

Making the Case for Loan Participations

The Economics of It All

VOLUNTEER CORPORATE CREDIT UNION

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Introduction

Purpose of This Document

This paper is written to outline the economic benefits of buying and selling loan participations, including the balance sheet and income diversification benefits and how you can maximize those benefits by partnering with LoanStreet Inc. (LoanStreet), a business partner of Volunteer Corporate Credit Union.

What is a Loan Participation and What are the Regulatory Requirements?

In general, a loan participation is an arrangement under which a lender (the originating credit union) originates a loan to a member and then sells some portion of that loan to one or more credit unions. The basic requirements governing loan participations by credit unions are set out in Section 701.22 of the NCUA Rules and Regulations.

Common Reasons Why Credit Unions Buy and Sell Loan Participations

Credit Unions, both buyers and sellers of loans, choose to engage in loan participations for a variety of reasons, including generation of alternate income streams, balance sheet diversification and risk management. The table below outlines some of the most common reasons credit unions engage in loan participations.

Reason for Participation	Sellers	Buyers
Balance Sheet Diversification	X	X
Geographic Diversification		X
Manage to MBL Cap, Loans to One Borrower or other Concentration Limits	X	
Liquidity Management	X	
Asset Liability Management	X	X
Risk Management	X	X
Increase Non Interest Income	X	
Increase Interest Income		X

Loan Participations allow credit unions to add another tool to their risk management tool kit. The balance sheet diversification benefits include reducing concentration risk with respect to any single loan. For credit unions selling participations this occurs both by reducing the principal exposure with respect to sold loans. As a result, if a loan the selling credit union had participated were to default the seller's loss would be a fraction of its original exposure (and could be as little as 1/10th the original loan amount). The selling credit also improves its loan diversification (and reduces concentration risk) by using the cash from loan sales to make

additional loans to its members, thereby increasing the total number of loans on its balance sheet. By increasing the total number of loans, a selling credit union can also help reduce the overall impact a problem with any single loan.

For credit unions with lower overall loan demand purchasing loan participations will also help improve its balance sheet diversification. In particular, purchasing loan participations allows the buyer to increase its loan-to-share ratio and increase the total number of loans on its balance sheet. Similar to a selling credit union, the increased loan count mitigates the overall impact of performance issues with any single loan. Loan participations also allow a credit union to diversify their loan portfolio by purchasing a variety of different loans types, including business loans, without incurring the burdens of loan servicing.

Participations allow originating (selling) credit unions to make above lending limit loans or loans that would otherwise exceed member borrowing limits or regulatory caps. Plus, a robust loan participation network can provide a selling credit union with a reliable source of liquidity allowing it to continue to meet its member's loan needs.

In addition to being a tool for balance sheet diversification, loan participations can also add to a credit union's income in a variety of ways. For a credit union selling loans, a strong participation program allows it to increase its noninterest income through premiums received at the time of sale and servicing income over the life of the participation generated from servicing the loans on



“The sale of loan pools, has not only allowed us to continue to lend and avoid asset concentrations, but we’ve also seen very advantageous results on our balance sheet as well ...”

Ron Smith, CEO, ESCU

behalf of the purchasers. For example, \$10 million of participated loans with 50 basis points of servicing spread will generate approximately \$50,000 of servicing income per year. In addition, for the same \$10 million participation, each point of sale premium above par will generate approximately \$100,000 of non-interest income.

Loan Participations & LoanStreet's Services

Unfortunately, the traditional reaction from many credit union managers is that the costs of engaging in old-fashion loan participations seem to outweigh the benefits.

Many of these costs are well known to sellers and buyers including the necessity of making and receiving numerous phone calls, negotiation of participation agreements with each buyer/seller, reliance on a combination of core processors and Excel spreadsheets to perform pro-rata share calculations, calculation errors and manual preparation of participant reports, all of which require a significant commitment of time and labor. Credit unions often believe that the result of using loan participations as part of their strategic plan will be increased headcount and personnel expense. As a result, credit unions often avoid loan participations and as a result the potential financial gains are lost or wasted.

LoanStreet can help credit unions avoid many of these challenges and issues. LoanStreet is an end-to-end participation management solution that eliminates many of the manual processes that were traditionally part of managing loan participations. LoanStreet believes that automation is the key to improving execution and reducing costs while maintaining data integrity and security for all involved parties. LoanStreet clients can use the system to automatically connect with other credit unions on the platform to find potential purchasers directly through the platform.

In addition, LoanStreet's innovative platform simplifies the manual processes traditionally encountered in loan participations by, among other factors:

1. Providing a centralized, encrypted location where credit unions can upload all of the relevant loan level and credit union specific due diligence information
2. Providing a centralized and secure location for monitoring the performance of and accessing monthly reports for each loan participated on the platform
3. Providing an intuitive online marketplace for buyers and sellers of loan participations
4. Providing automated accurate monthly reports for all participants

Through these features, LoanStreet helps credit unions of all sizes efficiently and cost effectively establish and manage their loan participation program. Users quickly find that they are able to rely on the automation and standardization that LoanStreet offers to streamline the loan participation process, save time and ultimately earn more money. The result is a significant reduction in time and expense for all parties and all parties enjoying the gains available from a robust participation program.

VolCorp - Credit Union Member – Seller Case Studies

Volunteer Corporate Member-Selling Credit Unions			
Credit Union	Assets	Members	Staff with Prior Selling Experience
Electric Service Credit Union	\$64 Million	6,700	Yes
Holley Credit Union	\$55 Million	6,729	No

Electric Service Credit Union (Seller)

Electric Service Credit Union (ESCU) is a community based credit union operating in middle Tennessee. According to Ron Smith, CEO, “ESCU’s management team and board set up a tactical plan around our loan to share policy and thresholds for when we would sell pools of our loans. We (our team and board) are very conservative and wanted to maintain liquidity while continuing to lend. Borrowing funds at this stage of the tactical plan was not an option for us.”

According to Ron, in order for ESCU, “to meet the requirements of our tactical plan we needed a partner to help us facilitate the sale of our loan pools. We turned to LoanStreet due to our continuing relationship with VolCorp and have found the process to be very positive. I have had prior experience selling loan pools with previous institutions and *by far* LoanStreet has made sales much easier than with my previous institutions.”

“LoanStreet provides great loan pool packaging and pricing assistance. They first review the loans in the potential loan pool and provide various servicing options and the correlating pricing options.” These are easy to interpret, which allows ESCU “to know exactly how much we are potentially going to make and receive in servicing fees.”

According to Ian Lampl, CEO of LoanStreet, ESCU began their relationship with LoanStreet in 2016 and has sold around six pools of consumer loans to date. “We value clients like ESCU and look forward to continuing to build on this relationship.”

For ESCU, “the sale of loan pools has not only allowed us to continue to lend and avoid asset concentrations, but we’ve also seen very advantageous results on our balance sheet as well, because we retain servicing, the servicing spread we retain has continued to provide us with a monthly benefit.”

“Additionally, the month end reports provided by LoanStreet are very clear, concise and easy to read. This allows our accounting department to reconcile in a timely manner, ultimately saving us money.”

According to ESCU, other than minor adjustments to its tactical plan onsite reviews by its examiners post sale of its pools have been very positive.

Holley Credit Union (Seller)

Holley Credit Union (Holley) in Paris, Tennessee, has assets totaling approximately \$55 million and approximately 6,729 members. According to CEO, Van Bowden, “the reasons Holley began to sell were two-fold; we need to free up liquidity and reduce a concentration of indirect loans in our portfolio.”

Prior to joining the LoanStreet platform, Holley had no experience selling loan participations. According to Van, “LoanStreet was very helpful throughout the entire process. They looked at our portfolio and made suggestions on which loans to sell. They even made sure we recouped some of the indirect dealer fees that we incurred when we initially booked the loans. We did that by selling the loans at a premium.”

“We have a great relationship with LoanStreet and have found their monthly reports to be very thorough and timely. “



“They (LoanStreet) even made sure we recouped some of the indirect dealer fees that we incurred when we initially booked the loans.”

Van Bowden, CEO, Holley Credit Union

VolCorp - Credit Union Member – Buyer Case Studies

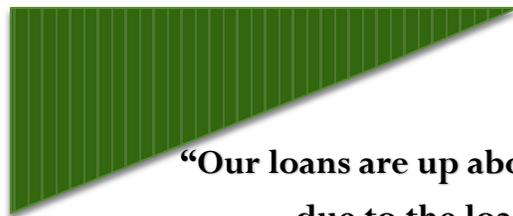
Volunteer Corporate Member-Selling Credit Unions			
Credit Union	Assets	Members	Staff with Prior Buying Experience
EPB Employees Credit Union	\$29 Million	2,400	No

EPB Employees Credit Union (Buyer)

EPB Employees Credit Union (EPB) in Chattanooga, Tennessee, has assets totaling approximately \$29 million and approximately 2,400 members. According to Trey House, EPB's Assistant Manager, more loans and a higher yield on the whole portfolio is what lead them to begin purchasing loan pools. By the end of June after their second purchase, Trey says, "Our loans are up about \$1.3 million due to the loan participation purchases and our income is up over \$2,000 per month. We've purchased even more loans since then, so the impact on EPB's financial condition is huge".

Trey says "his board was skeptical at first about buying loans from other credit unions, but they realized we needed to try something different to increase our income. Our examiners were happy to hear we were doing loan participations. We utilize our loan department to review the loans we are considering purchasing, so we don't expect any problems with the NCUA."

"We've found LoanStreet staff very helpful in answering questions regarding the process of purchasing loans. We also have found their month end reports easy to read and understand."



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Trey House, EPB Employees Credit Union

Conclusions: Why VolCorp Member Credit Unions Buy and Sell Loan Participations Through LoanStreet:

- Automated and cost efficient processes
- Clear, Concise and Timely Month End Reports
- Friendly Staff Willing to Work with Credit Unions of All Sizes
- Loan Pool Packaging, Pricing and Placement Assistance
- Immediate Positive Impact on Credit Union's Financial Results

In this paper, we have addressed many topics and issues related to the economic benefits of loan participations while also highlighting the successes credit unions have had maximizing those benefits through the LoanStreet platform. Credit unions of all sizes and all experience levels that partner with LoanStreet can use loan participations to create real and reliable sources of liquidity and diversified income.

Contacting LoanStreet and Additional Resources

Registration to the LoanStreet site is free of charge. For additional information about LoanStreet's products and services, please visit www.loan-street.com. For additional information and for assistance with registration, please contact Cassie Fivecoat, Series 7 & 53, Investment Representative, Volunteer Corporate Credit Union at 800-470-3444, Ext 7922 or cfivecoat@volcorp.org

