



3 Steps for Influencing Loan Covenants

Did you know that you can negotiate loan covenants with your banker? Covenants are often seen as non-negotiable terms that are driven by the bank's internal regulations and the external regulatory environment in which they operate. However, well prepared organizations that have a strong banking relationship may be able to help guide the direction of the covenants included in their loans.

Prepare for the Discussion

Prior to opening a dialogue with your bank, make sure that your business plan, current financial performance, and expected future performance has been fully conceptualized and measured. Then, create a list of specific financial covenants that may not allow you to effectively execute your current and/or long term business plan. For example, if you are preparing to make a large capital expenditure in the near future that you believe will positively affect your ability to grow sales or increase productivity, you could breach a covenant that limits capital expenditures. Be prepared to communicate your intentions and the intended impact on your business plan to your banker. Banks may not allow you to negotiate your way out of a covenant altogether, but you may be able to negotiate the specific levels that are considered a breach if you can effectively communicate your short-term and long-term business plan and how those covenants will most likely affect you. After you create a list of potentially harmful covenants, think about the covenants that you would require from your business if you were the banker. Determine how those covenants would impact your business plan, and then think about alternative covenants, if necessary, that can be both beneficial to you and your bank. Lastly, compare the alternative covenants to both your short-term and long-term business plans as well as your current and expected future performance.

Open the Dialogue

Once you feel that you have adequately prepared for the discussion, it is now time to open up the dialogue with your bank. Start the discussion loosely so that you don't start with facts and hard negotiating before gaining a better understanding of your bank's current position. Use the loose dialogue to suggest possible covenants and key financial ratios that you are using to monitor your own business. Open dialogue with your current bank is essential, but is also beneficial to open up a dialogue with other banks. Keeping your options open and understanding the options that are available at other banks will help you evaluate whether your bank's policies are fair and reasonable. Getting competitive offers can also help negotiations with your current bank.

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Monitor Covenants!!!

One of the most important tools for effective covenant negotiation is to monitor your organization's compliance with current covenants. These should be monitored with the preparation of interim financial statements. When a breach appears imminent, begin speaking with the bank immediately. Being proactive will help your organization effectively maintain a waiver for covenant violations. Moreover, showing the bank that you are actively monitoring these covenants and their impact on your business will help future negotiations. It gives you the opportunity to discuss the reasons for the violations with the bank and reasons why they may need to be changed for the future.