



Managing Lending Risk

In Times of Crisis

November 19, 2020

Presenters and Agenda



- **Introductions:** Carolina Martinez, CEO, CAMEO
- **Opening Remarks:** Scott Wu, Executive Director, IBank
- **State Guarantee Program Overview:** Megan Hodapp, Loan Officer, Business Finance Center, IBank
- **Risk Management Strategies:** Susan Brown, VP of Capacity Building, CAMEO
- **Meet the FDCs:** Heidi Pickman, VP of Programs, CAMEO

Scott Wu



- IBank Executive Director
- Partner and Head of Investments for the Omidyar Network
- White House Presidential Innovation Fellow and Senior Advisor to the Innovation Funds of USAID





CALIFORNIA INFRASTRUCTURE & ECONOMIC DEVELOPMENT BANK - IBANK

Managing Lending Risk -- Cameo

Nov. 19, 2020



ABOUT US

IBank is the State of California's only general-purpose financing authority. IBank provides financial assistance to support infrastructure and economic development in California.

Created by the Legislature in 1994

LOANS, BONDS, SMALL BUSINESS SUPPORT

Finance public infrastructure/private development

Create jobs and a strong economy

Improve quality of life for the people of California

Broad authority to issue tax-exempt and taxable revenue bonds

Climate Catalyst Fund

Leverage state and federal funds

CA Rebuilding Fund



IBank's Small Business Finance Center Programs

- ❖ Small Business Loan Guarantee Program
- ❖ Traditional Disaster Relief Loan Guarantee Program
- ❖ COVID-19 Disaster Relief Loan Guarantee Program
- ❖ Jumps Start and Farm Loan Direct Lending

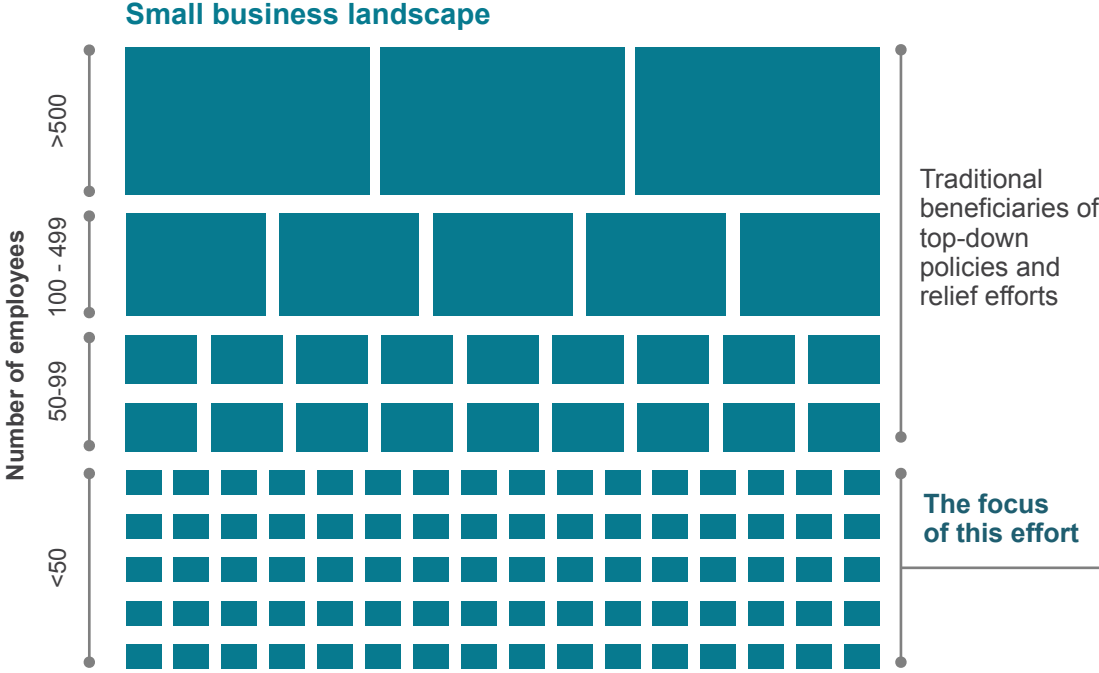


The image features a vibrant field of yellow California poppies in full bloom against a clear blue sky. The flowers are the central focus, with some in sharp focus and others blurred in the foreground and background. The overall scene is bright and cheerful. On the left side, there is a dark teal vertical bar containing the title and subtitle in white text. The top and right edges of the image are decorated with a green and white geometric pattern of circles and lines.

California Rebuilding Fund

A public-private partnership to increase access to capital and support for the smallest businesses in under-banked communities across California

THE ECONOMIC IMPACT OF COVID-19 IS UNPRECEDENTED AND IS CRUSHING COMMUNITY-BASED ORGANIZATIONS

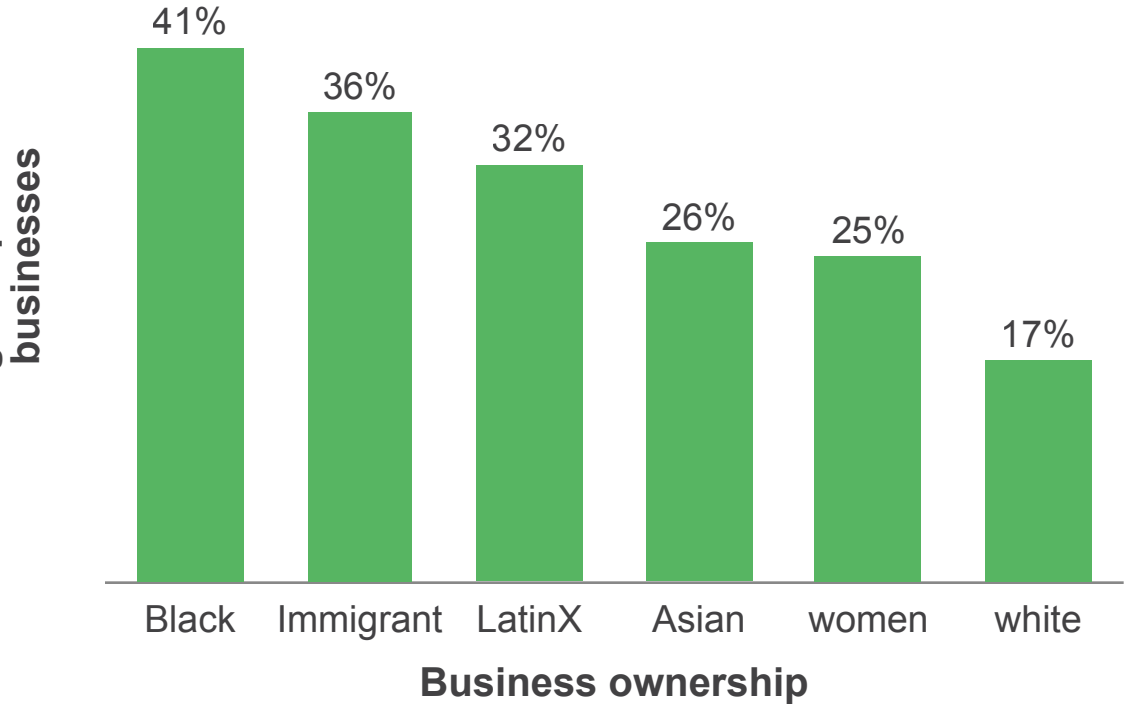


Smaller, community-level organizations – particularly those in distressed or under-banked communities – were already **suffering from decades of discrimination, lack of access to affordable capital, and an insufficient safety net**

If we do not authentically and intentionally create the right resources for these community organizations this crisis will **widen the racial wealth gap, worsen outcomes for already vulnerable communities, and wipe out an entire segment of our economy**

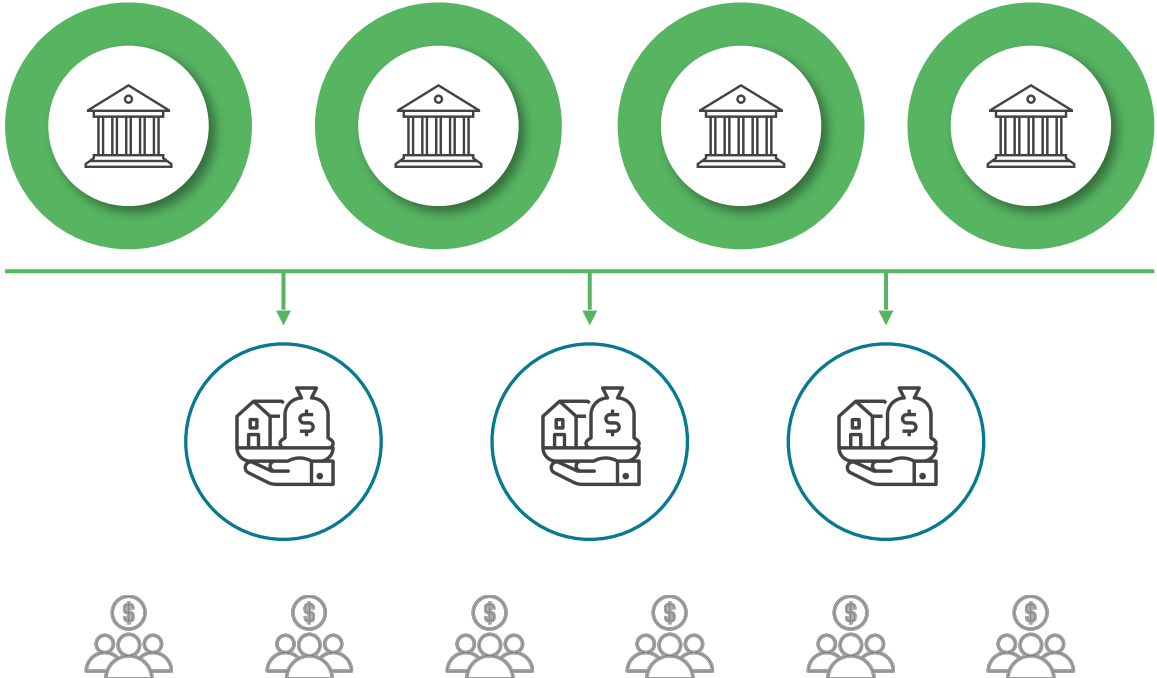
**EARLY INDICATORS
SHOW
DEVASTATING
EFFECTS OF
COVID-19 ON THE
SMALL BUSINESS
COMMUNITY –
WITH OUTSIZED
NEGATIVE IMPACT
ON COMMUNITIES
OF COLOR AND
IMMIGRANTS**

Reduction in Self-Employed Business Owners
February - April 2020



COVID HAS HIGHLIGHTED THE LACK OF CONNECTIVITY IN THE BANKING SYSTEM

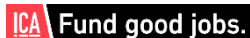
If you picture our banking system as an electric grid, we learned quickly that a massive share of our economy was in the dark



PARTICIPATING LENDERS AND SUPPORTING PARTNERS HAVE DECADES OF EXPERIENCE SERVING SMALL BUSINESSES IN LOW-INCOME COMMUNITIES ACROSS THE STATE



Participating lenders



Supporting partners



Small Business Finance Center

The Small Business Finance Center supports businesses throughout the state with various credit enhancements and programs, including:

- A loan guarantee program designed to assist small businesses that experience capital access barriers. The Small Business Loan Guarantee program encourages lenders to provide funds to small businesses to help them grow and prosper.
- Direct lending program, Jump Start, for new businesses in amounts up to \$10,000.
- Disaster Relief Loan Guarantee program.



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SMALL BUSINESS LOAN GUARANTEE PROGRAM USES



+470

In the fiscal year 2019-2020, the Small Business Loan Guarantee Program worked with our partner FDCs to guarantee 470 loans

Loan Guarantees were used for:

- Business Expansion
- Inventory
- Working Capital
- Line of Credit
- Agriculture
- Disaster Relief



\$223 million

The loans made resulted in more than \$165 million of loan guarantees supporting more than \$240 million in small business loans

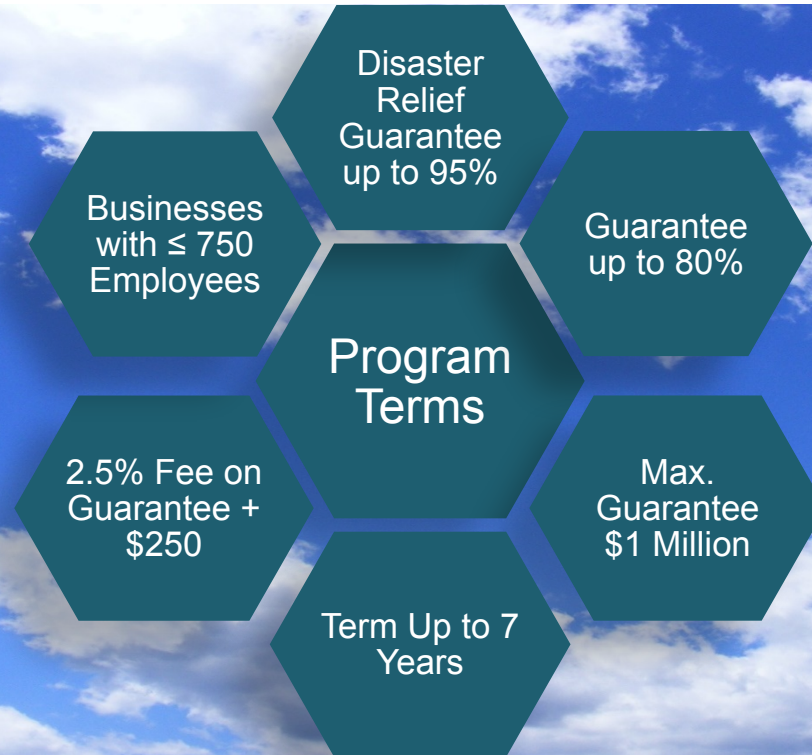
Small business owners reported more than 15,400 jobs were created or retained as a result of these loan guarantees



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Small Business Loan Guarantee Program Terms



SBFC CASE STUDY – HOW IT WORKS

The Stasher, IBank's 1,000th Small Business Loan Guarantee Program client

THE PRODUCT: A certified B Corp and member of 1% For The Planet, Stasher bags are silicon, plastic-free and can be used up to 3,000 times each. They can be boiled, put in the freezer, microwave or dishwasher.

THE PROBLEM: In order to expand, Stasher needed an infusion of capital. Denied by banks, she went to an IBank partner FDC and was finally approved for a loan, guaranteed by IBank. Stasher expanded enough to be on Shark Tank and has since experienced further growth.

THE RECAP: Stasher goes from small online-only to Target/Amazon and other national retail chains



Small business

Online only sales

Denied by banks

Small Business loan guaranteed by IBank through one of 7 partner Financial Development Corporations

Infusion of capital aided growth

Guest on Shark Tank – caused further growth

Now available in retail stores and Amazon

Small Business Finance Center Partners -- FDCs

IBank's SBFC has seven partner Financial Development Corporations throughout the state of California



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FDC Staff



- Caucasian
- African American
- Hispanic
- Asian/Pacific Islander

- ❖ FY 19-20, 470 loans were made resulting in more than \$165,000,000 of loan guarantees
- ❖ FDCs can help process loan guarantees, disaster loan guarantees, Jump Start loans and more

SBFC Participating in the SBLGP

- ❖ Lenders are provided coverage on guaranteed loan defaults. Loans can be term loans or lines-of-credit, short-term or long-term, have fixed or variable rates, be secured or unsecured, and bear any type of amortization schedule. The loan must be for an eligible business purpose.
- ❖ Participating lenders enrolled in the SBLGP perform all loan underwriting and submit an application to the SBFC on behalf of the borrower for a loan guarantee.
- ❖ The FDC must first file a conditional approval request, a lender credit memo and loan memo for SBFC review. Once approved, the FDC works with the lender to process the financing request.
- ❖ To participate in the SBLGP and maintain a lender/guarantor relationship with FDCs, a lender must first certify that it is in possession of sufficient commercial lending experience, financial and managerial capacity, and operational skills.
- ❖ A lender can apply for enrollment into SBLGP by completing a “Lender Certification to Participate” and IBank will review the certification and evaluate the lender according to SBFC procedures.

COVID-19 Disaster Relief Loan Guarantee Program

- ❖ In FY 19/20, with a \$50 million allocation from the Governor of California, 141 disaster guarantees were conditionally approved, resulting in more than \$5.2 million in disaster loan guarantees that supported more than \$5.6 million in small business loans. Small business owners reported 842 jobs retained because of these loan guarantees.

- ❖ 83% of the COVID-19 Disaster Relief Loan Guarantees have gone to Target Borrowers: Woman or Minority Owned Businesses or Located in Low/Moderate Income Census Tract.

As of 10/30/2020	Number of Loans	Dollar Amount of Loans	% of Total Number of Loans	% of Total Dollar Amount of Loans
Caucasian/White	254	\$9,528,195	38.60%	43.44%
African American/Black	64	\$2,246,511	9.73%	10.24%
Mixed Race	26	\$891,000	3.95%	4.06%
Other Minorities	247	\$7,835,749	37.54%	35.72%
Not Yet Provided	54	\$970,200	8.21%	4.42%
Declined to State	13	\$462,161	1.98%	2.11%



FEDERAL PROGRAMS HAVE PROVIDED WIDESPREAD DIRECT SUPPORT, BUT HAVE NOT BEEN SUFFICIENT



Paycheck Protection Program



Rebuilding Loans

Loan size

Tied to certain expenses; very limited for the smallest businesses

Tied to three months revenue from any three-month period in 2019

Use of proceeds

Tied to spending on certain expenses

Flexible working capital

Reach + eligibility

Unavailable to many businesses that exist outside of the banking system; immigration status, criminal history can affect eligibility

Outreach through local, community-based networks; broad eligibility standards based on FTE and revenue size

Lenders

Mostly large and regional banks; CDFIs have participated but with limited liquidity available

Non-profit community development loan funds

THE LOAN PRODUCT IS TAILORED TO MEET THE CREDIT NEEDS OF SMALL BUSINESSES DURING POST-COVID RECOVERY

Rebuilding Loans

Loan Terms

Interest rate

4.25% fixed interest

Repayment term

60-month term

- 0-12 months: interest only payments, paid monthly
- 13 to 60 months: interest and principal payments with flat payments on a 48-month schedule, paid monthly

Use of proceeds

Working capital including payroll, operating and emergency maintenance, utilities, rent, supplies, etc.

Recourse

No collateral required

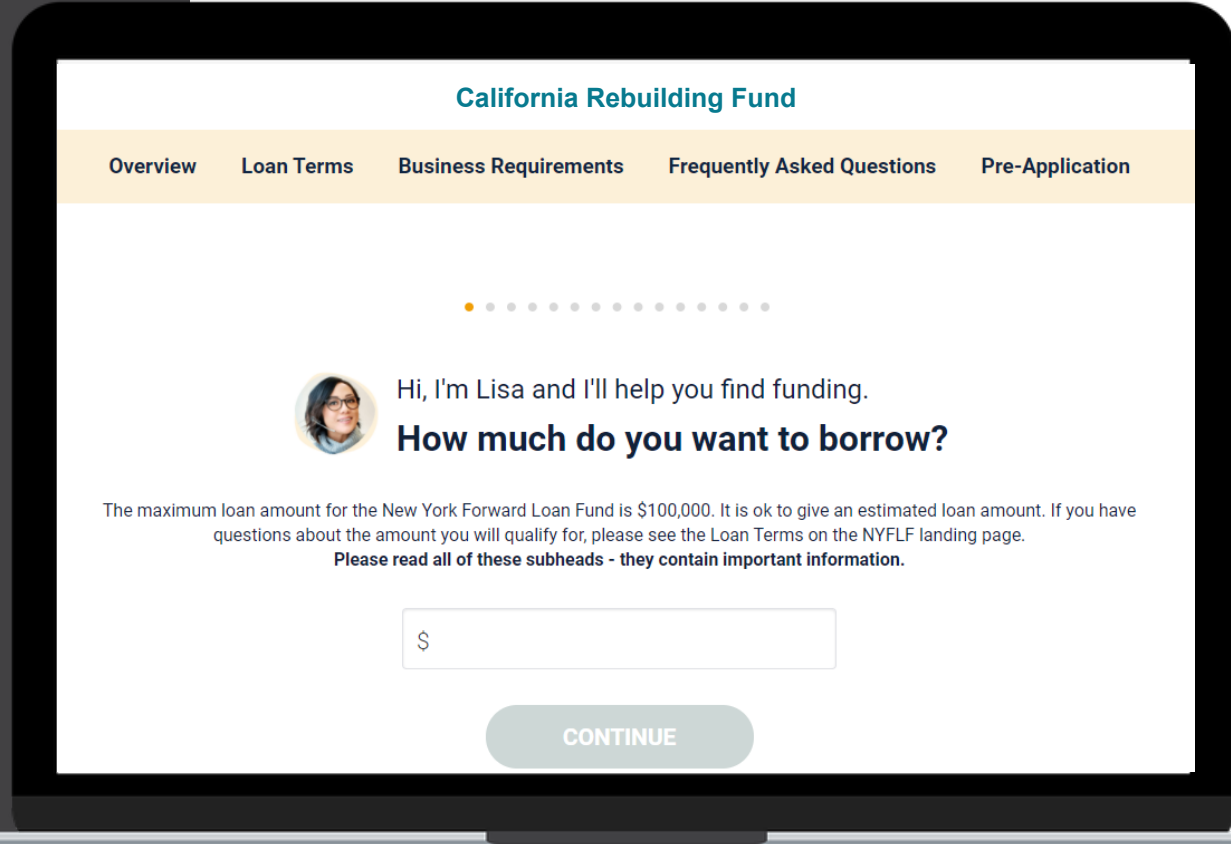
Fees

No upfront fees

Loan amount


Lesser of (a) \$100,000 or (b) 3x average monthly revenue prior to the COVID-19 outbreak


SMALL BUSINESS OWNERS ACCESS THE PROGRAM THROUGH A SIMPLE, EASY PORTAL THAT MATCHES THEM WITH A LOCAL COMMUNITY LENDER




THANK YOU



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OPEN

Why Risk Management?

- Prevention of potential problems
- Early detection of actual problems
- Adjust policies and procedures based on repayment evidence.
- Consciously evolve loan program operations and credit culture
- End-to-end risk management
- Preserve your capital, meet your mission, create impact, satisfy your funders
- Sleep better!



Intro to Risk Management

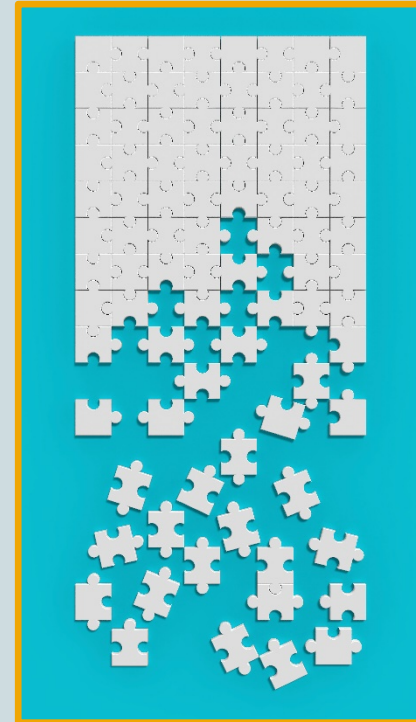
- Even in good times, CDFIs need end-to-end risk management
- During this economic downturn, risk management is more important than ever
- Every CDFI needs to practice multiple strategies, one of which should be the State Loan Guarantee Program.



Risk Management Elements



- State Loan Guarantee Program
- Risk Rating System
- Underwriting Grid
- Healthy Loan Committee
- Loan Loss Reserves
- Servicing
- Data Collection



State Loan Guarantee Program



**CDFI/Community
Lender**



Borrower



**Financial Development
Corporations**



IBank



Risk Rating Systems

Risk Rating: Tool for quantifying the overall risk in your portfolio by segmenting the loans into risk grades.

- **Risk Rating Matrix:** The risk rating matrix segments the loan portfolio by level of risk.
- **Risk Measurements:** What are the best predictors of performance and/or risk?
- **Policy:** Procedures and practices that state who sets and validates the initial grade, under what conditions a loan can be upgraded or downgraded, and how grades are tested.

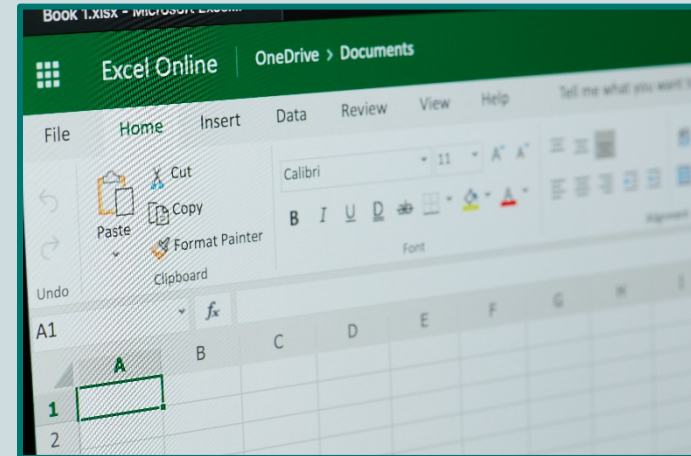
Risk Rating at Closing: Example

Risk Factor	Weight	Low Risk: 1	Medium Risk: 2	High Risk: 3
Debt Service Coverage	30%	DSC > 2.0	2.0 > DCS > 1.25	DSC < 1.25
Management Experience	20%	Experience running a biz in this industry	Experience working in this industry	No experience in running a biz nor work exp in industry
Collateral Coverage	20%	Collateral > 125% of loan amt	125% > Collateral > 75%	Collateral < 75% of loan amt
Guarantor	15%	yes	→	no
FICO Score	15%	FICO > 600	600 > FICO > 550	FICO < 550

This a made-up example -- not a recommendation. Please determine your system using your CDFI's data & experience

Underwriting Grid

- Document that outlines loan products
- Lists specific standards for **C**redit, **C**ash (Debt Service Coverage), **C**ollateral, **C**haracter or **C**apital
- Best predictors of repayment
- Guides all underwriting decisions
- Exceptions have solid reasons



Healthy Loan Committee



A healthy loan committee supports risk management through quality decision making that is aligned with the overall lending program.

- Job description
- Training from the start
- Roles and authority clearly defined
- Agreement that committee and staff consultant help when issues arise



Loan Loss Reserves

A loan loss provision is a set-aside as an allowance for uncollected loans.

Two types:

- An **accounting entry** (Allowance for Loan Losses) to show the true value of your loan receivables
- A **cash reserve** (Restricted Cash Account) to replenish the loan capitalization pool and/or ensure cash is available to pay investors



Allowance for Loan Losses: Contra Account

Example

Assets

Cash		\$50,000
Loans Receivable	\$400,000	
ALL	<u>-\$ 40,000</u>	
<u>Net Loans Receivable</u>		<u>\$360,000</u>
Current Assets		\$410,000

Restricted Cash Set Aside

This second type of loss reserve is a **cash set aside**.

A **Restricted Cash Account** provides a different function than ALL. It is a source of liquidity used to repay obligations to investors in the event there are portfolio losses and/or to replenish loan capital lost.

This cash reserve account is on the Balance Sheet and can also be in a separate checking/savings account.

Servicing

- Tracking Payments
- Rigorous Delinquency Policy
- Periodic Financial Document Collection
- Periodic Credit Check
- Covenant Tracking
- Regular, frequent Portfolio Watch
- Connection/Relationship Coaching

Maintenance



Data and Reporting

- Your data represent the actions you've taken for your mission and the impact you're making in the world.
- Collecting and studying your data is the only way to learn and evolve your program.
- Incorporate data as part of the culture so it is second nature to collect, review and act on it.

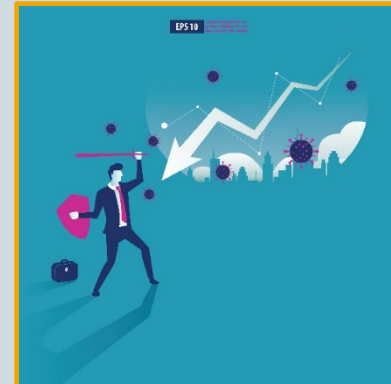
CALLED "DATA MATURITY"

"Becoming a Data-Informed Organization"

Twelve Reasons why Data Is Important

Lending in Economic Downturn: Existing Portfolio

- Start by focusing like a laser on your existing portfolio
- Strategic, frequent review of portfolio, especially troubled deals
- Communicate with executives and board on troubled deals and overall performance
- Deferments, grace periods, restructuring where it helps a business stay afloat
- Help businesses pivot in the new economic reality
- See your organization as a Community Asset



Lending in Economic Downturn: New Originations

- Projection-based lending – policy and practice
- Ask for 2019 financial information to ascertain past performance, not future cash flow; 2020 financials might not be useful
- Document current cashflow with bank statements or QuickBooks
- Revise loan product design
- Research industries / local economy
- Robust Loan Loss Reserve
- Loan guarantee programs

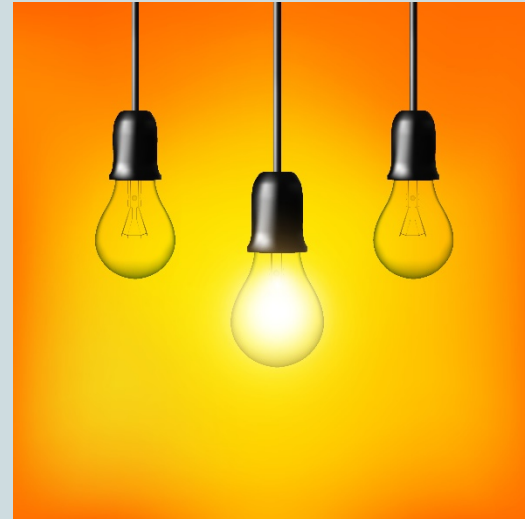


Projection-Based Lending Ideas

- **Sales:** Justified with research and explained with notes?
- **COGS:** Reflects industry standards as % of sales?
- **Overhead:** Reflects costs in your region?
- **Industry:** High or low risk?
- **Household Expenses:** Application? Chart?
- **Working Capital:** Accounted for?...especially for start-ups
- **Alternative Source of Income** for start-up period?

Your Ideas

- Several experienced CDFIs are in this meeting.
- Do you have suggestions on managing risk?



Successful Risk Management



- Robust use of the State Loan Guarantee is an important CDFI risk management tool
- It requires strong working relationships between the FDCs and the CDFIs
- CAMEO is here to facilitate this relationship

Meet the Financial Development Corps (FDCs)



- [California Capital Financial Development Corporation](#)
Sacramento
- [California Coastal Rural Development Corporation](#)
Salinas
- [California Southern Small Business Development Corporation](#)
San Diego
- [Small Business Development Corporation of Orange County](#)
Santa Ana
- [Nor-Cal Financial Development Corporation](#)
Oakland
- [Pacific Coast Regional Small Business Development Corporation](#)
Los Angeles
- [Valley Small Business Development Corporation](#)
Fresno

Additional Resources

OFN's Risk Rating Systems (portfolio reports examples in appendix)

OFN's CDFI Portfolio Reporting: Definitions and Accounting Treatment

[CDFI: Best Practices in Liquidity Management During the COVID-19 Pandemic](#)

[COVID-19 Response: An Open Letter from CDFI Leaders to Our Supporters](#)





CAMEO's Microlender Incubator

CDFI Essentials: Once-per-month, year-long training

Microlending Essentials: Seven-week, online underwriting training

LendingFront: End-to-end, cloud-based lending technology

Carrot Fund: Loans to young CDFIs for lending capital

Microlenders Forum: Annual conference

Free Archive: <https://CAMEONetwork.org/coaching-academy/>

Interested? Contact: Heidi Pickman, hpickman@CAMEOnetwork.org

Questions? Comments?

