LEND ACADEMY

PODCAST TRANSCRIPTION SESSION NO. 220 - LUZ URRUTIA

Welcome to the Lend Academy Podcast, Episode No. 220, this is your host, Peter Renton, Founder of Lend Academy and Co-Founder of the LendIt Fintech Conference.

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Today's episode is sponsored by LendIt Fintech USA, the world's largest fintech event dedicated to lending and digital banking. It's happening on May 13th and 14th, 2020, at the Javits Center in New York. Lending and banking are converging and LendIt Fintech immerses you in the most important trends of the day. Meet the people who matter, learn from the experts and get business done. LendIt Fintech, lending and banking connected. Go to lendit.com/usa to register.

Peter Renton: Today on the show, I am delighted to welcome Luz Urrutia, she is the CEO of Opportunity Fund, a position she has held for about a couple of years now. I wanted to get Luz on the show because I've always been fascinated, for several years now, with Opportunity Fund. They are the largest non-profit small business micro lender in the country and I feel like they have such an interesting story where they're loaning money to people who are underserved at very reasonable rates and have very reasonable default rates so I wanted to sort of dig into that and find out why.

Luz is actually very generous in sharing a lot of the insights that has really enabled her company to be successful and so we talk about the underwriting, we talk about how they are sort of more than just a lender to these people, they really are a part of their borrowers' lives. We talk about how they've sort of managed their relationship with Lending Club, that's a big part of what they do, and where their capital comes from and what's next for 2020. It was a fascinating interview, I hope you enjoy the show.

Welcome to the podcast, Luz!

Luz Urrutia: Thank you, Peter, glad to be here.

Peter: Okay, so I'd like to get this thing started by giving the listeners a little bit of background about yourself and...you've had quite a storied career, I would say, so far, with working in the banking system, so just tell some of the highlights of your career to date, before Opportunity Fund.

Luz: Sure. So, I'm originally from Venezuela so I'm an immigrant myself, I've been here for a very, very long time, came to this country to learn English and finish my undergraduate and then started working for a bank, at that time was Wachovia Bank, then went and got my MBA.

Then I got this little bug in me driven mostly by my original experience when I started working at Wachovia that I was turned down....I applied for a credit card and they turned me down because I didn't have any credit. And so I thought that was pretty odd because I could be working for a financial institution, but they wouldn't give me credit and I promised that one day, in the future, I would go build a bank or a financial services organization to serve the under-banked population with responsible and affordable financial services for people that didn't have access.

And so, that sort of drilled my, you know, pursuit of working in a number of different organizations that developed knowledge and understanding about this community. So, from that, I built a bank, ran it for about 13 years, sold it, then I came to California, started working for a company called today Oportun, it was Progreso Financiero, and they also worked with small dollar....primarily at that time, immigrants, Hispanic immigrants, that didn't have credit or had thin files.

And then, you know, I decided that I needed to think about......I've been in the for-profit world my whole life and sort of balancing profits with mission is the real difficult tension at times and so that kind of brought me to coming and joining Opportunity Fund...a) because I was passionate about their mission, and two, because I felt that how about if I start with a mission and allow the mission to drive the sustainability of the business. So really, my whole entire career has been focused on financial services in the last 17 pretty much serving underserved populations.

Peter: Right, right, interesting. So, you know, we had Oportun, we had Raul on the show before and, you know, they certainly are focused on an underserved population. So, I'm curious about the crossover between the population, but, let's just hold that thought because maybe we should start by explaining what Opportunity Fund does. So, why don't you give us a little bit of a spiel there.

Luz: Sure. So, Opportunity Fund, we are largest non-profit micro lender in the country and our focus is to tackle the widened inequality by investing in underserved and overlooked small business owners and communities across the country, both urban and rural. You know, small businesses are a critical driver of new jobs, they employ 50% of the population and generate 64% of net new jobs and entrepreneurship is a proven pathway to help move people into the middle class.

But, unfortunately, many deserving small business owners don't have access to the affordable and responsible credit that they need to support and grow their businesses. So, we provide small loans mostly to low to moderate income ethnic minorities, women and immigrants to help them make that permanent and lasting change in their lives. So, you can look at our model as a hand-up not a handout. You know, we've seen first hand the ripple effect of the loans that we make in the form of growing businesses, more jobs, more vibrant communities.

The organization has been in existence since 1994 and since that time, we've deployed more than $900 Million and helped thousands of entrepreneurs invest in their futures. Right now, we are launching....last year launched our new 5-year strategic plan where we are committed to deploy an additional $1.2 billion to small business owners across the country by 2023. Our focus, as I said, we do about..... 75% of our borrowers are low to moderate income, 30% are women and 85 to 90% are minority-owned businesses.

Peter: Right, right, okay. And in addition to that, I also believe you are also CDFI so you get some of the benefits from that designation, I'm guessing, so maybe just a quick rundown for the listeners, just a short spiel on what the CDFI is.

Luz: Sure. So, CDFI's are community-based specialized financial institutions that serve low income communities, or people that live in distressed communities and often they are working in market niches that may be underserved by traditional financial institutions. The CDFI is a designation that's provided by the US Treasury Department for institutions that help low income communities.

So, they are very strict in the measurement on who we serve, they opened a pool of low cost capital to us and actually, on September 23rd of this year marked the 25th anniversary of the CDFI fund, you know, which aims to expand economic opportunity by investing in organizations like Opportunity Fund to provide loans, technical assistance and financial services.

Peter: Okay, so the other thing I want to talk about because it's not......from my understanding when I was researching Opportunity Fund, it's not just about the loans, it's also.....why don't you tell us about this New Markets Tax Credit, what is that and how does it fit in with what else you're doing.

Luz: Sure. You know, it's very much complimentary to what we do. So, the CDFI Plan also administers the New Markets Tax Credit Program which builds and supports high impact development projects like healthcare centers, homeless shelters, services for at risk youth, food banks and other much needed services by low income populations and neighborhoods. You know, I look at that as a prime example of successful public and private partnering.

So, CDFI's across the country leverage an additional $12 in private capital for every dollar of federal funding received through that New Markets Tax Credit Program. And so, in our case, what we do is our program is designed to increase the flow of capital that's going to businesses and low income communities and it provides a modest tax incentive to private investors. Over the last ten years, it really has proven that this program is a really effective targeted and cost-efficient financing tool for businesses, communities and investors across the US.

So, we work with a variety of banks who act as the investors and we're providing those tax credits to those investors. We've received, gosh, over $350 Million worth of allocations from the CDFI Fund and have allocated those to, right now, about $330 Million of that has been put to work in this very high impact, as I said, you know, homeless shelters, food banks, education services. I mean, you may have heard some of these in California....you know, the Boys and Girls Clubhouse, Ravenswood Health Clinic, Compass Family Services....so these are the kind of projects that we are helping to finance.

Peter: Right, right, okay. So, I want to get back to the borrowers, I want to actually talk....you guys are a little bit of a demographic of who the borrowers are, but I want to dig a little deeper there. Maybe, you know, what kinds of companies are these small business owners borrowing money for, you know, like just tell us a little bit about who they are.

Luz: Sure. So, you know, our clients really come from nearly every industry that you can imagine across the country and they share a number of things in common. First, many of them are small mom and pops, anywhere between one to three employees and up to about half a dozen or so. We do have very few clients that have a hundred employees, but that's really not the norm, it's more the smaller micro businesses.

They're all incredibly hardworking and resilient, they're established and successful, they're looking to grow their businesses so think about the dry cleaners expanding to a second location, or a woman who makes tamales, you know, ready for a cargo van to start taking catering deliveries, or the restaurant in the corner from your house. These are borrowers....when they come to us, many of them, unfortunately, come to us looking to recover because these days we see that many of the small businesses are trapped in debt cycles by not very good actors that are offering short term, high cost financing, you know, with a direct take into their bank account, it's called merchant cash advance and so they're drowning in debt.

These are very healthy businesses with great cash flow, but have a need for capital that's responsible and affordable, and, unfortunately, they go online and they find these very easy to qualify for loans, they take them and then they come to realize that they're doing more damage to their business than help. Our borrowers also, in many cases, don't have traditional documentation, you know, over 15 to 20% don't have credit, or have thin files, so, obviously, they're not a focus for many of the banks and lending institutions.

You know, many of them have been....their average to give you an idea....the median household income is about $38,000 of our borrowers, so these are really, you know, individuals that are looking to set up their business and support themselves and their families, create jobs in their community and then cause that ripple effect of, you know, people that invest and save and invest in their community.

Peter: Right. So then, you sort of set up a business which made think, are these new businesses as well as established businesses?

Luz: So, our requirement is that we look at borrowers that have been in business at least for one year.

Peter: Okay.

Luz: However, in some cases, if we have a borrower coming to us that have a lot of experience in the trade in which they're trying to set up...so they've been in the food industry, in the restaurant as a cook and they come to us and say, look, we want to buy a mobile food truck to start our own, we will finance that mobile food truck, but it's because they've got experience in the trade and the business that they want to start.

Peter: Right, got it. So, what about the loans themselves? Let's just talk about the terms of these loans, what's the typical size, interest rate, the loan terms, tell us about the loans themselves.

Luz: Sure. So, we loan anywhere between $2,600 to $250,000 and, obviously, that's a big range. The average term is about 33 months, our loans go anywhere from 12 months to 72 months, and our rates vary, and, again, it depends on the size of the loan, the profile of the borrower, but our rates go anywhere between 7.5 to 18%.

Peter: Okay. So, 18% is the high that they're going to pay?

Luz: Yeah.

Peter: It sounds like some of them are really re-financing existing high interest debt like if they've got a merchant cash advance that's really crushing them. You're finding that a few of them will just need to get out from under that and so they're coming to you to try and re-finance?

Luz: Yes, as a matter of fact, there is a paper that you can access on our website on affordable and on sustainable which was a research that we did a few years back when we spoke. We got about a hundred clients that came to us to get re-financing and we found that many of them...the average interest rate was 94% on the loans that they were borrowing for their business.

Some of them we saw had rates up to 350% and what we also learned was that most of these businesses were paying twice the amount in debt that had available for their own cash flow. We were able to help about 50% of those borrowers, Peter, unfortunately, the other 50% were so deep in the hole that we could not help them, but our focus is to get them into a responsible loan before they even have to go out and find a loan of that magnitude and that rate. If they go there and find them before they find us then trying to re-finance them into a better loan that's going to help their business.

Peter: Right, right. So, I'm curious about the loan performance because you've got.....I mean, these are very reasonable rates, there's no question about it. These are from a small business to an underserved community...these rates are very reasonable. Are there any metrics you can share on how the loans have been performing?

Luz: Sure. So, you know, we have a 95% repayment rate which is one of those huge misconceptions that these borrowers are very high risk. If you apply the principles of responsible lending which is underwriting every borrower for ability to pay making sure that they have sufficient cash flow so that they can afford the loan, reporting credit to the credit bureaus, providing, you know, reasonable pricing, what you're going to find is that you have not only very responsible borrowers that pay back 95% of the time, but also very loyal.

And so that is one of our sort of biggest rewards, if you will, to see that these borrowers can take money, can do so much, invest and grow their business and yet, you know, we get a 95% repayment rate.

The other piece is the survival rate of the businesses. Our business is after having taken and paid the loan after a few years, they show a 94% business survival rate and that is twice that of the national average. So that's another statistic that we measure that we're very, very proud about.

Peter: So then, what is it about your underwriting, you think, that is being able to have....I mean, obviously, it's more than underwriting. It sounds like you really got this sort of bond with your borrowers, but I want to just talk about the underwriting briefly, you know, what kind of data do you use, how do you approach it and what's your approval rate on these borrowers?

Luz: Yeah. So, you know, it's a combination of things, right. The first thing is, you know, we underwrite every single borrower for ability to pay so that's at the top of the list. If you think about what are the first things you do, those are the first things we do. We believe that it doesn't make any sense to put a borrower in a loan that they cannot afford, particularly because we report credit to the bureau, so that's number one.

The number two is, you know, we look beyond the numbers. We underwrite loans taking into consideration the borrower's experience, as I mentioned earlier, as well as the character. So, you know, when we talk about collateral, for us, we look at collateral in terms of assets, but we look at moral collateral which is very, very high within the community that we serve.

As I mentioned, we report all loan payments to the credit bureaus because we believe that helping someone build or improve a credit score is helping borrowers build an asset that is critical for any business or individual that's looking to grow and be able to do some of the very most basic financial transactions in this country, right.

So, running a place, connecting utilities, you know, getting a cell phone, so that's very important to us. The other thing that we do that I think is critical in the success of our lending is that we build in businesses advising and feedback throughout the underwriting process and the life of the loan. We believe that a little bit of the seed money with the right kind of financial advice, those two combined, are a real powerful combination to ensure the success of that loan and that borrower.

Peter: Right.

Luz: The other thing that we do which is also very unique is we, you know, have a very empathetic collections programs. So, from time to time, we know that our borrowers get into trouble and many cases for reasons that are beyond their control and so rather than sending that loan to collection immediately and charging against the customer, we take an approach to understand what are the challenges they're having, how can we help them restructure the loan, extend the payment terms. And so what we find is that in 80% of the cases those loans that go delinquent get that current, okay.

And then, finally, you know, we make the process of paying us back as easy as possible and I think that makes a huge difference and then if you take that further down to dealing with immigrant population, I think one of the most important things is making sure that you have cultural competence in our team and that we understand the market, in other words, our people serving our people.

When you build that trust with the borrower and they know that they're going to see Adela not just closing a loan, but they're going to see her in the school with her kids, in the soccer field, in the grocery store, there is a trust bond that's established between the lender and the borrower that really lasts for a very long time. If they get in trouble, they're going to pick up the phone and call you.

Peter: Right, right, that makes sense. So then, I know you can apply online to these loans, but you can also, I believe, apply in person. So, are most of your loans coming from the online channel, or how do borrowers get in touch?

Luz: Yeah. So, we have a combination of outreach and customer acquisition so, you know, we have boots on the ground for the very small micro businesses and we work with a network, a significant network of community partners in California, about 50. These are other CDFI's that are providing either technical assistance, business advising, tax, legal and accounting services, but need somebody to provide the capital and that's where we come in so we get, you know, a significant number of borrowers coming through our community partnership network.

We also work with mobile food truck manufacturers, we work with trucking dealerships, we work with other banks that may decline customers for credit and they send them to us, and then we have our online channel. Our online channel is mostly with the Lending Club partnership that I know you covered when we launched that expanded partnership back in April and so that partnership is in 45 states now; California and 44 states outside of California. I say that our online channel generates about a third of the volume that we do, a third to 40% of the volume that we do and the other channels that I talked about generate the remaining.

Peter: Right, right. So, just maybe tell us about this relationship with Lending Club. I think most listeners would remember that Lending Club decided to stop originating loans and they're sending them off to you guys and to Funding Circle, so maybe....like is this sort of...that's where most of your online is coming from, is this a partnership that you're hoping to deepen? What are your expectations for this partnership going forward?

Luz: Sure. So, you covered this, again as I mentioned earlier, which was a very exciting time for us. So, Opportunity Fund established a partnership with Lending Club back in 2016 and at that time it was....thank you to a grant made by the J.P. Morgan Chase organization where they wanted to see how a marketplace lender, the largest marketplace lender, could partner with a non-profit to help borrowers that were declined by the online lenders.

So, if a borrower came to Lending Club and they were declined for credit reasons then we interfaced our systems with theirs through API's and they, in the background, would run that borrower against our own credit box. And then if we approve them, the borrower would get an immediate notification, congratulations, you have been approved, pre-qualified by one of our partners and so we would take the borrower relationship from there and we would underwrite the loan and, you know, close the loan, service the loan, etc.

We had that partnership in 13 states for a couple of years, a lot of success, we were able to help a lot of borrowers reduce their pricing from other options that they had if they had been turned down by Lending Club and by us and so we felt that it was time to expand it. And so what we did is we said, look, we want to go nationwide with them, leverage your technology, integrate more and then start to provide pre-qualified offers, not just to second look customers throughout the country, but to what we're calling near prime customers.

Near prime customers are customers that are not yet being approved by banks, or other responsible lenders and are still going to, you know, higher cost online lenders. With that partnership and the expansion of that partnership back in April, we also recognize that, you know, there's a lot of prime borrowers coming in through the Lending Club channel, but those are not necessarily Opportunity Fund's target market. Those are more the target market of organizations like Funding Circle. So, Opportunity Fund is getting the second look in the near-prime and Funding Circle is getting all the prime-based customers.

Peter: Right, right. So then, is this relationship unique? Are you looking to like duplicate this with other potential online lenders, or what are you...how do you view it as a channel you can expand?

Luz: Sure. So, you know, we obviously just launched this in April. We have met all of our goals in terms of loan originations which has been wonderful. We believe that the combination of, you know, our credit technology, their capabilities, our mission-based high touch lending model that we can continue to dramatically expand access to affordable capital to more underserved business owners across the country. If you think about our partnership, you know, we're taking care of about 80% of the market that we believe 80% of the market of underserved small businesses.

So, we still have a lot of work to do with Lending Club to expand the partnership, we're in the final stages of building the more integrated technology solution and so we're expecting to work on that for the next six to 12 months and then decide, you know, where do we go from here. Is there opportunity for us to extend to other partnerships which is a key element of our strategic plan that I mentioned earlier, to deploy $1.2 Billion. It is to partner with other organizations, both online, other CDFIs, you know, other referral partnerships in order to extend our capability and be able to help more underserved populations across the country.

Peter: Yeah, so what about like an organization like Oportun where you used to work. Obviously, they're more focused on the consumer, consumer and personal loans, but is that the sort of company that you would consider partnering with?

Luz: Well, you know, we're not a consumer lender. We are a small business lender and while they are sort of....you know, when you get to the lower end of the pyramid, as I call it, there is a real blurry line between what's a consumer loan and what's a business loan because a lot of consumers will borrow under their personal credit and they're investing and they have other jobs, right, during the day, but they have a side business, whether they're at landscaping, or restaurant, etc. So, we don't have plans to become a consumer lender, at least for the foreseeable future, so our partnerships are going to be more focused with organizations that are applying through underserved small businesses.

Peter: Right, okay, that makes sense. So then, what about the capital that you're lending out? I mean, obviously, you've got the CDFI Fund that you talked about and banks, I believe, can get CRA credit for the loans they're putting up there, but maybe you could tell us what other sources of capital that you're working with.

Luz: Sure, absolutely. So, the CDFI Fund is crucial for us and, you know, we've.....I think we've gotten like $16.5 Million worth of allocations since the fund has been in existence which has been great. The bulk of our funding comes from traditional banks, financial institutions that are lending us through their Community Re-Investment Act. So, you know, it's highly critical, highly impossible because it's low cost capital and as you probably know, banks are required to invest capital into communities in which they take deposits from and where they operate and a lot of financial institutions don't necessarily have the expertise, the know how, or the desire to lend to the kind of businesses that we lend to.

So, what they do, in turn, is they give us those loans and we lend to those local communities and so that has been incredible capital for us. You know, right now, we have over $110 million worth of lines of credit, the bulk of that comes from CRA banks, we also have an impact investment note. Two years ago, we issued the largest impact investment note that has even been issued by a non-profit small business lender, CDFI.

We raised about $11.5 Million from that, we're expanding that and that had, you know, investors foundation, a lot of accredited individual investors and so that provides another important source of capital for us, and then we have a number of foundations that provide program-related investments, banks provide EQ2's and other low cost capital which is, obviously, so critical for us because the rates you were talking about that are reasonable. The reason we can provide those kinds of rates is because we get very low cost of capital that help support the lending at those rates.

Peter: Right, right, for sure. Okay, we're just about out of time, Luz, maybe we could end with talking about what's next for you guys. You've talked about your 5-year strategic plan, but maybe give us a bit of a window into next year and what do you hope to achieve in 2020.

Luz: Yeah. So, as I said, you know, we're marching towards a $1.2 Billion deployed by 2023. You know, next year, we're looking at deploying close to 140 million worth of capital, we are launching our Women of Opportunity initiative. As you can imagine, I am keenly focused on helping women on businesses achieve their true potential and that's one segment of the population that, unfortunately, gets a minimum amount of debt capital when they ask for it.

We're working, obviously, with Lending Club to expand that partnership and make it as productive as it can be. We also established a partnership with Key Bank to open new markets with our trucking lending starting in New York and, hopefully, expanding into other markets. We're looking to expand our impact investment fund to attract more institutional and individual accredited investors.

We will continue..... one of the key areas of our business is to advocate and help influence policy, both at the state, but, you know, national and regional level and that's a big part, especially in these days where, you know, every time we turn around, we see that one of the programs that is benefitting these low income communities is at risk of being eliminated. So, our policy and advocacy work is going to take a very intense approach in 2020. I'm going to be spending time, you know, talking at the CFPB next month about the need for us to collect data from small business owners under Section 1071 that they're evaluating.

We're going to continue hiring, seeing our staff grow, you know, hopefully, by 200 people by the time we're done with this strategic plan, and just you know, relentlessly trying to manage risk, adopt new technology which is key. You know, technology and data analytics are key for us to deliver the kind of growth and impact that we want to deliver, and just helping more borrowers, say more yeses to borrowers that as we can so that we can continue to close that income and equality and support the communities in which we all work and serve.

Peter: Okay, it is a noble cause and I think your organization, I think...I hear about it talked all the time, about what great work you guys are doing. So, I really appreciate your coming on the show today, Luz.

Luz: Peter, thank you so much for your time. As always, it's a pleasure.

Peter: Okay, see you.

Luz: Talk to you soon, bye.

Peter: Bye.

You know, you can really tell talking with Luz right there that her company has developed a bond with their borrowers that is real, and, obviously, they have....you know, they're serving underserved population and these people are very grateful for receiving this money, but it's more than that because they develop this loyalty, I mean, this 95% repayment rate for what is essentially, let's face it, a near prime or subprime population.

That to me is astounding and not just in a consumer, but in a small business setting where these businesses are potentially.....many businesses fail, as we know, and they've got a better success rate than average there as well. So, they've worked out how to really attach themselves into the lives of these people where they consider paying off their Opportunity Fund loan a very high priority and that's, I think, the story here. They've, obviously done a great job in attracting these customers and underwriting them, but what they've done best at, as far as I can tell, is they have got loyalty. Loyalty, I think, that many other small business lenders would be quite envious of.

Anyway on that note, I will sign off. I very much appreciate you listening and I'll catch you next time. Bye.

Today's episode was sponsored by LendIt Fintech USA, the world's largest fintech event dedicated to lending and digital banking. It's happening on May 13th and 14th, 2020, at the Javits Center in New York. Lending and banking are converging and LendIt Fintech immerses you in the most important trends of the day. Meet the people who matter, learn from the experts and get business done. LendIt Fintech, lending and banking connected. Go to lendit.com/usa to register.

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