How To Choose A Participation Partner

Dan Gushue

Extensia FINANCIAL

CALLAHAN & ASSOCIATES
the credit union company

Knowledge. Insight. Strategy.

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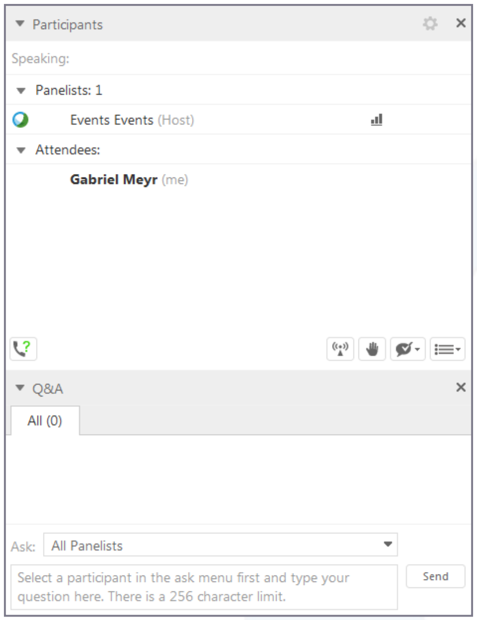
Slide Link

Today's slides can be found online at:

http://bit.ly/2019-12-05-participation-partner

We Encourage Questions



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Questions Box

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Tell Us What You Think!

Please take our post-event survey. We value your feedback!

Extensia Financial LLC

How to Choose a Participation Partner

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Who We Are

Extensia Financial is one of the nation’s most seasoned credit union service organizations (CUSO) focused on commercial real estate.

Established in 1998, Extensia is a customer service-driven organization connecting credit unions with loan opportunities brought to the CUSO by commercial real estate brokers, commercial mortgage brokers and high-net-worth investors. These opportunities are then funded through participation or whole loan lending through our proprietary participation web portal.

The company is headquartered in Northridge, California and has employees across the US to provide local support and coverage. The average tenure of the Extensia employees is approximately 8.5 years, with many having over 20 years of CRE lending experience.

Today's Topics

Benefits of Participation Loans

MBL Participation Loan Marketplace

How to Get Started

Additional Considerations

Choosing an Origination Model

How Extensia Can Help

Participation Loans

The benefits of participation lending

The Role of Participation Loans

Participation loans offer credit unions the opportunity to add diversification to their loan portfolio either at origination or through participating in seasoned loans held in credit unions' portfolios. These diversification opportunities fall into several categories:

> Asset Class

> Loan Size

> Geographic Region

> Borrower/Guarantor

Benefits of Participation Loans

Loan to Share Growth

Asset Class Diversification

Low Cost of Acquisition

Geographic Diversification

Managing Interest Rate Risk

MBL Participation Marketplace

CU Times Outlook

- While only comprising a small portion of the market, credit unions increased their business lending faster than banks in past years.
- Credit unions held $65.6 billion in commercial loans backed by real estate at the end of 2018, up 16.5% from a year earlier. Commercial loans not backed by real estate rose 7% to $7.5 billion.
- FDIC data showed banks held $2.16 trillion in commercial and industrial loans on December 31, 2018, up 7.8% from a year earlier. Last year's growth rate was nearly twice that of the 4% growth rate in 2017.
- Banks also held $2.33 trillion in real estate-backed loans for business purposes, including construction and development, offices, stores, apartments and farmland. Growth of those business-related loans was 4.3% in 2018 and 5.6% in 2017.
- Many credit unions have shied away from business lending because they are too small to afford the personnel and software needed.

Scotsman Guide October 2019 Issue

According to the Mortgage Bankers Association and its quarterly survey of commercial bankers:

> Q2 2019 originations increased 10% over the same quarter last year

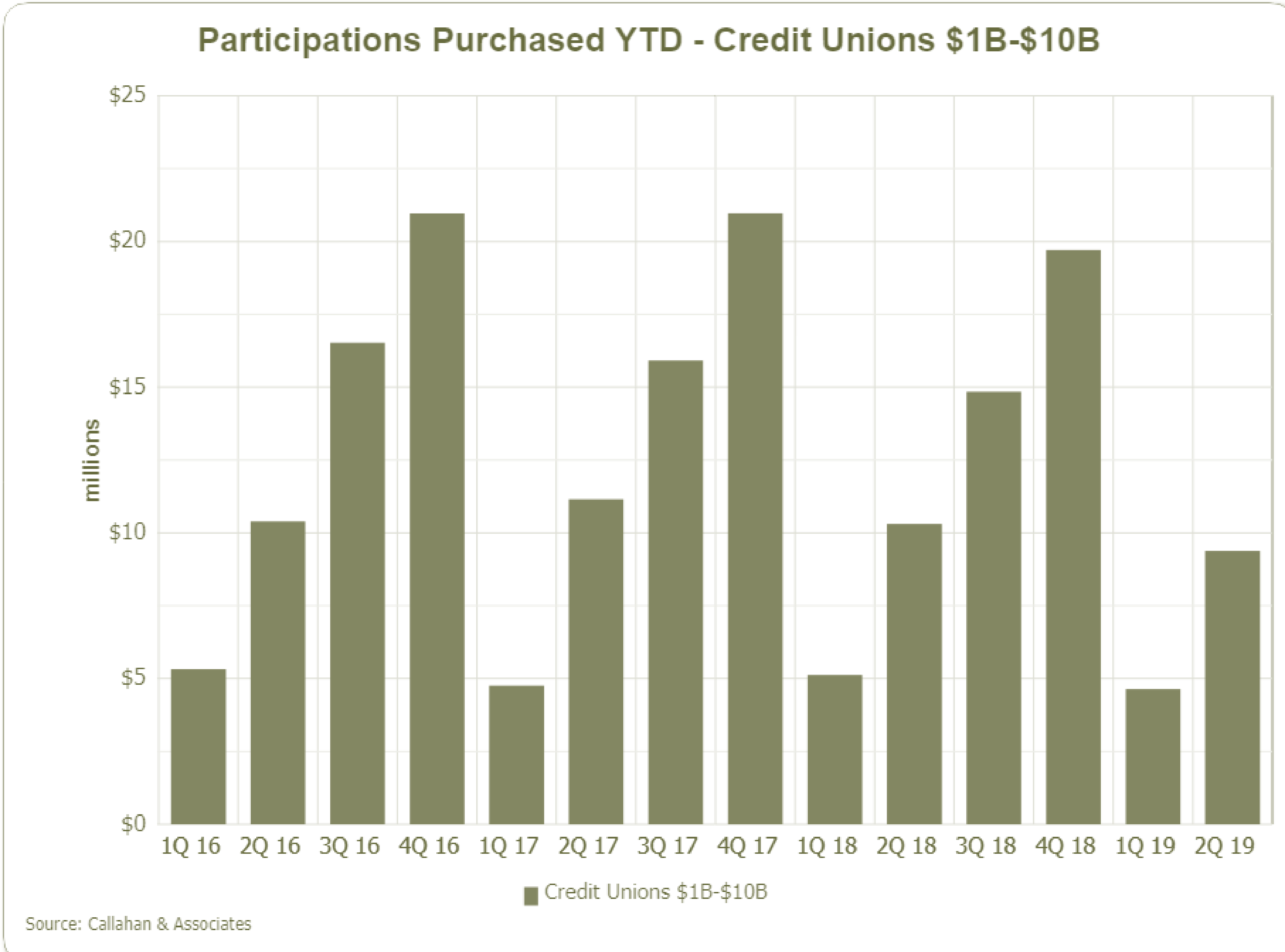
> Top asset classes for new loan origination:

- Office
- Industrial
- Multifamily
- Healthcare

> Declining asset classes for new loan origination:

- Retail
- Hospitality

Extensia also saw an increase in volume, but experienced success in participating both single and multi-tenant retail secured loan opportunities


Participations Purchased YTD - Credit Unions $1B-$10B
$25
$20
$15
$10
$5
$0
millions
1Q 16
2Q 16
3Q 16
4Q 16
1Q 17
2Q 17
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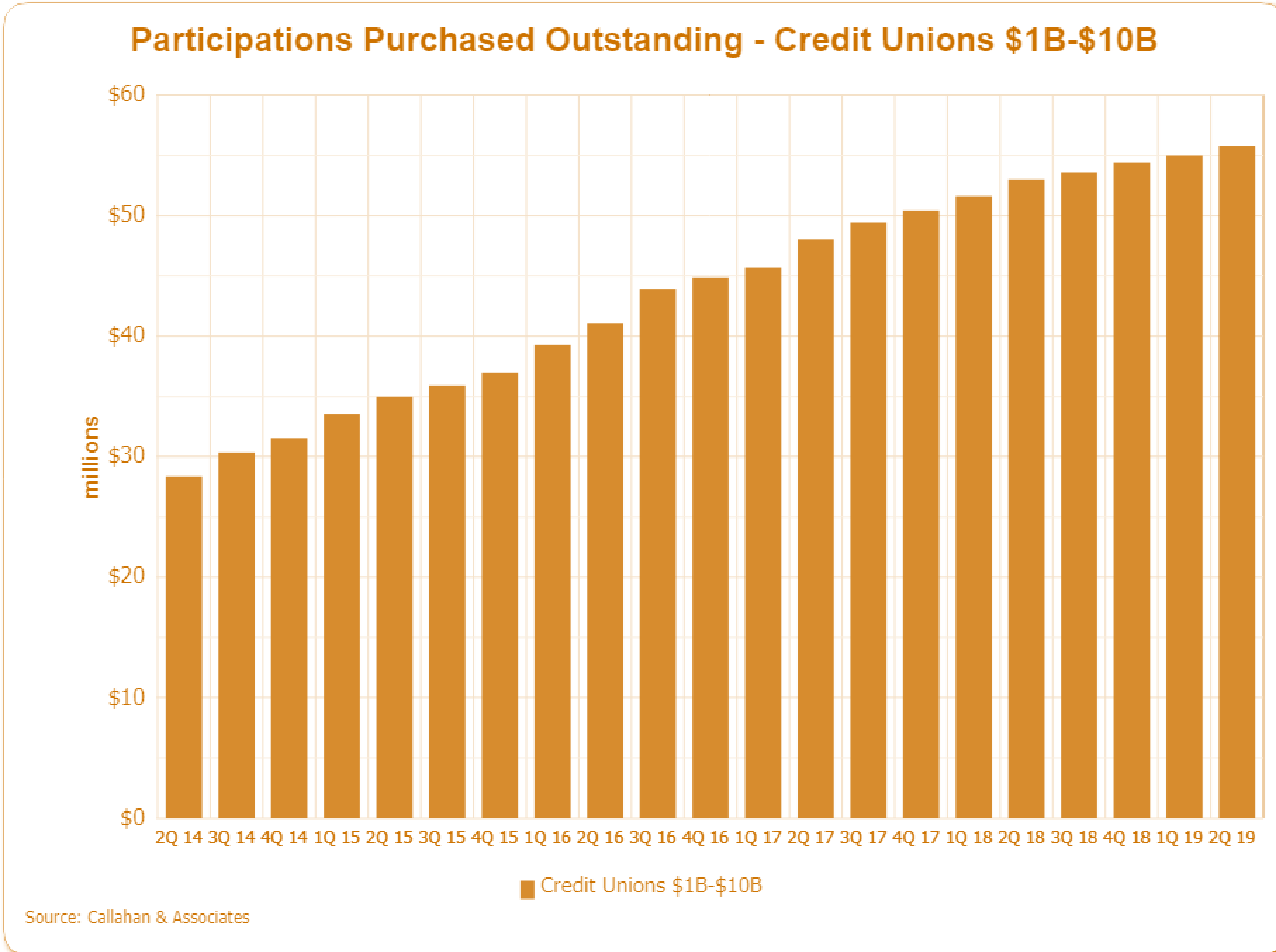
Credit Unions $1B-$10B
Source: Callahan & Associates


Participations Purchased Outstanding - Credit Unions $1B-$10B
millions
$60
$50
$40
$30
$20
$10
$0
2Q 14 3Q 14 4Q 14 1Q 15 2Q 15 3Q 15 4Q 15 1Q 16 2Q 16 3Q 16 4Q 16 1Q 17 2Q 17 3Q 17 4Q 17 1Q 18 2Q 18 3Q 18 4Q 18 1Q 19 2Q 19
Credit Unions $1B-$10B
Source: Callahan & Associates

Best Practices

How to get started and what to consider

Best Practices

> Ensure your credit union participation partners have well documented lending policies and procedures
  - Policies should be conservative and not call for leverage that is too aggressive for the subject market, lender or the economic cycle
  - Payments should call for both principal and interest components

> Clear understanding of credit union/CUSO lending policy
  - Adhere strictly to the written policies
  - Avoid temptation to meet year-end production goals or to lend on a trophy property at the expense of additional, unnecessary risk

> Clear definitions for exceptions to policy
  - Clearly document exceptions & reasons any exceptions are made
  - Detail the mitigants warranting any additional risk or policy exception

> Understanding of local regulators interpretation of risk

> Collaboration
  - Other credit unions and CUSOs are a great source of information

Origination of Participated Loans by the CUSO

> Understanding Credit Union Preferences of all Participants
  - What type of loans
  - What markets
  - Tenant considerations
  - Guarantor liquidity requirements and net worth
  - LTV limits
  - DSCR limits
  - Loan Term
  - Participation size (loan volume)

> Sourcing Approach needs to mesh with all CU needs
  - Once loan is obtained, determine who will underwrite the loan participation for each CU
  - Determine who will process, close and service the loan
  - Participation Agreement must be executed by lead and participants

Servicing

> Loan Servicing Agreement must be signed by Originating Credit Union & Servicer

- Determine who will service loan
- Determine the cost for servicing the loan
- Determine which aspects of servicing are included
  - Payment collection & remittance
  - Collection and tracking of impounds
  - Tracking of taxes and insurance
  - Monitoring late payments and/or loan collection
  - Annual loan reviews
  - Property inspections
  - Appraisals
  - Collection of loan, borrower & guarantor financials and tax returns
  - Loan risk rating analysis
  - Communication methodology and frequency

Special Servicing

> Special Servicing Agreement must be signed by Originating Lender and Servicer
  - Determine who will handle special servicing of loan
  - Determine cost for special servicing
  - Determine which aspects of special servicing are included
    - Collection efforts
    - Litigation management
    - Foreclosure oversight
    - Loan modifications
    - Annual loan reviews during delinquency and/or foreclosure
    - Property inspections during delinquency and/or foreclosure
    - Appraisals
    - Collection of loan, borrower & guarantor financials and tax returns
    - Loan risk rating analysis
    - Communication methodology & protocols during special servicing

Additional Considerations

The Right Stuff

> When beginning an MBL participation program credit unions should consider the following:

- NCUA regulations require the credit union, or a third-party vendor the credit union engages to work on its behalf, to have at least two years of commercial loan underwriting experience
- In addition to an underwriter the credit union will also need a loan processor to work with borrowers, third party vendors, title and perhaps escrow to assemble the complete loan package necessary to thoroughly underwrite the loan
- Once the loan has been underwritten it will need to be approved. It is important to establish a Credit Committee (which will most likely be comprised of top executives from within the credit union and/or board members) to review, discuss and determine if the loan being presented falls within the CU's risk tolerance

How Do We Do All of This?

- The good news is there are several third-party vendors that can assist you in ensuring your credit union starts off correctly adhering to MBL best practices
- There are a number of MBL CUSOs, such as Extensia Financial, that can walk you through an on-boarding process to ensure that both parties are sure the necessary policies, personnel and processes are in place at the credit union
- Most credit unions that are already engaged in MBL are willing to help a credit union just embarking on the process by sharing experiences and suggestions if asked
- The NCUA has resources available to assist credit unions desiring to establish an MBL program

Origination

Who should originate the loans

Credit Union and CUSO Origination Models

Credit Union Model

- BDO is an employee of the CU, is in the Branch, and generates leads locally through business deposit or loan relationships
- Works with local real estate sales agents to acquire leads or referrals for commercial loan opportunities
- Also works with commercial loan brokers to acquire commercial loan opportunities

> Participation loans originated by the credit union model are typically whole loan opportunities

- SBA or CRE loan opportunities are underwritten, funded and serviced by the CU or in conjunction with SBA service provider

> Loans held by the CU typically have smaller balances

> Property securing loans are often located locally or nearby

> Larger CUs sometimes participate loans out to other CUs. This can be done directly or through a CUSO

Credit Union and CUSO Origination Models

CUSO Models

- BDO is an employee of the CU, is located in the branch and generates leads locally through business deposit and/or loan relationships
- BDO is located in CUSO, may be an employee of either the CU or CUSO, is paid by the CU if employed by the CU, and is paid by the CUSO if employed by the CUSO, who is subsequently reimbursed by the CU(s), and works with commercial loan brokerage(s) to acquire commercial loan opportunities
- BDO is an employee of CUSO, is paid by the CUSO, and works with commercial loan brokerage(s) to acquire commercial loan opportunities
- BDO is an employee of the CUSO, is located in CU Owner(s) Branch(s), and generates leads locally through business deposit and/or loan relationships

> Loans can be whole loan or partial balance participation opportunities

> Loan opportunities can be underwritten, funded and serviced by the CUSO, in conjunction with the owner credit unions, or by third party providers or any combination

> Property securing loans can be local or located nationwide, based upon CU preferences

Benefits of CU Sourced Programs

> Targeted geographic market
  - Deeper and better understanding of the local market
    - Risks
    - Mitigants

> Lender is known – participations pose additional complexities

> CU relationship with borrower allows greater flexibility
  - CU established terms
  - Typically not yield driven

> Single lender underwriting guidelines

Benefits of CUSO Sourced Programs

- Large Sales Team
  - Review larger volume of loan requests quickly
  - Produce more volume throughout multiple BDOs
- Geographic diversification
  - National presence
  - Nationwide relationships
- Target specific markets for consolidated volume
  - Broker relationships can be managed to provide the volume of loans desired in a market
- Challenges
  - Securing Lead Lenders
  - Conflicting and changing lender preferences

Extensia Financial

How we can help

Developing Origination Preferences

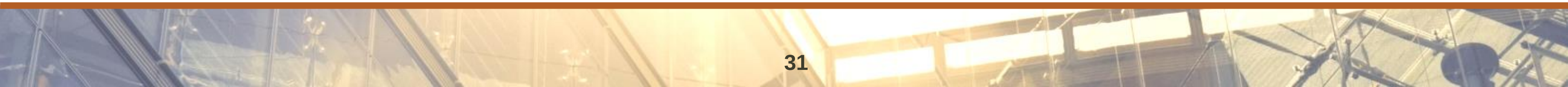
Current credit union preferences:

> Loan amounts are typically $1MM to $6MM
  - Extensia will entertain larger and smaller deals based on the relationship, market and asset class.

> Loan terms are flexible to aid mitigation of concentration risk.

> Major markets are preferred but secondary and tertiary markets are considered if there are appropriate mitigating risk factors.

> Asset Classes
  - Retail single and multi-tenant
  - Multifamily
  - Light industrial and logistics
  - Medical office, single and multi-tenant
  - Office, single and multi-tenant
  - Other asset classes reviewed on a case-by-case basis



Flexibility through Products and Pricing

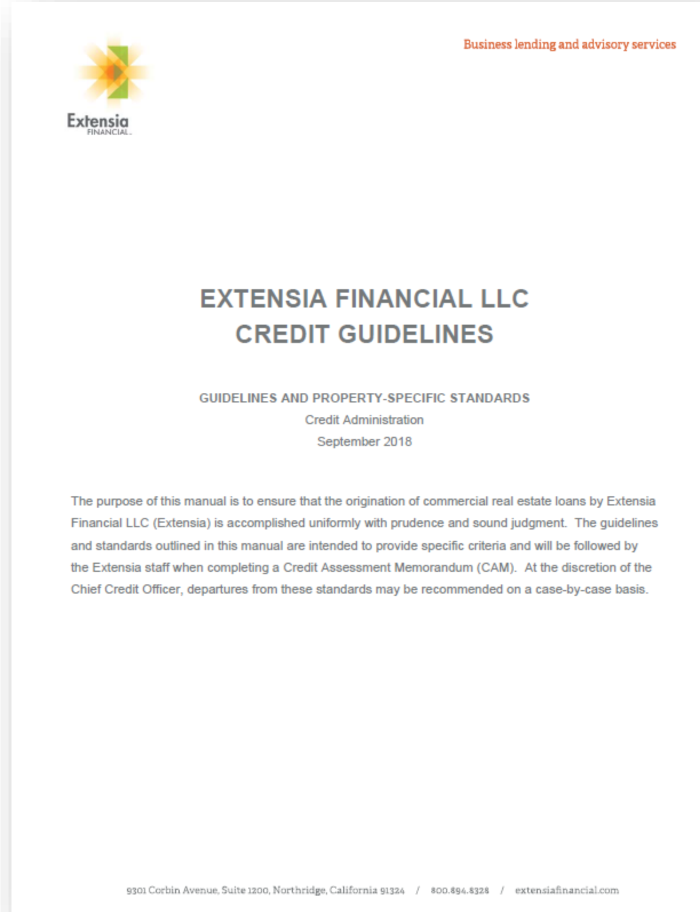
> Extensia's loan products and pricing

- Most popular is a 5+5 term that provides stability to both the borrower and the lender
  - Quantifies the risk at the point of the rate reset
  - Competes well with the 10-year fixed product offering, but allows for better interest rate risk management for the credit union
- Flexible terms to assist credit unions and borrowers with risk laddering (7+3, 5+2, 7 Yr Fixed, etc.)
- Flexibility in pricing to match the risk in the loan
  - Lower rate for highly qualified borrowers with lower risk

Underwriting Approach

Extensia approaches each credit as an opportunity for a risk-priced loan. The goal of underwriting a loan request is to accurately identify the significant factors that comprise risk in a loan request, and to weigh those risk factors against established standards and best practices to determine the overall level of risk in a loan request. In addition to identifying risk, the underwriting function also involves mitigating general and specific risks through the appropriate loan structure, covenants, and controls.

Extensia maintains its underwriting standards in the Credit Guidelines document.



Business lending and advisory services

Extensia FINANCIAL

EXTENSIA FINANCIAL LLC
CREDIT GUIDELINES

GUIDELINES AND PROPERTY-SPECIFIC STANDARDS
Credit Administration
September 2018

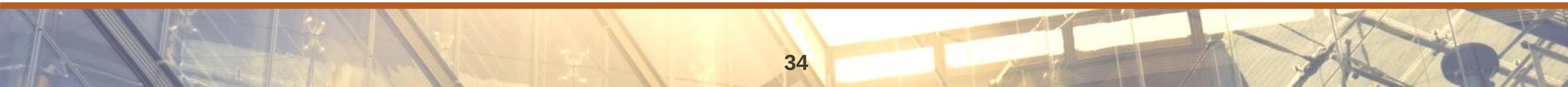
The purpose of this manual is to ensure that the origination of commercial real estate loans by Extensia Financial LLC (Extensia) is accomplished uniformly with prudence and sound judgment. The guidelines and standards outlined in this manual are intended to provide specific criteria and will be followed by the Extensia staff when completing a Credit Assessment Memorandum (CAM). At the discretion of the Chief Credit Officer, departures from these standards may be recommended on a case-by-case basis.

9301 Corbin Avenue, Suite 1200, Northridge, California 91324 / 800.894.8328 / extensiafinancial.com

Servicing Includes…..

- Communication with lender group
  - Updates/ Approvals (service bulletins)
  - Loan origination
    - Participation opportunities
    - Credit Recommendations
- Escrow management (taxes & insurance)
  - Monitor
  - Payments
  - Reporting
- Non-escrow management (taxes & insurance)
  - Monitor
  - Reporting
  - Force place insurance, if cancelled
- Payment / Demand processing
  - Delinquency monitoring
  - Collections
  - Credit reporting
- Holdback & Reserves
  - Post-Closing Improvements / repairs
  - Tenant improvements
  - Leasing commissions

With Extensia, all of the referenced services are included in the credit union’s monthly servicing fee.



Servicing Includes (cont'd)….

- Covenant monitoring
  - Lease review
  - Review borrower performance metric covenants
- Term loan reviews
  - Annual financial monitoring
    - Property strength assessments
      - Tenant
      - Property condition
      - Site inspection
      - Market conditions
      - Net realizable value
    - Borrower strength assessments
    - Guarantor strength assessments
  - Risk Rating monitoring & recommendation
  - Exit strategy analysis
- Financial & Risk reporting
  - Various monthly reports regarding CU portfolio
  - Risk reporting
- Guarantor administration

Mitigating Risk through the Annual Term Loan Review (ATLR) Process

> The annual loan review process starts with the loan documents which obligate the borrower to provide the borrower, guarantor and property financial information needed to complete the review.

> This information is requested and received in conjunction with getting a new, independent property inspection. Most loans are reviewed annually, but some are marked for more frequent review.

> All pertinent factors, including, but not limited to the borrower and guarantor financial health, the property financial and physical condition, period and upcoming rent roll changes, major tenant financial health, current market conditions and comparison to the subject property, and market and property specific trends to make the best possible prediction for the upcoming risks to the loan.

> Armed with this knowledge, the risk rating is then recommended.

Thank You

Questions and answers