# Coleman

## Government Loan Solutions' CPR Report

Providing the most detailed monthly SBA 7(a) and 504 prepayment, default and market information

Volume 6, Issue #4

April, 2012


*Bob Judge, Editor*

*Bob Judge is a partner at Government Loan Solutions.*

*Government Loan Solutions is a provider of valuation services, prepayment analytics and operational support for the SBA marketplace.*

*Bob has 25 years of experience in the fixed income markets. He holds a B.A. in Economics from Vassar College and an M.B.A. in Finance from NYU Stern School of Business.*

**INSIDE THIS ISSUE:**

**Special points of interest:**

- CPR Stays Below 6%
- SBLA: Income and NAICS 72
- SMA: Why CDCs Should Care About FMLP
- Default Rate Stays Below 3%



## CPR Stays Below 6%

After the first sub-6% reading of 2012 last month, we stayed below that number once again in March.

March's results were very similar to February with only a slight-uptick in the overall average CPR.

As for the largest sector of the market, 20+ years to maturity, prepayment speeds fell 18%, going below 4% for the first time this year. In 2011, this sector was below 4%

*Continued on page 2*

## SBLA: Income Demographics and its Impact on Restaurant and Hotel Default Rates

*By Robert Judge*

When looking at income demographics, one would expect to see lower default rates for all types of businesses in upper income areas, with gradual increases as income levels fall.

But, is this truly the case? Let's test this theory on the largest NAICS industry in the SBA lending arena, "Accommodation and Food Services", which includes all NAICS codes that begin with 72.

Historically, Hotels and Restaurants have comprised around 17% of all 7a and 504 loans since 2000.

When we calculate the county location of each loan and calculate that county's income level relative to it's State, we get

*Continued on page 3*

## SMA: Why CDCs Should Care About FMLP

*By Jordan Blanchard*

**Volume**

Eight FMLP loan pools settled in the month of April. This figure is typical of the normal 8 to 10 pools settled each month. The guaranteed interest in all loan pools settled was $20,811,078, equating to $26,013,847 in gross loans. A total of 24 loans were pooled.

**Why CDCs Should Care About FMLP**

Without congressional intervention, the FMLP program is slated to sunset in September with FMLP-bound first mortgages funding no later than late June/early July. So making the case for CDCs to support the FMLP program may seem like too little, too late. But given the recent introduction of Senate bill 2364 (see legislative update below), there is time for CDCs to inform Nadco leadership and their local lawmakers as to the benefit of the FMLP program, and push for the inclusion of an FMLP extension into S 2364.

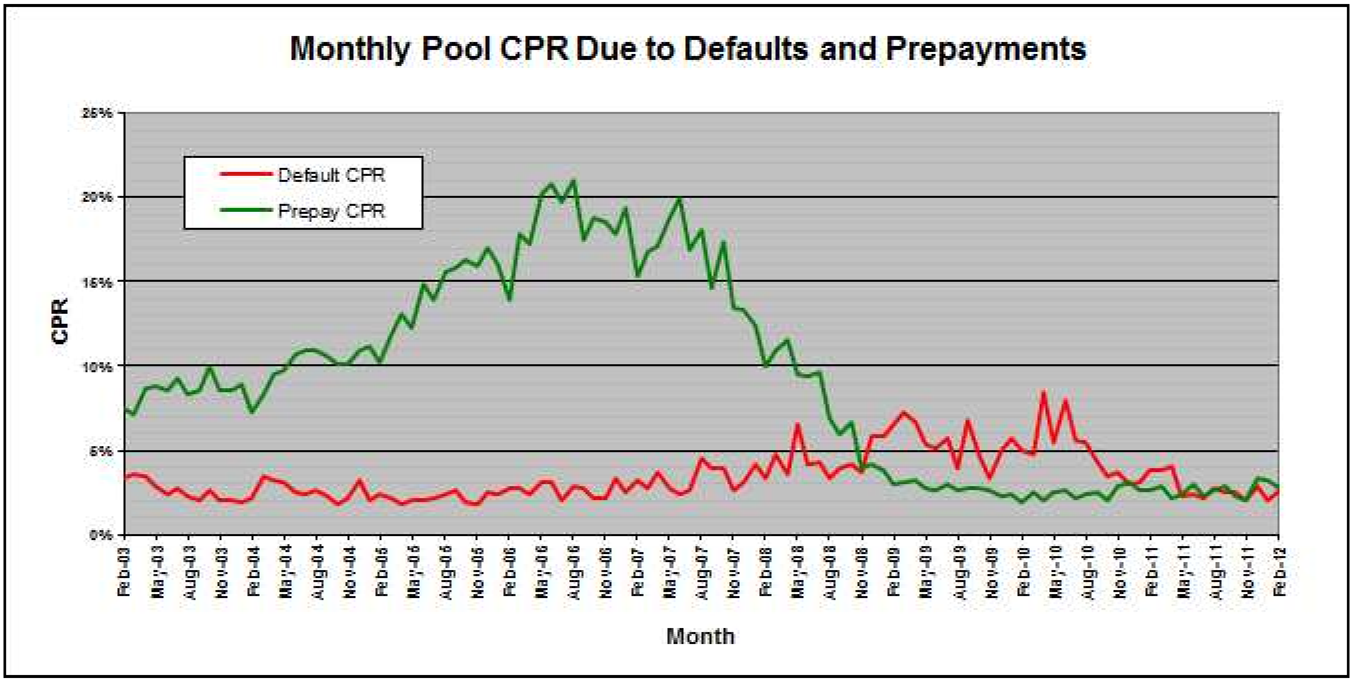
Many CDCs often make the

*Continued on page 6*

## SMALL BUSINESS FACT OF THE MONTH

There are 28 million small businesses in the U.S. – which outnumber corporations 1,162 to 1.

# PREPAYMENT SPEEDS...CONTINUED




in 4 out of 12 months.

Turning to the CPR breakdown, the default CPR rose by 30% to 2.59%, after going sub-2% for the first time in seven years. While this is a significant uptick from February, the default CPR remained below 3% for the 10th month in a row.

Voluntary prepayments dipped in March, going back below 3% for the first time in 3 months. Overall, the prepay CPR decreased to 2.69%, a 17% drop from February.

Looking at the specifics, overall speeds came in at 5.28%, a 1% increase from February's reading of 5.23%. This month continues an unbroken streak of 18 consecutive months of sub-7% prepay speeds.

As for next month, preliminary data from Colson suggests a return to sub-5% prepayments for the first time since last November.

Turning to the default/voluntary prepayment breakdown, the **Voluntary Prepay CPR** (green line) fell to 2.69% from 3.24%, a 17% decrease from the previous month.

While the VCPR went below 3%, the **Default CPR** (red line) rose above 2%, representing a 30% increase from last month's reading of 1.98%.

Last month, prepayment speeds fell in four out of the six maturity categories. Decreases were seen, by order of magnitude, in the 8-10 sector (-53% to CPR 5.31%), <8 (-25% to CPR 6.22%), 20+ (-18% to CPR 3.98%) and 13-16 (-16% to 5.16%).

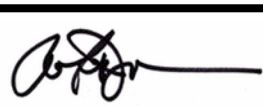
Increases were seen in 16-20 (+92% to 5.91%) and 10-13 (+62% to 8.24%).

Once again, evidence suggests defaults are under control and voluntary prepayments remain muted as we enter the 2nd quarter of 2012.

*For further information on the terminology and concepts used in this article, please refer to the "Glossary and Definitions" at the end of the report.*

*Data on page 19-20*

***"Once again, evidence suggests defaults are under control and voluntary prepayments remain muted as we enter the 2nd quarter of 2012."***



*Bob Judge can be reached at (216) 456-2480 ext. 133 or bob.judge@glsolutions.us*

## SBLA: Income Demographics...Continued

| NAICS Industry 72 - Accommodation and Food Services | | | |
|---|---|---|---|
| County % of State Income | 504 Gross Disbursed | 504 Gross Defaults | 504 Default Pct |
| HIGH INCOME | $3,657,883,000 | $634,823,772 | 17.35% |
| MODERATE INCOME | $2,426,768,000 | $330,122,258 | 13.60% |
| LOW INCOME | $737,190,000 | $108,260,360 | 14.69% |
| VERY LOW INCOME | $2,959,000 | $0 | 0.00% |
| **Grand Total** | **$6,824,800,000** | **$1,073,206,391** | **15.73%** |

| All Non-NAICS Industry 72 | | | |
|---|---|---|---|
| County % of State Income | 504 Gross Disbursed | 504 Gross Defaults | 504 Default Pct |
| HIGH INCOME | $17,261,102,000 | $1,416,806,991 | 8.21% |
| MODERATE INCOME | $9,274,568,220 | $772,633,962 | 8.33% |
| LOW INCOME | $1,616,929,000 | $165,206,462 | 10.22% |
| VERY LOW INCOME | $2,548,000 | $630,694 | 24.75% |
| **Grand Total** | **$28,155,147,220** | **$2,355,278,109** | **8.37%** |

| NAICS Industry 72 - Accommodation and Food Services | | | |
|---|---|---|---|
| County % of State Income | 7A Gross Disbursed | 7A Gross Defaults | 7A Default Pct |
| HIGH INCOME | $11,989,223,479 | $2,359,085,120 | 19.68% |
| MODERATE INCOME | $7,529,832,798 | $1,262,413,853 | 16.77% |
| LOW INCOME | $2,209,567,176 | $343,812,740 | 15.56% |
| VERY LOW INCOME | $14,435,885 | $1,951,977 | 13.52% |
| **Grand Total** | **$21,743,059,339** | **$3,967,263,690** | **18.25%** |

| All Non-NAICS Industry 72 | | | |
|---|---|---|---|
| County % of State Income | 7A Gross Disbursed | 7A Gross Defaults | 7A Default Pct |
| HIGH INCOME | $68,388,416,419 | $10,229,758,499 | 14.96% |
| MODERATE INCOME | $39,375,532,601 | $5,293,136,201 | 13.44% |
| LOW INCOME | $7,973,970,272 | $1,199,166,108 | 15.04% |
| VERY LOW INCOME | $28,358,528 | $3,108,483 | 10.96% |
| **Grand Total** | **$115,766,277,820** | **$16,725,169,291** | **14.45%** |

| NAICS Industry 72 - Accommodation and Food Services | | | |
|---|---|---|---|
| County % of State Income | 7A & 504 Gross Disbursed | 7A & 504 Gross Defaults | 7A & 504 Default Pct |
| HIGH INCOME | $15,647,106,479 | $2,993,908,892 | 19.13% |
| MODERATE INCOME | $9,956,600,798 | $1,592,536,111 | 15.99% |
| LOW INCOME | $2,946,757,176 | $452,073,100 | 15.34% |
| VERY LOW INCOME | $17,394,885 | $1,951,977 | 11.22% |
| **Grand Total** | **$28,567,859,339** | **$5,040,470,080** | **17.64%** |

| All Non-NAICS Industry 72 | | | |
|---|---|---|---|
| County % of State Income | 7A & 504 Gross Disbursed | 7A & 504 Gross Defaults | 7A & 504 Default Pct |
| HIGH INCOME | $85,649,518,419 | $11,646,565,490 | 13.60% |
| MODERATE INCOME | $48,650,100,820 | $6,065,770,163 | 12.47% |
| LOW INCOME | $9,590,899,272 | $1,364,372,570 | 14.23% |
| VERY LOW INCOME | $30,906,528 | $3,739,177 | 12.10% |
| **Grand Total** | **$143,921,425,039** | **$19,080,447,400** | **13.26%** |

some interesting results.

But first, let me define what I mean by a "HIGH INCOME", MODERATE INCOME", "LOW INCOME" and "VERY LOW INCOME" county. A "HIGH INCOME" county is one where the median income is greater than the median income for the State in which it is located. A "MODERATE INCOME" county is one where the median income falls between 80% and 100% of the State level. A "LOW INCOME" county has a median income between 50% and 80% and a "VERY LOW INCOME" one has a median income below 50% of the Statewide level.

These percentages are calculated on an annual basis by the U.S. Department of Housing and Urban Development (HUD) and available online at www.huduser.org.

In this analysis, we utilize the then prevailing income ranking at the time of loan origination.

If we examine the above chart, we see that for NAICS industry 72, we find that highest default rate since 2000 is in "HIGH INCOME" areas for both the 7a and 504 programs.

The lowest default rate for the 504 program is in "MODERATE INCOME" counties and for the 7a program, "LOW INCOME" counties have the lowest default rate.

As a comparison, for all other NAICS codes, the 504 program has the lowest default rate in "HIGH INCOME" counties, much closer to expectation. For the 7a program, the lowest rate is in "MODERATE INCOME" counties, followed by "HIGH INCOME" areas.

Please note that we do not include "VERY LOW INCOME" counties in this analysis, since the dollar volume of loans is too low to provide a fair comparison. However, this income level actually has the lowest default rate for both NAICS 72 and other codes in the 7a program.

The finding that "HIGH INCOME" counties have the highest default rate for NAICS 72 not only challenges conventional thinking, it also defies the findings for all other industry types in both SBA programs.

Could it be that there is a natural advantage for low and moderate income counties when it comes to the restaurant and hotel industry?

*Continued on next page*

## SBLA: Income Demographics...Continued

While I am not an expert in lending to these industries, I will attempt to discuss some of the potential reasons for the discrepancy:

1. The cost of building out both a restaurant and/or a hotel in high income areas is naturally higher than low to moderate income ones.
2. The cost of running these establishments is also higher in higher income counties than lower income ones.
3. With higher upfront and ongoing costs, these small businesses must produce more revenue in order to stay in business in high income areas.
4. Also, alternatives are greater in high income areas, since most restaurants and hotels are built in upper income counties. With more choice, competition is greater, resulting in higher degrees of business failure.
5. Since many restaurants and hotels are built for the convenience of customers, i.e. off of highways, rest stops, etc., the income level of the location is less important than the convenience of having these services available when and where you need them.

This would suggest that consistent customer flow is more important than the prestige of the address, all things being equal.

Let's look at the largest restaurant franchise in the SBA database, Subway Sandwich Shops. By looking at a ubiquitous franchise such as Subway, we remove the element of quality, since I am going to assume that all Subways are basically the same from a quality standpoint. For Subway, the default rate is the highest in high income areas (6.77%), followed by moderate income counties (6.03%) and the lowest in low income areas (4.03%). For Subway franchises, it would seem that high income areas are not the best locations in which to locate their restaurants.

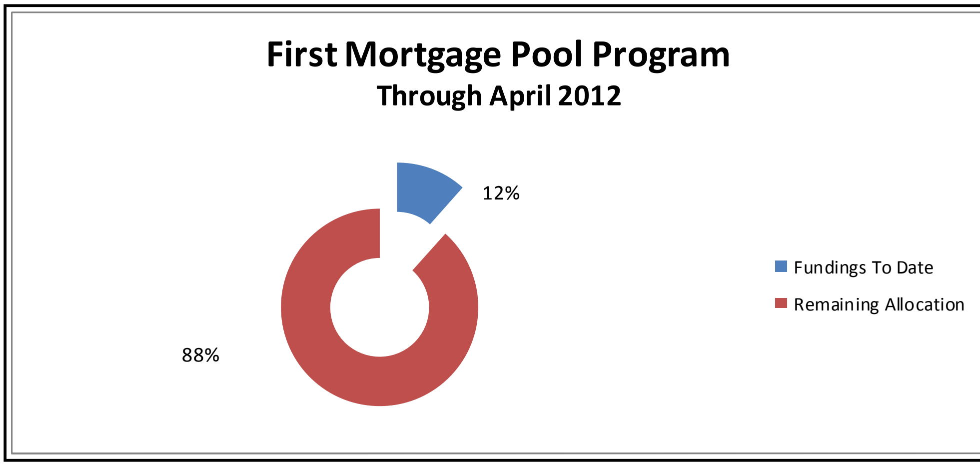
This data would suggest that costs and competition in NAICS 72 are more important to business survival than where the business is located, at least from a county income standpoint.

So, the next time you walk into a fancy restaurant in a swanky area, remember to enjoy the experience since it may not be repeated…

This type of analysis, along with numerous other variations, is available to you by subscribing to our new website, www.SBLA.us. SBLA provides 7a and 504 loan performance information through a user-friendly, searchable database. For more information, please visit our site, or see our ad on the next page.

Bon Appetit...

# SECONDARY MARKET ACCESS...CONTINUED




statement 'my banks aren't interested in the 504 secondary market.' What the CDCs probably mean is that their first mortgage lending partners may not be interested in traditional 504 secondary market program that involves selling 100% of a loan for only premium, servicing released, and giving up the business relationship to the buyer of the loan. Banks are interested in a program where they can sell less than 100% of a loan, receive both premium and servicing income, and still remain the business relationship partner with the small business. The staff at SMA continues to be contacted (even at this late date) by banks across the country in all geographic markets asking why they did not hear about the program sooner. The only answer is that their local CDCs either made the decision for the bank that the bank would not be interested in the FMLP program, or the CDCs did not spend the time necessary to learn about a key program enhancement that can greatly benefit their 504 first mortgage lending partners.

Educating and informing their first mortgage lending partners as to any potential enhancements to the 504 program should be every CDCs goal. But many CDCs may not know how much of their own volume is currently dependent on the FMLP program, and how much 'opportunity' volume CDC will not be lost if the FMLP program expires as scheduled.

single purpose property types without the credit enhancement of the FMLP program. This conclusion is supported by the fact that the single largest property type funded by the FMLP program is hospitality (greater than 33%).

Overall 504 volume is expected to decline by at least 15% from current levels with the expiration of the FMLP program. The average SBA 504 Debenture volume is roughly $300MM per month. The average FMLP volume is running $40MM to $50MM in gross loan amounts pooled per month over the past 6 months. A funding level of $50MM in first mortgage loans works out to be roughly 15% of $333MM, an approximate estimate of the monthly 504 first mortgage lending volume. A 15% reduction in SBA 504 volume is not necessarily devastating, but it also does not take into account the 504 volume that will be lost if the FMLP program was extended and became more well-known and widely used.

| NAICS Description | Loans Made % | Dollars Approved % | Jobs Created |
|---|---|---|---|
| Health Care & Social Assistance[1] | 1,144<br>18.1% (1) | $774MM<br>16.0% (2) | 12,491<br>13.7% (3) |
| Accommodation & Food Service[2] | 1,047<br>13.1% (2) | $837MM<br>17.3%(1) | 18,214<br>19.9% (1) |

**Notes:**

[1]Including assisted living, day care, etc. [2]Including hospitality

The above table notes the top two property types financed by the SBA 504 program in FY 2011:

Most major banks have policies in place that prohibit financing single purpose properties such as hospitality and assisted living facilities. The list of major banks unwilling to finance single purpose properties under the 504 program include Wells Fargo Bank, Bank of America, Chase, Zions Bank, and numerous other major banks comprising the top 10 SBA 504 lenders. If major banks are unwilling to finance the top two property types, then the burden and responsibility to finance two of the top three job creating industries funded by the 504 programs falls to community banks and non-bank lenders. Non-bank lenders are out of business without FMLP, and community banks are still very resistant to financing

FMLP should also be considered by CDCs as a defense against lost market share to the SBA 7A program. SBA 7A loans can now finance up to a $5MM per project – which used to be the domain of the 504 program, and fixed rate 7A's are becoming ever more prevalent. Two of the most critical competitive advantages for the SBA 504 program (loan size and fixed rates) are now being eroded by the 7A program. Shouldn't CDCs want to see the continuation of a program that gives lenders one more reason to consider offering a 504 loan versus a 7a loan?

# SECONDARY MARKET ACCESS...CONTINUED

| MO / WAM BUCKET | <192 Mos. | 192-263 Mos. | 264-288 Mos. | 289+ Mos. | Total by Month |
|---|---|---|---|---|---|
| Jan-11 | 0.00% | 0.00% | 0.12% | 0.00% | **0.09%** |
| Feb-11 | 0.00% | 0.00% | 0.00% | 0.00% | **0.00%** |
| Mar-11 | 0.00% | 0.00% | 0.00% | 0.00% | **0.00%** |
| Apr-11 | 0.00% | 0.00% | 0.00% | 0.00% | **0.00%** |
| May-11 | 0.00% | 0.00% | 11.49% | 3.49% | **9.28%** |
| Jun-11 | 1.04% | 0.00% | 0.00% | 0.00% | **0.06%** |
| Jul-11 | 0.00% | 0.00% | 0.00% | 0.00% | **0.00%** |
| Aug-11 | 0.00% | 0.00% | 0.00% | 0.13% | **0.03%** |
| Sep-11 | 0.00% | 0.00% | 0.00% | 0.00% | **0.00%** |
| Oct-11 | 0.00% | 0.00% | 0.00% | 0.09% | **0.02%** |
| Nov-11 | 0.00% | 0.00% | 15.67% | 0.00% | **9.78%** |
| Dec-11 | 0.00% | 0.00% | 0.00% | 0.00% | **0.00%** |
| Jan-12 | 0.00% | 0.00% | 23.69% | 0.00% | **11.66%** |
| Feb-12 | 0.00% | 0.00% | 0.00% | 0.00% | **0.00%** |
| Mar-12 | 0.00% | 0.00% | 0.00% | 0.00% | **0.00%** |
| Apr-12 | 0.00% | 0.00% | 0.00% | 0.00% | **0.00%** |
| **Total** | **0.04%** | **0.00%** | **3.83%** | **0.13%** | **2.19%** |

| RESET TYPE | FIXED RATE | FHLB VARIOUS | PRIME RATE | 5 YR LIBOR SWAP | 3 MO LIBOR | 5 YR CMT | Total by Month |
|---|---|---|---|---|---|---|---|
| Jan-11 | 0.16% | 0.00% | 0.00% | 0.13% | 0.00% | 0.00% | **0.09%** |
| Feb-11 | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | **0.00%** |
| Mar-11 | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | **0.00%** |
| Apr-11 | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | **0.00%** |
| May-11 | 34.52% | 0.00% | 0.00% | 1.88% | 0.00% | 0.00% | **9.28%** |
| Jun-11 | 0.00% | 0.00% | 0.15% | 0.00% | 0.00% | 0.00% | **0.06%** |
| Jul-11 | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | **0.00%** |
| Aug-11 | 0.00% | 0.00% | 0.06% | 0.00% | 0.00% | 0.00% | **0.03%** |
| Sep-11 | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | **0.00%** |
| Oct-11 | 0.00% | 0.00% | 0.00% | 0.06% | 0.00% | 0.00% | **0.02%** |
| Nov-11 | 0.00% | 0.00% | 0.00% | 27.92% | 0.00% | 0.00% | **9.78%** |
| Dec-11 | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | 0.00% | **0.00%** |
| Jan-12 | 0.00% | 1.24% | 21.92% | 0.00% | 0.00% | 0.00% | **11.66%** |
| Feb-12 | 0.00% | 0.00% | 0.00% | 0.00% | 0.03% | 0.00% | **0.00%** |
| Mar-12 | 0.00% | 0.00% | 0.00% | 0.00% | 0.03% | 0.00% | **0.00%** |
| Apr-12 | 0.00% | 0.00% | 0.00% | 0.00% | 0.02% | 0.00% | **0.00%** |
| **Total** | **2.44%** | **0.12%** | **2.44%** | **2.18%** | **0.01%** | **0.00%** | **2.19%** |

**Legislative Update**

On April 26, Senators Snowe, Landrieu and Shaheen introduced Senate bill 2364. The sole provision of the bill is to extend the 504 Debt Refinance authority for a period of one year. Why wasn't FMLP included? It's anyone's guess at this point, but there are two leading theories:

1. **FMLP was already extended once, so now 504 Debt Refi gets its' chance for a short term extension.**

   Response: It should not matter if FMLP was extended once, twice, or ten times. Has the secondary market for SBA 504 loans recovered by any measure without FMLP? No. Is the economy in need of job creating programs that also happen to be zero subsidy? Yes. So should the number of extensions factor into the decision making progress? The cost-to-benefit ratio should be considered, not the number of times the program has already been extended.

2. **FMLP is a regional program benefiting mainly California, Florida, and Georgia.**

   Response: This is simply not the case. FMLP has financed projects across the nation in a wide geographic dispersion. It's true that a large number of FMLP projects come from California, Florida and Georgia, but that is a reflection of the fact that these are the highest 504 volume states overall. By this logic, 504 Debt Refinance should not be extended because, you guessed it, the 504 Debt Refi program primarily benefits California, Florida and Georgia. Of course this should not be the conclusion, but neither should not extending FMLP because of geographic benefit.

These two issues may not be the reasons FMLP was excluded from S 2364, but these happen to be the two most discussed. Regardless, we encourage FMLP beneficiaries to push for the inclusion of a short term extension of the FMLP program to complement the 504 Debt Refi extension.

**FMLP Tips…**

- It's only an assumption that SBA will allow loans to pool in September if the Debenture also funded in September. SBA could rule that for a loan to be pooled in September, the Debenture must fund in August or earlier. This timing should be considered until there is formal guidance by the SBA.

**Prepayment Analysis**

*By Robert Judge*

For April, we had the third month in a row without any meaningful prepayments, which include both defaults and voluntary curtailments. The CPR for the entire program to date stands at 2.19%.

Please also note that I have added 2 new Reset Types to the above charts.

# Morgan Stanley

## SBA 504 FIRST MORTGAGE PROGRAM Loan Premiums

| INTEREST RATE PAR SPREADS | | |
|---|---|---|
| INTEREST RATE INDEX | RESET FREQUENCY | SPREAD |
| 90 Day LIBOR Swap Rate | Every 90 days | 3.00% |
| 3 Year Swap Rate | Every 3 years | 3.00% |
| 5 Year Swap Rate | Every 5 years | 3.00% |
| 10 Year Swap Rate | 10 years followed by every 5 years | 3.25% |
| 20 Year Swap Rate | Fixed for life (up to 25 years) | 3.40% |

- *Each 0.25% in rate above the par rate earns 1% in premium*
- *The initial rate will be the interest rate floor*
- *Swap rates are published under Libor Swaps (USD) at: http://online.wsj.com/mdc/public/page/2_3020-moneyrate.html?mod=topnav_2_3010*

| PREPAYMENT PENALTY OPTIONS | | | |
|---|---|---|---|
| PREPAYMENT PENALTY | QUARTERLY ADJUSTABLE | 3 & 5 YR RESETS | 10 YR RESET & FIXED |
| Declining 5%, 4%, 3%, 2%, 1% | 1.00% | Required | Not Available |
| Flat 5% for first 5 Years | 1.50% | .50% | Required |
| Declining 7%, 6%, 5%, 4%, 3%, 2%, 1% | 1.75% | .75% | .25% |
| Flat 5% for years 1-6, declining 4%, 3%, 2%, 1% for years 7-10 | 2.00% | 1.00% | .50% |
| Declining 10%, 9%, 8%, 7%, 6%, 5%, 4%, 3%, 2%, 1% | 2.50% | 1.50% | 1.00% |
| Flat 10% for first 10 years | 3.50% | 2.50% | 1.50% |

- *Borrower may make annual additional principal reductions without penalty up to 20% of the original note balance.*
- *The referring lender retains any origination fee. Note, Morgan Stanley will keep .50% to pay the SBA participation fee.*
- *Lenders who fund at least $5 million in a calendar year will receive an annual volume incentive.*

| PREMIUM EXAMPLE FOR $1 MILLION SBA 504 FIRST MORTGAGE LOAN | | |
|---|---|---|
| DESCRIPTION | OPTION | PREMIUM |
| Interest Rate | 10-year swap + 4.40% | 4.00% |
| Prepayment Penalty | 10%, 9%, 8%, 7%, 6%, 5%, 4%, 3%, 2%, | 1.00% |
| Total Premium | 1% | 5.00% |

- *The premium cannot exceed the first year's prepayment penalty %.*
- *A 365/360 rate accrual basis is required. The premium will be reduced by .50% if another basis is used.*
- *Only banks, thrifts and other regulated lenders are eligible to earn loan premiums.*

FOR MORE INFORMATION CONTACT:

JORDAN BLANCHARD
Executive Vice President
951.552.4157
jblanchard@cdcloans.com

KEN ROSENTHAL
Sr. Advisor – Lending, Education and Training
858.967.7817
krosenthal@cdcloans.com

CDC Direct Capital
2448 Historic Decatur Rd #200, San Diego, CA 92106

## GLS 7(a) Sale & Settlement Tip # 44— Sell Loans on a FIFO Basis...

When scheduling loans for sale, sell the "oldest" loans first. Historically, the market prefers to purchase new production loans for the purpose of securitization or sale and often pays higher premiums for new loans. Over the course of the last year however, the street has begun to redefine what it considers new production.

Currently, loans with note dates within three months of the date of sale are generally considered new and will usually offer sellers the best execution and greatest liquidity.

*Scott Evans is a partner at GLS. Mr. Evans has over 18 years of trading experience and has been involved in the SBA secondary markets for the last eight of those years. Mr. Evans has bought, sold, settled, and securitized nearly 20,000 SBA loans and now brings some of that expertise to the* ***CPR Report*** *in a recurring article called* ***Sale and Settlement Tip of the Month****. The article will focus on pragmatic tips aimed at helping lenders develop a more consistent sale and settlement process and ultimately deliver them the best execution possible.*

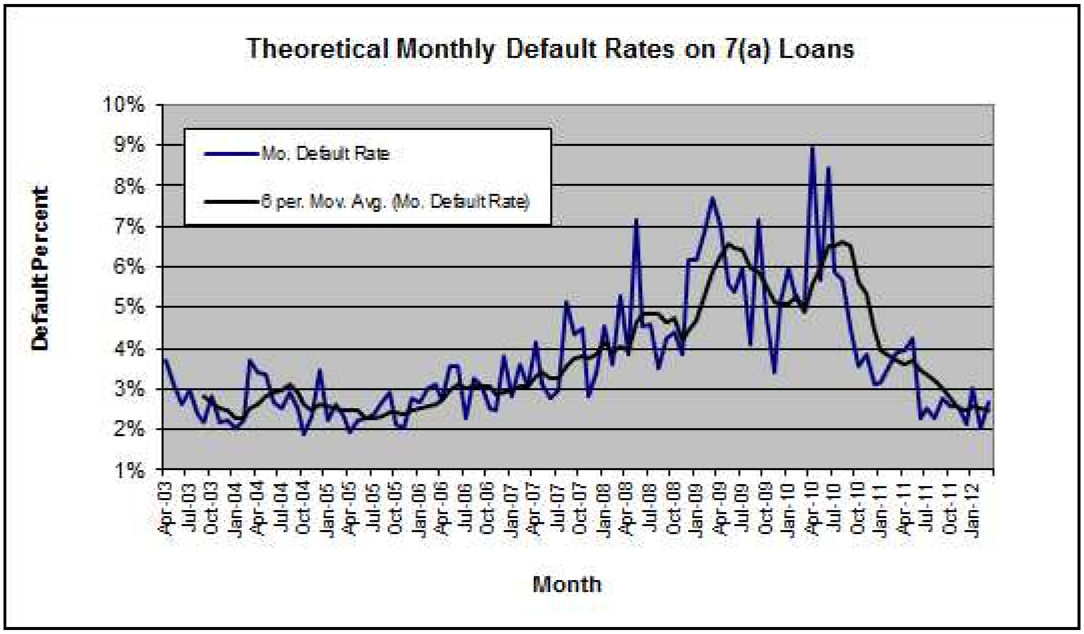
# DEFAULT RATE STAYS BELOW 3%

In March, the theoretical default rate moved higher, but stayed below 3% for the ninth time out of the last ten months.

By any measure, the default rate in 7a loans is back to where we were prior to the credit crisis and continues to remain in the 2% to 3% range symbolic of economic growth and stability.

Looking at the details, the default rate rose by 30% to 2.66%, but that was after we hit an extremely low level of 2.04%, a reading last seen in 2005.

As for next month, expect another sub-3% reading which has become commonplace since last April.




Turning to the chart on the right, we see that defaults remain in the "healthy" range of 2-3%. With no reason to believe that defaults will rise, we expect to remain in this range for the rest of 2012, if not beyond.

While economic statistics continue to disappoint, small business is on the mend and there is nothing, short of another recession, that can stop it.

*For further information on the terminology and concepts used in this article, please refer to the "Glossary and Definitions" at the end of the report.*

# DEFAULT-CURTAILMENT RATIOS

In our Default-Curtailment Ratios (DCR) we witnessed an increases in both the 7a 504 ratios after significant decreases in both last month.

Please note that an increase in the DCR does not necessarily mean that the default rate is rising, only that the percentage of early curtailments attributable to defaults has increased.

### SBA 7(a) Default Ratios

In February, the 7a DCR, after having hit a 41-month low of 37.96%, rose 29% to 49%. While the increase is significant, we remain below 50%, a bellwether level for this measure of small business health.

This month, defaults rose while voluntary prepayments decreased. With the nominator (defaults) rising by a greater degree than the denominator (defaults + voluntaries), the ratio increased.

Turning to actual dollar amounts, defaults rose by 29% to $86 million from $66 million. As for voluntary prepayments, they decreased by 18% to $89 million versus $108 million the previous month.

### SBA 504 Default Ratios

The 504 DCR registered a modest increase due to a 39% increase in defaults that was almost offset by a 25% increase in voluntary prepayments. The overall level was 46.06%, a 6% increase over the previous level of 43.47%.

Specifically, the dollar amount of defaults increased by $24 million to $88 million (+39%). As for voluntary prepayments, they also rose by $20 million to $103 million (+25%).

### Summary

After significant decreases last month, both ratios edged higher, but remain off the highs seen in 2009-2011. We remain convinced that both ratios are on their way to consistent, sub-40% readings prior to the end of 2012.

*For further information on the terminology and concepts used in this article, please refer to the "Glossary and Definitions" at the end of the report.*

*Graph on page 23*

# GLS VALUE INDICES MOSTLY LOWER

After significant price increases in February, the GLS Value Indices came in with four out of six sectors lower.

For the second month in a row, the Base Rate / Libor spread rose, reaching +2.84% from 2.81% in January. As for the prepayment element, CPRs were lower in three out of six sub-indices.

By the end of February, secondary market pricing had moved considerably higher, reaching levels last seen in mid-2011.

After a slow and steady increase in pricing since the end of 2011, prices gapped higher by the end of February. Once again, long maturity, fully priced loans re-visited the 115 level by month-end. Speculation in the market is that institutional investors have stepped-up their purchases of SBA pools, due to the strong fundamentals in the market.

Turning to the specifics, the largest decrease was seen in the GLS VI-2, which fell by 54% to 65 basis points. The other decreases, by order of magnitude, were: VI-6 (-15% to 178), VI-4 (-2% to 148) and VI-3 (-1% to 130).

Increases, by order of magnitude, were seen in VI-5 (+6% to 214) and VI-1 (+1% to 114).

After such a significant increase in pricing in one month, expect the market to pause at these levels while the market digests these lower yields.

*For further information on the terminology and concepts used in this article, please refer to the "Glossary and Definitions" at the end of the report.*

*Data on pages 16-17, Graph on page 18*

## 7(a) Secondary Market Pricing Grid: February 2012

| Maturity | Gross Margin | Net Margin | Servicing | This Month Price | Last Month Price | 3-Mos. Ago Price | 6-Mos. Ago Price | 1-Yr. Ago Price |
|---|---|---|---|---|---|---|---|---|
| 10 yrs. | 2.75% | 1.075% | **1.00%** | **112.0625** | **110.375** | **111.25** | **111.75** | **110.70** |
| 15 yrs. | 2.75% | 1.075% | **1.00%** | **112.75** | **110.75** | **111.75** | **112.25** | **111.50** |
| 20 yrs. | 2.75% | 1.075% | **1.00%** | **114.50** | **113.00** | **113.75** | **114.125** | **113.125** |
| 25 yrs. | 2.75% | 1.075% | **1.00%** | **115.375** | **114.125** | **114.75** | **115.0625** | **113.95** |



# GLS VALUE INDICES: SUPPORTING DATA

Table 1:

| MONTH | BUCKET 1 CPR | BUCKET 2 CPR | BUCKET 3 CPR | BUCKET 4 CPR | BUCKET 5 CPR | BUCKET 6 CPR |
|---|---|---|---|---|---|---|
| Sep-08 | 14.02% | 12.45% | 12.75% | 12.67% | 12.36% | 15.20% |
| Oct-08 | 12.97% | 11.67% | 12.14% | 11.50% | 11.97% | 14.06% |
| Nov-08 | 12.08% | 12.36% | 11.44% | 10.85% | 11.49% | 13.22% |
| Dec-08 | 12.37% | 11.77% | 10.45% | 9.45% | 11.08% | 11.41% |
| Jan-09 | 12.86% | 11.51% | 10.42% | 9.29% | 10.61% | 10.40% |
| Feb-09 | 12.30% | 11.26% | 10.35% | 8.39% | 9.99% | 9.30% |
| Mar-09 | 12.96% | 11.93% | 10.56% | 8.57% | 10.47% | 8.79% |
| Apr-09 | 13.23% | 12.30% | 11.22% | 8.75% | 9.81% | 8.55% |
| May-09 | 13.12% | 11.85% | 11.79% | 8.68% | 9.92% | 7.98% |
| Jun-09 | 13.18% | 11.85% | 12.35% | 8.57% | 8.73% | 8.02% |
| Jul-09 | 12.40% | 12.00% | 12.51% | 8.56% | 8.23% | 7.36% |
| Aug-09 | 13.34% | 12.49% | 12.36% | 8.01% | 7.34% | 7.21% |
| Sep-09 | 12.74% | 11.01% | 11.83% | 7.48% | 6.70% | 6.89% |
| Oct-09 | 12.45% | 11.03% | 11.31% | 7.25% | 7.85% | 6.79% |
| Nov-09 | 12.11% | 10.89% | 11.01% | 6.96% | 7.13% | 6.32% |
| Dec-09 | 11.33% | 11.20% | 10.55% | 7.09% | 7.80% | 5.75% |
| Jan-10 | 11.16% | 10.69% | 10.30% | 6.99% | 8.00% | 5.75% |
| Feb-10 | 10.05% | 9.97% | 10.00% | 7.33% | 8.84% | 5.71% |
| Mar-10 | 9.90% | 10.73% | 10.07% | 7.12% | 8.75% | 5.75% |
| Apr-10 | 9.96% | 10.45% | 9.72% | 7.34% | 8.12% | 5.32% |
| May-10 | 10.56% | 11.09% | 10.28% | 7.88% | 8.53% | 5.86% |
| Jun-10 | 10.94% | 11.18% | 10.41% | 7.83% | 8.53% | 6.38% |
| Jul-10 | 10.32% | 11.15% | 10.57% | 7.13% | 8.59% | 7.48% |
| Aug-10 | 10.45% | 11.02% | 10.16% | 7.38% | 8.25% | 7.60% |
| Sep-10 | 11.29% | 10.76% | 10.54% | 7.48% | 8.01% | 7.70% |
| Oct-10 | 11.35% | 10.06% | 10.28% | 7.27% | 7.29% | 7.84% |
| Nov-10 | 10.55% | 9.24% | 8.82% | 7.05% | 6.45% | 7.21% |
| Dec-10 | 10.89% | 8.48% | 8.45% | 7.30% | 5.61% | 7.11% |
| Jan-11 | 11.99% | 8.87% | 7.84% | 7.49% | 5.03% | 5.96% |
| Feb-11 | 11.22% | 9.01% | 7.57% | 7.22% | 4.91% | 5.53% |
| Mar-11 | 10.43% | 8.86% | 7.07% | 7.20% | 5.13% | 5.37% |
| Apr-11 | 10.60% | 9.69% | 7.38% | 6.90% | 4.95% | 5.17% |
| May-11 | 10.82% | 9.75% | 7.26% | 6.11% | 5.51% | 5.45% |
| Jun-11 | 10.25% | 9.69% | 6.81% | 5.39% | 5.70% | 5.12% |
| Jul-11 | 10.02% | 9.51% | 6.38% | 4.94% | 6.11% | 5.12% |
| Aug-11 | 10.25% | 8.86% | 6.16% | 5.14% | 6.04% | 4.88% |
| Sep-11 | 10.23% | 9.18% | 6.13% | 5.00% | 5.15% | 4.69% |
| Oct-11 | 10.29% | 8.59% | 5.53% | 4.77% | 5.77% | 4.57% |
| Nov-11 | 9.94% | 8.22% | 5.59% | 4.85% | 5.75% | 4.20% |
| Dec-11 | 9.74% | 7.83% | 5.62% | 4.78% | 5.59% | 4.12% |
| Jan-12 | 9.00% | 8.29% | 6.20% | 5.23% | 5.04% | 4.15% |
| Feb-12 | 9.17% | 9.19% | 6.18% | 5.11% | 4.64% | 4.35% |

Rolling six-month CPR speeds for all maturity buckets. Source: Colson Services

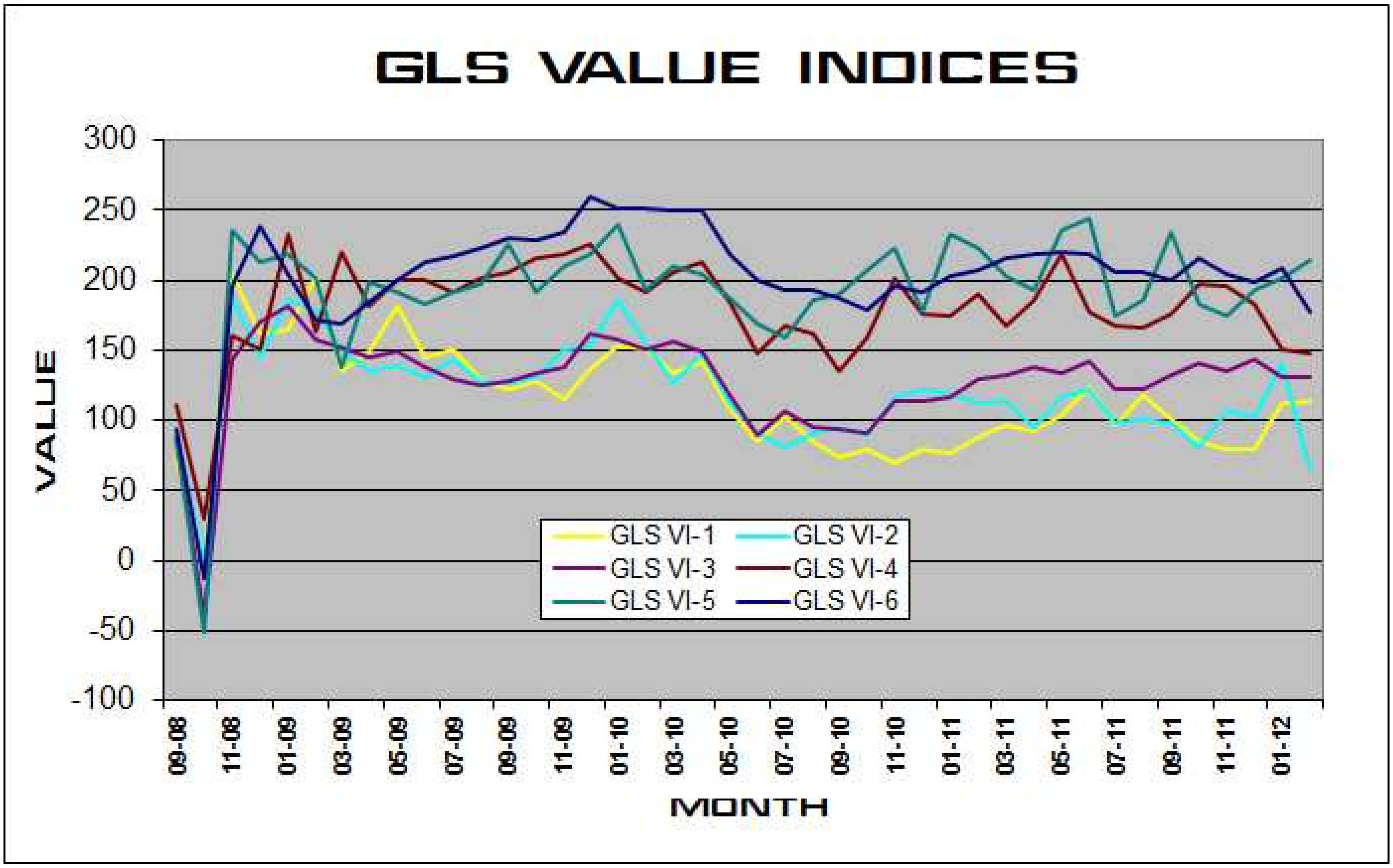
# GLS VALUE INDICES: HISTORICAL VALUES

Table 2:

| MONTH | WAVG LIBOR | WAVG BASE | BASE LIBOR SPD | GLS VI-1 | GLS VI-2 | GLS VI-3 | GLS VI-4 | GLS VI-5 | GLS VI-6 |
|---|---|---|---|---|---|---|---|---|---|
| Sep-08 | 3.00% | 5.00% | 2.00% | 73.3 | 91.2 | 88.5 | 111.3 | 85.2 | 94.2 |
| Oct-08 | 4.43% | 4.56% | **0.12%** | **2.3** | **-3.1** | **-38.6** | **30.5** | **-51.0** | **-12.9** |
| Nov-08 | 2.06% | 4.00% | 1.94% | **203.9** | **187.0** | 143.2 | 161.1 | 236.0 | 196.6 |
| Dec-08 | 1.64% | 3.89% | 2.25% | 162.2 | 144.9 | 170.3 | 151.0 | 212.5 | 238.6 |
| Jan-09 | 1.11% | 3.25% | 2.14% | 164.8 | 185.5 | **181.7** | **233.2** | 218.3 | 204.4 |
| Feb-09 | 1.15% | 3.25% | 2.10% | 203.6 | 179.5 | 157.4 | 162.9 | 201.5 | 171.3 |
| Mar-09 | 1.06% | 3.25% | 2.19% | 135.3 | 150.3 | 151.6 | 220.4 | 138.0 | 169.7 |
| Apr-09 | 0.96% | 3.28% | 2.32% | 149.4 | 134.8 | 144.3 | 182.0 | 198.3 | 184.5 |
| May-09 | 0.70% | 3.26% | 2.57% | 182.1 | 138.7 | 149.6 | 200.3 | 192.4 | 200.8 |
| Jun-09 | 0.55% | 3.25% | 2.70% | 144.8 | 130.3 | 137.3 | 200.2 | 183.8 | 212.8 |
| Jul-09 | 0.48% | 3.25% | 2.77% | 150.9 | 143.8 | 129.1 | 191.9 | 192.4 | 217.4 |
| Aug-09 | 0.39% | 3.25% | 2.86% | 129.7 | 127.4 | 125.7 | 201.7 | 197.3 | 222.8 |
| Sep-09 | 0.29% | 3.25% | 2.96% | 122.0 | 126.5 | 128.3 | 205.5 | 225.3 | 229.6 |
| Oct-09 | 0.26% | 3.25% | 2.99% | 128.2 | 131.3 | 133.9 | 216.0 | 191.2 | 228.8 |
| Nov-09 | 0.26% | 3.25% | 2.99% | 115.3 | 150.9 | 138.0 | 219.2 | 210.8 | 234.2 |
| Dec-09 | 0.25% | 3.25% | 3.00% | 136.1 | 153.4 | 162.0 | 226.3 | 218.0 | **259.6** |
| Jan-10 | 0.25% | 3.24% | 2.99% | 153.9 | 186.5 | 157.2 | 201.0 | 240.6 | 250.7 |
| Feb-10 | 0.25% | 3.23% | 2.99% | 150.8 | 155.1 | 150.4 | 192.3 | 193.0 | 250.7 |
| Mar-10 | 0.26% | 3.25% | 2.99% | 133.1 | 126.0 | 155.8 | 206.4 | 209.5 | 249.2 |
| Apr-10 | 0.29% | 3.25% | 2.96% | 142.1 | 147.5 | 149.3 | 213.6 | 205.1 | 250.0 |
| May-10 | 0.41% | 3.25% | 2.84% | 107.5 | 112.1 | 117.5 | 184.4 | 187.2 | 218.1 |
| Jun-10 | 0.52% | 3.25% | 2.73% | 85.9 | 90.9 | 90.1 | 147.5 | 168.7 | 200.4 |
| Jul-10 | 0.46% | 3.26% | 2.80% | 102.7 | 81.0 | 106.7 | 167.0 | 159.5 | 193.5 |
| Aug-10 | 0.33% | 3.26% | 2.93% | 85.6 | 91.6 | 95.4 | 161.6 | 186.6 | 193.2 |
| Sep-10 | 0.28% | 3.25% | 2.97% | 74.1 | 95.3 | 94.0 | 135.6 | 190.8 | 187.2 |
| Oct-10 | 0.28% | 3.25% | 2.97% | 79.8 | 89.7 | 91.3 | 159.8 | 207.2 | 179.5 |
| Nov-10 | 0.27% | 3.25% | 2.98% | 70.5 | 117.2 | 113.5 | 202.0 | 223.5 | 195.4 |
| Dec-10 | 0.29% | 3.25% | 2.96% | 79.7 | 121.8 | 113.3 | 175.5 | 178.1 | 191.3 |
| Jan-11 | 0.29% | 3.25% | 2.96% | 77.0 | 119.8 | 117.3 | 175.2 | 232.3 | 203.7 |
| Feb-11 | 0.29% | 3.25% | 2.96% | 88.9 | 112.9 | 129.8 | 190.4 | 222.9 | 207.6 |
| Mar-11 | 0.30% | 3.25% | 2.95% | 96.8 | 113.5 | 132.3 | 167.8 | 203.4 | 216.0 |
| Apr-11 | 0.27% | 3.25% | 2.98% | 92.5 | 95.9 | 137.6 | 186.2 | 192.5 | 218.8 |
| May-11 | 0.24% | 3.25% | 3.01% | 104.3 | 116.1 | 134.3 | 219.2 | 235.1 | 220.2 |
| Jun-11 | 0.23% | 3.24% | **3.01%** | 123.1 | 123.0 | 141.8 | 178.1 | **243.7** | 218.4 |
| Jul-11 | 0.24% | 3.25% | 3.01% | 96.8 | 98.4 | 121.7 | 167.9 | 175.4 | 206.5 |
| Aug-11 | 0.27% | 3.24% | 2.97% | 118.6 | 101.5 | 122.8 | 165.8 | 186.4 | 205.3 |
| Sep-11 | 0.32% | 3.25% | 2.93% | 101.6 | 98.0 | 132.7 | 176.2 | 234.9 | 200.5 |
| Oct-11 | 0.34% | 3.24% | 2.90% | 85.5 | 80.8 | 141.1 | 197.4 | 183.4 | 216.3 |
| Nov-11 | 0.41% | 3.25% | 2.84% | 79.1 | 106.3 | 134.9 | 195.8 | 175.2 | 204.9 |
| Dec-11 | 0.50% | 3.25% | 2.75% | 79.6 | 103.0 | 143.8 | 182.6 | 193.6 | 198.5 |
| Jan-12 | 0.44% | 3.25% | 2.81% | 112.1 | 141.1 | 130.7 | 151.0 | 201.1 | 208.5 |
| Feb-12 | 0.41% | 3.25% | 2.84% | 113.5 | 65.0 | 130.5 | 148.1 | 214.0 | 177.6 |

| INDICES LEGEND | |
|---|---|
| (green) | HIGHEST READING |
| (red) | LOWEST READING |

GLS VI values for all maturity buckets for last 42 months.


GLS VALUE INDICES
300
250
200
150
100
50
0
-50
-100
VALUE
GLS VI-1
GLS VI-2
GLS VI-3
GLS VI-4
GLS VI-5
GLS VI-6
09-08
11-08
01-09
03-09
05-09
07-09
09-09
11-09
01-10
03-10
05-10
07-10
09-10
11-10
01-11
03-11
05-11
07-11
09-11
11-11
01-12
MONTH

# YTD PREPAYMENT SPEEDS

Table 3:

| CPR/MO. | <8 | 8 - 10 | 10 - 13 | 13 - 16 | 16 - 20 | 20+ | ALL |
|---|---|---|---|---|---|---|---|
| Jan-12 | 8.58% | 10.72% | 7.83% | 6.85% | 2.98% | 5.37% | **6.20%** |
| Feb-12 | 8.34% | 11.36% | 5.10% | 6.11% | 3.07% | 4.85% | **5.23%** |
| Mar-12 | 6.22% | 5.31% | 8.24% | 5.16% | 5.91% | 3.98% | **5.28%** |
| **Grand Total** | **7.71%** | **9.21%** | **7.06%** | **6.05%** | **4.00%** | **4.73%** | **5.57%** |

2012 monthly prepayment speeds broken out by maturity sector. Source: Colson Services

Table 4:

| POOL AGE | <8 | 8 - 10 | 10 - 13 | 13 - 16 | 16 - 20 | 20+ | ALL |
|---|---|---|---|---|---|---|---|
| Jan-12 | 25 Mos. | 35 Mos. | 34 Mos. | 65 Mos. | 48 Mos. | 49 Mos. | **45 Mos.** |
| Feb-12 | 25 Mos. | 36 Mos. | 34 Mos. | 66 Mos. | 48 Mos. | 49 Mos. | **45 Mos.** |
| Mar-12 | 25 Mos. | 37 Mos. | 34 Mos. | 67 Mos. | 48 Mos. | 49 Mos. | **45 Mos.** |

2012 pool age broken out by maturity sector. Source: Colson Services

# YEAR-TO-DATE CPR DATA

Table 5:

| < 8 BY AGE | 0-12 Mos. | 13-24 Mos. | 25-36 Mos. | 37-48 Mos. | 48+ Mos. |
|---|---|---|---|---|---|
| Jan-12 | 4.61% | 10.56% | 11.52% | 8.08% | 9.00% |
| Feb-12 | 0.62% | 8.06% | 18.49% | 9.44% | 9.94% |
| Mar-12 | 6.41% | 7.45% | 5.74% | 3.48% | 5.81% |
| **Grand Total** | **3.99%** | **8.73%** | **11.96%** | **7.07%** | **8.28%** |

| 10-13 BY AGE | 0-12 Mos. | 13-24 Mos. | 25-36 Mos. | 37-48 Mos. | 48+ Mos. |
|---|---|---|---|---|---|
| Jan-12 | 4.98% | 13.62% | 11.17% | 8.87% | 4.67% |
| Feb-12 | 2.23% | 8.94% | 8.43% | 5.94% | 3.39% |
| Mar-12 | 13.56% | 5.97% | 8.58% | 9.41% | 4.63% |
| **Grand Total** | **7.07%** | **9.53%** | **9.40%** | **8.05%** | **4.23%** |

| 16-20 BY AGE | 0-12 Mos. | 13-24 Mos. | 25-36 Mos. | 37-48 Mos. | 48+ Mos. |
|---|---|---|---|---|---|
| Jan-12 | 0.00% | 0.00% | 10.01% | 0.83% | 3.98% |
| Feb-12 | 1.78% | 0.33% | 0.00% | 0.54% | 5.52% |
| Mar-12 | 0.00% | 0.00% | 10.43% | 19.56% | 6.01% |
| **Grand Total** | **0.61%** | **0.11%** | **6.76%** | **7.15%** | **5.19%** |

| 8-10 BY AGE | 0-12 Mos. | 13-24 Mos. | 25-36 Mos. | 37-48 Mos. | 48+ Mos. |
|---|---|---|---|---|---|
| Jan-12 | 5.92% | 18.80% | 12.03% | 6.23% | 8.78% |
| Feb-12 | 2.64% | 15.16% | 17.87% | 8.30% | 7.31% |
| Mar-12 | 2.89% | 8.57% | 5.56% | 3.42% | 4.94% |
| **Grand Total** | **3.98%** | **14.43%** | **11.92%** | **6.03%** | **6.98%** |

| 13-16 BY AGE | 0-12 Mos. | 13-24 Mos. | 25-36 Mos. | 37-48 Mos. | 48+ Mos. |
|---|---|---|---|---|---|
| Jan-12 | 10.25% | 0.00% | 22.29% | 0.00% | 5.87% |
| Feb-12 | 8.14% | 20.32% | 0.00% | 0.00% | 4.64% |
| Mar-12 | 0.00% | 6.22% | 4.96% | 7.71% | 5.84% |
| **Grand Total** | **6.62%** | **9.35%** | **8.10%** | **2.16%** | **5.45%** |

| 20+ BY AGE | 0-12 Mos. | 13-24 Mos. | 25-36 Mos. | 37-48 Mos. | 48+ Mos. |
|---|---|---|---|---|---|
| Jan-12 | 3.34% | 5.45% | 10.66% | 7.13% | 4.76% |
| Feb-12 | 3.49% | 5.92% | 5.67% | 7.27% | 4.68% |
| Mar-12 | 1.77% | 5.65% | 5.18% | 5.46% | 4.04% |
| **Grand Total** | **2.86%** | **5.67%** | **7.10%** | **6.58%** | **4.49%** |

2012 YTD CPR by maturity and age bucket. Source: Colson Services

# GLOSSARY AND DEFINITIONS: PART 1

## Default-Curtailment Ratio

The Default-Curtailment Ratio (DCR), or the percentage of secondary loan curtailments that are attributable to defaults, can be considered a measurement of the health of small business in the U.S. GLS, with default and borrower prepayment data supplied by Colson Services, has calculated DCRs for both SBA 7(a) and 504 loans since January, 2000.

The default ratio is calculated using the following formula:

***Defaults / (Defaults + Prepayments)***

By definition, when the DCR is increasing, defaults are increasing faster than borrower prepayments, suggesting a difficult business environment for small business, perhaps even recessionary conditions. On the flip side, when the DCR is decreasing, either defaults are falling or borrower prepayments are outpacing defaults, each suggesting improving business conditions for small business.

Our research suggests that a reading of 20% or greater on 7(a) DCRs and 15% or greater on 504 DCRs suggest economic weakness in these small business borrower groups.

---

## Theoretical Default Rate

Due to a lack of up-to-date default data, we attempt to estimate the current default rate utilizing two datasets that we track:

1. Total prepayment data on all SBA pools going back to 2003. This is the basis for our monthly prepayment information.

Total prepayment data on all secondary market 7(a) loans going back to 1999, broken down by defaults and voluntary prepayments. This is the basis for our monthly default ratio analysis.

With these two datasets, it is possible to derive a theoretical default rate on SBA 7(a) loans. We say "theoretical" because the reader has to accept the following assumptions as true:

1. The ratio of defaults to total prepayments is approximately the same for SBA 7(a) pools and secondary market 7(a) loans.

    **Fact:** 60% to 70% of all secondary market 7(a) loans are inside SBA pools.

2. The default rate for secondary market 7(a) loans closely approximates the default rate for all outstanding 7(a) loans.

    **Fact:** 25% to 35% of all outstanding 7(a) loans have been sold into the secondary market.

While the above assumptions seem valid, there exists some unknown margin for error in the resulting analysis. However, that does not invalidate the potential value of the information to the SBA lender community.

**The Process**

To begin, we calculated total SBA pool prepayments, as a percentage of total secondary loan prepayments, using the following formula:

***Pool Prepay Percentage = Pool Prepayments / Secondary Loan Prepayments***

This tells us the percentage of prepayments that are coming from loans that have been pooled. Next, we calculated the theoretical default rate using the following equation:

***((Secondary Loan Defaults * Pool Prepay Percentage) / Pool Opening Balance) * 12***

This provides us with the theoretical default rate for SBA 7(a) loans, expressed as an annualized percentage.

---

## GLS Long Value Indices

Utilizing the same maturity buckets as in our CPR analysis, we calculate 6 separate indexes, denoted as GLS VI-1 to VI-6. The numbers equate to our maturity buckets in increasing order, with VI-1 as <8 years, VI-2 as 8-10 years, VI-3 as 10-13 years, VI-4 as 13-16 years, VI-5 as 16-20 years and ending with VI-6 as 20+ years.

The new Indices are basically weighted-average spreads to Libor, using the rolling six-month CPR for pools in the same maturity bucket, at the time of the transaction. While lifetime prepayment speeds would likely be lower for new loans entering the secondary market, utilizing six-month rolling pool speeds allowed us to make relative value judgments across different time periods.

We compare the bond-equivalent yields to the relevant Libor rate at the time of the transaction. We then break the transactions into the six different maturity buckets and calculate the average Libor spread, weighting them by the loan size.

For these indices, the value can be viewed as the average spread to Libor, with a higher number equating to greater value in the trading levels of SBA 7(a) loans.

# GLOSSARY AND DEFINITIONS: PART 2

## Prepayment Calculations

SBA Pool prepayment speeds are calculated using the industry convention of Conditional Prepayment Rate, or CPR. CPR is the annualized percentage of the outstanding balance of a pool that is expected to prepay in a given period. For example, a 10% CPR suggests that 10% of the current balance of a pool will prepay each year.

When reporting prepayment data, we break it into seven different original maturity categories: <8 years, 8-10 years, 10-13 years, 13-16 years, 16-20 years and 20+ years. Within these categories we provide monthly CPR and YTD values.

In order to get a sense as to timing of prepayments during a pool's life, we provide CPR for maturity categories broken down by five different age categories: 0-12 months, 13-24 months, 25-36 months, 37-48 months and 48+ months.

As to the causes of prepayments, we provide a graph which shows prepayment speeds broken down by voluntary borrower prepayment speeds, denoted VCPR and default prepayment speeds, denoted as DCPR. The formula for Total CPR is as follows:

***Total Pool CPR = VCPR + DCPR***

## SBA Libor Base Rate

The SBA Libor Base Rate is set on the first business day of the month utilizing one-month LIBOR, as published in a national financial newspaper or website, plus 3% (300 basis points). The rate will be rounded to two digits with .004 being rounded down and .005 being rounded up.

Please note that the SBA's maximum 7(a) interest rates continue to apply to SBA base rates: Lenders may charge up to 2.25% above the base rate for maturities under seven years and up to 2.75% above the base rate for maturities of seven years or more, with rates 2% higher for loans of $25,000 or less and 1% higher for loans between $25,000 and $50,000. (Allowable interest rates are slightly higher for SBAExpress loans.)

## Risk Types

The various risk types that impact SBA pools are the following:

**Basis Risk:** The risk of unexpected movements between two indices. The impact of this type of risk was shown in the decrease in the Prime/Libor spread experienced in 2007 and 2008.

**Prepayment Risk:** The risk of principal prepayments due to borrower voluntary curtailments and defaults. Overall prepayments are expressed in CPR, or Conditional Prepayment Rate.

**Interest Rate Risk:** The risk of changes in the value of an interest-bearing asset due to movements in interest rates. For pools with monthly or quarterly adjustments, this risk is low.

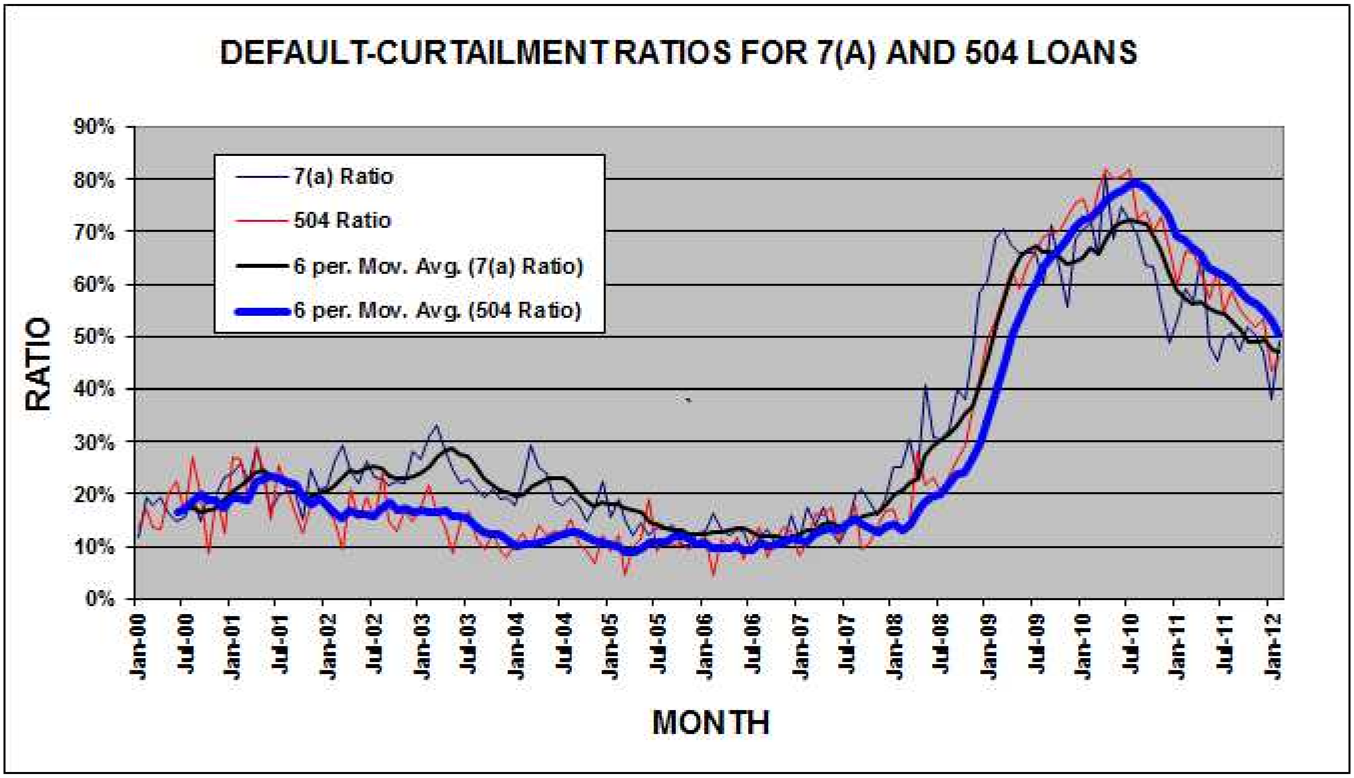
**Credit Risk:** Losses experienced due to the default of collateral underlying a security. Since SBA loans and pools are guaranteed by the US government, this risk is very small.

## Secondary Market First Lien Position 504 Loan Pool Guarantee Program

As part of the American Recovery and Reinvestment Act (AKA the Stimulus Bill), Congress authorized the SBA to create a temporary program that provides a guarantee on an eligible pool of SBA 504 first liens. The program was authorized for a period of two years from the date of bill passage – February, 2009. The eligibility of each loan is dependent on the date of the SBA Debenture funding. To be eligible, the Debenture must have been funded on or after **February 17, 2009**. The total guarantee allocation is $3 Billion. HR 5297 provides for a two-year extension from the first pooling month, so that the end date of the program is now **September, 2012**.

**The SBA announced that they will begin issuing the first pool guarantees in September, 2010 for early October settlement.**

For the purposes of the program, a pool is defined as 2 or more loans. A pool must be either fixed (for life) or adjustable (any period adjustment including 5 or 10 years). If the pool is comprised of adjustable rate loans, all loans must have the same base rate (e.g. Prime, LIBOR, LIBOR Swaps, FHLB, etc.). Finally, each loan must be current for the lesser of 6 months or from the time of loan funding. Congress mandated that this be a **zero subsidy program to the SBA** (and the US taxpayer). The SBA has determined the program cost (management and expected losses) can be covered by an ongoing subsidy fee of .744% for fiscal year 2012.



DEFAULT-CURTAILMENT RATIOS FOR 7(A) AND 504 LOANS
7(a) Ratio
504 Ratio
6 per. Mov. Avg. (7(a) Ratio)
6 per. Mov. Avg. (504 Ratio)
RATIO
90%
80%
70%
60%
50%
40%
30%
20%
10%
0%
Jan-00
Jul-00
Jan-01
Jul-01
Jan-02
Jul-02
Jan-03
Jul-03
Jan-04
Jul-04
Jan-05
Jul-05
Jan-06
Jul-06
Jan-07
Jul-07
Jan-08
Jul-08
Jan-09
Jul-09
Jan-10
Jul-10
Jan-11
Jul-11
Jan-12
MONTH

## POWERED BY:

Phone: (216) 456-2480
Fax: (216) 456-2481
Web Site: www.glsolutions.us
E-mail: info@glsolutions.us

**Government Loan Solutions**

812 Huron Road
Cleveland, OH 44115

*Partners*

*Scott Evans*
*Bob Judge*
*Rob Herrick*

CPR Report Staff:

Robert E. Judge II, Production Assistant

**www.glsolutions.us**



Government Loan Solutions' CPR Report is distributed in pdf format via e-mail. Spreadsheets relating to the presented data are available to paid subscribers upon request.

The subscription to the Government Loan Solutions' "CPR Report" is free to all members of the SBA Community.

To subscribe, please contact Coleman at (800) 617-1380 or via email at: bob@colemanpublishing.com

***Government Loan Solutions, Inc. (GLS)*** *was founded by three former Bond Traders in Cleveland, OH. Scott Evans, Rob Herrick and Bob Judge possess a combined 70 years experience in the institutional fixed income markets, 40 of which are in the loan securitization business. GLS formally began operations in January, 2007. Our mission is as follows:*

> *"The purpose of Government Loan Solutions is to bring greater efficiency, productivity and transparency to the financial markets. Through the use of proprietary technology, we intend to aid lenders in all aspects of their small business lending, help loan securitizers be more productive in their operational procedures and provide quality research to the investor community ."*

***Services available include:***

***Lenders:***

- *Manage loan sales to the secondary market*
- *Process loan settlements via our electronic platform, E-Settle*
- *Third-Party servicing and non-guaranteed asset valuation*
- *Model Validation*
- *Specialized research projects*
- *Mortgage Servicing Valuation*

***Loan Securitizers:***

- *Manage loan settlements and pool formation*
- *Loan and IO accounting*
- *Loan, Pool and IO Mark-To-Market*
- *Specialized research projects*

***Institutional Investors:***

- *Loan, Pool, and IO Mark-To-Market*
- *Specialized research projects*
- *Portfolio consulting*

*For additional information regarding our products and capabilities, please contact us at:*
*Phone: (216)456-2480 E-mail at: info@glsolutions.us web: www.glsolutions.us*