

Brief Guide to
Loan Finance
for Trustees

Foreword

In any review of the needs of the voluntary and community sector, access to finance ranks high on the list. While many trustees use debt finance, from credit cards to mortgages or business loans, in their everyday lives, they often overlook the empowering ability of credit to help their charity deliver its mission now. But even when they do acknowledge its usefulness they don't know where to find a sympathetic lender or how to use what is on offer. That is why we welcome and support the development of this guide.

Charity Bank is a regulated bank and a registered charity. We need to deliver financial return for our own sustainability but we also focus on the needs of charities and help them to use loan finance, often for the first time. There are a growing number of choices open to trustees now in the space between grants and commercial finance. This Brief Guide will help you navigate amongst those options and, in doing so, help your charity.

Malcolm Hayday

Chief Executive, Charity Bank

An Introduction to Loan Finance for Trustees

Trustees are responsible for ensuring the financial stability of their organisation. This involves being aware of the variety of funding and financing sources available to voluntary and community organisations (VCOs). One option that is increasingly playing a more important role for VCOs is loan finance.

Loan finance is different from an income source and should be seen as a financial tool or enabler. Loans may not be suitable for all organisations, or for all projects, but all trustees should be aware of what loan finance can offer and be able to weigh up the alternatives before deciding either way.

This guide is designed for trustees considering loan finance, or who just want to be better informed. It introduces the benefits, presents some factors that should be thought through and signposts to further information.

Why loan finance?

Unlike grants, loans require repayment. Interest will also be charged in most circumstances and arrangement fees may apply. But loans are worth serious consideration because they offer a number of benefits:

Speed

Loans can be faster to arrange than grants. Grant-makers often have prescribed timetables for applications, with decisions being made at prearranged meetings. Loan applications can be made when needed and the decision process is usually much quicker.

Non-competitive

Grant programmes are generally competitive: most grant rounds are heavily over-subscribed and only the organisations whose applications best meet the funder's conditions will be successful. Loans are different because if the application meets the lending criteria it will usually be successful.

Flexibility

Applicants to grant programmes are often restricted in what they can apply for by funders' areas of interest. A loan applicant can present their project idea according to what they feel will best benefit their beneficiaries. The application will then be judged based on the acceptance of a business plan demonstrating an ability to manage and repay the loan whilst achieving what you want to do.

Reduced bureaucracy

Loans often involve less reporting and monitoring. Once the initial application is approved, payment is made, and the VCO is then responsible for making timely payments. Grants usually require regular reporting to the funder, with instalment payments dependent on submission of these reports.

Advance payment

Loan payments are made in advance, on meeting agreed milestones. Grants are often paid in instalments in arrears.

Is loan finance the right choice?

The three considerations below are a good starting point to determine whether a loan may be suitable: for a particular project, within a particular organisation and at a particular point of its lifecycle.

1

Consider what the money will be used for

Loans are available for a variety of purposes, including:

- bridging grant and fundraising income cycles;
- managing delays between producing goods and services, selling them and receiving the cash;
- investing in organisational growth or funding a merger with another organisation;
- buying equipment;
- kick-starting new ventures or projects;
- renovating existing buildings, or purchasing new property.

2

Determine how this will benefit the organisation

Before embarking on a loan application, trustees should prepare a business plan for the project and consider:

- Will the project generate enough income to meet loan repayments? Can taking out the loan provide the organisation with a means of generating future income and thereby contribute to the ongoing sustainability of the organisation?
- Does it allow the organisation to better achieve its core mission; that is, will it help more beneficiaries or improve the services offered?

3

Ensure the correct organisational structure and systems are in place

Once satisfied the project is suitable for loan finance, trustees need to ensure:

- the governing document gives the power to borrow and, potentially, to pledge assets as security;
- the organisation has robust finance systems to manage the loan and the project.

Benefits to the organisation should be financial as well as social, and loan providers that lend to the voluntary and community sector are looking to achieve social as well as financial returns.

Fundamentally the organisation should ensure that there will be enough income available to meet loan repayments.

However, consideration should also be given to whether the loan financed project or activity will benefit the organisation financially in the long term. For example, taking out a loan to renovate a room that can then be rented out for community use could continue to generate income long after the loan repayments are complete. It should also be remembered that taking out a loan for an activity that can be self-financing frees up grant applications for other projects that are unable to generate income.

Loan finance in action – The Nadair Trust

The Nadair Trust supports 38 environmental, cultural and heritage projects in the Argyll Islands of Scotland. These are often small-scale charity projects in remote communities, ranging from bird and butterfly conservation to countryside management, heritage gardens and other facilities. The Trust has secured over £4.5 million of funding for these projects from the Heritage Lottery Fund in a second three-year programme.



The need

While some projects are large enough or sufficiently accessible to be able to raise their own banking facilities, the Heritage Lottery Fund funding for the projects can take up to five weeks to reach the charities. This can leave them with serious cash flow problems that prevent them from completing important projects on time, for example building work, because they are unable to pay their suppliers.

How loan finance helped

Charity Bank provided the Nadair Trust with a £100,000 global facility that can be allocated to the individual projects as a bridging finance facility, enabling them to pay contractors and finish their projects on schedule even if the Heritage Lottery Fund funding doesn't arrive in time.



“The loan facility from Charity Bank has helped enormously,” said Dugie Bannatyne, Manager of the Nadair Trust. “Commercial banks are usually unwilling to provide bridging finance for such small groups in remote locations to which they do not have easy access. The revolving loan from Charity Bank has made it very simple for our charities to get the cash flow assistance they need to continue their work at a time when they need it.”

Frequently asked questions

Q: *I am a trustee of a VCO. Will I be personally liable to repay the loan if the project fails to generate the income to repay the loan?*

A: No, provided you have acted prudently you will not be personally liable for the loan. You are only at risk of personal liability if you cause loss to the charity by acting unlawfully, imprudently or outside the terms of the charity's governing document; or commit the charity to debts which amount to more than its assets.

Q: *My organisation's governing document does not mention borrowing specifically. Does this mean we cannot take out a loan?*

A: Not necessarily. You should take advice from the Charity Commission or a solicitor.

Q: *I thought finance providers considered VCOs too risky for loans. Will we be wasting time applying?*

A: No. Although high street banks have not always been receptive to applications from VCOs, there are now more providers willing to offer finance to organisations unable to access mainstream funding. A list of providers is included with this guide.

Q: *I'd like my organisation to consider loan finance as an option. What skills should I ensure exist?*

A: You need strong planning, financial and cash management skills. Your staff also need to support the idea of a loan through understanding why it is being used and how it will benefit the organisation and its beneficiaries. Some providers, including Futurebuilders England, Charity Bank and Venturesome provide support to help organisations work through the finance need and develop skills to manage loans. This can include advisors discussing requirements, provision of loan calculators or providing grants for development.

Q: *Why should I consider borrowing when my organisation has always had adequate grant support?*

A: It is unwise to rely on a single source of funding. Utilising varied sources of financing increases sustainability. Additionally, loans for self-financing projects offer a number of benefits and allow grants to be used for alternative purposes. Benefits of loan finance are discussed in the section, 'Why loan finance?'

Q: *What are the potential risks and implications of taking out a loan?*

A: When planning a project trustees consider risks, but the unexpected can always happen. Trustees are legally binding the organisation to an agreed repayment schedule; terms and conditions; and, possibly, security in the form of a charge on the organisation's assets. Trustees must understand the terms and conditions associated with a loan. Non-compliance can result in demands for immediate repayment.

When trustees act prudently, they are not held personally liable for the loan. However, they should be aware that ultimately the lender may have a charge on the organisation's assets and require them to be disposed of to make repayments due.

Q: *How can I minimise the risks associated with taking out a loan?*

A: Provide good project management, abide by the terms and conditions, and always communicate clearly with the lender. Remember, if a provider is willing to finance an organisation's project, they believe it will work. Providers work to understand an organisation's needs and undertake due diligence before agreeing to any loan.

Q: *My organisation has taken out a loan but I'm worried we won't be able to make the next repayment due. What should I do?*

A: Sometimes, loan repayments cannot be met. This happens for a number of reasons:

- delay in starting the project;
- differences in the timing of income receipts from the anticipated cashflow;
- the project may fail to generate the overall income projected;
- cost increases.

If repayments cannot be made on time, it is essential that lenders are informed at the earliest opportunity. Lenders usually work with their borrowers to find solutions, unless trustees have acted recklessly.

Always keep in close contact with your lender and explain reasons for any potential difficulties. Lenders want to help, and can often restructure your financing. If the lender is not satisfied of the continued financial viability of the project, they may choose to implement any charges they have on your organisation's assets.

Providers of loan finance

A number of providers sympathetic to VCOs exist. They look for both financial and social return. Different providers take on different levels of risk, focus on different areas and have varying levels of engagement with the voluntary and community sector. Below is a selection of some providers.

Adventure Capital Fund offers a combination of finance and support to community organisations. It aims to help organisations become sustainable in the long-term and become less reliant on short-term grants. Its focus is on organisations that are trading or undertaking other income-generating activities that produce surpluses for reinvestment in the community.

Web: www.adventurecapitalfund.org.uk **Tel:** 0207 488 3455
Email: info@adventurecapitalfund.org.uk

BIGinvest is a large loan fund set up by The Big Issue. It works with social enterprises and the income-generating activities of registered charities. Financing is available for commercial property renovation or purchase, equipment purchase, growth or acquisition and working capital.

Web: www.biginvest.co.uk **Tel:** 0207 074 0060
Email: enquiries@biginvest.co.uk

Charity Bank is unique, being both a charity and a bank. It works to create a sustainable, alternative finance market complementing the conventional banking system. It makes loans for a wide range of charitable and social enterprise activities.

Web: www.charitybank.org **Tel:** 01732 774040
Email: enquiries@charitybank.org

Co-operative & Community Finance lends to co-operatives, employee-owned businesses and social enterprises. They offer business loans for: employee buy-outs; delayed grant payments; property or business purchase; capital equipment or working capital; to replace inappropriate existing finance.

Web: www.icof.co.uk **Tel:** 01179 166750
Email: info@co-opandcommunityfinance.coop

Some lenders will participate in the Small Firms Loan Guarantee scheme — details at www.businesslink.gov.uk. This assists companies limited by guarantee unable to obtain a loan from a bank or other financial institution because they do not have enough assets to offer as security and provides lenders with a government guarantee against default in certain circumstances.

Futurebuilders England, established by the Home Office, offers a combination of grants and loans for organisations that deliver public services and earn revenue by forming contracts with public sector agencies. It aims to improve an organisation's ability to deliver public services in one of its five key areas: education and learning; health and social care; community cohesion; crime; and, support for children and young people.

Web: www.futurebuilders-england.org.uk **Tel:** 0191 261 5200
Email: info@futurebuilders-england.org.uk

Local Investment Fund (LIF) lends to social and community enterprises that have been unable to access traditional funding. LIF aims to help organisations move from grant dependency towards self-sufficiency.

Web: www.lif.org.uk **Tel:** 0207 680 1028 **Email:** information@lif.org.uk

Triodos Bank lends exclusively to projects with clear social, environmental and cultural objectives covering a wide range of activities.

Web: www.triodos.co.uk **Tel:** 0800 328 2181
Email: businessbanking@triodos.co.uk

Unity Trust Bank provides banking services to the trade union, charity, voluntary, credit union and membership organisation sectors. An extensive range of flexible funding initiatives is offered, including property development funding, fundraising bridging loans, social mortgages, rent to buy and grant bridging overdrafts.

Web: www.unity.uk.com **Tel:** 0845 11 777 22
Email: utb@unity.co.uk

Venturesome is a Charities Aid Foundation initiative, providing loans and investment support to charities and other social enterprises.

Web: www.cafonline.org **Tel:** 0207 832 3000

Additionally a range of regional providers exists, specialising in funding organisations based in specific areas of the UK. Some regional providers are listed on NCVO's Sustainable Funding Project website at www.ncvo-vol.org.uk/sfp. Alternatively, Community Development Finance Association, available at www.cdfa.org.uk, and Business Link, available at www.businesslink.gov.uk, offer finance finding options, searchable by specific area and requirements.

Applying for loan finance

Thorough preparation makes the process run smoothly for both applicant and provider. Begin by researching the providers that offer the type of loan required. Prepare a business plan that can be used when approaching suitable providers, covering:

- the purpose and objectives of the organisation and the project;
- key staff and trustees involved;
- an analysis of strengths, weaknesses and the external environment;
- current work and how the proposed project fits with this;
- potential risks and how the organisation will deal with them if they occur;
- the financial and social returns arising from the project;
- timescales and milestones;
- budget and cashflow for both the organisation and the project.

Providers will also ask for other information to aid their decision making, such as the organisation's constitution, management accounts and financial projections. In a small number of cases, a loan provider may require information to be submitted during the course of the loan e.g. interim certificates for building work. Remember to ask if this is necessary.



Nadair Trust took a loan from Charity Bank (details on page 5)

Further information

NCVO's Sustainable Funding Project

available at www.ncvo-vol.org.uk/sfp, works to encourage and enable VCOs to explore and exploit a range of funding and financing options. The website includes case studies illustrating how VCOs have pursued income diversification and useful resources providing ideas, information and inspiration.

The Introductory Pack on Funding and Finance: Guide to Loans and Other Forms of Finance

provides an introduction and guide to accessing loan finance, listing the variety of scenarios in which loans can be used, along with case studies. This 38-page guide, produced by the the Sustainable Funding Project for the Finance Hub, is free to download from www.ncvo-vol.org.uk/sfp/Introductory-Pack.

The Charity Commission, available at www.charity-commission.gov.uk, provides a wealth of information on running a charity, particularly:

- CC3 – The Essential Trustee: What you need to know
- CC3a – Responsibilities of Charity Trustees: A Summary

Unlocking the potential: A guide to finance for social enterprises

is published by the Social Enterprise Coalition and focuses on the different forms of non-grant finance available for social enterprises. It is available to order from www.socialenterprise.org.uk.

Every effort has been made to ensure the accuracy of the information contained within this publication. However, NCVO cannot be held responsible for any action an individual or organisation takes, or fails to take, as a result of this information. The details provided in this guide are offered for general information purposes only and are not a substitute for legal advice.

Checklist for loan finance decision-making

		Yes	No
1	Has a business plan been prepared?	<input type="checkbox"/>	<input type="checkbox"/>
2	Does the project make a surplus after loan repayments?	<input type="checkbox"/>	<input type="checkbox"/>
3	Does the project allow more beneficiaries to be helped?	<input type="checkbox"/>	<input type="checkbox"/>
4	Does the governing document give the power to borrow and pledge assets?	<input type="checkbox"/>	<input type="checkbox"/>
5	If no to 4, has the Charity Commission, or a solicitor, been consulted and agreed that the organisation can undertake borrowing?	<input type="checkbox"/>	<input type="checkbox"/>
6	Are staff & trustees happy with the idea of using loan finance?	<input type="checkbox"/>	<input type="checkbox"/>
7	Does the organisation have the expertise to manage a loan?	<input type="checkbox"/>	<input type="checkbox"/>
8	Are trustees satisfied that repayments can be made?	<input type="checkbox"/>	<input type="checkbox"/>
9	Have appropriate lenders been identified?	<input type="checkbox"/>	<input type="checkbox"/>
10	Are trustees aware if the lender needs a charge on any of the organisation's assets as security?	<input type="checkbox"/>	<input type="checkbox"/>
11	Do trustees know whether any information is required throughout the term of the loan?	<input type="checkbox"/>	<input type="checkbox"/>
12	Have trustees taken specialist advice, where necessary, on the terms of the loan?	<input type="checkbox"/>	<input type="checkbox"/>
13	Have trustees determined when the money is needed and are adequate timelines in place?	<input type="checkbox"/>	<input type="checkbox"/>

The Sustainable Funding Project is a first-stop shop encouraging and enabling voluntary and community organisations to explore and exploit a full range of funding and finance options to develop a sustainable funding mix.

The Sustainable Funding Project *funding in the round*
www.ncvo-vol.org.uk/sfp Tel: 0800 2 798 798, Email: sfp@ncvo-vol.org.uk



This guide has been supported by Charity Bank.