Plugging the gap

The creation of a new industry body for short-term lenders means mortgage brokers can have greater confidence in recommending caveat loans for business clients in need of a quick financial fix

Caveat loans are quick-settling, short-term loans of 1–4 months, which are priced between 3% and 6% per month. HomeSec's managing director Paul Stone uses an analogy to describe this segment of lending. "The big myth here is people multiply this rate by 12 and freak out. They are not long-term loans, which is why they are priced accordingly.

"It's a bit like catching a taxi. You wouldn't hire one to drive around interstate, but they're handy if you need to make a quick trip. So it's important to see short-term loans in the correct context."

Redilend's general manager Dan Isaak says people have a bad image of the market because of

a few "unlicensed shonks". "These were fly-by-night caveat cowboys who had only one objective in their minds – to maximise profits. The truth of the matter is that there definitely is a place for this type of finance in the industry – to bridge gaps between what banks can't or won't do, especially when time is of the essence," says Isaak.

As an example, Isaak describes a recent scenario between his company and a business client. "A client who had a strong asset standing, but was cash-strapped, approached us. He had a major construction contract with a government body and over 46 staff members, all paid fortnightly. The government body had delayed his next drawdown, which he depended on to pay his staff. He expressed major concern that if he didn't pay his staff within three days he would not only lose them, but also the contract to complete the $9m project. So we said we could assist via our sophisticated investor caveat funds," Isaak says. "We followed all legal and ethical protocols and ensured that the client was happy. He realised that these facilities can cost more than normal, however he said that he would rather pay a few bob more than risk losing the entire project. So we settled this loan within 72 hours – providing cash in his account – and he continued on powering our economy. So it's a double winner: since then, we've refinanced him back to a standard lender and everyone lives happily ever after."

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Short-term lenders were particularly useful during the credit crunch. The high cost of funding and the major banks' focus on gaining market share in the home loan market meant business customers found it increasingly difficult to obtain credit. During the height of the credit crisis, Dun & Bradstreet's chief executive officer Christine Christian noted that the circumstances had made it more difficult for Australian businesses to access funds. "It has also caused significant volatility in the movement of the Australian dollar," she says. "As a result, executive confidence has declined sharply, with expectations falling to levels not seen since the 1990s."

The economic climate, in turn, increased the prevalence and importance of short-term lenders. In an interview with *MPA* last February, Interim Finance's Andrew Littleford explained that the credit crisis actually had a positive effect on his business. "To be frank, the GFC has provided this company with a greater level of business activity than experienced in previous years. Regardless of the economic environment, businesses need credit – it is the lifeblood of enterprise. Fewer lenders and a return to a more rigid credit assessment by banks have opened the door for alternative credit sources."

But along with good lenders, there are always a few bad ones: it is with this in mind that the existing ethical short-term lenders have built a new industry body.

ASTLA

The Australian Short-Term Lenders Association was officially launched in October 2010 with three founding members. While it had been in the making for more than 12 months, the group really got off the ground in July 2010 when fellow board members and executive directors of PSAL Limited, Jaime Dormer and Peter Flanders, held a formal meeting for short-term lenders in Melbourne.

They chose a name for the association, nominated board members and within eight weeks established a Code of Conduct along with an association entity and structure, as well as a mission, vision and values statement. At the time of writing, ASTLA had approximately 15 new members ready to be accredited, but spokesman Paul Stone says they anticipate having up to 40 members nationally by Christmas, with a gradual increase from there.

As short-term finance is a relatively small segment in the overall lending landscape, Stone points out that the association will never have a level of membership in the hundreds or thousands. It is also an association that is strictly made up of lenders only and does not include other related industry professionals.

"At this stage we believe ASTLA represents approximately 20% [of the industry], however due to the fragmentation of this end of the finance industry, the true quantum of short-term business lenders won't be known until awareness of ASTLA reaches a peak in the coming months," Stone says.

He explains that, traditionally, short-term business lending has been made up of hundreds of private lenders across the country, with most being private individuals or companies solely using their own funds.

"Therefore, as most are not listed companies or do not have a prospectus (as there is no capital raising activity), short-term lenders seem to have kept to themselves. In other words, there has been no formal requirement to disclose book size or performance. There is nothing sinister about the fragmentation, however the downside is that there has been no collective voice to dispel the many myths or sing the praises about short-term business lending. With ASTLA, this is finally about to change," he says.


Paul Stone

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Case study: Redilend

Redilend's general manager Dan Isaak says he has high expectations for the new industry body.

"ASTLA will be the first of its kind to have ever supported this sector of finance. Hopefully their efforts will do multiple things; cleaning up the industry and ensuring that only legitimate players remain in the arena is the priority. Secondly, it is hoped that ASTLA will bring greater transparency to the industry and open up a dialogue between funders, consumers and industry bodies – this will then create a whole new legitimacy to the private mortgage market."

According to Isaak, the industry segment needs an official representative to help consumers feel safe when obtaining short-term finance. "I believe the consumer is the main objective here and the lender the second priority," he says. "The fact that lenders will be able to market themselves as ASTLA members is no different to the current model of trusting an MFAA-accredited broker to offer you honest service. So [the ASTLA] logo will provide the client with comfort."

Isaak welcomes further inspection of the industry under the Australian Securities & Investments Commission. "The fact that ASIC intends on paying a lot of attention to the industry isn't such a bad thing. In fact, it will ensure a higher level of ethics is maintained. The concept behind ASTLA and ASIC intervention is that the industry offers compulsory safer service to all consumers who need such an important product," he adds.

Government liaison

The organisation has four main objectives, the first of which is to liaise with the government and ASIC on the formation of legislation and enforcement. Stone says ASTLA's job will be to ensure the regulator "has all the facts about short-term lending, and that they fully understand what we (lenders) do and what role we play in the all-important small business finance sector".

ASTLA has hit the ground running with a submission to ASIC during the regulator's consultation on Phase Two of the national consumer credit regulations. ASTLA is "gravely concerned" that the consumer credit code may be applied to business lending. "This would then totally destroy the short-term business lending sector, and in turn would impact on small business and its ability to borrow short-term funds fast," Stone explains.

The industry body's main objectives were to highlight the merits of short-term business lending and fully explain the need for caveat lending, why businesses use it, why the interest rates appear high and also to dispel the myths surrounding the sector. By way of example, Stone suggests that if you run a small business, you might need access to $100,000 today so you can buy some surplus stock that a supplier is clearing out at a fraction of the usual wholesale price. "Unless you had that kind of cash sitting in the bank, how do you obtain it? Going to banks and traditional lenders is not the answer, as that can take weeks or months to get the money by way of an overdraft, refinance, or business loan. The only way is to take out a short-term business loan," he says.

Stone adds that it is important for regulators to recognise that short-term business loans are for business purposes only. "Therefore if you need to take out a short-term business loan, you simply do a cost/benefit analysis, and if the benefit of getting the funds fast outweighs the cost – go for it. If it doesn't, then don't do it," he says. "I understand that there needs to be interest caps and other protection afforded to consumer lending, as you can't do a cost/benefit analysis when borrowing for a holiday, or buying a jet ski. However, bringing business lending under the NCCP will take away the ability for businesses to borrow quickly over a short term. We do, however, strongly support the changes made by ASIC, where business declarations are no longer sufficient on their own, as we only want to see members funding caveat loans for bona fide business purposes."

Stone says there also needs to be a viable exit strategy with these loans, as lenders do not want borrowers to have these loans any longer than the minimal short term required. "If regulation makes short-term business lending unviable, the real losers will be small businesses that may need access to funds fast. Like we have seen with other forms of prohibition, there is also the risk that this legitimate sector could be driven underground and be run by organised crime syndicates, which would be the worst possible outcome."

Industry standards and support

The second objective for the industry body will be industry compliance. According to Stone, the defragmentation of the short-term business lending sector is vital to its survival. However, to be taken seriously the sector also needs to run with a uniform framework (the ASTLA Code of Conduct), to ensure it is not tarnished by the one or two unscrupulous lenders who may still exist.

"So by being a member of ASTLA, you are telling the world that you have met the criteria set down by the association, you will abide by the Code of Conduct, you are answerable to ASTLA should a complaint be made by a member of the public and you are a genuine and reputable short-term business lender," Stone says. "For members, this is also a great marketing tool, as it gives the member the right to display the ASTLA logo on their website and stationery, which sends a signal to the public that you are a genuine and reputable short-term business lender," he adds.

The body will also give support to its members. Until now, Stone says the fragmentation of the short-term lending community has meant that lenders have been easy prey for fraudsters. "There have been many cases of fraudulent loans inadvertently being funded by short-term lenders, resulting in substantial losses," he says.

While some lenders will pick up an elaborate fraud attempt, others won't. ASTLA members will have exclusive access (via the members-only area of the website) to a live database of fraudulent deals, and other suspicious documentation doing the rounds, as well as a 'caution list' of other people associated with the overall finance industry who may have engaged in deceptive or misleading conduct. "This alone is potentially a huge money-saver for every member," Stone says.

ASTLA members also have access to legal, marketing and operational tips, which will help short-term lenders run their business better. Lastly, the organisation will provide a service to small businesses that need finance solutions, but are afraid of dealing with a disreputable short-term lender. "There are all kinds of myths out there, but now if they see that the lender they're choosing to borrow from is an ASTLA member, they can proceed with confidence knowing that the lender is genuine, and abides by a very visible Code of Conduct," Stone says. **MPA**

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