LOANS

1. How To Make Loans Your Friend

1) Definition:

A loan is money that is borrowed and must be paid back, usually with interest and other associated costs such as loan processing costs, insurance fees, stamp duty etc.

2) Most loans must be secured

The lender needs to make sure that he doesn't lose his / her money if you don't pay back your loan. You may therefore be required to present proof of security or collateral. This is something you own (e.g. a piece of land) and which will become the lender's if you fail to pay back the loan. Some lenders accept another person to be a guarantor. In case you fail to pay back your loan, the guarantor must cover for you and pay back that loan.

You may also be required to provide the lender with indications/proof of your cash-flow and business activity. This will give the lender an understanding of your ability to pay back the loan and will therefore inform you of his/her decision of whether or not to give you a loan and how much to lend you.

Some loans may not require security. Banks or other lenders that do not require security may charge very high interest rates or other fees because it is very risky for them to give out a loan that has no security. Therefore, in case you are offered a loan without security, make sure you understand the cost of the loan.

3) Every loan comes with a cost

When you take a loan, you must understand that you have to pay back the amount which you have received from the lender, plus an additional cost called interest, together with possible further charges. Before you take a loan, ask the lender about the total you have to pay back over the entire period of the loan. This is called the Total Cost of Credit and includes the amount you borrowed + interest + any other fees/charges. It is the responsibility of the lender to tell you the Total Cost of Credit. If he does not, ask for it.

4) *Interest is the “price” you pay for borrowing money.*

Interest is the additional money you have to pay to the person or financial institution that lends you money. Interest is expressed as a percentage of the amount you have borrowed. It is mostly calculated on an annual or on a monthly basis. Depending on the loan, you may be asked to pay interest yearly, monthly, or weekly. There is a big difference between a yearly, monthly, and weekly interest rate.

Yearly interest rate: If you took a loan of 100,000/= with 12% interest per year, you would pay an interest of 12,000/= per year in addition to the 100,000/= you have received. After one year, you would therefore have to pay the lender 112,000/= plus any other fees/charges.

Monthly interest rate: If you took a loan of 100,000/= with 12% interest per month, you would pay an interest of 12,000/= every month. Over the year, this would amount to 144,000 in interest. You would therefore have to pay back 100,000/= + 144,000/=, which would total to 244,000/=.

5) *If your loan comes with variable interest, you might end up paying more*

Interest can be “fixed” or “variable”. If it is variable, this means that it can change over time. Therefore, you might end up paying more. Fixed interest is one where the interest rate doesn't fluctuate during the period of the loan repayment. This allows you to accurately predict your future payments. If the interest is variable, the rates can change during the period of the loan (for example, if the Bank of Uganda's Central Bank Rate changes). A variable interest rate may go up or down.

6) *If your loan comes with a flat interest rate it is more expensive*

Interest may be “flat” or “declining”. A loan with 10% declining interest will cost you less than a loan with 10% flat. This is because with a “declining” interest rate you only pay interest on what you actually owe the lender while with a “flat” interest rate you keep paying interest on the original amount until this amount is entirely paid back. For example, if you take a loan of 100,000/= at 10% interest per month and you pay back 50,000/= (plus the interest) after one month, with flat interest you still have to pay 10% of 100,000/= which is 10,000/= in the second *month; with declining interest you only pay 10% of 50,000/= which is 5,000/= in the second month.*

7) Be aware of any additional charges

In addition to interest, financial service providers may charge further fees/charges. These include insurance, stamp duty and loan processing fees. Make sure you understand the total amount you will have to pay back. Once you have understood this, think again and ask yourself if you will be able to pay back the loan. If not, you may want to opt for a different financial service provider or a smaller loan size.

8) Do you know what penalties you would face if you don't pay back on time?

Understand what penalties you would face if you make a late payment, miss a payment or make an early repayment.

9) Shop around for the best offer

When you want to take a loan, compare the offers from different financial institutions by considering: interest (rate, period, currency, declining/flat, fixed/variable), charges and penalties – understand the "Total Cost of Credit". If you shop around for the best lender, you will most likely end up paying a little less with good payment terms. Borrowing from the wrong lender could cost you a lot, so research your options and choose wisely. Be confident when asking financial institutions for costs and terms of products – it is their responsibility to provide you with all the information you need to decide which product is the best for you.

10) Plan for your loan

Do not borrow to substitute your own efforts of savings. Before taking a loan, plan how

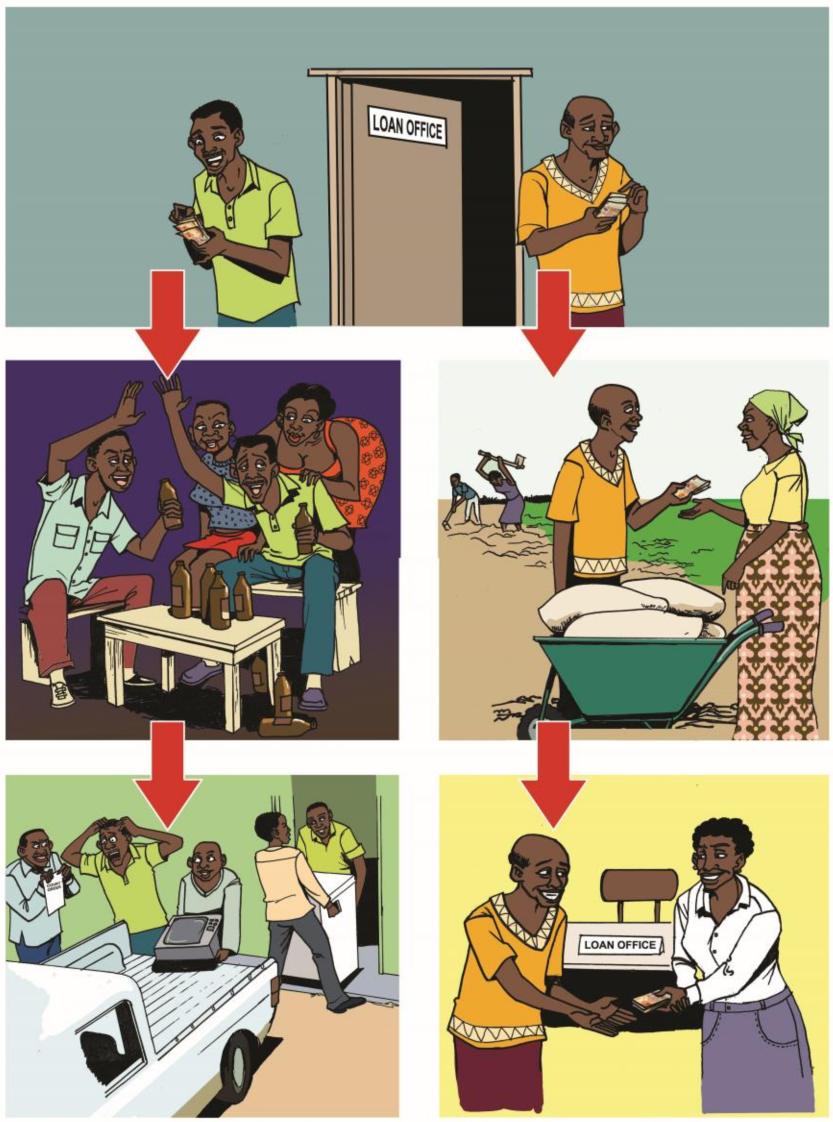
you will pay back the loan and the interest payments. You have an obligation to pay back the amount you borrowed plus the interest payments and any further charges/fees. If you know that you will not have a means to do so within the agreed time, you should not take the loan.

11) It's easy to get into debt but hard to get out

If you borrow money, plan carefully how you will use your loan and how you will pay it back – and stick to your plans. Always use borrowed money for the purpose you borrowed it. Avoid borrowing to pay debt.

12) Make that money productive

To pay back your loan, you have to make the money work. Borrow for productive investments such as acquiring a piece of land, so you can increase your earnings. Pay back the loan and maybe borrow more later if it is necessary. Use loans wisely and never rush into borrowing. Think twice before borrowing for luxuries, or things that lose value (e.g. car, furniture, clothes, etc.).



13) Don’t borrow because others are borrowing

It is not wise to take a loan just because other people around you are doing so. Ask yourself if you really need the loan. Mostly, it is better to save than to take a loan. Take a loan only as a last resort

14) If you don’t pay back, you might lose your security

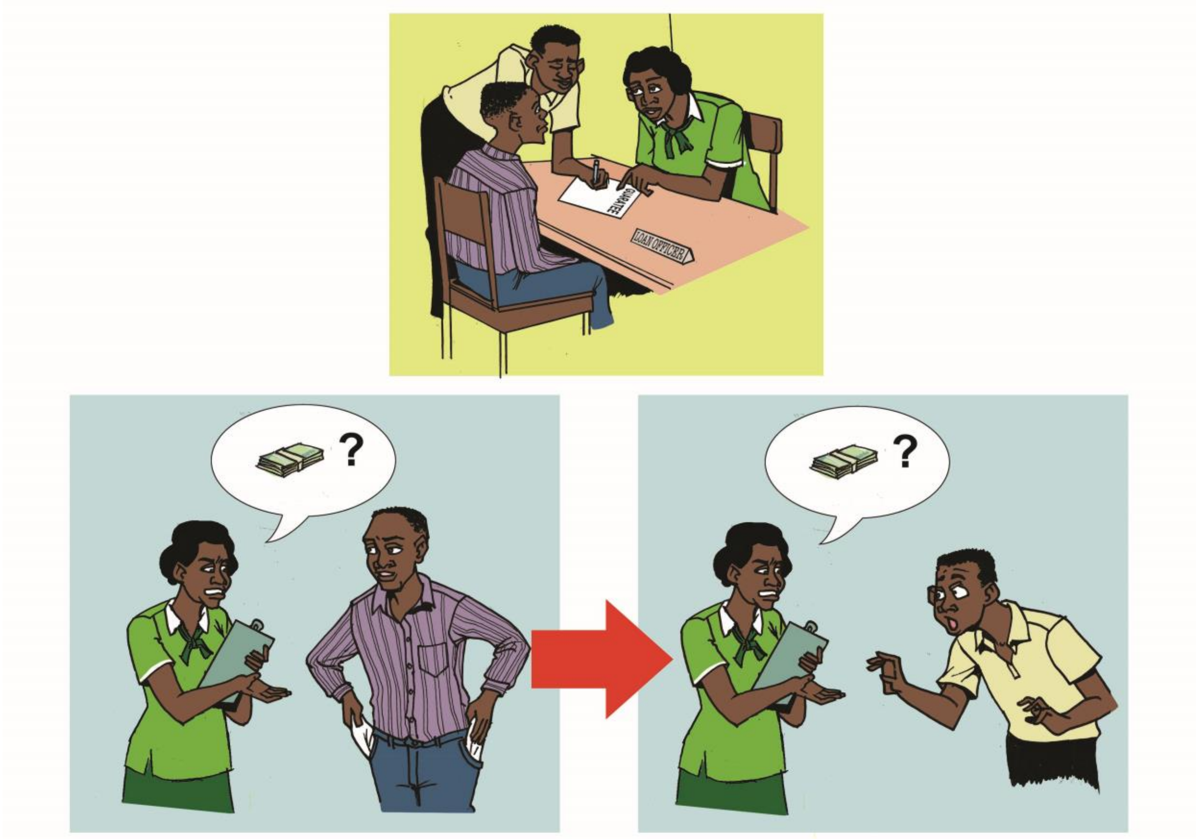
Remember that when you apply for a loan you may be required to give the lender some form of security. This can be your house, land, vehicle, animals or salary. If you don’t pay the loan back in a timely manner, you will lose your security. The lender has the right to keep the security if you fail to pay back.

15) Beware of aggressive lenders

Avoid "easy" loans and lenders who discourage you from reading and understanding the loan documents. They might try to take advantage of you. Always insist on reading all the loan documents and ask for explanations so you understand the "Total Cost of Credit" as well as all the conditions attached to the loan before you sign. It is your right to ask and the responsibility of the lender to provide you with all the information you need before agreeing to take a loan. Both you and the lender should be honest in disclosing information to avoid nasty surprises in future.

16) Think before becoming a guarantor

*Be careful about being a guarantor for other people's loans. If the people you are guaranteeing for fail to pay back the loan, you **must** pay the loan.*



17) Don't "dig a hole" to fill up "another hole".

If you are already struggling with debts, avoid taking another loan since this will only add to your debts hence increase your burden. Remember you will be paying additional charges, fees and interest since this is a new loan.

18) Protect your financial image

- *Do not despair or lose hope if you have difficulties paying back your loan. Consult with family and friends on how to handle the situation.*
- *Don't declare yourself bankrupt – people may lose trust in you.*
- *If you fail to pay on time as laid out in the contract, inform your lender in advance.*

- *Don’t try to buy time by paying with a cheque that “bounces” (issuing a cheque when you do not have enough money on your account).*
- *Don’t give any false or misleading information.*

19) Keep your financial history clean

If you take a loan, your repayment history will be kept. The next time you apply for a loan, this information will be used to decide on whether to give you a loan or not and to which conditions. The better your history, the better the loan conditions will be.

2. RULES OF THUMB

LET'S BORROW!

	Taking a Loan	Using Your Own Money
Advantages	You gain access to more money than you have in savings.	You avoid the costs of borrowing. You are free to use your money as you wish. You avoid the obligation of future loan repayments.
Disadvantages	You bear the cost of borrowing (with interest, fees and time to apply). You are responsible for repaying your loan on time, and face penalties for late payment. You must meet the requirements of group membership (attend meetings on time, etc.) if the loan is through a group.	You have limited access to needed capital. Your business grows more slowly. You have limited ability to respond to opportunities.

Use of the Debt	Good Debt	Bad Debt
Purchasing an asset or consumables	The asset or goods purchased outlast the time it takes to pay off the lender. The income earned from the asset exceeds the cost of the loan.	Debt is still owed after the item is consumed or the income earned from the asset is less than the cost of the loan.
Working capital	The loan makes it possible to pursue a business opportunity that is profitable enough to repay the loan and have something left. The loan helps you save money on inputs or inventory and thus increases your earnings from the final product.	You cannot earn enough to repay the loan. You have other less-costly sources of financing. You cannot get the loan in time to take full advantage of a specific opportunity.
Emergency loan	The loan helps you solve an immediate problem without undue hardship.	The loan terms are too costly, or cannot be adjusted to your ability to repay.

3. ARE YOU A LOANS PRO?

QUIZ – PLEASE PICK THE RIGHT ANSWER!

1. ***Which of the following can serve as a security or collateral for a loan?***

☐ *A) Piece of land* ☐ *B) Another loan* ☐ *C) Loans don't require collateral*

2. ***An interest rate which doesn't change during the period of the loan repayment is called…***

☐ *A) Variable Interest Rate* ☐ *B) Flat Interest Rate* ☐ *C) Fixed Interest Rate*

3. ***The total cost of a loan of 100,000 /= with a yearly interest rate payment of 10%, plus 10,000/= fees/charges to the bank would be…***

☐ *A) 100,000/=* ☐ *B) 120,000/=* ☐ *C) 110,000/=*

4. ***Which of the following has the lowest total cost?***

☐ *A) A loan of 100,000 with a 15% <u>monthly</u> interest*
☐ *B) A loan of 100,000 with a 15% <u>yearly</u> interest*
☐ *C) They have the same total cost*

5. ***Which of the following loans will cost you less?***

☐ *A) A loan of 10,000 with a <u>flat</u> interest rate*
☐ *B) A loan of 10,000 with a <u>declining</u> interest rate*
☐ *C) They both cost the same*

CORRECT ANSWERS: 1A, 2C, 3B, 4B, 5B

4. PLAN YOUR LOAN WISELY

SELF ASSESSMENT TEST: Is it Wise to Take Up this Loan?

1. *Is this loan creating a good debt?* ☐ *Yes* ☐ *No*

2. *Do I understand the total cost of credit, i.e. all the administrative charges + interest rate payment + amount borrowed?*
   ☐ *Yes, it is:* ☐ *No*

3. *Do I know whether my interest rate is fixed/variable, flat/declining?*
   ☐ *Yes, it is:* ☐ *No*

4. *Am I aware of the penalties for not paying back on time?*
   ☐ *Yes, they are:* ☐ *No*

5. *Am I aware that I might lose my security if I do not pay back?*
   ☐ *Yes* ☐ *No*

6. *Have I compared offers by different institutions and is this the most favorable one?*
   ☐ *Yes, I have compared these institutions:* ☐ *No*

7. *Is the institution I chose trustworthy and do I feel respectfully and fairly treated as a customer?*
   ☐ *Yes* ☐ *No*

8. *Have I made a plan for the repayment?*
   ☐ *Yes, I will pay back:* *(weekly/monthly)* ☐ *No*

9. *Can I afford to pay these instalments?*
   ☐ *Yes* ☐ *No*

*!!!IF YOU HAVE ANSWERED **ONE OR MORE QUESTIONS** WITH **NO**, THEN YOU SHOULD RECONSIDER TAKING OUT THIS LOAN!!!*

5. THE ABC OF LOANS

Total Costs of borrowing	*Loan amount + interest + fees/charges*
Interest	*This is the price you pay for borrowing money.*
Security/Collateral	*Security/collateral is a property or asset that a borrower offers to a lender to secure a loan.*
Variable Interest Rate	*An interest rate which can change during the period of the loan, for example when the Bank of Uganda's Central Bank Rate changes.*
Fixed Interest Rate	*An interest rate which doesn't change during the period of the loan and therefore allows you to accurately predict your future payments.*
Flat Interest Rate	*This means that you keep paying interest on the original amount of the loan until this amount is entirely paid back.*
Declining Interest Rate	*This means that you only pay interest on what you actually owe the lender.*