

# Loan Guarantees

A loan guarantee is a promise to pay all or part of the principal and or interest on a debt obligation in the event of default of the borrower.

A loan guarantee is a **contingent liability** of the municipality. Therefore, a provision for loss should be recorded when it is determined that a loss is likely. The provision should include both the outstanding principal and interest. Only loan guarantees to organizations outside of the Municipal Reporting Entity need to be accrued and / or disclosed. Loans held by organizations within the Municipal Reporting Entity will already be recorded and disclosed in the consolidated financial statements.

Certain financial criteria would have to be reviewed to determine if there was a risk of default by the borrower.

|  | Yes                      | No                       |
|--|--------------------------|--------------------------|
| Do the financial statements of the borrower portray a decline in the current financial position, particularly in the area of liquidity, as evidenced by a deficiency in working capital or cash flow or an excess of liabilities over assets?              | <input type="checkbox"/> | <input type="checkbox"/> |
| Do the economic conditions of the country, region or industry in which the borrower operates or for individuals, their income stability or income earning potential, affect the likelihood that the borrower will be able to repay the loan in the future? | <input type="checkbox"/> | <input type="checkbox"/> |
| Has there been a recent default in making the required principal or interest payments when due?  | <input type="checkbox"/> | <input type="checkbox"/> |
| Has the borrower failed to meet debt covenants on existing obligations?  | <input type="checkbox"/> | <input type="checkbox"/> |
| Have independent credit reports indicated concerns about an individual's or organization's ability to meet its continuing obligations?   | <input type="checkbox"/> | <input type="checkbox"/> |
| Is there inadequate security pledged for the loan at the security's current market value to repay the amount of principal and interest outstanding?  | <input type="checkbox"/> | <input type="checkbox"/> |

Answering one of these questions as "Yes" would not by itself indicate that the loan guarantee should be recorded as a contingent liability. However, if there are several "yes" answers then the recording of the outstanding balance of principal and interest owed by the borrower should be considered.

Even without recognition of a contingent liability, municipalities are required to disclose sufficient information in the notes for readers to understand the nature, terms and risk of loss on each class of loan guarantees. The information that should be disclosed is:

- i) the authorized limit;
- ii) the principal amount outstanding;
- iii) the amount of provision for losses, if any; and
- iv) general terms and conditions