NAVAJO COMMUNITY DEVELOPMENT FINANCIAL INSTITUTION

LOAN POLICIES

Approved August 25, 2014
NCDFI Board of Directors

NAVAJO COMMUNITY DEVELOPMENT FINANCIAL INSTITUTION
LOAN POLICIES

TABLE OF CONTENTS

SECTION	TITLE	PAGE
1	AUTHORITY	1
2	PURPOSE	1
3	GENERAL POLICIES OF NCDFI	1
4	SCOPE	2
5	LOAN REQUIREMENTS	2
6	EVALUATION OF LOANS	5
7	LOAN APPROVAL PROCEDURES	8
8	LOAN DOCUMENTATION	8
9	LOAN CLOSING	9
10	SERVICING THE LOAN	10
11	COLLECTIONS	11
12	WRITE-OFF OF LOANS	12
13	MODIFICATION OF GUIDELINES	12

(Revised 08/25/14)

SECTION 1 - <u>AUTHORITY</u>

A. The Navajo Community Development Financial Institution, Inc. ("**NCDFI**") is a wholly owned entity of the Navajo Nation. The Articles of Incorporation were filed with the Navajo Business Regulatory Office on September 12, 2006. The 21st Navajo Nation Council Resolution CJA-02-10 (dated January 27, 2010) ratified the NCDFI as a for-profit corporation, wholly owned by the Navajo Nation, authorizing a member of the each of the Standing Committees of the Navajo Nation Council to serve as the Shareholder representatives and Community Advisory Council for the Corporation (enacted into law on February 8, 2010).

B. The NCDFI's mission is to provide financial products, in arms length transactions, to individuals, businesses, Chapters, Navajo Nation and Chapter enterprises, and communities (collectively, "**Eligible Borrowers**") to build a strong economy based on individual initiative, entrepreneurial creativity and community and traditional values.

SECTION 2 - <u>PURPOSE</u>

A. The primary purpose of NCDFI's financing is to support the healthy growth of the Navajo Nation's economy by providing loans or loan guarantees to Eligible Borrowers who meet the credit requirements and otherwise satisfy these "**Loan Policies**" ("**Qualified Borrowers**" or "**Borrowers**").

B. NCDFI shall:

1. Promote the development of the Navajo Nation economy by providing a source of financing for Qualified Borrowers;

2. Protect and maintain the value of the entrusted NCDFI funds through the making of quality loans and assisting in the collection of monies due and owing the NCDFI; and

3. Ensure that loans made by NCDFI are made in compliance with these Loan Policies and applicable Navajo Nation laws.

SECTION 3 - <u>GENERAL POLICIES OF NCDFI</u>

A. All loan applications made to NCDFI shall be processed according to these Loan Policies.

B. All loan applicants shall be treated with dignity and fairness.

C. Any exception to these Loan Policies shall be reviewed by the Loan Committee and approved by the NCDFI Board.

D. It is the policy of the NCDFI to operate all loan programs in a business-like manner, to extend credit only upon a thorough review and sound credit analysis taking into consideration the overall economic situation that exists within the Navajo Nation, to maintain accurate account records, and to service and maintain credit accounts so as to protect the assets of the NCDFI.

E. It is the policy of the NCDFI to consider the special needs of Navajo Eligible Borrowers, to be sensitive to cultural concerns that may arise, and to make a special effort to accommodate qualified Navajo loan applicants on an equal opportunity basis, regardless of age, sex, religion or political affiliation.

F. It is the policy of the NCDFI to hold Borrowers responsible for their debts. The NCDFI expects loan agreements to be honored and for repayments to be made accordingly. Property pledged as collateral may be seized and sold to satisfy delinquent accounts to the fullest extent permitted by Navajo Nation Law.

G. NCDFI may report a borrower's loan status to a Credit Bureau.

H. In order to avoid the existence and even the appearance of undue influence and conflict of interest, prior to the completion of a loan application, an employee of the Navajo Nation or its political subdivisions, an elected official, appointed official, judicial official, or other elected or appointed official, shall execute a signed and notarized Ethical Certification form provided by NCDFI attesting that the individual will refrain from requesting any special consideration from the NCDFI and will abide by the Navajo Ethics in Government Law.

SECTION 4 - <u>SCOPE</u>

A. These Loan Policies are of a general nature and are not intended to replace the development and adoption of operating procedures, lending guidelines, application forms, reporting forms and implementation policies and procedures.

SECTION 5 - <u>LOAN REQUIREMENTS</u>

Eligible Borrowers shall make loan requests ("**Loan Applicants**" or "**Applicants**") on loan application forms approved by NCDFI for that purpose. The NCDFI shall not process a loan application if the application has not been completed in full and all required information is not provided. NCDFI may require any additional information that it deems necessary in order to help make the credit decision.

A. Knowingly making any false statements on the loan application shall be grounds for disqualification of the Applicant as a Borrower. Any evidence of fraud may be referred to the Office of the Prosecutor for appropriate action.

B. The Loan Application shall be on a form provided by the NCDFI and shall include the following:

1. Signatures by the Applicant and any co-Applicants and guarantors attesting to the completeness and accuracy of the material provided in the loan application and supplemental documents.

2. An executive summary of the business concept, loan proposal, description and current estimated market value of collateral supported by appropriate documentation.

3. A business plan which describes the market to be served, expected or existing competition, location of the business, legal form of business organization, personnel, operating plans and or service plans, financial plans for the next three years, and expected operating results if the loan is approved.

4. For existing businesses that have a proven, successful track record for three or more years, a brief description of the business may be submitted in lieu of a full-fledged business plan. Additionally, the Applicant must submit its last three (3) years Federal tax returns (personal and business), a current loan application and a statement of what the loan proceeds will be spent for.

5. For existing businesses, the following additional information may be requested:

    a) Financial Statements for the past three years, including Balance Sheets and Income Statements, projected Cash Flow Statement, and projected capital expenditures during the term of the loan;

    b) Projected rates of returns;

    c) An accounts receivable aging report; and

    d) An accounts payable aging report.

6. Applications for start-up businesses shall provide pro-forma financial projections of the balance sheet, income statement, and cash flow for a period of three years. For purposes of these Loan Policies, applications from businesses that have been in operation for less than one year will be considered as applications from start-up businesses.

7. Personal and business federal and, when applicable, state income tax returns, for the past three tax years and Navajo Nation sales and possessory income tax returns.

8. Site Location - Documents authorizing the use of the land or commercial space in which the business is to be located.

9. A detailed statement regarding the use of the business proceeds, including equity contributions and loans, current purchase quotations and bids as appropriate, for equipment and inventory with a value over $1,000 or construction costs over $5,000.

10. Resumes of managers, principal owners, officers, members of the Board of Directors, and others as appropriate, setting forth the qualifications of those individuals as such pertain to the business venture.

11. A report from an established credit bureau, evidencing an acceptable credit history, or if such is not available due to lack of credit experience by the Applicant, then three verified credit references evidencing a history of repayment.

12. Supporting documents such as partnership agreements, Corporation Certificate, corporate resolutions authorizing borrowing, business licenses, permits, insurance policies, agricultural tax schedules, and such other documents as requested.

C. All financial statements shall be prepared according to generally accepted accounting principles. All financial projections shall contain full explanations of all assumptions utilized and a break-even analysis.

D. Loan proceeds shall not be used for the following purposes:

1. The purchase of, or down payment on, any real estate, unless such is to be used exclusively in the conduct of the business and is essential to the success of the business;

2. To pay all or part of any delinquent tax assessment of any type (income, property, etc.) to the Internal Revenue Service, State Department of Revenue, Navajo Tax Commission or other similar tax agency; an

3. To pay an existing personal debt or unrelated business debt whether owed to the Nation or to any other entity, except that working capital loans may be used to pay trade payables, and other debts may be refinanced on a case by case basis as approved by the Loan Committee.

4. The acquisition of or use in one of the following businesses: golf courses, race tracks, gaming facilities, massage parlors, hot tub facilities, suntan facilities, and stores where the principal business is the sale of alcoholic beverages for consumption off the premises.

E. All information submitted by the Applicant, including the loan application and business plan, and required information shall be verified to the greatest extent possible, given available resources and sound business practices.

F. All projections of income and cash flow must be as accurate and reasonable as possible.

G. Loan amounts shall not exceed 100% of the purchase price of assets to be acquired, or more than 100% of the value of any permanent improvements constructed on a business site.

H. The Applicant shall be responsible for the payment of all applicable fees necessary for the loan approval, including but not limited to lien searches, UCC filing fees, appraisals, title and registration fees, and legal fees.

SECTION 6 - EVALUATION OF LOANS

A. A loan committee (the "**Loan Committee**") shall be established. The initial Loan Committee shall be comprised of the NCDFI Board Chairperson and the CEO.

B. The Loan Committee shall review the completed loan application (including supplemental information, if requested), conduct a financial evaluation, and make recommendations to the NCDFI Board based upon the following criteria.

1. Cash Flow: An evaluation of cash flow helps determine whether the Applicant has sufficient cash flow coming into the business to pay existing expenses plus the additional burden of principal and interest payments on the proposed loan. In a start-up company pro-forma statements will be used in calculating the cash flow, after an analysis has been made of the reasonableness of the assumptions in the pro-forma statements.

2. Liquidity. The NCDFI will also evaluate the liquidity of the business to assess the ability of the Applicant to convert assets into cash or cash equivalents without significant loss.

3. Leverage Ratio. In addition, the NCDFI will evaluate the leverage ratio. Leverage is the debt of the business in relation to equity. The more long-term debt there is, the greater the financial leverage. As the leverage ratio increases, so do the principal and interest payments and therefore the risk of default.

4. Collateral. Because the attachment, replevin, foreclosure and repossession of collateral is expensive and time consuming and will not likely allow the NCDFI to be made whole in the event of a default on the loan, collateral is not the most important factor when evaluating a lending decision. However, the NCDFI will take all available collateral in order to help protect the NCDFI's loan investment. It is a goal of the NCDFI that loans will be secured by discounted collateral valued at one hundred percent of the loan proceeds. Valuations of collateral will be conducted by NCDFI or, when appropriate, by independent third-party appraisers.

5. A discount formula will be applied to the appraised value of the asset which will be used as the basis on which to establish the maximum amount of loan proceeds for which an applicant is eligible assuming that collateral were the sole criterion for determining whether the loan should be funded. The discount formula is

based on to the following asset classifications:

a) Cash will be valued at 100% of the amount of cash.

b) Accounts receivable will be valued at 80% of all receivables that are less than 60 days delinquent. In the event that the primary collateral for an approved loan is accounts receivable, the NCDFI may require the borrower to provide periodic schedules of those accounts, detailing the total receivables by categories (current, 30-days delinquent, 60-days delinquent, and 90 or more-days delinquent) during the term of the loan. If the value of the accounts receivable declines, based on the most recent accounts receivable aging report as compared to the report provided at the time of loan approval, the NCDFI may consult with and make recommendations to the borrower intended to improve the value of this collateral.

c) Inventory will be valued at 80% of non-obsolete inventory, as demonstrated by periodic inventory listings and an analysis of the inventory turns. If the primary collateral support for the loan comes from inventory, the borrower will be required to provide periodic schedules of inventory, which include sufficient detail to identify obsolete inventory. If the value of the inventory declines, based on the most recent inventory list as compared to list provided at the time of loan approval, the NCDFI may consult with and make recommendations to the borrower intended to improve the value of this collateral.

d) Equipment will be valued, if new at 80%, and if used at 50%. Further adjustments may be made if the equipment has a rapid obsolescence factor or if it is equipment that has limited resale value due its specialized use in a particular business.

e) Vehicles will be valued at 80% of the Blue Book loan value.

f) Improved commercial real estate held in fee simple title will be valued at 80% based on a current appraisal or broker evaluation.

g) Unimproved or undeveloped land held in fee simple title will be valued at 50% based on a current appraisal or broker evaluation.

h) Personal property, if the property can properly be secured and if a valid appraisal can be made of the property. If personal property is the sole collateral for a loan then the loan proceeds cannot be more than 80% of the value of all personal property securing the loan.

6. Although the NCDFI prefers to be in a first lien position on all collateral, a subordinate lien position will be accepted if the discounted collateral value adequately covers NCDFI's position in addition to any senior lienholders, and the

NCDFI is able to negotiate an intercreditor agreement detailing an acceptable liquidation plan, in the event of a default on the senior lienholder's notes. If the NCDFI is in subordinate position on all of the collateral or the collateral value isn't sufficient to cover NCDFI in addition to senior lienholders, the NCDFI may condition the loan on additional requirements, including but not limited to the addition of satisfactory guarantors ("**Guarantors**").

7. Structuring the Loan.

a) The NCDFI will recommend the structure for the loan based on the use of the loan proceeds and financial analysis. The NCDFI will also recommend loan covenants and conditions designed to support the strengths and manage the risks identified by the NCDFI in the recommendations provided to the NCDFI Board.

b) Loans will have the structure, maturity dates and terms recommended by the Loan Committee and approved by a resolution of the Board. Loans may be structured in a variety of ways, including but not limited to short-term (e.g., ninety (90) day) or long-term loans, single or multiple payment loans, term loans or revolving credit lines, drawdown loans or loans fully-funded at closing, interim or permanent loans, fixed rate or variable rate loans.

c) Unless otherwise agreed to by the Board, all loans will be secured.

d) The term of each loan will be limited by the purpose of the loan and the asset life of the collateral securing the loan as set forth in the following guidelines:

(i) Loans secured by working capital or inventory should have no more than a three-year term, with some consideration given to the amount of the loan.

(ii) The term for loans secured by equipment should be for the lesser of ten years or the useful life of the equipment.

(iii) Loans secured by real estate should have no more than 20-year terms, and in no event should the term of the loan exceed any underlying lease.

e) Efforts will be made to match the loan repayment schedule with the actual cash flow of the Borrower, of particular concern are businesses that have peak-revenue seasons (e.g., agricultural tourism and construction businesses). Generally the loan repayment schedule will require monthly payments (with the exception of small, short-term loans of less than a year, which may have a single end of term payment). In the case of businesses with peak-revenue seasons, the loan repayment schedule may provide for small, token payments during off-season months with substantial payments during the peak-season months.

f) Unless otherwise agreed to by the Board, all construction loans will be structured as drawdown loans with disbursements from the NCDFI to occur upon the completion of construction stages. The NCDFI will monitor the progress and completion of construction.

SECTION 7 - LOAN APPROVAL PROCEDURES

A. Applications and all required documents must be completed before presentation of the loan request is made to the Loan Committee for consideration. An executive summary of the loan application shall be prepared, along with such other information, as the Loan Committee shall require. The Loan Committee shall make recommendations to the NCDFI Board.

B. Applicants will be notified in writing of the final decision of the Board. Successful Applicants will be advised that disbursement of the loan proceeds is conditioned upon the Applicant meeting various pre and post closing requirements. Unsuccessful Applicants will receive written notification including the reasons for denial and may receive suggestions of actions that could be taken before submitting a renewed application to the NCDFI.

C. A successful Applicant may be asked to undertake business management/accounting training courses, to improve the Applicant's knowledge or experience.

D. A loan approval shall be documented by a Loan Commitment Letter. The Loan Commitment Letter shall include the terms of the loan and shall advise that the Loan Commitment shall expire at the end of ninety days.

SECTION 8 - LOAN DOCUMENTATION

A. Loans which have been approved by the NCDFI shall be properly documented and prepared for a formal loan closing. The loan documentation (collectively, the "**Loan Documents**") shall be prepared according to standards and procedures adopted by the NCDFI, which shall include the following:

1. A promissory note and a security agreement signed by the Borrower and, where applicable, a co-signer and/or Guarantor.

2. An accounts payable authorization from the Borrower granting to the NCDFI the right to withhold all or a portion of any payment from an employer or payer to the Borrower;

3. UCC Filing Documents pledging collateral and granting to the NCDFI a lien on all property (real and personal) acquired with the proceeds of the loan;

4. If the Borrower is securing financing from other lending institutions and NCDFI agrees, a documents evidencing the subordination of Borrower's debt to such other financial institution.

B. The Borrower must own the property used as collateral. Borrowers who pledge property that can be titled and registered (automobiles, mobile homes, trailers, etc.) must consent to a title document showing the NCDFI as the first lien holder, and must show a current registration. Borrowers who pledge property (i.e., inventory, office furniture, fixtures, equipment, machinery, etc.) must consent to the lien showing the NCDFI as the secured party and submit required fees. Borrowers who pledge property that does not have title documents, must specifically identify such property (brand name, model, serial number, etc.).

C. Property pledged as collateral must be covered by a comprehensive insurance policy covering loss due to damage; with a loss payee clause payable to the NCDFI if such a payee clause is available. Such insurance shall be written for a term coinciding with the term of the loan, or for such other reasonable term as the NCDFI shall require. Borrower shall be responsible for adequate insurance coverage at all times. If insurance coverage is threatened with lapse, NCDFI may pay any and all sums needed to continue coverage, and add such costs to the outstanding principal balance of the loan. A certificate of insurance coverage shall be provided to NCDFI prior to disbursement of the loan funds.

D. All borrowers must, if reasonably obtainable, maintain adequate property and liability insurance, covering their business operations and facilities. Proof that such insurance is in place shall be documented prior to loan closing. NCDFI may require such other business insurance, as it deems advisable. If insurance coverage is threatened with lapse, NCDFI may pay any and all sums needed to continue coverage, and add such costs to the outstanding principal balance of the loan.

E. All borrowers shall file copies of annual financial reports with NCDFI, including a balance sheet and income statement, and such other reports as are provided in the Loan Documents.

SECTION 9 - LOAN CLOSING

A. The Loan Closing shall generally take place in the principal place of business of NCDFI. However, a closing may take place at an alternative location convenient to all the parties.

B. Disbursements of loan proceeds shall be made in accordance with the Loan Documents and may be made in the name of the borrower or jointly in the name of the borrower and a third party. All disbursements shall be made by check, or cashiers check or wire transfer.

C. No loan proceeds shall be disbursed until the loan closing has occurred and all Loan Documents have been executed and, where appropriate, have been properly recorded.

D. A loan shall be closed within ninety days of the NCDFI loan approval. If the loan is not closed within ninety days for any reason, the loan commitment may be canceled and the client must reapply for a loan. If an Applicant presents legitimate extenuating circumstances, a written request for an extension can be made prior to the expiration of the ninety days. The request for extension shall be reviewed and approved or disapproved by the Board.

SECTION 10 - SERVICING THE LOAN

A. The NCDFI respects the confidential information presented to it as part of the loan application and loan servicing obligations. Access to the loan files will be controlled and limited. Original legal documents will be kept in a secure and fireproof vault at all times with dual control access. Copies of the Loan Documents will be marked as such and placed in the loan files. Loan files will not ordinarily leave the NCDFI office. Exceptions to this policy may be made for review by legal counsel, litigation, and other related circumstances. Loan files are confidential and contain both proprietary information on the Borrower and legal documents and, therefore, must be under affirmative control of the NCDFI at all times.

B. The NCDFI intends to develop a close relationship with its Borrowers. The NCDFI intends to provide a pro-active schedule of contact with each Borrower at the closing of each loan, including a regular cycle of NCDFI visits to the Borrower at its place of business. This contact is intended to alert the NCDFI of any inability to meet the terms of the loan, including but not limited to, failure to meet the reporting requirement deadlines of the loan agreement and failure to make payments on time. The NCDFI intends to provide technical assistance to those Borrowers that have developed problems in complying with the terms of the loan.

C. Loan payments are due as provided in the Loan Documents. It is the Borrower's responsibility to ensure that the payments are received timely. Repayment shall generally be on a monthly basis and shall commence thirty days after the Loan Closing. Alternative repayment schedules may be provided in the event that cash flow of the business is cyclical or some other conditions would deem such variance appropriate.

D. All loan payments in the form of a check or money order shall reference the assigned loan number and be made to the following address:

NCDFI
P.O. Box 4919
Window Rock, Arizona 86515

E. There shall be no pre-payment penalty. Borrowers are encouraged to prepay their loans.

F. Within 30 days after a loan is paid in full, the liens on collateral pledged as security shall be released to the borrower.

G. The Loan Documents shall provide that interest shall start accruing as of the date of the promissory note.

H. All loan payments shall be credited in the following order of priority to the respective loan number:

1. First, to accrued interest due and owing calculated from the date of the last payment;

2. Second, to late fees;

3. Third, to direct expenses incurred by NCDFI in servicing the loan account, and

4. Fourth, to the principal balance.

I. If payments are not received within ten (10) days following the due date, the loan shall be subject to late charges and penalty interest in accordance with the terms of the Loan Documents.

J. If payments are not received within sixty (60) days following the due date, and after NCDFI has sent out written notices to the Borrower and, when applicable, co-signers or Guarantors, NCDFI shall notify the Borrower, co-signers and Guarantors, that the loan is in default and NCDFI shall proceed with loan collection processes ("**Collections**").

K. A modification of any term and condition of a loan, including a change in the use of proceeds, a reduction in the scheduled repayment amount, restructuring of the loan or an extension of the term of the loan shall be administratively handled by the Chief Executive Officer and subject to Board approval.

L. Release of all or a portion of collateral upon partial repayment of a loan will be considered on a case by case basis by the Chief Executive Officer, subject to Board approval.

SECTION 11 - COLLECTIONS

A. Loan accounts that are in arrears or otherwise not in compliance with the Loan Documents are forwarded for Collections. The goal of the collection effort is to have the Borrowers repay their debt on a timely basis through the process of negotiation and cooperation without having to resort to legal proceedings.

B. Judicial efforts by NCDFI shall be in compliance with all applicable Navajo Nation, Federal and state laws.

C. NCDFI will be responsible for collections and shall keep detailed records of efforts and contacts with Borrowers. Periodic contacts shall be made with the Borrowers and co-signers or Guarantors, either in person, by mail to the last known address, or by telephone to demand payments due and owing on the loan account.

D. It is the responsibility of the Borrowers, co-signers and Guarantors to keep NCDFI informed of their current address and telephone numbers. NCDFI is not responsible for sending correspondence to other than the last address and telephone number provided by the Borrowers.

E. Throughout the Collection process, efforts shall be conducted to contact the Borrowers, co-signers and Guarantors to collect monies owed to NCDFI.

F. The Borrowers, co-signers and Guarantors will be given opportunities to bring loan accounts current in a specified time by entering into a new payment agreement with NCDFI.

G. In the event a new agreement can be reached, voluntary settlements, whereby the Borrower relinquishes the collateral pledged as security for a loan, or such other property as may be available, or takes such other action as is appropriate, are encouraged.

H. In the event of death of a Borrower, NCDFI shall contact the surviving spouse or the administrator of the deceased's estate to file a claim in the probate in compliance with the Navajo Nation Rules of Probate Procedures.

SECTION 12 - <u>WRITE-OFF OF LOANS</u>

A. The write-off of a loan account shall be made by the NCDFI Board upon a recommendation of the CEO and only after all collection efforts have been exhausted and the CEO has determined that the loan is uncollectible. The CEO shall consider factors such as death, bankruptcy and other circumstances on a case-by-case basis before recommending a write-off. Any recommendation to write-off a loan or any portion thereof shall require final approval of the Board of Directors.

SECTION 13 - <u>MODIFICATION OF GUIDELINES</u>

A. These guidelines may be modified from time to time, as the need arises, by action of the NCDFI Board of Directors.