Loan Financing

Loan

A loan is money, property, or other material goods given to another party in exchange for future repayment of the loan value or principal amount, along with interest or finance charges.

Loans are typically issued by corporations, financial institutions, and governments. Loans allow for growth in the overall money supply in an economy and open up competition by lending to new businesses. Loans also help existing companies expand their operations. The interest and fees from loans are a primary source of revenue for many banks, as well as some retailers through the use of credit facilities and credit cards. They can also take the form of bonds and certificates of deposit.

Loan Financing

Loan Financing means any money borrowed from (A) a bank, financial institution, hedge fund, pension fund, or insurance company or (B) any other entity having as its principal business the lending of money and/or investing in loans, in each case other than public or quasi-public entities or international organizations with a public or quasi-public character.

Loan financing includes both secured and unsecured loans. Security involves a form of collateral as an assurance the loan will be repaid. If the debtor defaults on the loan, that collateral is forfeited to satisfy payment of the debt. Most lenders will ask for some sort of security on a loan. Few, if any, will lend you money based on your name or idea alone.

Two of the main types of finance include:

Debt finance – money borrowed from external lenders, such as a bank

Equity finance – investing your own money, or funds from other stakeholders, in exchange for partial ownership.

It is possible to have both types of finance in your business.

Type	Advantages	Disadvantages
Debt finance	You retain full control of your business. The interest on the loan is tax deductable. The loan can be short or long term.	The loan must be paid back within a fixed time period. Loan repayments will commence shortly after the loan is approved. The loan is often secured against collateral which may include assets of the business or the owner's property. It can be difficult to grow the business because of the cash drain of repaying the loan.
Equity finance	Less risky than a loan as the investment does not need to be paid back immediately. You'll have more cash on hand as profits do not have to be used to repay loan. The investor(s) can provide additional credibility and skill sets to your business.	The investor(s) will want some ownership or controlling interest of your business and will have a say in business decisions. It takes time and effort to find the right investor for your business.

Sources of finances

The main sources of debt finance are:

Financial institutions - banks, credit unions and building societies. Finance can be provided as loans, overdrafts and lines of credit.

Retailers - purchasing goods for your business through store credit via a finance company. Store cards can attract high interest rates; however some retailers offer an interest free period.

Finance companies – most finance companies offer finance products via a retailer. Financial companies must be registered with the Australian Securities and Investments Commission (ASIC).

Suppliers – trade credit allows you to delay payment for goods.

Factor companies – also referred to as debtors finance. Factoring is when a business sells its accounts receivable (invoices) to a third party (called a factor) so that it can receive cash without waiting the 30 or 60 days for customer payment. Customers pay their invoice directly to the factor company. The cost for providing this service will vary between companies and it is important for you to research these costs before entering into any agreement.

Invoice finance – essentially the same as factoring, however invoices are paid to your business and customers are not aware of your arrangements with the financier.

Peer-to-peer lenders - matches people who have money to invest with people looking for a loan. Loans may need to be repaid within a certain time period and interest rates may vary according to the level of risk.

Family or friends – may offer you money as a loan. To avoid misunderstanding it is important to have a formal written agreement specifying the terms of the loan, repayment requirements and terms of interest. Seek legal advice to draw up the loan agreement.

The main sources of equity finance are:

Personal finances - self funding your business from personal savings or sale of personal assets.

Venture capitalists – professional investors that invest large funds into businesses (as equity) with potential for high growth and profit.

Family or friends – may provide funds in return for a share in your business or as a partnership. Carefully consider this option as a breakdown in business relationships may affect your personal relationships. Read Partners in Business for more information.

Private investors – also known as 'business angels' are generally wealthy individuals who invest large sums of money in a business in return for equity and a share of the profits.

Crowd funding – raising capital through the collective efforts of a large pool of individuals, primarily online via social media or crowd funding platforms. It allows investors to provide large sums of money in exchange for equity, or small amounts in return for a first-run product or other reward.

Crowd-sourced equity funding - a way for start-ups and small businesses to raise finance from the public. They usually rely on raising small amounts from a large number of investors. Each investor can invest up to $10,000 a year in a business, receiving shares in exchange.

Government – most government assistance for small business is in the form of free or low cost advisory services, information or guidance. However, you may be eligible for a grant in certain circumstances, such as business expansion, research and development, innovation or exporting.

Here are some types of security you can offer a lender:

- **Guarantors** sign an agreement stating they'll guarantee the payment of the loan.
- **Endorsers** are the same as guarantors except for being required, in some cases, to post some sort of collateral.
- **Co-makers** are in effect principals, who are responsible for payment of the loan.
- **Accounts receivable** allow the bank to advance 65 to 80 percent of the receivables' value just as soon as the goods are shipped.
- **Equipment** provides 60 to 65 percent of its value as collateral for a loan.
- **Securities** allow publicly held companies to offer stocks and bonds as collateral for repaying a loan.

- **Real estate**, either commercial or private, can be counted on for up to 90 percent of its assessed value.
- **Savings accounts or certificate of deposit** can also be used to secure a loan.
- **Chattel mortgage** applies when equipment is used as collateral–the lender makes a loan based on something less than the equipment's present value and holds a mortgage on it until the loan's repaid.
- **Insurance policies** can be considered collateral for up to 95 percent of the policy's cash value.
- **Warehouse inventory** typically secures up to only 50 percent of the loan.
- **Display merchandise** such as furniture, cars and home electronic equipment can be used to secure loans through a method known as "floor planning."
- **Lease payments** can be assigned to the lender, if the lender you're approaching for a loan holds the mortgage on property you're trying to lease.

Project Financing

Project financing is a loan structure that relies primarily on the project's cash flow for repayment, with the project's assets, rights, and interests held as secondary collateral. Project finance is especially attractive to the private sector because companies can fund major projects off-balance sheet.

Project finance is the financing of long-term infrastructure, industrial projects and public services using a non-recourse or limited recourse financial structure. The debt and equity used to finance the project are paid back from the cash flow generated by the project. Project financing is a loan structure that relies primarily on the project's cash flow for repayment, with the project's assets, rights and interests held as secondary collateral. Project finance is especially attractive to the private sector because companies can fund major projects off-balance-sheet.

Key Elements of BOT Project Finance

Project finance for BOT projects generally includes a special purpose vehicle (SPV). The company's sole activity is carrying out the project by subcontracting most aspects through construction and operations contracts. Because there is no revenue stream during the construction phase of new-build projects, debt service only occurs during the operations phase.

For this reason, parties take significant risks during the construction phase. The sole revenue stream during this phase is generally under an off take agreement or power purchase agreement. Because there is limited or no recourse to the project's sponsors, company shareholders are typically liable up to the extent of their shareholdings. The project remains off-balance-sheet for the sponsors and for the government.

Off-Balance Sheet

Project debt is typically held in a sufficient minority subsidiary not consolidated on the balance sheet of the respective shareholders. This reduces the project's impact on the cost of the shareholders' existing debt and debt capacity. The shareholders are free to use their debt capacity for other investments. To some extent, the government may use project financing to keep project debt and liabilities off-balance-sheet so they take up less fiscal space. Fiscal space is the amount of money the government may spend beyond what it is already investing in public services such as health, welfare, and education. The theory is that strong economic growth will bring the government more money through extra tax revenue from more people working and paying more taxes, allowing the government to increase spending on public services.