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## Long-term business finance

Long-term business finance includes instruments which service a financing need for periods greater than one year. These include, term loans, leasing, hire purchase, and revolving credit.

### Term loan

A term loan is an advance of money repayable in full by a fixed date.

The agreement may provide that the advance will be reduced by instalments before the fixed date.

It may also be known as a fully drawn advance.

A facility providing for repayment in one sum on maturity is termed a 'bullet'.

### Advantages

- ✦ Certainty of conditions applicable to the advance;
- ✦ Amortisation of principal by regular instalments;
- ✦ Interest will usually be payable monthly in arrears. The lender will be able to enforce its agreement for the principal outstanding and accrued interest; and
- ✦ An interest-only loan with single repayment may be negotiated.

### Disadvantages

- ✦ Inflexibility of conditions;
- ✦ Available for one-off transactions only; and
- ✦ Variability of interest rates.

### Leasing

A lease involves the hiring of goods by one party who owns the goods (the lessor) to another party who uses the goods (the lessee). The lessee does not have the right or option to buy goods at the end of the term or otherwise.

Leasing is a method of acquiring the use of specific goods, normally plant and durables, but not the ownership of them (as in hire purchase). There is a liability to pay rent for the goods over the period while the lessee has the use of the goods. At the end of the agreed period of use, unless the lease is renewed, the goods must be returned to the lessor.

### Advantages

- ✦ Leasing is a very flexible method of finance and allows for different cash flow and taxation results to be achieved.
- ✦ Leasing offers a financing method largely uncontrolled by statute, making it the most flexible. Even with taxation limitations, leases can still be structured on a tax-effect basis to provide lower rentals. Because the nature of the transaction involves supply by the owner, there is not the problem of registration of charges or obtaining consent of debenture holders which arises, for example, in finance by chattel mortgage.
- ✦ An operating lease is still an off-balance-sheet method of acquiring the use of plant or equipment.

## Hire purchase

A hire purchase transaction involves the hiring of goods by one party (the hirer) from the owner of the goods (the owner) where the hirer has an option to purchase the goods before the end of the term, and obtains title on completion of the contract.

Hire purchase is a method of acquiring specific goods, normally plant and durables, by instalment payments.

It may be used for some floor plan (demonstration model) transactions. There is a liability to pay the purchase price plus terms charges (interest component) over a period, while the hirer has the use of the goods. When all payments are made, ownership passes.

### Advantages

Hire purchase:

- ✦ Has been used for about a century and the law and practice is well settled. It can be used to supply goods to be acquired by the hirer. In a lease, the hirer has no right or option to acquire the goods.
- ✦ Can be used by the owner to pay income tax on the financing method which might otherwise not be available.
- ✦ Because the nature of the transaction involves supply by the owner, there is not the problem of registration of charges or obtaining consent of debenture holders which arises in, for example, finance by chattel mortgage.

### Disadvantages

- ✦ Statutory requirements and compulsory conditions and warranties have made hire purchase rates higher than those for leasing.
- ✦ The statutory format is inflexible on some matters.

## Revolving credit

Revolving credit is a facility provided by a financier to an agreed maximum limit where periodic repayments of a fixed amount are required.

Amounts repaid are available for re-drawing.

A new drawing may be utilised in making a required repayment.

### Advantages

- ✦ Flexibility in the form of credit amounts and term.
- ✦ The ability to draw credit so that bills or loans are utilised over shorter periods, thus attracting current interest rate or bill discount rates.
- ✦ Notification as to changes in interest rates and other charges.

### Disadvantages

- ✦ If the rates of interest or bill discount rates are volatile, the borrower will be subject to fluctuations in cost, unless rates are fixed for a period.
- ✦ The lender, in granting a facility to be drawn at the discretion of the borrower, has some uncertainty in how much the facility will be called on at any particular time.
- ✦ In the case of a fixed-rate facility, the lender must commit to that rate for that time, even though the lender's own cost of funds may vary.

## See Us First

- ✦ Before making any financial decisions.
- ✦ To assist you in meeting the necessary legal or financial requirements.
- ✦ If you consider that any of the issues contained in this fact sheet may affect you.

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## Disclaimer

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