Loan Finance
A guide for trustees

An Introduction to Loan Finance for Trustees
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Charity bank

Introduction

As a charity trustee, you have the responsibility to manage your organisation's finances in a way that supports your charity's mission and ensures its long-term sustainability.

One of the key financial tools available to charities is loan finance. Loans can provide the necessary funding your organisation needs to start a new project, purchase a property or deal with cash flow issues. It's therefore important to understand the different types of loan finance available and the benefits, risks and responsibilities that come with borrowing money.

This guide will provide you with an introduction to loan finance for charities, helping you understand what loan finance has to offer so you can determine whether it is a suitable option for your organisation.

Benefits of loan finance

Taking on loan finance can allow your charity to move to its future goals more quickly, help your charity grow, create security, and achieve sustainability for the long-term.

Speed

- Loans can help kick-start your projects and achieve your goals quicker than fundraising alone. This can be particularly important when delays can lead to price rises and additional costs.

Flexibility

- Loans can be tailored to meet the specific needs of a charity, allowing them to fund projects or investments that may not be covered by traditional sources of funding.

Predictable cash flow

- With a loan, charities can plan and budget their cash flow more effectively, knowing exactly what their monthly payments will be.

More control

- Unlike grants, loans give charities more control over how the funds are used, allowing them to make strategic investments in their operations.

Match funding

- Match funding means that to receive grant, you need to put up some of your own funds. Loan finance can often be used for match funding.

Boost in income & diversify

- Loan finance can be used to develop core operations, pay off debts, launch new projects, purchase new premises, or help during a cashflow problem.

Growth

- Loans can help charities expand their operations, take on new projects, and reach more people.

Reputation

- By taking out a loan and making timely payments, charities can build up their credit profile, making it easier to secure both grant and loan funding in the future.

For example, many of our borrowers use their loan to buy property. The loan repayments are often lower than the charity's previous rental costs.

Plus, the charity gains the freedom of being able to change the property as they see fit. Once the loan is repaid, the charity will have a valuable asset.

Other borrowers use their loan to create a new income stream, for example by buying a property to rent out, opening a café or shop, or expanding a paid-for service.

What can a charity use **loan finance for?**

The three main uses of loan finance for charities are:

Capital expenditure

Used if your organisation wanted to purchase long-term assets for its' operations.

For example, to buy a building that you currently rent or land on which you plan to construct a new building. Building refurbishments or regeneration also fall under capital expenditure.

Development/growth capital

This could be used to get a product or service up and running. It can be useful when you have an idea to generate income for your organisation but don't have the resources to make it happen.

Working capital

Used if your charity needs help to get it through difficult times or if you need to bridge the gap between delivering your services and receiving funding.

For example, working capital can be used to bridge grant and fundraising income cycles or to help cover payroll or bills when a charity needs to keep operations going through a rough patch.

What types of loan finance are **available to charities?**

As a charity trustee, you have the responsibility to manage your organisation's finances in a way that supports your charity's mission and ensures its long-term sustainability.

Some things remain the same no matter what type of finance you undertake. Be prepared to pay interest at a set rate (this is often linked to the Bank of England base rate). It's a good idea to compare the interest you will be charged with that of other lenders.

The next two pages provide an overview of the different types of loan finance available to charities:

Standard term loan:

Is a fixed amount of money borrowed from a lender and repaid with interest over an agreed period (typically between two and 25 years).

Repayment schedules will vary depending on the charity and the lender and may be either secured or unsecured. These are generally used for capital or working capital projects, for example for building a property.

Secured loan:

Secured loans require a charity to pledge collateral or assets as security for the loan. The collateral can be in the form of property, investments, or equipment.

Secured loans often have lower interest rates compared to unsecured loans because as there is a lower level of risk for the lender. If the charity defaults on the loan, the lender may seize the collateral to recover their losses.

Unsecured loan:

Unsecured loans do not require any collateral from the charity. They are granted based on the charity's creditworthiness and ability to repay the loan and are generally used for working capital or investment purposes.

As there is no collateral, interest rates are typically higher and borrowing amounts may be lower.

Whilst these may be more difficult to obtain, they offer a way for charities to access funds without risking their assets.

Asset finance

Is where a loan is used to acquire an asset, such as equipment of vehicles, without having to pay the full cost upfront. It typically involves a lender purchasing the asset on behalf of the charity and then leasing it back to them over an agreed period of time.

The charity makes regular repayments to the lender, which include interest and a portion of the asset's cost, until the end of the lease term when ownership of the asset may be transferred to the charity.

This can help charities to spread the cost of acquiring assets, preserve cash flow, and avoid the need for large capital expenditure.

Example of asset finance:

The simplest example is a minibus loan, where you are taking out a loan to buy a minibus and are securing the loan against the minibus itself.

Alternatively, an asset house provider can provide funding for the purchase of the minibus but would take a charge over it.

If the charity fails to pay back the finance that they take on to purchase the minibus the asset provider would reclaim the minibus until the charity has paid for it.

Bridging facility

Is a short-term loan or credit facility that can be used to bridge a cap in cash-flow. For example, a bridging loan can be used to cover expenses or help a charity meet its financial obligations until it receives expected income or funding from other sources.

Standby facility or overdraft facility

Is a type of financial arrangement that can be used as a form of insurance against unexpected emergency situations. It provides a line of credit that can be drawn upon if and when needed.

A standby facility is different from a bridging loan in that it's not intended to cover short-term cash flow gaps. Instead, it is designed to provide a safety net for charities in case of unforeseen circumstances such as a sudden drop in donations or a major unexpected expense.

The lender charges a fee for making the funds available and then charges interest if any of those funds are actually utilised. It may also charge a reduced level of interest for unused sums. The specifics of a standby facility will be agreed between you and the lender but can be either a loan or an overdraft.

Revolving loan

A revolving loan facility provides the ability to draw down or repay and withdraw again up to an agreed maximum limit. Unlike a term loan where a borrower is provided with a fixed payment schedule, a revolving loan allows the borrower to pay the loan and take it our again. This type of facility offers a great deal of flexibility.

Making sure loan finance is the **right choice**

Whilst we can't tell you whether loan finance is right for your organisation, we can give you a few pointers to help you understand whether loan finance is the right move for your charity.

Be aware of the risks

It's important to consider the risks involved with loan finance. If you are not sure if your charity can afford the monthly payments, or if you are not comfortable with the terms of the loan, it may be best to look for other options. A loan repayment calculator is a useful tool that can help you work out indicative repayments for a loan.

A reputable lender will make you aware of the risks and help you assess your ability to repay the loan.

Don't borrow more than you need

Make sure that you don't borrow more than you need. Consider alternative possibilities if things don't go to plan and listen to your colleagues if they say that you need to consider borrowing less.

Always talk to your lender if you think there is an issue

Although all lenders want to be repaid, a good lender will also want to understand the situation that you are in.

Responsible lenders will do their best to help you tackle short-term problems and will want to understand what solutions you have considered for the long-term.

Choose the right lender

Choosing to work with a lender that knows the sector, reflects your values and understands the unique needs of charities is an important thing to consider when you are thinking about where to apply for loan finance.

Make sure your charity has the right experience

Lenders will be looking to protect both you and their investment by looking into your charity's history.

For example, if you are proposing to pay the loan back by increasing your fundraising activities, you are more likely to be successful if you have a strong history of raising donations.

Lenders like Charity Bank will look to consider how much you plan to raise your fundraising by and whether this is an achievable target.

Frequently asked **questions**

Over the next few pages, we'll answer some questions that commonly come up when charities are considering taking out a loan.

Before Applying

I've heard that finance providers think charities are too risky for loans.

Social lenders, like Charity Bank exist to help charities, social enterprises and other social purpose organisations assess affordable and appropriate finance.

A social lender will generally have a better understanding of how charities work.

There's no mention of borrowing in my charity's governing document. Does that mean we can't have a loan?

You may still be able to take out a loan, but you will need to speak to the Charity Commission or a solicitor first to make sure.

What skills do we need as an organisation before we take out a loan?

Ideally, the person who manages the loans process will have strong planning, financial and cash management skills. It also helps to have someone with financial experience on your Board.

> "The trustees were understandably nervous about taking out a huge loan, but the only other option was to let things spiral out of control. We knew that if we didn't do something soon, we were in danger of losing the whole estate. It was becoming more and more difficult to fill the cottages.
>
> We realised that we needed to extend them in order to attract new residents. It's much easier to let the cottages out now. People come for a viewing, and they want to live here."
>
> **David Skellum, Treasurer of sheltered housing charity Glover's Trust**

> "It's the first time we've ever had a property loan, but it was a unanimous decision by the trustees. We want our residents to have modern homes with affordable day-to-day running costs.
>
> We felt as trustees that it was our responsibility to regenerate the village. The loan repayments will be covered by the rental cost of the new properties."
>
> **Harvey Jennings, Chair of War Memorial Village Derby**

The loan application **process**

How does the process work?

Each lender will have their own process and should provide details when you first apply. At Charity Bank, we've made the process as straightforward as possible. In most cases, you'll want to agree one person at the charity to manage the application.

The process has five key stages:

1. The charity makes an initial enquiry and is allocated a Relationship Manager.
2. The Relationship Manager guides the charity through the loan process.
3. We let the charity know our decision and confirm the terms.
4. The charity works with us and our professional advisers to meet the loan conditions, for example by providing key documents.
5. The charity requests its funds and the money reaches its account in seven working days.

For a more detailed explanation, please see our Loans Process guide, which can be downloaded from our website at http://www.charitybank.org/news/loans-frequently-asked-questions

What will lenders need during the **loan application process?**

You will be asked for a range of information at different stages of the application process, typically this will include:

- Details of your charity, including a list of trustees and/or directors
- The project you need the loan for
- The charity's financial situation
- Charity's annual report
- Three years of finalised accounts
- Financial projections for the current and next financial year, including cash flow forecasts and annual budgets
- Internal management accounts for the financial year to date
- Copies of the bank or building society statements for the last six months
- Your governing documents
- A business plan
- A fundraising plan of strategy
- Valuations of property
- Evidence of your organisations legal form e.g., limited company status

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If you're struggling to pull together the relevant financial information, we may be able to help you.

However, this may indicate that your charity isn't ready for loan finance as you don't have the necessary financial and administrative structures.

Professional guidance

Section 124.2 of the Charities Act 2011 requires you to have 'obtained and considered proper advice' when borrowing funds, and when securing them against charity assets. Who this advice must come from isn't prescribed.

However, it must be from someone who can reasonably offer advice to the trustees and has the experience to evidence it, such as an independent financial adviser, accountant or other qualified professional. It may be another trustee or a staff member of the charity.

Business Plan

The charity will need to provide a robust business plan showing how the project to be financed fits with the charity's overall objectives and how risks will be managed, along with financial forecasts, timescales, and so on.

Key questions to answer in your business plan:

- What do you want to achieve?
- Why do you want to do it?
- How do you intend to make it happen?
- How do you see the costs and revenue from the activity developing in the short, medium and long term?
- Can you obtain any evidence that you will receive the income you are predicting?
- Are your predictions realistic?
- What if you don't get the income you're expecting?
- What if costs rise?
- What will happen if interest rates rise in the next two years?

There is no specific format that you need to follow to present you business plan. It can be that you can cover everything you need to on a single side of A4. The lender will be looking for evidence that the charity has a clear sense of direction.

You can find a good business planning template on The Prince's Trust website: Business plans and templates | Business tools | The Prince's Trust (princes-trust.org.uk)

Managing the loan **repayments**

Do trustees have a personal responsibility to pay the loan if the charity can't?

If your charity or social enterprise has a legal corporate status (such as company limited by guarantee, charitable incorporated organisation, or community interest company), we do not need personal guarantees from trustees. The only times you would be personally liable for the loan is if:

- You've caused the charity to lose money because you've acted unlawfully, imprudently or outside the terms of the charity's governing document.
- You've committed the charity to debts which amount to more than its assets.

If you are an unincorporated organisation, the trustees will, by default, be personally liable for the loan, so we do recommend achieving corporate status (if this is appropriate for your organisation) before you take the loan.

We can signpost you to organisations that can help with this.

What happens if the charity can't afford payments?

This will depend on the lender. At Charity Bank we seek to be patient and understanding throughout the lending process. Our reason for existence is to support charities and social enterprises through affordable loans.

We know that unexpected challenges arise, and that times are incredibly difficult for many of our borrowers. We offer a range of support to borrowers who are struggling to make loan repayments.

We ask that you get in touch as soon as you know the charity is finding it difficult to make repayments.

How can the charity minimise the risk of not being able to pay the loan?

We only offer loans to charities who we feel can comfortably afford a loan. Good governance and a strong management team should help to minimise any risks.

Can the loan be repaid earlier without penalties?

At Charity Bank, in most cases, our loans are flexible, so you can pay it off earlier without a penalty.

What is the worst-case scenario?

If the charity is unable to make repayments, and no agreement can be reached, then the assets that are secured against the loan may be at risk. At Charity Bank, it is very rare for this to happen – less than 0.5% of our loans have defaulted.

"Charity Bank go through everything with you. If you send something over and it's not quite what they want, they'll come back to you and say, "Can you just tweak this bit?" We went through all the paperwork side of it together."

Megan Morris, Finance Manager of Ruby's Fund

"Of course, we had our worries at times. It's all a risk, isn't it? But we felt confident after going through our risk management assessment. And also the loan application process actually really helped with this.

Being forced to go into the real details of the charity, create cash flows, business plans, and look at donation patterns and the potential future uses of the new building really helped to reassure us of the position we were in and that we could afford the loan."

Tracee McAtear, Executive Pastor of Connect Church UK

Case Study: **Aspatria Dreamscheme**

Aspatria Dreamscheme started as a youth charity and is now expanding its services to the wider community. An old chapel came up for sale near the charity's youth centre, and Charity Bank agreed to loan Aspatria Dreamscheme £84,500 towards the cost of buying and renovating it.

The loan repayments are £200 a month lower than the rent would be on a similar property. Ownership also makes it far easier to get grant funding, which the charity needs to fund a commercial kitchen and other equipment.

Plus, as Aspatria Dreamscheme's Youth & Community Development Manager, Linda Hunter, says, ownership gives long-term security,

> "If you lease a building, you're legally required to pay rent, even if a project closes and you're no longer using the property. But if you own the building, you can sell it and reinvest the money in your other services."

Aspatria Dreamscheme has big plans for the new building. All of the new services, from cookery classes to craft activities and low-cost hot meals, will help to bring people together and tackle loneliness.

Case Study: **Target Housing**

Target Housing provides homes for people who would otherwise be on the street. Their clients often have multiple needs, including drug addiction, alcohol dependency, mental health issues and learning disabilities.

In 2008, the charity decided to take a step forward and buy its first properties. It secured funding from the Futurebuilders England fund and a loan from Charity Bank. Since then, the charity has increased its borrowing to buy more properties. It now owns almost 100 properties, around 40 of which it's bought with the help of Charity Bank.

CEO Shaun Needham sees property as crucial to the charity's long-term stability:

> "For me, this is Target Housing's lifeline – we'll survive by being the master of our own destiny. With a portfolio of 100 properties, we can do anything.
>
> We currently have numerous local authority contracts, a contract with the Home Office, and a few other smaller contracts.
>
> If we lost everything tomorrow, we'd still have those 100 properties, which means we could still offer bed spaces to vulnerable people, and the rent would still come in. Target would look vastly different, but it would be able to carry on."

Next **steps**

Checklist for loan finance decision-making:

	What would you like to achieve?
	How much money do you need?
	Do you have the funds to pay for it?
	If not, what funding options are there? Is borrowing the best of these?
	If you decided to take out a loan, will you be able to afford to repay it?
	Does your charity's governing document give it the power to borrow and pledge assets?
	Have you checked through your operating structure and chosen legal entity?
	Do you have a business plan prepared? Is it realistic?
	How will your project generate positive social impact?
	Will what you spend the money on generate income to help you pay back the loan?
	Who is the best lender to borrower from? Have they worked with charities before?
	What type of repayable finance is best for your needs?
	What level of interest will you pay?
	Have trustees taken specialist advice, where necessary, on the terms of the loan?
	Does your charity have the necessary expertise and governance controls to borrow safely?
	Do you have agreement from your senior management team to borrow?
	Have you determined when the money is needed and are adequate timelines in place?

About Charity Bank

Charity Bank is the loans and savings bank owned by and committed to supporting the social sector. Our UK-wide network of regional managers have a detailed understanding of the unique requirements of charities and social enterprises and are driven to support and strengthen impact-led organisations.

Over the past 20 years, we have made more than 1,200 loans worth over £450 million to social sector organisations across the UK.

Every single one of our shareholders is either a charitable trust or foundation or a social purpose organisation.

If you're considering a loan for your charity, please visit Charity Loans For UK Charities & Social Enterprises - Charity Bank.

You may also find our Loans Process guide useful. It can be downloaded from our website at www.charitybank.org/news/loans-frequently-asked-questions

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