

Alternative Financing for Small Businesses - IBANYS

June , 2015

Jim Conroy, Senior Vice President

New York Business Development Corporation

About NYBDC

- ▶ NYBDC was formed in 1955 and is owned by banks
 - ▶ Approximately 90% of referrals come from banks
- ▶ NYBDC's mission is to provide creative and innovative financing to help NYS small businesses. We fit where the bank/small business needs us.
- ▶ NYBDC is a transactional term lender. We are there to help a deal but not compete with banks.
- ▶ NYBDC can accommodate loans ranging from \$25,000 - \$5,500,000.



About NYBDC (cont.)

- ▶ We are small business underwriters. It's all we do!
- ▶ We utilize government programs available through the US Small Business Administration (SBA) and US Department of Agriculture (USDA) to reduce risk of loss. Successful usage of these programs has helped keep us around for 60 years!
- ▶ NYBDC assets under management now exceed \$1.4 billion and close to 100 employees. We are a major force in small business financing in New York State.



Jim Conroy - Presenter

- ▶ **Senior Vice President with NYBDC**
 - ▶ Manage a team of 7 lenders across upstate NY including Rochester, Syracuse, Southern Tier, North Country and Capital District regions
 - ▶ 17 years at NYBDC
 - ▶ Adept at all government guaranty and local economic development programs
 - ▶ RMA Empire Chapter Board Member
 - ▶ MBA – Rensselaer Polytechnic Institute (RPI)
 - ▶ BA – Siena College



Lending Landscape

- ▶ **2014 Survey of Credit Underwriting Practices by the OCC indicated:**
 - ▶ “Show a third consecutive year where underwriting standards have eased within both commercial and retail products. This compares to very similar results noted in the 2006 underwriting survey, just prior to the most recent credit crisis.”
 - ▶ “Competition, abundant liquidity, and the search for yield in the current low-rate environment caused banks to relax pricing and terms. In addition, examiners reported a trend of increasing policy exceptions for both commercial and retail products... Large banks reported the highest share of eased underwriting standards.”



Lending Landscape (cont.)

- ▶ **2Q2014 Private Capital Access Index (PCA):**
 - ▶ Small Business PCA results, “reflect weakness in demand for external loans and other financing. This number represents a 3.9% decrease from Q1, 2014 index value.”
 - ▶ “59.2% of [business] respondents expect it would be a difficult business environment in which to raise new financing in the next six months.”



Lending Landscape (cont.)

- ▶ “Why small businesses don’t want a loan” – Kate Rogers, CNBC:
 - ▶ “Small businesses haven’t had a good enough reason to go out and borrow money and invest heavily yet.”
 - ▶ “Small business owners are turning to alternative lenders – this has given rise to the success of companies like Prosper and Lending Club. The size of the nonbank financial system is estimated to be at \$3.2 trillion in the US, according to the Bank for International Settlements.”
 - ▶ The latest PCA Index found that 3.4% of businesses with \$5 million or less in revenue attempted to raise financing via an online marketplace lender in Q1 2015 compared to 2% of larger businesses with \$5 million to \$100 million in revenue.”



Challenges for IBANYS Banks

- ▶ **Overall weak demand??**

- ▶ Is business not there or are businesses not borrowing because they are not comfortable with the environment and/or the chances for loan approval?

- ▶ **Intense competition for qualified deals**

- ▶ Big banks being especially competitive
- ▶ Credit unions
- ▶ Emergence of “on-line” lenders taking market share
 - ▶ Simplicity – no paperwork
 - ▶ Speed is more important than loan terms to customers



Opportunities - New Normal

- ▶ Need to be more aggressive in seeking qualified loan opportunities to keep up with competition (SBA 504)
 - ▶ Pricing
 - ▶ Speed
 - ▶ Options
- ▶ Need to be more resourceful in seeking approval for challenging credits (SBA 7a and USDA B&I Program)
- ▶ Need to provide
 - “Alternate lending opportunities for your customers – How to provide a solution.”



Financing the tough ones...

The scenario

- ▶ A company has used \$125,000 of credit cards to start a retail clothing store.
- ▶ Credit cards were used to make leasehold improvements, buy initial inventory and provide capital for the business.
- ▶ The company's finished their 18th month in business and performance shows the ability to repay the credit card debt over 5 years at a reasonable interest rate.

The challenges

- ▶ Still considered a start up < 2 years
- ▶ Retail business
- ▶ Little or no collateral
- ▶ Small loan amount has not attracted many bankers' interest.

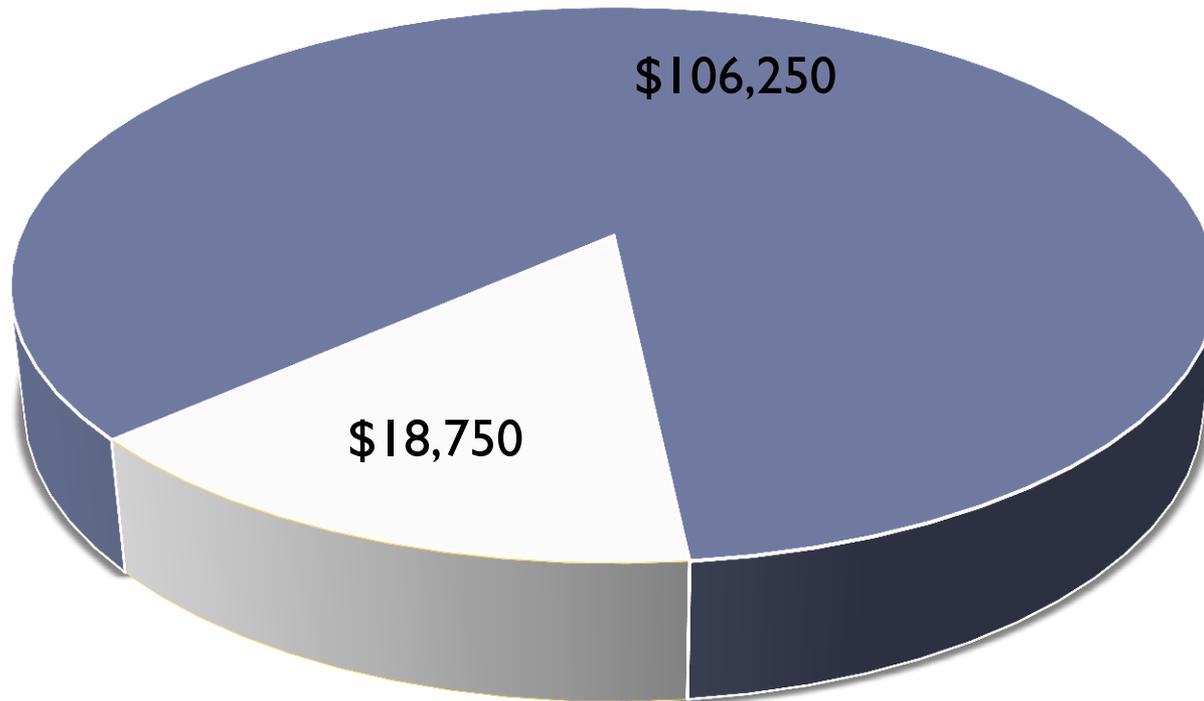


SBA 7a Program

- ▶ Bank makes a loan for \$125,000 contingent on SBA 7a.
- ▶ Structured as a normal loan transaction. Five year repayment term, market interest rate, collateral, submission of financial information, sound underwriting, credit checks, etc.
- ▶ Bank receives an 85% guaranty from the SBA. In other words, the SBA is saying that they will pay the lender \$.85 for every \$1.00 lost should liquidation occur.
- ▶ Bank's **NET** loan exposure is \$18,750 or 15% of the \$125,000.



SBA 7a Loan Guaranty

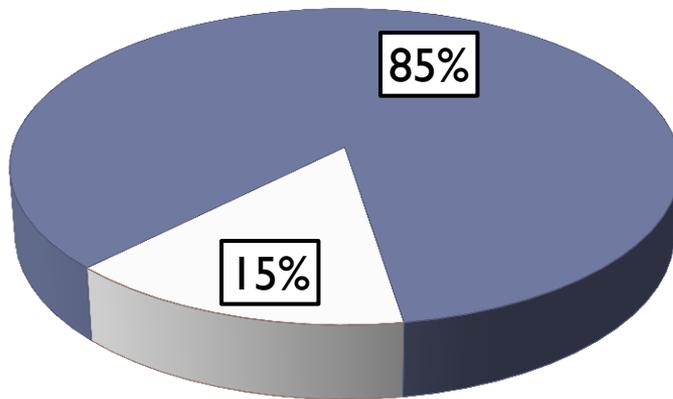


■ SBA □ Bank



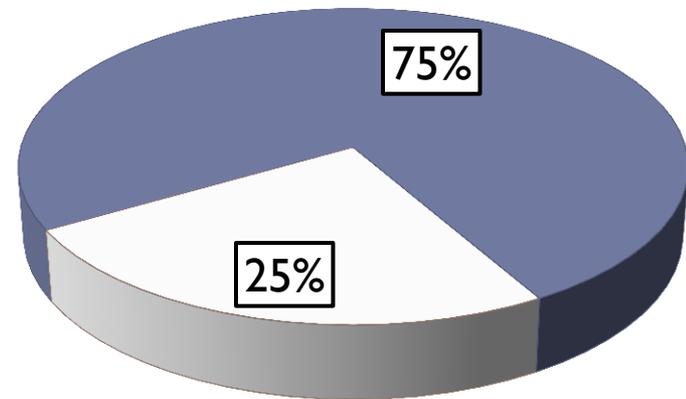
SBA 7a

Loans < \$150,000



■ SBA Guar. □ Bank Exposure

Loans > \$150,000



■ SBA Guar. □ Bank Exposure



SBA in the eyes of the banker

- ▶ SBA guaranty requires the borrower to pay a fee. Can range from 2% to 3.75%. This is usually financed but is a deliberate competitive disadvantage. Collateral requirements can also be a disadvantage. “If the bank can do the loan without federal assistance, than the federal government should not be used.”
- ▶ SBA approval process is not difficult but is a bit time consuming. Some lenders are very comfortable with the SBA eligibility guidelines and processes but others are less so.



SBA in the eyes of the banker (cont.)

- ▶ SBA loans must be closed and serviced correctly. If you do not manage your SBA portfolio appropriately, the “guaranty” can be reduced when you call for it. SBA conducts audits to verify if the lender closed and is servicing the loans properly.
- ▶ I need an SBA guaranty to get it approved by my loan committee but do not have the time or expertise to do an SBA transaction...

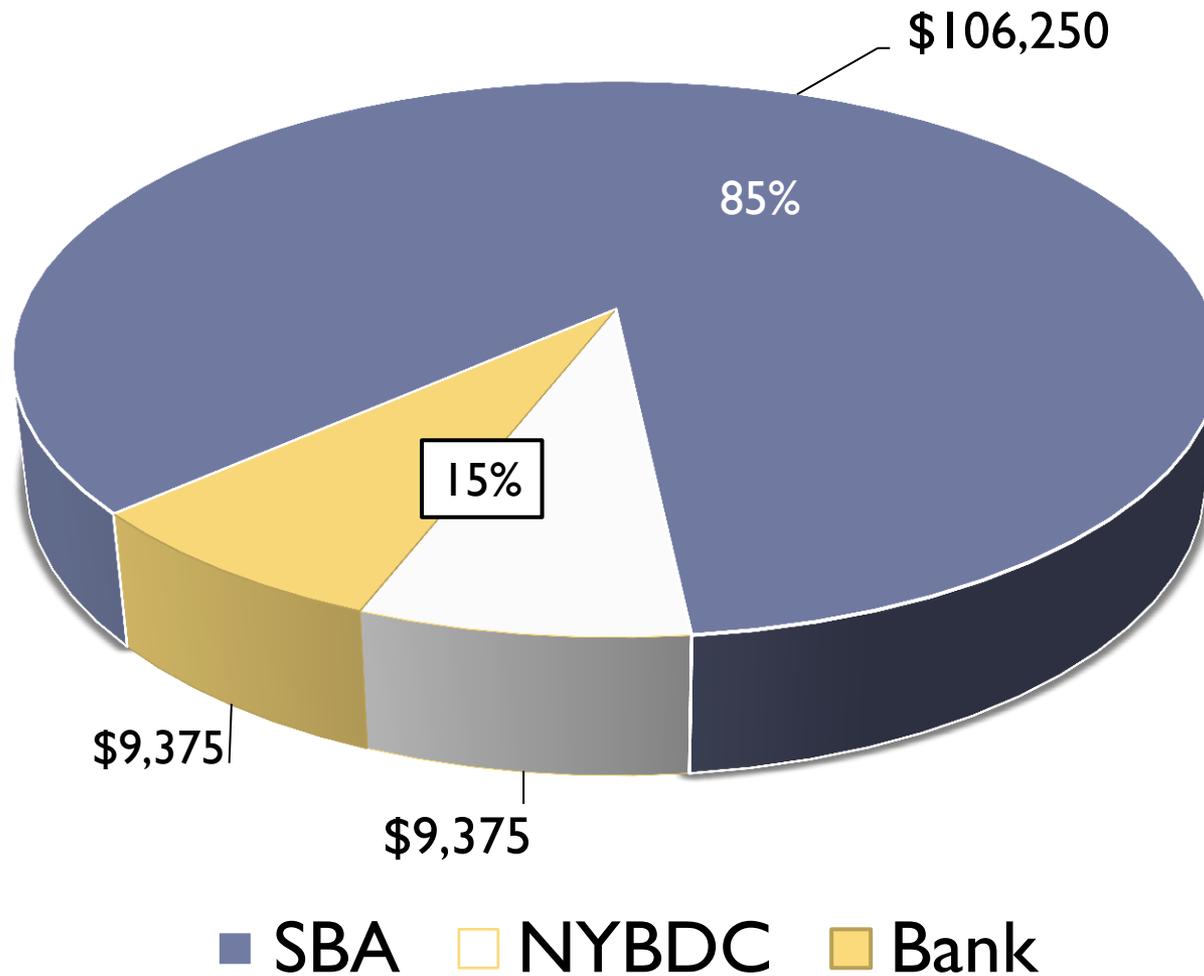


Banker decides to turn “high drag” loan into a “low drag” loan

- ▶ Banker asks for NYBDC to provide 50% of the borrowing need. \$125,000 term loan is broken into:
 - ▶ \$62,500 from NYBDC
 - ▶ \$62,500 from Bank
- ▶ NYBDC contacts the borrower directly, prepares a loan report and shares it with the bank for their approval.
- ▶ NYBDC processes the SBA approval.
- ▶ NYBDC closes the loan with in-house legal counsel.
- ▶ NYBDC services the loan after it is closed in accordance with SBA requirements and sends the bank their portion of payments.
- ▶ NYBDC handles all liquidations and SBA workouts.



SBA 7a Loan Guaranty (\$125,000 Loan)



Financing the really tough ones...

The scenario

- ▶ A 30 year old second generation owned lumber distributor (mostly export).
- ▶ Had a \$1.3 million write off of bad debt from an overseas customer in 2008.
- ▶ Inventory included considerable amounts in foreign countries.
- ▶ Had no availability on their line-of-credit from one of the largest banks in the world. Bank was not comfortable and insisted on a reduction in the balance of the LOC. \$1,450.0 was outstanding and needed to reduce to \$750.0.
- ▶ Had real estate for collateral.
- ▶ Had a local bank willing to try and help but needed SBA/NYBDC.

The challenges

- ▶ Concern about management.
- ▶ Very volatile industry and areas of operation. Projections were hard to analyze.
- ▶ Real estate collateral included a special use commercial building and a second mortgage on a house with a large first mortgage.
- ▶ Without restructuring balance sheet, the company would die. 13 jobs
- ▶ Local bank would help with the term loan but not the LOC. Needed to keep existing LOC bank in the deal

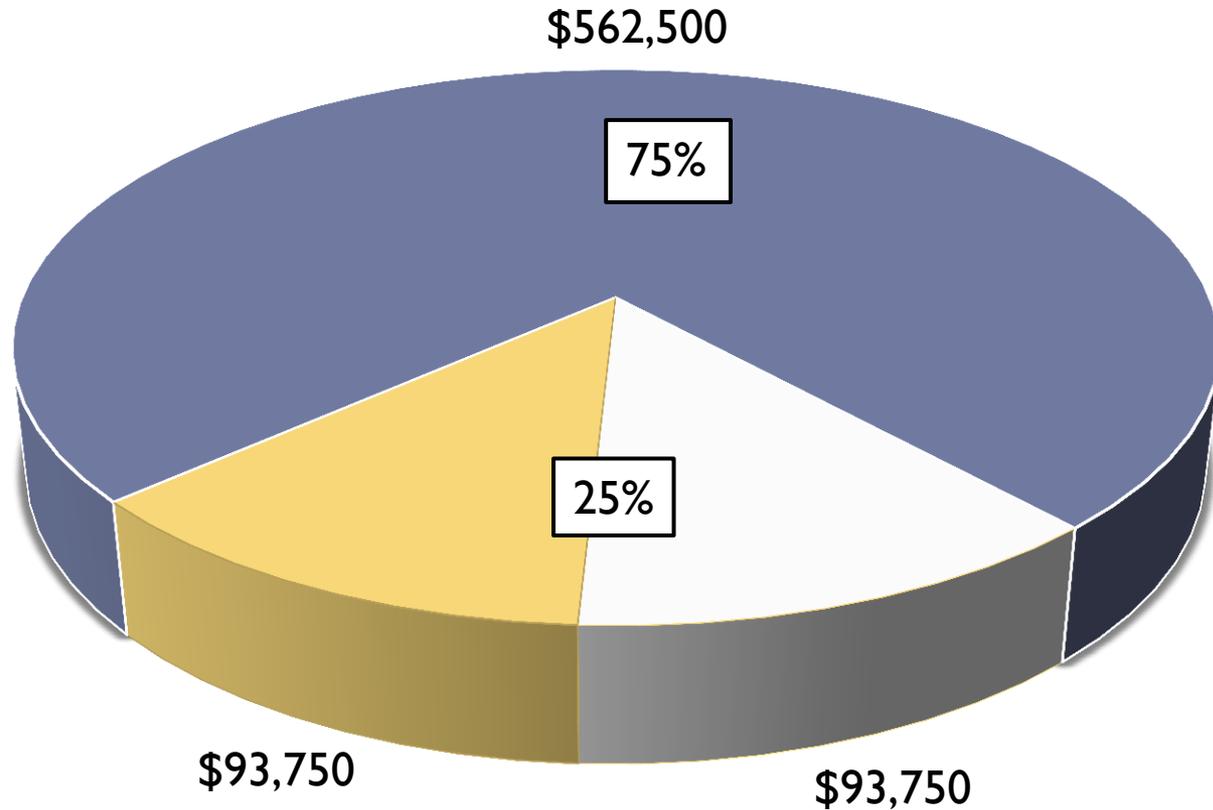


The Solution

	Term	LOC	Total
Uses of Funds:			
Pay Down LOC	\$750,000		\$750,000
New Avail. in LOC		\$100,000	100,000
Continued LOC		750,000	750,000
Total	\$750,000	\$850,000	\$1,600,000
Sources of Funds:			
NYBDC/Bank (10 yrs)	\$750,000		\$750,000
Existing Balance LOC		\$750,000	750,000
New Avail. in LOC		100,000	100,000
Total	\$750,000	\$850,000	\$1,600,000



SBA 7a Loan Guaranty (\$750,000 Loan)



■ SBA ■ NYBDC ■ Bank



Example #2

The scenario

- ▶ A 5 year old company involved with web hosting and cloud computing datacenter.
- ▶ Bought a building but realized renovations were going to be much higher than expected.
- ▶ Carrying 2 locations at the same time was draining cash.
- ▶ Revenues grew 160% in 3 years and leased facility was maxed out.
- ▶ Had a local bank willing to try and help but needed SBA/NYBDC.
- ▶ Had economic development support (\$375,000) but not enough to finance the entire project.

The challenges

- ▶ Management???
- ▶ Technology business.
- ▶ Large amount of financing needed for utility upgrades and redundant power.
- ▶ Strained working capital position that was deteriorating by the day.

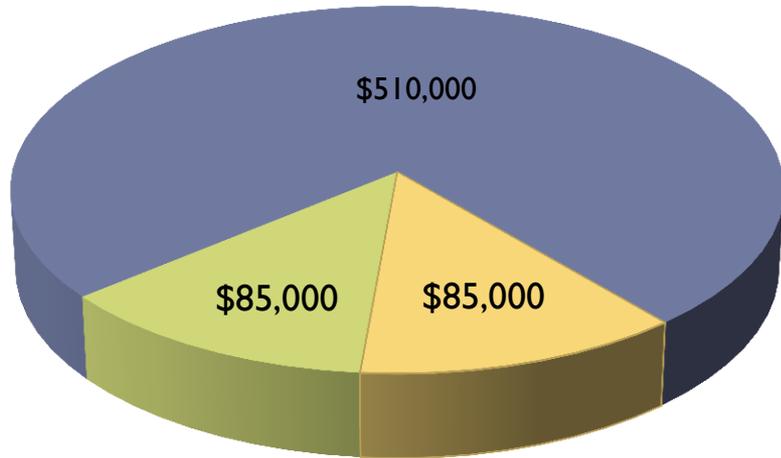


The Solution

	Mtg.	Term	Total
Uses of Funds:			
Refinance Mortgage	\$307,000		\$307,000
Renovations	318,000		318,000
Refinance Debt		\$250,000	250,000
New Equipment		442,000	442,000
Working Capital	55,000	133,000	188,000
Total	\$680,000	\$825,000	\$1,505,000
Sources of Funds:			
NYBDC/Bank (25 yrs)	\$680,000		\$680,000
NYBDC/Bank (5 yrs)		\$450,000	450,000
Economic Development		375,000	375,000
Total	\$680,000	\$825,000	\$1,505,000

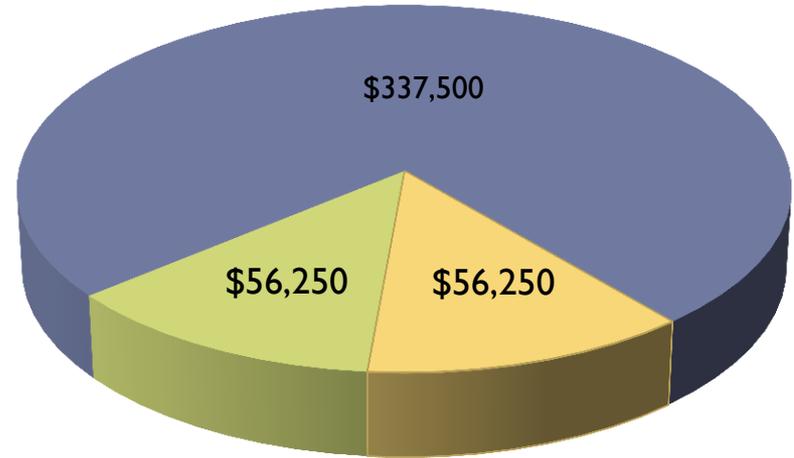
Loan Exposure

Exposure \$680,000



■ SBA ■ NYBDC ■ Bank

Exposure \$450,000



■ SBA ■ NYBDC ■ Bank



Summary

- ▶ Borrower requested \$1.5 million in financing to construct a datacenter.
- ▶ 15 jobs to be created and a vacant building will be occupied and improved.
- ▶ Willing economic development support.
- ▶ Willing bank support so long as NYBDC/SBA are involved.
- ▶ \$1,130,000 of NYBDC/Bank/SBA financing:
 - ▶ \$565,000 from NYBDC with net exposure of \$141,250
 - ▶ \$565,000 from Bank with net exposure of \$141,250
- ▶ Economic developer used NYBDC loan report to approve \$375,000 of financing.



Weighted Average Risk Rating

Weighted Average Risk Rating			
Loan	Exposure	Risk Rating	Weighted Dollars
1a (SBA)	\$ 510,000	1	\$ 510,000
2a (SBA)	\$ 337,500	1	\$ 337,500
1b	\$ 170,000	5	\$ 850,000
2b	\$ 112,500	5	\$ 562,500
	\$ 1,130,000	2.00	\$ 2,260,000



Weighted Average Risk Rating

Weighted Average Risk Rating			
Loan	Exposure	Risk Rating	Weighted Dollars
1	\$ 100,000	1	\$ 100,000
2	\$ 1,000,000	4	\$ 4,000,000
3	\$ 250,000	3	\$ 750,000
4	<u>\$ 3,500,000</u>	<u>6</u>	<u>\$ 21,000,000</u>
	\$ 4,850,000	5.33	\$ 25,850,000

Weighted Average Risk Rating			
Loan	Exposure	Risk Rating	Weighted Dollars
1	\$ 100,000	1	\$ 100,000
2	\$ 1,000,000	4	\$ 4,000,000
3	\$ 250,000	3	\$ 750,000
4a(SBA)	\$ 2,625,000	1	\$ 2,625,000
4b	<u>\$ 875,000</u>	<u>6</u>	<u>\$ 5,250,000</u>
	\$ 4,850,000	2.62	\$ 12,725,000

SBA 504

Fixed Asset Projects using “50-40-10”

SBA 504

- ▶ Unlike the SBA 7(a) program, you must be an authorized Certified Development Company (CDC) by SBA to access the 504 Program.
 - ▶ **Empire State CDC** is our affiliate company.
 - ▶ Only statewide CDC in New York.
 - ▶ Of 260 CDCs in the US, ESCDC is ranked 3rd largest.
 - ▶ Streamlined process that is very consistent and predictable.
- ▶ This is one of the best economic development financing tools available to small business!
- ▶ The spirit of the program is to help companies limit the amount of cash they need to buy fixed assets to grow and expand.



Is the company....

- ▶ Purchasing/constructing a fixed asset?
- ▶ A for profit business?
- ▶ Going to occupy a majority of the building with their business?
 - ▶ 60% of to be constructed building
 - ▶ 51% of existing building
- ▶ Wants to reduce the amount of cash that they need to buy the building?

504 is the best option available!

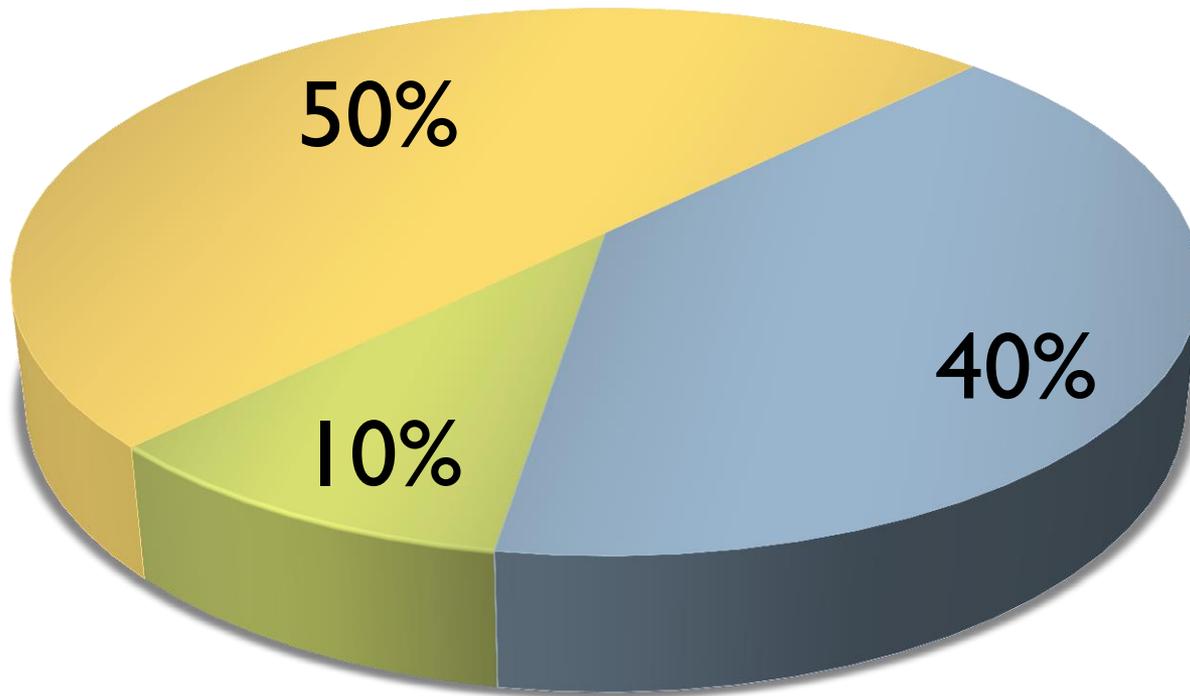


How real estate is usually financed

- ▶ Bank requires a borrower to contribute 20% - 25% towards a fixed asset project (ie real estate and/or equipment) in cash and they will finance the rest.
 - ▶ Term is usually 10 years with a 15 or 20 year amortization. Some may be fully amortizing.
 - ▶ Interest rates vary but are generally in the 5% - 5.5% range currently and adjust every 5 years.
 - ▶ Borrower may not be able to finance closing costs.



50 – 40 - 10

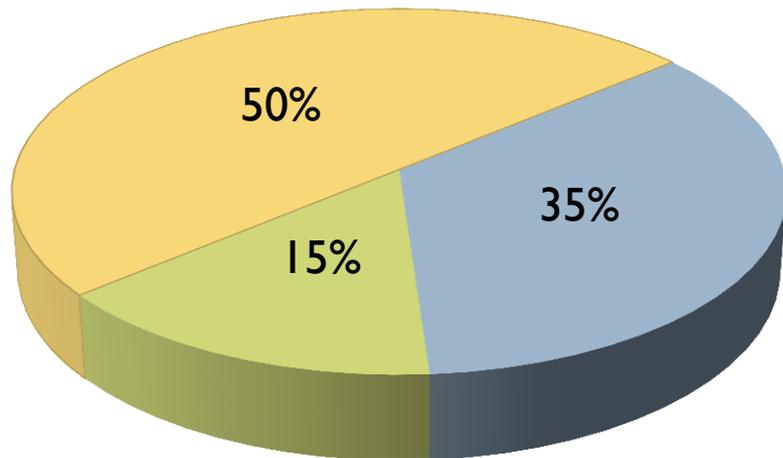


■ Bank ■ SBA 504 ■ Equity



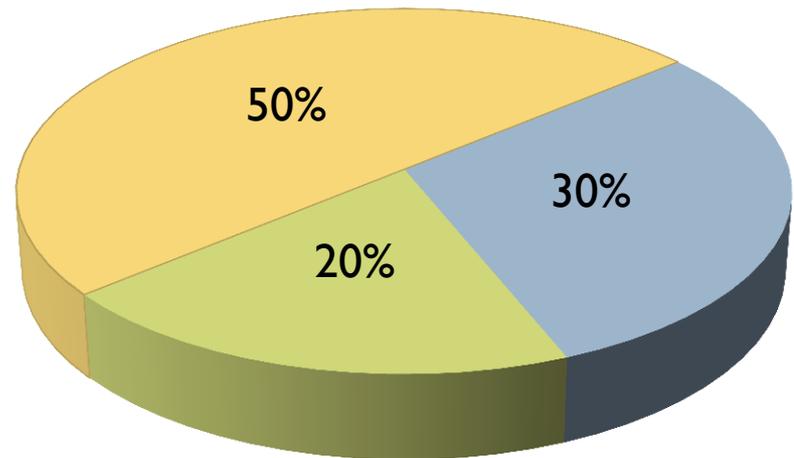
Alternate Financing Structures

Start Up **OR Special
Use Real Estate**



■ Bank ■ 504 ■ Equity

Start Up **AND Special
Use Real Estate**



■ Bank ■ 504 ■ Equity



504 comparison

504		
Purchase Bldg.	\$350,000	
Renovations	50,000	
Soft Costs	<u>20,000</u>	
Total	\$420,000	
Bank – 1 st Mtg.	\$210,000	50%
504 – 2 nd Mtg.	168,000	40%
Equity	<u>42,000</u>	10%
Total	\$420,000	100%
Mo. Debt service	\$2,566	

Conventional		
Purchase Bldg.	\$350,000	
Renovations	50,000	
Soft Costs	<u>20,000</u>	
Total	\$420,000	
Bank – 1 st Mtg.	\$315,000	75%
Equity	<u>105,000</u>	25%
Total	\$420,000	100%
Mo. Debt service	\$2,166	20 yrs/ 5.5%



Benefits to the borrower

- ▶ Limits cash needed to as low as 10%.
- ▶ 504 second mortgage is fixed for 20 years.
- ▶ 504 second mortgage interest rate is generally at-or-below market rates (currently 4.8%).
- ▶ 504 second mortgage is exempt from mortgage recording tax.
- ▶ Bank has a 50% loan-to-value on the first mortgage. This enhances opportunity for approval and helps with ancillary financing needs that the company has with the bank (LOC, equipment financing, etc.).
- ▶ ESCDC works seamlessly with the bank.
- ▶ Transaction costs are financed.
- ▶ Can finance real estate, equipment and soft costs into one request.



Benefits to the Banker

- ▶ 50% Loan-to-Value first mortgage is an easy loan to approve.
- ▶ The 504 provides a competitive advantage to the lender that recommends it.
- ▶ ESCDC takes care of the SBA paperwork (“low-drag”).
- ▶ ESCDC can still integrate other economic development programs into the project (ie Linked Deposit, local economic development programs, IDA PILOT, etc.)



Daycare

Uses of Funds:		
Purchase Land	\$350,000	
Construct Building	607,500	
Soft Costs	30,000	
Total	\$987,500	
Sources of Funds:		
Bank – 1 st Mtg.	\$493,750	50%
ESCDC 504 – 2 nd Mtg.	395,000	40%
Equity	98,750	10%
Total	\$987,500	100%

In business for 10 years.

Relocating and expanding their daycare facility.

Loan was approved based on projected cash flow.

Equity came from a combination of cash and a Home Equity LOC.

Custom Vehicle Assemblies

	504		Bus Purch
Uses of Funds:			
Purchase Bldg.	\$600,000		
Purchase Equip.	300,000		
Soft Costs	20,000		
Purchase Business			\$100,000
Total	\$920,000		\$100,000
Sources of Funds:			
Bank—1 st Mtg/Lien	\$460,000	50%	
ESCDC 504—2 nd	322,000	35%	
Equity	138,000	15%	
Seller Debt			\$100,000
Total	\$920,000	100%	\$100,000

- ▶ Business is very unique and operating for 11 years.
- ▶ Current owner retiring and selling to 2 existing employees.
- ▶ Because the business is transferring ownership, 15% equity is needed instead of 10%.
- ▶ Retained 15 jobs and creating 3.
- ▶ Equity came from HELOC, liquidation of retirement, cash.
- ▶ Seller helped finance the sale.

Distribution Company

	Building		Equipment
Uses of Funds:			
Purchase Land	\$135,550		
Construction	8,998,609		
Contingency	546,000		
Soft Costs	360,274		
FF&E			\$1,616,213
Total	\$10,040,433		\$1,616,213
Sources of Funds:			
Bank – 1 st Mtg.	\$4,469,433	44.51%	
ESCDC 504 -2 nd Mtg.	3,971,000	39.55%	
IDA – 3 rd Mtg.	500,000	4.98%	
NY State Loan			\$ 616,213
FF&E Leases			1,000,000
Equity	1,100,000	10.95%	
Total	\$10,040,433	100.00%	\$1,616,213

Our challenge

- ▶ Recommend to bankers and economic developers to consider a 504 as “Option B” for every owner-occupied real estate transaction or fixed asset transaction you see!
 - ▶ 504 is able to be used by good, well established companies not just those that need a credit enhancement.
 - ▶ 504 second mortgage can go up to \$5.5 million.
 - ▶ 504 is able to be processed just as fast as a conventional loan request through a bank.
 - ▶ 504 can go up to 100% LTV in certain cases.



Excelsior Growth Fund (EGF)

On-Line Lending

OnDeck Capital Data

OnDeck Term 24 Rates as low as 19.99% APR for larger businesses with established credit history.

Term Length	12 – 24 months			
Loan Amount	\$50,000 – \$250,000			
Rate	19.99% – 39.99% APR			
For Businesses With	<ul style="list-style-type: none"> •3+ years in business •\$100,000+ per month in revenue •Strong business and personal credit •Frequent business checking transactions 			
Origination Fee	APR includes an origination fee of 2.5% of the loan.			



OnDeck Capital

Lender	Type	*Current Balance	Current Rate	Current Pmt	New Term (Mos)	New Int. Rate	New Pmt	Savings	Savings %
OnDeck Capital	Term	\$94,501		\$6,125.00	10	9.25%	\$1,209.92	\$4,915.08	80%



EGF is a Community Development Financial Institution (CDFI)

- ▶ NYBDC now has a CDFI. Task is to promote access to capital and local economic growth in urban and rural low-income communities.
- ▶ We are currently raising money to make small loans to New York businesses through an on-line expedited loan portal.
- ▶ EGF will also provide business consulting services to entrepreneurs and small business owners.
- ▶ Enter the space currently occupied by very high cost competitors such as OnDeck Capital, Biz2Capital, etc.



EGF Goals

- ▶ Loans up \$150,000
- ▶ 72 hour turnaround credit approval
- ▶ Rates of P+9%
- ▶ Business consulting
- ▶ No SBA enhancements



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