer be in breach of covenants and also be in a better position to repay interest. Your assistance in this matter would be much appreciated.

Yours faithfully,



STEPHEN FERGUSON
AHA NATIONAL CEO