



>opinion

Value-subtracted assets

The credit crisis is causing particular distress for SMEs, and the key problem of lending against depreciating assets may be here for some time. **Simon Woolcott** considers whether there is a viable alternative.

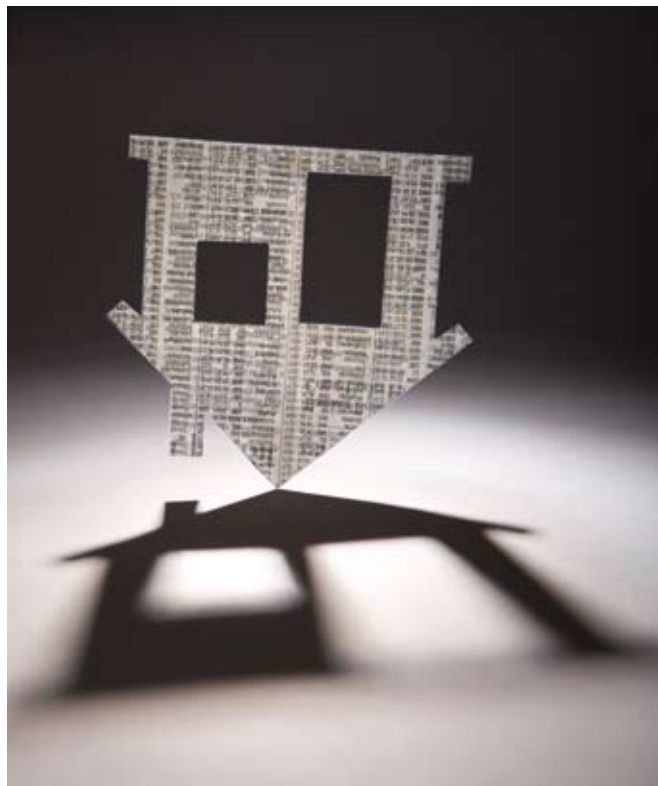
The UK government's second attempt to bail out the banks has highlighted the problems that individuals and smaller businesses are continuing to face when trying to obtain credit. Despite receiving extra public funds, the banks seem to have pulled up the drawbridge, more concerned with building regulatory capital at a time when capital is under pressure and the regulators are looking for higher capital ratios.

But there is another view about why bank lending has collapsed and why the problem will not be solved solely by freeing the money markets. All banks base lending decisions on a number of criteria, but in essence these come down to two core questions: can the potential borrower repay the loan and what security can they offer?

Borrowers' ability to repay loans has been affected by rising unemployment – the number of people out of work in the UK is now near to two million and is expected to rise to three million – and by an increase in the number of SME failures. These are important elements, but I believe that the main reason why we will not return quickly to the halcyon days of lending is that we have fundamental asset valuation problems.

Most personal and SME lending is based on the security of assets, but asset values have been declining since 2007 and the outlook is pessimistic. For example, mortgage lending has been weakened by a 14 per cent drop in property values, with some pundits suggesting that the peak-to-trough decline will be 35 per cent. Similarly, used-car values have fallen by up to half.

SMEs have seen significant falls in commercial property values, along with those of most other assets. For example, inventory values have fallen because of reduced economic activity and a substantial



So, while reckless bankers have been held responsible for the financial crisis, abetted by lax governments and regulators, our profession cannot sit idly by. I do not believe that the world will return quickly to the days of easy credit based on stable and increasing asset values. Accountants must, therefore, find new ways to value complex assets, bearing in mind that we have to be realistic. But we must also ensure that we don't undermine market confidence. We need to help the banking industry move on from a point-in-time basis of valuation for SME and individual lending. By definition, this will mean that the best offers will be available only to those people who least need them.

Perhaps the time has also come for new developments in borrowing. Peer-to-peer lending may be the future for many SMEs and individuals. This involves an intermediary business pooling small, often regular, investments, which are then used to advance loans. In the

decline in high-street sales, while credit insurance problems have reduced the security value of receivables.

In short, a proposal to lend, say, 90 per cent of a property value today will become 113 per cent of the value of the underlying property security value if it drops by 20 per cent. If a lender wishes to cap its exposure to 90 per cent of the projected value of the property used as security for a loan, then the maximum loan-to-value percentage today can be only 72 per cent.

Similarly, the problems in bank lending have partly been because "old-world" bases for valuing assets, whether tangible or financial, on a mark-to-market basis have been found wanting. These approaches were based on the assumption of generally stable or increasing asset values and that a market always exists from which to formulate a value.

UK, Italy, Japan and US, an organisation called Zopa (www.zopa.co.uk) facilitates unsecured personal loans. The US also has Prosper (www.prosper.com), while Auxmoney (www.auxmoney.com) operates in Germany.

Although these organisations are small and focus on issuing unsecured loans to individuals, peer-to-peer lending has been forecast as a growth area by the Gartner Group, which predicts that it will represent ten per cent of the global retail lending market by 2010. How long is it before these businesses expand their products and offer a wider range of opportunities to investors? Surely it's time for a change in the way that we fund our smaller businesses.

Simon Woolcott FCMA is a director of Marchwood Associates (www.marchwoodassociates.com).