
FARM LOANS AND SUPPORT · PART 8 OF 10

Bank covenants on farm loans and what a breach means

By Nick Clunes · Updated 26 October 2026 · 7 minute read

SHORT ANSWER

Covenants are the promises in your loan agreement, such as keeping interest cover above a set level, keeping debt under a share of the land value and sending figures on time. A breach doesn't automatically mean the bank calls in the loan, but it gives the bank rights it didn't have before. Test your numbers against each covenant before the bank does, and if a breach is coming, tell the bank early.

You signed the facility letter three years ago, and the page headed "financial undertakings" went straight in the drawer. Then a dry year knocks profit down, and someone mentions the interest cover covenant. Covenants are easy to forget in a good year and hard to ignore in a poor one.

What a covenant is

A covenant is a promise you make in the loan agreement. Some are about your numbers, some are about information, and some are about what you can do with the security. If you don't keep one, that's usually called a breach or a default, depending on the wording.

The terms vary a lot between banks and between loans. Everything below is general. Your own facility letter is what counts, and a solicitor is the person to read it with you.

Financial covenants

These set a level your figures must stay above or below. They're usually tested once a year from your financial statements, sometimes more often.

Interest cover

How many times your profit covers the interest bill. It's usually worked out as earnings before interest and tax (EBIT) divided by interest paid. A covenant might say it must stay above a set number of times.

Loan to value ratio (LVR)

How much you owe against what the security is worth, as a percentage. If the land is revalued lower, your LVR goes up even if you haven't borrowed another dollar.

Debt service cover

Whether the cash the business earns covers both interest and principal repayments. Banks define it differently. Some start from EBITDA, which is profit before interest, tax, depreciation and amortisation, and take off drawings.

Others

You may also see an equity ratio, a minimum working capital or a cap on new borrowing elsewhere. Each one is spelt out in the agreement.

Reporting covenants

These are promises to send information: annual financial statements within a set time after 30 June, a budget each year, stock numbers, insurance certificates. They're the ones most often broken, usually because the accountant is behind.

They matter more than they look. For small business customers, the Banking Code of Practice lists the defaults other than missed payments that a bank can act on (paragraph 87). Not providing financial information your agreement requires is on that list.

Review events

A review event is a clause that lets the bank review the facility if something happens. Common examples are a fall in security value, a change in who owns or controls the business, or a covenant being missed. It usually means the bank can ask questions and reset terms.

A worked example

This is an invented sheep and cattle business in the Central West, and the figures are illustrative. It has \$3.0 million of debt secured over land valued at \$7.5 million. Its covenants are invented too: interest cover of at least 2.0 times, LVR no higher than 50%, and debt service cover of at least 1.25 times.

	Average year	Poor year
EBITDA	\$500,000	\$350,000

	Average year	Poor year
Depreciation	\$80,000	\$80,000
EBIT	\$420,000	\$270,000
Interest	\$150,000	\$150,000
Principal repayments	\$120,000	\$120,000
Drawings	\$100,000	\$100,000
Interest cover (EBIT ÷ interest)	2.8 times	1.8 times
Debt service cover ((EBITDA less drawings) ÷ (interest plus principal))	1.48 times	0.93 times

In the average year, both ratios are comfortably inside the covenants. In the poor year, interest cover falls to 1.8 times, under the 2.0 minimum. Debt service cover falls to 0.93 times, which means the business can't meet its repayments from the year's cash.

Now the LVR. At a \$7.5 million valuation, \$3.0 million of debt is 40%. If a new valuation came in 15% lower, at \$6.375 million, the LVR would be about 47.1%. That's still under 50%, but the room has nearly gone.

You can run your own figures through the bank ratio check, and try a poor year with the season stress test.

What a breach can lead to

It depends on the agreement and on the bank. Possible responses range from a letter and a waiver, to a higher interest margin, to new conditions such as monthly reporting. In a serious case it can lead to the bank asking for repayment.

For small business customers, the Banking Code sets some limits. The bank generally has to give at least 30 days' notice of a default other than a missed payment, and time to fix it where it can be fixed (paragraph 88). It can only act on a default that is material, or likely to have a material effect (paragraph 90).

Paragraph 91 allows financial indicator covenants as triggers for default action in property development and specialised lending.

The Code's small business definition is turnover under \$10 million in the previous financial year and fewer than 100 full-time equivalent staff. Overdrafts and on-demand facilities have their own rules (paragraph 85). A solicitor can tell you which apply to you.

There are farm-specific protections too. Under Part B7 of the Code, a bank won't charge default interest on a farm loan while the land is in drought or a natural disaster, and you may need to tell the bank about it (paragraphs 128 and 129). In NSW, a creditor must invite a farmer to mediation in writing before enforcing a farm mortgage, and the farmer has 20 business days to respond.

Talk to the bank early

If your forecast shows a covenant will be missed, tell the bank before the statements arrive. Bring the numbers, the reason and your plan, such as selling stock earlier or holding off on a machinery purchase. A breach the bank hears about from you, with a plan, is a much easier conversation than one it finds itself.

The Code asks customers in financial difficulty to contact the bank as soon as possible (paragraph 167). Help is decided case by case and can include a short interest-only period or a longer loan term (paragraph 178). You can ask the bank to deal with your financial counsellor (paragraph 170).

Help with hardship

The Rural Financial Counselling Service gives free, independent help to primary producers in financial hardship, or at risk of it. It is co-funded by the Australian and state governments. Its counsellors help with cashflow budgets, negotiating with lenders and preparing for farm debt mediation, and the national number is 1300 771 741.

The Regional Investment Corporation also lends to eligible farm businesses, with its own eligibility and credit criteria. Its variable rate is 5.71% from 1 August 2026.

When to get help

I check where a client sits against every covenant as part of the Bank Review Pack, at \$1,850 plus GST. If you'd like to know before the review whether any covenant is at risk, start with the Farm Health Check at \$850 plus GST.

Common questions

Where do I find my covenants?

In the facility letter or loan agreement, usually under headings like financial undertakings, conditions or review events. If the wording is hard to follow, a solicitor can explain what it means for you.

Does the Banking Code of Practice stop banks using financial covenants?

For small business loans under the Code, the list of defaults other than missed payments that a bank can act on is set out in paragraph 87, and a financial ratio breach isn't on it. Paragraph 91 allows financial indicator covenants as default triggers for property development and specialised lending. Larger loans fall outside the small business definition, so check your agreement with a solicitor.

What is a review event?

It's a clause that lets the bank review the facility if something happens, such as a change in ownership or a fall in security value. A review event usually starts a conversation rather than an enforcement step, but read your own agreement.

Who can help if I'm in financial difficulty?

The Rural Financial Counselling Service is free, and its counsellors can help you negotiate with lenders. The national number is 1300 771 741. The Banking Code also says you can ask your bank to deal with your financial counsellor.

Sources

1. Australian Banking Association, 2025 Banking Code of Practice (screen reader version)
2. Australian Banking Association, Banking Code of Practice
3. NSW Rural Assistance Authority, Farm debt mediation: an overview
4. Agriculture Victoria, Rural Financial Counselling Service
5. Regional Investment Corporation, RIC variable interest rate change from 1 August 2026

General information only, not financial, tax or credit advice. Worked examples use made-up figures.