Low Income Investment fund

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GLOSSARY of LOAN TERMS

The Players: In any loan transaction there are at least two parties. A "Borrower" applies for a loan. If determined eligible, a "Lender" provides a loan. There are many types of Lenders including banks, savings and loans, nonprofit organizations, public agencies and even relatives. In some cases, a third party, the "Guarantor" will also be included in the transaction (see Guarantee).

Amortization: The period of time on which the repayment of loan principal and interest is based. Loans have different amortization schedules and terms. There are three basic ways to repay a loan:

1. In equal installments, each containing a blend of principal and interest.
2. In varying but regular installments, each containing a blend of principal and interest.
3. In irregular installments of principal or interest only with a large final payment (see Balloon Payment).

Balloon Payment: The final payment of a loan with an amortization period that is longer than the loan term. For example, if the loan amortization period is 10 years but the loan term is 5 years the unpaid principal at year 5 is the Balloon Payment. This type of loan is awarded to borrowers who need a smaller or more affordable monthly loan payment but have the capacity to refinance at the end of their loan term.

Bridge Loan: Short-term loan made in anticipation of long-term funding or financing.

Building and Real Estate Costs:

Soft Costs – Expenses, other than Hard Costs, incurred in developing a real estate project, including legal and lending fees, architectural and design fees, permits, etc.
Hard Costs – The direct costs to construct a building or structure, otherwise known as "bricks and mortar" costs, including acquisition of property, construction, equipment, etc.
Hidden Costs – Less visible costs associated with the facilities development process, such as staff and board time and attention.
Contingency Costs – A portion of the construction costs set aside to cover unexpected "hard" or "soft" costs.

Building Reserve: A capital improvement reserve fund. This is money set aside to pay for facilities upkeep. The amounts can be large, the ultimate need a certainty, but the exact timing is uncertain. These are often big-ticket items, like replacing the roof, which are difficult to accommodate in a single year's budget.

Collateral: The property a borrower pledges to a Lender to secure repayment of the loan. Collateral could include: a lien on your house, equipment from your business, or a bank account. If the borrower defaults, the lender has the legal right to seize the collateral and sell it to pay off the loan.

Debt: Money, goods or services that one party is obligated to pay another in accordance with an expressed or implied agreement.

Debt Service Coverage or Debt Coverage Ratio: A calculation a Lender uses to determine ability to repay a loan. This calculation is typically expressed as a ratio. Most Lenders have minimum debt service coverage requirements ranging from 1.05: 1.00 (i.e. the net income must be 5% in excess of the loan payment) to 1.25: 1.00 (i.e. the net income must be 25% in excess of the loan payment).

$$\text{DSC or DCR} = \frac{\text{Net Income (after all expenses excluding debt service)}}{\text{Total Loan Payment}} = 1.10 : 1.00$$

Default: Failure to pay a debt or meet an obligation.

Equity: Represents the difference between an asset's current market value and the amount of debt or other liabilities. In terms of a child care equity that is provided through internal assets, savings, grants, individual donors, collaborative resources and other sources can be used to assist in funding some of the facilities development costs. It is best to use equity funding for the planning and predevelopment stages of developing child care facilities, while debt (loan financing) is more fitting for the real estate acquisition and construction costs incurred during the development stage.

Fees: Charges by a Lender for making the loan. Fees can include a range of costs. Such as a loan origination fee, service fee and monitoring fee (also see "Points).

Forgivable loan: A loan made with the understanding that if the borrower meets certain requirements, repayment of the loan will not be required. A requirement example could be if the property use continues to be child care for the term of the loan.

Guarantee: A promise by one party to pay a debt or perform an obligation contracted by another if the original party fails to pay or perform according to a contract. Loan guarantee or loan insurance programs are designed to make certain loans less risky for lenders, such as loans for community economic development projects and for small businesses like child care.

Interest: The cost of using loaned money, usually expressed as an annual percentage that a lender charges a borrower for the use of the principal over time.

Interest Rate: The amount a Lender will charge for the use of its funds. Interest rates vary greatly from loan to loan and are frequently tied to industry measures such as Prime Rate. For example, if Prime Rate is 4.75%, then a "Prime Plus Two Percent" rate would mean a loan with a 6.75% interest rate.

Leasehold Improvements: Renovations to leased space to suit the renter's needs. These may be paid by either the landlord or the tenant.

Lien: A claim a Lender places on property in return for making a loan. If a borrower is unable to make loan payments as agreed, it gives the Lender the right to collect repayment of the loan through selling the borrower's property. If the lien is placed on real property such as a house, this lien is often referred to a "Mortgage."

Line of Credit: A set amount of money available for the Borrower to use. The borrowed amounts are then paid back in installments determined by the Lender. A line of credit is distinct from a loan because after the money is paid back a borrower can use it again, which makes it similar to a credit card.

Loan: Transaction wherein a Lender allows a Borrower the use of a sum of money for a specified period of time at a specified rate of interest.

Loan Amount: The amount of a loan is determined by how much the Borrower needs to complete the project and the Lender's assessment of the Borrower's ability to repay. Lenders have minimum and maximum loan amounts.

Loan-to-Value Ratio: The ratio of money a Lender is willing to loan relative to the current appraised value of the property or other security.

Mortgage: Security instrument by which the Borrower (mortgagor) gives the Lender (mortgagee) a lien on property as collateral for the repayment of a loan.

Operating Reserves: Funds set aside annually to be used to offset possible operating losses due to unexpectedly low revenues or unusually high expenses.

Points: An up front fee a Lender may charge for a loan, expressed as a percentage of the loan amount. "One point" equals one percentage of the loan amount. Thus, one point on a $10,000 loan is $100 ($10,000 X .01).

Prime Rate: The rate of interest that serves as a benchmark for the interest rates banks will charge. (See Interest Rate). Banks typically lend at an Interest Rate that is Prime Rate plus an additional percentage based on the loan type and borrower.

Principal: The original amount of money borrowed, and the amount that the Borrower must pay back, not including interest.

Term: The agreed upon period of time for which a loan is made. A loan provided for 10 years has "a 10 year term."