LVR for Pharmacy Lending – Demystified

Say you're about to buy a pharmacy for $2,000,000

Of the $2,000,000 purchase price, let's assume that its made up of $1,700,000 Goodwill; $200,000 Fixtures and Fittings and $100,000 stock.

Let's also assume that the pharmacy has a market value matching its purchase price – more on this a bit later.

If you do not have the cash to complete the purchase, chances are that you are going to a credit provider, such as a bank, and asking for a loan.

Determining which credit provider is right for you is a big step. To assist you, let's look at one aspect of the Bank's decision making process – the **Loan to Value Ratio ("LVR").**

LVR

LVR is the proportion of money you intend to borrow compared to the value of the property or business.

You may be familiar with the term LVR as in the case of most home loans, the majority of credit providers usually lending 80% of the value of the property.

But what does it mean for pharmacy lending?

Pharmacy finance for a credit provider is a specialised security and is often a complex lending solution. Therefore, different credit providers have their own view when it comes to LVR percentages. This primarily comes down to their comfort level or risk appetite. And this changes!

Where some providers lend 75% of the market value others will lend 80% of just the goodwill portion.

Using the example above, let's see how a LVR set at 75% of market value compares to 80% of goodwill.

75% LVR against Market Value

$2,000,000 x 75% = $1,500,000

Therefore, the provider will lend $1,500,000 towards the purchase using the pharmacy as security.

80% LVR against Goodwill

$1,700,000 x 80% = $1,360,000

Therefore, the provider will lend $1,360,000 towards the purchase using the pharmacy as security.

The difference between the two LVR policies is $140,000

This could be a huge difference when it comes to providing funds to meet settlement.

<u>Lower of Market Value or Purchase Price</u>

Credit providers general assess LVR based on the ***lower of*** Market Value or Purchase Price.

In our example above, the purchase price of $2,000,000 is also the Market value. This is an important fact because if it's different, it may lead to a different outcome down the track.

For example, let's say you've exchanged on the pharmacy for the $2,000,000. However, the credit provider values the pharmacy at $1,900,000. This is the market value of the pharmacy. If we assume the credit provider's LVR policy was 75% of the lower of Market Value or Purchase Price, then the loan would be:

$1,900,000 x 75% = $1,425,000

This is a difference of $75,000 lower than anticipated. It would mean that cash or another security may be needed to complete the purchase.

The flip side to this equation is that the market value of the pharmacy is greater than the purchase price.

This usually does not factor into the funding equation. IE: if you purchased the pharmacy for $2,000,000 and the credit provider valued it for $2,100,000 the credit provider would not lend 75% of the $2,100,000 for the purchase.

<u>Existing Pharmacy Security</u>

In the years ahead after the purchase, let's assume you are now ready to buy another pharmacy.

We'll assume you've paid down your existing loan that was originally used for that first purchase and that you would also like to use your existing pharmacy as security for your second pharmacy purchase.

For example:

Existing pharmacy – revalued at $2,500,000 market value with debt of $1,300,000

New Pharmacy to be purchased for $1,200,000

After talks with the credit provider, they are prepared to lend 75% of the market value of your existing and 75% of the purchase price for your new pharmacy (let's assume this price matches its market value)

Therefore, to complete the purchase of the new pharmacy, the equation would look like this:

> **Existing Pharmacy** Value $2,500,000 x 75% less debt of $1,300,000 = $575,000
>
> **New Pharmacy** Purchase $1,200,000 x 75% = $900,000

A new loan of $1,475,000 would be available using both pharmacies as security. (This would be in addition to the existing loan of $1,300,000)

LVR policy changes

It is well known that credit provides update and change their lending policies regularly. They usually determine and set their policies according to their current risk appetite and return on investment as outlined in their responsibility to their shareholders.

What this means is that one year they may feel comfortable lending 75% LVR based on the market value of a pharmacy and the next, they wish to reduce their risk by only lending 80% of its goodwill.

If you have a loan that was based on 75% of market value and the bank's policy changes to 80% of goodwill, they may ask you to pay down the loan in line with their new policy. This is usually in the form of increased principal and interest repayments or lump sum reductions.

How can they do this? Well, this often occurs during the bank's annual review process or when your loan is due to expire. Most pharmacy loans have a 2-3 year terms, which can be a trigger event for the bank to implement their new policy.

Summary

- Check which LVR policy your current or future credit provider is using to see how it fits with your own situation.
- Knowing when your existing loan is up for review or about to expire is key so you can plan ahead.
- Seek specialist advice to navigate the types of LVRs on the market to see which one is right for you.

This article should be seen as guide to assist you to with more information on the LVR. In each example above, it has been assumed that debt servicing has been found acceptable by the credit provider.

About the Author

Manoj Miranda has over 20 years' experience as a Finance Professional and has worked in the Healthcare banking industry for over 9 years.

He has held senior management roles at National Australia Bank Health and Westpac Healthcare as State Industry Leader, initially charged with constructing Westpac's banking proposition to the healthcare industry and building and developing a team of specialist industry bankers.

Areas of leadership / influence / development was inclusive of:

- Credit policy & industry underwriting standards;
- Process and procedure (standardised templates, continuous improvement processes, industry bench marking);
- Market presence & delivery;
- Team structuring & portfolio purity; and
- Continuous professional industry development of Bankers

Manoj has a leading industry presence in the NSW healthcare banking industry market, as well as their professional advisors (accountants, lawyers, brokers). From this foundation he started his own business - ***Healthcare Capital Management***.

His previous professional experience covers roles undertaken for GE Commercial and Macquarie Bank in various Credit roles. Further with his overall experience in the finance sector in both Sales and Credit roles, asset finance, commercial and residential lending Manoj can bring a wealth of experience to the healthcare market.

Credentials include a Master of Business (Finance) and MBA (Professional Accounting). He has also completed an Advance Diploma in Financial Planning.