Achieve Yield and Insights Into Loan Participations

LendKey and Inspire Credit Union

Data provided by Cornerstone Research

Presenters

James Merrill
CEO and President
Inspire Federal Credit Union
merrill@inspirefcu.org

Christian Widhalm
SVP, Lender Partnerships
LendKey
Christian.widhalm@lendkey.com

CUNA LENDING COUNCIL

Company Overview

inspire federal credit union

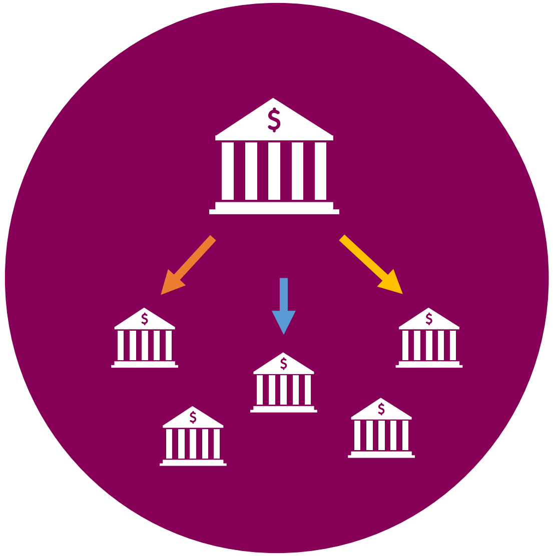
- $170MM in assets
- Community-based credit union
- Based in Pennsylvania
- Active in participation programs
- for ~4 years

LendKey

- Recognized leader in digital lending solutions
- Originated over $1B in participations on behalf of partner lenders
- ~300 credit unions and community bank partner lenders

What is a Loan Participation?

- Allows **multiple lenders** to share in the funding of a loan
- One **lead originator** underwrites and closes a loan then sells portions of the loan to other lenders to mitigate risk
- Participations match low loan-to-share and high loan-to-share credit unions allowing them to **balance a need for loans and a need for liquidity**



CUNA LENDING COUNCIL

Types of Participations

- Large Commercial
- Pooled Purchase
- Real-Time

The Need for Loan Participations

- Increased loan-to-share
- Member business lending cap management
- Portfolio diversification
- Risk management
- Investment optimization
- Maintaining loan distribution channels

Credit Union Trends in Participations

- Credit unions of **all sizes** are utilizing participations, though larger credit unions are more active in purchasing

Percentage of credit unions purchasing participation loans by asset category

Asset Category in Millions	2014	2017
<$10	2.8%	2.7%
$10 - $50	12.6%	16.2%
$50 - $500	40.9%	50.6%
$500 - $1	63.6%	74.7%
>$1	68.6%	75.0%

Source: SNL

CUNA LENDING COUNCIL

Credit Union Trends in Participations

- A shift towards consumer loans

  ~50% growth in consumer loans and over **50% decrease** in commercial loans in the past 5 years due to the financial crisis shifting demand and credit worthiness

Participation Loan Distribution 2012 versus 2017

Loan Type	2012	2017
Commercial Loans (non C&D)	53%	28%
Real Estate	20%	22%
Consumer	15%	28%
Construction & Development	3%	3%

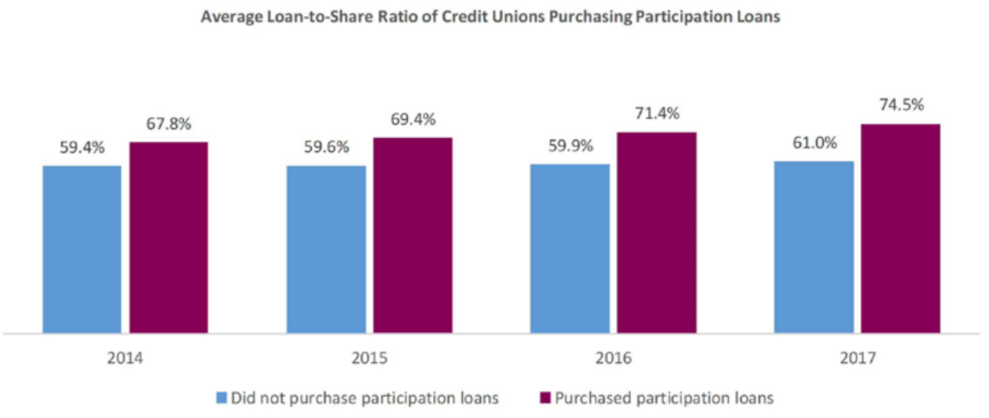
Source: Callahan and Associates, SNL

Results of Loan Participation

Increase loan-to-share

- Credit unions purchasing loan participations **increased loan-to-share by nearly 7%** over 4 years
- Credit unions **without** loan participations had an **increase of less than 2%** in loan-to-share in 4 years

Loan-to-Share Ratio of Credit Unions Purchasing Participation Loans, 2014 to 2017



Source: SNL

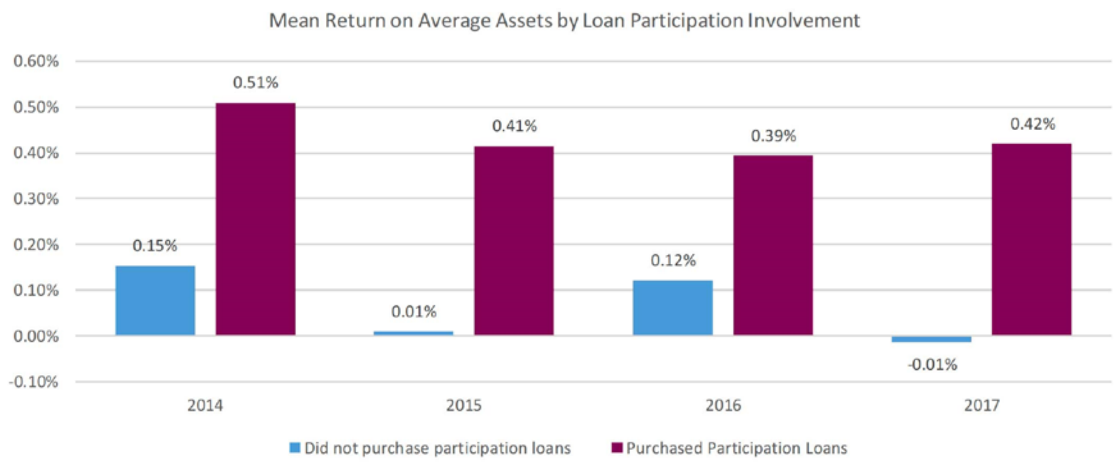
CUNA LENDING COUNCIL

Results of Loan Participation

Increased Return on Average Assets

- 4 year average **ROAA of 0.06%** for credit unions who did not purchase participation loans as compared to an average **ROAA of 0.40%** for credit unions who purchased participation loans.

Mean ROAA of Credit Unions Purchasing Participation Loans, 2014 to 2017



Source: SNL

Loan Participation Model

If a $500 million credit union deployed 10% of non-loan assets into loan participations, instead of in cash or lower yielding investments, with a 5% net return the following results would occur:

- Boost return on assets from 0.54% to 0.77%
- Return on equity from 5.77% to 7.97%
- Increase of net income by 14%
    - $1.66MM additional net interest income
- Increase ROA by 42%

	Baseline	Participation (5% yield)	Participation (4% yield)
Total Interest Income	$13,083	$12,368	$12,368
Participation Interest	$---	$2,369	$1,895
Net Interest Income	$11,798	$13,452	$12,979
Net Income	$2,856	$4,042	$3,568
Ratios			
LTS	47.3%	57.3%	57.3%
ROA	0.54%	0.77%	0.68%
ROE	5.77%	7.97%	7.11%
Efficiency Ratio	81.26%	76.23%	78.14%

Chart: Impact of Participation Loans on Sample of $500 Million Credit Unions

Inspire Credit Union Case Study

Built successful participation strategy

- Started in 2014 as part of income enhancement strategy. Goal was to leverage balance sheet to drive net income and build capital.
- Loan to share ratio was 62% ($49M in balances)
- Investment portfolio $22.4 M (Avg. yield 0.97% - mostly low yielding share certificates)
- Acquired small pools of indirect auto from large, reputable credit union with strong track record in the indirect auto space.
- Continued to identify asset pools in which credit union had expertise in originating and underwriting.
- Two major focuses: Asset diversification and complete and thorough due diligence process

Inspire Credit Union Case Study - Results

Before Participations
2010 – 2013[1]

- ROA of 0.25%
- Assets: $87.5M
- Loans: $49.4 M
- LN/Share 62.9%
- Total Equity $8M
- Loan Income 2.6M
- Delq Ratio 0.72%
- Charge-offs 0.82%

After Participations
2014 –2017[2]

- ROA of 0.70% – a 0.45% increase
- Assets: $170M- 82.5M growth in assets
- $128.9MM in loans – 160% increase in loans
- LN/Share 101.6%
- Total Equity 12.8M – 60 % increase in equity
- Loan Income 5.5M (annualized)
- Delq. Ratio 0.14%
- Charge-offs 0.09%

[1] ROA is reflective of period ending 12/31/2013
[2] ROA is reflective of period ending 12/31/2017

Inspire Credit Union Case Study

August 2018

- 20% of assets in participations ($34 Million)
- Have acquired participation loans in 7 different asset classes (diversification)
  - Mortgages, home equity loans, indirect auto, consumer loans, recreational vehicle loans, home improvement loans, student loans
- Have sold pools of loans to other credit unions to manage concentration risk limits, provide liquidity and fuel continued organic growth.
- Strategy has allowed credit union to expand in community and provide more value to membership
  - 3 new branch locations
  - New corporate headquarters
  - New technology
  - Expanded community outreach and brand recognition
  - Resources to build strong management team

Inspire Credit Union Participation Insights

- Sourcing and assessing participation loans
- Diversification
- Due Diligence process
- Stay with what you know
- Engage your Board of Directors
- Transparency with examiners
- Success in driving earnings and key element in growth

Selling Participation Loans

Seller profile

- Originating credit unions sell participations to credit unions with similar underwriting guidelines
- Originate loans above normal credit union borrowing caps
- Potential for selling at premiums, in addition to servicing fees
- Ability to build out and vet a network of like-minded credit unions through broker or in-house advisor

CUNA LENDING COUNCIL

Selling Participation Loans

Benefits

- Balance sheet diversification
- Improved asset and liability management
- Increased non-interest income
- Improved risk management
- Concentration management (including MBL caps)

Pain Points and Objections

- Increased complexity of loan participations
- Greater risk for larger participations
- Greater regulatory scrutiny
- Due diligence efforts
- Finding and vetting credit unions with the same underwriting criteria and managing their expectations along the way

Solutions

- Understanding risk is a core competency of credit unions
  - Evaluating loan pools is not overly complex compared to evaluating other types of loans.
- Regulatory scrutiny is a way of life for credit unions.
  - If loan pools can add to a credit unions ROA the extra regulatory risk is worth it
- Loan participation platforms address the challenges of finding and vetting loan participation partners along with monitoring and executing the participations themselves.

The Outlook of Loan Participations

- Market and balance sheet pressures will result in an increase of credit unions utilizing loan participations
- Operational obstacles (time, effort and costs) will decrease with technology partnerships on the rise

Thank you

Q&A

Visit business.lendkey.com to download the full Participation Report today