



NADCO

*Spring* **SUMMIT**

MAY 10-13, 2015 // WASHINGTON, DC

**Breakout Session XIII**

**Best Practices for Portfolio  
Management & SMART Reviews**

**Studio B**

**1:15 pm – 2:15 pm**

**NADCO**  
National Association of Development Companies

Small business loans

**DELIVERED**

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# Speakers

- **Hollis Carter, Principal**  
Hollis Carter, LLC
- **Mary Kropp, President**  
Power Steering Unlimited, Inc.
- **John Evans, Executive Vice President and  
Credit Administrator**  
Mountain West Small Business Finance

# The MWSBF On-site Audit Experience

- By way of background...
  - The MWSBF portfolio consists of +1,600 loans, with a total balances in excess of \$600MM
  - We had our Annual Internal Review in the Fall of 2014, which was very intense
    - The Reviewer was very much “up to speed” on OCRM expectations
    - He had a few findings and some recommendations
    - These results were immediately addressed and reported to our Board



# The MWSBF On-site Audit Experience

- Our OCRM on-site SMART review was done in April 2015
- 8 reviewers on site
  - SBA: One OCRM, One SBA (Fresno), One OGC
  - Contractor firm: Five
- One full week
- Reviewed all components of SMART

# The MWSBF On-site Audit Experience

- The review process consisted of:
  - Several meetings and interviews with various members of CDC staff and management
    - Including financial/accounting staff
  - Interviews with two board members (separately)
  - **Comprehensive** review of 52 loan files
    - 30 “active” performing
    - 22 problem or charged off loans

# The MWSBF On-site Audit Experience

- As each loan was reviewed, the reviewer would generate an Deficiency Sheet, which listed deficiencies with each loan
  - I believe there were ~ 80 questions addressed on every loan
  - Rumor has it this list may still be changing, updating.
- The CDC was given the opportunity to find “missing” docs and/or to address each deficiency
  - We returned each sheet with the documents, a written response (“Agree”, “Disagree”, “See enclosed documents”, a rebuttal, etc.)
  - The CDC CEO reviewed/signed each returned sheet

# The MWSBF On-site Audit Experience

- The reviewers needed all week to get through the 52 loans (so you can see how intense it was)
- All of the reviewers were pleasant and professional.
  - CDC employees should respond in like manner
- As general issues were identified or if policies/practices needed clarification, they were willing to have impromptu meetings to enhance their understanding.



# The MWSBF On-site Audit Experience

- What can a CDC do to prepare?
  - Have a competent intensive Internal Review done by an independent party that really understands credit, SBA 504 lending, SOP, risk rating, and the SMART expectations
    - Address problems found in that review
  - On a few occasions, I think it probably helped us to say: “that issue was addressed in our internal review six months ago and it has been addressed as follows...”

# The MWSBF On-site Audit Experience

- What can a CDC do to prepare (cont'd)?
  - Search for and fix any problems that could result in cause a loss
    - Perfection of security interest, particularly UCC filings
    - Documentation of TPL paydown/modification
    - Property tax monitoring
    - Hazard Insurance coverage
    - Collateral verification and liquidation procedures, particularly equipment, verification of TPL Trustee's Sales, etc.
    - Life insurance

# The MWSBF On-site Audit Experience

- What can a CDC do to prepare (cont'd)?
  - Organize your files, so stuff can be easily found
  - Document major actions, particularly liquidation
    - Wrap Up Reports are a major focus
      - Go back and beef them up with missing facts, details.
    - Again, explain how/why collateral was liquidated
  - A somewhat new liquidation item: don't just refer guarantors to Treasury...first, assess “collectability”, to see if a lawsuit is warranted (>\$50,000 net collectability)



# Portfolio Management Best Practices



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# Portfolio Management Defined

Loan portfolio management is the process by which *risks* that are inherent in the credit process are managed and controlled.

- Risks associated with lending must be accurately identified and appropriately communicated to senior management and the board of directors.
- Focus is on what management does to identify issues before they become problems.
- Appropriate corrective action is taken when necessary.



# How Is Risk Managed

## *Loan Level*

- ❑ Effective underwriting that identifies and mitigates risk
- ❑ Clear and effective communication
- ❑ Effective monitoring and servicing
- ❑ Timely and firm approach to collections
- ❑ Technical assistance



# How Is Risk Managed

## *Portfolio Level*

- ❑ Loan Policy
- ❑ Internal Control Policy
- ❑ Portfolio Management
  - Loan monitoring
  - Reporting
  - Problem loan & liquidation case management
  - Portfolio diversification
  - Risk rating system
  - Independent loan review
- ❑ Credit Culture



# Loan Monitoring

- ❑ Financial statements & tax returns
- ❑ Hazard insurance certificates
- ❑ Life insurance
- ❑ Real property taxes
- ❑ UCC continuations
- ❑ 504 loan performance
- ❑ TPL loan performance

# Reporting

- ❑ Management, board and SBA
- ❑ What should be reported?
  - Portfolio quality
  - Problem loans
  - Delinquent loans
  - Risk ratings
  - Concentrations
  - ILR results
- ❑ How often?

# Problem Loans/Liquidation

- ❑ Why do loans go “sideways?”
- ❑ Communicate! Borrower, TPL & SBA
- ❑ Make collections a priority
- ❑ What were the risks that led to the problems?
- ❑ Are these risks identified in underwriting?
- ❑ Lessons learned?



# Portfolio Diversification

- ❑ Why is this important?
- ❑ Should be addressed in loan policy.
- ❑ Limit portfolio concentrations.
  - Industry
  - Single Borrower Limit
  - Collateral type
  - Borrower location
  - Stage of development, i.e., start ups

# Risk Rating System

- ❑ Required of all CDCs by SBA SOP 51 00.
- ❑ Should be addressed in internal control policy.
- ❑ Timely and accurate loan classification.
- ❑ SBA doesn't dictate a particular risk rating system.
- ❑ Requires consistency with classifications used by Federal Financial Institution Regulators, i.e., Special Mention, Substandard, Doubtful & Loss.
- ❑ Must be risk rated at origination and at least annually on an ongoing basis.
- ❑ Should be used as a portfolio management tool and reported to board.

# Independent Loan Review

- ❑ Should be addressed in internal control policy.
- ❑ In-house review permitted, but must be independent.
- ❑ Should be conducted annually.
- ❑ Should evaluate credit risk levels and credit risk management.
- ❑ Results reported to board and management.
- ❑ Results should be used to improve loan underwriting, credit administration and monitoring functions, i.e., portfolio management.

# Credit Culture

- ❑ The board and all staff should understand the CDC's credit culture and risk profile.
- ❑ This knowledge should pass from the CEO to loan officers to support staff.
- ❑ Credit culture is the sum of its credit values, beliefs and behaviors.
- ❑ It is what is done and how it is accomplished.
- ❑ *Values and behaviors that are rewarded become standards and will take precedence over written policies and procedures.*

# Final Thought

To stay out of trouble with SBA... lend, service and liquidate your 504 loan portfolio like you would if it was your own money!



# What's Up Next?

**2:15 PM – 3:15 PM**

- **General Session V**

**Governance Concerns: How Does Your Organization Stack Up?**

Grand Ballroom Salons 1-4

**3:30 PM – 5:00 PM**

- **General Session VI**

**SMART Review Process and Potential Loss: What Else Do You Need to Know?**

Grand Ballroom Salons 1-4