



# Consumer Loan Underwriting

The CDFI Fund's Capacity Building Initiative: Building  
Native CDFIs' Sustainability and Impact II

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ICF and First Nations Oweesta Corporation, Inc.



# Disclaimer

*About the creation of this presentation:*

*The development of this presentation was funded by the CDFI Fund, under Contract No. GS00Q14OADU119. The information provided and opinions expressed in this presentation are those of the authors, who are solely responsible for the content, and do not reflect the opinions of the CDFI Fund or any other person, entity, or organization.*

# Introduction

Feel more confident in your underwriting efforts and process! This webinar lays the foundation for the underwriting series, details the basics of the underwriting process while focusing on and uses examples specific to consumer lending. It is the first of a two-part series focused on underwriting.

## **This Webinar Will Help Participants:**

- Describe the elements of effective loan policies
- Explain the role of an underwriter
- Outline the 5 C's of credit
- Prepare a credit memo
- List the components of loan files

# Presenters

- Florence Ludka, First Nations Oweesta Corporation
- Emily Trump, First Nations Oweesta Corporation

# Poll

My experience level with underwriting is:

- No experience
- Beginner
- Intermediate
- Advanced
- I should be running this webinar!

# Poll

My organization underwrites:

- Housing loans
- Consumer loans
- Small business loans
- Other

# 10 Elements of a Good Loan Policy

1. Define the mission and market
2. Specify the lending authority
3. Delineate responsibilities for reporting loan information
4. Describe origination, underwriting criteria and process
5. State documentation needed for a complete credit file

# 10 Elements of a Good Loan Policy, cont...

6. Provide collateral guidelines
7. Set loan rating and loss reserve system
8. Outline how interest rates and fees are set
9. Set a preferred upper limit for total loans outstanding/concentrations
10. Determine how to detect, analyze, and work out problem loans



# Loan Loss Risk

## Definition

- Probability that a loan will not be repaid

## Sources

- Risk profile of product line (mission and market)
- Effectiveness of training programs
- Quality of loan policies
- Staff, Loan Committee, and Board

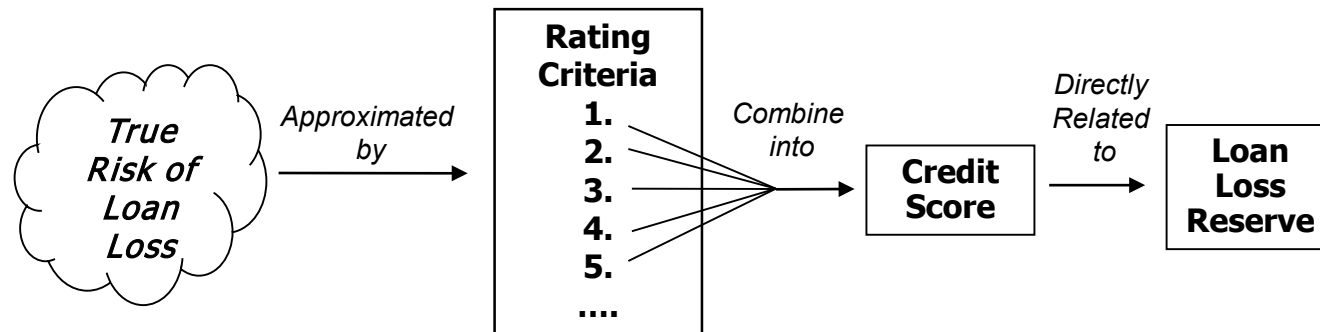
**Loan Loss Risk is the predominant risk faced by lenders**

## Management of Loan Loss Risk

- Use structuring and eligibility criteria to remove unacceptable risks
- Accept certain risks through analysis and planning
- Continually monitor and evaluate portfolio quality

# Loan Rating System

- A systematic methodology to estimate loan loss risk for each loan in a portfolio
- Attempts to impose objectivity to a subjective judgment process



# Two Primary Roles of the Underwriter

1. Risk assessment
2. Risk management



# Managing Risk Through Relationship

- Use the TA process to assess risk:
  - assess character & commitment
  - assess management capacity
  - identify potential risks
- Use the TA process to manage risk:
  - ongoing TA to strengthen business / individual
  - continue to build relationship with borrower
  - anticipate and avoid late payments or worse



# Chat Box

- How do you evaluate risk for your Native CDFI? Do you have different systems for different types of loans?

# The Five Cs of Credit

- ✓ **Capacity** – Income and Debt Payments
- ✓ **Character** - Credit History and Reputation
- ✓ **Collateral** - Assets to Guarantee the Loan
- ✓ **Capital** - Personal Investment / Net Worth
- ✓ **Conditions** - Situations that Affect Repayment

# Capacity (Cash Flow)

- Income is key to the question of whether the borrower can afford to repay the loan
- For most borrowers, examining income means looking at employment history:
  - Has employment been continuous?
  - What are the reasons for any gaps?

# Other Sources of Income

- Child support or alimony payments
- Disability payments
- Retirement payments
- Workers comp benefits
- Public assistance payments
- Part-time income
- Per Capita



# Debt-to-Income

Debt-to-Income: the borrower's total monthly debt payments compared to gross monthly income

“total monthly debt” = any debt paid monthly, including the new loan, i.e. mortgage, car payments, student loan payments, and credit card payments

“gross monthly income” = all income before taxes

Commonly used by mortgage lenders

Lenders may want to consider all fixed regular payments, such as rent and utility bills. Ask: could the borrower avoid this expense? Would they want to?

# Character

## Factors to Consider:

Credit report

Non-traditional credit history

Training completed

Stick-to-it-iveness

Work history



# Payment history

We want to look at:

- Does the individual have any late payments?
- Is there a pattern of late payments, or were they isolated incidents?
- How delinquent were the payments (30 days late, 60 days late, 90 days...)?
- When were the late payments (within the past 12 months, the past 24 months, more than 24 months ago...)?

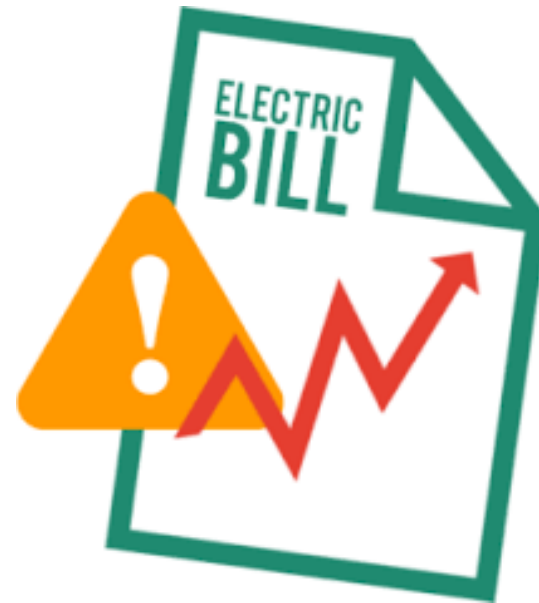
# Major derogatory credit

- Bankruptcies
- Judgments, liens, garnishments
- Federal debt
- Collections
- Foreclosure

Do all derogatory marks count equally?

# Non-Traditional Credit

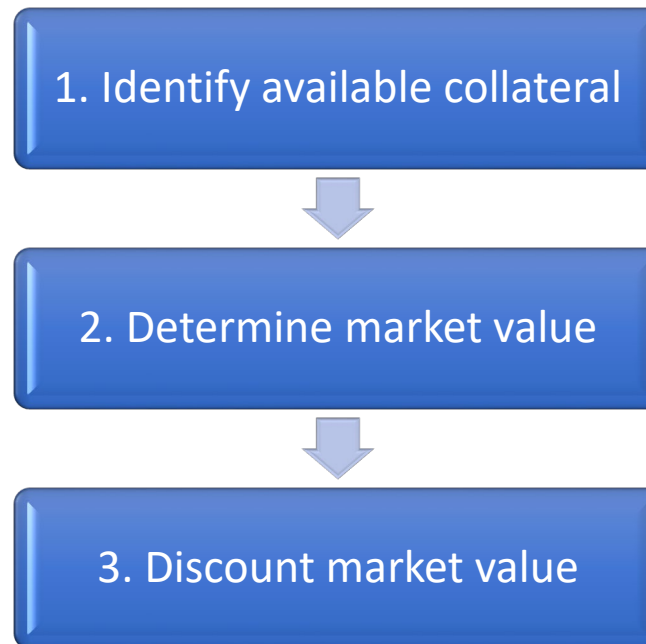
- Rent payments
- Utility payments
- Insurance premiums
- Bank account history



# Chat Box

- Should consumer lenders look at credit the same way mortgage or business lenders do? Why or why not?

# Evaluating the Value of Collateral



# Collateral Valuation

Type	Discount Rate	Max Term	Valuation Source/Other
Accounts Receivable	80%	One year then renew if A/R still available as collateral	Detailed list w/ account name Only include A/R <90 days Only accept up to 25% of A/R from one customer
Inventory	75%	3 years	Purchase price
Titled Vehicles	100% if new 80% if used	5 years if new 3 years if used	Purchase price if new NADC or Kelly Blue Book online if used
Equipment	50%	3-5 years	Purchase price if new Auctioneer /online sources if used
Ag Equipment Tractors Harvest equip Tillage equip	60-80% 60-80% 60-80%	7 years 5 years 4-5 years	Purchase price if new Local/regional ag equipment suppliers Auctioneers
Yellow Equipment (construction)	85%	7 years	Purchase price if new Local/regional construction equip suppliers Auctioneers
Residential Real Estate	90%	30 years	Appraisal Tax assessed value times x% (x depends on local market and how tax assessed value compares to market value....can check w/ realtors for this info)
Commercial Real Estate	80%	25 years	Appraisal Tax assessed value times x%



# Collateral: Mitigating Risk

- Take more of it
  - Make sure it's valuable to the borrower
  - Require insurance
  - Reduce loan amount
  - Make sure other C's are strong
- 
- Hold titles and file liens immediately
  - Verify annually

# Capital

## Factors to Consider:

- Down payment
- Cash savings



## Ways to Help:

- Matched savings programs
- Budget assistance

# Conditions

## **Factors to Consider:**

- Planned use of funds
- Economic factors
- Interest rate
- Size of loan

## **Ways to Help:**

- Make direct payments to vendors/creditors
- Structure the loan to match cash flow
- Make payments easy through ACH or payroll deduction

# Common Lending Mistakes

- Absent, incomplete, or incorrect cash flow analysis that overestimates a borrower's ability to repay debt
- Subjective risk definitions that do not accurately reflect the financial condition of, or the risks posed by, borrowers
- Absence of ongoing loan monitoring
- Loan pricing that is not commensurate with risk

# Credit Memorandum

- Prepare for review by appropriate approval authority per your loan policy
- Should contain a summary of all information necessary to make decisions, plus documentation of any policy exceptions and loan covenants

# Credit Memo Sample

## CREDIT BUILDER CREDIT MEMO

### APPLICANT:

### DATE COMPLETE APPLICATION RECEIVED:

### LOAN OFFICER PREPARING:

**LOAN TERMS:** A loan of \$1,500, plus loan origination fee of \$25 and credit report and filing fees of \$20, with 26 bi-weekly payments by payroll deduction. First payment on December 16th, 2019. Interest rate fixed at 10%.

### QUALIFICATIONS:

- ☐ Does the loan applicant live in the Two Rivers Community Loan Fund target market?
- ☐ Applicant over 18 years of age?
- ☐ Classes Completed:

*Credit When Credit is Due, Graduation Date:*

- ☐ Debt to Income Ratio under 45%:

**Debt to Income Ratio:**

### USE OF PROCEEDS:

- ☐ Use of proceeds verified:

**List creditors/vendors, addresses, and amounts:**

### COLLATERAL:

- ☐ Collateral value (after discount) at least 75% of loan amount

### **Description and valuation of collateral:**

1990 Car Model

VIN:

Value: \$ZZ after XX% discount

### **Total valuation:**

### **Percent of Loan Amount:**

- ☐ Two Rivers as first lien holder on the official title, if applicable

Title Received:

### APPLICATION:

- ☐ Loan application completed and signed
- ☐ Copy of driver's license.
- ☐ Copy of tribal enrollment card (if applicable)
- ☐ Verification of income for last six months (pay stubs, tax returns, etc.)

### **Current Employer:**

### **Length of Current Employment:**

- ☐ Automatic ACH Authorization with voided check or automatic payroll deduction completed

### STRENGTHS AND WEAKNESSES OF APPLICANT:

Note conditions and character factors here.

# Loan Closing

- Schedule a time for closing the loan with your borrower
- Make copies of all documents to give to the borrower
- Give borrower the opportunity to thoroughly review all documents prior to signing
- Answer any questions
- Have customer sign the documents
- Disburse funds

# Loan Documentation and Perfection

- Use a loan documentation check list to ensure you have appropriate forms
- File title documents, UCCs, deeds of trust, etc
- Don't delay— you don't want to wait until the loan goes bad to learn there's a problem with your collateral



# Data Entry and Loan File

- Enter loan information on your loan system
- If possible, enter follow up data such as titles needed, final title policy, insurance expiration dates, etc.
- File documents
- Store file in fireproof, secure area

# What's in a Credit File

- Application
- Data Collection Form
- Financial Documents
- Eligibility Documents
- Authorization for Release of Information
- Credit Memo
- Collateral Documents
- Promissory Note/Closing Documents

# Questions?

- OFFICE HOURS SCHEDULED: **THURSDAY, DECEMBER 5, 2019, 1PM-2PM ET**
  - Open forum for more individualized questions and/or questions related to collections that were not covered in this webinar
- Registration reminder will be sent