Treasury Trends

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Managing funding, interest rate and liquidity risks in today's environment

The inflation-fighting efforts of central banks have heralded the end of an exceptional period of cheap and abundant funding, the swift policy pivot resulting in significantly higher funding and liquidity costs for businesses. Reflective of the rapid reversal in interest rates, bank credit departments have been kept busy with bank covenant 'discussions', the key metrics of many interest rate sensitive businesses quickly squeezed by the much higher interest rate environment.

In general, we've seen flexibility from banks, particularly for clients who have engaged with their lenders early and have presented a realistic plan for regaining compliance. From our experience, having the support of a good advisor in these discussions is highly valuable, bringing a familiarity with banking and finance sector norms, remedial alternatives, and ensuring information is presented in the most favourable light.

Key points:

- Opportunity to capture 'best' funding structure
- Credit conditions have settled, providing a useful window to progress bank refinancing plans
- Those with a material interest rate exposure need to be managing that risk on an ongoing basis
- Always have a plan B
- Ensure best foot forward

Best or better?

In terms of overall facility replacement/extension or update, Boards in particular have been pleased to see 'best' outcomes achieved through pragmatic negotiation and consolidating a bank relationship(s), leading to significant financial and other benefit, rather than simply settling for a 'better than we had before' comment in an Audit and Risk Committee paper.

The swift rise in interest rates has also put a renewed focus on the role of interest rate hedging, those with favourable hedging in place afforded the ability to reprofile interest costs and moderate the worst of the interest rate rise. While the interest rate hiking cycle appears to have peaked, there remains considerable uncertainty around the timing and pace of eventual interest rate cuts, with policymakers wanting to see further progress in bringing inflation under control before signalling any policy relaxation.

Good policy provides business discipline

This will be an anxious wait for the many borrowers targeting hedging opportunities at lower levels, although those operating under a considered Treasury Policy framework will not have been idle over the past eighteen months. While interest rate risk appetite, objectives and strategy vary across organisations, a sound policy will typically act as a regular prompt for decision making and help avoid an 'all-or-nothing' response. While several decades of generally declining interest rates helped breed a sense of complacency by some (it appears a number of entities, and often 'bigger' borrowers opted against hedging arrangements), recent interest rate movements have provided a painful reminder that those with a material interest rate exposure need to be managing that risk on an ongoing basis.

A much higher cost of borrowing has also put a lens on working capital and idle cash balances, something not always given due consideration when interest rates were negligible. For many, strategy centres on the medium to longer term, especially when it comes to funding facilities and bank relationship management. Whilst not suggesting that should not remain a priority, there is benefited to also look closer to home – trusting that policy recognises this risk/opportunity. Where is my cash now? How could I better manage 'surplus' cash? Could my funding facilities be better structured to match my cash practices – with a view to lowering all up costs? Our transactional banking and cash management experts can attest to the fact that a few tweaks in liquidity and cash management processes can often now equate to real dollar savings.

Bank funding margins

Local bank funding margins experienced a noticeable lift earlier in the year as a direct result of the US banking crisis, which saw a number of US banks fail over the course of several days.

A timely response from US regulators curtailed contagion fears, although more recently, ratings agencies have undertaken a series of ratings downgrades across US mid-sized banks, citing growing financial risks and strains that could erode their profitability.

These offshore events provided a reminder of the benefits of having ready access to a selection of highly rated bank funders in this part of the world.

Coinciding with the US banking sector issues, our benchmarking showed an average 0.30% increase in corporate lending margins being offered by domestic banks, a lift which was slow to unwind. While banks are quick to point out continuing moves by both Australian and New Zealand regulators to increase bank capital requirements, this upward pressure is being offset by a moderation in bank lending growth following a cooling in the housing market, leaving banks looking for other avenues to put their money to work.

Plan B

For those thinking about bank refinancing, market conditions are currently settled/favourable. Events which can trigger a rapid tightening in credit conditions do not tend to be well telegraphed, so 'making hay while the sun shines' is always a good starting point. Starting the refinancing process well in advance of requirements will provide scope for T&C's to be properly negotiated and documented and allow for a 'plan B' to be put in place should lending appetite not initially be forthcoming or market stresses arise.

For those with multi-bank relationships or who are able to engage in a bank tender process, we are seeing competitive tension deliver significant pricing benefits, and often a wide variation in the bank pricing offered. ESG considerations are also now a formal part of the bank credit process, with bank pricing increasingly linked to ESG goals.

Managing funding risk

As always, bank refinancing provides an opportunity to test 'outside-the box' solutions. Having the right funding structure is often more beneficial than screwing down the lowest possible pricing, which is often the sole focus for some, failing to recognise the costs from a sub-optimal structure.

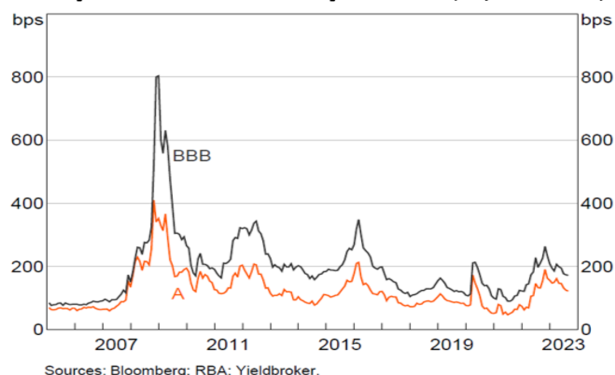
While not always practical for smaller borrowers, those with larger borrowing requirements should typically look to stagger their debt maturity profile, to reduce refinancing risk. Any such requirements should be outlined in the Treasury Policy (e.g., "*Funding maturity dates will be spread so that no more than $XXm of facilities are maturing in any 12-month period.*").

Banking preferences and trends are always changing but understanding current funding market drivers and industry (and individual bank) trends can help throughout the refinancing process, whether it be in the type of funding structure, or which T&C's are negotiable/non-negotiable.

Best image crucial

Optimising your organisation's financial image is crucial (particularly if dealing with a lender for the first time).

Our treasury and debt advisory teams have significant experience and up to date market knowledge. If you would like to discuss a Treasury Policy, interest rate risk management strategy, or refinancing plan for your business, please speak with your advisor.



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