

Bob Judge, Government Loan Solutions, Editor



Bob Judge is a partner at Government Loan Solutions.

Government Loan Solutions is a provider of valuation services, pre-payment 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:

- CPRs Fall Below 6%
- 504 Debenture Speeds
- SMA: Record in August
- Default Rate Falls to 12-Year Low

7a Prepayment Speeds **1-3, 19-21**

504 Debenture Speeds **1, 4-6**

SMA **1, 7-9**

Default Rate **14**

Default Curtailment Ratios **14 & 24**

Value Indices **15-18**

## 7A CPRs FALL BELOW 6%

After rising above the 6% barrier in June, pre-payment speeds went back below 6%, falling to 5.39% in July.

This reading represents the fourth lowest reading this year and is the fifth

time in seven months that the overall prepayment speed has been below 6% in 2012.

In comparing prepayment speeds for the first six months of 2012 to the same period for 2011,

2012 is currently 6.26% lower than last year. Specifically, 2012 has an average speed of 5.50% to date, versus 5.87% for the first six months of 2011.

*Continued on page 2*

## 20 YEAR DEBENTURE SPEEDS RISE 7%

In July, 20 year debenture speeds rose by 6.98% to CPR 8.31% from 7.77% in July.

This represents the second highest level this year. As for

the cause of this increase, both the CDR and CRR rose by single digit percentages.

The CDR moved higher by 6.13% reaching 3.13% and

the CRR jumped 7.50% to 5.18%.

Since this is an "off" month for payment on 10s, we do not have an update for 10 year

*Continued on page 4*

## SMA: ANOTHER RECORD IN AUGUST

By Jordan Blanchard

much higher than normal.

#### Volume

Ninety-one loans were pooled in August for a total of \$113,295,711 in guaranteed interests. That represents over \$140,000,000 in gross loans.

The dollar volume was more than double the next closest month. A total of 19 pools were settled. September is expected to even busier.

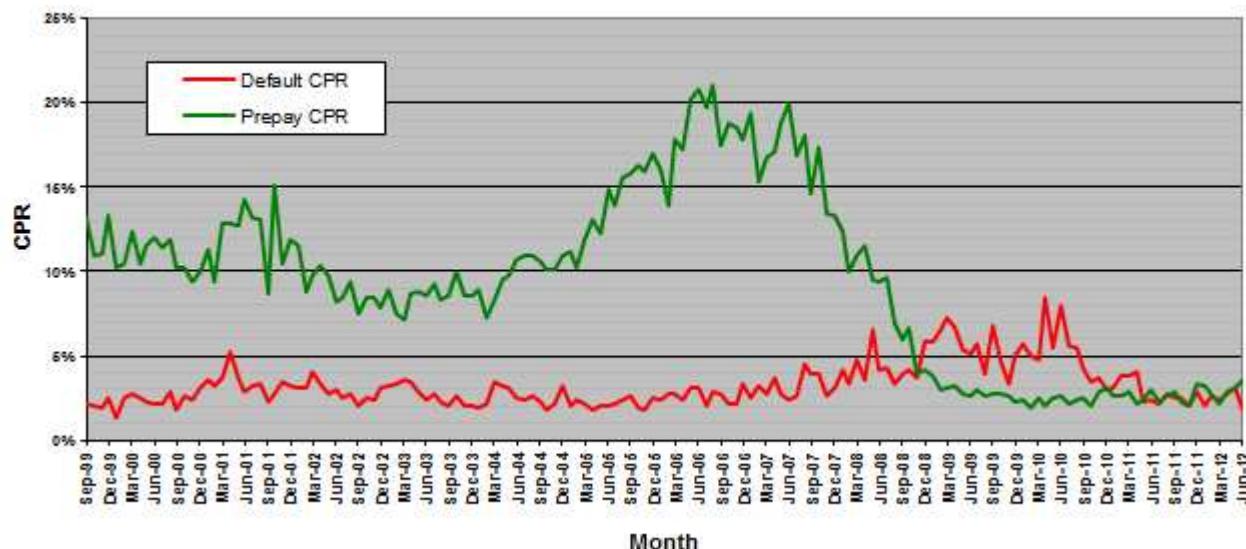
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## SMALL BUSINESS FACT OF THE MONTH

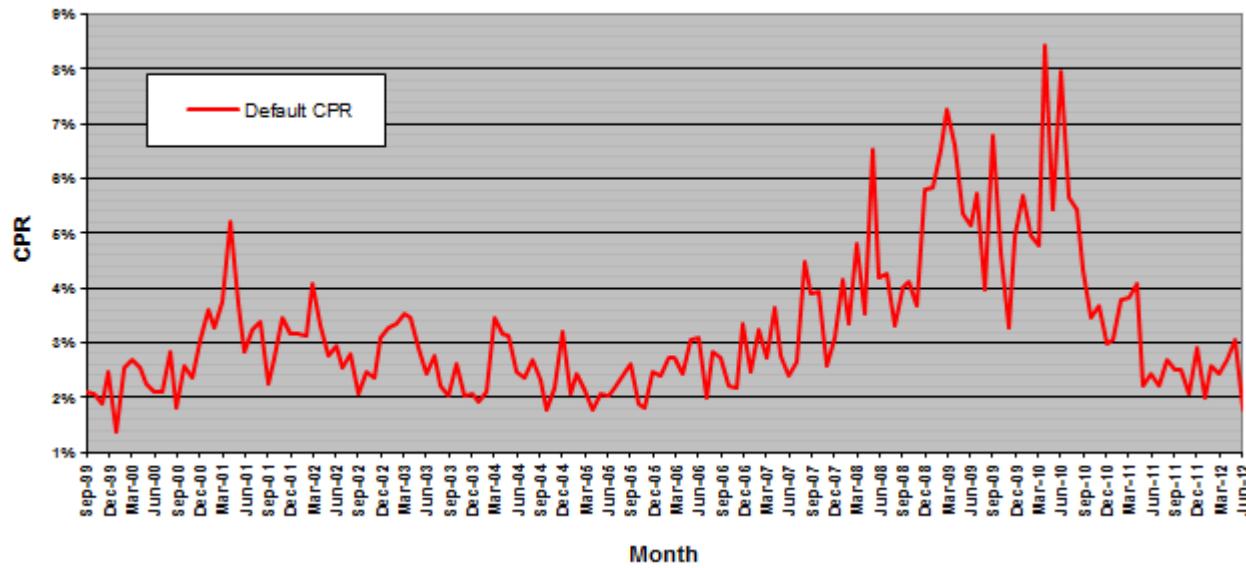
The 77 million people that make up the US small business workforce would rank as the 17th most populous country in the world, just ahead of Iran.

## PREPAYMENT SPEEDS...CONTINUED

Monthly Pool CPR Due to Defaults and Prepayments



Monthly 7a Pool CDR



As for the largest sector of the market, 20+ years to maturity, prepayment speeds fell 18% to 4.25% from 5.18%.

Turning to the CPR breakdown, the default CPR fell by 41% to 1.79%, the lowest level since April, 2005. Please note

that we have added a graph showing only the default CPR, or CDR, to allow the reader to see more historical detail. Additionally, we gather

more data last month, allowing us to push the history back to 1999 from 2003.

*Continued on following page*

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## PREPAYMENT SPEEDS...CONTINUED

Regarding voluntary prepayments, they increased by 16% to 3.60%, reaching the highest level since January, 2009.

As previously stated, overall speeds came in at 5.39%, a 13% decrease from June's reading of 6.16%. This month continues the unbroken streak of 22 consecutive months of sub-7% prepay speeds.

As for next month, preliminary data from Colson suggests results similar to this month, with overall CPRs staying below 6%.

Turning to the default/voluntary prepayment break-

down, the **Voluntary Prepay CPR** (green line) rose to 3.60% from 3.11%, a 16% increase from June.

While the VCPR remained above 3%, the **Default CPR** (red line) fell by 41% to 1.79% from 3.05% the previous month.

In July, prepayment speeds fell in three out of the six maturity categories. Decreases were seen, by order of magnitude, in the 8-10 sector (-19% to CPR 9.06%), 20+ (-18% to CPR 4.25%) and 10-13 (-14% to 6.52%).

Increases were seen, by order of magnitude, in 16-20 (+34% to 6.76%), <8 (+11% to 10.75%) and 13-16 (+9% to 7.46%).

After a brief visit above 6% in June, CPRs have fallen back into a comfortable range of 5% to 6%.

*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 19-21*

***“Turning to the CPR breakdown, the default CPR fell by 41% to 1.79%, the lowest level since April, 2005.”***



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For further information, please contact Bob Judge at (216) 456-2480 ext. 133 or at [bob.judge@glssolutions.us](mailto:bob.judge@glssolutions.us)

## 504 DEBENTURE SPEEDS...CONTINUED

debenture sector. However, next month, we will have that information.

For the year, 20s have been consistently in the CPR 7-8% range, much like most of 2011.

Please refer to pages 5 and 6 for the actual data over the past 5 years.



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Finally a Web-based Loan Analytics Portal  
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- **Franchise:** franchise code or franchise name
- **Geography:** state, county, or MSA as well as area type (urban or rural)

**Demographics:** county income as a percentage of state or national income levels, woman or veteran owned business

Armed with this information, users can refine their decision making process based on empirical data and in turn, enhance revenues and returns from their government guaranteed lending and investing activities.

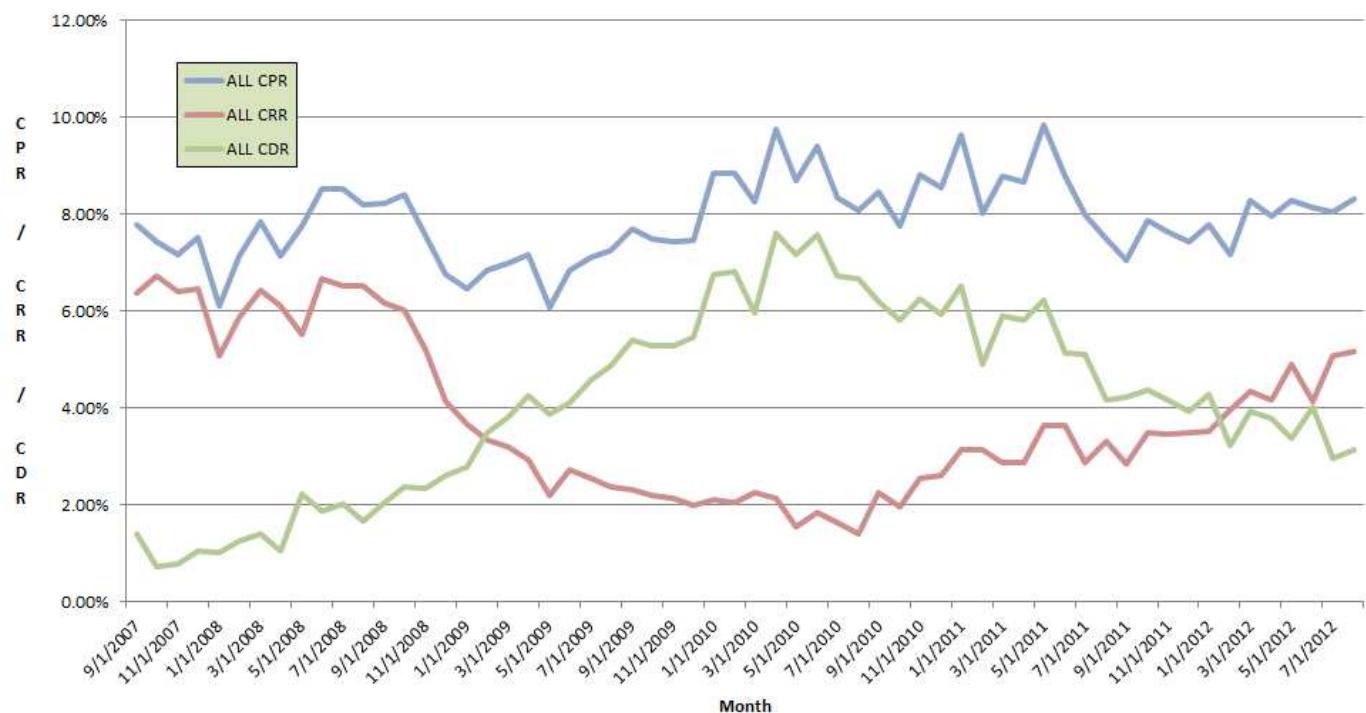
For more information, please call Scott Evans or Bob Judge at 216-456-2480  
or visit the website [www.sbla.us](http://www.sbla.us)

## 504 DCPC PREPAY SPEEDS - LAST 5 YEARS

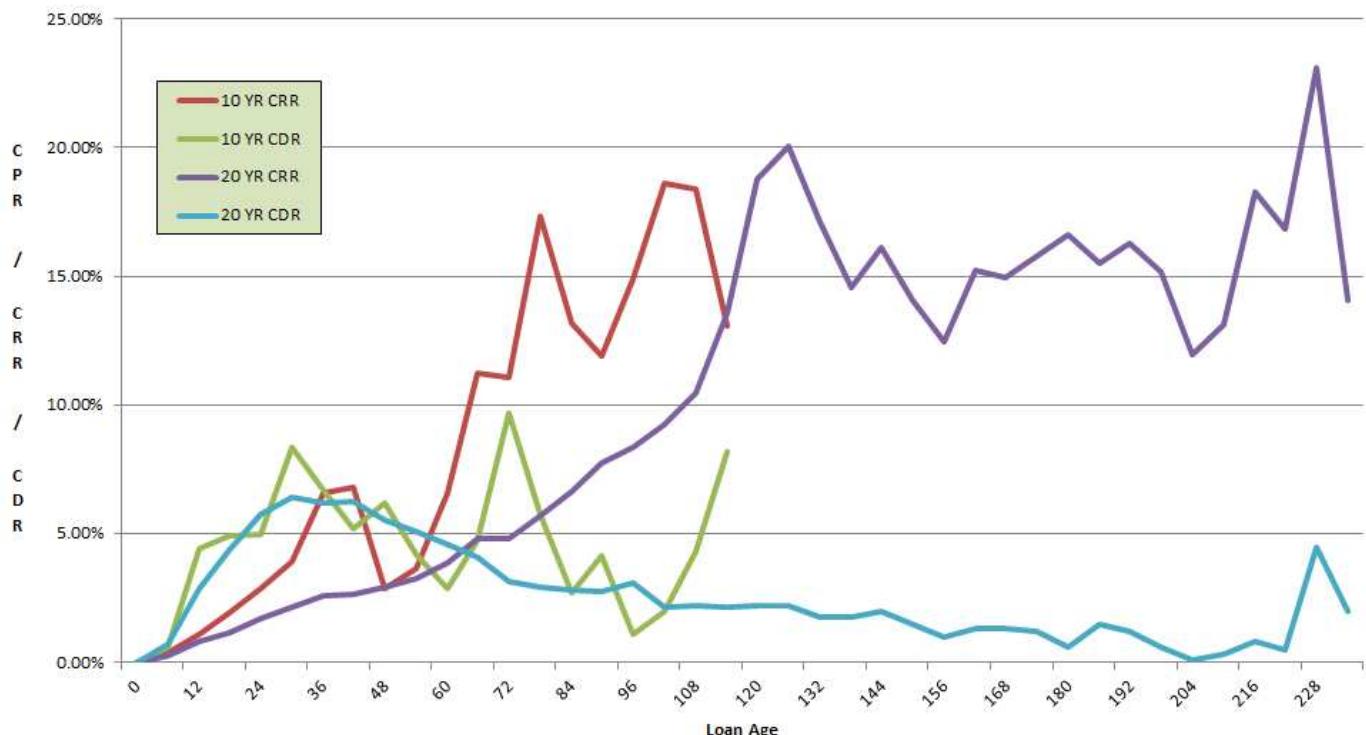
DATE	20 YR. CPR	20 YR. CRR	20 YR. CDR	10 YR. CPR	10 YR. CRR	10 YR. CDR	ALL CPR	ALL CRR	ALL CDR
9/1/2007	7.77%	6.42%	1.35%	8.05%	4.74%	3.30%	7.78%	6.37%	1.41%
10/1/2007	7.43%	6.71%	0.72%	NA	NA	NA	7.43%	6.71%	0.72%
11/1/2007	7.20%	6.47%	0.73%	5.99%	3.66%	2.33%	7.17%	6.39%	0.78%
12/1/2007	7.51%	6.46%	1.05%	NA	NA	NA	7.51%	6.46%	1.05%
1/1/2008	6.23%	5.19%	1.04%	2.72%	1.73%	0.99%	6.10%	5.07%	1.03%
2/1/2008	7.12%	5.87%	1.25%	NA	NA	NA	7.12%	5.87%	1.25%
3/1/2008	7.90%	6.50%	1.40%	6.43%	4.48%	1.95%	7.86%	6.44%	1.42%
4/1/2008	7.15%	6.10%	1.05%	NA	NA	NA	7.15%	6.10%	1.05%
5/1/2008	7.66%	5.51%	2.15%	10.57%	6.20%	4.37%	7.75%	5.53%	2.22%
6/1/2008	8.53%	6.65%	1.87%	NA	NA	NA	8.53%	6.65%	1.87%
7/1/2008	8.48%	6.52%	1.96%	9.55%	6.20%	3.35%	8.52%	6.50%	2.01%
8/1/2008	8.20%	6.52%	1.68%	NA	NA	NA	8.20%	6.52%	1.68%
9/1/2008	8.32%	6.23%	2.08%	5.43%	4.11%	1.32%	8.21%	6.16%	2.06%
10/1/2008	8.39%	6.03%	2.37%	NA	NA	NA	8.39%	6.03%	2.37%
11/1/2008	7.58%	5.26%	2.32%	6.31%	3.51%	2.80%	7.54%	5.20%	2.33%
12/1/2008	6.76%	4.15%	2.61%	NA	NA	NA	6.76%	4.15%	2.61%
1/1/2009	6.41%	3.72%	2.69%	8.08%	2.57%	5.50%	6.47%	3.68%	2.79%
2/1/2009	6.84%	3.35%	3.49%	NA	NA	NA	6.84%	3.35%	3.49%
3/1/2009	6.96%	3.15%	3.81%	7.80%	4.12%	3.68%	6.99%	3.18%	3.81%
4/1/2009	7.18%	2.93%	4.25%	NA	NA	NA	7.18%	2.93%	4.25%
5/1/2009	6.12%	2.24%	3.87%	5.07%	1.34%	3.73%	6.08%	2.21%	3.87%
6/1/2009	6.83%	2.73%	4.11%	NA	NA	NA	6.83%	2.73%	4.11%
7/1/2009	7.09%	2.62%	4.47%	7.71%	0.45%	7.26%	7.11%	2.54%	4.57%
8/1/2009	7.24%	2.37%	4.87%	NA	NA	NA	7.24%	2.37%	4.87%
9/1/2009	7.59%	2.34%	5.25%	10.52%	1.46%	9.07%	7.70%	2.31%	5.40%
10/1/2009	7.48%	2.21%	5.28%	NA	NA	NA	7.48%	2.21%	5.28%
11/1/2009	7.49%	2.16%	5.33%	5.41%	1.74%	3.67%	7.42%	2.15%	5.27%
12/1/2009	7.46%	1.99%	5.47%	NA	NA	NA	7.46%	1.99%	5.47%
1/1/2010	8.72%	2.09%	6.63%	12.44%	2.37%	10.07%	8.85%	2.10%	6.76%
2/1/2010	8.86%	2.05%	6.81%	NA	NA	NA	8.86%	2.05%	6.81%
3/1/2010	8.28%	2.24%	6.03%	7.24%	2.90%	4.35%	8.24%	2.27%	5.97%
4/1/2010	9.76%	2.15%	7.61%	NA	NA	NA	9.76%	2.15%	7.61%
5/1/2010	8.83%	1.56%	7.26%	4.98%	0.85%	4.12%	8.69%	1.54%	7.15%
6/1/2010	9.41%	1.84%	7.57%	NA	NA	NA	9.41%	1.84%	7.57%
7/1/2010	8.30%	1.58%	6.71%	9.73%	2.86%	6.87%	8.35%	1.63%	6.72%
8/1/2010	8.08%	1.42%	6.66%	NA	NA	NA	8.08%	1.42%	6.66%
9/1/2010	8.38%	2.22%	6.16%	10.61%	3.38%	7.23%	8.46%	2.27%	6.20%
10/1/2010	7.76%	1.95%	5.81%	NA	NA	NA	7.76%	1.95%	5.81%
11/1/2010	8.65%	2.43%	6.22%	13.45%	6.11%	7.34%	8.82%	2.56%	6.26%
12/1/2010	8.54%	2.61%	5.93%	NA	NA	NA	8.54%	2.61%	5.93%
1/1/2011	9.68%	3.10%	6.58%	8.76%	3.75%	5.02%	9.65%	3.12%	6.52%
2/1/2011	8.03%	3.14%	4.89%	NA	NA	NA	8.03%	3.14%	4.89%
3/1/2011	8.71%	2.77%	5.94%	10.61%	5.49%	5.13%	8.79%	2.88%	5.91%
4/1/2011	8.67%	2.87%	5.80%	NA	NA	NA	8.67%	2.87%	5.80%
5/1/2011	9.53%	3.37%	6.16%	17.64%	10.06%	7.58%	9.84%	3.63%	6.21%
6/1/2011	8.78%	3.65%	5.13%	NA	NA	NA	8.78%	3.65%	5.13%
7/1/2011	7.92%	2.87%	5.05%	9.69%	3.01%	6.68%	7.99%	2.87%	5.12%
8/1/2011	7.49%	3.31%	4.18%	NA	NA	NA	7.49%	3.31%	4.18%
9/1/2011	6.83%	2.76%	4.07%	12.27%	4.53%	7.74%	7.06%	2.83%	4.23%
10/1/2011	7.87%	3.50%	4.36%	NA	NA	NA	7.87%	3.50%	4.36%
11/1/2011	7.81%	3.52%	4.29%	3.07%	1.88%	1.19%	7.62%	3.46%	4.17%
12/1/2011	7.43%	3.50%	3.94%	NA	NA	NA	7.43%	3.50%	3.94%
1/1/2012	7.76%	3.48%	4.27%	8.39%	4.13%	4.25%	7.78%	3.51%	4.27%
2/1/2012	7.17%	3.95%	3.22%	NA	NA	NA	7.17%	3.95%	3.22%
3/1/2012	8.17%	4.23%	3.94%	10.74%	7.05%	3.69%	8.28%	4.35%	3.93%
4/1/2012	7.96%	4.17%	3.79%	NA	NA	NA	7.96%	4.17%	3.79%
5/1/2012	8.43%	4.95%	3.48%	4.96%	4.02%	0.94%	8.29%	4.91%	3.37%
6/1/2012	8.15%	4.13%	4.02%	NA	NA	NA	8.15%	4.13%	4.02%
7/1/2012	7.77%	4.82%	2.95%	14.04%	11.15%	2.89%	8.04%	5.09%	2.95%
8/1/2012	8.31%	5.18%	3.13%	NA	NA	NA	8.31%	5.18%	3.13%

504 DCPC Prepayment Speeds by 10 year, 20 year and All. Source: BONY

### 504 DCPC Prepayment Speeds by Month - Last 5 Years

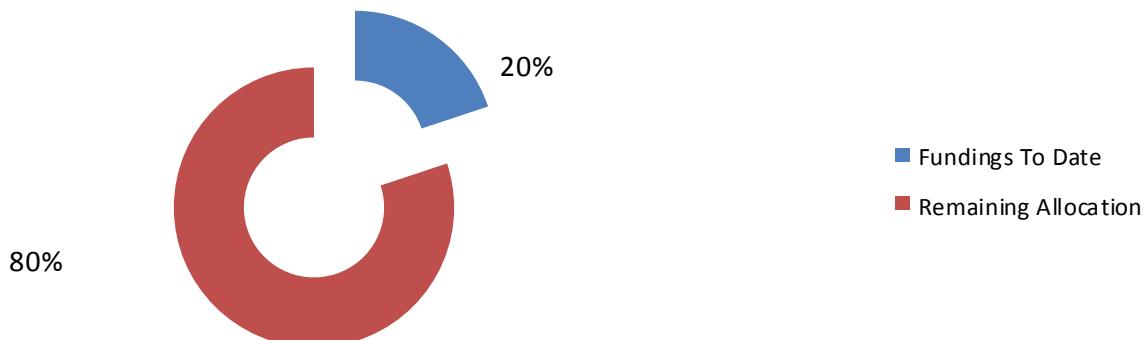


### 504 DCPC Prepayment Speeds by Loan Age - Last 5 Years



## SECONDARY MARKET ACCESS...CONTINUED

### First Mortgage Pool Program Through August 2012



To date, 536 loans in 132 pools have been issued for a total \$597,155,816 in guaranteed interests, or \$746,444,770 in gross loans.

#### Special Thanks

On the eve of the last FMLP pool, we would like to recognize certain SBA and Colson personnel that made the FMLP program happen. Without their dedication, patience, and unpaid hours during the evening on and weekends, this program would not have become a reality. At least not at the levels ultimately funded.

A special thanks goes out to Marybeth Kerrigan of the SBA. Marybeth was the primary point-person within the SBA for the FMLP program. Marybeth had to approve each and every loan and every pool. She also had to manually input each new seller into the SBA database, a laborious task when dealing with outdated technology. Marybeth coordinated with Colson on all aspects of FMLP processing, settlement, and post-closing activities. She was the industry's go-to person for the hundreds of questions involving a new and complex government guaranteed loan program. We are

not sure what Marybeth will do with all of her newfound free time after FMLP sunsets, but knowing her personality, we're sure she will find some challenging problem or problems to solve.

Jim Hammersley was the person that essentially created the FMLP program from scratch after the Stimulus Bill was signed into law. Jim did his best to make the program as efficient as possible while still staying within the (very limited) language of the law. Areas where Jim positively influenced the efficient operation of FMLP included:

- Requiring only 2 loans to form a pool
- Requiring automatic draft of the payment on the first – while challenging for banks and borrowers, this allowed the contract with Colson to proceed much more quickly and a much lower cost to SBA (Congress authorized no dollars for SBA to pay for FMLP)
- Allowing any loan with a similar index to be pooled (for instance, a loan based on 3 year LIBOR swap is able to be

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Pool Originator	# of Loan Pooled	Guaranteed Interest	% Of Market
Pacific Enterprise Bank	83	\$90,809	15%
Bank Of America	51	\$70,720	12%
Zions Bank	88	\$66,616	11%
Coastal Securities	66	\$64,855	11%
Southwest Capital Bank	36	\$61,270	10%

## SECONDARY MARKET ACCESS...CONTINUED

MO / WAM BUCKET	<192 Mos.	192-263 Mos.	264-288 Mos.	289+ Mos.	Total by Month
<b>Jan-11</b>	0.00%	0.00%	0.12%	0.00%	<b>0.09%</b>
<b>Feb-11</b>	0.00%	0.00%	0.00%	0.00%	<b>0.00%</b>
<b>Mar-11</b>	0.00%	0.00%	0.00%	0.00%	<b>0.00%</b>
<b>Apr-11</b>	0.00%	0.00%	0.00%	0.00%	<b>0.00%</b>
<b>May-11</b>	0.00%	0.00%	11.49%	3.49%	<b>9.28%</b>
<b>Jun-11</b>	1.04%	0.00%	0.00%	0.00%	<b>0.06%</b>
<b>Jul-11</b>	0.00%	0.00%	0.00%	0.00%	<b>0.00%</b>
<b>Aug-11</b>	0.00%	0.00%	0.00%	0.13%	<b>0.03%</b>
<b>Sep-11</b>	0.00%	0.00%	0.00%	0.00%	<b>0.00%</b>
<b>Oct-11</b>	0.00%	0.00%	0.00%	0.09%	<b>0.02%</b>
<b>Nov-11</b>	0.00%	0.00%	15.67%	0.00%	<b>9.78%</b>
<b>Dec-11</b>	0.00%	0.00%	0.00%	0.00%	<b>0.00%</b>
<b>Jan-12</b>	0.00%	0.00%	23.69%	0.00%	<b>11.66%</b>
<b>Feb-12</b>	0.00%	0.00%	0.00%	0.00%	<b>0.00%</b>
<b>Mar-12</b>	0.00%	0.00%	0.00%	0.00%	<b>0.00%</b>
<b>Apr-12</b>	0.00%	0.00%	0.00%	0.00%	<b>0.00%</b>
<b>May-12</b>	0.00%	0.00%	0.00%	0.00%	<b>0.00%</b>
<b>Jun-12</b>	0.00%	0.00%	0.01%	0.00%	<b>0.00%</b>
<b>Jul-12</b>	0.00%	0.00%	0.00%	0.00%	<b>0.00%</b>
<b>Aug-12</b>	0.00%	0.00%	0.17%	0.00%	<b>0.05%</b>
<b>Total</b>	<b>0.02%</b>	<b>0.00%</b>	<b>2.93%</b>	<b>0.07%</b>	<b>1.39%</b>

RESET TYPE	FIXED RATE	FHLB VARIOUS	PRIME RATE	5 YR LIBOR SWAP	3 MO LIBOR	5 YR CMT	Total by Month
<b>Jan-11</b>	0.16%	0.00%	0.00%	0.13%	0.00%	0.00%	<b>0.09%</b>
<b>Feb-11</b>	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	<b>0.00%</b>
<b>Mar-11</b>	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	<b>0.00%</b>
<b>Apr-11</b>	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	<b>0.00%</b>
<b>May-11</b>	34.52%	0.00%	0.00%	1.88%	0.00%	0.00%	<b>9.28%</b>
<b>Jun-11</b>	0.00%	0.00%	0.15%	0.00%	0.00%	0.00%	<b>0.06%</b>
<b>Jul-11</b>	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	<b>0.00%</b>
<b>Aug-11</b>	0.00%	0.00%	0.06%	0.00%	0.00%	0.00%	<b>0.03%</b>
<b>Sep-11</b>	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	<b>0.00%</b>
<b>Oct-11</b>	0.00%	0.00%	0.00%	0.06%	0.00%	0.00%	<b>0.02%</b>
<b>Nov-11</b>	0.00%	0.00%	0.00%	27.92%	0.00%	0.00%	<b>9.78%</b>
<b>Dec-11</b>	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	<b>0.00%</b>
<b>Jan-12</b>	0.00%	1.24%	21.92%	0.00%	0.00%	0.00%	<b>11.66%</b>
<b>Feb-12</b>	0.00%	0.00%	0.00%	0.00%	0.03%	0.00%	<b>0.00%</b>
<b>Mar-12</b>	0.00%	0.00%	0.00%	0.00%	0.03%	0.00%	<b>0.00%</b>
<b>Apr-12</b>	0.00%	0.00%	0.00%	0.00%	0.02%	0.00%	<b>0.00%</b>
<b>May-12</b>	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	<b>0.00%</b>
<b>Jun-12</b>	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	<b>0.00%</b>
<b>Jul-12</b>	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	<b>0.00%</b>
<b>Aug-12</b>	0.43%	0.00%	0.00%	0.00%	0.00%	0.00%	<b>0.05%</b>
<b>Total</b>	<b>1.78%</b>	<b>0.09%</b>	<b>1.55%</b>	<b>1.36%</b>	<b>0.00%</b>	<b>0.00%</b>	<b>1.39%</b>

pooled with a loan based on a 5 year LIBOR swap)

- Allowing the pool originator to be the investor for a very short period of time – this was very beneficial in the first few pools in order to recruit buyers for a previously unknown program

Maria Lamonaca and Simone Gallo were the two specialists at Colson that inputted each and every loan – which was no easy task. Unlike the SBA 7A or the 504 debenture program, FMLP first mortgages were not homogenous, nor were the documents boilerplate. Each lender has their own way of writing loan documents and describing the terms. Decoding the promissory notes was one of biggest time consumers for Maria and Simone, in addition to all of the normal settlement work.

Other folks at Colson who had a material impact on the FMLP program included Tom Orrico, Chris Anthony, Pat Boddie, and Dharyl Russell. They were not on the front line, but they were involved every step of the way.

There are countless other people that had a major or minor impact on the FMLP program, but the people noted above deserve our thanks and gratitude for a job well done.

### Pool Originator Statistics

The table on the previous page shows the ranking and volume for the top 5 pool originators through August, 2012.

### Next Month's Article

Next month's article will delve into the final statistics of the FMLP program. One project will be to review the percentage of newly originated loans for special purpose properties as compared to the 504 program as a whole. One critique of the FMLP program has been that it focused too heavily on special purpose property loans and therefore presented an undue credit risk to the 504 program. Ignoring for the moment that the 75 bps subsidy fee (on top of the SBA 504 and 504 Refi subsidy fee) more than makes up for any additional credit risk, we suspect that once the initial pools of loans funded prior to the creation of the FMLP program are removed, the average of special purpose property loans pooled through the FMLP program will be in line with the 504 program as a whole.

### FMLP Prepayment Analysis

For the first time in seven months, FMLP had a small prepayment, equaling CPR .05%. The overall prepayment speed in the Program has now fallen to CPR 1.39%. With the Program ending, we will continue to track the performance for those investors fortunate enough to own some of these assets.

Our new website can be found at [www.SMA504.com](http://www.SMA504.com).

For more information about SMA, please contact either Bob Judge ([bob.judge@glsolutions.us](mailto:bob.judge@glsolutions.us)) or Jordan Blanchard ([jblanchard@wholesale504.com](mailto:jblanchard@wholesale504.com)).



## 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](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:

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CDC Direct Capital  
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## Non-Traditional 504 Loan Referral Program

If you have a 504-eligible transaction that you are unable to fund for whatever reason, GLS can match you with another, non-competing lender looking to fund non-traditional 504 loans. This allows you to earn referral fees, while preserving the business relationship with the borrower.

### Program Overview:

- ⇒ An outlet for those transactions that you typically would not fund.
- ⇒ All commercial property types are eligible.
- ⇒ Can accommodate projected income and inferior credit.
- ⇒ Loan amounts up to \$10 million with 30-year loan terms.
- ⇒ Rate terms are quarterly adjustable, with a 5-year fixed rate option available.
- ⇒ A referral fee for you on the first mortgage portion.

For more information, please contact Bob Judge, GLS, at (216) 456-2480 ext. 133 or at [bob.judge@glssolutions.us](mailto:bob.judge@glssolutions.us).



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## GLS 7(a) Settlement & Sales Strategies Tip #47 – Get ahead of audit...

Anecdotally, we are hearing more and more that bank regulators and auditors are scrutinizing the way loan sales are accounted for and loan servicing valued. In the past, materiality was usually the determining factor but in today's world, that's no longer the case. While examinations and audits are not the most fun a banker can have, being prepared is a great way to mitigate some of the difficulty. By adopting sound and consistent methodologies for accounting for and valuing these assets on a recurring basis, you reduce the likelihood that problems arise when you least need them, in this case, while an examiner or auditor is sitting across the desk from you...

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.



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## DEFAULT RATE FALLS TO A 12-YEAR LOW

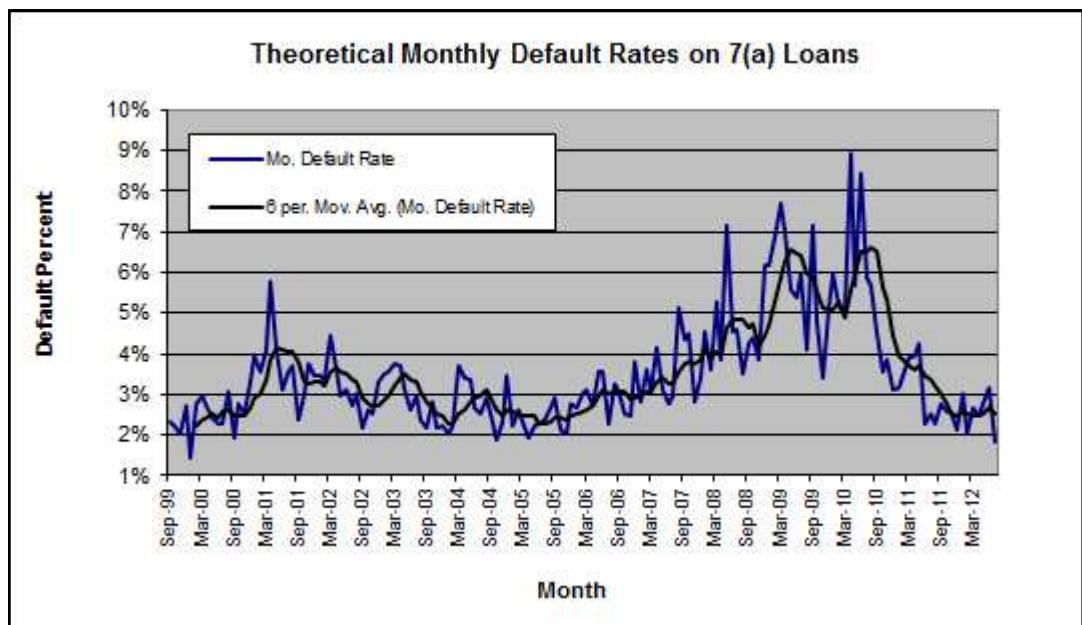
In July, the theoretical default rate fell by 41% to 1.85%, reaching the lowest rate in 12 1/2 years and the second lowest reading since our dataset began in September, 1999. For the record, the lowest recorded default rate was 1.45% in February, 2000.

*Please note that new data received last month allowed us to push back the default rate to 1999, and is reflected in the graph on the right.*

This reading reversed a three month trend of increasing default rates that pushed it above 3% in June.

Once again, small business has defied expectation by lowering default rates in the face of uncertain economic times.

In fact, 7a default rates have been consistently below the 504 program, which generally



speaking, has had lower default rates than its sister program.

Moving on to next month, we expect similar results, providing continued evidence of a strong small business sector even in the face of weak overall economic growth.

*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 significant decreases in the both the 7a and 504 ratios.

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

Last month, the 7a DCR fell significantly, going below 40% for the first time in six months. Overall, the ratio fell by 33% to 33.25% from 49.48% the previous month.

This month, defaults fell while voluntary prepayments rose, pushing the ratio lower.

Turning to actual dollar amounts, defaults decreased by 39% to \$64 million from \$105 million. As for voluntary prepay-

ments, they rose by 20% to \$129 million versus \$108 million.

### SBA 504 Default Ratios

The 504 DCR moved back below 40% after a one month stay above that level. With voluntaries rising and defaults falling, the ratio decreased considerably.

Specifically, the dollar amount of defaults decreased by \$28 million to \$59 million (-31%). As for voluntary prepayments, they rose by \$15 million to \$109 million (+16%).

### Summary

After some steady decreases that were interrupted by an increase in June, both DCRs fell considerably last month, reach-

ing multi-year lows. Expect more of the same next month.

*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.*

## GLS VALUE INDICES RISE

In June, the GLS Value Indices came in higher in five out of six sectors.

The Base Rate / Libor spread rose by 2 basis points to +2.83%. As for the pre-payment element, CPRs were slightly higher in all six sub-indices.

By the end of June, the secondary market continued its rise, moving significantly above 115 for fully price, long maturity loans.

While the secondary market moved higher we saw increases in most of the indices. The cause of this phenomena is that we

analyze all of the transactions we see in a month, and the lower levels at the beginning of June, combined with the sale of some older loans that trade cheaper than new ones, pushed the indices higher.

Turning to the specifics, the largest increase was seen in the GLS VI-5, which rose by 34% to 172 basis points. The other increases, by order of magnitude, were: VI-4 (+10% to 146), VI-3 (+9% to 84), VI-1 (+7% to 87) and VI-6 (+6% to 180). The sole decrease was seen in VI-2 (-61% to 44).

By the end of June, we had witnessed increases across the board in the secondary market.

As we mentioned last month, expect more of the same over the months to come.

*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: June 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%	113.125	112.75	111.75	110.00	111.25
15 yrs.	2.75%	1.075%	1.00%	113.25	113.125	112.50	110.50	111.40
20 yrs.	2.75%	1.075%	1.00%	114.85	114.25	114.25	112.75	113.75
25 yrs.	2.75%	1.075%	1.00%	115.50	115.0625	115.25	113.75	114.50



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# 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
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%
Mar-12	8.53%	8.57%	6.34%	5.16%	5.14%	4.30%
Apr-12	8.52%	8.55%	6.18%	5.46%	4.65%	4.20%
May-12	10.19%	8.24%	6.31%	6.03%	4.86%	4.28%
Jun-12	10.42%	9.19%	6.72%	6.54%	4.93%	4.58%

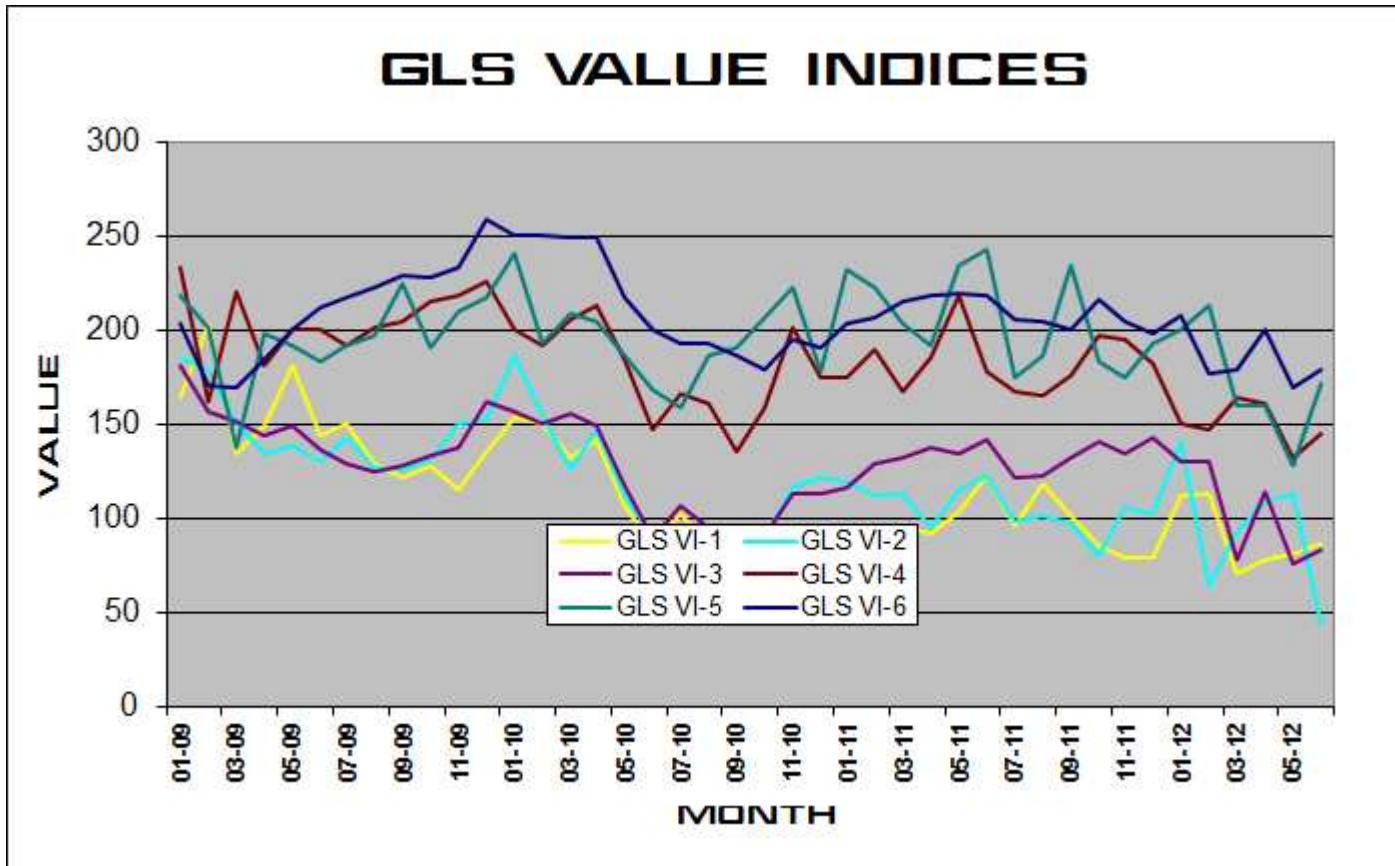
Rolling six-month CPR speeds for all maturity buckets. Source: Colson Services

# 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	INDICES LEGEND
										HIGHEST READING
										LOWEST READING
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	
Mar-12	0.44%	3.25%	2.81%	71.5	93.3	78.5	164.3	160.2	179.3	
Apr-12	0.42%	3.25%	2.83%	78.7	109.6	114.6	161.0	160.2	200.8	
May-12	0.43%	3.24%	2.81%	81.3	113.4	76.4	132.5	128.0	169.8	
Jun-12	0.41%	3.23%	2.83%	87.1	44.0	83.7	145.5	172.0	179.8	

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



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## YTD PREPAYMENT SPEEDS

Table 3:

CPR/MO.	<8	8 - 10	10 - 13	13 - 16	16 - 20	20+	ALL
<b>Jan-12</b>	8.58%	10.72%	7.83%	6.85%	2.98%	5.37%	<b>6.20%</b>
<b>Feb-12</b>	8.34%	11.36%	5.10%	6.11%	3.07%	4.85%	<b>5.23%</b>
<b>Mar-12</b>	6.22%	5.31%	8.24%	5.16%	5.91%	3.98%	<b>5.28%</b>
<b>Apr-12</b>	12.23%	8.27%	4.76%	6.21%	4.98%	3.87%	<b>4.61%</b>
<b>May-12</b>	17.10%	7.97%	6.73%	8.11%	7.40%	4.25%	<b>5.62%</b>
<b>Jun-12</b>	9.68%	11.23%	7.59%	6.81%	5.06%	5.18%	<b>6.16%</b>
<b>Jul-12</b>	10.75%	9.06%	6.52%	7.46%	6.76%	4.25%	<b>5.39%</b>
<b>Grand Total</b>	<b>10.46%</b>	<b>9.17%</b>	<b>6.69%</b>	<b>6.66%</b>	<b>5.20%</b>	<b>4.53%</b>	<b>5.50%</b>

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
<b>Jan-12</b>	25 Mos.	35 Mos.	34 Mos.	65 Mos.	48 Mos.	49 Mos.	<b>45 Mos.</b>
<b>Feb-12</b>	25 Mos.	36 Mos.	34 Mos.	66 Mos.	48 Mos.	49 Mos.	<b>45 Mos.</b>
<b>Mar-12</b>	25 Mos.	37 Mos.	34 Mos.	67 Mos.	48 Mos.	49 Mos.	<b>45 Mos.</b>
<b>Apr-12</b>	26 Mos.	37 Mos.	35 Mos.	67 Mos.	49 Mos.	49 Mos.	<b>45 Mos.</b>
<b>May-12</b>	26 Mos.	36 Mos.	34 Mos.	68 Mos.	48 Mos.	49 Mos.	<b>45 Mos.</b>
<b>Jun-12</b>	26 Mos.	36 Mos.	35 Mos.	69 Mos.	49 Mos.	48 Mos.	<b>45 Mos.</b>
<b>Jul-12</b>	26 Mos.	35 Mos.	35 Mos.	68 Mos.	48 Mos.	48 Mos.	<b>45 Mos.</b>

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%
Apr-12	6.62%	10.67%	23.99%	6.82%	12.01%
May-12	28.92%	16.66%	8.73%	3.58%	14.15%
Jun-12	0.88%	16.05%	8.50%	6.76%	17.59%
Jul-12	16.34%	9.46%	5.95%	7.86%	10.74%
<b>Grand Total</b>	<b>9.82%</b>	<b>11.08%</b>	<b>11.76%</b>	<b>6.60%</b>	<b>11.43%</b>

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%
Apr-12	2.39%	3.07%	8.48%	4.01%	6.43%
May-12	1.38%	11.76%	10.66%	8.24%	5.67%
Jun-12	7.21%	11.80%	7.84%	6.17%	5.42%
Jul-12	3.00%	10.42%	10.85%	6.63%	4.93%
<b>Grand Total</b>	<b>5.03%</b>	<b>9.45%</b>	<b>9.46%</b>	<b>7.14%</b>	<b>5.04%</b>

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%
Apr-12	4.43%	6.18%	14.80%	0.00%	3.42%
May-12	2.10%	9.62%	9.97%	12.97%	6.81%
Jun-12	0.00%	0.00%	9.03%	8.84%	6.91%
Jul-12	0.00%	12.88%	19.54%	0.00%	4.88%
<b>Grand Total</b>	<b>1.20%</b>	<b>4.97%</b>	<b>10.62%</b>	<b>6.46%</b>	<b>5.38%</b>

## YEAR-TO-DATE CPR DATA

Table 5:

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%
Apr-12	10.49%	1.45%	15.15%	6.87%	5.71%
May-12	0.23%	10.39%	12.68%	7.19%	6.40%
Jun-12	1.55%	14.98%	14.97%	16.50%	7.61%
Jul-12	1.82%	13.74%	13.50%	11.02%	6.56%
<b>Grand Total</b>	<b>3.48%</b>	<b>12.16%</b>	<b>13.11%</b>	<b>8.48%</b>	<b>6.75%</b>

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%
Apr-12	3.16%	12.59%	6.20%	42.15%	4.25%
May-12	0.00%	8.07%	36.75%	0.00%	4.63%
Jun-12	0.00%	0.00%	21.04%	0.00%	6.89%
Jul-12	0.00%	10.73%	13.65%	20.32%	6.85%
<b>Grand Total</b>	<b>3.83%</b>	<b>8.23%</b>	<b>15.69%</b>	<b>10.24%</b>	<b>5.56%</b>

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%
Apr-12	0.02%	3.88%	4.72%	6.94%	4.95%
May-12	0.96%	6.24%	4.07%	7.02%	4.66%
Jun-12	0.04%	2.93%	8.80%	9.29%	6.78%
Jul-12	1.79%	2.69%	5.74%	6.24%	5.32%
<b>Grand Total</b>	<b>1.67%</b>	<b>4.61%</b>	<b>6.39%</b>	<b>7.03%</b>	<b>5.03%</b>

## 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:

$$\text{Defaults} / (\text{Defaults} + \text{Prepayments})$$

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:

$$\text{Pool Prepay Percentage} = \text{Pool Prepayments} / \text{Secondary Loan Prepayments}$$

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:

$$((\text{Secondary Loan Defaults} * \text{Pool Prepay Percentage}) / \text{Pool Opening Balance}) * 12$$

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:

$$\text{Total Pool CPR} = \text{VCPR} + \text{DCPR}$$

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### 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.)

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### 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.

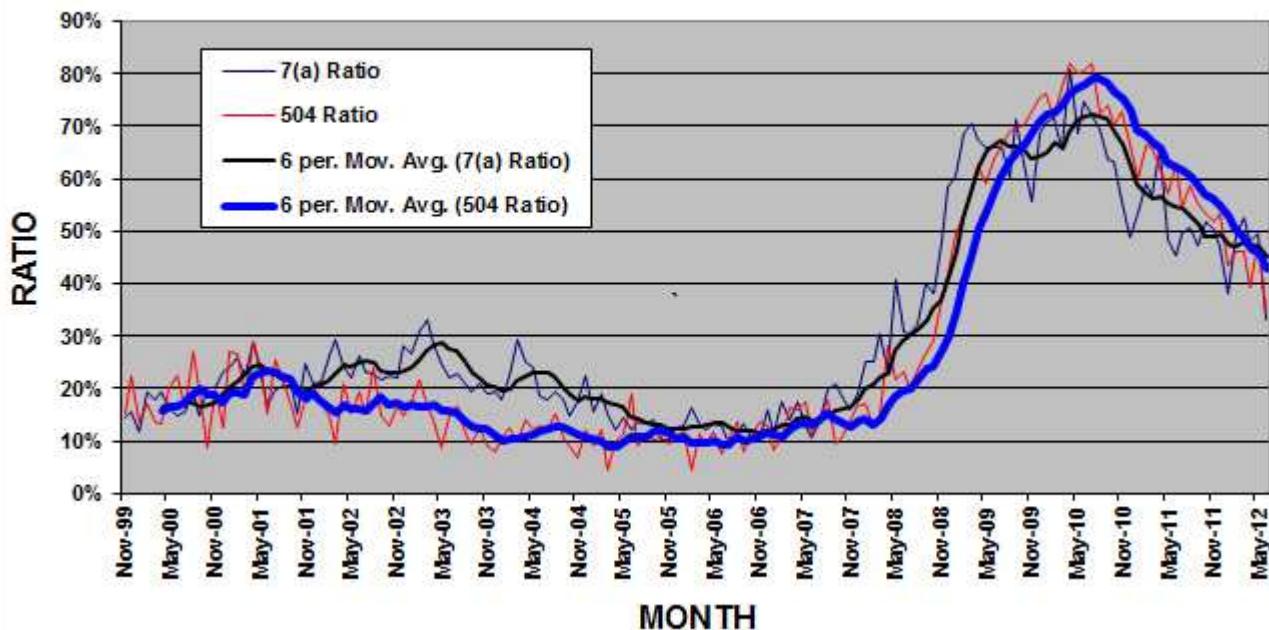
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### Secondary Market First Lien Position 504 Loan Pool Guarantee Program

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.

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