Managing Lending and Investing Operations

- Four Key Activities
  - Marketing and identification of projects
  - Review and screening of projects
  - Underwriting of requests and commitment of funds
  - Servicing and monitoring of loans and investments
Triple Bottom Line Approach

- Policies and screening metrics that encompass economic, environmental, equity outcomes
  - TBL investment criteria
  - Target industry and business models that advance TBL outcomes
  - Financial products tailored for TBL investments
- Partnerships and services to enhance borrower TBL practices & results
  - CEI EcoTag: audits for more efficient operations; reduced interest rate with implementation
- TBL Scorecard
1. Marketing and Deal Identification
   - Integrate services to expand impact
   - Yes: Firm Submits Application
   - No: Refuse/Refer to TA

2. Initial Screening Review
   - Yes: Is the Project Ready to Apply?
   - No: Does Project Fit Criteria?

3. Underwriting Analysis and Review
   - Yes: Will Project Succeed/Meet Financial Goals?
   - No: Refer to Other Programs

4. Service and Monitor Investment
   - Yes: Loan Repayment or Equity Investment Exit
   - No: Firm Meets Closing Conditions

5. Close Investment
   - Yes: Refer to Other Programs
   - No: Provide or Refer to Technical Assistance
Principles For An Effective Investment Process

- Create relationships for shared goals and mutual benefit
- Clear policies and procedures that align decisions with economic development and financial objectives
- Transparent process to facilitate successful applications, provide accountability and build trust
- Skilled staff devoted to all aspects of the process
- Accountability at the policy and transaction level
- Commitment to continuous improvement
Marketing and Identification of Projects

- Marketing objectives
  - Increase awareness and understanding of program
  - Identify lending or investment opportunities
  - Build relationships that help you achieve objectives
  - Obtain information on your market and clients’ needs

- Marketing approaches
  - Wholesale: advertising, social media, press coverage
  - Retail: One-on-one marketing: calling officer approach; referral networks
  - In between: presentations to selected audiences

- Best Practices
  - Annual plans with senior staff commitment & resources
  - Engage all staff in marketing
  - Strong referral networks
  - Track information sources for new inquiries & customers
Initial Project Screening

- **Screening objectives**
  - Determine applicant/project fit with goals & financing
  - Diagnose weaknesses and provide/refer to assistance
  - Potential to advance/broaden impacts
  - Assess readiness for financing
  - Clear picture of how to apply and qualify for financing

- **Best Practices**
  - Screening criteria and standards to review requests
  - Application standard: what a firm needs to apply and must have accomplished to be seriously reviewed
  - Help firms meet standards and secure financing:
    - *Ineligible*: refer and introduce to appropriate sources
    - *Incomplete information/weakness in project*: Define what needs to be done, refer to technical assistance or provide it directly
    - *Infeasible or poorly conceived project*: explain why
Underwriting and Commitment of Funds

- **Underwriting Objectives**
  - Assess feasibility and ability to repay/provide return
  - Understand risks and how to reduce or manage them
  - Structure financing to fit project needs and your goals
  - Document decisions and financing transaction

- **Three Components**
  - Underwriting standards
  - Due diligence process
  - Decision making process

- **Best Practices**
  - Sound, explicit underwriting standards
  - Well-defined and thorough due diligence process
  - Expertise in target market or industries
  - Leadership in financial packaging: visualize a viable plan to meet all parties' objectives
  - Good systems to close loan and transition to servicing
Option A

Staff Underwriting Analysis and Investment Proposal → Internal Manager or Committee Review → Investment Authorized

Option B

Staff Underwriting Analysis and Investment Proposal → Internal Manager or Committee Review → Board Review → Investment Authorized

Option C

Staff Underwriting Analysis and Investment Proposal → External or Board Inv. Committee Review → Board Review → Investment Authorized
Servicing and Monitoring

- Objectives of loan servicing and monitoring
  - Ensure timely repayment of the loan/investment
  - Protect collateral (tax liens, insurance, security interest)
  - Track the firm's progress in meeting objectives
  - Identify/respond to problems: help firm and minimize losses

- Options
  - Underwriting staff handles loan monitoring
  - Separate staff handles loan monitoring
  - Contract to third party

- Best Practices
  - Clear and comprehensive servicing requirements
  - Regular financial and TBL outcome reporting; actual vs. projections
  - Strong internal tacking systems
  - Follow-up quickly on non-performance
  - Communicate with borrowers and develop trust
  - Understand the source of problems and seek solutions
  - Portfolio wide risk analysis; action plans to address problems
Rural Enterprises

- What are the key challenges faced by RE’s lending program?
- How to best address these challenges:
  - lending strategy vs.
  - loan products vs.
  - operations?
- What would you propose to improve the results and sustainability of RE’s lending activities?
- What changes to RE’s lending systems and operations would you recommend?
- What should be the Board’s role in implementing proposed changes?
Rural Enterprises
### Figure 1. Rural Enterprises Lending Profit and Loss Statement, 2004 to 2007

<table>
<thead>
<tr>
<th></th>
<th></th>
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<th></th>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total Notes Receivables</strong></td>
<td>$25,628,059</td>
<td>$25,359,480</td>
<td>$25,258,579</td>
<td>$26,427,648</td>
<td>$25,668,442</td>
</tr>
<tr>
<td><strong>Revenue</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Grants &amp; Contracts</td>
<td>$190,218</td>
<td>$165,736</td>
<td>$164,869</td>
<td>$117,144</td>
<td>$159,492</td>
</tr>
<tr>
<td>Fee Income</td>
<td>$262,374</td>
<td>$337,232</td>
<td>$317,762</td>
<td>$302,394</td>
<td>$304,941</td>
</tr>
<tr>
<td>Interest-cash</td>
<td>$106,804</td>
<td>$196,708</td>
<td>$253,374</td>
<td>$128,551</td>
<td>$171,359</td>
</tr>
<tr>
<td>Interest-lending</td>
<td>$1,559,078</td>
<td>$1,450,310</td>
<td>$1,522,835</td>
<td>$1,415,794</td>
<td>$1,487,004</td>
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<tr>
<td>Recovery of bad debt</td>
<td>$15,560</td>
<td>$21,849</td>
<td>$45,553</td>
<td>$72,000</td>
<td>$38,741</td>
</tr>
<tr>
<td><strong>Total Revenue</strong></td>
<td>$2,134,034</td>
<td>$2,171,835</td>
<td>$2,304,393</td>
<td>$2,035,883</td>
<td>$2,161,536</td>
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<tr>
<td>Note interest expense</td>
<td>$535,266</td>
<td>$520,416</td>
<td>$480,308</td>
<td>$434,268</td>
<td>$492,565</td>
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<tr>
<td>Loan loss expense</td>
<td>$608,994</td>
<td>$687,829</td>
<td>$413,673</td>
<td>$557,445</td>
<td>$566,985</td>
</tr>
<tr>
<td><strong>Expenses</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Staff &amp; fringe</td>
<td>$762,471</td>
<td>$801,299</td>
<td>$811,013</td>
<td>$823,104</td>
<td>$799,472</td>
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<tr>
<td>Travel</td>
<td>$20,087</td>
<td>$17,799</td>
<td>$21,730</td>
<td>$27,391</td>
<td>$21,752</td>
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<tr>
<td>Occupancy &amp;</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>communications</td>
<td>$71,732</td>
<td>$81,171</td>
<td>$76,897</td>
<td>$82,983</td>
<td>$78,196</td>
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<tr>
<td>Other Expenses</td>
<td>$72,138</td>
<td>$88,211</td>
<td>$72,216</td>
<td>$63,186</td>
<td>$73,938</td>
</tr>
<tr>
<td><strong>Total Expenses</strong></td>
<td>$926,428</td>
<td>$988,480</td>
<td>$981,856</td>
<td>$996,664</td>
<td>$973,357</td>
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<tr>
<td><strong>Net Profit/Loss Before Adjustments</strong></td>
<td>$63,346</td>
<td>($24,890)</td>
<td>$428,556</td>
<td>$47,506</td>
<td>$128,630</td>
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<tr>
<td>Adjustment for NCLF &amp; prior year income</td>
<td>$104,091</td>
<td>$115,015</td>
<td>$57,200</td>
<td>$15,989</td>
<td>$73,074</td>
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<tr>
<td><strong>Net Profit/Loss After Adjustments</strong></td>
<td>$167,437</td>
<td>$90,125</td>
<td>$485,756</td>
<td>$63,495</td>
<td>$201,703</td>
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<tr>
<td>Inter-agency expenses charged to lending</td>
<td>-$249,452</td>
<td>-$232,050</td>
<td>-$207,699</td>
<td>-$249,482</td>
<td>-$234,671</td>
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<tr>
<td><strong>Net Profit/(Loss) After</strong></td>
<td>($82,015)</td>
<td>($141,925)</td>
<td>$278,057</td>
<td>($185,987)</td>
<td>($32,968)</td>
</tr>
</tbody>
</table>
Rural Enterprises

### Table 1. RE Loan Portfolio and Loan Write-offs by Loan Size

<table>
<thead>
<tr>
<th>Original Loan Size</th>
<th>Percent of Total Number of Loans</th>
<th>Percent of Total Amount of Loans</th>
<th>Percent of Loan Write-offs, FY 2004 to 2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Under $35,000</td>
<td>45%</td>
<td>10%</td>
<td>20%</td>
</tr>
<tr>
<td>$35,000 to $100,000</td>
<td>35%</td>
<td>29%</td>
<td>36%</td>
</tr>
<tr>
<td>Over $100,000</td>
<td>19%</td>
<td>61%</td>
<td>44%</td>
</tr>
</tbody>
</table>

### Table 2. RE Loan Portfolio and Write-offs by Loan Sector

<table>
<thead>
<tr>
<th>Sector</th>
<th>Percent of Total Number of Loans</th>
<th>Percent of Total Amount of Loans</th>
<th>Percent of Loan Write-offs, FY 2004 to 2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Farms/Fishing</td>
<td>9%</td>
<td>6%</td>
<td>2%</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>14%</td>
<td>17%</td>
<td>22%</td>
</tr>
<tr>
<td>Wholesale</td>
<td>2%</td>
<td>3%</td>
<td>14%</td>
</tr>
<tr>
<td>Retail</td>
<td>9%</td>
<td>7%</td>
<td>18%</td>
</tr>
<tr>
<td>Real Estate</td>
<td>9%</td>
<td>25%</td>
<td>7%</td>
</tr>
<tr>
<td>Healthcare/Social Assistance</td>
<td>8%</td>
<td>9%</td>
<td>9%</td>
</tr>
<tr>
<td>Accommodations/Food Service</td>
<td>8%</td>
<td>5%</td>
<td>3%</td>
</tr>
<tr>
<td>Other Services</td>
<td>6%</td>
<td>4%</td>
<td>12%</td>
</tr>
<tr>
<td>Other Sectors/Unclassified</td>
<td>34%</td>
<td>25%</td>
<td>14%</td>
</tr>
</tbody>
</table>
Rural Enterprises

Table 3. Comparison of RE to Other Community Development Lenders

<table>
<thead>
<tr>
<th>Ratio</th>
<th>RE</th>
<th>CDFI Data Project Peer Business Loan Funds FY 06</th>
<th>CDFI Data Project All Loan Funds FY 06</th>
<th>Microtest 2006 Credit-led Programs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Capital</td>
<td>$38,453,795</td>
<td>$18,799,402</td>
<td>$23,466,385</td>
<td>$3,607,548</td>
</tr>
<tr>
<td>Share of Capital from Debt</td>
<td>49%</td>
<td>51%</td>
<td>63%</td>
<td>NA</td>
</tr>
<tr>
<td>Total Loans/Financing Receivable</td>
<td>$25,725,525</td>
<td>$13,604,173</td>
<td>$17,765,581</td>
<td>NA</td>
</tr>
<tr>
<td>Average Loan Size</td>
<td>$44,534</td>
<td>$93,464</td>
<td>NA</td>
<td>NA</td>
</tr>
<tr>
<td>Deployment Rate</td>
<td>66%</td>
<td>71%</td>
<td>NA</td>
<td>75%</td>
</tr>
<tr>
<td>Annual Number of Financings</td>
<td>79</td>
<td>82</td>
<td>NA</td>
<td>220</td>
</tr>
<tr>
<td>Delinquency Rate &gt; 90 days</td>
<td>14.0%</td>
<td>5.1%</td>
<td>NA</td>
<td>NA</td>
</tr>
<tr>
<td>Delinquency Rate &gt; 30 days</td>
<td>15.7%</td>
<td>6.4%</td>
<td>NA</td>
<td>8%</td>
</tr>
<tr>
<td>Loan Loss Reserve</td>
<td>7.3%</td>
<td>5.7%</td>
<td>NA</td>
<td>NA</td>
</tr>
<tr>
<td>Cumulative Loss Ratio</td>
<td>15.6%</td>
<td>6.4%</td>
<td>NA</td>
<td>NA</td>
</tr>
</tbody>
</table>