

Lending Mini Case: SoFi

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Background

San Francisco-based Social Finance, operating under the trade name “SoFi”, launched in 2011 with the aim of making student loans more affordable, particularly for high income earners, by refinancing federal and private student loans together into a blended loan offering with favorable terms. The Company since has emerged as the leader in the student loan refinance industry, having refinanced more than \$5 billion in student debt. SoFi is known for its comparatively low interest rates and the ancillary benefits it offers customers, including career coaching services and access to local networking events. With its unique loan offerings, SoFi addresses pain points not previously met by its competitors, namely lower loan balance thresholds (SoFi has a \$5,000 minimum loan balance requirements) and the elimination of ‘caps’ or maximum balances placed on loans qualifying for refinance.

Tactically, SoFi has eliminated and continues to solve for problems associated with the student loan market. However, the company’s vision is not limited to refinancing student loans. On a broader level, SoFi wants to solve the pain point of millennials’ disenchantment with the finance industry and distrust of large commercial banks. As the company has expanded its offerings, it has begun to sell its student loan borrowers on mortgages and, more recently, unsecured personal loans.¹ Its strategy revolves around selling select low-risk borrowers on refinancing their student debt, in a space where there had not been a great alternative to high rate federal loans. SoFi initially financed its lending by matching groups of alumni investors to borrowers, providing extra “incentive” for borrowers to avoid default.² This pool of alumni also provides borrowers access to a network of connected, experienced professionals.

In January 2016, the company announced it would no longer consider FICO scores when evaluating potential customers. Instead, SoFi looks at overall financial behavior, such as position and length of employment, bill payment history, and leftover income after expenses. This method can work in favor of graduates with short credit histories

¹ Alternative Lender SoFi Expands into Personal Loans, American Banker, accessed 11/2/16

² A New Spin on Student Loans, Stanford Social Innovation Review Summer 2013, accessed 11/2/16

who haven't yet built good or excellent scores under traditional credit scoring models. However, SoFi has identified these borrowers as lower risk of default than these scoring models may suggest, in addition to potentially high salaries based on performance of graduates from similar schools. By taking a more modern data-driven approach to assessing borrower risk, SoFi is able to distinguish and market to prime borrowers among the estimated \$200-plus billion outstanding student loans eligible for refinance that have not yet refinanced.³ As seen in Appendix A, the typical SoFi borrower qualifies for refinancing on his own (no co-signer needed) and has excellent credit and low six-figure salary.

Competition

SoFi issues personal and mortgage loans as well as loans to refinance mortgages and student loans. It also provides loans to parents to help them finance their children's educations. For those paying more than 10 percent interest on credit cards and want to pay them off or just want to make a major purchase, SoFi offers fixed rates on personal loans starting at 5.95% APR when using autopay, and there are no origination fees or prepayment fees.

One advantage of using SoFi is its community benefits, one of which suspends monthly SoFi loan payments and provides you with job placement assistance should a borrower lose his job through no fault of his own. Further, it offers access to its alumni investors for career coaching, mentoring, and general networking.

Lending Club:⁴ SoFi doesn't have a clear-cut minimum credit score, but it's recommended to have a score of 700 or greater. Those with strong repayment histories will also have a good chance at getting approved, as SoFi doesn't approve applicants based off of FICO score alone. LendingClub's minimum credit score is 600 for its personal loan.

³ Dash, Stephen: Why You Should Be Bullish On Student Loan Refinancing Companies, Forbes, July 2015, accessed 11/1/16

⁴ Millard, Erin: Sofi vs. LendingClub, *Magnify Money*, April 2015, accessed 11/1/16
<http://www.magnifymoney.com/blog/personal-loans/sofi-vs-lendingclub-better-good-credit419441706>

SoFi doesn't have any fees associated with its loans - not even an origination fee. However, a late fee will apply after 15 days of non-payment. This will be the lesser of \$5 or 4% of the amount due. However, SoFi offers Unemployment Protection service for borrowers who have involuntarily lost their job. This grants forbearance for up to twelve months. However, interest continues to accrue during forbearance. LendingClub has the following fees:

- Origination Fee: Ranging from 1%-6%, depending on the loan grade
- Late Payment Fee: LendingClub gives borrowers a 15-day grace period for making a payment on their loan. On the 16th day, a late fee will be assessed. The amount of the fee is the either \$15 or 5% of the unpaid installment amount, whichever is greater. This is higher than SoFi's late payment fee.
- Check Processing Fee: This \$15 fee only applies for those choosing to pay by paper check. LendingClub allows borrowers to make automatic payments with direct debit.
- Unsuccessful Payment Fee: A \$15 fee is charged if automatic payment is unsuccessful.

Both SoFi and LendingClub conduct a "soft pull" on an applicant's credit score, allowing a borrower to see his qualified rate before committing to a loan at no harm to his credit score. This is great for borrowers who are merely exploring their refinancing options, and aren't necessarily committed to a refinance.

In addition, SoFi has a better APR range, meaning a borrower will likely pay less over the life of a loan. Additionally, SoFi's maximum loan amount is much greater. Borrowers with more debt to consolidate or pay off may not be able to refinance their full debt with LendingClub.

Common Bond:⁵ The consolidation services offered by both companies are also very similar. Both offer fixed rate loans and variable rate loans. Both companies offer a

⁵ Lux, Michael: SoFi vs. CommonBond: The Showdown, *Student Loan Sherpa*, May 2015, accessed 11/2/16
<http://studentloansherpa.com/sofi-commonbond-showdown/>

maximum repayment length of 20 years, and interest rates start just above 2% (though this ultra low rate is only for 5 year variable interest loans). Both SoFi and CommonBond target low-risk borrowers with high income potential and clean credit history. However, SoFi's approach is to roll out the red carpet for student loan refinancing. They have some perks similar to those that you might find with a premium credit card. Perhaps the best SoFi perk is its job placement program. While most borrowers do not want to have to use this feature, it is a nice added benefit should the need arise.

Though SoFi has a few extra perks when compared with CommonBond, very little separates these two companies. The best company for most borrowers will be the one that offers the lowest interest rate. Applying to refinance with both is likely the best option, especially since the initial inquiry to view refinancing rates will not affect an applicant's credit score.

Investors/Financing

SoFi launched in 2011 by arranging student loan refinancing with funding provided by alumni investors. It raised roughly \$100M to fund refinancing in its first year in business.

⁶ Following its initial rounds of funding, it took on several rounds of debt financing, as it expanded into other lines of business beyond student refinancing. One key that sets SoFi's financing apart from its competitors is the added value of alumni investors. By having this group of investors who share the same interest to see its borrowers succeed in their careers, both the investor and the borrower benefit.

As of 2014, when competitor Lending Club went public, SoFi was targeting an IPO in the neighborhood of \$200-250M. However, they were focused on growing their mortgage line of business, stating that they would hold off on going public at least until they were originating 2.5 times their current amount of home loans.⁷

⁶ Zlomek, Erin: To Fund Your MBA, Borrow From Alums, Business Week, July 2012, accessed 11/2/16

⁷ SoFi's IPO Target May Grow, American Banker

Following their \$1B Series E round of funding in late 2015, speculation arose as to whether SoFi would move forward with going public at that time, especially given Lending Club's decline in stock price following its IPO, which dropped 50% from January to August in 2015.⁸ As the first and only FinTech company to receive a \$1B round of funding, SoFi may wish to remain private for as long as possible, continuing to grow both its pools of borrowers and investors under less scrutiny as a private company.

SWOT Analysis

Strength - Interest rates: SoFi offers lower interest rates than many competitors. Rates start at 3.5% for a five-year, fixed-rate loan and 2.24% for a five-year, variable-rate loan. All rates include a 0.25% discount for signing up for automatic payments from a checking or savings account.⁹ It is able to do so through its advanced data algorithms, which help reduce overhead and operational costs compared to other lenders, especially banks. As with other lenders, having an attractive financial profile and choosing a shorter loan term will qualify you for SoFi's lowest rates.

By looking beyond traditional means of creditworthiness and repayment ability, SoFi is able to undercut established banks and compete for overlooked prime borrowers at lower interest rates. Once SoFi has established a relationship with these borrowers who have proven their ability to repay, SoFi can continue to market its other products such as home loans and personal loans.

Career coaching: SoFi keeps career services representatives on staff to help customers practice job-hunting skills or learn how to negotiate a higher salary. You can work with a staff member one-on-one or attend online webinars, whether you're

⁸ SoFi's \$1B Haul Exposes Clashing Perceptions..., American Banker

⁹ <https://www.sofi.com/refinance-student-loan/refinance-student-loan-rates/>, accessed 11/1/16

employed or not. You can also make professional connections at SoFi-hosted happy hours, dinners and networking events.

Weakness - Forbearance limitations: SoFi's unemployment protection program offers borrowers who have involuntarily lost their jobs the ability to pause loan payments for three-month periods and a total of 12 months. The company says it will work with borrowers who experience other types of financial hardship on a case-by-case basis. However, some lenders offer longer forbearance periods than 12 months total in cases of unemployment or economic hardship. They include CommonBond (24 months) and U-fi (24 to 36 months).

Opportunity - Low Penetration: While total student loan debt has been on the rise, borrowers have yet to take advantage of refinancing opportunities. Of the estimated \$211B of qualifying student loan debt, a mere 2% of that amount has refinanced to lower rates.¹⁰ This student debt is spread across 40 million Americans, who have shown increasing interest in student loan refinance in the recent years, according to Google.¹¹ See Appendix B for a graph of search history over time for "student loan refinance" in the United States.

Opportunity - Growth in Student Debt: In addition to a large target market of existing borrowers, new students continue to amass student debt and add to this total. Despite the rising average cost of college attendance, demand for a college education does not appear to be impacted. Further, each year the graduating class sees the *average* borrower taking on more debt.¹² According to MarketWatch's Student Loan Debt Clock,

¹⁰ Dash, Stephen: Why You Should Be Bullish On Student Loan Refinancing Companies, Forbes, July 2015, accessed 11/1/16

¹¹ Google Trends, "student loan refinance", 2004-present

<https://www.google.com/trends/explore?date=all&geo=US&q=student%20loan%20refinance&hl=en-US>

¹²

<http://www.forbes.com/sites/shaharziv/2016/05/16/stop-prioritizing-student-loan-payments/#4f01b79972ec>

the national student debt total is growing at an average \$2,700 *per second*.¹³ This translates directly to a large and growing market for SoFi to refinance.

Opportunity - Mortgage loans: In the world of mortgage lenders, SoFi is looking to stand out by opening its lending doors to jumbo borrowers who earn high incomes but have little saved up for down payments. This approach differs from traditional lenders that are hesitant about entering the jumbo lending arena. With stiff credit scoring criteria and strict debt-to-income ratios, other lenders are more apt to reject applicants than is SoFi, which will look closely at their disposable income after expenses as a more comprehensive way of approving them for a home loan.

Threat - Economic climate: While SoFi, like other alternative lenders, are overseen by the Consumer Finance Protection Bureau, their business model has only proven successful in a positive economic climate. It has yet to be seen what will happen during a market downturn, where its borrowers may become more of a default risk. While SoFi typically only carries loans on its balance sheet for four to six weeks before selling them as securities¹⁴, the rating and demand of such securities may decline dramatically should its borrowers fail to pay on time due to less employment or tougher financial circumstances. As seen in Appendix C, default rate among student debt is growing, with other types of loan defaults on the decline.¹⁵ While SoFi's typical borrower is less of a default risk than the average borrower, any sort of student loan bubble could threaten SoFi's entire business model and cause investors to stop seeking SoFi securities backed by student loans.

Threat - Regulatory tightening: As a non-bank marketplace lender, SoFi is exposed to the possibility of new regulations to protect consumer borrowers. Should it decide to go

¹³ Watch America's Student Loan Debt Grow, *MarketWatch*, June 2015, accessed 10/30/16
<http://www.marketwatch.com/story/every-second-americans-get-buried-under-another-3055-in-student-loan-debt-2015-06-10>

¹⁴ Avery, Helen: US non-bank lenders close in on mortgages, *Euromoney*, January 2016, accessed 11/2/16

¹⁵ <http://www.valuwalk.com/2016/06/student-loan-delinquencies-soar/>

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public, added scrutiny and regulation would likely add to its operating costs, reducing its ability to compete by offering such low interest rates.

Appendix A - Do you qualify?

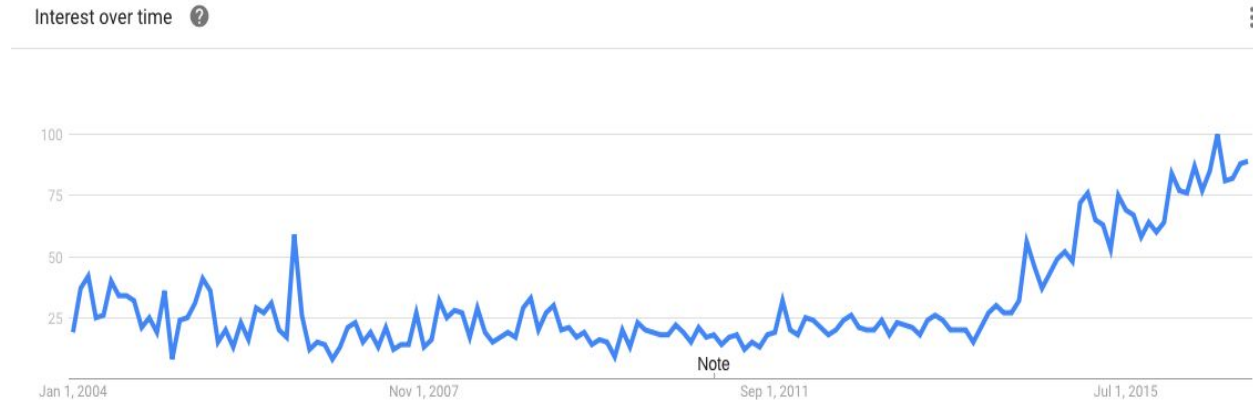
	MINIMUM QUALIFICATIONS	THE TYPICAL BORROWER
Credit Score	None. Considers factors including employment history, income and record of meeting financial obligations.	774
Annual Income	None; taken into account with other factors.	\$124,630

Appendix B - Funding Rounds (10) - \$1.58B¹⁶

Date	Amount / Round	Valuation	Lead Investor	Investors
Sep, 2015	\$1B / Series E	(est \$4B)	SoftBank	9
Jan, 2015	\$213.03M / Series D	—	Third Point Ventures	6
Apr, 2014	\$80M / Series C	—	Discovery Capital	9
Sep, 2013	\$50M / Debt Financing	—	—	0
Aug, 2013	\$50M / Debt Financing	—	East West Bank	1
Jun, 2013	\$41M / Debt Financing	—	The Bancorp	1
Mar, 2013	\$60M / Debt Financing	—	Morgan Stanley	1
Sep, 2012	\$77.2M / Series B	—	Baseline Ventures	3
Mar, 2012	\$4M / Series A	—	—	1
Sep, 2011	\$4M / Series A	—	—	4

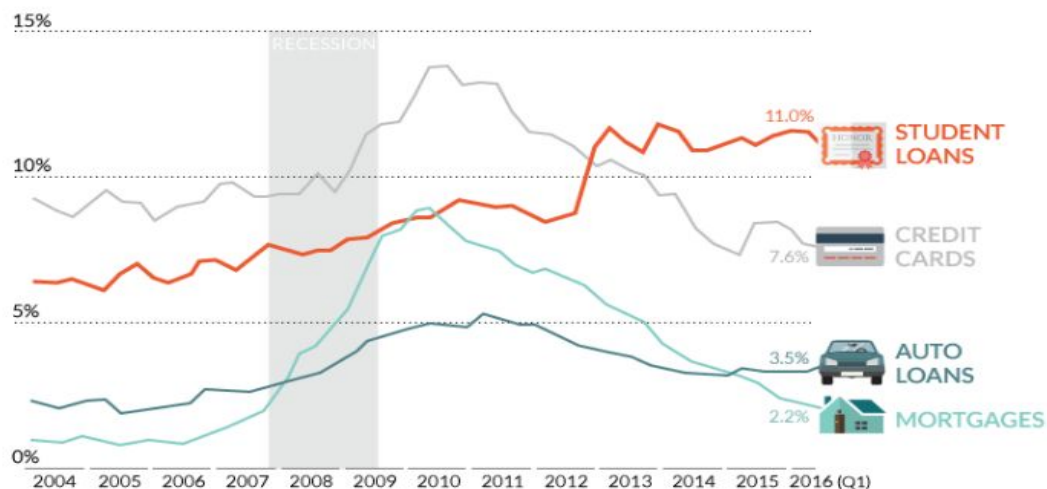
¹⁶ Crunchbase, <https://www.crunchbase.com/organization/social-finance#/entity>

Appendix C - Google Trends “student loan refinance”, 2004 to present¹⁷



Appendix D - Student Loan Delinquencies Soar¹⁸

% of Balance 90+ Days Delinquent



¹⁷ Google Trends, “student loan refinance”, 2004-present

<https://www.google.com/trends/explore?date=all&geo=US&q=student%20loan%20refinance&hl=en-US>

¹⁸ <http://www.valuewalk.com/2016/06/student-loan-delinquencies-soar/>

Simple Process: Get refinanced in as little as 15 minutes

