PODCAST TRANSCRIPTION SESSION NO. 161 / EVERETT SANDS

Welcome to the Lend Academy podcast, Episode No. 161. This is your host, Peter Renton, Founder of Lend Academy and Co-Founder of LendIt Fintech.

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Today's show is sponsored by LendIt Fintech Europe 2018, Europe's leading event for innovation in financial services. It's coming up on the 19th and 20th of November in London at the Business Design Centre. We've recently opened registration as well as speaker applications. You can find out more by going to lendit.com/europe.

Peter Renton: Today on the show, I'm delighted to welcome Everett Sands, he is the CEO and Founder of Lendistry. Lendistry is a small business lender, but they're a bit different to most. What they are doing and what Everett has pursued is what he calls a hybrid approach between a community bank and an online lender, a fintech lender. It's interesting because we go into this in some depth on the show where Lendistry employees will go and have face-to-face meetings with many of their borrowers.

At the same time, they've got an online approach, a tech heavy approach so we talk about that. We talk about the industries they serve, why they decided to get a CDFI certification, an interesting new partnership with the Federal Home Loan Bank of San Francisco, we talk about capital and much more. It was a fascinating interview, hope you enjoy the show.

Welcome to the podcast, Everett.

Everett Sands: Thank you, thank you, Peter, appreciate it.

Peter: So I like to get these things started by giving the listeners some background about yourself and tell us what you've done so far in your career before Lendistry.

Everett: Sure, sure. So as a kid, I grew up in Washington D.C., spent the majority of my time there, in high school, I ended up going to a school called St Paul's which is in Concord, New Hampshire, spent some time in Japan as an exchange student and then I went on to Penn. As you may or may not know, most of those kids end up on Wall Street somewhere. I didn't quite get to Wall Street.

I made a decision to go into the mortgage business so in financial services, but didn’t decide to go to New York, stayed in the Philadelphia area and then on to the DC/Baltimore area, started a mortgage company, we grew it to about 120 people, we were a top 10 lender and eventually sold that company to a community bank in Baltimore, Maryland. I became a vice president of lending there and helped that team grow and that bank grow by about 600%.

2008 happened and didn't find myself out of a job, but definitely found myself in a scary scenario where the bank was a mutual bank and made a decision not to convert the stock which meant that if a subjective regulator came our way we might have to build up bigger loan loss reserve and/or if we had some bad loans go south that could be pretty risky. At the time, every bank that went south, the top leaders, would go under federal investigation. I was number three at the bank and I was not interested in going under federal regulation so I jumped over to Wells Fargo, joined their consumer lending team on the East Coast and then I got promoted to California, to the West Coast.

Peter: Okay, so then was it from Wells Fargo that you first got the idea for Lendistry?

Everett: I would say, yeah, definitely Wells Fargo cemented it. The idea came shortly before joining Wells where I started participating in loans with what at that time was called peer to peer lenders and it was kind of a friends and family/angel investors who would help companies to make sure they didn't hit their concentration limits so we would represent the equity piece of the loan that they might have to put up in a traditional credit facility an advance rate structure and that started...I guess now it has been about nine years ago so that was before Wells.

And then when I got to Wells what was interesting is Wells taught me....well what I saw at Wells was I saw the bank purchasing loans from other banks and purchasing loans from other alternative lenders, that really piqued my curiosity. As my career at Wells went on, I really, really got to learn about the opportunity available to sell loans to banks and different things like that which I kind of knew was happening on the residential side of the world, I just didn’t realize how much it was happening on the small business side of the world.

Lendistry actually got started because I went to some of my friends who will remain nameless and I told them, hey, I think you guys could cut a deal with some of these banks and you could start selling loans to them and at the time they thought the banks were, you know, the worst thing ever.

Peter: Right.

Everett: They weren't transparent, they weren't fast enough and quite frankly, the fintech industry basically said the banks were bad and they were kind of in opposition to the banks. I would say to my friends, hey, but you know, I'm a banker and I'm a good guy and they would laugh and say, yeah, well you're different. (Peter laughs)

So you know, as cliche as it might be, one time we were having a conversation and I said to them, I think you should partner with banks, I think there's a real opportunity, there are some regulatory items that you could really help with and they basically said, if you think it's such a great idea, why don't you do it and that planted the seed that led to Lendistry.

Peter: Right, interesting. So then why don't you step back and tell us about Lendistry. In our previous conversation you described it as a hybrid of a community bank and a fintech company, but you're not a bank so tell us what you are and what products you have.

Everett: Yeah, so I think what led us to come up with this hybrid concept is that we've looked at kind of the two industries; one on the private side if you could imagine I'm participating in a loan to them and would really...the participation started because five years out of my twenty year career I was an underwriter so what I was trying to figure out was how did they take those 100 to 200 sheets of paper....my friends in these fintech companies, and how are they able to make a decision in such a short period of time. So what started out as curiosity led me to really be intrigued and what I felt was that the companies had two really good things.

Number one, they were able to filter the sales process and I thought, oh my gosh, if we didn't have to pick up the phone and talk to everybody and go through kind of this brain damage of figuring out who's the right and wrong customer for a variety of reasons, that would be great.

The second thing is what I would call a proactive approach to servicing which is where they really focused on taking a look at the borrower based on risk and credit profile and making a decision about how to collect from that borrower and what to monitor. I found that a lot of these systems that fintech companies were using were actually used in the bank, they were just utilized on the compliance side as opposed to the sales and marketing side so I thought that was really interesting.

When I looked at the fintech world I saw that there were three things that were kind of fundamental in banking that I thought they were missing. That was cost of acquisition, I thought it was just too high, cost of funds, I thought that was way too high and then the third thing was risk management.

So I said, well if we could take what's great about what's going on in the fintech world, and we could take what's great about what's going on in the banking world and if we could kind of mush them together it could be a really interesting company and that's how Lendistry was started. So what we are, again, is kind of a hybrid of the best of both worlds and constantly improving on the different features and different things that we offer.

In terms of products, we offer really four main products. One is a bridge loan which is basically a loan to help people when they're either going to get an SBA 504 loan or some type of real estate loan and the timing is off so they need some help in terms of financing it.

In the banking world, a lot of times that happens when you're doing a construction of a property. In the modern kind of small business world, it just happens when costs are...maybe the business is going through a lot of growth or there's something happening and they just need to kind of bridge it. That will eventually, and we've already started this process...that's going to transform itself into a line of credit product which we've already started exploring and I can see big things for that.

The second thing we offer is a term loan. A term loan is usually five years or less. Most customers are coming in at around three to four years just based on credit profiles and essentially, that is a fixed rate product that allows the borrower to get generally working capital, expansion capital or business acquisition.

The third product is our SBA loan which is really similar to the term except the difference is that it goes out ten years and has a lower rate, generally. A lot of borrowers like that naturally for cash flow.

The fourth product which is probably the newer one is the commercial real estate. What we found is that a lot of these same businesses that were coming to us and couldn't get financing for working capital expansion, debt consolidation were also having some similar issues in terms of purchasing or refinancing their property so we decided we would add that as another product to our list of products that we offer.

Peter: Okay, so on the SBA one, are you partnering with a bank on those SBA loans or do you have direct access to the SBA program?

Everett: So part of the hybrid concept for us was we would take a couple of years and we would look at different licenses that were out there. We looked at a SBIC, which is a Small Business Investment Company and that was an interesting license, but what we actually focused on was a CDFI, Community Development Financial Institution, and we liked that one because, quite frankly, it had more of a community feel. We felt that we were serving this underserved market, this market that was really a victim of lack of community banks. You know, there's a lot of people out there that say big banks don't lend.

As a banker, I would argue that you have it exactly wrong. The big banks were the secondary markets source to the community banks and 30 years ago, there were 18,000 community banks, now there's arguably 6,000 of them depending on what marketing material you’re looking at. So that 67% gap or loss of banks is really what has caused this major vacuum. So we got the CDFI certification thinking about, okay, what we're really going after is an underserved market and what that certification gave us was the opportunity to apply with the SBA to be a direct lender to them and we took that opportunity.

Peter: Okay, okay, that makes sense. I guess one thing that I'd like to take some time to explore is the typical kinds of customers that you've got. I mean, these small businesses, are these...you're operating online, but you're sort of trying to build a community feel kind of thing. Tell us the typical customers that come to Lendistry.

Everett: Sure, so most of the customers that come to us come by bank referrals. The banks are our clients, the customers are the small business owners and so the actual metrics of them are they've been in business for about three and a half years, their revenues have a tendency to be under $3 million, they're typically looking for a loan amount size of a range of about $194,000. In terms of the community feel versus call it a national banking feel, our definition of community is just someone who'll listen to you, hear you out and try to help you out.

And so we leverage the technology as an enabler to make the process smoother, faster, stronger, but at the same time there are triggers or different things that will let us know when there's a customer we need to talk to. It could be them asking us a lot of questions, it could be us digging into their profile, it can even be a high growth scenario where we see a client that maybe made $150,000 one year then $800,000 and then $2.5 million and $3 million where we're trying to figure out what's going on there because part of the risk management that your taught at banks is to really understand exactly where this customer is going.

And that, again, goes to that product line where we said, you know, we need to evolve our bridge product really into a line of credit product because we've got some high growth companies out there that really are looking for a line of credit as opposed to just a term loan or some, you know, fixed loan amount.

Peter: Right, got it okay. So then I want to dig into underwriting just for a bit because, you know, you said, when we chatted before, that you have a portfolio management approach to underwriting and I wanted to find out firstly what you mean by that exactly and what is your approach to underwriting?

Everett: Sure, so in underwriting we look at three things. We look at the primary source of repayment which is cash flow of the business, the secondary source of repayment which is a personal guarantee and the third or tertiary source of repayment would be the collateral or maybe some type of federal or state guarantee. We've built the business around these three things knowing that any one of the three could be off. What I mean by portfolio management is you take a look at your risk factors, you take a look at how you could potentially lose money and you effectively build a moat around it.

Now that could be in the form of loan loss reserves, that could be in the form of government programs, that could be in the form of how you price a loan and I think that was kind of interesting to us because when we first got into the peer to peer fintech world it seemed like the focus was okay, I'm going to do risk-based pricing and I'm going to outrun my defaults. As a banker, we saw that that didn't work two times in history; one in the subprime mortgage world and in the subprime auto loan world. So we said we don't want to take that approach, we think we've already learned that lesson twice, let's try a different approach to this.

Peter: Okay, so I'm curious...like on your website you really emphasize the banks, the banking partners and you even say join our banking partners by investing in our communities, you know, 6% net annualized yield, are you working with banks on both sides of the equation like are you working with banks to say here is an investment, are you working with banks to say we can take your turndown, the client that you can't help, but we can help? Explain sort of the partnerships you're having with banks.

Everett: Sure, I mean, the first thing we did was we said is it truly possible to disrupt the banks or is it truly possible to partner with the banks, which one has the best shelf life, for lack of a better term, where's the biggest opportunity. And what we saw was that it appears that customers still, I forget the exact study, but one of the studies said 84% of customers are still going to banks.

And so what that meant to me is that it's impossible to escape the banks. I definitely believe that people can disrupt the banks and companies can make things change, but I think at least in the US, there's a long road before banks really get disrupted.

And so we said let's just try to figure out the different angles where banks need help and so we saw that as a regulatory scenario and a yield scenario and so we really, really focus on what are the regulatory needs that a bank might be going through and how do we help with those, how do we make ourselves look as much like a bank as possible so that we can be a good partner to them.

And then we also have a team that, quite frankly, 70% of them have come from the banking world and I think that's part of our unique sauce is that we spend more time looking like a bank, thinking like a bank than we do anything else. And so to answer your question, banks have turned around and said, okay, we don't want to do this type of loan and it could be anything.

Peter: Right.

Everett: It could be credit profile, it could be operational efficiency, anything, would you be willing to do this for us. Sometimes the answer is no, a lot of the times the answer is yes. The other thing is they will say, well I've got this same thing as a peer to peer lender concept with a person, right, there's a person who has their money in let's call it a checking account or savings account, they're not making any money and they decide, okay, I want to invest in loans.

Well banks invest in things too and they want opportunities to earn higher yields just like the peer to peer investor does. And so we focus on that knowing what they traditionally invest in and say, okay, we can give the same sense of security or the same optionality. Would you be willing to take that and a lot of times they say yes.

Peter: So then just to be clear on that, are you providing them with a way to offer business loans like lending as a service type thing or are you just taking their capital and investing it in your loans? What's the level of depth of the partnership, I guess, is what I'm asking.

Everett: Yes, so capital for us comes in equity capital, it's coming in debt capital, it's coming in the ability to participate in loans so there's a variety of different things that they're looking at us as a source for them. Different banks want different things, regionally, size wise, etc., but we're giving them all of the options.

Peter: So are you giving them an option to run a banking program under their own brand like an online offering? I know there's other companies doing this as well, but is that part of what you're offering or how integrated are you in the...like the experience of that bank's customer. Can one of your partner banks make a loan to their clients under their own brand or do they refer them to you and then you take over?

Everett: Typically, it's the latter where they're referring it to us although we have definitely started to talk to a couple of banks that want to do the former. And so that's really a compliance thing today which we believe we figured that out and we have a couple of banks that are now exploring it. So hopefully in the next 12 months you'll see that come to light. I don't necessarily know that it will be transparent when it comes to light, but it definitely will come to light.

Peter: Right, okay. So then just on your loan products, obviously you've got a few different loan products, is the term loan the most popular product, as far as demand, or which one is? I just want to dig in a little bit about these products.

Everett: Yes, I would say that SBA loan and the term loan go hand in hand. We cap our SBA loans at $250,000 so we're generally looking...the program that we're in is called SBA Community Advantage which is a $50,000 - $250,000 loan product so it's looking for a specific type of customer.

The term loan goes up to $1 million so generally the reason why our customer would choose one or another just purely has to do with how much money they're looking to borrow, but the two go hand in hand in terms of which ones are the top product at the time. I would also say that some are regional; Southern California has a tendency to have bigger borrowing amounts than Northern California unless we're dealing with like San Francisco or the Bay Area.

Peter: Right, that makes sense. So then what are the range of interest rates that you're charging? Obviously, SBA loans are probably going to be pretty low rates, but the term loans…can you just give us some sense of the range of interest rates?

Everett: Sure, the SBA generally is ranging somewhere in the range of about 8 to 10% right now with a ten year fix, that's the majority of customers we're getting so as you can imagine, from a cash flow perspective, that's pretty cheap borrowing and that's a fixed rate too as opposed to a variable which a lot of times when they're going to other places they're getting a variable rate for an SBA. We have started to consider the variable, but for right now, we've been doing fixed rates.

And then the term loan generally ranges somewhere in the range I'd say about 8 to 16% and that's going to depend on credit profiles. Again, that's up to five years. A majority of people are coming in right around three to four years and so one of the things we're looking forward to as more banks invest, we'll be taking those rates down further.

It'll be interesting because it'll contradict the interest rate movement which obviously prime and LIBOR are shifting upwards but because we're generally borrowing from banks we've got a little bit lower cost of capital. So what we've been doing from a risk management perspective is we don't put our bank capital into 100% of loans just to kind of spread our own risk management philosophy and spreading out the risk across our different bank partners.

Peter: Okay, so then let's just talk about that for a minute. I mean, you said the majority of your capital comes from banks, how does it work? I guess how has it evolved over time too? You're still a relatively new company, obviously you've got people, yourself included, people at Lendistry who have deep bank experience and deep bank connections so, you know, what I'm trying to get at is when you're funding these loans are you sort of taking a marketplace approach or are you...or you just got the banks....the banks are providing a warehouse line, and you're funding loans through that line.

Everett: Yeah, so I would share with you, Peter, that probably the majority of our funding comes from institutional investors today...

Peter: Okay.

Everett: ...and banks are catching up quick, just to be clear. The answer to your question is I would say it's part existing or permanent bank capital where they've either invested in a loan fund or they're providing debt and then the other part is a marketplace where we have banks out there that are just saying, I'm looking for a loan placement here, or yield here or credit profile here, so to speak, and if it meets one of those criteria then that's when we kind of turn into somewhat of a marketplace. Again, not quite transparent to the borrower because the servicing is retained, but that is how it works.

Peter: Okay, okay, that makes sense. Just going back to the community aspect, I mean, you're an online lender, I guess how much of what you're doing is in Southern California where you're based and how much of it is in other states? Maybe tell us your geographic footprint and how you sort of…are you doing this face-to-face, how are you building the community in your business?

Everett: Yeah, so I guess it's a little convoluted I guess is the best way to answer, but the answer to your question is we are a national lender, however, 90% of our business is in California. Now part of that is because that is what we've chosen to do, we've said let's stay focused at home. We have a lot of different regulatory things that we wanted to put in place. You might have saw recently we got approved by Federal Home Loan Bank of San Francisco so there were certain things that we really wanted to focus on and concentrate on inside of California and quite frankly, it's California, right.

So if there's any economy, you know, you want to deal with, if you look at the states as an individual economies outside of New York, California, to me, is where you want to be. So it gives us such a broad bandwidth to really focus, fine-tune and do a lot of things that we wanted to do in terms of building the company. That being said, we call it the Big 6, which is New York, Miami, Atlanta, Houston or Dallas, depending on where you want to choose in Texas and Chicago in addition to Southern California which I will call the LA market. Those are the markets that we plan to really, really sink our teeth in and then we've got some sub-markets like Philadelphia, San Francisco and a couple of others that were, you know, close seconds, so to speak.

In terms of how we talk to our customers, we have a group of bankers who in our world we call relationship managers who literally pound the streets and they take a grassroot approach and so those are generally face-to-face. It's really a center of influence business, it is a face-to-face, it's going to different conferences and different things like that and that's going to be a lot more interaction with the customers.

Then we've got another group that is really coming through SEO marketing, Google, different marketing things that we’re pushing out and those customers are coming online. At the end of the day, everybody ends up inside of our portal, but in terms of how we actually attract and talk to customers, we want to do a couple of different things.

I look at it from a leadership standpoint, you want to be regional just because markets change, economics change, environments change, God forbid, but California could have a major earthquake whereas Miami could have a hurricane, right, we saw that last year so part of that is risk management and part of that is where you want your deal flow to come in.

The other thing to me is your verticals and how you bring in customers. You should also have diversity in your different approaches and again, that's something that I learned when I was at the banks and I think it’s extremely important. I think at Wells Fargo we did an amazing job of stuff like that and so that's always kind of top of mind for me is that a singular source or a singular vertical, I think I can never see that inside of one of the companies I'm leading.

Peter: Right, right. So let me go back to the Federal Home Loan Bank of San Francisco. I saw the press release a few weeks ago now so firstly, maybe explain what the Federal Home Loan Bank of San Francisco is and what it means for your business to be a member.

Everett: Federal Home Loan Bank is what we call a banker’s bank, It's a place where a bank goes when it needs to borrow money, or economics, it just makes sense to borrow money. Maybe that money is cheaper than another place that you could borrow from. What we liked about the Federal Home Loan Bank is a couple of things; number one, it has a community focus. You know, for all intents and purposes, it's a community bank, right, or a co-op of community banks and so that was really important to us because it kind of met the same mission.

The second thing is it gave us the ability to look at different asset classes as we think about building out the scope of Lendistry, you’ve heard me talk about cost of funds, you've heard me talk about risk management and considering we’re in probably one of the best points in the economy, I think all of us who want to go beyond, you know, the next rough spot in the economy you want to look at asset diversification.

And so what this allows us to do is really, really sink our teeth into commercial real estate, have asset diversification, have leverage and also have a cheaper cost of funds. And so that's why we’re excited about it and it just seemed like a natural move for us.

Peter: Right, right. Okay, so I want to talk just briefly....I see on your website here that you are a signatory of the Small Business Borrowers Bill of Rights. This is a guideline set by the Responsible Business Lending Coalition and I just wanted to get your perspective like why did you do that? What does it mean for your business to be part of this coalition?

Everett: I think one of the things that I would charge all lenders to be that consider themselves good guys, is number one, stake your claim that you're a good guy. Number two, show up in a high quality way and I think this is part of us staking our claim like we recognize that there are businesses out there that are underserved, we want to make sure they don't get taken advantage of and then we want to basically tell others about it and hopefully others will consider it. I think that's what the Borrower Bill of Rights and those that are involved in the Borrower Bill of Rights, they represent that community for us that's all thinking and have the same mindset and it just made perfect sense for us.

Peter: Right, right, okay, that makes sense, yeah. I'm a big fan of...you know, I always feel like small businesses especially, there's protections in place for consumers, but I think for small businesses, there are fewer protections in place and I think it's got to be a win-win situation. There are some organizations out there that…not that this is purely based on interest rate or anything like that, but I think there are some companies I feel like it isn't as clear cut a win-win.

Anyway, we're almost out of time. Okay before I let you go, a couple of more things. You talk about your partnership with The Center, it's a non-profit so I want to just dig into that a little bit. Tell us briefly, what is The Center and why are you a partner with them?

Everett: Sure, so be ready, The Center is a nickname, the company has a long name. It's called the Center for Strategic Economic Studies and Institutional Development.

Peter: Wow.

Everett: It was started in 1999 to help African Americans grow and build their small businesses. When you ask the question about us being involved in the community, it's just a natural partnership for us and we leverage The Center, it's members and it's board members, it's volunteers, etc. to help us kind of really reach into the community and that looks a couple of different ways.

One is face-to-face seminars where we generally have anywhere from 50 to 100 people, it's small business coaching or sometimes there's a customer that just doesn't fit right or they really need some help and then we can leverage The Center which collaborates with other non-profits to bring them the resources.

And then, more importantly, recently it started building an online platform for customers to go online and learn different things and different educational things so it's just very, very exciting to partner with them. Again, with 70% of our team being bankers, and a lot of them being community bankers, this is a part of the banking job that they've always wanted to do so we figured if we bring it in house and bring it really close to home, it makes it a hell of a lot easier.

Peter: Right, interesting, really interesting. Okay, so then last question, what's your vision for Lendistry, where are you taking this?

Everett: So when I when I look at us as a hybrid of the fintech world and the community banking world, I'd also like us to be a gateway. I'd like for the banks that are out there that want to do more lending for them to be able to expand their small business lending or other departments and leverage Lendistry or maybe leverage one of our fintech partners.

On the flipside, I know there's a lot of good fintech lenders out there who maybe need some help in the cost of funds and I'd love to be a gateway for them for the banks, so that's number one. Second thing is naturally I'd love to keep growing our business and add additional products and additional offerings to our clients which are banks and our customers which, again, are the small business owners.

Down the road, we're going to start looking at some other intricacies in terms of residential real estate and others things just as we kind of come full circle and take a holistic approach with this customer that we have all their financial information already, what other services can we offer to them.

Peter: Great, well I think that's a noble mission and I wish you all the best. Thanks for coming on the podcast today, Everett.

Everett: Thank you so much, Peter, I really appreciate your time and the opportunity.

Peter: Okay, see you.

Everett: Thanks.

Peter: We all know about the reduction in the number of community banks nationwide, Everett just touched on it earlier, and really the community banks though they serve a wonderful purpose, a noble purpose and a useful purpose because they are connected to their local community. I often feel like that's what's missing in a lot of these nationwide online lenders, is a connection to the local community so it's interesting to me that Everett sees this as...he is really a fintech company, he's a non-bank lender, but he is very much focused on serving the local community and he's doing that in a really interesting way.

I think it's going to be interesting to see how they can scale this operation and whether they can truly reach a national scale, but the reality is this is the approach we need I think because people, particularly small businesses when they're dealing with complex financial matters, they want to have a relationship. They want that relationship to be more than just a phone call or whatever and I think being in the local community, being able to serve it in a local way, I think that is a huge advantage and one that I wish Everett and the team at Lendistry all the best with.

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

Today's show was sponsored by LendIt Fintech Europe 2018, Europe's leading event for innovation in financial services. It's happening November 19th and 20th at the Business Design

Centre in London. Registration is now open as well as speaker applications. Find out more by going to lendit.com/europe

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