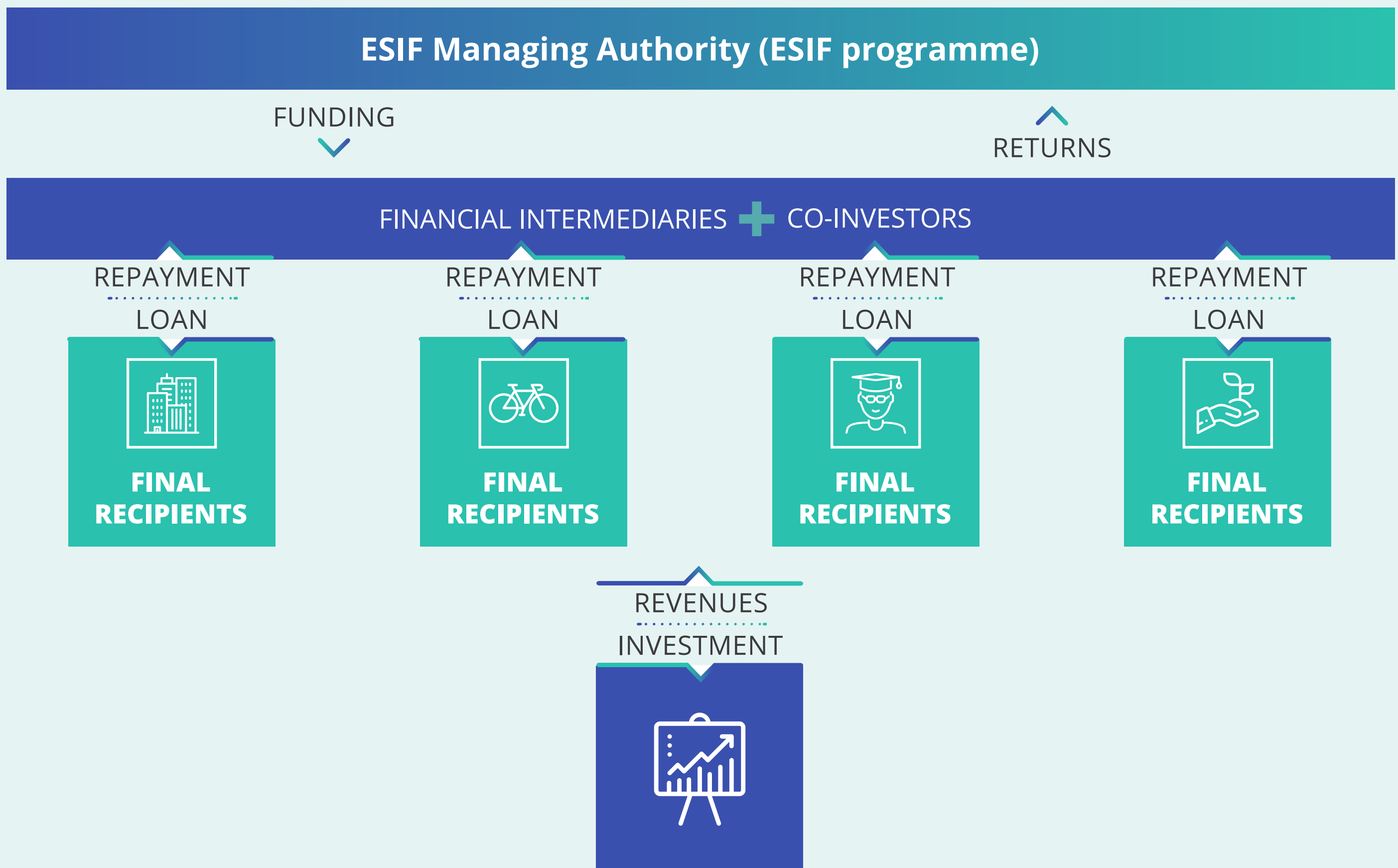
LOAN

“Agreement which obliges the lender to make available to the borrower an agreed sum of money for an agreed period of time and under which the borrower is obliged to repay that amount within the agreed time*”.

How does it work?



NOTES

1. In addition to disbursing loans through FIs (in an implementation structure with a Fund of Funds (FoF) or without), MAs may undertake implementation tasks directly (see CPR, Art. 38(4)(c)).
2. Co-investment may come from the same FIs or a third party investor, contributing either to the fund or to individual projects.
3. Resources returned from repaid loans, which are attributable to the support from ESI Funds, i.e. excluding national co-financing, have to be re-used for purposes defined in Articles 44 and 45 of the CPR.

TECHNICAL FEATURES

The involvement of **ESI Funds** results in loans that are offered at a lower than market interest rates, with longer repayment periods, the possibility of grace periods, when loans do not need to be repaid in the first years or with **reduced collateral requirements**; these are called **soft loans**.

In general, for commercial loans, the **interest** charged on the loan is the market rate plus a **risk premium** that reflects the likelihood of a lender getting their money back. The risk premium includes **credit risk** which varies with the borrower's credit history and expected cash flow.

One way to decrease the risk premium is through **collateral**, where the borrower offers assets such as property, receivables, or investments as security which become the property of the lender if the borrower **defaults** (does not repay the loan). Risk completely ceases only on the date the loan is fully repaid, the maturity date. Therefore, the later the **maturity date**, the higher the risk premium. Individual **repayments** must cover the interest due, but the sooner the principal of the loan is repaid then the lower the total payments will be.

PROS

1. Not particularly difficult to administer (so there are limited management costs/ fees).
2. A defined repayment schedule makes budgeting easier.
3. The lending mechanism is well understood, reducing the need for capacity building and the risk of misunderstandings.
4. Loans preserve the equity of the FRs as there is no claim on the ownership of the enterprise.

CONS

1. Funded products such as loans require more initial resources than unfunded products such as guarantees.
2. It is sometimes difficult to establish the probability of default, especially with a lack of history of FRs.
3.The advantage for the FRs is almost entirely financial. There are limited additional benefits as know-how is not transferred.