LEND ACADEMY

PODCAST TRANSCRIPTION SESSION 52: DAVID HABER

Welcome to the Lend Academy podcast, Episode No. 52. This is your host, Peter Renton, Founder of Lend Academy.

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Peter Renton: Today on the show, I am delighted to welcome David Haber. He is the CEO and Co-Founder of Bond Street. They are a relatively new small business lender and I wanted to get David on the show to talk about a bit about his company, to discuss what makes them different in what is becoming a more and more crowded market, shall we say, as far as small business lenders go and I wanted to talk about their approach to underwriting. They've hired a very senior person to sort of manage their underwriting and also to get his views on the Small Business Borrowers Bill of Rights and the whole self-regulation thing. We cover all that and more in this podcast. I hope you enjoy the show!

Welcome to the podcast, David.

David Haber: Thanks so much for having me.

Peter: Why don't we kick it off with giving the listeners a little bit of background about yourself and what you did before you started Bond Street and sort of some of the things that you did that led you to decide to go out and start this new company.

David: Yeah, absolutely. So we started Bond Street about two years ago, but prior to that I'd spent almost three years working in venture capital and I was at a firm called Spark Capital initially up in Boston and then I helped open up the New York office with one of the partners, Mo Koyfman. I was essentially the only junior person on the team so my job was to go run around and find interesting new companies to invest in and bring them back to the partners to ultimately lead the deals. One of the areas I was particularly passionate about that many of the other partners really got excited about, Santo Politi and Mo and others included, was sort of how technology was going to help reshape financial services.

So I ended up going fairly deep in the space and helped them invest in probably six or seven companies, not just in lending, but across sort of the broader fintech stack so helped Santo lead the seed round in Orchard and Mo in seeding Plaid and Andrew in Quantopian and a number of others that we did while I was there. I think what's exciting is they've gone on now and really made it a focus and they've invested in Wealthfront and Affirm and IEX and Fundbox and a whole bunch of others within the ecosystem.

It was a cool sort of perch to kind of get a really interesting sense of what was happening in this sort of emerging ecosystem and...you know, for me what was I think more fascinating was...you know, I spent most of my time talking to technology companies, but would often run across fast growing physical products businesses or services companies who were also looking to raise financing, didn't really fit within our mandate or made sense yet for venture capital, but who were doing real revenue, were profitable, were growing and either struggling to raise bank financing which I didn't fully understand at the time or were very bankable but kept telling me how painful and antiquated the process was.

So at the time, you know, I just started calling anybody that would chat with me and eventually the heads of small business lending at most of the major banks and a bunch of community and regional banks across the country and, as you're well aware, learned about a lot of the structural issues that existed in the market which make it very difficult for them to serve small businesses well, not least of which was certainly regulation, but also really a lack of technology and process to make these loans cost effective.

Peter: Okay, so you basically decided that small businesses weren't getting access to funding. Obviously, as a VC you were totally focused on equity investments, but sounds like your research drove you to the lending side of the equation. So when you decided…because I think we first spoke, I think, when you were still at Spark Capital and I can't believe it's been over two years (laughs), but, anyway...so I guess there's a big leap between being a VC and looking at companies to getting out there and doing it all, bootstrapping it yourself. So what was sort of the tipping point for you in that process?

David: Yeah, you know, I've always thought of myself more as an entrepreneur than an investor and I had started a bunch of little companies as a kid, nothing super serious, but it taught me at an early age that it was possible to create something from scratch and I found myself, even when I was at Spark, often meeting really interesting entrepreneurs building incredible companies and I'd be like, well I just want to go leave and build this thing with you (laughs). When I finally found something that I was really passionate about myself it was a pretty obvious choice.

Another big catalyst was my partner, Peyton, and, you know, I like to say jokingly that I collect people (laughs). Peyton was always sort of at the top of my list of people that I wanted to start a company with. I had met him in 2009, he had graduated from Harvard in 2004 and I'd met him when I first moved to the city after graduation and he was at D.E. Shaw at that time, he had spent about five or six years there working directly for David Shaw, sort of his personal CTO, essentially, you know, writing software for the fund, but also on like technical and research projects they would come up with together and so…even after our first meeting we just started kind of brainstorming.

This was even before I went to Spark and we stayed in touch along the way and around the time that I joined Spark, he went to go run engineering at a company called Venmo which was a mobile payments business and they ended up getting sold twice. They got bought by a company called Braintree and then PayPal bought both companies at the end of 2013. When that transaction happened it was really a catalyst for us to go leave and start this business.

Peter: Sure, so then you started up like.…can you just describe, I guess, exactly what kind of borrowers, what kind of company Bond Street is and who you're going after.

David: Sure, yeah, so we are exclusively a small business lender. Our average loan size, I think, today is around $175,000, one to three-year durations, but they've certainly skewed towards three years.

These are businesses looking to invest in some sort of growth opportunity that they see ahead of them, whether that's opening a new location, hiring additional employees, buying a piece of equipment, in some cases refinancing an existing merchant cash advance in a number of industries. Certainly a lot of creative and professional services companies. Our first customer was a company called Gin Lane which is probably New York's top digital agency. So they've built Warby Parker's website, Harry's, Sweetgreen, Saturdays Surf, a bunch of other other companies and it was actually through Emmett and their founders experience that I sort of…initially had learned about the challenges that these interesting companies were facing in raising bank financing because here was a business that was profitable, growing, doing millions of dollars a year in revenue, but still having a tough time getting bank financing. So we worked with them multiple times and, yeah, it's been an interesting mix.

Peter: How many states are you operating in right now? Are you just in New York or you've got multiple states?

David: Yeah, so today we can lend in actually 46 states across the country.

Peter: oh wow!

David: I think the only four states that we can't lend in are North and South Dakota, Vermont and Nevada.

Peter: Okay, do you have licenses in those states? Are you partnering with a bank? How are you actually originating?

David: Yeah, we've gotten licenses in states where we needed them and then because our loans are fairly low rates...commercial lending is treated fairly differently than consumer and so we fit comfortably within most existing state usury caps. I think that's, you know, one of the main reasons why you've seen certainly companies like Lending Club and others partner with folks like Web Bank because the state caps on a consumer level are much, much lower or existent at all in most states across the country.

Peter: Right.

David: Whereas it's treated a little bit differently on the small business side.

Peter: Okay, so I'm curious about how you differentiate yourselves because you're in sort of a wheelhouse that is...Funding Circle is obviously playing in the same, Lending Club, Fundation, several others I could name as well. So what is different about Bond Street compared to those other companies?

David: Yeah, absolutely. Look, I mean, we are all in some ways in the business of selling money and our dollars are just as green (laughs) as any of those you listed or Chase or Wells Fargo or others. While today we can certainly compete on rate and on speed, the question we often ask ourselves is, you know, the future is one where capital is available online. I think speed eventually will become table stakes and so if that's true we have to be providing much more than just the economics of each transaction. It's not just about the economics of the loan itself, it's about all the other value we can provide. So we really think of ourselves and aspire to be more than just a lender, but to be sort of every customer's financial advocate and I think you'll see us continue. We're already working on this build...you know, more and more interesting technology around offering value even before somebody's even thinking about applying. I mean, the interesting thing about most of these platforms is they're only useful when somebody's immediately ready to apply.

Peter: Right.

David: However, I think there's a huge opportunity to build a much earlier relationship with your customer. We collect so much data across the network of companies we work with, why shouldn't somebody be able to sync their accounts and learn something interesting about their business. Ultimately, we can, through that information, anticipate future financing needs and that's true even existing customers and something we already do today is because we've written these software integrations into products like Quickbooks, into the bureaus, into the IRS, into deposit accounts.

We're not just underwriting once, we're actually continuing to monitor these financials on an ongoing basis so we've seen a lot of interesting repeat business. I think the future, in my opinion, is one that's not necessarily delineated between simply term loans and lines of credit. I think it's one where it's really about capital being available on demand where somebody applies once and we're not underwriting them once, we're underwriting them everyday, every second and that pool of capital grows with them over time and the rate adjusts accordingly as well so that in the future it's not another application, it's a push notification that says...hey, look we see this sort of accounts receivable gap, you should draw down on this capital to avoid a working capital issue for that quarter or we see that you're stocking up on inventory every November for the holiday season, you've already been pre-approved for this additional capital for that time period.

You know, we're not quite there yet, but, I think we're well on our way to building that. So I'd say at a high level like…really our differentiation comes through the team that we've built and the technology that we're building. It's sort of a unique mix of folks at the company, I mean, the first hire that Peyton and I made was a guy named Jerry Weiss and it was sort of funny because the Orchard founders were working out of my office at Spark and Peyton and I realized very early on in the company that we were going to live and die by the quality of loans we made and neither of us had ever...didn't come from a credit or risk background.

So I was spending a lot of time running up and down AmEx, Citi and Chase talking to senior risk folks and actually kept bringing them to Angela and David, Matt's co-founders at Orchard, who had spent their careers in risk and they were we like yeah, these guys are good, you should really go talk to Jerry. I'm like, who's Jerry? He was our bosses boss at Citi, he was the Head of Risk for small business lending nationwide and so they actually had facilitated the initial introduction and we pulled him out of the bank as our first hire which is a funny juxtaposition, a funny conversation when you're asking the Head of Risk at a big bank who had spent 30 years running big risk teams to join two people at a tiny company with...we didn't even have our payroll set up.

Peter: (laughs) I remember reading about that. That was quite the coup for you guys. I'm sure he's sort of had a bit of a culture shock, I imagine.

David: Yeah, and actually it's been much less of one than I thought. I was initially quite skeptical, but he dove right in and I think it's been one of the best decisions we've made as a company. He's a great example of bringing in somebody with a different perspective. And then we have folks recently who joined like Peter Vidani who was the fifth employee at Tumblr and led all product design as their Creative Director. So these are two people I think who would never have worked with each other I think in any other business (laughs), frankly, but ultimately it's that sort of diversity that creates…that is sort of magic and I think it allows us to build interesting and differentiated products for our customers.

Peter: Right, right, so let's talk…I know you're not Jerry, but I do want to talk about your underwriting process and get a sense of how you're doing it, what are you doing that may be different to others and like how much automation you're bringing in...can you just give us a little bit of a sense of how you're underwriting the borrowers that come through?

David: Yeah, absolutely. As I sort of described earlier, one of the big catalysts for Peyton and I to go leave and build Bond Street was sort of the shift we saw happening in the financial software space where companies like Intuit with 5 million Quickbooks users, but also Xero and Stripe and Harvest and Braintree and Expensify, and Tradeshift. All of these companies that have really valuable data on the financial health of small businesses were suddenly opening up and launching APIs so really the genesis was...wow, we could collect a lot of this data directly and actually create a much better customer experience.

So that's essentially the product or loan application that we built. It's one that integrates with products like Quickbooks, with Experian and Equifax, with the IRS who around the time that we started…started accepting e-signature so we could collect a digital copy of somebody’s tax filings and then also integrations into...I think we have coverage for five out of the 7,000 banks in the country for deposit data and whether that's through Intuit customer accounts API or...you know, I had invested in Plaid when I was at Spark which is building a competitor to them and Yodlee...you know, we can quickly get a holistic view into the financial health of a company.

I think what was really interesting to me to learn and frankly surprising after talking to Jerry was that at most banks, and this is true at many of the largest ones in the country, for loans certainly under $250,000 and many under $500,000, the ultimate credit decision was based almost entirely off consumer and business credit score. So they would have somebody sign a 4506-T tax form, but they wouldn't actually pull tax filings. Because they didn't have a cost effective way to actually analyze financials, in my opinion, they were getting a pretty two-dimensional view of a customer.

It's like, if you and I both had 750 FICOs, you made $500,000 a year, I made $50,000 a year, you're going to lend very differently to the two of us and that's essentially, I think, the blind spot that most of these large banks had so I think one of the exciting things certainly for Jerry in joining the company was that we're actually giving him and the team and all of the algorithms that we’ve built, more data on a $50,000 credit than he often had on $1 million loan at a bank. To me it's not just about speed, but it's actually about making smarter decisions.

Peter: Right, it sounds like a lot of this stuff then is automated. When someone goes in, fills out an application you can fire up the APIs of these different companies and pull in stuff in an automated fashion, but I presume then...given that you're still a pretty young company, are you talking everyone on the phone, I mean, how does it work?

David: Yeah, I mean, there is still review....Jerry is still reviewing and not just him, our credit team is reviewing every application that we ultimately approve, but we have built a lot of automation into the process. Some of it...we ended up getting about a million historical small business records when we started and did a lot of analysis on essentially the probability of default relative to somebody's personal and business credit scores, but I think the more interesting piece is actually automating the financial statement analysis which...in my opinion, I haven't seen this at most other places, I haven't seen anybody else really automate to any significant degree and this is something which is I think much harder from a technical perspective, but automatically calculating things like debt service coverage and comparing that to what we see in somebody's tax filings and the cash flows that we see in their deposit accounts…and do sort of the combination of those things to determine not just who you should approve, but how much you should lend and at what rate.

But we do...I mean, we do speak to every single customer on the phone and certainly some of it is helpful from a risk perspective, but primarily it's to learn about their experience with our product and our site and to ask questions about how they came to us and ways in which we can improve and so we built a pretty thorough feedback loop from those conversations continuously trying to improve the customer experience. So I think we'll continue to do that for a long time and I think at a high level my philosophy on building technologies that ultimately it should enable us to afford the human touch. We should be able to instantly approve a $500,000 loan to be directly deposited in somebody's bank account, but also be able to provide the level of customer service somebody might come to expect from many of their other favorite brands.

Peter: Right, right, okay, so what about volume, how many loans are you doing a month? What did you do in October, can you share that information?

David: Yeah, I don't know if we've shared like specific volume numbers, but it's grown a lot certainly since we've closed this Jefferies relationship. We are confidently on path to do $100 million by the end of 2016. Hopefully…I mean we have sort of a number of interesting partnerships that really could accelerate that, but, yeah, we've been pleasantly surprised by the volume.

Peter: Okay, one of those partnerships I read fairly recently was with WeWork, the co-working space. Describe what the partnership is and what it means for you guys.

David: Yeah, WeWork is a brand and a business that we had admired for a long time. They have, I think, close to 60 locations worldwide, I think 50 or 45 of those in the United States, 35,000 members, but growing incredibly quickly. They estimate to be like 100,000 in a couple of years. There was a lot of alignment in terms of our brand values and sort of the community of customers that we're ultimately going to be addressing. What we've done is we're now sort of essentially the lender of record into all WeWork locations and companies.

In addition to offering a discount to their community, we've also been hosting events at various locations across the country, have provided a bunch of educational materials to help these businesses understand sort of the trade-offs and how to think about financing options. They've built co-branded landing pages that they promote within their site, our logo is on a number of their…I think it's like on every TV screen in every New York location, they've sent an e-mail out to every member in the community so they've leaned pretty heavily into the relationship and it's been a really nice sort of symbiotic one.

We funded our first loan within 48 hours of them announcing that partnership, from application to money in the person's bank account. It was actually a digital agency based in one of their LA offices. I think what was interesting about that was that they were really using the capital to staff up and what that ultimately meant was that they could afford more desks within WeWork. So it's sort of an interesting way for them not only to benefit their community and help these companies grow, but it's also driving incremental revenue for them which just makes it a much more interesting partnership, I think, for the long term.

Peter: Yeah, that makes sense, that makes sense. So I want to switch to the other side of the marketplace, the other side of the equation shall we say, because I believe right now...I guess you could clarify, my understanding is you have a credit line, you're a balance sheet lender. Can you just talk about who is funding these loans, what your plans are for the future there.

David: Yeah, so we're not actually a balance sheet lender, we are structured more as a marketplace, but we have today at least one large institutional buyer of our loans, which is Jefferies. Yeah, it's been a great partnership, I mean, as you know, they've been very active in the space with companies like Avant and Affirm and others, yeah, it's been a good one. We definitely have other interest from institutional investors to participate so I imagine over time we will certainly expand the pools of institutional capital that we have on the platform.

Peter: So your plan is long term then to have like a true marketplace where you'll have multiple investors each with their own kind of criteria, I guess, and deciding. Is that…sort of in an open way, I mean, what are your plans there?

David: It's a little bit TBD, I mean the way that this one had worked is they had done a lot of diligence initially to understand our underwriting model and then that sort of diligence defined the parameters essentially of a box and they've committed to buying loans that could fit within that box. So whether it's sort of more dynamically on a per loan basis or it's essentially commitments...and different investors may have different sort of risk parameters, some want less risky loans that have a lower return parameter or more risky loans that have a higher yielding one, you know, that's more likely. I mean, ultimately, I think about…I think it's really a business model question much more than a customer one. I don't know that the customer really cares about whether it is one institutional investor or ten institutional investors or 300 individuals so long as the customer experience is a good one so that's what we've really tried to focus on while also providing very meaningful return to our institutional partners.

Peter: Right, right, okay, so would you say, are you open to talking to new investors today or are you pretty much all set there?

David: Yeah, I mean, Jeffries definitely has a big appetite for the loans that we're originating, but I think they've also been willing to chat with partners who wanted to participate. As every start-up knows, you're always in market (laughs), you know, fundraising, because if things continue to go as we expect them to, we will definitely be raising additional debt capital in the near future.

Peter: Right, okay, so before I let you go I want to talk about the Small Business Borrowers Bill of Rights. This is something that has been around now for a few months about building transparency and all that sort of thing. I didn't see your name on the website, so I wanted to get your perspective on that and how your company views it.

David: Yeah, honestly I'm good friends with Brayden who was sort of the primary drafter of the document with Jared at Fundera. I think it was actually a great...a very positive step in the industry. I completely agree with everything that's written and I think we even go above and beyond what's there, we always show exactly what our interest is or APR is. We even give a full amortization schedule to customers…like we pride ourselves in being incredibly transparent to our businesses so that they can fairly and accurately compare our products with other companies and other lenders in the space. We should sign it, I actually have no reason not to…it's just that we have had a bunch of other stuff to do.

Peter: Right, it's just you haven't gotten around to it so it's not like you don't embrace it.

David: No, not at all. I mean, in fact, I think I would even probably push it further. I think it's a...we submitted our, you know, a Treasury RFI response and that was one of the things that I had actually called for in that document. It was basically encouraging people to not obfuscate the true cost of the loans that people get into. You know, some like to talk about factor rates…when you actually amortize the actual true cost it's triple digit interest in some cases.

I'm not against higher interest rate lenders. I think they serve an important function in the marketplace, but, I think, as with any sort of any financial transaction people have an almost moral obligation to understand what they're getting themselves into. I think that's especially true for small business owners, many of whom are incredibly passionate about their product or their service, but they're not finance people.

Peter: Right.

David: ...nor should they be. We certainly believe...again, that in being more than just a lender, being their financial advocate and helping them make the best and most informed decision for their business. So there's a lot of work to be done in this space for sure.

Peter: Sure, and for some people doing a merchant cash advance or a short term high interest loan actually makes sense.

David: Yeah.

Peter:...and they can do for a seasonal business or something like a big spike, big customer comes in or whatever. The total cost of the loan is negligible to the profit they are going to make by taking that loan on. I think it does make sense for some people.

David: That said, we've seen pretty negative examples of cases where companies were in dire straits and yet, whether it was through a broker relationship or directly other lenders, mostly MCAs, piling on to their existing debt burden.

Peter: Yeah.

David:....and ultimately crippling these businesses and putting them into bankruptcy because the actual debt service payments were unavoidable. You kind of have to ask yourself, is…if people are willing to do that, A….are they actually underwriting the customer, or B...do they even care if the business survives so long as they get their capital out.

Peter: Right, there's been some bad actors, there's been lots of stories written about...yeah, there are certainly bad actors in the space and I think in that situation, yeah, it's got to be...every transaction, in my opinion, has to be a "win win." If it's not a "win win" then you don't have a sustainable business and eventually, the regulations are going to catch up with you or you're going to be found out.

David: Totally. I think that's like....my hope for the industry is that people sort of self-regulate and it becomes some sort of...again, it behooves everybody to not put anybody in a bad situation where they can't pay back so let's continue to sort of elevate the conversation together.

Peter: Right, right, okay. Well, on that note we will sign off. I very much appreciate you coming on the show, David.

David : Thank you so much, Peter, always a pleasure.

Peter: Okay, see you.

I just wanted to touch on that self-regulation piece that David just mentioned. I think it's critically important. I know there are several associations or trade groups that have been discussed, nothing has been formalized yet, but we are certainly...I think it's beyond time. I think we need an association that is inclusive and strong so we can have a voice in Washington and provide some kind of guidelines for best practices in the industry. I feel like in the next six months, I'll be very surprised if we don't have something like this in place. I think that will be a good thing for this industry.

On that note, I will sign off. Thank you very much for listening. If you haven't already, I would love to get your feedback. Please go to iTunes or Stitcher, however you're listening to this show, and give us a feedback. I read all the feedback that we receive and it's how I can improve and make the show better. Thanks again for listening and we'll catch you next time. Bye.

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