

Questions & Responses

David Johnson, Acting Chief, Division of Capital Investment, Office of Indian Energy and Economic Development, Office of the Assistant Secretary – Indian Affairs

1. What is the turnaround time from application to closing?

Supposing a complete application, we typically review and provide an answer within 30 days. Being somewhat short-handed at the moment; however, larger and more complex applications have recently been taking a little longer than that.

2. For the loan insurance program, what does the process look like as far as a timeline and also, is the Institution responsible for underwriting?

Once a lender has been approved for our Program by receiving a signed copy of our Loan Insurance Agreement (copy available on our website, www.bia.gov/DCI), the next step is to request an allocation of insurance ceiling, a designation of the total dollar amount of loans the lender is authorized to issue with Program insurance. We typically offer ceiling in \$500,000 increments, which we specify in writing must be used by a certain date, after which we may withdraw it for use elsewhere. While an insured lender has a ceiling, it is 100% responsible for using it in accordance with Program requirements, including proper underwriting.

3. David, can you talk a little bit about the interest subsidy program?

In addition to the answer just provided, insurance is a good fit for smaller deals, particularly those with good numbers but that are located in geographically remote areas the lender would otherwise avoid because they're difficult to monitor. One of the main benefits of insurance is that if the loan amount is \$250,000 or less, the lender can approve the deal on its own initiative and simply supply appropriate notification along with the premium payment after the deal is closed. Also, the insurance premium is less in the case of insurance – 1% of the insured portion of the loan, rather than 2% of the guaranteed portion of the loan when using a Program guarantee. If there is a loan default, however, the lender must liquidate all collateral before making an insurance claim on any deficiency there may be. Also, there is a statutory cap on the amount the Program can pay an insured lender: the lesser of 90% of a given loan, or 15% of the lender's then-portfolio of Program insured loans. In essence, this means that a lender should build up a portfolio of 7 or so similar sized loans to have any one of the insured at the 90% level. Remember, however – all Program guaranteed or insured loans may be bought and sold with their guarantees and insurance intact. A lender wanting to go into the insured element of our Program could therefore originate an insured loan, and then buy several other insured loans from other lenders. Voila – each loan is now individually insured at a full 90%, as long as only one fails at a time.

There is no reason a lender seeking Program coverage for a loan over \$250,000 or interest subsidy (discussed in answer 10) can't use insurance, but the application must be approved by DCI beforehand.

4. Can you discuss again the process when a loan goes into default?

First, the lender should be clear that DCI's definition of "default" in 25 CFR §103.44 controls this discussion. A lender doesn't get to casually ignore a major covenant violation or a long string of very late payments because it doesn't yet feel that its loan is threatened. Our rules require notice to DCI within 60 days whenever a borrower's default goes uncured. We then

require that a lender formally announce its chosen remedy within 90 days if the borrower's default remains uncured.

The choices are to try to negotiate a loan modification that permanently cures the default, or to liquidate loan collateral (and if there is a deficiency after completing that process, making a claim for loss on the unpaid portion of the loan), or to make an immediate claim for loss on the entire loan before liquidating any collateral. (Lender do not get to partially liquidate a loan by cherry-picking easily liquidated assets, and leaving the hard ones for DCI to pursue.) The claim form is fairly straightforward, but must be submitted along with background information, such as a payment history and copies of relevant correspondence with the borrower.

DCI typically renders decisions on a claim for loss within 60 days of receiving a complete claim.

5. Which Native CDFIs have used the ILGP?

Arizona Tribal Community Development Financial Institution (dba Native Capital Access), Cherokee Nation Economic Development Trust Authority, Citizen Potawatomi Community Development Corporation, Four Bands Community Fund, Inc., and The Lakota Funds have all used loan insurance; some of these may also have secured loan guarantees. We have other CDFIs who have signed up either to use our loan guarantees or our loan insurance, but I cannot off the top of my head confirm that they've actually used Program resources yet.

We're updating our lender records at the moment, as well as our files on guaranteed and insured loans, so forgive me if this list is incomplete. Rather than putting out a data call to my staff, I would prefer to respond more accurately at a later time when it will be much, much easier to answer with precision.

6. Where are the regulations found?

25 CFR Part 103. Note that they are a bit dated, and we're hoping to replace them soon. While they still offer good guidance, they speak of BIA running the program, though DCI does now and BIA has no hand in Program delivery. Also, there are a few statutory changes that have made some regulatory provisions obsolete, such as the \$250,000 limit mentioned in answer 3 above. That limit was established by Congress in 25 U.S.C. §1484 after we set a \$100,000 limit in 25 CFR §103.18. The larger statutory amount now controls.

7. Jeff talked about a Tribal entity borrowing monies. Do you do many independent businesses owned by individual Native Americans?

Yes. The Program is available to individual Indians (members of a Federally-recognized tribe), any Indian-owned business entity organized under Federal, State or tribal law with a structure reasonably acceptable to DCI, tribes, or any business enterprise established and recognized by a tribe. Whatever the structure, the entity must be at least 51% owned by Indians. In the case of a non-profit borrower, the organizational structure must place Indian membership in charge of decision-making.

8. Is the loan guaranteed "up to" 90% or is it always at 90% if approved?

Lenders are supposed to specify a guarantee percentage with their application, and justify why that percentage has been selected. Since the guaranteed portion of the loan does not count against the lender's lending limit, nearly all applications specify that the deal requires a 90% guarantee. However, in some circumstance there are nuances of the deal that DCI will use to negotiate a lower percent coverage, and that will be reflected on our loan guarantee certificate. A lower percentage reduces the required premium.

9. Approximately how many loan guarantees do you issue in a year? What are the loan sizes that you work with; what is the lowest and highest amount?

We cannot control the size, speed or number of incoming applications, of course, but in a typical year we'll guarantee from 22 to 35 loans, varying in amounts from under \$200,000 to sometimes as much as \$35 million or more. There are no legal limits, just prudential ones. The average loan size in the past several years has been somewhere in the \$3.3 - \$3.5 million range.

10. Do you offer any other products or services for Native Americans that can be taken advantage of by financial institutions?

Aside from the expertise of DCI officials, which they're pretty generous about offering despite their workload, DCI has a seldom-used tool called interest subsidy. For certain borrowers, interest subsidy allows us to rebate a portion of the interest the borrower pays on a loan for up to the first 5 years of the loan term. The refund belongs to the borrower, but of course the borrower and lender can decide together how best to use that Program feature to enhance the prospects of loan repayment and business survival. The details are better explained by the regulations themselves, and in discussion with DCI officials.

In the case of default, the Program also allows lenders to make precautionary advances of funds on behalf of the borrower under certain circumstances. For instance, a borrower may not have the funds to make an insurance premium payment; if the lender does so on the borrower's behalf in accordance with Program requirements, the amount spent on the premium payment would be covered by the Program guarantee or insurance to the same extent as unpaid principal and accrued interest.

Jeff Bowman, President and CEO, Bay Bank, Green Bay, Wisconsin

1. How were you able to get bank senior management and the board of directors comfortable with lending on tribal lands?

It was easy.

- a. As CEO, I am part of the Senior Management team, so I have the opportunity to shape the philosophy for our lending efforts. Providing loans in tribal communities is actually in writing in our strategic plan for the bank.
- b. I am a tribal member myself, so I want to use my work experiences and resources in banking to help effect change in tribal communities. And providing access to capital is one of the tools we can use to effect change.
- c. We are a tribally-owned bank. This is what we do. We help other tribes and tribal people with their business projects. Senior management and the Board are on the same page when it comes to these types of commercial loans.
- d. We already make mortgage loans on tribal trust lands, we've been doing that for 20+ years. We have a very strong residential mortgage lending business, and a significant percentage of loans are secured by mortgages on trust land.

2. Do you have any recommendations for approaching banks and management teams with limited experience to encourage them to lend on tribal lands?

I think it is as simple as looking for a commercial loan project with a Tribe that makes good business sense from a credit standpoint. You do the same when vetting commercial loans to

non-tribal borrowers, right? You pursue the good opportunities and you dispense with the marginal commercial loan requests. If the only difference between the tribal project and a non-tribal project is the fact that the project is located on trust land, then you move it ahead by figuring out how to document your lien and perfect your security interest. You figure out how to perform that due diligence and you talk to legal counsel that understands the tribal aspects of it. The loan guaranty from Indian Loan Guaranty is intended to mitigate your credit risk by providing up to a 90% guaranty so you don't have to rely just on collateral. But like every other commercial loan opportunity, it all starts with a project that makes good business sense and can cash flow. You wouldn't ask for a loan guaranty on a deal with negative cash flow just so you could originate a weak loan, would you?

3. In preparing for this webinar today, I know that you take advantage of a lot of federal programs available for your customers. Was this a conscience decision on the part of the bank or did it grow from customer demand?

Both. It was a conscious decision in the sense that we need the loan guaranty to reduce our exposure. This particular loan is a very large loan for a small community bank of our size. The loan guaranty means that we only have to count the unguaranteed portion against our legal lending limit. But using this loan program also allows us to respond to customer demand for larger loans. In the past 5-6 years we have solicited commercial loan business from the other tribes (there are 11 tribes in Wisconsin). Prior to that, we only focused on our immediate community (the Oneida Tribe). As we started to look for new commercial loan opportunities with the other Tribes' opportunities, we found that they tended to have larger projects and therefore larger loan sizes. And that resulted in our bank learning how to utilize government loan guarantees to effectively manage our credit risk, so it was an evolution over time.

4. What are some of the biggest considerations for lending on trust land?

Going into this you need to know that this is a process that is different than fee land. You will learn a lot, but it's going to take some time.

- a. There is no title insurance related to a leasehold mortgage on trust land.
- b. The title search is called a Title Status Report (TSR). It is generated by that Tribe's area BIA office.
- c. You should know of all of the underlying documentation. If the project is owned in a separate entity, which means the land is leased from the Tribe to the project entity. Look at that documentation to make sure it was approved and documented. That lease should be recorded at the BIA and it will be reflected in the TSR.
- d. Your mortgage and assignment of the land lease gets recorded at the BIA office.
- e. Ask about the Tribe's environmental process. If any dirt is being moved, there is a formal process to assess any environmental impact. This could include impacts to plants or burial areas. Each Tribe has their own process for this. You also need to know at what point a project would trigger a more significant review and assessment process.

5. Did the fact that the tribally-chartered LLC was relatively new create any problems with getting the loan guaranty?

No, it did not. The retail business was operating for many years before its assets and liabilities were transferred to the new tribally-chartered LLC. So it had an operational track record. Isolating the management of these retail businesses into a single LLC actually helps, in my opinion, because it isolates it from the tribal government body, meaning it is now a free-standing business out on its own and accountable for its own operations. From a

documentation standpoint, there was a paper trail with a formal resolution from tribal council approving the new LLC and the asset transfer. It was thought out and well documented.

6. You said that the Tribe has a separate parent company to hold ownership of its non-gaming businesses. Is it important to separate gaming from other businesses?

Yes, I think so. This type of structure is becoming more common. An economic development/business development holding company is set up to own and operate multiple for-profit businesses. It isolates these businesses away from the Tribe and allows them to operate independent of the governmental body. Typically we see the Tribal Council establishing/electing the Board for the parent company. Then that board is charged with the responsibility to recruit, hire and retain competent management. Some/all of the senior management could come from its own tribal membership.

7. Jeff said that you can receive a credit enhancement – up to a 90 percent guarantee for the term of the note. Does the amount of the guarantee vary depending on the note? If so, what is the lowest percent of guarantee that can be provided?

The program allows up to a 90% guaranty. So why wouldn't you ask for the maximum? The SBA will guaranty up to 75%. So you could say the minimum you would accept is 75%, but that is up to you and your credit culture and loan policy requirements.