Family First Credit Union

Lending Policy
Member Business Loans

Purpose:
The Board of Directors authorizes Family First Credit Union to engage in member business loans, either as an originator or participant, in accordance with the guidelines of this policy. All loan participation activities will be conducted in compliance with applicable state and federal regulations, within portfolio limitations of the approved loan policy, and in accordance with Asset Liability Management policy and strategy.

Member Business Loan Defined:
NCUA rules and regulations define any loan, line of credit or letter of credit, when added to other loans of any one borrower equals or exceed $50,000, and the proceeds are used for a commercial, corporate, business investment property or venture, or agricultural purpose as a business loan.

<u>The following are not considered member business loans</u>:

- A loan fully secured by a lien on a one to four family dwelling that is the member's primary or non-primary residence.
- A loan fully secured by shares in the credit union making the extension of credit or deposits in other financial institutions
- A loan where a federal or state agency (or its political subdivision) fully insures repayment, or fully guarantees repayment, or provides an advance commitment to purchase in full
- A loan granted by a corporate credit union or a credit union to another credit union or a Credit Union Service Organization

U.S. General Services Administration (GSA) Leases:
A GSA Lease is considered a "Full Faith and Credit" obligation of the United States Federal Government. Loans or refinances for property that are accompanied by a GSA Lease will be excluded from the business loan limits. To be excluded from Business Loan Limits, proof of additional underwriting will be documented in each GSA loan file.

<u>These additional requirements for GSA financing are as follows</u>:

- The loan matures prior to the expiration of the GSA Lease.
- A Certificate of Good Standing from the Secretary of State where the Lessor is duly formed and, in the jurisdiction, where the property is located if the Lessor is an entity.
- Duly executed GSA Lease and any related instrument, document, and agreement to which it is party.

- A Certificate of Appointment for the Lease Contracting Officer who signed the most recent Supplemental Lease Agreement so long as it is endorsed with a closing paragraph that states, "All other terms and conditions of the lease remain in full force and effect." Should the Certificate of Appointment be unavailable, due to the Lease Contracting Officer's departure from GSA, additional documentation will be requested from the current Lease Contracting Officer to ratify the validity of the lease endorsement.
- Validation of the Lease as a binding document with a Statement of Lease.
- Verification that the term of the GSA Lease does not exceed twenty (20) years.

Authorized Loan Types and Limits on MBL Portfolio Concentrations:
(maximum total loans- including unfunded commitments per category)

The following chart details the current policy maximums:

Property Type	Max as % of Net Worth
Commercial/ Industrial	50%
Faith Based	20%
Unimproved Land	10%
Leased Land	10%
Leasehold Estate	10%
Hospitality	20%
Restaurant (Franchise)	5%
Mixed Use	25%
Multi-Family	45%
Office	40%
Other Non-Profit	25%
Retail	40%
1-4 Non Owner Occupied	25%
Fitness	10%
Education	35%
Single Purpose	20%

Business Loans (including federal and state guaranteed), other C & I and miscellaneous business purpose loans:

Loan Type	Max as % of Net Worth
Unsecured	10%
Secured with UCC on all business	25%
Equipment and Auto	15%
Secured by Second TD (LOC & Term)	30%
Person residence (business purpose)	20%
Construction	10%
Share Secured	50%

- **Business loan participations:** 50% of net worth to any one originator.

Commercial Real Estate MBL Requirements - Loan to Value (LTV) and Debt Service Coverage (DSC)

- **Loan-to-Value (LTV)** for a Conventional Loan *(also called a permanent loan in contrast to a construction or development loan)* shall not exceed 80%. It will be considered an "Exception" when a conventional loan LTV exceeds a limit for certain property types:
- **Debt Service Coverage (DSC)** requirements include both property and global minimum DSC:

Commercial Collateral Type	LTV	DCR
GSA Lease	65%	1.10x
Commercial/Industrial	80%	1.20x
Office medical	80%	1.20x
Office (non-medical)	80%	1.20x
Retail (anchored)	75%	1.25x
Retail (non-anchored)	70%	1.30x
Mixed Use	80%	1.25x
Multi-Family 5 or more units	80%	1.25x
Multi-Family 1 to 4 units Non Owner	80%	1.20x
Leasehold Estate (on Ground Lease Parcel)	75%	1.20x
Leased Land – unimproved income	75%	1.30x
Unimproved Land – non-income producing	65%	1.40x
Specific CRE Collateral Type	**LTV**	**DCR**
Hospitality	70%	1.30x
Restaurant	75%	1.30x
Automotive	75%	1.30x
Fitness	75%	1.30x
Education	75%	1.20x
Faith Based - Non profit	65%	1.20x
Other Non-Profit (ex. Assisted Living)	70%	1.20x
Other Special Purpose – (e.g. self-storage	75%	1.25x

C & I BUSINESS LOANS

Commercial Collateral	LTV	DCR
Business Assets/Equipment	80%	1.20x
Rolling Stock aggregate over $50,000	100%	1.20x
Rolling Stock aggregate below $50,000	100%	N/A
Government Guaranteed	SBA	1.20x
Share Secured	100%	N/A
Unsecured	N/A	1.20x

Construction and Development Loans are where the borrower intends to construct or renovate a commercial property *(per MBL definition):*

- The maximum LTV for a construction or development loan is 75%.
- The collateral value is the lesser of the project's cost to complete or its prospective market value.
- Debt Service Coverage (DSC) must have a minimum coverage of 1.25X.
- A construction loan agreement is required to be executed outlining the responsibilities of the borrower and builder to meet the loan requirements.
- Builders Risk Insurance is required in the amount of the loan to ensure construction performance and for good credit risk management.

The cost to complete is the sum of all qualifying costs necessary to complete a construction project and documented in an approved construction budget:

- Building construction including general contractor's fees, bonding and insurance.
- Land value determined as the lesser of appraised market value or purchase price plus the cost of any improvements.
- A contingency account to fund unanticipated overruns.
- Other development costs such as fees and related pre-development expenses.
- Interest expense only to the extent it is included in the construction budget and is calculated based on the projected changes in the loan balance up to the expected "as complete" date for owner-occupied commercial real estate or the "as-stabilized" date for income producing real estate.
- Project costs for related parties, such as developer fees, leasing expenses, brokerage commissions, and management fees if reasonable in comparison to the cost of similar services from a third party.

The prospective market value "as completed" reflects the property's market value as of the time that development is to be completed. The prospective market value "as-stabilized" reflects the property's market value as of the time the property is projected to achieve stabilized occupancy.

For an income producing property, stabilized occupancy is the occupancy level that a property is expected to achieve after the property is exposed to the market for lease over a reasonable period and at comparable terms and conditions to other similar properties.

For construction and development loans greater than $500,000 – Family First Credit Union engages an independent qualified third party to conduct Construction Risk Management ("CRM") whose services are consistent with American Institute of Architects ("AIA") standards. CRM is monitored by Family First Credit Union. CRM includes the following services:

- Review of general contractor qualifications.
- Review plans and validate project scope.
- Review and approve line item construction budget.

- Utilize a funds management control process, conduct on-site %-of-complete inspections, and obtain lien waivers as requisites to draw disbursements.

The completion guarantee in-lieu-of-bond is provided by the third-party CRM firm having appropriate capabilities to act as contractor, which will step in to complete a project where the contractor has defaulted.

NOTE: A loan that includes financing of maintenance, repairs, or improvements to an existing commercial property that does not change its use or materially impact the property is not **considered a construction or development loan.**

Construction Servicing: Construction lending involves a moderate level of risk; therefore, the Credit Union closely monitors all construction loans.

All construction loans extended by the Credit Union are to be supported by current appraisals in compliance with FIRREA requirements and Family First Credit Union's loan policy. The borrower must obtain all appropriate building permits, and the project must comply with applicable zoning requirements for the site.

All projects are to have controlled disbursements based upon satisfactory inspections indicating the project status merits the draw**.** All loans for commercial properties and multi-family housing must be supported by a satisfactory takeout from a strong source. Speculative units for home builders are to be limited to a level the home builder can support from sources in addition to the future sale of these units.

Family First Credit Union will maintain a detailed description of our construction servicing procedures that is entitled, "Construction Draw & Funding Procedures".

PROHIBITED LOANS:

The following categories of commercial loans are prohibited by FFCU:
- Stand-alone restaurants, except for an investment grade corporate store or tenant.
- Stand-alone liquor stores, unless a credit union makes the request to Family First Credit Union.
- Stand-alone properties having adult entertainment or a gambling business or bar.
- Stand-alone hospices.
- Convenience stores with gas stations (*unless a credit union participation loan)*
- Property having a dry cleaner (*currently using chlorine-based solvents or having a past use of chlorine-based solvents without obtaining an acceptable Phase II environmental report conducted in coordination and approval by Family First Credit Union).*
- Raw land.

- Automotive repair centers with in-ground lifts.
- Stand-alone car or truck dealerships
- Purchase publicly or non-publicly traded stocks or commodities.
- Loans to Family First Credit Union's Officers (Vice President level and above) or any associated member or immediate family member of these employees.
- Loans to any Director (unless the Board approves granting the loan and this Director is not involved in the credit decision)

Member business loans may not be granted if any additional income is received by Family First Credit Union or Family First Credit Union's Officers (Vice President level and above). The member business loan cannot be tied to the profit or sale of the business or commercial endeavor for which the loan is made.

Business Loan Participations:

- Business loan participations can be purchased provided the appropriate due diligence is performed in selecting partner credit unions and in approving the specific loan pieces being purchased.
- The credit union may buy or sell loan participations in order to diversify concentrations of risk.
- Participations will be evidenced in writing by a participation agreement between the parties participating in the subject loan(s).
- Specific guidelines for loan participations are established in the Credit Union's Loan Participation Policy."

Trade Area:

The trade area for member business loans is limited to Fulton County, Georgia and the counties surrounding Fulton County, Georgia, where we have participating credit union partners with area knowledge to inspect and monitor the member business loan and collateral. Member business loans secured by residential real property and credit card line of credit programs offered to non-natural person members for routine purposes which both may be made by the credit union in all fifty (50) United States and the District of Columbia, so long as the credit union complies with all "doing business" laws in that State applicable to the Credit Union, if any. The trade area for GSA loans is all fifty (50) states and territories of the United States.

Interest Rates and Terms:

The interest rate and terms will be set by the President/CEO and the Vice President of Lending acting jointly. The President/CEO and the Vice President of Lending jointly will have authority to change rates on an "as needed" basis to meet changing market conditions.

<u>The following displays but are limited to the rates</u>:

Mortgage loans for residential property held for rental and investment purposes:
- Rate to be set by management
- Maximum term - 15-year fixed or 30-year amortization with up to 10-year balloon

Mortgage loans accompanied by GSA Lease:
- Rate to be set by management
- Maximum term - 15-year fixed or 30-year amortization with up to 10-year balloon

Mortgage loans for commercial/professional property:
- Rate to be set by management
- Maximum term - 15-year fixed or 30-year amortization with up to 10-year balloon

Business Equipment Loans:
- Rate to be set by management
- Maximum term - 10 years

Automobile and Truck Loans:
- Rate to be set by management
- Maximum term - 66 months
- Up to 100% loan to value on cars, vans, pickup trucks, and SUV's
- Up to 90% on fleet vehicles
- Up to 90% on commercial vehicles for business purposes

Unsecured Loans:
- Rate to be set by management
- Maximum term - 4 years

Origination Fees:
- Charged on real estate secured loans
- Fee to be set by management

Loan Limits:
The aggregate limit of total business loan balances (*including any unfunded commitments)* is the lesser of 1.75 times Family First Credit Union's actual net worth, or 1.75 times the minimum net worth required under section 1790d (c)(1)(A) of the Federal Credit Union Act. Some loans exempt from the limit are listed under the Member Business Loan Definition. Family First Credit Union has set our MBL aggregate limit to .50 times the actual net worth which is currently $7,618,000 through December 31, 2019.

The maximum loan amount to any one member or group of associated members (company) will not exceed the greater of 15 percent of Family First Credit Union's net worth or $100,000, plus an additional 10 percent of the credit union's net worth if the amount that exceeds the credit union's 15 percent general limit is fully secured at all times with a perfected security interest by readily marketable collateral as defined in 723.2.

- The aggregate of the **unsecured** outstanding member business loans to any one member or group of associated members will not exceed $100,000.
- The aggregate of all unsecured outstanding member business loans will not exceed 10% of FFCU's net worth.

Loan Authority:
The Credit Committee has the overall responsibility for the granting of loans and supervision of loans to members. The Credit Committee may also empower all or certain groups of loan officers to act together as a Loan Committee with authority to approve and deny loans.

The Management MBL Committee consists of the President/CEO, Vice President of Lending, and Chief Financial Officer who will review loans from the commercial expertise underwriter. If the committee approves to move forward, the President/CEO will present the member business loan opportunity to the Credit Committee for review. If approved, the committee or President/CEO will present to the Board at the next board meeting.

The Credit Committee has the authority to approve member business loans or participation loans up to the maximum loan amount as defined in this policy.

Commercial Expertise Required:
Family First Credit Union will either use a staff member, independent contractor or another third party with a minimum of two years direct experience with the type of commercial lending involved for screening and underwriting Business Loans.

The actual decision to grant a loan will reside with Family First Credit Union and not with a contractor or other third party.

Underwriting Standards & Requirements:
A fundamental part of all loan evaluations will be determining the ability of the borrower(s) to repay the loan, the expectation of repayment and the protection provided by the collateral.

To provide an adequate basis for loan evaluation, the following will be the minimum information required by the Credit Union to evaluate a request to make a member business loan or increase a member business loan or line of credit, except as hereinafter provided; as follows:

1. <u>Requirements for Underwriting</u>:
    - 2-page loan application
    - Diagram/description of ownership structure of subject property *(entities and individuals)*
    - Professional experience for each principal and guarantor *(BIO or Resume)*
    - Personal Financial Statement (*within 60 days)* <u>for each principal and guarantor</u> – signed
    - Banking statements - verify personal liquidity on PFS for each principal and guarantor
    - A schedule of real-estate for each principal and guarantor
    - Authorization to release credit for each principal and guarantor *(Spouse must also sign)*
    - Two most recent years' personal tax forms as submitted to IRS for each guarantor
    - Two most recent years' business tax forms as submitted to the IRS: *for all business entities and related affiliates that roll to the personal taxes (SCHED E) for each guarantor. For entities with less than 20% passive ownership, the Schedule K's are sufficient*
    - One 4506-T for each individual and each business entity, to validate tax forms
    - Most recent year and YTD business financials *(P&L and Balance Sheet)* for each business entity/property
    - Business debt schedule(s) for non-real estate debt (as applicable).
    - Tenant rent roll
    - Copies of all leases
    - 12-month tenant payment history
    - Most recent year tenant financials, if permitted by lease (required for % rent leases)
    - Credentials of property management and management agreement (*if applicable)*
    - Copy of recent mortgage statement and 12-month payment history (*refinance*)
    - Purchase agreement *(acquisition*)
    - Franchise agreement (*if applicable*)
    - Survey for the property (*needed at time of appraisal I title*)

2. <u>Cash flow analysis</u> will be conducted on the borrowing entity or property to determine ability to service the debt. Further, a <u>global cash flow</u> will be conducted on all of the borrower's materially owned entities and related liabilities to determine the overall adequacy of cash flows to service total debt.

3. <u>RMA Analysis</u>: An analysis of the leverage related to the requested financing by Industry type will be analyzed by comparable Industry using the Risk Management Association (RMA) statistical guide.

4. Collateral Analysis: The value of the proposed collateral will be established, and the loan-to-value analyzed to determine the adequacy of collateral coverage dependent on current environment, perceived credit risk related to collateral type, borrower or location. Note the required LTV requirements listed in this policy.

5. Break-even Analysis: will be conducted on the borrowing entity or property on all large complex income producing properties. This analysis will be completed by an independent contractor or another third party and documented in the business loan partipation review prior to engaging in a loan. Family First Credit Union's maximum break-even ratio is 85%.

6. Covenants: Family First Credit Union is not currently originating Member Business Loans from our membership. If we begin to offer Member Business Loans to our membership, we will require loan covenants to mitigate and control risk and instill discipline in the lending relationship. The covenants will include the borrower's leverage position, repayment capacity, and liquidity. In addition, the covenants will limit cash distribution to owners/shareholders and include standard performance and financial reporting requirements. The type of covenant will be specific to the loan type and part of this policy.

   CUBS and Family First Credit Union utilize both affirmative (must happen) and negative (not allowed to happen) covenants. Certain covenants are found in all loans such as reporting requirements discussed below, although the details of any covenant are tailored to each loan.

   a. A standard affirmative covenant in CUBS participation loans with Family First Credit Union is a periodic reporting requirement for the borrower(s) and guarantors. The timing is typically annual, but in some circumstances may be quarterly or monthly (loan documents allow the timeframe to be changed depending upon circumstances). Required documents typically include personal financial statements, tax returns, business financials and rent roll. If a borrower fails to provide certain documentation needed to perform loan reviews on a periodic basis, a penalty is applied. The covenant calls for an increase in interest rate of 0.75% until the month following compliance.

   b. A standard negative covenant in CUBS participation loans with Family First Credit Union is to not allow without approval of Lender the transfer of ownership interests in the borrowing entity from principals having control of the borrower. Normally those individuals were underwritten when evaluating the credit and re-underwriting (or possibly refinancing) would be required in context of any such transfer.

   c. Additional covenants may be required from time to time by CUBS and Family First Credit Union in consultation with the other participating credit unions on a loan-by-loan basis. The benefit of utilizing a covenant shall be weighed against the consequences of enforcing the covenant.

For instance, it will be uncommon to require a DCR covenant since the enforcement of a DCR covenant typically constrains a borrower's ability to sustain loan payments at the very time the borrower needs flexibility. A covenant that could place a borrower into payment default when the borrower is making full and on-time loan payments is counterproductive. Further, covenants cannot be inconsistently enforced from loan to loan as failure to enforce one covenant creates a "slippery slope" with regards to legal standing in the enforcement of all covenants.

Nonetheless, it is not uncommon for CUBS, as the servicing agent of Family First Credit Union participation loans, to implement additional covenants from time-to-time, such as requiring the borrower to fund reserves for maintenance and/or leasing purposes. Another situation-specific covenant is requiring a borrower to complete certain maintenance or improvements within a specified period after the loan closes. In some situations, CUBS may require a borrower to sign a negative pledge, which is a covenant that prevents a borrower from placing debt on a specific asset. The penalty for failure to comply with the covenant is also evaluated deal-by-deal.

NOTE related to MBL PARTICIPATIONS: CUBS or other Participating Originating Lenders control the required documentation on any Participation Loan. As a Participating Credit Union, we have the right to participate or not. Therefore, it is our comfort and understanding, of CUBS as a CUSO or other Lead Participants, with our credit decision of whether to participate and accept their loan requirements.

Property Type Analysis:

<u>Conventional Owner-Occupied 51% or more</u>

- Property cash flow - both real estate (lease) and operating (business) entities.
- Obtain guarantee from operating entity.
- Require lease between real estate and operating entity.

<u>Retail / Office / Industrial</u>

- Examine tenant financials for leases that provide % of revenue lease income.
- Examine tenant financials for single-tenant leases.
- Subordinate management agreement when manager is less than arms-length.

<u>Hotel</u>

- Obtain STR reports and examine trends and competitiveness.

- Consider flag, age of property, number of rooms, format.
- Review PIP history or pending PIP for prospective reserve requirements.

Self-Storage
- Examine ratio of indoor vs. outdoor.
- Examine ratio of climate controlled.
- Seek sub-market capacity and utilization information as available.

Assisted Living
- Examine tenant turnover and receivables history.
- Examine operator experience, staffing and management agreement.
- Examine historic occupancy relative to depth of wait list.

Church
- Examine flexibility to adjust/reduce expenses during economic slowdown.
- Examine cash on-hand history for minimum of 3-months operating expenses.
- Examine trends in membership attendance, giving and capital campaigns.

Multi-family
- Evaluate ownership's management experience and role in subject property.
- Examine tenant credit evaluation process, turnover and receivables history.
- Evaluate location and market trends (*rental rates, occupancy, etc.)* Examine trends in membership attendance, giving and capital campaigns.

Additional Requirements based on circumstance:
- **Acquisition**: Purchase agreement.
- **Refinance**: Current mortgage statement; 12-month payment history.
- **Hotels**: STR report; flag agreement; information for last or pending PIP.
- **Churches:** 3-year trends for membership, attendance, giving/tithing.

NOTE:
For member business loans made to natural persons and secured by residential real estate (herein sometimes referred to as the "Residential Loans"); credit card line of credit programs offered to non-natural person members that are limited to routine purposes normally made available under those programs (herein sometimes referred to as the "Credit Card Programs"); and member business automobile and small truck loans made to natural and non-natural persons (herein sometimes referred to as the "Auto Loans"), the Board of the Directors of the Credit Union has determined that supporting loan documentation standards should differ from those set forth above.

The Board of Directors of the Credit Union find that it is in the best interest of the Credit Union, and its members to tailor its supporting loan documentation guidelines for Residential Loans, Credit Card Programs and Auto Loans to those generally available for, and utilized by, institutional lenders doing business in the credit union's trade area.

For this reason, the Board of Directors of the Credit Union find that the supporting loan documentation requirements for Residential Loans shall generally follow and conform to the supporting loan documentation guidelines for marketable residential mortgage loans, as set forth in the loan correspondent underwriting manuals promulgated by the Federal National Mortgage Association (FNMA") and the Federal Home Loan Mortgage Corporation ("FHLMC"), from time to time, but only to the extent inconsistent with the loan documentation guidelines set forth above.

For Credit Card Programs and Auto Loans, the supporting loan documentation required by the Credit Union shall be of the type required by the Credit Union pursuant to and in accordance with its internal consumer loan policies and procedures, which policies and procedures are incorporated herein and made a part hereof by this reference.

Collateral & Security Requirements:
An attorney representing Family First Credit Union will close all loans secured by a first or second mortgage on real property. The following will be obtained as needed:

- A full commercial title examination and tax search of the property to determine that title is or will be vested in the borrower on the date of closing, and to confirm that there are no encumbrances affecting said title that is unacceptable to Family First Credit Union.
- A title insurance policy in the amount of the loan issued by a title insurance company approved by Family First Credit Union and its counsel and containing such endorsements thereto as Family First Credit Union or its counsel may require. Family First Credit Union's insured interest may not be subject or subordinate to any prior liens, encumbrances, restrictions or exceptions, other than those approved by Family First Credit Union.
- Survey of the property, if required for title insurance.
- Hazard insurance equal to the loan balance or full replacement value, whichever is less and shall contain no deductible in excess of $10,000.00 for all perils and contain a standard mortgagee loss payee endorsement naming Family First Credit Union as mortgagor.
- Flood insurance if the property is located within a flood hazard area under the National Flood Insurance Act containing no deductible in excess of $10,000.00 naming Family First Credit Union as mortgagor.
- Appraisal of property by an appraiser acceptable to the Credit Union. All appraisers utilized by the Credit Union shall be state certified or state licensed appraisers.
- Non/Structured Recourse: The personal unconditional guarantee(s) *(joint and several)* of principals representing at least 51% of ownership when the Borrower is a non-natural person will be generally routine.
    - An <u>exception</u> may be granted requiring either a structured recourse or non-recourse requirement when a loan demonstrates numerous substantial strengths in many of the following areas:
        - Experienced borrowers in property types

  - Low loan to values (ideally below 70%)
  - Long term or credit tenants
  - Stable long-term occupancy of 75% or higher
  - Debt service ratios of 1.3:1 or higher
  - Consumer credit scores of 725 or higher
  - Medical professionals in practice five years or longer

  Additionally, there are numerous examples of quality commercial real estate owned by investment partnerships or REITS where ownership is distributed across many natural persons where personal recourse might not be available.
- The request would be evaluated using the criteria above as well as the strength of the entity as a business guarantor (where appropriate or applicable). Corporate owned entities will be evaluated based on the above as well as a minimum rating of BBB- or higher or Moody's Baa3 or higher.
- A first-priority Assignment of Lease and Rents to Family First Credit Union of all leases, usufructs, and licenses now or hereafter existing with respect to the real property and all income and rents derived therefrom.
- A first-priority Deed to Secure Debt, Mortgage or Deed of Trust (as applicable to the jurisdiction) and Security Agreement on the fee simple interest of the borrower in the property.
- Properly executed Note; Deed to Secure Debt, Mortgage or Deed of Trust (as applicable to the jurisdiction); UCC Financing Statement; and Loan Agreement. The Note; Deed to Secure Debt, Mortgage or Deed of Trust; and UCC Financing Statement to be recorded by the closing attorney.
- Articles of Incorporation and By-Laws if borrowing entity is a corporation. Partnership Agreement if the borrowing entity is a partnership. Articles of Organization and Operating Agreement if the borrowing entity is a Limited Liability Corporation.
- If the borrower is a legal entity other than a natural person, the borrower shall provide at or prior to closing, satisfactory resolutions and approvals to evidence the approval and authority to enter the loan with Family First Credit Union and to bind the borrower and the corporate guarantor.
- Environmental screening report for all properties and Phase I environmental site assessment on loans over $500,000 (over $1,000,000 for and GSA loans) that is independent of the commercial appraisal. After reviewing this environmental site assessment, a Phase II or Phase III environmental assessment may be required.
- Opinion of Borrower's counsel for loans exceeding a principal amount of $1,000,000 prepared by borrower's independent third-party counsel and who shall be licensed to practice in the property jurisdiction.

The minimum requirements for all business equipment financing except automobile and small truck loans are:

- A full description of the collateral including invoice and/or estimated market value, supplier or manufacturer descriptions and serial numbers.

- Tax and lien search of the borrower(s).
- Executed security agreement(s) covering the collateral to be recorded.
- Executed UCC filing and recording instruments to be properly recorded.
- Funds for the purchase of equipment will be disbursed directly to the equipment seller to preserve the priority of lien.
- Principals, other than a not for profit organization or those where NCUA grants a waiver, must provide their personal liability and guarantee.
- Building owners consent for access to premises and equipment if applicable.

Credit Risk Rating

Credit risk ratings are the primary indicator of credit exposure based on assessments of the borrower's creditworthiness and the severity of a prospective loss. These ratings shape and reflect the nature of commercial lending decisions made from loan inception until loan payoff.

As part of Family First Credit Union's ongoing review process and to assess loan portfolio quality, risk rating procedures will be applied to each member business loan relationship in excess of $250,000 and monitored at minimum annually, based on the month in which it initially closed or month in which the last review was completed, for the life of the loan.

The initial rating on member business loans will be assigned by the business loan department and noted during the underwriting of the loan. Periodic review will be performed thereafter to determine if it is recommended to adversely rate or to improve the rating of a loan. Any recommended change will be accomplished through the completion of a rated loan status report.

In the event of a change in quality of a loan, which is rated (up or down), the change will need to be approved by the Management MBL Committee and ratified by the Credit Committee.

The **<u>Credit Risk Ratings</u>** used by Family First Credit Union are as follows:

- **Excellent:** Loans fully secured with a certificate of deposit or other share account with no ability for the borrower to access these deposit funds.
- **Above Average Loans:** Loans with above average credit qualities including higher net worth, above average liquidity, above average cash flow or earnings and above average collateral position.
- **Average Loans:** Loans with average credit qualities.
- **Watch Loans:** Loans with potential weaknesses, which may, if not checked and corrected, weaken the collateral or inadequately protect the Credit Union's position at some future date. These loans may require resolution of the specific pending events before associated risk can be properly evaluated.

- **Substandard Loans:** Loans which are inadequately protected by the present sound net worth and paying capacity of the borrower or the collateral pledged. The credit risk in this situation relates to the possibility that some loss of principal or interest may occur if deficiencies are not corrected. These loans need to be brought to the attention of the Management MBL Committee to determine if the Allowance for Loan Loss (ALL) needs to be adjusted accordingly.
- **Doubtful Loans:** Loans that are not presently protected by the current sound net worth or paying capacity of the borrower or by means of the collateral pledged to the extent that a substantial amount of principal may be lost if immediate actions to protect the Credit Union's position are not taken. In other words, the possibility of loss is high. In these situations, it should be somewhat clear as to the Credit Union's loss exposure. These loans need to be brought to the attention of the Management MBL Committee to determine if the Allowance for Loan Loss (ALL) needs to be adjusted accordingly.
- **Loss Loans:** Loans which are considered uncollectible and continuance as a bankable asset is not warranted. Such loans should remain active no longer than it takes to receive the necessary approval for charge-off. These loans need to be brought to the attention of the Management MBL Committee to determine if the Allowance for Loan Loss (ALL) needs to be adjusted accordingly.

Annual Risk Rating Review:
The following will be performed as part of the annual risk rating review for all member business loans:

- Review the payment and performance of the member business loan.
- Ensure all required documentation has been provided (*financials, rent rolls, insurance, etc.)*
- A cash flow analysis and other necessary analytical calculations to document the analysis of the financials including any adverse trends or other concerns.
- A review of the personal and/or business credit reports for borrowing entity and for each of the guarantors and/or principals.
- A review of any potential collateral weaknesses, Ex. delinquent property taxes, lapse in insurance, lien imperfections, loan to value etc.
- A review of the borrowing structure, Ex. any material changes in a borrowing and/or guaranteeing business entity.
- If it is a loan on a GSA leased property, an analysis of the existing lease including any potential weaknesses which could cause the current tenant to vacate or terminate the lease in advance of its expiration date.
- Family First Credit Union requires members to provide their current financial statements, copies of income tax returns (including all supporting schedules and further including all requests for extensions of filing deadlines), and such other reports and information relating to any collateral securing the Note or any guaranty of the Note for all member business loans on an annual basis.

Once the annual risk rating review is performed the Risk Rating Matrix along with the Member Business Lending Risk Rating Procedures will be referenced to determine if the rating of loan should change or remain the same. The timing of the periodic reviews thereafter will be based on the rating and the reason for it.

Approved Organizations (Sellers):
Family First Credit Union can use financial institutions, brokerage firms, government entities, and financial groups to establish member business loans through participations. The Credit Committee must review and approve the organization (seller) before doing business with them. Family First Credit Union is currently approved to use:

- CULS
- CUBS
- FFCU
- Coastal Carolina Credit Union
- Atlanta Postal Credit Union

Upon adding a new seller, The Management MLB Committee will complete the due diligence required from the participation policy and present the seller to the Credit Committee for approval. The new sellers will be added to the policy annually.

Approved Underwriters:
Family First Credit Union can use underwriters that have been approved in this policy to establish good quality loans that fit within our member business/participation loan policy. The following underwriters are approved and have provided information on their expertise, work history, and resume:

- Credit Union Business Group
- Ty Glenham

SBA & Secondary Market Commitments to Purchase:
SBA 7A and 504 loans may be originated for sale into the secondary market including loan types that would be normally prohibited by this policy i.e. franchises, restaurants etc. *(loans to credit union insiders remain prohibited)* subject to the following conditions.

- That a written advance commitment from the SBA to purchase the second mortgage loan that would be originated by this transaction and a written advance commitment from a commercial bank or similar secondary market entity to purchase the first mortgage loan originated by this transaction.

Loan Administration:

1. A **credit file** will be maintained for each borrower. This file will contain all credit documentation related to all loan or loans of the borrower. The note, security deeds or other security instruments will be maintained separately.
2. A **tracking system** will be maintained that will indicate upcoming maturities, and status of past due to payments (at 10 days, 30 days, 60 days and 90 days &

over). A designated staff member will be responsible for following collections of all payments due. A record will also be kept of the past due payments' history of each borrower.

3. **Collection monitoring** –
    - There will be automatic past due notices mailed to the borrower at each of the following times; 15 days past due, 30 days past due, 60 days past due and 90 days past due.
    - Upon a loan or payment reaching 30 days past due, an assigned staff member will contact the borrower by phone and seek payment. This personal following will continue until the account is brought current.
4. The terms of each loan will require that each Business Loan borrower annually furnish to the Credit Union a copy of both its year-end financial statements and income tax returns. The Credit Union will have a system of follow-up designed for the timely receipt and review of this information**.**
    - Loan documentation or an addendum will be utilized by Family First Credit Union requiring the business member borrower to provide this information.
5. In cases of individual business loans secured by commercial real property or inventory or equipment other than automobiles or small trucks and having an unpaid balance of $300,000 or greater, a representative of the Credit Union will visit each business and facility on an annual basis to view and evaluate the collateral. A written report of such visit will be made a part of the credit file.
6. If any individual or borrowing entity is the borrower or guarantor of loans in more than one name, such files will be cross-referenced to keep up with the total debt obligations.
7. In the case of borrowers whose loans are secured by residential or commercial real property, the value and marketability of the collateral will be reviewed as follows:
    - If the general economy or the real estate sector is involved in an economic turndown over a period and the Credit Union's management deems that a re-evaluation of the collateral is needed; the Credit Union will have the appraisal updated to determine the current value. Based upon the current value and the remaining loan balance, the adequacy of the collateral will be evaluated. Generally, a re-evaluation shall not be required for performing loans secured by residential real property unless FNMA or FHLMC would require such an evaluation for a similar type of loan.
    - For loans that are demonstrating either regular past-due status or some other indications of possible financial question about the borrower, then the Credit Union management may, but shall not be required, to have the appraisal valuation updated.

During periods in which real estate tends to increase in value or retain value, loans secured by residential real property shall not require an annual inspection or re-evaluation of the collateral unless such inspection or re-evaluation is or would be required by FNMA or FHLMC for a similar type loan. For loans secured by commercial real property, a re-evaluation of the collateral shall only be required if any required annual inspection of the collateral discloses that the borrower is not maintaining the collateral as required by the loan documentation or if some question exists about financial condition and viability of the borrower, and the borrower's ability to pay its debts as they become due and payable.

For all other types of member business loans, other than loans secured by commercial or residential real property, the value and marketability of the collateral shall be re-evaluated on an annual basis, except in the case of non-performing loans which will be monitored more frequently as the circumstances dictate on a case by case basis.

Definitions:

Associated Member - Any member with a shared ownership, investment, or other pecuniary interest in a business or commercial endeavor with the borrower.

Certificate of Appointment - FAR 53.301-1402 (48 C.F.R. Part 53, Standard Form 1402) Such Certificates of Appointment were in effect on the date on which the applicable contracting officer signed the GSA Lease and any supplemental lease agreements related thereto. Any dollar limitation on the authority is greater than the total lease obligations.

Fleet - A minimum of five vehicles used for commercial purposes for hire to transport people or property.

Immediate Family Member - A spouse, parents or children.

Lease Contracting Officer - An individual holding a valid Government-issued warrant providing authority to enter and administer leases on the Government's behalf.

Loan to Value Ratio - The aggregate amount of all sums borrowed including outstanding balances plus any unfunded commitment(s) or line(s) of credit from all sources on an item of collateral used to secure the loan divided by the value of the collateral.

Net Worth - (When applied to Net Worth of Family First Credit Union) is retained earnings as defined under generally accepted accounting principles. Retained earnings normally include undivided earnings, regular reserves and any other appropriations designated by management or regulatory authorities.

Net Worth - (When applied to Net Worth of a borrower) is the same as defined under generally accepted accounting principles. (total assets minus total liabilities).

Supplemental Lease Agreement (SLA) - Document used to change or modify an existing lease, such as for acquisition of additional space, partial release of space, revision in terms or rental payments, change in ownership or payee, or any other action that changes the lease.

APPENDIX A: Credit Risk Ratings

Rating	General Definition	Categories	Characteristics
1 **Excellent**			Loans fully secured by a CD or other credit union deposit savings account.
2 **Above Average**	Loans to established member borrowers that display sound financial conditions and operating results.	Operations/ Cash Flow	Consistently demonstrates positive profitability with results consistent with industry norms. Demonstrates strong and/or stable margins. Debt service coverage consistently above 1.75.
	Capacity to service debt is consistent with or above the industry norm.	Collateral	Good collateral value/loan-to-value ratio at or below the maximum allowed. No known or suspected environmental implications affecting collateral. LTV ratio between 51-70%. LTV enhanced by cash injection rather than leveraging additional collateral.
	Borrower and industry outlook are considered good.	Balance Sheets/ Financial Trends	Key balance sheet ratios (current ratio, debt-to-worth, A/R & A/P days) consistent with industry norms. Stable balance sheet with some amount of liquid assets and strong capital position. Leverage is slightly lower or on average with industry norms. Good positive net worth with stable or increasing trend.
		Management	Borrower has good management depth supported by experienced succession. Past projections exhibit consistency with actual performance. Borrower effectively utilizes outside resources. Borrower has been in the industry for 5+ years coupled with historic profitability and success.
		Guarantors	Excellent credit history with no delinquencies in the last 12 months over 30 days, low personal debt-to-income ratio, strong net worth and high liquidity. Strong FICO scores (generally between 700 +).
		Industry/ Economic/Market Conditions	Business market is stable. Long-term industry outlook is satisfactory. Adverse material implications because of normally anticipated changes in general economy are manageable.
		Quality of Financial Information	Accountant prepared review-quality statements or compilations.

Rating	General Definition	Categories	Characteristics
3 **Average**	Loans to borrowers whose current financial condition, while functionally adequate, may be deficient in one or two categories (excluding cash flow and debt service). Acceptable levels of risk tolerance achieved through close monitoring of the credit and strength of loan collateral and or guaranties.	Operations/ Cash Flow	Operating performance is adequate and demonstrates a stable trend of profitability. Historical debt service coverage ratio is marginally sufficient yet below industry norms, improved future debt service coverage is projected. Debt service coverage consistently above 1.20.
		Collateral	Collateral value/loan-to-value ratio is at or near the maximum allowed and stable. No known or suspected environmental implications affecting collateral. LTV ratio between 71-80%.
		Balance Sheets/ Financial Trends	Maintains adequate current position (within parameters of industry norms), however, leverage is somewhat higher than industry norms and fixed assets are leveraged. Net worth is positive; however, trends may show a steady decline in net worth.
		Management	Company exhibits capable management; however, depth and successor management appear lacking. Business planning appears rudimentary; however, management is perceived to exhibit adequate foresight and direction and can provide reliable supportive projections. Outside sources may not be fully utilized. Borrower has been in the industry for 2+ years (may utilized outside resources to help offset lack of experience) coupled with limited success and positive business trends.
		Guarantors	Credit history is satisfactory at this time; some derogatory history is noted, but no current delinquencies. Personal debt-to income ratio is adequate, positive net worth and somewhat liquid. Good FICO scores (generally between 680 – 699).
		Industry/ Economic/Market Conditions	Business market is neither expanding nor contracting, is new or not known for its stability. Long-term industry outlook is acceptable. Adverse material implications because of changes in general economy are not anticipated to be catastrophic.
		Quality of Financial Information	Accountant prepared compilations, tax returns, or company prepared financial statements supported by tax returns.

Rating	**General Definition**	**Categories**	**Characteristics**
4 **Watch Loans**	Loans in this category may have a strained liquidity and leverage capacity or earnings; covenant violations; slow pay; or poor reporting. * There are characteristics that lead us to believe that correction of the issues is a realistic possibility and likely to be upgraded within a reasonable period.	Operations/ Cash Flow	Operating performance inconsistent (declining trends, marginal profits, or small losses common). Historical debt service coverage inconsistent. Only nominal potential improvement is anticipated. Debt service coverage consistently below 1.20.
		Collateral	Specific concerns have been cited about declining value of collateral. Loan-to-value ratio may be above maximums allowed.
		Balance Sheets/ Financial Trends	Key balance sheet ratios (current ratio, debt-to-worth, A/R & A/P days) below industry norms, probably declining trends. Significant reliance on short-term borrowing to support trade debt which may be stretched. Nominal equity in fixed assets and net worth is negative.
		Management	Borrower lacks management depth, including demonstrated lack of understanding of all aspects of business operation. Management succession lacking. Planning severely deficient, difficult to determine business direction. Projections, if provided are unreliable. Use of outside resources is limited.
		Guarantors	Credit history is unsatisfactory, delinquency on obligations. Personal debt-to-income ratio is inadequate, weak net worth and low liquidity. Significantly decreasing FICO scores.
		Industry Economic Market Conditions	Stagnant or declining industry outlook. Significant adverse financial implications as a result from anticipated change in general economy.
		Quality of Financial Information	Poor quality financial reporting and/or insufficient financial information is present.

Rating	General Definition	Characteristics
5 **Substandard**	A substandard loan is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged. Loans so classified must have a well-defined weakness, or weaknesses, that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the credit union will sustain some loss if the deficiencies are not corrected.	Substandard loans have a high probability of payment default, or they have well-defined weaknesses. Cash flow from operations may be insufficient to meet principal reductions as expected, with the prospect that this condition may not be temporary. Operating losses may exceed 20% of net worth. A restructuring not in the ordinary course of business has occurred or is anticipated. There is a dependence upon favorable business, financial, and economic conditions to meet timely payment of interest and repayment of principal. If such conditions are not favorable, disruption in scheduled debt payments is possible (at least 20% probability but less than 50%). If deficiencies are not corrected, there is a possibility of loss (less than 20% probability) and a question regarding the company's ability to operate as a going concern. Generally, the asset/loan is considered collectible as to both principal and interest primarily because of collateral coverage. Loss of principal is not at question, unless current trends continue. Weakened conditions for more than four quarters. For some substandard loans, the likelihood of full collection of interest and principal may be in doubt; such loans should be placed on nonaccrual. Although substandard loans in the aggregate will have a distinct potential for loss, an individual loan loss potential does not have to be distinct for the asset to be rated substandard.

Rating	General Definition	Characteristics
6 **Doubtful**	A loan classified as doubtful has all the weaknesses inherent in one classified substandard with the added characteristic that the weaknesses make collection or liquidation in full, based on currently existing facts, conditions, and values, highly questionable and improbable.	A doubtful loan has a high probability of substantial loss, but because of specific pending events that may strengthen the loan, its classification as loss is deferred. Doubtful borrowers are usually in default, lack adequate liquidity or capital, and lack the resources necessary to remain an operating entity. Because of high probability (50% or greater) of loss, nonaccrual accounting treatment is required for doubtful assets. Management will need to determine ALL reserve adjustments.

Rating	General Definition	Characteristics
7 **Loss**	Loans classified loss are considered uncollectable and of such little value that their continuance as a bankable asset is not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather that it is not practical or desirable to defer writing off this basically worthless loan even though partial recovery may be affected in the future.	With loss loans, the underlying borrowers are often in bankruptcy, have formally suspended debt repayments, or have otherwise ceased normal business operations. Once a loan is classified as loss, there is little prospect of collecting either its principal or interest. When access to collateral, rather than the value of the collateral, is a problem, a less severe classification may be appropriate. Loss loans should remain active no longer than it takes to receive the necessary approval for charge-off from Management.