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Increasing Value: Lender Checklist for Consumer Loan Portfolios

Many of today's resort developers are looking for advice on consumer loan receivables or want to sell their portfolios. Perhaps they are looking to free up either capital or cash to continue fueling their sales growth or to invest in new projects that will provide better yields than what they are earning by current loan portfolios. Or maybe they're under pressure to reduce their current levels of debt employed to finance their loan portfolios. Some just don't want to have all their eggs in one basket and consequently want to reduce the risk to their balance sheets by replacing their loan receivables with cash or T-bills. Finally, others have discovered that their competency is not in consumer loan financing and wish to focus their efforts only on their core competencies—building, selling, and managing their resorts.

Even through what economists and financial commentators are now calling the worst financial crisis since the Great Depression, there continues to be a strong market for consumer portfolios. The catch is: the price of such a portfolio is a function of its "quality." By "quality," I do not mean 800 FICO scores with the borrowers having a net worth of $1 million—I mean quality information. It is the provision of details about (1) your portfolio, (2) each borrower in the portfolio, and (3) your company and resort that build quality in the investment.

I am always amazed when presented with a consumer portfolio where all the seller can provide is the balance, interest rate, and monthly payment for each loan. This same seller would demand far more information if s/he were buying a security equal to the value of what was being offered. Yet, sellers of receivables portfolios are surprised when asked to provide more information. Many developers don't realize that to create and maintain value in their consumer portfolios, they need to obtain and manage the right information from the beginning of the loan application process, continuing then to generate this information over the life of the loan. Otherwise, how do you know what the value of portfolio is and what a fair price will be when you sell it?

So, what does it take to build this "quality portfolio?" What are the questions you need answered first? Here's a checklist of what most lenders typically ask, so you're prepared and can maximize your return.

1. Are your sales contracts, loan agreements, and supporting documentation enforceable?

Did a knowledgeable law firm review your documents to provide an informed opinion that your documents are lawful and enforceable in both resort's jurisdiction and in the borrower's jurisdiction? I've discovered resort developer documentation that is defective—which could turn into a class action lawsuit.

2. Is your documentation prepared correctly?

You've just spent the price of five brand new Porsches on legal opinions, but are you and your team following your lawyer's advice about completing the documents? Does anyone in your office thoroughly review and vet the contracts for accuracy and correctness? Twenty percent of contracts in one of the consumer portfolios we reviewed could not be purchased due to documentation errors. Most people could retire on the amount of money this 20 percent represented.

3. Would a bank or credit union use your credit applications? Are all of the fields in the application completed? Are they accurate?

Portfolio buyers need more information than just the borrower's name, address, and phone number. You should be able to provide their date of birth, Social Security Number (or Social Insurance Number for Canadians), income, length of residence, monthly shelter payment, and, if they own their residence, the value of the property and mortgage balance. Without these details, it is difficult to determine a borrower's true credit rating and their ability to service their monthly payments.

Do you check to make sure the information collected is true and accurate? Nearly 40 percent of the applications we reviewed in one portfolio had misrepresentations that were attributed to two of the seller's salespeople. All of this information will become more necessary as the lending standards only continue to tighten.

4. Do you have a credit policy? Do you follow it?

Set up your credit policy and understand the implications of the standards you set. Having an "everyone qualifies no matter what" credit policy versus one with some specific qualifications will mean the difference between an extravagant or reasonable commitment fee. Establishing and following a consistent credit policy saves time when it comes to the buyer's due diligence process, for rather than auditing every file (which is also expensive), the buyer will review only a sample of loans. It also provides a higher degree of comfort.

5. Can you provide a summary data of a portfolio in an Excel spreadsheet?

The summary should include all the customer information cited in point 3, plus purchase price, down payment, opening loan balance, current loan balance, interest rate, payment, term, amortization (if different from the term), payment date, status (current, past due, paid), etc.

6. Are you able to provide your historical portfolio monitoring reports and analysis?

It's key to have monitored reports that show several years of monthly delinquency stratified by months past due, write-offs, and early payout reports. Static pool reports and analysis for delinquency also improve the value of your portfolio, as you and the buyers can use this information to build forecast models for the portfolio's expected cash flows over time.

7. Are loan transactions histories available for each loan?

Ideally, these should be provided to a buyer as an SQL database, but it is generally provided by developers in paper format. The information provided should show the opening balance for each month, interest charged, monthly payment, and dates for each activity. Otherwise, it is very difficult to prove an outstanding balance to a customer.

8. Is your resort financially sound? How satisfied are your customers?

Consumer legislation in most jurisdictions will invalidate a loan agreement if the goods or services are not provided as contracted. This risk is inherent in all resort developer portfolios. However, the risk can be mitigated by the financial strength of your company, your resort's operational history, and customer surveys results. Be prepared to provide sufficient information to make a buyer confident that you really are a great company and that a consumer decision's to invest is sound.

9. What representations and warranties will you provide?

Regardless of how great a portfolio is, there will most likely be borrower defaults on some intervals. When the time comes

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for the lender to sell off these intervals, you need to give all the help you can. What's best for you? You may choose to remarket the lender's intervals or buy them back at fixed price. The stronger your representation and warranties, the more valuable your portfolio will be.

10. Will your buyer treat your customers with the professionalism and respect they deserve?

You find a buyer willing to pay you more than the price you expected. That sounds great, right? However, if their customer service and collection departments do not deliver a satisfactory customer experience, this better price could be illusionary. We have all heard horror stories of how good resort customers are lost due to an unprofessional collector's rude call to a customer for overdue payment.

Both you and your portfolio buyer are going to partner until the borrower's loan is repaid, so make sure you choose one whose business practices align with yours. The buyer needs you to keep providing a quality experience, and you need the portfolio buyer to treat your customers right—a satisfied customer is the best promoter.

Wrap-up

This can be a lot to consider and handle and can require extensive personnel, expertise, and time to ensure maximum value. Often companies will underwrite and buy loans at the point of sale to handle the ongoing management, credit/risk management, customer service, and collections for the developer. Regardless of what option you choose, these 10 questions are top issues everyone should consider for today's consumer loan portfolios. D

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