Portfolio Management Basics:

- Philosophy (and psychology)
- Approach
- Techniques
First things first …

What are you seeing in your portfolio?
Our work is our harbor

- Our mission is *empowerment*
- Our method is *service*
- The *magic* is the *change* our clients create in the world

Collections as a deep connection

- It is the most intimate *mission-centered* part of what we do
- It is the time to deliver the *value* we’ve promised our clients
- *How you feel* about this work will show – especially now
Psychology matters in collections

Behavioral psychologists tell us:
• Ambivalence and resistance to persuasion are core human traits.
• Motivation is formed in the context of relationships.
• No one is completely unmotivated.
• We tend to believe what we hear ourselves say.

Your psychology matters

• If you’re arguing for change, you may be in the wrong role.
• Help the client discover how he/she can make changes.
• People respond to options, not obstacles.
• Remember your kindergarten fire safety rule!
Your approach makes the connection real

• Invest early and often in the relationship

• Give your collectors the right tools

• Have fun!

• Seriously, fun is possible!

Good quality must start early

• Marketing and outreach
  – Messages that support philosophy

• Credit application process
  – Offers value, is thorough

• Underwriting
  – Codified, clear standards

• Ongoing account education
  – Send regular statements

• Great customer service at every step!
Good collectors need good protocol

- How does your organization define key terms?
- Who’s collecting and when?
- What expertise and resources are available? (i.e. legal, auction, repo, etc.)

### An example

<table>
<thead>
<tr>
<th>Calendar Days</th>
<th>ACTION</th>
</tr>
</thead>
<tbody>
<tr>
<td>y 1-3</td>
<td>- Call(s) to client/guarantees from Portfolio Quality Team (minimum 1)</td>
</tr>
<tr>
<td></td>
<td>- Auto DQ letter (Day 1) generated, mailed &amp; logged in client file</td>
</tr>
<tr>
<td></td>
<td>- Add optional personalized note to Day 1 letter</td>
</tr>
<tr>
<td>y 4-10</td>
<td>- Continued calls to client/guarantees (minimum 2), including the use of blocked call (60%) or work cell phones</td>
</tr>
<tr>
<td></td>
<td>- Auto DQ letter (Day 5) generated, personalized note added, mailed and recorded in TREA.</td>
</tr>
<tr>
<td></td>
<td>- If first payment default, site visit is conducted</td>
</tr>
<tr>
<td></td>
<td>- Call all references, including sales desk members</td>
</tr>
<tr>
<td>y 11-19</td>
<td>- Site visit conducted for loans &gt; $5,000</td>
</tr>
<tr>
<td></td>
<td>- 2nd site visit for first payment default</td>
</tr>
<tr>
<td></td>
<td>- Auto DQ letter Day 10 generated, mailed &amp; logged in TREA</td>
</tr>
<tr>
<td></td>
<td>- Continue calls</td>
</tr>
<tr>
<td>Day 20-23</td>
<td>- Auto pre-demand collection letter sent with past due note, time frame when ‘demand’ to accelerate full repayment of loan will be sent, urgent confidential envelope, logged in TREA</td>
</tr>
<tr>
<td></td>
<td>- Continue calls</td>
</tr>
</tbody>
</table>
Injecting fun and joy is key!

• How do you regularly celebrate your portfolio quality activities?

• What do you do to care and nurture your frontline folks?

• When was the last time you changed the routine to inject some fun?

Breakout session

• Your team has just made a loan to a borrower they think could make a good future success story and he fails to make his first payment. What’s next?

• Consider philosophy, approach and techniques
Breakout session

• One of your portfolio’s all-stars has just slipped into the 31+ bucket for the first time. What do you do?

• Consider philosophy, approach and techniques

Technique 1: Prioritization

• Follow your protocol
  – That should start Day 1 of delinquency!

• Schedule activities
  – What are the best times to reach clients?

• Set goals!!
  – No. of calls per day, week or month
  – $$ collected per week or month
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Technique 2: Current information

• Are you pulling regular reports on the aging of your portfolio?
  – Look for movement between buckets
• Calculate average dollar amount past due as a starting point:
  – Outstanding $/# of DQ accts = ave. past due balance
• Are you tracking communication?
  – That log is a critical tool

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Technique 3: Preparation

• Before the call
• Your opening
• Overcoming objections
• Motivational appeal
• CLOSE the deal
• Follow up
Technique 4: Practice makes perfect

- Do your collectors have an opening that feels comfortable and is effective?
- Do your collectors walk through options beforehand?
  - An empowering option for new collectors
- What’s your motivational appeal?
  - Core values; honest broker; maintain good credit; future business

Portfolio management is problem-solving

- Strong portfolio performance helps us all
- Portfolio managers need to be effective problem-solvers
- Relationships matter
Know Your Portfolio

- Develop relationships in the good times
- Collect and analyze financial statement
- Call borrowers to discuss results
- Work collaboratively to forestall problems

Protect Your Sanity

- These are hard times for borrowers and lenders, find common ground
- See yourself as a problem-solver, not an enforcer
- Celebrate small victories every day
Remember the fundamentals

• A great portfolio doesn’t just happen!

• Stick to the basics:
  – Straightforward and transparent credit application process
  – Sound underwriting
  – Great customer service
  – Early intervention
  – Enforcement of contractual obligations

Breakout Session 2

Your borrower has a seasonal business, and this year he’s 31+ days delinquent going into the slow time. Collateral includes subordinate liens on business and personal real estate, equipment and vehicles. She wants a payment plan over the winter. How do you respond?
Your borrower’s retail location burned this week. His insurance won’t cover all his losses; he’s trying to decide whether to close the business, file bankruptcy or to rebuild.

Trouble may be coming – now what?

• Check your docs!
  – Be sure the original loan documentation is in order
• Chat up the borrower
  – Now is the time to emphasize relationship
  – decide who
  – Dig until you find the reason for trouble
• Pull a credit bureau
  – Recent activity can reveal a lot
• Are there other lenders involved to consult?
Trouble may be coming - now what?

- Know where your collateral stands
  - Are landlord waivers and subordination agreements in place?
  - Are you sure your lien position is perfected? (check UCC status, mortgage/deed status)
  - Is it where you expect it to be and in the condition you expect?

- Know where Uncle Sam stands
  - Tax liens can throw a major wrench in your plans

Constraints to consider

- Covenants to grantors or funders
- Audit procedures
- Loan program guidelines
Be aware of lender liability

- Follow through on your agreements and honor your contracts
- Make sure your records are accurate
- Follow your procedures consistently
- Be very careful about giving advice to borrowers

If you don’t have procedures, where should you start?

- Consistency with mission and goals
- Clarity
- Flexibility
- Efficient decision-making authority
- Everyone understands the rules
And when there are no warning signs?

- Step 1: As soon as a borrower becomes delinquent, make contact!
  - Determine nature of the problem
  - Other lenders and status of those loans?
  - Are other obligations delinquent? (rent, taxes, personal mortgage, insurances)
  - How is the business operating? Is it a cash-timing issue or a lack-of-work issue?
  - What is status/condition of business assets? (receivables, inventory, equipment)
  - Is the borrower cooperative?

First sign of trouble is delinquency

- Get updated financials and projections, including cash flow analysis.
- Can accountant join you and the borrower to discuss performance?
- What’s creating the cash flow problem, and what does the borrower plan to do about it?
- Evaluate the borrower’s state of mind – a lot of coaching and questioning may be necessary to get to the heart of the issue.
Now evaluate your options

• Step No. 2: Understand and evaluate your options
  • Modify the loan on a short-term basis
  • Find additional supportive lender(s)
  • Available consultants to provide support?
  • Provide additional funds with appropriate controls and expectations
  • Get more detailed financial information to track progress closely
  • Allow borrower time to cut costs/sell assets to get back on track
  • Develop cooperative work-out plan

And if it still goes from bad to worse?

• You already have a handle on your options
• Determine a realistic and probable outcome:
  – Is the company itself viable? (Could management turn it around? Do they need a consultant?)
  – What position are other lenders taking? A common approach may help all parties.
  – Is there a viable market for the product or service? Are vendors supportive?
  – What are the key factors that will support success?
And if it still goes from bad to worse?

- Is there anything left to work with?
- If you need to liquidate:
  - What are the major, salable assets?
  - Do you have access to the assets?
  - How easy will it be to sell the assets?
  - What are likely auction values?
  - What are the carrying costs of obtaining, storing or maintaining assets?
- What are the probable carrying costs?

Consider making demand

- You should have correspondence at this point regarding delinquencies and planned actions.
- Making demand is a necessary step to legal proceedings.
- Can alienate and frighten a borrower into non-cooperation.
Understand timelines and triggers to achieve success

- This is a moving target in many cases, so be flexible
- Communication and cooperation are key
- Seek out appropriate legal and auctioneer counsel to understand specific courses of action

And when liquidation is your last option

- Engage counsel
- Declare default and make demand
- Assess the likely realizable asset values versus costs
  - legal, auction, rents, utilities, and any other ancillary costs as part of the process
- Have counsel determine necessary legal steps and timelines (including guarantor pledged assets)
- Determine whether it’s better to liquidate
  - You may be better off not proceeding
More on liquidation

• Consider fallback positions and possible outcomes
  – Ex: Guarantees secured by houses
• Consider whether a borrower or guarantor will provide a deficiency note and continue to make some payments after business closure
  – If you are cooperative, they may be as well
• Consider with borrower potential buyer for the business as a going concern with your cooperation (and potentially your financing)

Short Sales

When you know that the price is right, this may be your best option.

Protect yourself:
  Document your agreement
  Approve proceeds
  Make sure that buyer is not a shill for borrower
  Reserve your rights against guarantors, unless you have waived this issue
  Clear escrow instructions
Does bankruptcy mean game over?

What steps to take to prepare for possible bankruptcy

• Choice of counsel is key
• Discuss options and strategy before filing

What to do when a bankruptcy notice hits your desk without warning

• First step: alert staff of the filing
• Stop letters and phone contact
• Call your attorney

Bankruptcy details

• Bankruptcy filing automatically protects debtors and their property from creditor actions - the "automatic stay"
• In exchange for bankruptcy protections, debtor provides full disclosure of its financial condition to creditors and the court
• Bankruptcy types we most often see:
  Chapters 7, 11, 13
• 2005 Bankruptcy Abuse Prevention and Consumer Protection Act
Chapter 7 - Liquidation

- Straight, complete or total bankruptcy
- Trustee liquidates assets for creditors' benefit
- To qualify, debtor must meet a means test
- For individuals, married couples, partnerships and corporations
- Some assets are exempt; exemptions vary by state.
- At conclusion, debts are discharged or canceled.

Chapter 13 - Reorganization

- Adjustment of Debts of an Individual with Regular Income – a.k.a. “working man’s bankruptcy”
- Used by debtors who don’t qualify for Chapter 7; may allow debtors to save homes from foreclosure
- 3- to 5-year plan must repay as much secured and unsecured debt as possible; trustee makes payments
- Debtor must complete plan in order to receive a discharge; may be converted to Chapter 7
Chapter 11 – Business Reorganization

- Usually filed by debtors with substantial assets or debts
- Complicated and expensive
- Bankruptcy estate is managed by a court-appointed trustee
- Creditor options: move for relief from stay, dismissal, influence bankruptcy plan

Chapter 11 Plans

- Debtor has exclusive right to file a plan for first 120 days
- Must file a disclosure statement with information to allow creditors to evaluate plan
- Reorganization plan approved by court
- Some debts may be paid, others discharged
Myths you can help dispel!

- “It’s the economy’s fault”
- Being a good collector = years of collections experience
- Collections = clean-up work
- Collections ≠ fun

Resources and suggested readings

- Training:
  – Your state’s independent community bank association or chapter of the American Bankers Association (www.aba.com)
  – Risk Management Association www.rmahq.com
- Readings:
  – Crucial Conversations: Tools for Talking When the Stakes are High, Patterson, et al., 2002.
Thank you and good luck!

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