Long-Term Loan

It is possible to obtain long-term debt financing through the sale of five-year bonds to various financial institutions. These financial institutions will buy your long-term notes for a premium interest rate over conventional bank loans (approximately 2 interest points: this is a floating number based on the debt to equity ratio). The acceptable debt capacity is two times the firm's equity position in the previous quarter minus any current debt.

FORMULA

Line of credit = 2 × equity of the firm − current debt

Long term debt

Key advantages:

- Larger debt capacity
- For a fixed period of time
- Financial institution will not call in your note due to short-term swings in income (except in the case of bankruptcy)

Key disadvantages:

- Higher interest rate
- Loan cannot be paid off before the 5-year term has elapsed.
- Need to put aside a fixed amount each quarter into a sinking fund in anticipation of paying the loan back at the end of the loan period.

YOUR TASK

In the Workspace, enter the amount of money you would like to borrow in the form of a long-term loan. Take note of the interest you will have to pay as well as the sinking fund payment each quarter. This money will be placed in an interest bearing account each quarter to ensure the loan will be paid back after five years.

To learn more about loans, take a look at the Debt Financing section in the Help file.