



Tools for Loans and Other Forms of Finance

Funding and Finance Toolkit 4



Tools for Loans and Other Forms of Finance

Funding and Finance Toolkit 4

Contents

	Page
About the Funding and Finance Toolkit series	1
About the author	2
How to use this Toolkit	3
Loans and other forms of finance in a nutshell	5
Tools	7
4.1 Checklist for loan finance decision-making	7
4.2 Assessing finance needs	9
4.3 Finance options planning	15
4.4 Negotiating finance	20
4.5 Demonstrating the social value of investment	25
Directory of Tools	31

About the Funding and Finance Toolkit Series

The *Funding and Finance Toolkit Series* has been designed to provide practical checklists, templates and exercises to help frontline Voluntary and Community Organisations (VCOs) improve their funding and finance for long-term sustainability. The exercises and templates can be completed by frontline VCOs independently or in conjunction with in-put from a Council for Voluntary Service (CVS) or other support-agency-based advisor who can help organisations consider their options and can signpost to further support where necessary.

The *Toolkits* are companion publications to the *Introductory Pack on Funding and Finance* and aim to complement it. The *Pack* provides information on key areas of voluntary sector funding and finance. The *Toolkits* provide supporting exercises and templates to help organisations put ideas into practice. There are four sections, each relating to an income generation topic covered in the *Introductory Pack*:

- Fundraising
- Trading
- Procurement and Contracting
- Loans and Other Forms of Finance

Two additional resources related to the *Toolkit Series* are the pocket guide, *Introducing Funding and Finance for Voluntary and Community Organisations* and the *Sustainable Sun Needs-Analysis Tool*. These are first-step awareness-raising tools designed to alert new, small and less-well-resourced VCOs to the funding environment and to highlight where development work may be needed to improve their place within it. They are appropriate for organisations not yet ready to engage with the exercises included in the *Toolkits* or the *Introductory Pack*.

The *Introductory Pack*, *Toolkit Series* and related resources were commissioned by the Finance Hub from NCVO's Sustainable Funding Project.

Copies of all these resources are available from both the Finance Hub and NCVO's Sustainable Funding Project. They can be downloaded from the Finance Hub website at www.financehub.org.uk or NCVO's website at www.ncvo-vol.org.uk/sfp/Introductory-Pack

About the author

Jim Brown works for Baker Brown Associates, a research and development co-operative based in Bristol, which specialises in the social economy and lifelong learning. Jim has worked in the social economy sector for over 25 years, during which time he has written numerous training manuals and books, the most recent being *Co-operative Capital*, a guide to equity finance for co-operatives and social enterprises. Baker Brown Associates was responsible for researching and writing the national occupational standards in social enterprise business support and development, and is currently working with Social Enterprise London to turn these standards into a series of nationally recognised qualifications in partnership with the Institute of Leadership and Management.

For more information see:
www.bakerbrown.co.uk

Toolkit authors, contributors and advisors

The *Toolkit Series* has been developed by experts in voluntary and community sector funding and finance with input on design and presentation from practitioners including an advisory group of front-line funding advisors.

Series editor and project manager

Deborah Turton, Sustainable Funding Project, NCVO

Authors and contributors

Jim Brown, Baker Brown Associates
Sara Burns and Kate Graham, Triangle Consulting
Sarah McGeehan, Community Development Finance Association
Paul Palmer, Cass Business School
Institute of Fundraising
Deborah Turton, Sustainable Funding Project, NCVO
Centre for Charity Effectiveness, Cass Business School, City University
Institute of Public Finance
Futurebuilders England

Advisors

Lynette Grant, Black Training and Enterprise Group (BTEG)
Tarn Lamb, Cornwall Neighbourhoods for Change
Mary Boucher, Gloucester CVS
Esther Jones, High Peak CVS
Stephen Awre, Sandwell CVO
Sue Wright, St Helens CVS
Ann Hunter, Community Technical Aid Centre
Katy Roberts, South Lincolnshire CVS

How to use this Toolkit

Who should use the Toolkit

These Tools have been designed with the aim of providing funding advisors (e.g. an advisor based within a CVS or other support agency) with a series of templates, checklists and exercises they can either work through with, or copy and hand out to, clients based on what support the advisor feel is needed.

VCOs can use the Toolkit independently, but best results will be achieved by working in tandem with an advisor who can provide additional support or advice where appropriate.

The Tools are best used by a group of stakeholders from within a VCO. Each Tool gives an indication of who should get involved for guidance, but this may vary between organisations.




Structure of the Toolkit

Each *Toolkit* contains Tools of varying levels of complexity. These are designed to build upon and complement the Tools and information included in the associated guide from the *Introductory Pack on Funding and Finance*. Some Tools are equally relevant to a number of income generation areas (e.g. developing a business plan). It is therefore useful to be aware of all the Tools available and to mix and match where appropriate. A complete list of the Tools contained within the *Introductory Pack* and *Toolkit Series* is available at the end of this document for reference.

Choosing Tools

The Tools that are most relevant to a particular organisation will depend on how familiar it is with the individual topic, the development stage it has reached, and the commitment it wishes to make in moving forward in that area.

The three Tool levels are:

Level/Symbol	Overview
Introductory 	Suitable for new organisations or for those getting to grips with a new area (e.g. contracting). Designed to help VCOs gain an understanding of the area (e.g. preliminary checklists or exercises to gauge whether an income stream is suitable).
Intermediate 	Suitable for organisations wanting to explore a topic further. Designed to help organisations get started in the topic area.
Advanced 	Suitable for organisations wishing to seriously explore a topic or income stream further. Activities requiring some time and resource commitment from an organisation. May be best used in conjunction with input from a funding advisor.

Each Tool level is indicated by the icon at the start of the Tool and highlighted in the reference list at the end of this document.

Intermediate and advanced-level Tools

These Tools use a design based on the advice cycle: an action learning approach to advising VCO clients. The overall aim is to equip clients with the skills to achieve sustainable funding for their organisations.

Each Tool is designed to achieve a specific aim and set of objectives. These are stated at the beginning, to set the scene for the three main stages of the advice cycle: planning, action and review.

The **planning** stage focuses on models and methods that can be used to research and explore key issues associated with the highlighted aim and objectives. This leads to the **action** stage, where organisations are required to put their plans into practice, and learn through their experiences. This learning is reinforced in the final stage of the cycle, where the organisation and advisor **review** the outcomes of their actions. Advanced-level Tools also include a case study demonstrating the concept covered in practice.

By engaging in this cycle, organisations will learn from their own actions and experiences, and will develop sustainable funding skills.

Loans and other forms of finance in a nutshell

Loans are a financial enabling tool. They can help VCOs in various ways. Loans may be an option to improve cash-flow, to bridge gaps between receipt of grant payments, where a large sum of money is needed (e.g. to purchase property or equipment), or to enable projects to move forward during the time taken to raise capital from more traditional fundraising methods. They can be particularly useful in situations where waiting while money is raised will mean an organisation misses a valuable opportunity.

Loans usually provide some flexibility in how the money is used (unlike grants which are tied to specific project outcomes). Furthermore, loans encourage business planning and thinking beyond the short-term (a frame of mind often encouraged by time-limited grant funding). Loans require a degree of financial discipline, but this can also be more widely beneficial for organisations.

New contract or trading activity is often enabled by loan finance. This is because expanding to take on contractual work, developing trading initiatives, or simply increasing the scale and scope of an organisation's work often requires investment (e.g. to train staff in new skills, or purchase equipment).

There has been a recent growth in the development of loan finance initiatives aimed at VCOs. Loans are now available from both high street banks and providers who have emerged specifically to meet the needs of VCOs, such as Charity Bank and Futurebuilders England.

Loans are not suitable for every organisation at all times. But, where conditions are right, they can have a tremendous positive impact.

Further detailed information on loans is available in the *Introductory Pack Guide to Loans and Other Forms of Finance* which is the companion publication to this Toolkit. The guide is available at www.financehub.org.uk and www.ncvo-vol.org.uk/sfp/Introductory-Pack



Tool 4.1 – Checklist for loan finance decision-making

Aim

VCOs establish whether loan finance is an option for them.

Objectives

- VCOs understand the issues associated with using loan finance.
- VCOs consult stakeholders when deciding whether to apply for a loan.

When to use

Useful for VCOs that are considering using loans but are unsure of the associated requirements and responsibilities. Ideally completed by the Trustee Board and/or a senior manager.

How to use

Thorough preparation is required when considering applying for a loan. This involves developing a business plan which sets out what the loan is needed for, how repayments will be made, and builds a case explaining why the money is needed.

The checklist below can be used as a precursory step to help an organisation decide whether it is ready for loan finance.

Loan finance checklist

	Yes	No
1 Have you prepared a business plan?		
2 Will the project make a surplus after loan repayments?		
3 Will the project allow more beneficiaries to be helped?		
4 Does your governing document give the power to borrow and pledge assets?		
5 If no to 4, have you consulted the Charity Commission, or a solicitor, and agreed your VCO can undertake borrowing?		
6 Are staff happy with the idea of using loan finance?		
7 Does your VCO have the expertise to manage a loan?		
8 Are trustees satisfied that repayments can be made?		
9 Have you identified appropriate lenders?		
10 If the lender needs a charge on any of your organisation's assets as security are the Trustees aware of this?		

		Yes	No
11	Do you know whether any information is required throughout the term of the loan?		
10	Have trustees taken specialist advice, where necessary, on the terms of the loan?		

If the VCO answers 'yes' to all the questions then loans are an option.

If the VCO answers mainly 'yes' to all the questions then a loan may be appropriate, but the organisation may need to undertake further work before moving forward (e.g. convince Trustees) or seek support (e.g. legal advice).

If the VCO answers 'no' to all the questions or mainly 'no' then a loan may not be an option right now. However, the VCO should be encouraged not to dismiss loans because they may well be useful at some point in the future.



Tool 4.2 – Assessing finance needs

Aim

The amount of finance required by a VCO for a new project is assessed and suitability of taking out a loan considered.

Objectives

- VCOs understand the amount of finance needed for a project and any associated costs of taking out a loan.
- VCOs understand the link between project lifetime and appropriateness of using loan finance.
- Capital costs for a project are estimated.
- Revenue budget for a project is prepared.
- An outline cash-flow forecast for the project is produced.

When to use

Useful for VCOs developing projects likely to require investment to cover capital costs and/or cash-flow requirements. Also a good general process for helping VCOs calculate new project costs whether funded by grants, reserves or loans.

How to use

1. Planning

- Ensure that the VCO has done all the preliminary work in developing their project proposal (e.g. research into likely project costs, draft outline of business plan).
- Working together, VCO and advisor should read through the **Six steps for assessing finance needs**. Check that all data needed to calculate capital costs and revenue flows has been obtained or is readily available.

2. Action

- Working together VCO and advisor should follow the **Six steps**:
 1. *Prepare estimates of capital costs for the project.*
 2. *Discuss the VCO's estimate of the project lifetime.* Note this needs to be known to inform final budget calculations; it may also ultimately determine whether a loan is an appropriate option – too short-term and a loan may still be being repaid once the project has finished.
 3. *Prepare estimates of revenue budget.* If assistance is needed see:
 - **Introductory Pack Guide to Financial Management: Tool – Example revenue budget.**
 4. Using the capital and revenue budget estimates, *prepare a cash-flow forecast.*
For illustration see the example provided.
- VCOs should be encouraged to use an electronic spreadsheet to design a cash-flow forecast suitable for their project. If needed, expert support should be pursued (e.g. from local accounting firms, pro bono services such as that run by Business in the Community).

3. Review

5. Once the above calculations have been completed, VCO and advisor can review the completed cash-flow forecast to *assess the VCO's potential finance needs*.
- Discuss the pros and cons of using different types of finance to meet the VCO's needs and the associated costs of using different types of finance. For assistance see:
 - ***Introductory Pack Guide to Loans and Other Forms of Finance: Tool – Comparison table of grants, loans and equity.***
6. If a loan is considered appropriate, the VCO should test its suitability by incorporating potential interest rate repayments into the cash-flow forecast. Having recalculated cash-flow, check that the project still fully recovers its costs and that the originally estimated loan amount will still be sufficient.
- Agree next steps towards obtaining finance and launching the project in question. For further assistance in obtaining finance see the remaining Tools in this document.

Six Steps for Assessing Finance Needs

Step 1 – Estimate capital costs

Capital costs are expenditure on assets such as –

- Land, buildings or other physical items.
- Equipment, machinery, tools, including vehicles.
- Product or service development costs which are not counted as revenue costs (patents, licence fees, initial registration, website development etc).
- Other one-off costs which are not judged to be revenue costs.

These items should only be treated as assets if the VCO plans to purchase them outright, rather than rent or lease them.

Step 2 – Estimate project lifetime

The project lifetime is the period over which the value of the project to the VCO is to be assessed. This depends on the nature of the project. For instance, projects involving new buildings will have long lifetimes of up to 20 to 25 years. Projects involving the development of new services usually have much shorter lifetimes of between three to five years. Some projects might have an indefinite lifetime, in which case the project lifetime can be linked to the lifetime of the project's major capital assets.

Step 3 – Calculate revenue budget

A revenue budget, estimating the income and expenditure of the project, should be prepared for each year of the project's lifetime. This revenue budget should not include any capital income or expenditure. Check that the project fully recovers its costs over its lifetime.

Step 4 – Produce a cash-flow forecast

Use a spreadsheet to construct a cash-flow forecast for the project, using the example on the next page as a template. If the project lifetime is five years or less, use quarterly intervals. For longer projects use yearly intervals. Calculate the closing balance, assuming that the opening balance for the project is zero.

Step 5 – Assess finance needs

If the cash-flow forecast shows a negative closing balance for one or more periods of time, then the VCO needs finance to cover the gap. The cash-flow forecast shows how much finance is needed, and how long it is needed for. This is the amount of money the VCO needs to raise.

Step 6 – Cost of finance

If the VCO plans to borrow money, remember to include the cost of finance (interest payments etc) as an expenditure item in the revenue budget. The plan should be tested by producing a second cash-flow forecast, with the finance cash-flows included. A reworked version of the example cash-flow template provided for step 4 illustrates this stage.

Example of a cash-flow forecast

All amounts shown are £'000	Q1	Q2	Q3	Q4	Q5	Q6	Q7	Q8	Q9	Q10	Q11	Q12
Revenue income (A)	0	3	5	5	5	5	5	5	5	5	7	10
Revenue expenditure (B)	5	4	3	3	3	3	3	3	3	3	3	3
Capital costs (C)	10	0	0	0	0	0	0	0	0	0	0	0
Total expenditure (B+C)	15	4	3	3	3	3	3	3	3	3	3	3
Quarterly net inflow A – (B+C)	-15	-1	2	2	2	2	2	2	2	2	4	7
Opening balance	0	-15	-16	-14	-12	-10	-8	-6	-4	-2	0	4
Closing balance	-15	-16	-14	-12	-10	-8	-6	-4	-2	0	4	11

The project

Step 1 – Capital costs Capital costs for this project were estimated to be £10,000 for a new website and computer equipment that would be purchased at the beginning of the project.

A local housing advice charity has decided to introduce a new service aimed at helping key workers who are moving to the area to find accommodation. The service will be paid for by the employers of the key workers.

Step 2 – Project lifetime The project's lifetime has been set at three years (twelve quarters), based on the length of contracts already negotiated with local public sector organisations.

Step 3 – Revenue budget Income will come from contracts totaling £60,000 over three years. The project will employ a full-time project worker, contribute to management overheads, and be housed in the service's existing office. Total revenue expenditure will be £39,000 over three years.

Step 4 – Cash-flow forecast Income will be received monthly in arrears until the end of the contract period. Capital purchases and additional revenue costs will be incurred in the first two quarters.

Step 5 – Finance needs There is a maximum finance need of £16,000 in Q2. Finance need continues to Q10. Based on this information, the charity decides to finance the project through a £10,000 loan for three years plus an overdraft facility to cover any remaining finance needs. A new cash-flow forecast is drawn up to incorporate potential repayments.

Step 6 – Finance costs Finance costs (interest on loan and overdraft) are estimated to be £2,000 in total. An interest and capital repayment holiday was negotiated for the first year. The cash-flow forecast was recalculated with the finance costs and repayment included. This showed that the maximum overdraft required would be £6,000. With these calculations incorporated into a business plan, the VCO proceeds to approach lenders for a loan and overdraft.

Reworked cash-flow forecast with finance costs included

All amounts shown are £'000	Q1	Q2	Q3	Q4	Q5	Q6	Q7	Q8	Q9	Q10	Q11	Q12
Revenue income (A)	0	3	5	5	5	5	5	5	5	5	7	10
Revenue expenditure (B)	5	4	3	3	3	3	3	3	3	3	3	3
Capital costs (C)	10	0	0	0	0	0	0	0	0	0	0	0
Total expenditure (B+C)	15	4	3	3	3	3	3	3	3	3	3	3
Quarterly net inflow A – (B+C)	-15	-1	2	2	2	2	2	2	2	2	4	7
Opening balance	0	-5	-6	-4	-2	-1.5	-1	-0.5	0	0.5	1	3.5
Loan received	10	-	-	-	-	-	-	-	-	-	-	-
Loan interest + capital repayment	-	-	-	-	1.5	1.5	1.5	1.5	1.5	1.5	1.5	1.5
Closing balance (overdraft requirement)	-5	-6	-4	-2	-1.5	-1	0.5	0	0.5	1	3.5	9

Case study: Assessing finance needs

free@last

free@last is a registered charity, established in 1998. It provides community services and support to the people of Nechells, in Birmingham. Its many services include a young parents group, benefit and debt advice, drugs and alcohol projects, sexual health peer education, peer mediation, youth drop-in sessions, crime and community safety initiatives, outdoor activities, and family and young people's holidays. free@last has also started businesses in graphic design and promotional material, training and consultancy, and outdoor education.

John Street, director of free@last says 'we want to be self-sufficient and not apply for grants, so that we can do what we believe is best for the community we serve, putting their needs first'. In 2005 free@last applied for funding from Futurebuilders England and received a £10,000 development grant which paid for support to enable them to focus on their strategies for expansion, and to identify if these included a viable further Futurebuilders investment.

Futurebuilders introduced free@last to Pilotlight, an independent consultancy that specialises in small and innovative charities, to help develop an operating plan for free@last. They provided advice on governance, marketing, property development and business planning, as well as providing mentoring support for John. This enabled the VCO to juggle a number of different projects at the same time and understand that to become more self-sufficient, and develop more sustainable income-flows, they need to focus on particular activities. Assessing the finance needs of individual projects was invaluable in helping the organisation understand what finance it needed and where to focus it.

Futurebuilders went on to make a £105,450 investment (including the £10,000 development grant) in free@last which will be used to increase its provision of outdoor activities designed to offer personal and life skill development to a range of children, young people and their families in the Birmingham area. Its plans include diversionary work with young offenders and those at risk of offending. Current and prospective purchasers include a Youth Offending Team, PCTs and the Home Office. Contracts with these agencies will be used to meet ongoing cash-flow needs, including loan repayments.

Further resources

Futurebuilders England is a government backed investment fund to help the third sector deliver better public services. The fund provides a combination of loans, grants and capacity building support for organisations that deliver public services. See www.futurebuilders-england.org.uk

Community Development Finance Association is the membership body for CDFIs – initiatives that exist to generate social as well as financial returns by providing investment for communities not always able to access finance from mainstream banks. A list of members, many of whom provide loans tailored to suit the needs of VCOs, is available on their website. See www.cdfa.org.uk



Tool 4.3 – Finance options planning

Aim

VCOs are aware of and able to review the finance options available to them when preparing finance plans for new projects.

Objectives

- VCOs understand the advantages and disadvantages of different types and sources of finance.
- VCOs are able to put together the most appropriate mix of finance for a project.

When to use

For VCOs that have already developed a business plan identifying the scale of their finance needs. This tool will help VCOs identify the types and sources of finance that will form an appropriate finance package for their needs. Ideally used by the Board or a senior manager.

How to use

1. Planning

- Establish whether the VCO has the constitutional powers to take out a loan or raise equity. If the constitution does not currently permit lending then this should not be seen as a barrier. If, following this exercise, it is established that a loan is the best option for financing a piece of work then the constitution can be changed if agreed by the Board. Some specialist VCO lenders may even provide advice about this.

2. Action

- Establish that the VCO representatives understand the difference between grants, loans and equity. For assistance see:
 - **Introductory Pack Guide to Loans and Other Forms of Finance: Tool – Comparison table of grants, loans and equity.**
- Use the **Types and sources of finance overview** (together with the above Tool if necessary) to discuss the advantages and disadvantages of different types of capital finance.
- Discuss what types of finance will best suit the VCO's needs. Bear in mind that mid to large-scale projects are often funded by a combination of grants, loans and fundraising. Consider which of these options, or combination of options, the VCO prefers, has the resources to generate, or would need support in achieving.
- Think about what will be affordable and achievable, based on the financial data in the VCO's business plan.

- Following discussion, use the **Finance plan matrix** to identify which sources of finance will be pursued and which potential funders or investors approached.
- Identify what further information or support is needed before the VCO can finalise their finance plan. Set a date to review this research.

3. Review

- Review the findings of the VCO's research. Discuss what changes are necessary to the finance plan in the light of this information.
- Discuss what the next steps are towards implementing the finance plan.
 - **See Tool 4.4 – Negotiating Finance** for assistance in planning approaching investors.

Materials

Types and sources of finance overview

Types of finance	
A – Gifts and Donations	Interest and repayment free. However, time and resources are required for fundraising activity in order to generate such money. Potential cost of fundraising should always be considered in advance to ensure any resulting income outweighs costs of generating it.
B – Grants	Grants are useful because they do not have to be repaid and do not incur any form of interest or dividend charges. However, time and resources are needed to complete funding applications and (depending on the funder) monitor outputs delivered through any grant awarded. Also bear in mind that grant applications compete for part of a limited pot of money. As such, even very good applications can be turned down – whereas loan applications succeed or fail on their own merit. Applicants are also dependent on funder timescales both for assessment and for how any resulting money is drawn-down.
C – Equity	<p>Shares – Very few VCOs have a legal constitution that allows them to issue shares, although they may own trading subsidiaries with appropriate constitutions. The main advantage of share capital is that it is often permanent (it does not have to be repaid). This means that the organisation can use share capital as security to borrow additional finance. Dividends on share capital are only paid if the directors think that the organisation can afford it. The main problem with share capital is that the organisation may end up serving the interests of shareholders rather than beneficiaries, although Community Interest Company regulations provide a framework for limiting shareholder interests.</p> <p>Patient capital – This term is used to describe long-term finance offered by some specialist VCO funds where there is an agreement to change the terms of the finance from loans to grants or non-voting shares, depending on the performance of the VCO.</p>

Types of finance	
D – Long-term loan (5 years plus)	<p>Bonds – These are a specialist form of loan. Bonds are issued to investors for a set amount, with a fixed date when they will be redeemed (typically 5 to 15 years ahead) and carrying a fixed rate of interest. Investors can buy and sell the bonds to other investors.</p> <p>Mortgages – These are long-term loans, between 15 and 25 years, which are secured against a major asset, usually property. If the organisation defaults on the loan, the lender can force the sale of the asset to pay off the loan.</p>
E – Medium-term loan (1-5 years)	<p>Secured loans – These are loans where the lender has first claim on the organisation's assets if it is unable to repay the loan.</p> <p>Unsecured loans – These are loans where the lender has no special claim ahead of the other creditors if the organisation is unable to repay the loan.</p> <p>Leasing – This is an alternative to a loan, where the organisation agrees to rent the asset from the finance provider for a fixed period of time, at the end of which the organisation might have the option of purchasing the asset for a fixed amount. Some local authorities provide VCOs with premises on these kind of terms.</p>
F – Short-term loan (less than 1 year)	<p>Overdrafts – This is a borrowing facility agreed with the organisation's bank, whereby its current account can go into deficit to an agreed level. Interest is only paid on the amount and time when the account is overdrawn. Overdrafts are highly flexible. Banks usually have the right to withdraw from an overdraft agreement without notice.</p> <p>Bridging loans – These are loans for very short periods, designed to fill cash-flow gaps caused by delays in grant payments, or when an organisation is buying and selling major assets, usually property.</p> <p>Credit facilities – These are agreements with suppliers to delay paying for goods and services received.</p>
Sources of finance	
Individual supporters	May be willing to support VCOs in a variety of ways, ranging from straightforward gifts and donations, through to more complex arrangements involving shares, bonds, secured or unsecured loans.
Grant-giving bodies	Range from large institutions (e.g. Big Lottery Fund) to highly specialised, local or small grant-giving Trusts and Foundations. A small but growing number of these engage in more complex finance arrangements involving loans or patient capital (e.g. Esmée Fairbairn Foundation).
Specialist VCO funds	These are funds that were established specifically to serve the needs and interests of VCOs. The two best known examples are Futurebuilders England and the Adventure Capital Fund.
Community Development Finance Institutions (CDFIs)	These are finance bodies that specialise in funding VCOs, communities and disadvantaged groups that have difficulties obtaining finance from commercial sources. For details of CDFIs, including specialist VCO funders, see www.cdfa.org.uk
Commercial sources	These are mainly high street banks.

Finance plan matrix

	Amount sought	% of total	Potential funder/investor
A. Gifts and Donations			
B. Grants			
C. Equity			
D. Long-term loan			
E. Medium-term loan			
F. Short-term loan			
Total amount sought		100%	

Case study: Finance options planning

His Upper Room Trust (HURT)

His Upper Room Trust (HURT) is a childcare and youth work charity, established in 1989 and based in Alfreton, Derbyshire. From modest beginnings the charity quickly outgrew its own facilities. It started in a converted pub and coach house, but by 1998 it had already added a new community resource centre. The growth in its activities continued and in 2002 it started drawing up plans to buy and redevelop an old bus depot into a family centre, with an attached sports centre, conference facilities, catering business and 30 workshop units for new and emerging social enterprises. A trading arm called Genesis was created to take the project forward.

The capital cost of the new project was £1.2 million, which covered the purchase of the leasehold of the bus depot and the initial site redevelopment. A further £150,000 was needed for expansion and £328,000 for ongoing revenue support in the early stages.

A finance package was put together involving six different funders and investors. A grant of £600,000 was obtained from the East Midlands Development Agency, covering half the cost of the initial building project, with the other half of the finance required coming from three institutions: a CDFI called East Midlands Community Loan Fund which provided a £100,000 ten-year loan, a £200,000 fifteen-year secured loan from HSBC, and a £300,000 twenty-year mortgage from Property Trust Ltd. A fourth loan of £150,000 for ten years was obtained from the Local Investment Fund, a national CDFI. The £328,000 required for ongoing revenue support was provided in the form of a grant from the Coalfields Regeneration Trust.

The loan from HSBC was secured against the other two properties owned by HURT, while the loans from the two CDFIs were secured by a second charge against all three properties.

Further resources

Community Development Finance Association (CDFA) is the trade association for CDFIs. It maintains a database of members and provides up-to-date information on the activities of CDFIs around the country. See www.cdfa.org.uk

Unlocking the potential: a guide to finance for social enterprises is available from the Social Enterprise Coalition, price £10. See the publications section of their website www.socialenterprise.org.uk



Tool 4.4 – Negotiating finance

Aim

VCOs feel equipped to negotiate good financial packages.

Objectives

- VCOs understand the key parameters of finance negotiations.
- VCOs are fully prepared for negotiations with potential investors.
- VCOs learn from their experiences of negotiation.

When to use

For VCOs who are planning to negotiate a finance package with an investor. To be used with the VCO staff responsible for seeking investment.

How to use

1. Planning

- Working together, VCO and advisor should review and discuss the CAMPARI approach to decision-making used by many financial institutions and outlined in:
 - **Introductory Pack Guide to Loans and Other Forms of Finance: Tool – Checklist of investment decision criteria.**
- Check the VCO has completed a business plan for the project for which finance is being sought and that a finance plan has been prepared. For further support see:
 - **Introductory Pack Guide to Loans and Other Forms of Finance: Tool – Designing a finance package.**
- The VCO should develop their knowledge of the contents of their business plan. For further support with this see:
 - **Tools for Trading: Tool 2.5 – Business plan test.**

2. Action

- Review and discuss the **Key parameters for finance negotiations**. Note that if a finance deal is to be agreed these parameters will be the main variables.
- Draw up a list of all the financial institutions the VCO is considering approaching or currently negotiating with.
- Use the **Establishing parameters sheet** to map out the approach/needs/acceptable parameters for each provider being approached.
- Discuss the **Negotiation preparation sheet**. Consider which of these techniques can be used to prepare for meetings with financial institutions.

3. Review

- Advisors should arrange a review meeting to reflect on the VCO's negotiations with financial institutions. Focus on what further information was obtained about the proposed investment, and the common ground between the two parties. Find out what follow-up actions were agreed by both parties, and what progress has been made with these actions.
- Reflect on the negotiations. What went according to plan? What unexpected things happened? What lessons could be carried forward to any future finance negotiations?

Materials

Key parameters for finance negotiations

There are five key parameters to most finance deals:

1. Amount – The amount of money being sought. This might be a fixed amount, or it could be variable if there is more than one development option for the proposed project, or if finance is being sought from more than one source.

2. Repayment – This depends on what type of finance is being sought. Grants for example are not repayable. In the case of loans, there are several variables to consider:

- Overall length of the loan (number of years).
- Repayment schedule, including the frequency and amount to be repaid.
- Arrangements for postponing the start of repayments, and taking holidays from repayments part way through the schedule.

3. Interest rates – These might be fixed, variable, or a combination of the two. Variable interest rates will usually be linked to the Bank of England Base Rate. Some lenders start loans at a fixed rate, moving to a variable rate later on.

4. Security – Lenders may ask for personal guarantees from directors or trustees, although this is not usual in the voluntary and community sector (any VCOs asked this should proceed with caution). More typically, loans might be secured by a fixed charge against a major asset (e.g. property), or a floating charge against a category of assets (e.g. warehouse stock), depending on the amount involved. Some financial institutions are willing to make unsecured loans, although they usually charge higher interest rates to offset the risks involved.

5. Other charges – Many financial institutions charge arrangement fees for setting up a finance deal. In some cases there may be an annual review fee for renewing a facility, such as an overdraft. Other charges might include penalties for early repayment or charges for rescheduling loan repayments.

Establishing parameters sheet

Use the following table to record the preferred terms, the minimum acceptable deal, and what is already known about any proposed investment.

	Preferred deal	Minimum deal	Proposed deal
Amount			
Repayment			
Interest			
Security			
Other charges			

Negotiation preparation sheet

1. Draw up a list of all the financial institutions that have been approached and are prepared to negotiate a finance deal. Prepare a timetable for these negotiations.
2. Establish the parameters for each deal using the **Establishing parameters sheet** to set the range between the preferred deal and the minimum acceptable deal.
3. Prepare for the first meeting with a financial institution by developing a ten minute summary of the business plan. Focus on the purpose of the proposed finance deal. Remember that this will be the investor's opportunity to assess the VCO's ability to implement the business plan.
4. Discover what common ground exists with the financial institution by finding out as much as possible about the parameters of what they propose to offer. Record this information using the table on the next page. Identify where their proposals are already acceptable, falling within the range between the preferred deal and the minimum acceptable deal.
5. Focus on any proposed parameters that fall below the minimum acceptable deal. Find out what scope exists for changing what is on offer.
6. Focus on the problem not the person. Do not be aggressive or defensive if negotiations are not going smoothly. Remain focused on the problem at the centre of the negotiations. Do not get distracted by the character or the communication style of the other person.
7. If engaged in a series of negotiations with different financial institutions, ask for time to think about new proposals, rather than making snap decisions. Be open and honest about any proposals already made by other financial institutions.
8. Before completing negotiations, confirm the details of any new proposals that have emerged from the discussions. Make sure that both parties understand precisely what is being proposed.
9. Stick to the schedule agreed for taking follow-up actions after the negotiations.

Case study: Negotiating finance

Bognor Fun Bus

Bognor Fun Bus was established over twenty years ago to provide recreational facilities for children living in deprived areas. The organisation has always relied upon grant funding, but has decided to develop a skate park as a self-sufficient enterprise, with its entire income generated from fees, refreshments and competitions.

Bognor Fun Bus found a warehouse, available on a five year lease, which would accommodate the skate park. Estimates were obtained for refitting and equipping the building. But when Bognor Fun Bus contacted their bank about obtaining finance for the venture, they discovered that the bank wanted security and grants to be in place before they would even consider making a loan.

Instead, Bognor Fun Bus turned to the Esmée Fairbairn Foundation, which had just introduced a loans scheme as part of its move towards programme related investment (PRI). Charitable foundations are allowed by the Charity Commission to make loans to organisations in order to further the foundation's charitable objectives, in addition or as an alternative to grant aid.

Bognor Fun Bus negotiated an unsecured loan for £37,110 from Esmée Fairbairn, repayable over four years with an interest rate of 7%. The drawdown of funds was tied to proof of expenditure on the new project. Bognor Fun Bus was also negotiating grants from other sources to complete the funding package. But before the final grant of £9,000 was obtained, the warehouse was leased to someone else and whole deal fell through.

Even though this was a very disappointing outcome, Bognor Fun Bus was now confident that a skate park could be a self-sustaining income generating activity. It gave them the confidence to sell their existing freehold property and to seek land on which to place a new prefabricated building in which they will base all their activities.

However, the project remains firmly 'on the table'. The charity has freehold premises in the town centre which it proposes to sell, using the substantial surplus (£120,000) towards the indoor centre should a new site be located. They are also contemplating erecting an industrial-style prefab building instead of renting existing commercial premises, so the quest is now for suitable land.

Further resources

Esmée Fairbairn loans programme was launched in 2003 to offer loans to the UK voluntary sector, for projects with charitable purposes. The programme is run in co-operation with Charity Bank, which provides the loan administration and management services. Loans of between £10,000 and £250,000 will be considered, with interest rates ranging from 0% to 7%. Rates are fixed, with the maximum rate reviewed annually. It will consider both secured and unsecured loans. The normal repayment period is five years. See www.esmeefairbairn.org.uk



Tool 4.5 – Demonstrating the social value of investment

Aim

VCOs feel able to demonstrate the social value of investment to investors.

Objectives

- VCOs identify key stakeholders in their work/projects.
- VCOs appreciate the need to understand an investor's own aims and social mission.
- VCOs develop a process for identifying and demonstrating the social benefits of their work.

When to use

Useful for VCOs receiving investment of funding (in the form of a grant, sponsorship, loan or other investment) for which they need to report the resulting social benefits. Also useful for VCOs that wish to build up an evidence base demonstrating their social impact for use in future funding applications or marketing material.

How to use

1. Planning

- Most investors in VCOs will have their own mission and objectives, which will influence their investment decisions. These can range from social objectives (e.g. of a Trust, Foundation, or VCO dedicated loan initiative) to commercial or marketing interests (e.g. of a high street bank or commercial sponsor).
- Understanding these objectives and demonstrating how a VCO's work will contribute to them will support applications for funding or investment.
- VCOs preparing an application or business plan for funding or investment should research potential funders or investors to establish what their aims are.
- Establish if and how the VCO currently identifies, monitors and reports their social achievements.
- Check what reporting requirements will be needed for any new or proposed investment and if there are already plans for monitoring the social achievements resulting from the proposed new investment.
- Bear in mind that it is useful for VCOs to monitor outcomes and achievements, even if unprompted by funders or investors as a means of gaining user feedback (from which to improve services), data demonstrating value (to support future funding or investment applications) and comments to use in marketing material.

2. Action

- Ideally working with an advisor, a VCO should consider the idea that their stakeholders may be both contributors to, as well as beneficiaries of, their social mission.
- Use the **Stakeholders – Contributors and beneficiaries sheet** to discuss this idea in the context of any new funding agreement or investment. Bear in mind that a VCO's work will probably lead to additional contributions from some stakeholders, as well as achieving benefits for others.
- Focusing on the specific project for which funding or investment has or will be obtained, use the **Social value of investment sheet** to analyse its potential impact. Consider what the purpose of this investment is and what social impact it will have. List the stakeholders most affected by this project, and identify what contributions and/or benefits it may lead to.
- Compare the contribution being made by the investor with the additional contributions being made by other stakeholders, as well as the benefits received by stakeholders. This could be quantitative (e.g. number of people helped into employment) or qualitative (e.g. verbal feedback from users demonstrating how the VCO's work has helped them improve their lives).
- Discuss how this analysis can be effectively presented to the investor.

3. Review

- Present findings to the funder or investor and subsequently find out how the investor responded to this presentation of the social value of their investment.
- Consider how presentation could be improved. What worked well? What did not?
- Keep a record of the analysis for use in future funding or investment applications, or in marketing literature for the VCO.

Materials

Stakeholders – Contributors and beneficiaries sheet

Use this table to identify the key stakeholders in a project, and to determine whether these stakeholders are contributors or beneficiaries, or both. Decide what contributions and/or benefits will be achieved. Those given are starting points only to which others may be added. Consider if it is possible to attach a monetary value to any of these contributions and benefits.

Stakeholder	Social contribution	Social benefit
Volunteers	<ul style="list-style-type: none"> • Work unpaid hours. • Provide skills and expertise. • Allow use of own resources (e.g. car, computer, home). • New friends and networks. 	<ul style="list-style-type: none"> • Acquire new skills. • Receive guidance and support. • Leads to paid employment. • Improved health and wellbeing.
Employees	<ul style="list-style-type: none"> • Provide skills and expertise. • Accept below market pay rates. • Work unpaid overtime. 	<ul style="list-style-type: none"> • Acquire new skills. • Contribution to local community, cause, or interest group.
Customers	<ul style="list-style-type: none"> • Pay premium price (e.g. fair trade products). 	<ul style="list-style-type: none"> • Obtain subsidised goods. • Support local economy. • Improved local community.
Service users	<ul style="list-style-type: none"> • Become volunteers, members and/or supporters. 	<ul style="list-style-type: none"> • Obtain free services. • Improved health and wellbeing. • Improved skills. • New friends and networks. • Improved safety. • Have say over the design of services.
Local community	<ul style="list-style-type: none"> • Become volunteers, members and/or supporters. • Donate goods. • Donate cash. • Provide local knowledge and expertise. 	<ul style="list-style-type: none"> • Become service users. • Improved local environment. • Improved community safety.
Suppliers	<ul style="list-style-type: none"> • Offer discounted supplies. • Donate supplies. 	<ul style="list-style-type: none"> • Money stays in local economy. • Paid premium price (e.g. fair trade products).
Investors	<ul style="list-style-type: none"> • Accept lower interest rates. • Accept less security. • Convert loan into grant. 	

Social value of investment sheet

Brief description of the Investment project:		
Which stakeholders will the project impact upon?	What social contributions will these stakeholders make (if any) to the project?	What social benefits will these stakeholders receive (if any) from the project?

Case study: Demonstrating the value of social investment

Tomorrow's People, Merseyside

Tomorrow's People is a specialist employment charity that has helped change the lives of thousands of individuals across the UK. Its social mission is to help people find and keep a job by providing job seekers with the skills and qualifications that local employers need. The charity was founded in 1984 and since that time it has helped over 400,000 long-term unemployed on their journey back to work. 90% of clients are still in employment three months later and 76%, twelve months later.

Tomorrow's People secured funding for a young offenders project in Merseyside called Getting Out to Work. The project, launched in 2003, aimed to reduce re-offending rates and improve employment in the local area by helping young offenders gain long-term, sustainable employment.

To demonstrate the value of this work, Tomorrow's People commissioned the New Economics Foundation (nef) to conduct an independent evaluation of the project, focusing on its effectiveness and the social and economic returns generated for the wider community. nef used a method of evaluation called Social Return on Investment (SROI) which enables understanding, measuring and reporting on the social, environmental, and economic value that is created by an organisation or project.

The evaluation found the project had achieved some very positive outcomes. In its first twelve months, the project placed 17% of its clients into jobs, exceeding the funder's objectives and regional averages. In addition, re-offending rates amongst the project's participants were 15-20% lower than the national average. nef's analysis also found that the quantitative social value created by the project was £492,000, or £4,470 per participant. This compares with an investment of £25,000 per year by the funder, which was matched by the European Social Fund.

For further information see www.tomorrows-people.co.uk

Further resources

New Economic Foundation (nef) is an independent 'think-and-do tank' focusing on economic well-being. It has pioneered new ways of measuring the social, economic and environmental impact of projects and initiatives. Among the many tools it has pioneered and developed are social auditing and Social Return on Investment (SROI). See www.neweconomics.org

Downloadable copies of nef's quality and impact toolkit are available at www.proveandimprove.org.

Directory of Tools

Further Tools in addition to those contained in this document are available in the other Toolkits in the series and in the accompanying *Introductory Pack on Funding and Finance*. Details of available Tools and their location are given below.

The Tools contained in this document are highlighted. Tools included elsewhere which are *directly* relevant to loans and other forms of finance are also highlighted for guidance. Those highlighted do not form an exhaustive selection, however, and others may also be relevant depending on a VCO's individual circumstances.

Topic	Tool	Level	Location
Sustainable funding	Summary overview of funding environment with first-step assessment exercises	Introductory	<i>Introducing Funding and Finance for Voluntary and Community Organisations</i> pocket guide
	Self-assessment needs-analysis tool		<i>The Sustainable Sun Needs-Analysis Tool for Voluntary and Community Organisations</i>
	SWOT and PEST environmental analyses		<i>Introductory Pack Guide to Sustainable Funding</i>
	Risk analysis		
	Business plan		
	Income diversification diagnostic tool		
	Organisational capacity and capability assessment grid	Intermediate	
	Skills/knowledge audit		
Financial management	Developing a financial strategy	Introductory	<i>Introductory Pack Guide to Financial Management</i>
	Example revenue budget		
	Example cash-flow budget		
	Example monthly budget report		
	Example of fixed and variable costs		
	Example cash-book summary		
	How to do a bank reconciliation statement		
	Example receipts and payments management account	Intermediate	
	Example of how accrual accounting works		
	Example contents of an annual report		
	SORP information required in the annual report		

Topic	Tool	Level	Location
Fundraising	How to prepare and use a Case for Support	Introductory	<i>Introductory Pack Guide to Fundraising</i>
	Fundraising from individuals jargon buster		
	Legacy fundraising jargon buster		
	Deciding who should fundraise		
	Applying to grant-making Trusts and Foundations	Intermediate	<i>Tools for Fundraising</i>
	Raffles and Lotteries		
	Charitable events		
	Hiring a fundraising consultant	Advanced	
Trading	Exploring attitudes to Enterprise	Introductory	<i>Tools for Trading</i>
	Developing an entrepreneurial culture		<i>Introductory Pack Guide to Trading</i>
	Developing a competitive advantage	Intermediate	<i>Tools for Trading</i>
	Deciding where to start		
	Peer-learning for trading activities		
	Establishing an enterprise team		
	Cultural shift	Advanced	<i>Introductory Pack Guide to Trading</i>
	Feasibility studies		
	Business plan test		
	Trading activity development framework		
	Trading subsidiaries checklist		
Procurement and contracting	Contract checklist	Introductory	<i>Tools for Procurement and Contracting</i>
	Is Value Added Tax (VAT) applicable?		
	Identifying likely customers checklist	Intermediate	<i>Introductory Pack Guide to Procurement and Contracting</i>
	Marketing to potential purchasers checklist		
	Making direct contact with purchasers checklist		
	Meeting potential purchasers checklist		
	Deciding whether to bid and what for		
	Checklist for tender preparation	Advanced	<i>Tools for Procurement and Contracting</i>
	Negotiating contracts		
	Working with other VCOs		

Topic	Tool	Level	Location
Loans and other forms of finance	Checklist for loan finance decision-making	Introductory	<i>Tools for Loans and Other Forms of Finance</i>
	Comparison table of grants, debt and equity		
	Preparing a proposal for finance	Intermediate	<i>Introductory Pack Guide to Loans and Other Forms of Finance</i>
	Checklist of information required by finance providers		
	Checklist of investment decision criteria		
	Assessing finance needs	Advanced	<i>Tools for Loans and Other Forms of Finance</i>
	Finance options planning		
	Negotiating finance		
Demonstrating the social value of investment			



The Finance Hub is delivering to the Government's ChangeUp programme to create voluntary and community organisations which are effective and independent because they are financially sustainable.

**The Finance Hub
Charities Aid Foundation**

St Andrew's House
18-20 St Andrew Street
London
EC4A 3AY
info@financehub.org.uk
www.financehub.org.uk
Tel (020) 7832 3014
Fax (020) 7832 3001



NCVO's Sustainable Funding Project encourages and enables voluntary and community organisations to explore and exploit a full range of funding and financing options to develop a sustainable funding mix.

The Sustainable Funding Project
funding in the round

Website: www.ncvo-vol.org.uk/sfp

Tel: 020 7520 2519

Email: sfp@ncvo-vol.org.uk

**National Council for
Voluntary Organisations**

Regent's Wharf
8 All Saints Street
London N1 9RL
Tel: 020 7713 6161
Fax: 020 7713 6300
Textphone: 0800 01 88 111
HelpDesk: 0800 2 798 798
Email: ncvo@ncvo-vol.org.uk
Websites: www.ncvo-vol.org.uk
www.askncvo-vol.org.uk

March 2007

Charity registration: 225922