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Which Best Practices Should Loan Buyers & Sellers Consider?

Our team has analyzed more than $2B in potential loan pools for sellers and more than $3B for buyers over the last several years. Through our Loan Transaction Network, we've also facilitated over $1B in transactions. This direct experience has given us unique insights regarding the loan sales and participations market. It may be a seller's market currently, but there are still opportunities for both buyers and sellers to thrive.

Reasons to Sell

Even in an environment where institutions are challenged to grow loans, there are many reasons that a depository may choose to sell loans. The most common include: *maintaining loan origination consistency*, *reducing risk* (interest rate, credit, concentration and regulatory limit to single borrower), *increasing liquidity* (asset and liability management & access non GSE secondary market), *gaining on sale/ongoing servicing income.*

Reasons to Buy

While the economic outlook is much more optimistic as we move forward in 2021, your institution may still need to explore new avenues for loan growth. Here are a few of the most common reasons to buy: *supplementing organic growth*, *diversifying asset portfolio* (geographies, loan type), *balance sheet management*(extend or reduce duration, improve efficiency), and *removing servicing headache* (if servicing retained).

High performing institutions understand the importance of evaluating all asset classes when constructing their balance sheets, including whole loans and participations. Just like a securities investment or loan origination, incorporating loan transactions into balance sheet strategy can often improve institutional performance.

Considerations for Buyers & Sellers

Whether you're a buyer or a seller, it always helps to start with the balance sheet in mind as participations can have a material impact. Does this transaction help your institution directionally/strategically?

Next, develop a consistent (risk adjusted, relative value) decision making framework to ensure that your institution is being adequately rewarded for your risk (credit, liquidity, etc.) and that your process identifies and mitigates risks. This may assist long-term with both loan pricing and sales.

Identify & empower key stakeholders to own the process. Finance, Credit & Legal all have a part to play. It's important to ensure that everyone understands their role to safeguard the best interests of the organization.

Best Practices for Buyers

Beyond ensuring that the transaction is a strategic fit for your institution, as a buyer, we recommend ensuring that you have:

1. An updated participation policy in place
2. Developed a decision-making process
3. Determined who owns it - including both your finance and credit/lending teams.

Successful buyers should also ensure the following is part of their process to evaluate participation opportunities:

- Utilize loan level analytics/modeling vs. averages
- Stress assumptions
    - Consider balance sheet/strategic fit
    - Consider risk adjusted relative value
    - Create a due diligence check list
- Counterparty due diligence
- Loan level/portfolio due diligence
- Legal review of documents
- Be opportunistic and stay current on macro/micro market dynamics

Buyers should be wary of structured participation pools, geared to have attractive yield, relative to averages (FICO, LTV, DTI etc). Get the loan/data tape and run loan level analytics to gain better transparency into true economic value and balance sheet fit.

Lastly, remain aware of the macro/micro economic factors impacting loan value & performance. Primary and secondary loan markets are dynamic and some sellers capitalize on less knowledgeable buyers. Don't skimp on the analysis and be sure to save/memorialize it along with your stressed assumptions & a record of your decision-making process when purchasing so that you may refer to it later with future examiners and other key stakeholders.

Best Practices for Sellers

Successful sellers determine who owns the process internally and get their due diligence items organized for potential buyers. These include:

1. Loan policies and procedures
2. Credit/static loss history
3. Show info by FICO tier, term, etc.
4. Historical prepay speeds
5. Electronic loan files
6. Your depository's financials.

As a seller, it's also important to have your standard legal documents drafted and ready, including:

1. Non-disclosure agreement (NDA)
2. Letter of intent (LOI)
3. Loan participation agreement (LPA).

Need a hand with loan transactions? Contact us to learn more about how ALM First's Loan Transaction Network may benefit your institution.