How banks and other lenders are supporting businesses impacted by COVID-19

Peter Brown, Head of Private Debt – Luxembourg, considers the ways in which lenders are supporting businesses through this difficult time

The strain placed on businesses by the coronavirus pandemic is unprecedented, and the response aimed at helping businesses through the crisis is also completely new territory for governments, regulators, the banks and other lenders. That said, it’s important to understand how that support is being provided, the challenges it presents for lenders, and the potential opportunities that are likely to come from the crisis.

Lenders playing their role in supporting the economy and jobs

Naturally, the government and financial services regulators have both made it very clear to all lenders that their role through this crisis is to play their part in supporting the economy and protecting jobs. For example, recent correspondence from the Prudential Regulation Authority suggested banks should use their liquidity buffers (including cash and short-term bonds) to continue to support customers through the coronavirus crisis.

That well-worn phrase “cash is king” is particularly relevant now. Whereas the global financial crisis started with a liquidity shortfall for banks that were heavily reliant on short-term inter-bank funding, the current crisis has created a cashflow emergency for a much broader range of businesses across the economy.

Importantly, banks are keen to be seen to be doing the right thing, especially since they were so strongly supported by governments throughout the global financial crisis. The same can also be said for a growing number of non-bank lenders who may face less government and regulatory oversight but are still demonstrating a willingness to provide liquidity to support their customers, while also protecting value.

Focus on helping existing clients

The primary focus of lenders generally is to support their existing clients. Indeed, many banks and non-bank lenders are spending a significant amount of time assessing the impact on their borrowers, the change in risk profile across their portfolio, and working out specifically where to get involved and give support where necessary.

In any respect, early dialogue between borrower and lender is crucial. Lenders are prepared to look far more favourably on those borrowers who have spent the time exploring different scenarios, and putting options on the table, and are prepared to work closely with those borrowers to come up with pragmatic solutions that alleviate short-term cash flow issues.

Roll-out of government schemes

In terms of those solutions, to date, many smaller borrowers have been grateful for several government initiatives aimed at boosting short-term cashflow (furlough support, VAT and Income Tax deferrals, etc.) and also government loan schemes, such as the Coronavirus Business Loan Interruption Loan Scheme and the Large Business Interruption Loan Scheme. With both schemes, the intention is that provided the business was viable before the crisis, the government will guarantee a significant proportion of any loan up to certain limits so that banks can ensure borrowers are “held harmless” as best as they can through the uncertainty.

At the time of writing, £2.8 billion in loans have been agreed through the Coronavirus Business Loan Interruption Scheme, but only 16,624 applications have been approved out of 36,000, which is a relatively low success rate. Critics are concerned that it is taking too long for money to reach small businesses, and pressure is intensifying on banks to speed up the application process and ensure businesses receive the cash they need to survive.

While banking staff are working hard to make their way through a significant application backlog, the key issue is that each case needs to be assessed on its own merits. This has led to the government agreeing to underwrite in full some loans to smaller businesses to expedite the approval process and get money out to the businesses that critically need it.

Alleviating cashflow concerns

Many sectors of the economy have been heavily impacted by the crisis. For example, within real estate, the lack of cashflow through reduced rent collection has become a significant concern. Already for the first quarter of 2020, we have seen rent collections falling by an estimated 20-30% in the office and industrial space, and 60-70% in the retail, leisure and hotel spaces.

Lenders have been demonstrating understanding and flexibility by offering businesses a number of cashflow-easing measures, including capital repayment holidays, interest roll-up in transactions, and extending credit terms that were due to expire. Again, each case needs to be addressed on its merits so that a truly 'bespoke' solution can be found.

Constructive dialogue regarding covenants

While a number of financial covenants have been, or are likely to be breached, banks have to date been taking a pragmatic view, providing waivers to those clients that have undertaken scenario analysis and can demonstrate clear plans to ensure a viable business in the future. In addition, lenders have been willing to provide working capital and new money where needed to help keep businesses afloat, on the assumption there will be a return to normality at some point.

From a pricing perspective, our experience so far is that, while risk profiles are deteriorating, lenders have chosen not to increase their margin or fees for existing borrowing. However, for new debt, pricing does reflect the additional associated risk. This therefore does present an opportunity for non-bank lenders to step in and provide competitive financing for businesses that find themselves further up the risk curve where more traditional lenders have limited appetite.

More challenging for businesses already in difficulties

It's worth noting that the landscape is far more challenging for businesses already under stress or in financial difficulties. Whereas during the global financial crisis many struggling firms benefited from sharply falling interest rates, this time with rates already at historic lows, no such benefit can be derived. Some businesses that already were on ‘life support’ may struggle to get through this difficult time without undergoing significant restructuring.

New transactions challenging, but there will be opportunities…

These are exceptional times, and no lender has infinite resources. The vast majority of lenders will find themselves significantly stretched for the next few months as they focus their resources on supporting their existing borrowers and dealing with those under the most stress. This means we expect live deals to suffer, either by being heavily amended or pulled completely, given the profound uncertainty of obtaining accurate asset valuations, or cash flow predictability.

That said, we do see some positives. This could be the time for non-bank lenders (particularly those private debt funds with dry powder) to step up and lend to those businesses that are further up the risk curve, and perhaps need to restructure their borrowings to ensure their longer term survival.

We are already seeing some private debt clients looking to ramp up origination activity. In addition, we expect there will be a number of secondary market opportunities, as well as potential portfolio plays as banks seek to manage the increased capital costs associated with deteriorating credit quality on their balance sheets.

If private debt funds need an incentive, it’s worth remembering that some of the best deals were completed in the years immediately following the global financial crisis, as liquidity left the market and pricing increased to reflect the risk. In these circumstances, fortune really can favour the brave.

So, in summary, lenders are highly motivated to help businesses through this crisis, but their focus is on helping existing clients, especially those who were deemed viable pre-COVID-19. It will remain a challenging environment for new transactions, but we expect some good deal origination opportunities to be found, and private debt funds could find themselves playing a key role supporting stressed businesses to weather the storm, and return to health once the crisis abates and economies start to recover.