

A Glossary of Loan Terms

Link to Online Glossary of Loan Terms: <http://www.gdrc.org/icm/loan-glossary.html>

■ Assets

Anything of value. Any interest in real or personal property which can be appropriated for the payment of debt.

■ Bad Debt

A debt that is not collectible and is therefore worthless to the creditor.

■ Balance Sheet

Financial statement presenting measures of the assets, liabilities and owner's equity or net worth of business firm or nonprofit organization as of a specific moment in time.

■ Bridge Loan

Short-term loan to provide temporary financing until more permanent financing is available.

■ Business Plan

A document that describes an organization's current status and plans for several years into the future. It generally projects future opportunities for the organization and maps the financial, operations, marketing and organizational strategies that will enable the organization to achieve its goals.

■ Capital

Broadly, all the money and other property of a corporation or other enterprise used in transacting its business.

■ Capitalization

Long-term debt, preferred stock and net worth. The loan capital of a community development loan fund; includes that which has been borrowed from and is repayable to third parties as well as that which is earned or owned by the loan fund (i.e. "permanent capital").

■ Capital Markets

Those financial markets, including institutions and individuals, that exchange securities, especially long-term debt instruments.

■ Cash Flow Financing

Short-term loan providing additional cash to cover cash shortfalls in anticipation of revenue, such as the payment(s) of receivables.

■ Collateral

Assets pledged to secure the repayment of a loan.

■ Covenant

An agreement or promise to do or not to do a particular thing; to enter into a formal agreement; a promise incidental to a deed or contract. The following are functional objectives guiding most covenants: full disclosure of information, preservation of net worth, maintenance of asset quality, maintenance of adequate cash flow, control of growth, control of management, assurance of legal existence and concept of going concern, provision for lender profit or program goals.

■ Current Asset

Assets that will normally be turned into cash within a year.

■ Current Liability

Liability that will normally be repaid within a year.

■ Current Ratio

Current assets divided by current liabilities -- a measure of liquidity. Generally, the higher the ratio, the greater the "cushion" between current obligations and a firm's ability to meet them.

■ Debt

An amount owed for funds borrowed. The debt may be owed to an organization's own reserves, individuals, banks, or other institutions. Generally, the debt is secured by a note, bond, mortgage, or other instrument that states repayment and interest provisions. The note, in turn, may be secured by a lien against property or other assets.

■ Debt Service

Amount of payment due regularly to meet a debt agreement; usually a monthly, quarterly or annual obligation.

■ Debt Service Reserve

Term used to refer to cash reserves set aside by a borrower, either by internal policy or lender covenant, to repay debt in the event that cash generated by operations is insufficient.

■ Default

A failure to discharge a duty. The term is most often used to describe the occurrence of an event that cuts short the rights or remedies of one of the parties to an agreement or legal dispute, for example, the failure of the mortgagor to pay a mortgage installment, or to comply with mortgage covenants.

■ Delinquent

In a monetary context, something that has been made payable and is overdue and unpaid,

■ Due Diligence

Refers to the task of carefully confirming all critical assumptions and facts presented by a borrower. This includes verifying sources of income, accuracy of financial statements, value of assets that will serve as collateral, the tax status of the borrower and any other material facts presented by the borrower.

■ Endowment or Trust

A fund that contains assets whose use is restricted only to the income earned by these assets.

■ Equity

The value of property in an organization greater than total debt held on it. Equity investments typically take the form of an owner's share in the business, and often, a share in the return, or profits. Equity investments carry greater risk than debt, but the potential for greater return should balance the risk.

■ Equity Participation

An ownership position in an organization or venture taken through an investment. Returns on the investment are dependent on the profitability of the organization or venture.

■ Fund Balance

Net worth in a nonprofit organization; total assets minus total liabilities.

■ General Recourse

Rights to demand payment from the general assets of the debtor, without seniority in access to any specific assets.

■ Guaranteed Loan

A pledge to cover the payment of debt or to perform some obligation if the person liable fails to perform. When a third party guarantees a loan, it promises to pay in the event of a default by the borrower.

■ Interim Financing

Short-term loan to provide temporary financing until more permanent financing is available.

■ Intermediaries

Non- or for-profit institutions that have specialized lending capacities. They obtain capital in the form of equity and low interest loans from a variety of sources, including foundations and other funders, to form a "lending pool." They then serve as "wholesalers" who process large numbers of small loans or investments. This "economy of scale" often allows intermediaries to be more efficient than a foundation or funder could be if it considered each investment individually. Also, intermediaries often develop expertise in a particular field or region that foundations or funders cannot afford to develop. In the context of this study, non-financial intermediaries include community foundations and financial intermediaries include credit unions, venture capital and loan funds, banks, etc.

■ Leverage

Using long-term debt to secure funds for an organization. In the social investment world, often refers to financial participation by other private, public or individual sources.

■ **Liabilities, Total Liabilities**

Total value of financial claims on a firm's assets. Equals total assets minus net worth.

■ **Limited Liability**

Limitation of shareholders' losses to the amount invested.

■ **Limited Recourse**

Rights only to specifically stipulated assets to satisfy an unpaid debt.

■ **Line of Credit**

Agreement by a bank that a company may borrow at any time up to an established limit.

■ **Linked Deposit**

A deposit in an account with a financial institution to induce that institution's support for one or more projects. By accruing no interest or low interest on its deposit, a foundation essentially subsidizes the interest rate of the project borrowers.

■ **Loan Agreement**

A written contract between a lender and a borrower that sets out the rights and obligations of each party regarding a specified loan.

■ **Loss Reserves**

That portion of a fund's earnings or permanent capital designated by the board of directors as a reserve against possible loan losses and, as such, unavailable for lending purposes. Generally accepted accounting principles governing for-profit and regulated financial institutions require that loan loss expense be deducted as an annual expense on an accrual basis and that the loan loss reserve be shown as a contra asset reducing loan assets. To date, no accounting convention has been established to govern loan loss reserve accounting for unregulated nonprofit institutions. The technical treatment is to establish the reserve through periodic charges against earnings, and actual losses, when and if incurred, and are charged against the reserve. For balance sheet purposes a loan loss reserve (should) be shown as a deduction from the loan portfolio to suggest that its true economic value should be reduced by the estimated loss exposure.

■ **Market Rate**

The rate of interest a company must pay to borrow funds currently. Program-related investments generally are offered at below market rates or at no interest rate.

■ Negative Covenants

Statements of actions or events of the borrower must prevent from occurring or existing, for example, additional borrowing without the lender's consent.

■ Net Working Capital

Current assets minus current liabilities.

■ Net Worth (Fund Balance in nonprofit organizations)

Total assets minus total liabilities. Aggregate net value of the organization.

■ Opportunity Cost

The potential benefit that is foregone from not following the best (financially optimal) alternative course of action.

■ Portfolio

A combination of assets held for its investment benefits, including financial and non-financial returns. The asset mix is usually varied in kind and size to maintain an acceptable level of risk and return.

■ Principal

In commercial law, the principal is the amount that is received, in the case of a loan, or the amount from which flows the interest.

■ Program-Related Enterprise

A business or enterprise designed to promote the social purpose goals of an organization as well as generate revenue. Among nonprofits, products and services are usually, but not exclusively, identified with the purpose of the organization. Activities can range from fee-for-service charges to full-scale commercial ventures.

■ Program-Related Investment

Broad, functional definition: A method of providing support to an organization, consistent with program goals involving the potential return of capital within an established time frame. In the context of this study, program-related investments include loans, loan guarantees, equity investments, asset purchases or the conversion of asset(s) to charitable use, linked deposits, and, in some cases, recoverable grants.

■ **Promissory Note**

Promise to pay. Written contract between a borrower and a lender that is signed by the borrower and provides evidence of the borrower's indebtedness to the lender.

■ **Receivables**

Accounts receivable; an amount that is owed the business, usually by one of its customers as a result of the ordinary extension of credit,

■ **Recourse**

Refers to the right, in an agreement, to demand payment from the person who is taking on an obligation. A full recourse loan refers to the right of the lender to take any assets of the borrower if repayment is not made. A limited recourse loan only allows the lender to take assets named in the loan agreement. A non-recourse loan limits the lender's rights to the particular asset being financed -- an approach that is common in home mortgages and other real estate loans.

■ **Recoverable Grants**

Funds provided by a philanthropist to fulfill a role similar to equity. A recoverable grant may include an agreement to treat the investment as a grant if the enterprise is not successful, but to repay the investor if the enterprise meets with success.

■ **Restructure**

A revision of a financial agreement that alters the conditions or covenants of the original agreement. For example, parties may agree to restructure a loan agreement, easing the payment schedule, when a borrower is delinquent or otherwise faces default on a loan.

■ **Roll Over**

Prior to or at the time of the maturity of an investment or loan, the interested parties agree to continue to carry over the investment or loan for another, successive period of time.

■ **Security**

A pledge made to secure the performance of a contract or the fulfillment of an obligation. Examples of securities include real estate, equipment stocks or a co-signer. Mortgages are a form of security with strong legal standing, because they are publicly registered following a formal legal procedure. A mortgage gives the lender holding a mortgage security the right to reclaim the asset being financed, if repayment is not made.

■ Senior Debt

Debt that must be repaid before subordinated debt receives any payment in the event of default.

■ Subordinated Debt (Junior Debt)

Debt over which senior debt takes priority. In the event of bankruptcy, subordinated debt-holders receive payment only after senior debt is paid in full. A subordination of security interest in property allows another creditor to have the rights to the proceeds of the sale of that property before the claim of the subordinated creditor.

■ Term

Refers to the maturity or length of time until final repayment on a loan, bond, sale or other contractual obligation.

■ User

A non- or for-profit entity that receives a program-related investment directly from a funder for use in its programs or ventures.

■ Warranties

Statement attesting that certain statements are true. For instance, the borrower may warrant that it is a corporation, that it is entering into the agreement legally and that financial statements supplied to the bank are true.

■ Working Capital

Technically, means current assets and current liabilities. The term is commonly used a synonymous with net working capital. The term often also is used to refer to all short-term funding needs for operations (excluding debt service and fixed assets). A company's investment in current assets that are used to maintain normal business operations. Net working capital, which is the excess of current assets over current liabilities is also interchangeable with working capital. Both reflect the resources in circulation to meet operating needs and obligations as they come due.

■ Write off

When an investment, such as a loan, becomes seriously delinquent or in default and is determined to be uncollectible, the lender may choose to charge the outstanding investment amount as an expense or a loss.