



OPTIMA

BANK & TRUST

Commercial Banking and Residential Mortgage Lending
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FOR THE NORTHERN NEW ENGLAND SCHOOL OF BANKING

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TOPICS FOR DISCUSSION

- **THE MORTGAGE CRISIS**
- **TRID**
- **PORTFOLIO & SECONDARY MARKET LENDING**
- **JOB OF THE UNDERWRITER**
- **THE SELF EMPLOYED BORROWER**
- **TYPICAL TYPES OF COMMERCIAL LOANS**
- **JOB OF THE CREDIT ANALYST**
- **INTERACTIVE CASE STUDY**

MORTGAGE CRISIS

SOME REASONS FOR THE MORTGAGE CRISIS:

- **MORTGAGES MADE TO CONSUMERS WITHOUT REGARD FOR THEIR ABILITY TO REPAY THE LOANS.**
- **LOOSE UNDERWRITING PRACTICES SUCH AS FAILING TO VERIFY CONSUMER'S INCOME OR DEBTS.**
- **QUALIFYING CONSUMERS BASED ON "TEASER" RATES THAT WOULD JUMP TO UNAFFORDABLE LEVEL.**

MORTGAGE CRISIS

CONSEQUENCES TO RESIDENTIAL AND COMMERCIAL LENDING:

- **VALUES OF PROPERTY WERE INFLATED AND BANKS HAD ADVANCED HIGHER AMOUNTS COMPARED TO THE VALUE OF THE PROPERTY, WHEN THE MARKET ADJUSTED THE PROPERTIES WERE UNDER WATER**
- **COMMERCIAL LINES OF CREDIT WERE IMPACTED AS WELL DUE TO THE UNEASINESS IN THE MARKETPLACE AND BANKS INCREASINGLY BEING CONCERNED ABOUT COLLATERAL VALUES AND ABILITY FOR A BUSINESS TO REPAY AS CONSUMERS GOT HIT HARD DURING THIS TIME**
 - THESE LOANS WERE ORIGINALLY UNDERWRITTEN ON INTEREST ONLY PAYMENTS BUT WERE NOW BEING MODIFIED TO P&I PAYMENTS AND IN MANY INSTANCES FROZEN OR REDUCED TO THE CURRENT OUTSTANDING BALANCE OR BEING DEMANDED ON FOR FULL REPAYMENT WHICH MADE IT DIFFICULT FOR THE BUSINESS CUSTOMER TO HAVE THE NECESSARY FUNDS AVAILABLE TO CONTINUE OPERATIONS

MORTGAGE CRISIS

RESPONSE TO THE MORTGAGE CRISIS:

- 2008 – FEDERAL RESERVE BOARD ADOPTS A RULE UNDER THE TRUTH IN LENDING ACT WHICH PROHIBITS CREDITORS FROM MAKING “HIGHER PRICED MORTGAGE LOANS” WITHOUT ASSESSING CONSUMERS’ ABILITY TO REPAY. THIS HAS BEEN EFFECTIVE SINCE OCTOBER 2009.
- 2010 – DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT IS PUT INTO PLACE BY CONGRESS. IT REQUIRES THAT FOR RESIDENTIAL MORTGAGES, CREDITORS MUST MAKE A REASONABLE AND GOOD FAITH DETERMINATION BASED ON VERIFIED AND DOCUMENTED INFORMATION THAT THE CONSUMER HAS A REASONABLE ABILITY TO REPAY THE LOAN ACCORDING TO ITS TERMS.
- DODD-FRANK AND THE RULE ADOPTED IN 2008 ARE SIMILAR BUT DODD-FRANK COVERS THE ENTIRE MORTGAGE MARKET NOT JUST HIGHER-PRICED MORTGAGES AND WE ARE INTRODUCED TO THE ABILITY TO REPAY AND QUALIFIED MORTGAGES

TRID

- **THIS IS THE TILA/RESPA INTEGRATED DISCLOSURE RULE.**
- **IT REPLACES THE GOOD FAITH ESTIMATE AND TRUTH IN LENDING STATEMENT WITH THE LOAN ESTIMATE**
- **IT REPLACES THE HUD-1 SETTLEMENT STATEMENT AND THE FINAL TRUTH IN LENDING STATEMENT WITH THE CLOSING DISCLOSURE.**
- **ON THE SURFACE IT WOULD APPEAR WE ONLY NEEDED TO LEARN A COUPLE OF NEW FORMS AND PAY ATTENTION TO SOME TIMING REQUIREMENTS OF THE RULE THAT ARE A LITTLE DIFFERENT THAN WHAT WE DID PRIOR TO OCTOBER 3RD.**

TRID

- **WHAT WAS NOT ANTICIPATED IS THAT THE VENDORS THE BANKS USE FOR THE SOFTWARE TO NAVIGATE THE PROCESS WOULD ONLY BE ABLE TO DELIVER A BARE BONES SYSTEM THAT JUST DOES ONLY EXACTLY WHAT IS REQUIRED BY TRID**
- **IT IS AN ENTIRELY NEW SYSTEM TO LEARN FOR SEVERAL DEPARTMENTS, WE HAVE TO TEST EVERYTHING AND MAKE SURE IT IS ACCURATE, IT DOESN'T HAVE ALL THE FUNCTIONALITY THAT THE OLD SYSTEM DID. I HAVE HEARD THAT SOME SYSTEMS WERE NOT EVEN READY TO TEST UNTIL RIGHT BEFORE OCTOBER 3RD AND I ALSO HAVE HEARD SOME BANKS CAN'T OFFER ADJUSTABLE RATE PROGRAMS UNTIL THE SYSTEM ISSUES ARE RESOLVED.**

PORTFOLIO LENDING

- **A PORTFOLIO LENDER IS A BANK OR OTHER LENDING INSTITUTION THAT MAKES MORTGAGE LOANS WITH THE INTENTION OF HOLDING THE LOANS IN THEIR INVESTMENT PORTFOLIOS.**
- **IT IS USEFUL WHEN A BORROWER DOES NOT QUALIFY FOR A CONVENTIONAL LOAN PROGRAM FROM FANNIE MAE, FREDDIE MAC OR FHA FOR EXAMPLE.**
- **PORTFOLIO LENDERS ARE MORE LIKELY TO BE SMALLER COMMUNITY BANKS, OFTEN PRIVATELY HELD, THAT HAVE MORE DISCRETION IN THE WAY THEY DO BUSINESS THAN LARGER, STOCKHOLDER DRIVEN INSTITUTIONS.**

PORTFOLIO LENDING

- **TO A TRUE PORTFOLIO LENDER, MORTGAGES ARE ALSO INVESTMENTS IN CUSTOMERS AND IN THE COMMUNITIES SERVED ALLOWING FOR GROWTH AND HELPING TO MAINTAIN A HEALTHY SOCIAL AND BUSINESS ENVIRONMENT.**
- **BY SERVICING A CONSUMER'S MORTGAGE OVER THE YEARS IT CAN HELP BUILD A SOLID, LONG-TERM RELATIONSHIP.**

SECONDARY MARKET LENDING

- **THE SECONDARY MARKET IS MADE UP OF INVESTORS, SUCH AS THE FEDERAL NATIONAL MORTGAGE ASSOCIATION (FANNIE MAE) AND THE FEDERAL HOME LOAN MORTGAGE CORPORATION (FREDDIE MAC) WHICH ARE THE LARGEST INVESTORS.**
- **FANNIE MAE AND FREDDIE MAC BUY LARGE NUMBERS OF LOANS FROM BANKS AND OTHER MORTGAGE ORIGINATORS AND THEN RE-PACKAGE THE LOANS IN GROUPS OF SIMILAR TYPE LOANS TO BE SOLD AGAIN AS WHAT ARE KNOWN AS MORTGAGE BACKED SECURITIES.**
- **THESE SECURITIES ARE TRADED LIKE STOCKS AND BONDS.**

SECONDARY MARKET LENDING

- **BANKS AT TIMES FEEL THEY HAVE TOO GREAT A PERCENTAGE OF ASSETS INVESTED IN MORTGAGE LOANS AND WILL DECIDE TO SELL SOME OF THOSE LOANS TO OTHER INVESTORS WHICH HELPS TO HEDGE RISK AND TO INCREASE LIQUIDITY.**
- **MANY INSTITUTIONS USE THE FUNDS RECEIVED FROM SELLING MORTGAGE LOANS TO MAKE FURTHER MORTGAGE LOANS. THIS IS BENEFICIAL TO A BANK THAT NEEDS A LARGER POOL OF MORTGAGE FUNDS AT A PARTICULAR TIME THAN IT CAN GENERATE FROM BANK DEPOSITS OR OTHER SOURCES.**

JOB OF THE UNDERWRITER

ASSESSING THE RISK OF THE BORROWER (THE 3 C'S)

- **CAPACITY AND THE DEBT TO INCOME RATIO - CAN THEY PAY THE MONTHLY PAYMENT**
 - 43% OR LOWER IS TYPICAL
 - TOOLS USED – PAYSTUBS, TAX RETURNS, BANK STATEMENTS
- **CREDIT AND THE SCORE - HOW IS YOUR PAYMENT HISTORY WITH OTHERS**
 - INDICATIVE OF YOUR HANDLING AND MANAGING THE REPAYMENT OF YOUR PAST BILLS AND HELPS IN THE DETERMINATION OF HOW YOU WILL HANDLE THE NEW LOAN REQUEST
 - 620 OR HIGHER IS TYPICALLY REQUIRED, CERTAIN FACTORS CAN CHANGE THAT REQUIREMENT SUCH AS LTV, PROPERTY TYPE, LOAN SIZE
 - TOOLS USED – CREDIT REPORT, BANK STATEMENTS
- **COLLATERAL AND THE LOAN TO VALUE - ASSESSING A PROPERTY'S VALUE AND ALSO THE TYPE OF PROPERTY IS VERY IMPORTANT**
 - PRIVATE MORTGAGE INSURANCE
 - RISKIER TYPES OF PROPERTY (INVESTMENT, CONDOS)
 - TOOLS USED – APPRAISAL REPORT, TAX CARDS, WEBSITES

JOB OF THE UNDERWRITER

TYPICAL INFORMATION NEEDED:

- **MOST RECENT 30-DAYS OF PAYSTUBS**
- **MOST RECENT TWO YEARS OF W-2S AND TAX RETURNS**
- **MOST RECENT TWO MONTHS OF BANK ACCOUNT STATEMENTS, INVESTMENT ACCOUNT STATEMENTS AND RETIREMENT ACCOUNT STATEMENTS**
- **PURCHASE & SALES AGREEMENT (IF APPLICABLE)**
- **AUTOMATED UNDERWRITING SYSTEMS**

THE SELF EMPLOYED BORROWER

- **HAS ALWAYS BEEN A DIFFICULT AREA DUE TO MANY FACTORS**
 - WRITING OFF AS MUCH AS THEY CAN OR NOT REPORTING ALL INCOME TO LIMIT TAX LIABILITY
 - LARGE SWINGS IN NET PROFIT YEAR OVER YEAR
 - MULTIPLE ENTITIES USED TO MOVE MONEY THROUGH THAT NEED TO BE DISSECTED TO FIND TRUE INCOME, AGAIN TO LIMIT TAX LIABILITY
 - ONE MAN/WOMAN SHOP OR A COUPLE AND THEY ARE NOT SAVVY WHEN IT COMES TO TRACKING INCOME AND EXPENSES AND THEIR REPORTING IS NOT TRULY REPRESENTATIVE OF WHAT THEY MAKE
- **2 YEARS OF HISTORICAL INCOME REPORTED ON TAX RETURNS IS ESSENTIAL**
- **IF CURRENT YEAR IS BETTER THAN HISTORICAL YEARS AND IS NEEDED FOR QUALIFICATION THEN CPA PREPARED INCOME STATEMENT AND BALANCE SHEETS ARE REQUIRED**

TYPICAL TYPES OF COMMERCIAL LOANS

- **COMMERCIAL REAL ESTATE MORTGAGES – USED TO PURCHASE OR REFINANCE A COMMERCIAL PROPERTY (COMMERCIAL USE PROPERTIES, MULTI-FAMILY OR MIXED USE PROPERTIES, COMMERCIAL CONSTRUCTION, LAND OR OTHER NON-RESIDENTIAL PROPERTIES). LOAN TERM IS TYPICALLY 20 OR 25 YEARS WITH THE RATE FIXED FOR THE FIRST 5 YEARS. RATE ADJUSTS EVERY 5 YEARS THEREAFTER.**
- **COMMERCIAL TERM LOAN – USED TO PURCHASE OR REFINANCE EQUIPMENT OR A COMMERCIAL VEHICLE. CAN ALSO BE USED TO FINANCE PERMANENT WORKING CAPITAL OR TERM OUT A LINE OF CREDIT. LOAN TERM IS TYPICALLY BETWEEN 5 AND 10 YEARS. RATE IS TYPICALLY FIXED FOR 5 YEARS AND THEN ADJUSTS. THE LOAN IS SECURED BY A LIEN ON THE EQUIPMENT FINANCED OR ALL BUSINESS ASSETS.**

TYPICAL TYPES OF COMMERCIAL LOANS

- **REVOLVING LINE OF CREDIT – USED TO SUPPORT ACCOUNTS RECEIVABLE OR SEASONAL WORKING CAPITAL NEEDS. TYPICALLY USED TO FINANCE SHORT TERM NEEDS. LINES OF CREDIT TYPICALLY OFFER A 1 YEAR TERM AND ARE RENEWABLE ON AN ANNUAL BASIS. RATES ARE VARIABLE AND ADJUST AS THE WALL STREET JOURNAL PRIME RATE ADJUSTS. MOST LINES OF CREDIT REQUIRE THAT THE BORROWER PAY THE LINE TO ZERO FOR 30 CONSECUTIVE DAY PERIOD ON AN ANNUAL BASIS. THE LOAN IS TYPICALLY SECURED BY A LIEN ON ALL BUSINESS ASSETS.**
- **SBA 7A AND 504 LOANS, BUSINESS FINANCE AUTHORITY– REAL ESTATE, EQUIPMENT OR WORKING CAPITAL LOANS BACKED BY THE U.S. SMALL BUSINESS ADMINISTRATION OR BUSINESS FINANCE AUTHORITY. THESE PROGRAMS ARE OFTEN USED TO REDUCE THE BANK’S EXPOSURE FOR HIGHER RISK TRANSACTIONS THAT THE BANK MIGHT OTHERWISE NOT FINANCE.**

JOB OF THE CREDIT ANALYST

THE 5 C'S OF CREDIT:

- **CHARACTER – HOW HAS THE BUSINESS AND THE PRINCIPALS OF THE BUSINESS PERFORMED ON THEIR PREVIOUS DEBT OBLIGATIONS**
 - DO THEY SEEM INTERESTED IN THE SUCCESS OF THE BUSINESS
 - IS MANAGEMENT SUFFICIENT FOR SIZE OF BUSINESS AND CAPABLE AS THE COMPANY GROWS
 - TOOLS USED – CREDIT REPORTS BUSINESS & PERSONAL, RESUME OF OWNERS, STANDING ON LOANS WITH THE BANK CURRENTLY, PERFORMANCE OF DEPOSIT ACCOUNTS, PERSONAL FINANCIAL STATEMENT, WRITTEN BUSINESS PLAN WITH FINANCIAL PROJECTIONS
- **CAPACITY – CAN THE COMPANY REALLY GENERATE ENOUGH CASH FLOW TO PAY BACK THE DEBT THEY HAVE AND THE DEBT THEY ARE REQUESTING**
 - PRIMARY SOURCE OF REPAYMENT
 - DEBT SERVICE COVERAGE RATIO, 1.2x OR GREATER IS TYPICAL
 - GLOBAL CASH FLOW
 - TOOLS USED – 3 YEARS HISTORICAL FINANCIALS AND INTERIMS, 3 YEARS BUSINESS AND PERSONAL TAX RETURNS, RENT ROLLS FOR LEASED PROPERTY, PERSONAL FINANCIAL STATEMENTS FOR ALL GUARANTORS, ACCOUNTS RECEIVABLE AND PAYABLE AGING
- **CAPITAL – CAN THE BUSINESS SUSTAIN A DOWNTURN IN THE ECONOMY AND COMMITMENT OF OWNER TO THE BUSINESS**
 - 20% - 30% IS TYPICAL, SKIN IN THE GAME
 - WAYS TO RAISE CAPITAL – OWNER'S CAPITAL (CASH INJECTION), RETAINED EARNINGS OF THE BUSINESS, PRIVATE INVESTORS, GRANTS AND/OR GOVERNMENT PROGRAMS (SBA OR USDA FOR EXAMPLE)

JOB OF THE CREDIT ANALYST

THE 5 C'S OF CREDIT:

- **COLLATERAL – SECURITY PLEDGED FOR A LOAN REQUEST**
 - DETERMINE QUANTIFIABLE VALUE TO BE USED IN A LOAN TO VALUE CALCULATION
 - SECONDARY SOURCE OF REPAYMENT, WHEN CAPACITY IS DIMINSHED THIS IS WHAT IS LEFT TO REPAY THE LOAN
 - PLEDGING OF PERSONAL ASSETS TO SHORE UP A DEFICIENCY OR UPSIDE DOWN COLLATERAL POSITION
 - TOOLS USED – APPRAISALS ON PROPERTY, EQUIPMENT LISTING AND DEPRECIATION SCHEDULES, STATEMENTS ON MARKETABLE SECURITIES
- **CONDITIONS – LOOKING AT ECONOMIC CONDITIONS OR DOWNTURNS THAT WOULD DIRECTLY AFFECT THE CAPACITY OF THE LOAN REQUEST**
 - INDUSTRY SPECIFIC AND AREA SPECIFIC ISSUES NEED TO BE ASSESSED

JOB OF THE CREDIT ANALYST

TYPICAL INFORMATION NEEDED:

- **A COMPLETED PERSONAL FINANCIAL STATEMENT FOR ANY PRINCIPAL THAT OWNS 20% OR MORE OF THE BUSINESS**
- **MOST RECENT 3 YEARS OF BUSINESS TAX RETURNS FOR THE APPLICANT AND ANY RELATED ENTITIES**
- **MOST RECENT 3 YEARS OF PERSONAL TAX RETURNS FOR ANY PRINCIPAL THAT OWNS 20% OR MORE OF THE BUSINESS**
- **CURRENT YEAR INTERIM P&L, BALANCE SHEET, AND ACCOUNTS RECEIVABLE/PAYABLE AGING SCHEDULE THROUGH THE MOST RECENT QUARTER END**
- **COPY OF A PURCHASE AND SALES AGREEMENT OR INVOICE (IF APPLICABLE)**
- **BUSINESS PLAN WITH PROJECTIONS (FOR ANY COMPANY THAT HAS BEEN IN BUSINESS FOR LESS THAN 2 YEARS)**
- **RESUMES ON THE PRINCIPALS OF THE BORROWING COMPANY**

INTERACTIVE CASE STUDY

Case Study 1: Mortgage Loan

Bill & Mary are very excited to be buying their first house. They come to you as a referral from a broker who has worked with you in the past and you did such a great job she is sending another client to you. Bill is the Athletic Director at a local college where he started 3 years ago and loves his job, which is why they have decided to settle down in this area and no longer commute over an hour just because their parents want them to stay close to them. Mary also has been working in this area for 1.5 years and prior to her current job did some part time work while she was looking for about 8 months, she is also at the local college as an administrator in the financial aid department. Their parents aren't thrilled with the move which takes them an hour away but are supportive and willing to help them with whatever they need.

Case Study: Mortgage Loan

Jim & Kelly are looking to buy a new primary residence in a quieter part of town. Their kids are grown and they have no use for all the square footage in their current home which they own.

They have found a condo in town and are excited about moving there, it is right near restaurants, theatres and shops which they love going to. Jim is a Computer Engineer who has been in the business for 20 years however did just switch employers a little less than a year ago that has more bonus potential but a lower base salary, he has historically received bonus payouts but they have varied quite substantially over the past two years. Kelly is self-employed and works as an interior designer with a lot of real estate brokers you know to stage homes for sale and has been doing it for 7 years.

Case Study 3 Commercial Loan

Borrower ABC Industrial Fasteners Inc.

Company Age: 0

Size: Start up

Ownership/Management Joe Jones

Industry Industrial Fasteners-nuts, screws, bolts, washers, clips, etc

Market: Domestic

Request: 1) \$400K Asset based line of credit

2) \$ 20K Equipment loan -

Case Study 4 Commercial Workout Loan

Borrower:	Foodie Inc.
Company Age:	10 yrs.
Annual sales:	\$8 million
Ownership:	Bob and Regina Smith 50% each
Industry:	Manufacturing- Food products, condiments, sauces, marinades,
Market:	Domestic
Request:	<ol style="list-style-type: none">1) \$3 million term loan for the purchase of another business, (a leveraged buyout) including equipment, recipes, inventory, licenses and goodwill.2) \$ 1.0 million Line of credit to support growth in A/R

Thank You!

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