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Why Do Lenders Love Management Rights ?

The average punter could be forgiven for thinking that lenders are falling over themselves to throw money at the management rights industry. You only have to do a bit of industry research to be confronted with any number of advertisements from banks and others proclaiming a desire to assist the intending purchaser. Given that in the majority of cases the lender's security lies in the going concern value of the management rights business this apparently bullish approach to the industry may at first seem puzzling. For business people more accustomed to lenders requiring full real estate security the situation can indeed be perplexing.

So why do banks see management rights as such an enticing lending risk as compared with other businesses ? Firstly, lenders place a significant degree of reliance on the legislative framework in which a particular business operates. In the case of Queensland management rights lenders believe that the legislation (BCCMA and PAMDA) provides a reliable and dependable set of ground rules for the industry to operate within. Other states are starting to follow the Queensland example and lenders are taking note. The risk of business values being eroded or agreements being invalidated due to untested or unexpected outcomes is considered as being quite low. The lender's rights and obligations are prescribed within the BCCM Act and this provides a significant degree of comfort to an intending finance provider. In other states a deed of consent with the owner's corporation or body corporate achieves the same result. Management rights do not carry many of the operational and cash flow risks associated with the majority of other types of going concern businesses. There is a guaranteed salary paid monthly. Letting income is accounted for via a trust account with the on-site manager being paid commissions on a monthly basis. Aside from the occasional small item there are no debtors, creditors or stock. There is no reliance on significant plant and equipment and therefore none of the fixed capital costs associated with many other business types such as manufacturing. Cash flows are extremely predictable in permanent sites and generally predictable in holiday resorts and short stay sites.

For the first time management rights operator the business profile provides an opportunity to leverage skills and knowledge which have been gained from a wide variety of previous work and life experience. With no need to control stock, work in progress, plant and equipment, debtors or creditors the new industry entrant is free to focus on managing the business and driving growth. A wide range of industry specific software supported by the availability of any number of consultancy services means that day to day technical management of the business can be handled by most competent first time managers. Again, the low risk of management failure and the infrastructure of support for the new manager is seen by lenders as a significant risk mitigant.

When making decisions about credit policy and suitable security lenders always try to understand the market demand for the asset being financed. In the case of Queensland management rights there is a clearly established, healthy and historically strong market for these businesses. The underlying economic growth in Queensland combined with strong tourism demand would suggest that the market will continue to prosper. Again, the Queensland trend is starting to be reflected in other states as well. All of these attributes add up to a business risk profile which has led many lenders to offer the market highly competitive finance packages. There are few other going concern businesses attracting the kind of funding offers now available to management rights borrowers, particularly where gearing is concerned. In fact, the question needs to be posed. Are the lenders risking loving the management rights industry to death ?

The fact is that as more and more people attempt to either enter the industry or increase existing investments demand for higher gearing has driven competitive forces within the finance industry. Not so long ago 50% gearing was pretty much to best a borrower could hope to achieve. Today it not unusual to see lenders offering gearing levels in excess of 70% with significant interest only options. As gearing levels rise the management rights operator becomes more exposed to risks associated with interest rate movements, occupancy demand, tourism trends and buyer demand. The risk is exacerbated if borrowers choose long periods of interest only funding as the debt risk exposure does not reduce over time. Highly geared funding is not without risk and should be approached with some care, particularly if you are new to the industry.

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