LOGGING INDUSTRY RESEARCH ASSOCIATION
NEW ZEALAND

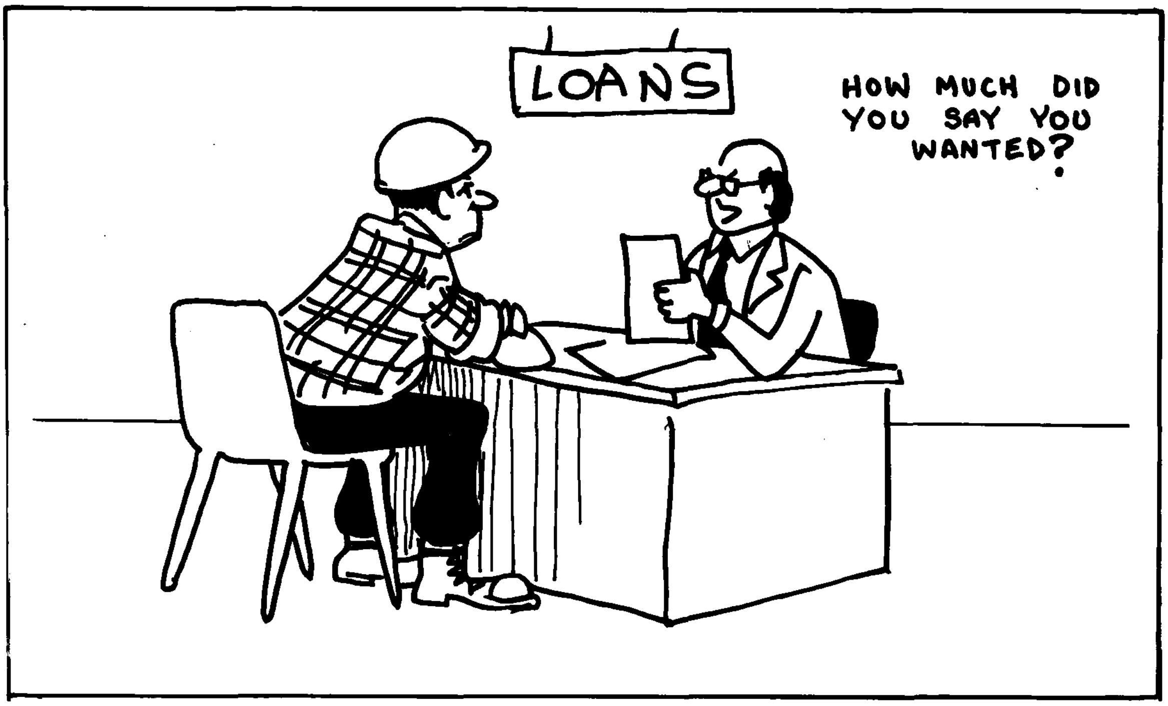
ISSN 0111-4743

TECHNICAL RELEASE

Vol. 6 No. 12 1984

FINANCE FOR CONTRACTORS – A BANKER'S VIEW

A Report by Craig W. Deere, Manager. ANZ Banking Group (New Zealand) Limited, Howick, Auckland.



INTRODUCTION

Life for logging equipment is relatively short and the cost to buy or replace machinery continues to escalate. This must be planned for.

An experienced contractor will know that he cannot run an existing piece of machinery into the ground without putting aside some funds for replacement. The chances of obtaining 100% finance for the replacement are non-existent. Being a prudent operator, he will be setting aside funds regularly for his next machine, or ensuring that there is sufficient trade-in value to meet part of the cost when replacement is necessary.

With prices of new or good second-hand equipment increasing, there are not too many contractors who can go out and spend $70,000 to $100,000 cash on a skidder or $150,000 to $200,000 on a logging truck.

Financing such equipment would require a deposit of 15% to 50%. The deposit required will depend on the lender's requirements, the borrower's circumstances (including his past record), capacity to repay, and the security offered. What chance have you got if you have not put the deposit aside progressively or retained sufficient worth in the machine you wish to trade in ?

ACKNOWLEDGEMENTS

The assistance of Mr. Peter Sharland of Cable Price Corporation and Mr. Phil Hanson of E.F. Hanson Contractors is appreciated.

SOURCES OF FINANCE

Finance for capital equipment is usually obtained from;the contractor's trading bank, its finance company, the finance company suggested by the equipment supplier, or a finance company the contractor has been previously associated with.

The trading banks traditionally remain the cheapest source of finance whether it is by way of overdraft, or loan borrowing, and they should always be the first source of finance to be investigated. Banks, from time to time, may not be able to assist to the degree sought but it should be remembered that your bank manager would prefer to say 'yes' if he could.

As finance companies obtain their funds from the general public at quite high costs, their lending rates are normally higher than the trading banks,but they are both geared and suited to lending for capital purchases.

Both the Development Finance Corporation and the Rural Bank may lend to the forestry sector but only in certain circumstances and, as far as the latter is concerned, generally in respect of land only. The Development Finance Corporation is more likely to be interested if the end product is exported. Whilst these institutions are not usual sources of finance, if a contractor feels he has a special case a telephone call will usually enable him to see if he warrants such consideration. In those areas where logging operations are not historical or traditional, Regional Development Finance may also be available.

Insurance companies, trustee savings bank and building societies do not normally lend for the purchase of forestry equipment but they may grant personal loans which would assist a contractor with his deposit.

INTEREST AND FINANCE RATE

The cheaper the interest rate and finance rate that you can arrange the better, but remember that interest on your borrowing is generally tax deductible. Interest rate is strictly the amount of interest charged for your loan,whereas the finance rate (required to be specified in lending contracts in terms of the Credit Contracts Act) is the total cost of borrowing reduced to percentage per annum terms, i.e. interest, arrangement or acceptance fees, etc. relative to the amount of borrowing and calculated as a percentage per annum rate.

Comparisons between typical bank and finance company loans are shown in the following table :

	MONTHLY REPAYMENTS		
BANK	*36 months*	*48 months*	*60 months*
Term Loan Account at 17% :	*$*	*$*	*$*
$ 30,000	*1,067.14*	*862.87*	*742.53*
50,000	*1,778.56*	*1,438.11*	*1,237.55*
75,000	*2,667.85*	*2,157.16*	*1,856.32*
100,000	*3,557.13*	*2,876.22*	*2,475.10*
150,000	*5,335.69*	*4,314.33*	*3,712.64*
FINANCE COMPANY	*36 months*	*48 months*	*60 months*
Loan Amount at 20% :	*$*	*$*	*$*
$ 30,000	*1,114.91*	*912.91*	*794.82*
50,000	*1,858.18*	*1,521.52*	*1,324.69*
75,000	*2,787.27*	*2,282.28*	*1,987.04*
100,000	*3,716.36*	*3,043.04*	*2,649.39*
150,000	*5,574.54*	*4,564.55*	*3,974 08*

EQUITY

Some contribution from the purchaser is required when borrowing to purchase or replace a machine. Banks do not have a hard and fast rule regarding equity, i.e. deposit contribution, but usually work in the range of one-third to one-half, preferring the purchaser to have as large a share as possible. On the other hand, the finance companies will accept down to 15% equity and in some circumstances even less than this.

SECURITY

Because of the lower costs of borrowing and because they are lower risk lenders, banks generally require the comfort of a strong security for overdraft or loans. Such security may be represented by a mortgage over landed property. The bank, like finance companies, may often accept bills of sale (chattels security) or mortgage debenture securities (company borrowers) encompassing the machinery being purchased or already owned.

Landed securities provide the borrower with greater flexibility in as much as the security can often be held to cover several different items of equipment or replacement items as they are bought and sold. They can also be utilised as security for working capital overdraft if applicable. Bills of sale need to be registered and discharged at each change of ownership. Mortgage debenture securities do not provide the lender with as much comfort because they create a non-specific or intangible charge over the company assets.

REPAYMENT AND TERM

Regardless of the lender, he will always assess the borrower's ability to service the repayments. Contractors applying for a loan should be prepared with not only the balance sheet and accounts for the previous two years' trading, but also budget/cash flow figures to support the application. More often than not, the latter would not include projections for the proposed new loan but the bank or finance company will incorporate the proposed loan servicing to establish whether or not the contractor can in fact service such a commitment. Most lenders look for repayment over a three to five year term by way of monthly instalments of principal and interest.

Another aspect the lender will consider when assessing a request for finance is the borrower's previous ' track record' in meeting his obligations. If the information is not readily available from his own records, the lender may obtain reports from a credit reference bureau, other trading banks, or finance houses.

Reliability, integrity and particularly a 'willingness to repay' are very important to lenders. Contractors, therefore, should ensure their borrowing record remains unblemished.

LENDING TO COMPANIES

The foregoing comments and requirements also apply generally to company borrowers. Additionally, the lender will usually seek personal guarantees from the company directors/shareholders and will consider carefully their equity in the company. If the equity and/or asset structure of the company is weak, security supporting the guarantee, in the form of a specific charge over personal assets, may be a requirement.

SUMMARY

Before approaching a lending institution for finance, contractors should :

- ensure that they have sufficient deposit
- have up-to-date financial details and forecasts
- be prepared to provide security for borrowing

REMEMBER always protect your borrowing record. If you cannot meet a repayment or other condition of the loan during its currency, tell your banker or finance company in order to protect yourself.

For Further Information Contact: N.Z. LOGGING INDUSTRY RESEARCH ASSOC. INC.
P.O.Box 147,
ROTORUA, NEW ZEALAND. Phone 87-168