The Third Resource:

A Manual on Fully Secured Borrowing for Nonprofit Organizations

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April 2025

The Third Resource, Fully Secured Borrowing for Nonprofit Organizations

Executive Summary:

Nonprofit organizations facing the crisis created by current circumstances need access to fully secured borrowing—the third resource—to supplement the first resource: gifts and grants, and the second resource: earned revenue. As funds are delayed or denied by governmental agencies or by their counterparts, organizations need protection to ensure that they can continue to operate. Over forty years, our approach has helped organizations to weather these financial pitfalls.This manual explains what fully secured borrowing is, why it is so valuable to nonprofit organizations, and how to obtain it.

Fully secured borrowing is a loan from a local bank that has been matched dollar for dollar with funds placed at the bank by supporters of the organization. The collateral that the supporters—creditholders—provide is aggregated by the organization and used to purchase a Certificate of Deposit. These funds are pledged by the creditholder to the bank as collateral. With the collateral in hand and with a cash flow budget and cash flow projections, banks are universally delighted to lend to organizations. This includes even organizations with no credit history.

This manual explains the creditholder concept in detail. It provides sample solicitation letters, a question and answer flyer, forms to be filled out by creditholders, and a sample contract between the organization and the individual creditholders. Since fully secured borrowing is an accepted practice in the banking world, the bank will provide the necessary documents to set up the loan.

The nonprofit organizations using fully secured borrowing report that the process is fast, relatively easy, and remarkably effective in smoothing out cash flow, or addressing emergency situations with term loans.

The Third Resource

Dire Straits. Bad times. Funds that were meant to be there suddenly are unavailable. Normally, nonprofit organizations simply need to solicit donations for gifts and apply for grants. Or use their services to earn as much as possible. But all nonprofits have access to the third resource. Namely, fully secured borrowing from a local bank.

While there is considerable interest in various types of loans, especially in hard times from well-meaning philanthropic institutions or donors, it is vital to carefully question whether these types of loans are appropriate or timely enough to meet the needs of your organization. In this manual, we will demonstrate how to obtain fully secured credit from your bank. These loans which are particularly well suited to nonprofit organizations in the midst of the current crisis.

Fully secured borrowing is a loan from a bank that has been matched dollar for dollar with creditholder's assets. The major advantages of this type of loan are:

- It is universally available from local banks.
- It is fast, since most the bureaucratic authorizations are missing.
- It allows your supporters to help in a significant way in addition to their donations.
- It puts control in the hands of your nonprofit organization, not the lender.
- It is a long-term solution, since established credit can be used over and over.

Why Borrow?

Nonprofit organizations need fully secured borrowing as the third resource to deal with the terrible fiscal problems posed by the current circumstances. Here are the reasons why:

• The first resource for most nonprofits are gifts and grants. All organizations need to continue to urge donors to be generous, but these pleas for help must compete with urgent needs in other sectors of the economy. It is likely that donations at this time will not equal the amounts needed by nonprofit organizations. These are unprecedented times and standard assumptions about unearned income may not hold. Funds are being slashed for educational programs, for health care and medical research, for vital environmental efforts, for desperately needed social services and even food aid for kids and the poor.

• The second resource for some nonprofit organizations is earned revenue. In the arts performances, gallery shows, festivals, and concerts, are threatened for lack of funds. In other areas, research funds, tuition assistance, and a host of social and health care services are all facing a grim future in which earnings simply cannot meet the operational needs of the institutions. All earnings are now in jeopardy in the current crisis. With less earned income, nonprofits need an alternative.

• The third resource is fully secured borrowing. This is a different form of borrowing than conventional loans. Despite its difference, fully secured borrowing really works for nonprofit organizations. During the past four decades the most efficient, ongoing, and least expensive resource for nonprofits is the use of credit. Today, in this time of crisis, a borrowed dollar is cheaper by far than a donated or earned dollar and is much more readily available from local banks.

However, unlike gifts and grants or earned income, the borrowed dollar comes with two qualifications: appropriate collateral, which is where the supporters we call creditholders come in, and evidence through the use of cash flow budgets and future projections that the institution can pay back the loan.

Collateral is often difficult in the nonprofit sector. Many organizations lack the stuff that bankers want. So, we developed the concept of creditholders. These are people who normally support your organization. They might be donors, or they may not yet be donors, but they can still help. Creditholders "park" some funds in an account that your organization creates. When enough dollars have been collected to buy a jumbo certificate of deposit at your bank, these funds are used as a liquid asset to form the collateral that triggers your borrowing.

We will provide you with letters to potential creditholders. We will supply the forms needed to engage them, and the arrangements that will allow them to pledge their funds on your behalf. This process is different from a donation. Creditholders may be a donor, but often they are not. Instead, they are people who support your mission, while keeping their money for themselves. What they do is allow you to gain access to the fully secured borrowing that you need to smooth out your cash flow or to respond to a serious emergency, like the present moment.

<u>How does my bank understand our capacity to repay the money?</u>

If you think about it, bankers are like the folks around the corner that rent tools. Both charge you fees, both pay special attention to time, and both will hound you if you don't bring back their item on time. Bankers rent money. To do this, they offer a variety of products, designed to balance their risk with their financial rewards. At best, it is a subjective business, and it is made more so in the nonprofit sector unlike the commercial world, by the lack of system wide comparable figures.

A multiple-year cash flow budget and some scenarios about the future will be a considerable help to the banker and to you. The cost of borrowing is clearly enumerated, so that the banker and board members can all see the impact of borrowed funds on the organization. The requirements for repaying debt service, and the time frame within which all this activity is taking place is included in your multiple year cash flow budget.

To start, you need a cash flow budget, not the usual annualized summary budget. The annualized summary budget has one column for income and expense over a year. The bottom line is a single number. This may be fine for a foundation or a donor, but your banker must see the relationship between money and time that characterizes your organization.

An Annualized Summary Budget Illustrated:

Income	
1. Grants	120,000
2. Donations	50,000
3. Gifts	35,000
4. Earned Revenue	225,000
Total Income	430,000
Expenses	
5. Salaries	244,992
6. Fringe Benefits	53,892
7. Part-Time Wages	15,000
8. Consulting Fees	7,500
9. Rent	22,000
10. Utilities	5,000
11. Legal and Accounting	13,500
12. Supplies	12,616
13. Printing	55,000
Total Expenses	430,000
Balance	0

Notice that your eye runs rapidly down the column to the bottom-line, which in this case is an intentional – through rare – zero. Because it is a convention, you may not notice that all the numbers are a summary of the entire year, which can leave you clueless about what happened on a daily, weekly, monthly, or even quarterly basis. This budget can indicate whether you have money or don't, but it does not allow you to see the relationship between money and time that is the essence of cash flow. Unlike foundation officers, your banker needs to see a cash flow budget that shows how money ebbs and flows through your organization in relation to time.

How do we quickly cobble together a cash flow budget?

Using a monthly income and expense format you will wind up with a twelve-column page, plus a column to summarize all the numbers. This enables you and your banker to actually see your on-going relationship to money. You can do this on an item-by-item basis, just as you normally do, but in this case, for example, on a monthly basis. You or your bookkeeper simply add up all the cash only items (no income that is promised, but not in your bank account, and no expenses that have not actually gone out the door).

Or, you can use a three-line budget, to quickly reflect your cash flow. In this budget you sum all your income and expense by month. Place these numbers in your twelve-column format, and add or subtract the different between income and expense for each month. This simple procedure will enable you to move beyond the "snapshot" that is the annualized summary budget. You will have a moving picture of income and expense by month. This will prove to be much more valuable for you, your board and for your banker.

A Three-Line Cash Flow Budget Illustrated

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Total
Income	30	32	38	45	50	40	50	25	20	35	40	45	430
Expense	41	40	35	32	30	35	40	45	42	35	30	25	430
Running Total	-11	-19	-16	-3	17	22	12	-8	-30	-30	-20	0	0

Note: All figures are in thousands.

Purely for illustrative purposes, we started both budgets with zero dollars in the bank and ended the same way. While the annualized summary budget provides a sense of the over-all solvency of the organization, it does not provide much information about your operations and its relationship to time. In contrast, even this simple summary cash flow budget allows you and your banker to chart out the flow of funds on a monthly basis.

You might notice that in this budget the first four months of the year and four of the five of the last months all end with negative numbers. Seems pretty grim, but then you see that this organization earns its money in May, June, and July, and usually finishes strong in December. These figures will show your banker when your organization might be able to use fully secured borrowing to smooth out your cash flow, because often it is time rather than money that is at the heart of fiscal woes. And this three-line budget illustrates time in relation to money for your organization.

To assist your banker, it will be most helpful if you include footnotes also with your cash flow budget. Many nonprofits use financial terms that may be unfamiliar to the bank, so a few notes will serve you well.

Here are the footnotes that are included in the cash flow budget we presented earlier.

Footnotes:

1. Grants. The total amount of grants anticipated this year is $120,000. Of this amount, $50,000 has been secured as part of a multiyear grant from the state. $40,000 is highly probable, since we are asking for funds from agencies and foundations that have demonstrated a strong interest in our activities or have shown an historical interest in funding our programs. This leaves $30,000 that is speculative. By the end of the first quarter, we will have proposals pending to five new foundations and six corporations.

2. Donations received as part of our annual auction and year-round volunteer telemarketing campaign. Last year the auction raised $15,000. It should do that well or better this year. Consequently, we are forecasting that the auction will raise $20,000 this year.

The telemarketing program has generated a fairly consistent $2,000 to $3,000 per month, with the exception of a sharp dip in midsummer and with some higher numbers in October, November, and December. We believe that at least $20,000 can be considered highly probable from this source.

The balance of the $50,000 scheduled for donations is speculative. We believe that the auction and the telemarketing will deliver these funds above and beyond our estimates, but we cannot be certain of achieving this goal. To increase our chances of reaching our mark, we will be using more part-time helpers for the auction this year, and we will be placing emphasis on obtaining more items and greater attendance at the event.

3. Gifts. We differentiate between donations, which are contributions made as a result of direct solicitation through telemarketing or as income from our annual auction, and gifts, which are contributions that come directly from friends and supporters of the organization. Most of our gifts come from planned giving. Although it is difficult for us to estimate the arrival of funds, our experience indicates that roughly $25,000 per year will come from this source. The balance of the $35,000 allocated to this category, while speculative, should come from a program that was initiated last year. By asking board and staff to secure matching funds for their gifts to the organization, we are confident that we will obtain and additional $10,000.

4. Earned Revenue from the services we provide is a constant source of cash.

5. Salaries are provided for members of the staff. The breakdown by position:

• Executive Director	$40,000
• Assistant Director	$35,000
• Operations Manager	$25,000
• Development Director	$20,000
• Two part time Clerical Staff at $16,500 each	$33,000
• Four Field Workers at $23,000 each	$92,000
Total Salaries	$245,000

6. Fringe Benefits are calculated at 22% of base salary. They include our health plan through United Health, the pension plan we offer through Cosmopolitan Life, and the portion of Social Security paid by the organization. ($245,000 x .22 = $53,900) Divided by 12, this amount equals $4,491.66 per month or $53,900 per year.

7. Part-time Wages are projected for assistance with our annual auction. This year, it is estimated that we will require up to 1,250 hours of effort. At an average cost of $12 per hour, we have budgeted $15,000 between January and March. (1,250 x $12 =$15,000)

8. Consulting Fees. Our strategic plan is being developed by a planning and consulting firm that will work for a total of 50 hours on this project. (50 hours X $150 per hour = $7,500)

9. Rent has been budgeted for 11 months this year. In December we will be moving into a rent-free space that has been made available to us by a local real estate developer who has room in one of his buildings. We can use the space for two years. At the end of this period, we will be asked to pay market-value rent.

10. Utilities have also been budgeted on an 11-month basis. The new space will be provided to us without utility charges for the first year.

11. Legal and Accounting services are higher than usual this year. We will be audited for the first time and will incur higher fees during the first three months of the year. Our normal legal retainer is $500 per month, and this year an additional $500 has been included for accounting services during the months of September, October, and November. No payments are scheduled for December.

12. Supplies have always been an important expense for us. The supplies are vital to the service we perform. With the exception of January, which is usually a costly month, our normal monthly cost is $1,093. During May, November, and December, our inventory of supplies is always allowed to decline.

13. Printing continues to be a major expense item because our publications are in considerable demand. Printing schedules are timed to coincide with our major program activities.
This combination of your cash flow budget and a few well-chosen footnotes will clarify many of the questions your banker may have about your organization.

We have collateral and the cash flow budget, what more is needed?

One more step, and it's easy. You are planning to give the banker a dollar for every dollar you borrow, so you have rock solid collateral. You have a cash flow budget, so the banker and you can see the movie of how income and expense dance their way across your year. Now, all you need is a clear sense of what the future might bring.

Absent a crystal ball, which none of us has, otherwise we would spend our time at the track or lottery offices, instead of trying to raise or earn money, we need to imagine a picture of a couple of futures. This is done by using your cash flow budget to project how the next one, two, three, four, five, or more years might look if you did what you expect to do.

These scenarios are not an accurate forecast. Instead they are your best guess for how things might work out. And, having two or three scenarios makes sense. You probably have a sense of how things work for you during normal times. But these are not normal times. Try to imagine how different assumptions about the future "could" play out. In a sense, the scenarios that you create are a form of a cash flow based business plan.

For example, in one scenario, if you imagine your expenses for the coming years will continue to rise by 8%, but your income is likely to only move up 2%, then you may need a line of credit to smooth out your cash flow during those months when expenses exceed income. If you are convinced that your organization is viable and this unfortunate fiscal state may be going on for many, many months, you need to talk to your banker about a term loan, say three-to-five years. The loan will enable you to hoist yourself back up to solvency. Some foundation officials may not like to hear this, but your banker certainly wants and needs to see both the good news and the bad news. This is because bankers have different tools to rent for different jobs.

In another scenario, the current crisis has passed, and suddenly, earned revenue and donations kick in again and you slowly and gracefully can pay off your loan.

Just remember, bankers pay attention to: the quality of your collateral, and the downside risk that their loan will not be repaid. You satisfy both of those concerns with your creditholders, so the borrowing we are talking about should be pretty straight forward and uncomplicated beyond the normal paperwork that is a misery we all must endure.
What you will be avoiding is all the time, energy, stipulations, and restrictions that government loans require prior to authorization.

<u>What is a creditholder?</u>

• A supporter of a nonprofit institution who “parks” funds with the organization’s bank.
• The funds are in the form of an aggregated certificate of deposit that your organization takes out with your bank.
• The creditholder earns interest income on their funds.
• These liquid assets are still owned by the individual, unlike a donation, and therefore there is no tax credit. The funds in the certificate of deposit are then pledged as collateral to the bank.
• The collateral enables the organization to fully secure its borrowing with the bank, for a line of credit, or a term loan to cure a short-term deficit, or to use for a new venture.
• Given the liquidity of the pledged assets, banks typically are quite willingly to lend.
• More importantly, the creditholders’s collateral enables the nonprofit institution to obtain the credit that it needs, when it needs it.
• The creditholder gets his or her funds back when the CD matures.

There is some risk of losing the collateral, if the nonprofit institution were to default on all its obligations. Therefore, you must convince all creditholders that they should put up no more assets than they could afford to lose.

In a number of cases, organizations have reached out to local philanthropic institutions to provide something called “Default Insurance.” Despite its dreadful name, this a relatively common practice in commercial transactions with the organization issuing insurance being compensated with a fee. The term also used is “credit enhancement” which sounds better. In the nonprofit world, we have demonstrated to funders and foundation officials that this approach is a positive way to greatly amplify their ability to provide service to the community. In this case, the insuring organization sets aside a reserve that can be tapped if the nonprofit organization is unable to meet its obligations. This is another way to hold the credit holders harmless in the event of failure.

Although it has never happened in over 40 years of experience with creditholder programs across the nation, if a nonprofit institution were to default, the creditholder collateral would be seized by the bank. In that event, the creditholder funds could be treated as a charitable contribution for tax purposes.

In this hypothetical case, the organization providing credit enhancement would act as what is called the third party in fiscal matters. The credit enhancement protects the remaining 50% of the support for creditholders, if a tax deduction is used.

<u>What do all the parties involved have to gain?</u>

• Creditholders gain an opportunity to help a nonprofit institution that they support, at no cost to themselves.
• The bank gains the collateral that it needs to justify lending.
• The nonprofit organization gains a stable resource that can be used to mobilize credit whenever it can be shown that other sources of revenue will repay the loan.
And, the foundation or donor providing credit enhancement can leverage far great impact in terms of the number of organizations assisted than regular grant programs.

<u>Who are creditholders?</u>

Creditholders are friends, family, volunteers, audience members, and supporters. Basically, they are people who believe in your mission and want to help you out. Some may be donors some may not be donors. Creditholders "park" some funds with you as a means to insure your survival. In our experience, over time, particularly if you share the good news and the bad news with them, they may become your most ardent supporters.

<u>How do we get them?</u>

Obviously, you have to ask. So here are some examples of solicitation e-mail messages that you can share after you put your own organizational information in the form. Of course, you can write your own letter.

Sample Cover Letter #1 to Prospective Creditholders

Dear Friend:

These are dire times for us all and they are particularly difficult for (our organization) _______________. Our ______________ (performances, concerts, shows, festival, fund raisers, bake sales, auctions, et.al.) are being cancelled and the revenues we need to operate have evaporated.

Luckily there are many people who refuse to see us disappear. Our board of directors has instituted new systems of financial controls. We have created a creditholder program that allows caring community members to place cash in a Certificate of Deposit with our bank to secure a loan that we need. These funds are not a donation, rather we are asking folks to "park" some funds with us so that we can borrow.

Please read the description of the creditholder program that accompanies this letter and consider how you can help us weather this terrible crisis.

Sincerely,

XXXX

Sample Cover Letter #2 to Prospective Creditholders

Dear Friends,

Until the present moment posed by the firings and delay or denial of funds, by the current circumstances, we were on the road to the best year in our recent history. (Your organization's name) has suddenly been tossed into the midst of a terrible, global crisis. As you know, we continue to provide an important resource to our community.

We understand there are many worthwhile causes out there that compete for your funds. So, we have come up with a different approach to our financial situation. Our Board of Directors and our staff have decided that in addition to our requests for gifts and grants, and our earnest attempts to generate earned dollars, we need to adopt a new approach.

We have developed a special program with our bank. (Fill in the name of the financial institution) is offering a FDIC insured certificate of deposit with a three-year term. Or, if using a credit union, there is a comparable form of cooperative insurance through the National Credit Union Share Insurance Fund (NCUSIF). These funds insure each member's share accounts up to at least $250,000. This certificate is competitive with other financial institutions in our area. (Please see the specific details on the enclosed flyer.)

This certificate of deposit, funded with funds aggregated from you and others, will act as our guarantee for a ($ YYYYYY) line of credit) or a ($ term loan of XXXX). Your collateral will enable us to borrow safely from the bank. In this way, our organization will be provided with the cash flow stability necessary to continue our work. And you will receive the satisfaction of knowing that your funds are helping us to manage in these difficult times. Equally important, you will be joining us in making it possible to continue the invaluable efforts of (your organization's Name).

(Five or XXX) members of the Board of Directors have already signed up for this program. We now need other supporters to make our financial stability a reality. Won't you please consider this? I have asked a member of the Board to give you a call in the coming weeks to discuss this program and to answer your questions. I trust I can count on your support.

Sincerely,

ZYX

p.s. I am working to put my funds together. I hope you can too.

<u>How can we use this type of letter?</u>

You can modify these letters, but always emphasize the idea that there are specific details associated with the creditholder program that you will be providing. Here are some examples of the specific information organizations have used in the past to explain their creditholder programs:

How does our creditholder program work?

Our organization is forming a creditholder group for the purpose of collateralizing a revolving secured line of credit (or a term loan) to meet the financial needs of our institution. The collateral will be a jumbo certificate of deposit owned collectively by individual creditholders. The CD will fully secure our borrowing.

Why should I consider becoming a creditholder?

With a secured line of credit, we will be able to meet our financial obligations in a timely manner, but if this crisis persists we may need a term loan to get through the coming years.

What will the amount of the secured credit be?

Although this present situation is difficult to chart, we are committed to maintaining tight fiscal controls. At the same time we will be attempting wherever possible to pay our vendors on time. They need the income as badly as we do. At this point, it seems clear that a line of credit of ($XXX) should be sufficient for us.

If we need to take out a term loan for three-to-five years, the amount should be in the neighborhood of ($YYYYY). This loan, at a reasonable rate of interest, will buy us the time we need to deal with present matters, and slowly and gracefully repay in the future.

Is there a minimum amount that required from us?

No, we will pull together all the funds that the creditholders provide and purchase a FDIC insured certificate of deposit. Each creditholder will receive a contract that spells out all the terms and conditions associated with this transaction. Our organization will be the sole depositor and we will account for and track each individual's funds and the interest they will accrue.

What is the length of the CD?

At this time, we anticipate purchasing a Three-Year Certificate of Deposit. If you chose to participate, you should anticipate that this three-year period will be the time your money is obligated.

The Certificate of Deposit is then pledged to the Bank as collateral to allow us to borrow. These liquid assets continue to be owned by you, but are obligated to be used as collateral for a period of three years.

Each creditholder will get his or her funds back when the Three-Year Certificate of Deposit matures. Prior withdrawal carries a penalty, so we plan to over-subscribe our creditholder program. This will be done by setting up a separate savings account. Our goal is to oversubscribe the amount of the Certificate of Deposit. If an individual creditholder has an serious emergency, he or she may be able to withdraw a portion or all of their funds without penalty from the savings account.

During this three-year period, we will be actively seeking addtional creditholders for the next round. This will continue through the life of the creditholder program.

Who gets the interest on my CD?

Creditholders earn interest income on their funds. The Bank and our staff will monitor these accounts on behalf of each individual participant.

What is the value of this program to the organization?

Given the liquidity of the pledged assets, our bank will typically lend at one or two points above the interest paid on the certificates of deposit. More importantly, the creditholder’s collateral enables us to obtain the credit that we now need to survive.

What risk is there to me as a creditholder?

As in all matters financial, there is some risk of losing the collateral, if we were to default on all our obligations. Therefore, all creditholders should put up no more assets than they could afford to lose.

Although it has not happened in over 40 years of experience with creditholder programs across the nation, if we were to default, the creditholder's collateral would be seized by the bank. In that event, the creditholder funds could be treated as a charitable contribution for tax purposes. Potential creditholders may wish to consult with their financial and legal advisers prior to making this commitment.

A Sample Form for Enrolling Creditholders

Just complete the form on this page and sent it to us at (XXXX) or call us to talk to YYYY.

The XXXX Creditholder Program

Please fill out the appropriate sections below and return to us. Upon receipt of your check, we will send you a deposit receipt and documents that assign your funds to our bank account specifically for creditholders. All processing can be handled through the mail, overnight courier, or in person.

Name

Social Security Number

Address

Telephone

E-Mail Address

Referred by

Cash (which will be aggregated and used to purchase a Jumbo Certificate of Deposit)

Amount $

Number of Years, (minimum 1-2-3 years)

Please attach your check and a copy of your driver's license or other picture ID to this form.

How do we formalize an agreement between the creditholder and our organization?

This following Sample Creditholder Agreement represents the "contract" between you and the individuals who become Creditholders. It spells out the relevant terms and conditions associated with the process. As you might guess, the prose was not crafted by us. Different States have different rules. You might want to check with your attorney to ensure that the wording conforms to your location requirements

A Sample Creditholder Agreement

THIS CREDITHOLDER AGREEMENT is made as of _______,______ by and between (your organization) a (your state/Commonwealth/Territory) nonprofit corporation and ____________ (Creditholder) for the purposes of setting forth the terms and conditions under which the Creditholder agrees to extend a security interest in certain collateral hereinafter described for the benefit of _____________ (your organization).

(Your Organization) is a nonprofit corporation organized under the laws of the State/Commonwealth/Territory of _______. (Your Organization) is exempt from Federal income taxes, except for income tax related to unrelated business income, under Section 501 © (3) of the Internal Revenue Code of 1986.

(Your Organization) desires to obtain and maintain a (revolving secured line of credit or a term loan or a combination of both credit instruments) with (name of your financial Institution) for the purpose of meeting working capital requirements of (your organization) as such needs arise in the ordinary course of business. (Your Organization) has agreed with the bank to secure this credit with a first security interest in a Certificate of Deposit provided by Creditholders and others (together referred to as the “Credithold Group”) pursuant to the terms as set forth in the “Security Agreement for Savings Accounts, Share Accounts, Time Certificates of Deposit and Time Deposits,” attached hereto as Exhibit A (Exhibit A will be provided by your financial institution) and hereinafter referred to as the “Security Agreement.”

The Creditholder, in support of the mission of (your organization), is willing to provide such a security interest in an aggregated Certificate of Deposit purchased by (your organization). Funds from Creditholders will be maintained in a special purpose savings account set up by (your organization). Once enough funds have been collected from the Creditholder Group, (your organization) will purchase a single Certificate of Deposit for the expressed purpose of providing collateral to enable borrowing to meet the financial needs of (your organization) .

THEREFORE, in consideration of the of the mutual benefits to be received by (your organization) and the Creditholder, the receipt and sufficiency of which is hereby acknowledged, (your organization) and the Creditholder agree as follows:

1. <u>Collateral:</u> The Creditholder has or will provide funds which will be aggregated with the funds from other Creditholders to purchase one large Certificate of Deposit at the Bank. The amount of the Certificate of Deposit, identified as CD#_________, maturing on ___________, will provide collateral for borrowing from (your organization.).
2. <u>Certificate of Deposit:</u> The Certificate of Deposit and a proportional share of the earnings thereon are at all times the property of the Creditholder Group, subject to the terms of the Certificate of Deposit and to the Security Agreement. The Creditholder will look to (your organization) in concert with the Bank for

payment of interest on the Certificate of Deposit, so long as the Bank has not applied all or any portion of the Collateral to the obligation of (your organization).

3. <u>Protection of Collateral:</u> (Your organization) acknowledges the trust the Creditholder is placing in (your organization) to provide the Certificate of Deposit as Collateral, (your organization) therefore agrees:
    - (a) (Your organization) will at all times abide by the terms and conditions of the promissory note and any other documents required by the Bank to obtain and maintain the secured (line of credit or term loan), including the obligation for payment of interest and principal in a timely manner and the provision of information;
    - (b) (Your organization) will strive to always maintain no less than 100 percent of the lesser of (i) the maximum loan balance outstanding or (ii) the approved (line of credit or term loan) in the collateralized Certificate of Deposit with the Bank. To accomplish this, (your organization) will collect funds held in a special savings account equal to or in excess of 10 percent of the value of the Certificate of Deposit. These funds will allow individual Creditholders with emergency needs to withdraw a portion or all of their funds. Thus, the collateralized Certificate of Deposit will be maintained to maturity without threat of early withdrawal penalties.
    - (c) (Your organization) will provide the Creditholder with regular and ongoing information as to the status of the secured (line of credit or term loan) and (your organization's) financial position. This information, as described below, will be provided quarterly to the Creditholder:
        - (1) Secured Line of Credit or Term Loan information, including loan balance outstanding under the secured credit, total collateral securing the loan balance, and anticipated repayment date of the outstanding loan balance.
        - (2) (Your Organization's) Financial Information, including interim financial statements as reflected in (your organization's) cash flow budget and projections.
    - (d) In the event that the secured (line of credit or term loan) goes into default for any reason (your organization) will notify the Creditholder within five business days or receiving such notification of default.
4. <u>Withdrawal of Collateral:</u> The Creditholder agrees that it will notify (your organization) of any emergency that the Creditholder may have that requires the withdrawal of their participating funds.
5. <u>Collateral Applied:</u> If the Bank applies all or any portion of the Collateral to payment of (your organization's) obligations under the (secured line of credit or term loan) (your organizations) agrees:
    - (a) It will immediately notify the Creditholder as to the amount of the Collateral provided by the Creditholder that has been applied to (your organization's) obligation;
    - (b) It will pay periodic interest to the Creditholder as to the amount of the Collateral provided by the creditholder that has been applied to (your

organization) obligation at the same rate and at the same times as provided for under the Certificate of Deposit;

(c) It will repay to the Creditholder the sums applied by the bank on the maturity date of the Certificate of Deposit.

6. Notices: Any notice or other communication required by or under the terms of the Creditholder Agreement will be in writing, addressed to the appropriate party, and delivered personally or sent by U.S. mail as follows:

   (Your Organization)
   Creditholder Coordinator
   Attention: Financial Manager
   P.O. Box XXXXX
   (your city State & Zip Code)

   Creditholder's address

   ____________________________________, _______

7. Binding Effect: The rights and obligations of the Creditholder under this Agreement shall inure to and bind the heirs, excutors, administrators, successors, and assigns of the Creditholder. The signature of the Creditholder represents that the Creditholder has had the Creditholder's attorney review this Agreement and the Security Agreement or has chosen to waive such opportunity.

When executed (your organization) and the Creditholder, this Agreement is effective as of the date first above written.

(Your Organization) Creditholder

__________________ _________________

By ______________

Key points in setting up a creditholder group:

- Your board of directors needs to understand the importance of stable cash flow to your organization. It needs to grasp the creditholder concept and members need to personally participate and recuit others.
- The arrangements with the bank need to be set up before anyone approaches potential creditholders.
- The communication from you and your board president to the creditholders needs to be clear, reasoned, and straightforward. It also needs to be backed up with some answers to commonly raised questions.
- The agreement between the creditholder and your organization needs to be formal; it must be articulated in correct legal terminology, including the occasional obscure phrase of the type that so often blights the linguistic landscape when lawyers draft contracts.
- Individual creditholders who wish to pledge stocks will require a separate and different agreement. (Check out our book *Cash Flow Strategies: Innovation in Nonprofit Financial Management*, Jossey-Bass, 2009 for this and other forms and documents needed in various special cases.
- Finally, we have not included the (pledge) hypothecation agreement between the bank and the creditholder, even though each creditholder may be asked to sign one. This agreement is fairly standard and the bank's staff gets paid to provide this information.

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In this brief manual we have attempted to share with you a sense of how and why fully secured borrowing is highly appropriate for nonprofit organizations. We have offered you some documents that you can modify and use to form a creditholder group and approach your local bank with confidence. After writing and publishing five books on this topic, in light of the current situation we have struggled to compress a great deal of information into a quick and easy guide for you. Much more information is available from our peer reviewed books: *The Cash Flow Solution: A Nonprofit Board Member's Guide to Financial Success,* Jossey-Bass, 2007 and *Cash Flow Strategies: Innovation in Nonprofit Financial Management,* Jossey-Bass, 2008. These books contain additional information, including more forms and advanced materials.

If you have questions, please contact us through our web site at www.linzerconsulting.com.