deBanked
November/December 2019

2020

THE END OF AN ERA

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deBanked

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Letter From the Editor

BY
SEAN MURRAY

This decade is officially over. The milestone is an especially momentous occasion for deBanked given that we launched at the beginning of the decade in 2010. Ten years! When it first came online, I hoped to provide news and information that could not be found anywhere else. And now here we are, still at it, and with a much bigger platform than ever before.

If you take a minute to stop and consider just how much has changed in this wild world, you may pick up some clues and ideas about how to prepare yourself for the decade to come. In this issue we revisit some pieces of alternative finance history to close out that era once and for all, while following up with insights on old products that may become new again: SBA lending and commercial real estate. Both of these areas of lending have segments that fall under the non-bank umbrella. Could there be opportunity?

In 2010 I turned 27 years-old. In 2020, I will turn 70. Or at least that's how it feels. Hopefully this decade was kinder to you. If we don't discover the fountain of youth in the years to come, perhaps one of the data scientists out there that are using their brains to develop artificially intelligent credit algorithms could take a break to reverse human aging. I see no reason why fintech can't spin off into skin-tech, kin-tech, or thin-tech. Even Chin-tech might do. With the buzzwords already out of the way, thanks to me, we'll just need someone to provide the capital to get this technology off the ground. My gut says it won't come from a bank, which means we'll come full circle and that you'll be reading about it here.

Thanks to everyone that has followed us since the beginning. It has been an honor and a privilege.

For the last time this decade, this is Sean Murray signing off.

Sean P Murray

–Sean Murray

! deBanked launched in 2010 (originally as Merchant Processing Resource) and was one of the first major sources of merchant cash advance information. Here are some of our historic highlights as well as snapshots of content and data we amassed over the years that will leave you yearning for simpler times.

The End

TOP 10

TOP 10 MERCHANT CASH ADVANCE FUNDERS OF 2008 BY ORIGINATION VOLUME

1. AdvanceMe
2. First Funds
3. Merchant Cash and Capital
4. Business Financial Services
5. AmeriMerchant
6. Greystone Business Resources
7. Strategic Funding Source
8. Fast Capital
9. Sterling Funding
10. iFunds

deBanked got some unwanted and strange web traffic in May 2011 when the hacker collective, Anonymous, published a response to the allegations that they were responsible for the Sony PlayStation hack that knocked 77 million users offline for a week. The rambling denial that lectured Sony on several issues including weak credit card processing security, cited and linked to a PCI compliance guide on our website.
See: **http://dbnk.news/2v**

Thanks Anonymous.

In early 2011, deBanked estimated that $524 Million of merchant cash advances had been collectively originated industry-wide in 2010. The figure was cited in numerous publications and was a leading driver of investor interest in the merchant cash advance industry at the time.

"I never wanted to manage an ISO, I wanted to be a salesman on the front lines. I wanted the ringing phones, the commotion, the marker boards with stats, the glory, the $20,000 checks.

I became a merchant cash advance salesman at the worst time in history. Fast Capital had long gone, Merit left the arena, and some of the good 'ol boys had changed to renewals only. Submitted applications were responded to by computer programs saying my deal was automatically declined due to something or other and would not even be reviewed. "How could my deal not get reviewed? I spent 30 days pitching this merchant only to find out he wasn't even worthy of review?"

My subsequent calls were met by agitated voices at funders who couldn't comprehend why I wanted to know the status only 2 days after I submitted the application.

I shrugged it off in the beginning. In fact I found myself not even submitting a large chunk of the applications I generated because they didn't look like approval material. That was the underwriter in me. I learned it to be a harmful habit."

- Excerpt from An Underwriter in Salesman's Clothing By: Sean Murray, April 2009

*- See: **http://dbnk.news/2w***

The boom years of 2007 and 2008 have come and gone, they have flown by and drifted into oblivion. Now we are faced with the grim reality of 2009. The time of submitting a file and receiving a same day approval, next day funding are a thing of the past. MCA Funding companies were hard hit in 2008. Approvals are down, the story of 90% approval ratio is now more like a 90% denial ratio.

Excerpt From: Merchant Cash Advance Publication Vol 1, Issue 1 – February 1, 2009

Of An Era

THE TOP 10 COMPANIES APPEARING IN GOOGLE'S SEARCH RESULTS FOR *MERCHANT CASH ADVANCE* IN FEBRUARY 2012

1. MerchantCashInAdvance.com
2. Yellowstone Capital
3. Entrust Cash Advance
4. Merchants Capital Access
5. Merchant Resources International
6. American Finance Solutions
7. Nations Advance
8. Bankcard Funding
9. Rapid Capital Funding
10. Paramount Merchant Funding

Source: http://dbnk.news/2x

In 2019, Kabbage surpassed OnDeck in quarterly loan originations, but in 2011 Kabbage was merely chugging along as a funding source for eBay sellers. An article in deBanked's inaugural magazine issue in 2011, titled: Kabbage, The MCA Provider For PayPal and Beyond, we quoted language from Kabbage's website that explained the application process:

"Simply enter your eBay marketplace ID and we will start the process. If you have sufficient activity and a great history of selling on eBay, we will then ask you to complete our application. You can go from eBay ID to cash (in your PayPal account) in as few as 10 minutes!"

Source: http://dbnk.news/2y

HOW MANY CONFESSIONS OF JUDGMENT WERE MERCHANT CASH ADVANCE COMPANIES FILING IN 2010?

As far as we can tell, zero. Despite a 2018 Bloomberg News story that claimed to expose widespread use of Confessions of Judgment that had begun as far back in 2012, deBanked had never published anything on the subject until a March 2016 guest post that analyzed a potential legislative reform of their use in commercial loan agreements in Ohio. The subject would never be mentioned on the site again until early 2017. In 2019, the New York State legislature passed a law that prevents them from being entered against out-of-state debtors in New York's courts and the United States Congress drafted a bill to ban them from being enforced in any state if they're connected to a commercial finance agreement. It just goes to show how fast things can move and how difficult it is to predict how the industry will shift in the future.

THE DEFAULT RATES OF YESTERYEAR

OnDeck
10/9/12
Default rate reported to be in the low single digits, but said that it was double that amount during the recession.
Source: Upstart Business Journal

3/27/13
Default rate is around 5%.
Source: Forbes

Capital Access Network
10/1/12
Default rate reported to be in low single digits.
Source: Digital Transactions

2/4/13
Loss rate (for a selection of their portfolio) reported to be 3.2%.
Source: Gigaom

Kabbage
11/13/12
Default rate reported to be below 2%.
Source: USA Today

IOU Central
9/30/12
8% of the loan portfolio reported to be impaired or past due.
Source: Public filed financials

Snippet of the Merchant Cash Advance Resource section of our website in October 2011. To this date, the merchantcashadvanceresource.com domain still redirects to our website as does the original merchantprocessingresource.com

A THROWBACK WITH A TWIST

In 2012, deBanked hosted a just-for-fun industry-wide fantasy football league for charity. Donations were collected from:

- Merchant Cash Group
- Rapid Capital Funding
- Financial Advantage Group
- RapidAdvance
- Sure Payment Solutions
- Meridian Leads
- Merchant Cash and Capital
- NVMS
- United Capital Source
- Swift Capital
- TakeCharge Capital
- Raharney Capital (owner of the deBanked website)
- Entrust Merchant Solutions
- Strategic Funding Source
- Paramount Merchant Funding

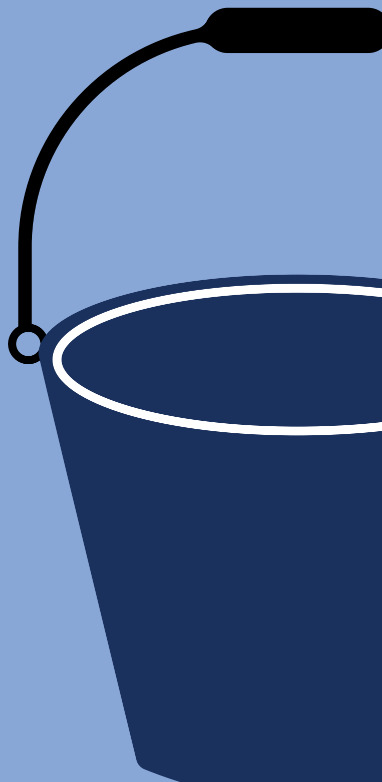
$7,100 was raised. Sure Payment Solutions, who won the tournament, earned the rights to choose the charity that the funds would be donated to. Originally, they had asked that the entirety of the funds be donated to the ALS Association but given that New York City was in the midst of recovering from Hurricane Sandy, they opted to split the $7,100 between the ALS Association and the Hurricane Sandy Relief Foundation (HSRF).

A GOOD DEED INDEED, RIGHT?

Two months later in March 2013, PayPal returned the money that had been donated to HSRF without any explanation. That same day, news outlets ran a story that alleged the organization did not have legitimate status as a charitable organization. That was coupled by a New Jersey Superior Court judge freezing the foundation's bank account and ordering a warehouse of donated food, clothing, and other goods to be confiscated. The state of New Jersey, who brought the case, alleged that as of January 2013, HSRF had raised $631,000 but had only issued $1,650 in gift cards to aid Sandy victims. The case eventually resulted in a settlement and any funds that had not already been returned to donors was properly distributed to legitimate charitable organizations.

deBanked was fortunate to have received the funds back in full. After notifying Sure Payment Solutions of the debacle, they directed those funds be donated to the ALS Association, just as the first half had been. All in all, the full $7,100 went to ALS research.

That following summer in 2014, as you may remember, birthed the ALS Ice Bucket Challenge.



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FEARS OF POSSIBLE RECESSION DON'T PHASE CRE LENDERS

By: CHERYL WINOKUR MUNK

Depending on your vantage point, a slowdown is either already in progress, just around the bend or several years away. But some alternative commercial real estate professionals are trying to filter out the noise.

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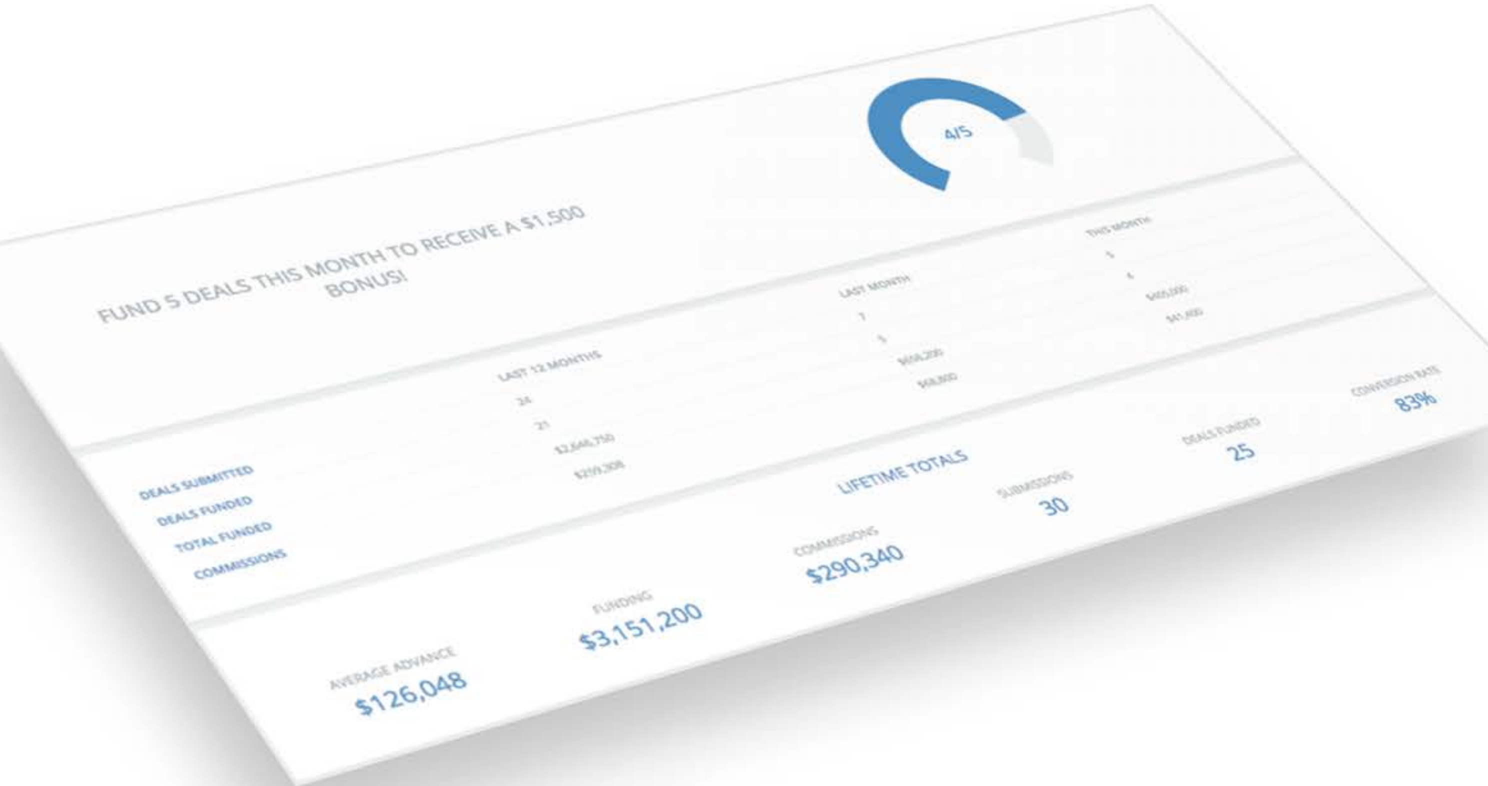

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Instead, they are more aggressively forging ahead with growth plans, including trying to grab market share from banks.

The commercial real estate lending market remains highly competitive and alternative lenders say they remain focused on looking for opportunities to expand their business, even as the possibility of recession looms. At present, a number of professionals don't see an imminent threat of recession, and even if there is one, they say they stand to benefit from picking up business banks don't want to take on—or can't—because of increased regulatory controls imposed on them since the last recession.

There are plenty of opportunities for alternative commercial real estate lenders to get ahead, even in this environment, says Chris Hurn, founder and chief executive of Fountainhead Commercial Capital, a Lake Mary FL-based, non-bank direct small business lender in the commercial real estate lending space.

To be sure, alternative commercial real estate lenders say that for the most part, there hasn't been a major pullback in their space. But due in part to mounting economic concerns and changing business priorities, banks—which had already scaled back from their pre-Great Recession exuberance—have been taking an even more cautious approach to lending. This is especially true in certain regions of the country, or in sectors deemed higher-risk such as hospitality and retail, alternative lenders say. While the pullback hasn't been broad-based, it's been enough in some cases to create strategic pockets of opportunity for opportunistic non-bank lenders such as private equity funds, debt funds, crowdfunding portals and others.

For many of these commercial real estate professionals, whether or not a recession is on the horizon is not a guessing game that's worth playing. And with good reason, given how much disagreement there is among market watchers, investment management professionals and others about where the economy is headed.

Certain economic data continues to be strong, for instance, but political and geopolitical factors such as trade wars continue to raise red flags. Then there's the fatalistic notion that the economy has been on a tear for so long that it's due for a pullback at some point. This all translates into a hodgepodge of speculation and indecision about the economy's direction. The dichotomy is evident from the difference in sentiment expressed in two fund manager surveys from Bank of America Merrill Lynch taken a month apart. October's survey was decidedly bearish; by November, the bulls were back, muddying the waters even more.

Instead of wavering in indecision, however, some alternative commercial real estate players are hunkering down and highly focused on building their business in a cautiously optimistic and strategic manner.

Hurn of Fountainhead Commercial Capital predicts a number of increased opportunities for alternative commercial real estate lenders due to pullback from banks and a growing need for capital. He cautions alternative lenders against being too pessimistic and losing out on potentially lucrative market opportunities as a result.

"I think we might be going into a period of slightly slower growth, but none of the indicators suggest we're remotely close to where things were 10 years ago," Hurn says. "If we're not careful, we're going to talk our way into recession. It's a self-fulfilling prophecy."

Indeed, even as perplexing questions about the economy's long-term health persist, some alternative commercial lenders anticipate growth in the coming year. Evan Gentry, chief executive and founder of Money360, a tech-enabled direct lender specializing in commercial real estate, says the company's loan origination business is on track to close between $650 million and $700 million in 2019. That's expected to increase to about $1 billion in 2020, fueled by growth in some strategic markets, including Washington DC, Atlanta, Miami and Charlotte, N.C., where the company is seeking to add loan origination personnel. Gentry says the company also continues to experience strength in many of the western markets, including the intermountain west markets of Colorado, Utah and Idaho, where growth is expected to continue.

CommLoan, a commercial real-estate lending marketplace in Scottsdale, Ariz., also sees strategic opportunities to grow in this environment. Mitch Ginsberg, the company's co-founder and chief executive, predicts 2020 will be a strong growth year for his company, after a several-year beta period. CommLoan has plans, for example, to start hiring account executives to build relationships in additional states. Initially, the focus will be on institutions in the Southwestern U.S., with plans to add lenders in Texas, Utah, Colorado and New Mexico in the early part of 2020, Ginsberg says.

Though certain regions or business lines within commercial real estate may be experiencing some pullback, he says his overall outlook for the economy and commercial real estate remains strong. "There is still an enormous amount of activity," he says. "If and when a nextwave FUNDING

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correction does happen, it's going to be a lot softer and not that deep and not that long because of the fundamentals in the economy."

FINDING WAYS TO COMPETE MORE EFFECTIVELY WITH BANKS AND OTHERS

Some commercial real estate professionals say they are focusing more attention on sectors, regions and concentrations that the banks aren't going after so readily.

If an alternative lender can offer more money than a bank on a particular deal or offer more flexible terms, or do deals that traditional lenders simply won't do, for example, then it's a boon for them. For a slightly higher price, alternative lenders—especially those whose business model relies heavily on technology—are able to take on slightly riskier deals than a bank might be able to stomach, says Jacob Goldsmith, managing partner of Goldwolf Ventures LLC, a privately held alternative investment and asset management company with offices in Miami and Austin.

"Alternative lenders are a lot more nimble," says Goldsmith, who keeps close tabs on the commercial real estate lending industry.

Especially given the ambiguous economic climate, there are several areas that could be prime opportunities for savvy alternative commercial real estate lenders to gain a leg up. For instance, some banks of late have shied away from certain special purchase property types like hotels, day care facilities and free-standing restaurants, says Hurn of Fountainhead Commercial Capital. These types of properties are traditionally seen as riskier in the latter part of an economic cycle.

Nonetheless, "there's opportunity here for non-traditional lenders to step in and fill that gap," he says.

Retail loans are another category where banks have been pulling back. One reason banks are being more cautious is the sentiment that as online shopping becomes more pervasive, there's less of a need for brick-and-mortar shops. This trend is underscored by the recent announcement of Transform Holdco—the company formed to buy the remaining assets of bankrupt retailer Sears Holdings Corp.—that it would close 96 Sears and Kmart stores by the end of February. Still, some industry watchers aren't ready to concede retail's demise.

While these types of announcements fan fears, concern over the death of retail is largely overblown, according to Troy Merkel, a partner and real estate senior analyst at RSM, which provides audit, tax and consulting services. "The banks are being too overly cautious," he opines.

The opportunity for alternative lenders, he says, is not in funding loans that add to the supply, but rather in funding loans that change the existing supply. While the need for new development may not be as great, there is

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a growing demand for repurposed properties, he says. This includes upscaling an older mall or turning an existing retail building into a mixed use property, namely a mix of retail stores and multi-family apartment complexes. There is still a real need for these types of developments, Merkel says, and with banks shying away, the door is open for alternative lenders to "make a play," he says.

Real estate professionals say they also see opportunities for alternative commercial real estate lenders to make loans in areas outside major metro cities, where the competition isn't as strong.

"There will always be opportunities in the ups and downs, the ebbs and flows of the cycle. You just have to be a lot smarter in this part of the cycle," says Goldsmith of Goldwolf Ventures.

BECOMING RECESSION-PROOF

Pockets of opportunity notwithstanding, alternative commercial real estate lenders have to play it smart, professionals say. For instance, they should not be overly bullish on a particular sector or throw caution to the wind when it comes to their underwriting practices.

That's because when the market turns—as it inevitably will at some point—there will likely be more defaults and lenders that haven't dotted their I's and crossed their T's will understandably face stronger headwinds. They need to keep their close eye on expenses as well, which may have ticked upward over the past several years. "People get complacent when times are good. This is probably not the time to be complacent anymore," says Hurn of Fountainhead Commercial Capital.

Another protective measure against an eventual downturn is to diversify sales channels and property types. "If you put too many eggs in one basket, it's a problem," Hurn says.

It's also important for lenders to have their guards up since higher risk deals can lead to losses if a recession hits. Lenders have to be smart when it comes to taking on risk, says Tim Milazzo, co-founder and chief executive of StackSource, an online marketplace for commercial real estate loans. "They have to have a certain expertise in underwriting these transactions correctly and assessing risk," Milazzo says.

In light of significant ambiguity about where the economy is heading, Gentry of Money360 says his company is protecting itself by taking an ultra-conservative approach. This means, for instance, only making first-lien position loans secured against income-producing properties at a loan-to-value ratio on average of 65 percent, he says. Some alternative lenders are making these loans at a loan-to-value ratio of 80 percent or 85 percent, but Gentry says this is too high a rate for his taste. Also, Money360's loans are also generally short-term—in the two-to-three-year range, which reduces some of the risk and seems especially prudent at this point in the cycle, he says.

When the market turns—as it inevitably will at some point—there will be more loan defaults, and those that are on the more aggressive end of lending will bear most of the challenges, he says.

He cautions other alternative lenders to avoid taking on excessive risk. "You've got to be thinking ahead and planning and lending as if the downturn is right around the corner—because it could be," he says. Even taking a conservative approach, there are still significant business opportunities, he says.

BE ON THE LOOKOUT FOR RECESSIONARY OPPORTUNITIES

Meanwhile, if a recession does hit, alternative commercial real estate lenders say they will have even more opportunities to gain market share, participate in workout financing and hire key personnel. Alternative lenders that are more steeped in technology may potentially have even more of an upper hand since this can enable them to close deals much more efficiently and quickly and at a lower cost, while at the same time giving borrowers broader access.

"In a tighter market, every reduction in rate and cost will make more of a significant difference to borrowers than it does at the moment," says Ginsberg of CommLoan, the commercial real-estate lending marketplace.

Although there are a growing number of alternative commercial real estate lenders who are relying more heavily on technology than they did in the past, commercial real estate lending still hasn't flourished online to the extent personal and small business lending has. One reason is that the loans are larger and human intervention is often seen as beneficial, says Gentry of Money360.

However, online lending within the commercial real estate lending space is still on the horizon, according to Ginsberg of CommLoan. "It's slow-go, but it's inevitable," he says.

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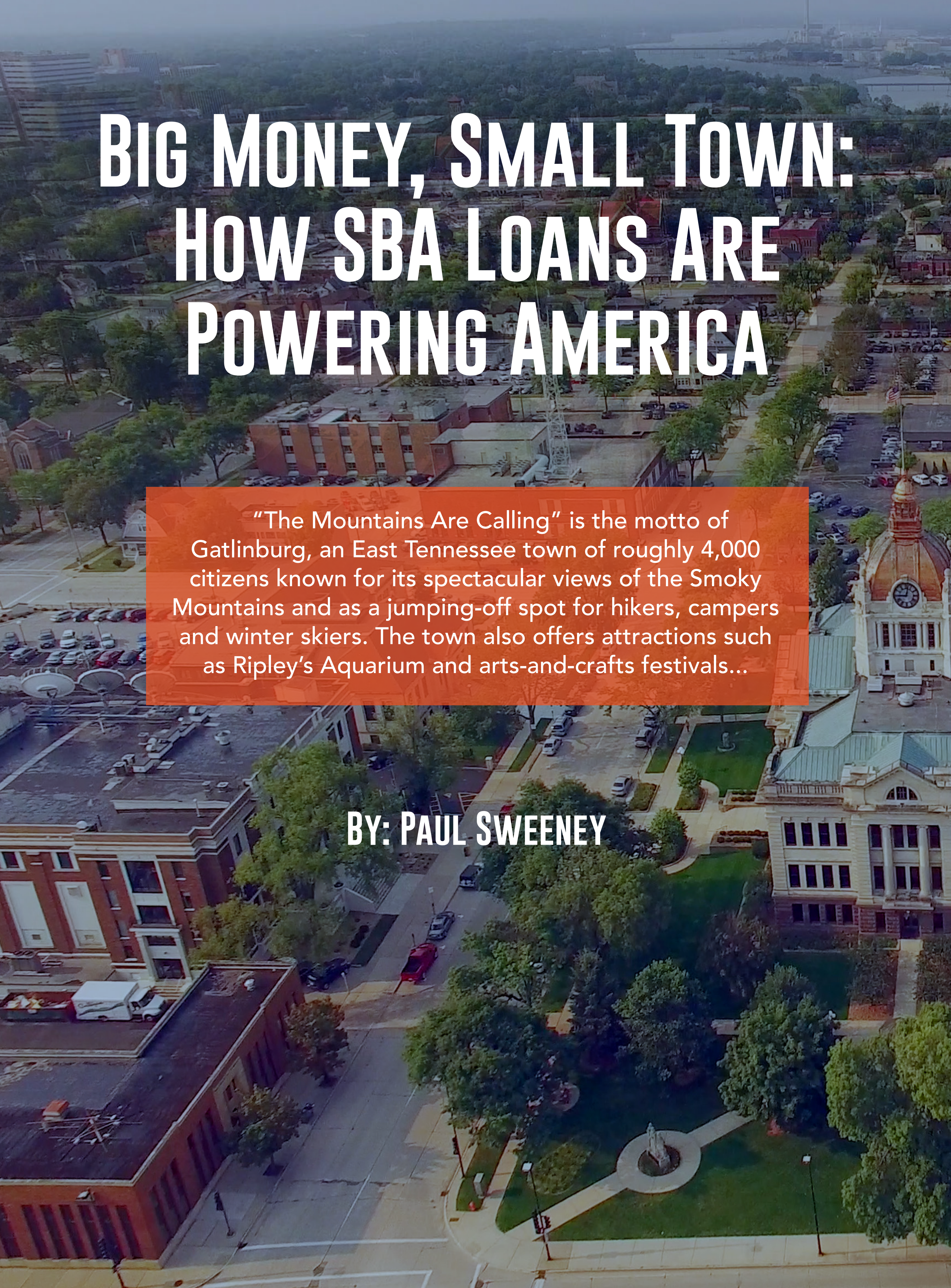

Big Money, Small Town: How SBA Loans Are Powering America

"The Mountains Are Calling" is the motto of Gatlinburg, an East Tennessee town of roughly 4,000 citizens known for its spectacular views of the Smoky Mountains and as a jumping-off spot for hikers, campers and winter skiers. The town also offers attractions such as Ripley's Aquarium and arts-and-crafts festivals...

By: Paul Sweeney

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To get around, 800,000 tourists and locals alike hop aboard the 20-odd trolley buses operated by Gatlinburg Trolley, the private transit system. Few riders marveling at the picturesque scenery and enjoying the sprightly vehicles, which recall San Francisco's cable cars, know that they're riding a custom-made trolley-bus built by Hometown Trolley of Cranford, Wisconsin.

And even fewer would know that the chief executive and president of that company is Kristina Pence-Dunow, making it the only female-owned manufacturer of transit vehicles in the US. Bolstering the manufacturing enterprise—which Pence-Dunow acquired in 1997 from her ex-husband, who wanted to "liquidate" it, she says—have been multiple bank loans backed by the Small Business Administration.

The most crucial SBA loan came in 2005, she says, just as she was nearly driven out of business in a price war. "We had to be innovative" to survive the cutthroat competition, Pence-Dunow told ***deBanked*** in a telephone interview.

Using a $350,000, five-year SBA credit issued by River Valley Bank (now IncredibleBank of Wausau, Wis.), the transit company developed the prototype for a "low-floor entry vehicle." The design feature made her trolleys accessible to riders with walkers and wheelchairs and enabled the company to beat out its competitor for a key contract with Hampton Roads (Va.) Transit. That deal, in turn, generated sales to transit authorities in Miami Beach, Laguna Beach, and the University of Oklahoma.

Subsequent SBA loans, Pence-Dunow says, enabled the company to create its own dealer network and develop battery-powered, clean-energy vehicles. The financings also allowed her to buy out, in 2016, the rival trolley company that had tried to run her buses off the road.

Her grit and determination—for many years Pence-Dunow ran the company as a single mother raising two children—have also paid dividends for her Wisconsin community. With annual sales of $20 million and 65 employees receiving health and life insurance as well as pension benefits, Hometown Trolley has brought good-paying jobs to successive generations of families in the Northwoods.

In 2018, she earned the SBA's "Small Business Person of the Year" award for the state of Wisconsin.

Hometown Trolley, meanwhile, is just one of 30 million small businesses that make up the backbone of the US economy. Small businesses—a small business is broadly defined as a commercial or professional enterprise with fewer than 500 employees—accounted for the employment of 58.9 million people in 2015, according to the US Census Bureau's most recent figures. That's just shy of 50% of the country's total workforce. And it seems that the smaller the better: In 2018, firms employing fewer than 20 employees added 1.1 million net jobs to the US economy, the largest gains among the small business cohort.

By contrast, large manufacturing companies only employ about 11% of the total workforce, notes Karen G. Mills, former SBA administrator and member of President Barack Obama's cabinet. The bottom line is that the contribution to the economy made by both small business and the SBA "is under-appreciated," says Mills, now a senior fellow at Harvard Business School and author of ***Fintech, Small Business & the American Dream***. "It's a much more powerful job-creator than the manufacturing component of the US economy," she adds.

During the Great Recession, which coincided with her tenure at the SBA, Mills reports that 60% of the country's job losses were in the small business sector. As many as 1.8 million jobs disappeared in a single quarter in 2009. Mills credits the SBA's lending as playing a key role in buffering the US economy against even more severe ravages.

To help reverse the economic free-fall, the SBA eliminated all SBA fees and temporarily upped the 75% government credit guarantee to 90%. The agency also persuaded a thousand commercial banks that had not issued an SBA-backed credit since 2000 to turn on the spigots. "Banks are the primary source of financing for small businesses," she notes. "They (small businesses) can't go to the credit markets like big business does."

S.R. Rosati, Inc., an Italian ice manufacturer based in Clifton Heights, Pa., is one of those small businesses that nearly went belly-up. Headed by Richard Trotter, a West Point graduate, former US Army captain and company president, the Italian ice business is thriving today. It has just under 30 employees and reports annual sales of $10 million. But ten years ago it was in desperate straits. "Even though we're a 100-year-old company," Trotter says, "we could have been like a ton of businesses that went out of business every week. The SBA helped us get through tough economic times in 2007-2008 when a lot of businesses took a hit."

The SBA's flagship product is the 7(a) loan, which range up to $5 million. Almost 2,000 US banks, as well as a number of nonbanks, participate in the program. The loans are currently backed by a 75% government guarantee and are targeted to those entrepreneurs who, the SBA states, "otherwise would not have access to capital to start, grow, or expand their small businesses."

An SBA loan, former Administrator Mills explains, "is designed to fill a market gap— to make loans to creditworthy borrowers that the market feels are too risky to make without some support."

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Currently bearing an interest rate of 7.75%-9%, according to financial technology firm Fundera, 7(a) loans are affordable and the terms are fairly generous: typically, the borrower has 10 years to repay the loan. The loans can be used for multiple purposes: as working capital, to purchase equipment and inventory, make a business acquisition, meet payroll, hire new employees, and (in some cases) refinance crushing debt.

If a borrower is eligible and able to secure a 7(a) loan, "it's the gold standard," remarks Levi King, chief executive and co-founder of Utah-based Nav, an online, credit-data aggregator and financial matchmaker for small businesses.

William McSweeney, chief operating officer in the business banking section at Citizens Bank in Boston, says that insufficient collateral is most often the reason that a small business fails to qualify for a conventional business loan. With an SBA loan, he says, the government guarantee serves as a bulwark "to cover the weakness of a collateral position."

He cites the case of a dentist who's attempting to acquire an existing dental practice for $1 million. Unless the practice owns a building, McSweeney says, there's probably not enough collateral to support a $1 million borrowing. Yet the deal is attractive: Dentistry is a reliable industry (or "vertical" in lender jargon), the targeted practice has a solid client base, there's strong cashflow, and the practice boasts a fully equipped armamentarium. "An SBA loan will guarantee the $1 million loan for 75 percent," McSweeney says. "Now I can ask, 'Is there $250,000 in collateral.' That's the way I look at it."

Adds Kirk Jacobson, an SBA lender at Northwest Bank branch in Independence, Ohio: "In my experience, the preponderance of SBA loans have a collateral shortfall. Even lending to hotels or something tangible can be risky. The collateral (the hotel) can lose value quickly. The challenge for banks like ours is to use the SBA as the tool where conventional lending doesn't work."

By at least one yardstick SBA lending appears to be at a crossroads. The SBA reports that the number of small businesses taking advantage of the 7(a) program fell by 13% in the most recent fiscal year, which ended September 30, 2019. The 52,000 small businesses securing 7(a) credits in 2019 was more than 8,000 fewer than the previous year. The dollar amount of credits acquired also dropped; the $23.7 billion in lending was a 6.5% drop.

This is being taken as a good sign by the agency. "A strong economy is powering America's 30 million small businesses, and the SBA's numbers bear that out," Chris Pilkerton SBA's acting administrator and general counsel, said in a recent statement. "When the economy is doing well, 7(a) lenders are more willing to provide capital without the need for a federal loan guarantee."

But even small businesses that are outwardly healthy and experiencing growth often face hardship. Consider the case of Kyle McClelland, owner of Have Lights Will Travel, a Reno-based contractor that handles illumination for office buildings, stores, parking lots, and warehouses across northern Nevada. He got in over his head this year when he subcontracted lighting work for Macy's and Target parking lots in a string of northern California cities.

There was no money advanced by the main contractor for materials, wages or expenses, he says. As a subcontractor, McClelland doesn't get paid until the job is done. Yet, almost overnight, he doubled his workforce to 70 employees, footed the bill for a platoon of workers to be lodged in motels, and purchased lighting equipment—all of which exhausted his $100,000 line of credit with a Reno bank. His situation looked dire and it was taking an emotional toll. "The company was on life support." he says. "I realized that I needed extra funds to make payroll. I honestly didn't sleep for months. I was lucky to get three hours of sleep a night."

McClelland was bailed out in August when he secured a $350,000 line of credit through an SBA Express loan fronted by Five Star Bank, a Sacramento financial institution. SBA Express loans, which are part of the 7(a) program but carry only a 50% government guarantee, can be made in as few as 36 hours. But McClelland says that it took him four weeks to obtain the loan.

Trotter, the owner of the Italian ice company, says that his business too is in an expansion phase and that its financial situation was cramped. He had been saddled with a pricey, short-term note for $1.4 million that was weighing down business. With the intercession of Multifunding, a Philadelphia-area broker, Trotter took out a $2.5 million, 10-year loan with Celtic Bank in Utah at prime plus 2.75%, his third SBA loan in 20 years. The refinancing, which closed in late July, is saving him $30,000 in monthly cashflow, he says, more than $100,000 to date.

"Now we can play a little bit of offense," he says. "We have the up-front money to go into convenience stores and supermarkets with our product."

One common experience of the business-people who spoke to *deBanked* is that assembling the required documents and applying for SBA loans can be a daunting and often discouraging task. "The whole thing with these loans is making sure the I's are dotted and the T's are crossed," says Domenic Rinaldi, managing partner at Sun Acquisitions, a Chicago-based firm specializing in lower-middle-market, merger-and-acquisition deals using SBA

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loans. “The government is demanding,” he adds, “and if everything is not in order, you won’t get your money.”

To cut through the inordinate amount of red tape, many businesses turn to brokers like Multifunding and other financial midwives, who receive a commission from the bank. “The fastest I’ve done an SBA loan is two weeks and the longest is 18 months,” says Ami Kassar, founder and chief executive of Multifunding. He says that the firm’s SBA credit business constitutes 70% of his work and that he relies on a network of 10 banks. “The average time it takes for an SBA loan is probably 90 days,” he adds.

“Grueling” is how Daniel Shemtob of Los Angeles describes his experience obtaining an SBA loan. “I had gone to 30 banks,” he says, “and I did qualify for a loan but I didn’t like the deal.”

Shemtob is the chief executive and—thanks to securing an SBA-backed financing for an acquisition—the sole owner of The Lime Truck, which has bragging rights to winning the Food Network’s “Great Truck Race.”

In addition to the truck, his Southern California business also includes a couple of brick-and-mortar restaurants and a catering company. The operation, which will do $5.5 million in sales this year, employs 40 fulltime workers plus part-time catering help.

Shemtob finally scored an SBA loan with assistance from Kassar’s Multifunding, which he found through Entrepreneurs’ Organization, where he’s a board member of the L.A. chapter. He was able to take out a pair of 10-year loans totaling $1.8 million with IncredibleBank at prime plus 2.75%. Even with a broker, he says, it took him three months to get the loan, which closed earlier this year. “The ten-year loans give you stability and an affordable payment,” he says. “If I hit my sales targets,” he adds, “the loans will allow me to grow the business.”

But what if he hadn’t obtained SBA-backed financing? “I don’t know if the company would be around today,” Shemtob says.

SBA loans used for acquisitions play a major role in extending the life of enterprises that likely would have disappeared upon the retirement or death of an entrepreneur, the unwillingness of succeeding generations to take control of a family business, or the break-up of a partnership, notes Rinaldi, the Chicago M&A specialist.

To arrange SBA acquisition loans for purchasers of small businesses, Rinaldi deals mainly with 18 banks, including Busey Bank (Champaign, Ill.), U.S. Bancorp (Minneapolis), Byline Bank (Chicago) and Canadian Imperial Bank of Commerce (Toronto). “Banks may say, ‘Bring us all your manufacturing deals’ and two years later there’s a management change and they’ll only make loans to distribution and service companies,” Rinaldi says. “Part of my job is understanding which sectors are handled by which banks.”

Meanwhile, an emerging debate is brewing within banking circles about the best use of SBA 7(a) loans, which were capped at $28 billion in the last fiscal year. While the overall U.S. economy has continued to prosper since the Great Recession, and the official unemployment rate has dipped below 4%, the lowest in 50 years, the bounty is being shared unevenly. While most large US cities and suburbs are generally adding jobs and experiencing good times, many rural areas and Rust Belt communities are dealing with stagnant wages, job losses and population outflows.

The question is: Should more banking resources be directed to distressed communities through SBA loans? Or should the banking industry lend as it sees fit, largely focused on profitability and shareholder value, albeit within the SBA’s guidelines, perhaps with a nod to businesses owned by women, minorities and veterans? Many banks incorporate both philosophies. But this dichotomy in operational goals can sometimes be seen in sharp relief.

The stark difference in SBA lending practices between Live Oak Bank of Wilmington, N.C. and Northwest Bank of Warren, Pa. is a case in point.

With $4.6 billion in assets, Live Oak Banking Company, which was founded in 2007, is just a dozen years old but it’s already become the No. 1 SBA lender in the US. In the most recent fiscal year, from just one branch on North Carolina’s

seacoast, it made 913 SBA loans totaling $1.347 billion, an average of nearly $1.5 million per loan. To comprehend the magnitude of that accomplishment: Live Oak nearly lapped Wells Fargo Bank, the No. 2 lender with $786.4 million in loan totals, despite the latter's making triple the number of SBA loans. It also out-lent such worthies as J.P. Morgan Chase and Bank of America, both of which lagged well behind Live Oak in the SBA lending tables.

With its adroit use of technology and its meteoric rise to become an SBA powerhouse, Live Oak has emerged as a Wall Street darling. Thomas Brown, a founder and chief executive at Second Curve Capital, a hedge fund that invests exclusively in financial services companies and manages $150 million in assets, calls Live Oak "a freak of nature."

"For their veterinarian-lending practice," Brown observes, "they hire a vet as their lending officer. They do this with all their verticals, whether it's chicken farming or funeral homes. And when they're dealing with a client, they have all this incredible expertise."

Steve Smits, chief credit officer at Live Oak, told *deBanked* that the bank now lends to 29 verticals across all 50 states. Its most recent additions were early childhood education centers and franchisees for aftermarket companies like Jiffy Lube and Meineke. Not only does Live Oak have experienced loan officers with deep knowledge of their sectors making the loans, but the bank is conscientious about keeping up with its clients. So much so that it maintains a stable of consultants, accountants and other professionals who are on call to add value.

For example, says Smits, a former associate administrator of the SBA's office of capital access, one of Live Oak's board members is Jerald Pullins, a former president of Service Corporation International, the Houston-based owner and operator of nearly 1,500 funeral homes and 481 cemeteries in the US and Canada.

For critics who say that an SBA lender should be modeled on George Bailey, the small-town banker immortalized in "It's a Wonderful Life," Smits says: "On a moral plane, we visit 100 percent of our small business owners face-to-face at a minimum of a two-year rotation. With 10-year loans, it would be easy to take a hands-off approach, but we're very vigilant."

Smits adds: "We've had our customers say to us, 'You know what. You've traveled across the country to see me. And I've been banking with the branch down the street and they've never been in my office.'"

Founded in 1896 and headquartered in Warren, Pa., Northwest Bank's service area looks like a jagged triangle traversing three states, running from Lancaster, Pa. to greater Cleveland to Buffalo, N.Y. and back. Inside the tri-state perimeter are a plethora of gritty old factory towns and Rust Belt communities.

"Our banks are located in all kinds of small cities," Jacobson, the bank's chief SBA lender, says. "I'm biased," he adds, "but I believe in reinvesting in our communities. Our business model is to lend in our footprint. It's where our branches are and where our clients are. Our strategy is not to lend around the US."

One example of Northwest's targeted SBA lending, Jacobson says, can be seen in Lorain, Ohio, a city of 64,000 on Lake Erie that is working to reinvent itself. Lorain was once the proud home of iconic heavy industries like the American Ship Building Company, a Ford Motor assembly plant, and U.S. Steel's sprawling mill on the city's south side. The economy was so dynamic that it "outshined Cleveland" says Kevin Nelson, the Lorain-based president of Northwest Bank's Ohio region.

But in the 1980s deindustrialization began to take its toll and the city experienced high unemployment, rising poverty, and urban decay. Now, however, Lorain is hoping to rise like the mythical Phoenix from its ashes. And Northwest Bank is doing its part by marshaling resources in concert with the city's government, the Black River Port Authority, the Chamber of Commerce, the Lorain Historical Society and other citizens groups to transform the waterfront and downtown into an entertainment center and destination for weddings, rock concerts, and other events.

Nelson is bullish on the just-completed Broadway Streetscape, in the heart of downtown, which has given Lorain a physical makeover. There are, Nelson says, "new sidewalks, lighting, archways, and parking areas." Condominiums are being built and the marina is under new management, which could make the city a boating center. Black River Landing has become a magnet for celebrants with more than 200,000 people attending the "Rockin' on the River" concerts over the summer. And the city is witnessing "new restaurants, coffee shops, bars, and other gathering places for people," the banker says. "We're seeing outside investment and we're just beginning to see Lorain becoming a destination for millennials."

Many of the trendy new establishments are being financed with SBA loans. "SBA lending has helped us support some of these new ventures coming in," Nelson says. "They don't make up for bad credit, lack of a business plan or cashflow," he adds. "It has to be the right type of business. But SBA loans are a component."

Who knows? Maybe Lorain will be home to the next Ben & Jerry's or Calloway Golf, both of which commenced life as small business start-ups. A city can hope, can't it?

A BIG YEAR FOR CANADA

By *SEAN MURRAY*

This year, deBanked attended three events put on by the Canadian Lenders Association. The most recent, which took place on November 20 at the MaRS Centre in Downtown Toronto, hosted hundreds of executives from the fintech and lending industries across Canada.

Neil Wechsler, CEO of OnDeck Canada, recently became the organization's Chairman. In a prepared statement, Wechsler said "We have a tremendous opportunity to advance the lending sector this coming year. I look forward to working closely with the CLA board and the esteemed members of the association to support the ever-evolving Canadian lending ecosystem, working to advance financial inclusion, credit access, responsible lending, sound public policy, and innovation in lending, with a commitment to open banking and safe, ethical lending across Canada."

deBanked also hosted its first-ever Canadian event in Toronto on July 25th at the Omni King Edward Hotel. With a keynote speech from celebrity entrepreneur Michele Romanow and a large turnout from the Canadian alternative small business finance industry, deBanked CONNECT Toronto was a resounding success.

Canadians are warming to fintech. A study published by Smarter Loans, an online loan comparison service, found that 24% of respondents indicated that they sought their first loans with an alternative lender in 2018. 29% of those surveyed sought funding from a traditional financial institution, such as a bank, the study found.

deBanked will return to Toronto in 2020. Look out for updates on www.debanked.ca

A directory of small business finance sources in Canada can be found at: https://debanked.com/canada/directory/

INDUSTRY *NEWS*

9/19/19
CircleUp Credit Advisors, a division of the investment platform, CircleUp, announced it had secured $200M to support emerging consumer brands with access to non-dilutive working capital financing.

9/23/19
Drum announced its launch. The company, which enables businesses to contract individuals to promote and sell products, was co-founded by Kabbage co-founders Rob Frohwein, Kathryn Petralia, and Troy Deus.

Michael Mann, the CEO of defunct payroll provider MyPayrollHR, was charged with bank fraud by the Department of Justice.

Avi Wernick and Boris Kalendarev joined RDM Capital Funding; Wernick as the new Director of Partnerships and Kalendarev as the new CFO/COO.

9/24/19
Fundbox, a b2b payments and credit network, Raised $326M in a Series C round. $176M was in growth equity and $150M came in the form of a credit facility.

9/30/19
ForwardLine Financial raised $20M in growth capital from Five Oceans Capital and Marsico Enterprises.

10/1/19
Rapyd, a global fintech-as-a-service provider announced a $100M round led by Oak HC/FT with participation from Tiger Global, Coatue, General Catalyst, Target Global, Stripe, and Entrée Capital.

10/2/19
nCino, a cloud banking company, completed a funding round led by T. Rowe Price Funds with participation from existing investor Salesforce Ventures.

Coinbase launched USDC rewards. Eligible US customers began earning 1.25% APY on every USD coin they hold on Coinbase. USD Coin is a stablecoin.

10/9/19
BFS Capital, a US-based small business lender, launched a data science and engineering hub in Toronto.

10/11/19
Brandon Becker, the former CEO of credit card processing company CardReady, LLC, was indicted and charged with 4 counts of fraud.

10/12/19
Google instituted a ban on loan apps from its app store where personal loan offers exceeded 36% apr.

10/15/19
BitPay added Bill Zielke as the company's first Chief Marketing Officer. Zielke previously held senior roles at eBay and PayPal.

WeWork shut down 2,300 office phone booths across North America because they potentially contained elevated levels of formaldehyde.

CAN Capital announced David Lafferty as the company's new Chief Credit Officer.

National Business Capital & Services expanded into cannabis funding with a new program called CannaBusiness Financing Solution.

10/21/19
Investors Bank, a subsidiary of Investors Bancorp, Inc, selected OnDeck's ODX Platform to begin digitizing small business lending.
Finitive, a fintech platform providing institutional investors with direct access to alternative lending investments, closed a $2M venture debt round with Silicon Valley Bank.

A federal judge ruled in favor of the New York Department of Financial Services in its quest to nullify the new special purpose "fintech" bank charter created by the Office of the Comptroller of the Currency.

10/22/19
Luge Capital, a fintech and AI-focused VC fund based in Canada, raised $85M to invest in Canadian fintech startups.

10/23/19
LendItFintech co-founder Peter Renton announced that their annual China conference had been cancelled due to a major crackdown on peer-to-peer lending by the Chinese government. Lendit's other events outside of China are unaffected. In fact, the fintech conference company introduced a new show called Finnosummit Miami by Lendit Fintech that takes place in Miami and focuses on the Latin American market.

10/24/19
Kabbage launched Kabbage Payments, which aims to cut down the time it takes for small businesses to get paid on an invoice.

deBanked held its 2nd CONNECT San Diego event at the Hard Rock Hotel with a crowd of more than 400 people.

OnDeck reported a Q3 profit of $8.7M and disclosed that it had repurchased 3.2M of its own shares for $11M since making its buyback announcement on July 29th.

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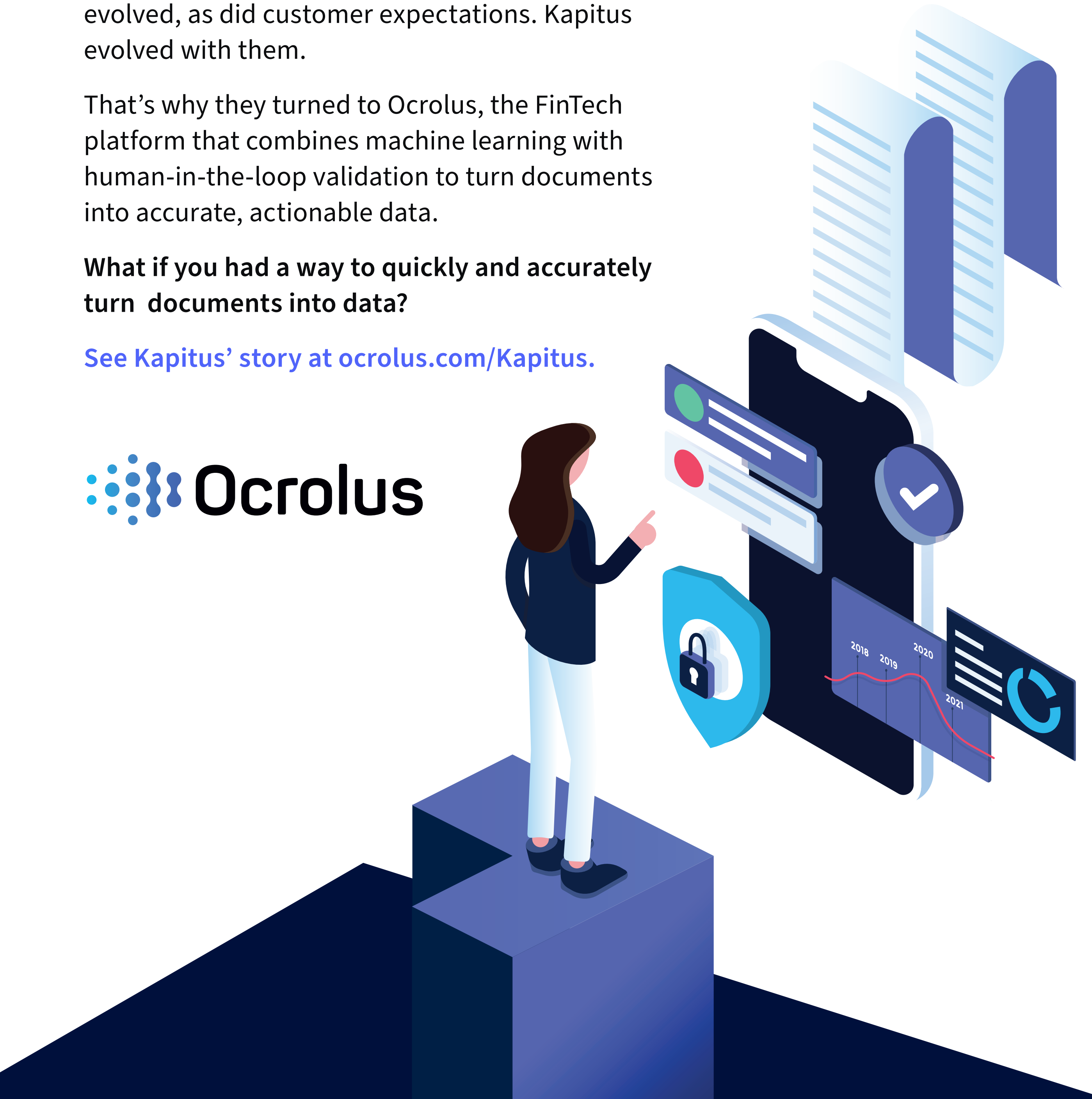

INDUSTRY *NEWS CONT'D*

10/25/19
Jan Douglas Atlas, a Florida attorney, pled guilty to 1 count of securities fraud for his role in the 1 Global Capital securities fraud collapse.

10/28/19
DecisionLogic surpassed 40 million customers since inception.

Lendio's Online Bookkeeping software, Sunrise, announced a partnership with WePay, the integrated payments business of JPMorgan Chase & Co.

PeerStreet, a platform for investing in real estate backed loans, announced a $60M Series C and $4.25B in new capital commitments.

Kapitus announced a partnership with DrChrono to provide financing options for physician practices.

StreetShares, a veteran-focused small business lender, reported a staggering $12.3M loss on only $4.4M in revenue.

10/29/19
Become, formerly known as Lending Express, finished its Series A funding round with $10 million having been raised from Benson Oak Ventures and Magenta Venture Partners, among others, as well as an additional $2.5M in venture debt from Viola Credit.

Shopify Capital originated $141M of loans and MCAs in Q3, an 85% increase year-over-year.

10/31/19
Flender, an Irish peer-to-peer business lender, secured a €75M funding line.

11/1/19
Knight Capital was acquired by Ready Capital Corporation for $27.8M.

11/2/19
It was revealed that Goldman Sachs had already lent out $10 billion through the Apple Card.

11/4/19
Deserve, a credit card startup that helps young people establish themselves in addition to providing a cloud-based credit card platform for businesses, raised $50M in a Series C round led by Goldman Sachs.

Kabbage announced a strategic partnership with GoDaddy where GoDaddy customers will have access to business loans through Kabbage.

11/5/19
Scott Bernstein was appointed General Counsel of Change Capital. Change Capital provides capital solutions to SMBs across the country through its offices in New York, Los Angeles, and Atlanta.

Lending Club originated $3.3B in loans in Q3.

Capify CEO David Goldin launched Lender Capital Partners to provided financing to merchant cash advance companies and alternative business loan providers.

11/7/19
PIRS Capital and Fundera both made Crain's New York Business Fast 50 companies list.

New York City Marshal Vadim Barbarovich resigned his Marshal position as part of a mutually agreed disciplinary stipulation after he was investigated by New York City's Department of Investigation.

11/8/19
OnDeck announced the pricing of a $125M securitization.

11/11/19
Canadian Lenders Association announced the winners of its 2019 Leaders in Lending awards. See the top 25 companies here: http://dbnk.news/2B | See the top 25 executives here: http://dbnk.news/2C

Funding Circle's UK business began referring out applicants seeking an amount above their maximum loan size to Iwoca, MarketInvoice, and French bank BNP Paribas, the Sunday Times reported.

11/12/19
Prosper reported Q3 net income of $10.8M.

OnDeck Canada CEO, Neil Wechsler, was announced the new chair of Canadian Lenders Association.

BFS Capital Hired Brian Simmons as its new COO.

11/13/19
deBanked announced that Brian Holloway, America's #1 most requested motivational team builder, would be speaking at deBanked CONNECT MIAMI on January 16, 2020.

11/14/19
CNN reported that WeWork had a net loss of $1.25B in the most recently completed quarter.

IOU Financial originated $41.4M in business loans in Q3 and had a net income of $1M.

11/16/19
Clearbanc expanded its offerings beyond capital for digital advertising into funding to businesses that are suffering from US-China tariff costs.

11/18/19
HR 5013, dubbed the Small Business Fair Debt Collection Protection Act, was approved by the House Financial Services Committee.

11/18/19
The Office of the Comptroller of the Currency proposed a rule to clarify the "Valid When Made" Doctrine that was undermined by the Madden v Midland court ruling.

11/19/19
BlueVine raised $102.5M in a Series F round led by ION Crossover Partners.

11/20/19
Financeit was awarded 2019 Company of the Year in Lending by the Canadian Lenders Association.

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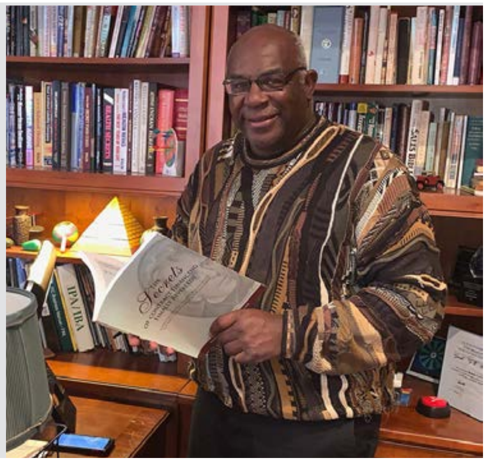
THE BROKER: HOW GERALD WATSON MIXES FACTORING WITH MCAS

By *BRENDAN GARRETT*

Role?

I'm the owner of The Watson Group, a factoring broker company.



Q: How did you end up in the industry?

A: I got started in what I call the contract financing industry about 35 years ago, kind of by accident. I had spent years working with a large management consulting company in Boston and we had some major contracts in the DC area. I was on an assignment there and my son was in school there with another kid, and I met the parents and the dad told me what he was doing and he said I needed to come by the offices to check it out.

I really had no intention of going at all, but finally to get this guy off my back, I went by one day and he showed me the business they were in. When I left I was totally on board. I had been working for several years in management consulting, but this was all new and I was excited because it was helping real businesses solve real problems and it was very hands-on.

(cont'd)

THE BROKER: HOW GERALD WATSON MIXES FACTORING WITH MCAS

By *BRENDAN GARRETT*

A: I came on board and I'll never forget my first day on the job: I didn't know anything from anything – rights, factoring, contracts financing – this was years before the MCA industry even existed, and my boss said he just got a job, 911 call from a printer and they needed some funding help. "Can you help them? Why don't you come ride with me? It'd be good on the job training for you." And so we sat down with the guy and found a solution for him. And to this day he hasn't had to close his business.

Q:

How were those early days?

A: Interesting because this was before the internet, almost before cell phones, in fact. I remember at one point when I was being hired, the Motorola flip phone was just coming out and they were like $1,500 around 25 years ago. And I said okay, I'll take the job but you've got to give me one of these Motorola phones, so he did and it was great but this is before the internet and I didn't really believe in traditional advertising or mailing out brochures, so the strategy I take is called "institutional referral-based marketing."

In a nutshell, what that is, is working with various institutions that refer clients to use on a regular basis and as part of that process, I'd give talks or seminars and workshops and sit on panels and teach some of these referral groups how to assess deals and package them and get them ready for funding. You know, develop a pretty solid reputation in the industry for what we did and even today we're 100% referral.

THE BROKER: HOW GERALD WATSON MIXES FACTORING WITH MCAS

By *BRENDAN GARRETT*

Q:

What can you tell me of the style in which you approach deals?

A:

The approach that I've always taken is really a diagnostic approach, we kind of almost see ourselves as doctors. If you go to a doctor and you have pain, you may not know what's causing that pain, you just want to feel better. And so what does the doctor do? They have to understand what's going on in order to make you feel better.

Client's got a pain: "I need money. I need working capital and I need it now." And so we get a clear picture of what their objectives are and what they're looking to accomplish: how much they need, what they need it for, timing, etc., and like a doctor, we go through a series of diagnostic tests, which can involve getting a list of documents – financials, bank statements, whatever it is – and going through them. You're drilling down on where they're at and coming up after that, coming up with what I call a treatment plan or funding strategy.

Here's the key: you've got to ask the right questions, because if you don't ask the right questions you'll never get the right answer. All too often what a broker will do is they'll get right into solutions and answers and talk about why what they offer is the best or why their funder is the best thing since sliced bread without having a picture of what their client's true needs are in this situation. So I have a whole series of quizzes I've done a million times so I don't need to write them down. I know what they are but I systematically go through 'em, and we call that a preliminary underwriting interview.develop a pretty solid reputation in the industry for what we did and even today we're 100% referral.

THE BROKER: HOW GERALD WATSON MIXES FACTORING WITH MCAS

By *BRENDAN GARRETT*

Q:

What is the value of combining MCAs and factoring?

A:

Funding solutions typically involve multi-funding products. And that's where the advent of MCAs came in, and why they're such a real asset. Because you meet a client today and it's Wednesday, or Tuesday, hell maybe even Thursday, and the guy's siting there with half a million dollars in receivables that we can convert into cash but we may need 3 days to do it, but he needs 2 days.

MCAs are a great product because we can step in, solve the problem, get him an immediate injection to stop the bleeding, and take it out from factoring proceeds a few days later. So it's a great compliment and tool and this is something I've tried to educate on both sides. It's not a threat it's a complement. The key is how you use it. It's like two medications. You go to a doctor, they'll prescribe a list of meds, the key is to make sure they all complement each other.

Q:

Any advice for those looking to combine MCAs and factoring?

A:

The first thing you want to do as an ISO who's interested in developing a factoring brokering business is to understand the basics of factoring: what is factoring, how does it work, how do you qualify, how much does it cost?

The second thing you want to do is look internally to develop your customer base and the quickest customer base is what we call the low-hanging fruit. These are existing merchants that didn't fund. Any merchant that is in B2B, whether they got funded or not, is a candidate for factoring. So go back through the files, look at the database and you may find out you probably have a lot more than what you ever imagined.

The third is to develop your database of funding resources – of funders.

And the last thing you want to have is a game plan. What's your game plan and what's your strategy for moving forward with your factoring broker business?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