OFN CONFERENCE 2016 RETHINK

Identifying a Set of Financial Covenants that Work for Your Organization

Wednesday, October 26, 4:15-5:30 PM

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Presenters

Moderator

- Beth Lipson, Interim CFO & EVP, Strategic Initiatives, OFN

Panelists

- Christina Travers, VP & Treasurer, LISC
- Jacki Robinson, CFO, NJCC
- David Wedick, CFO, CEI

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Agenda

- Introduction to Topic
- Questions to Panelists
- Interactive Questions to Audience
  - Small group discussion
- Q&A

Reference Handout: Sample covenants of three CDFIs

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Goals of Performance Counts

- Achieve greater consensus in financial metrics, financial statements, and financial reporting
- Streamline reporting and create clearer messaging by CDFIs
- Ultimately enable increased access to capital
  - Easier for current and prospective investors to understand financial statements and financial wherewithal

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Performance Counts

- Industry led
- Participation by approximately 15 CDFIs (primarily CFOs)
  - Diverse (type, size, geography)
  - Rotate participation annually
- Managed by OFN
- Accounting (and Legal) Advisors
- Input from the CDFI industry
- Input from Investors, Funders, and other key stakeholders

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Publications and Online Community

- Published 3 papers to encourage standards and best practices
  - Net Assets and Grants
  - Portfolio Definitions and Reporting
  - Liquidity and Cash Management
- Online Community for CDFI CFOs and Finance professionals
  - Post documents, ask and answer questions
  - More than 100 people in the community
  - Private community to enhance transparency and questions (excludes investors, auditors, and funders)

Why Topic of Covenants

- Many CDFIs have upwards of 30 financial covenants
  - Some as high as 100-150 unique calculations
- Need to streamline process for both CDFIs and investors
  - Example: 6-8 FTE days to complete and distribute investor financial reporting packages for a CDFI
  - Benefit investors to have more conformity within their portfolio and to be more consistent with other investors in a particular CDFI
- Will never have a single set of financial covenants for all CDFIs

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Questions to Panelists

- Briefly describe your organization and the corporate structure of your organization
- Describe the number of covenants your organization currently manages and the any processes you have taken to streamline the number or complexity of covenant
- How did you select the primary covenants your organization has and what factors related to structure, products, size, type of organization contributed to selecting those covenants
  - Primary covenants in 5 areas
- What is your biggest challenge in managing your covenants.

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Primary Covenant Areas

- Leverage
- Liquidity
- Portfolio Quality
- Security

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Small Group Discussion

- What are the challenges you are facing related to covenants
- What can the industry do to help mitigate challenges CDFIs faces
- Report back on small group discussion and reflection of panelists on those topics.

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Q&A

- What other questions do you have of panelists

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Handout for Session
Identifying a Set of Financial Covenants that Work for Your Organization

Enclosed are sample financial covenants utilized by the three CDFIs on the panel which will be discussed at the session. OFN, Performance Counts, or the CDFIs on the panel are not endorsing these covenants to be used by the industry. We are presenting them for discussion purposes only.

CEI Sample Financial Covenants

Leverage (Sustainability – Net Asset Growth)

1. Average Change Unrestricted Net Assets ≥ 0 over past 3 fiscal years - ANNUAL

Leverage (Financial/Balance Sheet)

2. Net Assets / Total Assets ≥ 25% - QUARTERLY

3. Unrestricted Net Assets ≥ 20% of Total Assets – QUARTERLY

Liquidity Ratios

4. Operating liquidity
    - (Unrestricted cash & cash equivalents + cash & cash equivalents restricted for operations) / (TTM Total Expenses net of non-cash expenses) ≥ 3 months – QUARTERLY

5. Capital liquidity
    - (Cash & Equivalents + 80% of Current Loans Receivable) / Current Liabilities ≥ 100% – QUARTERLY

Portfolio Quality

1. Loans > 60 days past due plus non-accruals, TDRs & impaired loans ≤ 12% of Notes Receivable – QUARTERLY

2. Trailing Twelve Month ("TTM") Net Charge Offs ≤ 10% of Notes Receivable – QUARTERLY

3. Loan Loss Reserve to be maintained at the level indicated by internal risk assessment of loan portfolio and consistent with Generally Accepted Accounting Procedures (GAAP) - QUARTERLY

LISC Sample Financial Covenants

Covenant Net Assets Definition

Net Assets

LESS: equity investments in affiliates, discounted long term and short term receivables, & other minor discounts

Leverage

1. Debt (including off balance sheet guarantees) < 450% Covenant Net Assets (quarter-end)
   < 350% (year-end)

2. Assets < 650% of Covenant Net Assets

Liquidity

3. Capital Liquidity- 6 months debt service < Unrestricted cash & investments +
   50% principal due on loans receivable (6 months) +
   Committed lines of credit (maturity exceeding 6mo) +
   50% of annual budgeted interest income

4. Operating Liquidity- 6 months unrestricted operating expenses < Unrestricted operating cash & investments

Portfolio Quality

5. Non-Performing Assets (delinquent < 90 days + other non-accruals + restructured + other real estate owned) < the greater of 15% of the loan portfolio or $40 million

Secured Debt

6. Value of collateral on which LISC has granted a lien to secure recourse indebtedness < 20% assets LESS value of credit enhancement funds

Guaranteed Indebtedness

7. Guarantees of affiliate indebtedness < $15 million

NJCC Sample Financial Covenants

Leverage

1. Net asset ratio of at least 20%

Or

2. Ratio of (i) total liabilities less equity equivalent investments less CAPC non recourse debt to CLF by (ii) total unrestricted net assets plus equity equivalents investments shall not exceed 4:1.

Liquidity

3. Ratio of the Borrowers Unrestricted cash, plus Unrestricted cash equivalents, plus 50% of current portion of loans receivable to Loans Payable due in one year or less shall not be less than 1:1

Portfolio Quality

4. Over 90 day delinquent loans to be not greater than 10% of the Gross Loans Receivable.

5. Loan Loss Reserves calculated in a manner consistent with GAAP and approved by external auditors.

Secured Debt

6. Borrower may enter into secured debt if such debt is non-recourse to the borrower and is not secured by any assets of the borrower other than property acquired with the proceeds of such indebtedness

And

7. Borrower may enter into secured debt that is full recourse to borrower and is secured assets of the borrower other than assets acquired with the proceeds of such indebtedness only if the secured party is a department or agency of the U.S. Government, State/Local Government, Federal Home Loan Bank or similar entity.