

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.

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## NOVEMBER CPR: PREPAYMENTS FALL BELOW 8%

After a jump in October, prepayment speeds fell 23%, dropping to CPR 7.34% last month. October notwithstanding, prepayment speeds have returned to the sub-8% prepayment trend that began in July of this year. In fact, preliminary data from Colson for December suggests that next month's prepayment speed could be sub-7%

and possibly below the record low of CPR 6.55% set in September..

To date, the 2009 overall prepayment speed is CPR 8.85%, having fallen from a YTD in October of 9.00%.

The **Voluntary Prepay CPR** (green line) remained below 3% for the sixth month in a row and remained at VCPR 2.73%. With the VCPR

remaining the same, the **Default CPR** (red line) was the reason for the decrease in overall prepayments.

Specifically, the DCPR fell 32% to 4.61% from 6.79% in October. This reading was the second time the DCPR has fallen below 5% this year, with

*Continued on page 2*

## FASB 166 AND SBA LENDING

By Bill McGaughy

Implementation of Financial Accounting Standard ("FAS") 166 for most lenders is January 1, 2010. The sale of the guaranteed portion of SBA 7a loans will change with the implementation of FAS 166. If the lender retains more than the 1% minimum lenders permanent fee, the transaction will be treated as a secured borrowing and not a sale. If the lender sells the guaranteed portion for a pre-

mium and only retains 1%, the transaction will be treated as a secured borrowing until the 90 day warrant period for prepayments expires and/or the borrowers' first three payments are received in the month in which it was due. After the warranty period expires the transaction can be treated as a sale.

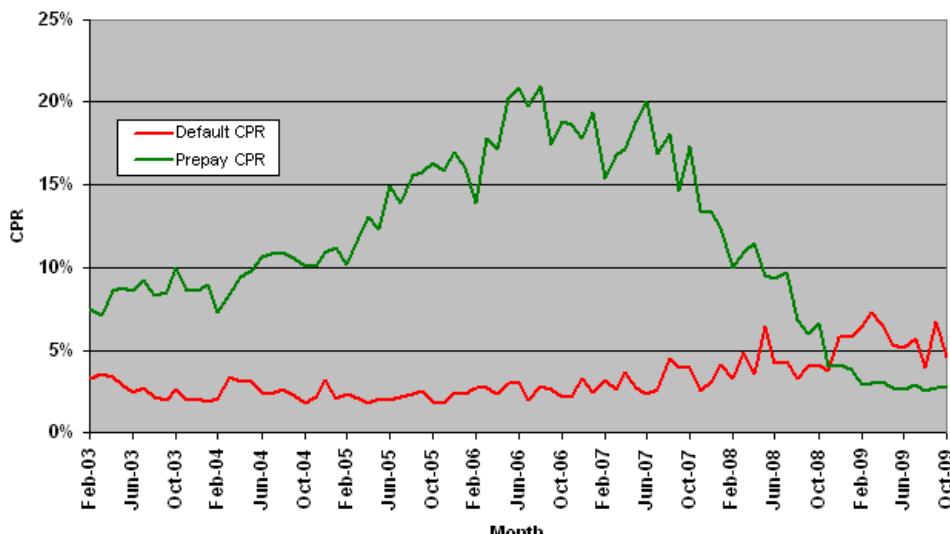
The implementation will have negative impacts to lenders that sell their guaranteed portions of

SBA 7a loans. The first impact is the loss of income from the gain on sale of loans that have been sold with a lenders permanent fee in excess of 1%. The second impact is the delay in recognizing the gain on sale of loans that were sold for a premium with the retention of a 1% lenders permanent fee. The third is the impact of not being able to remove the guaranteed portions of SBA 7a loans from

*Continued on page 4*

## NOVEMBER CPR...CONTINUED

### Monthly Pool CPR Due to Defaults and Prepayments



the low of 3.96% having been seen in August.

For November, prepayment speeds fell in five out of the six maturity categories. The largest decrease was seen in the 16-20 year maturity bucket, which fell 57% to CPR 5.69%. Other decreases were seen in the 20+ (-39% to CPR 4.95%), 13-16 (-11% to CPR 6.68%), 8-10 (-6% to CPR 12.05%), and <8 (-3% to CPR 9.72%). The only increase was seen in the 10-13 category, which rose by 3.24% to CPR 11.72%.

With the Default CPR falling back below 5% and next month's reading expected to be

below 4%, fears of defaults reaching double-digits this year have fortunately not materialized.

From a prepayment perspective, this is good news. The recent recipe of voluntary prepayments below 3% and defaults sub-6% calls for an expectation of sub-10% for overall prepayment speeds into 2010.

As to how long we can remain in a sub-10% prepay environment, our expectation is for single digit speeds throughout next year.

The reason for this call is that defaults continue to trend down and there is no reason to believe that voluntary prepayments will approach pre-2008 levels.

From an investor perspective SBA-related assets remain attractive, from a fundamental point of view, as we head into the new year.

*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 14-16*

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***"With the Default CPR falling back below 5% and next month's reading expected to be below 4%, fears of defaults reaching double-digits this year have fortunately not materialized."***

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SBA 7(a) Lender's Gain on Sale  
Income to be Reduced by 25% in 2010.  
FAS 166 will delay secondary market  
sale gains by 90 days beginning Jan 1st.

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## Speakers

### **Bob Judge, Partner, Government Loan Solutions, Cleveland, OH**

In October 2006, Bob, along with Scott Evans and Rob Herrick, founded Government Loan Solutions, Inc. (GLS), for the purpose of bringing greater efficiencies and productivity to the SBA marketplace, through the use of technology.

### **Bill McGaughey, Executive Vice President, Excel National Bank, Beverly Hills, CA**

Bill McGaughey is the Executive Vice President and Director of Capital Markets at Excel National Bank. Bill is the author of Accounting for SBA Loans Sold in the Secondary Market, published by NAGGL in 2008.

## FASB 166...CONTINUED

the lender's balance sheet, which results in the lender having to provide capital for guaranteed portions of SBA 7a loans sold.

If a lender were originating and selling \$5,000,000 in guaranteed portions a month, the delay in sales treatment per FAS 166, would result in the lender having to retain an additional \$750,000 in capital based on a leverage ratio of 5%. (\$5,000,000 x 3 months x 5%) Also, due to the delay the lender would postpone the recognition of approximately \$1.2 million in income during the first year of adoption of FAS 166. (The income is based on \$15,000,000 in loan sales at 110% with an assumption that 80% of the premium would be recognized as income.)

Example: A SBA 7a loan is made for \$1,000,000 for 25 years with an interest rate of prime + 2.75% (6%). The guaranteed portion of \$900,000 is sold on the same day for 108% or \$972,000 with a pass through rate of prime + 1.75% (5%). The implicit interest rate of the sold portion of the note is 3.85%. (The implicit interest rate is based on \$972,000 with payments of \$5,049 a month over 300 periods.) The accounting entries would be as follows:

### Make the Loan:

Loans	\$1,000,000
Cash	\$1,000,000

### Settle the loan sale:

Cash	\$972,000
Secured Borrowing	\$972,000

### Balance Sheet:

<b>Assets:</b>	
Cash	\$972,000
Loans	<u>\$1,000,000</u>
Total Assets	<u>\$1,972,000</u>

### **About the Author:**

Mr. McGaughy is the Executive Vice President and Director of Capital Markets at Excel National Bank. Bill is the author of Accounting for SBA Loans Sold in the Secondary Market, published by NAGGL in 2008. He has experience originating, purchasing, selling and securitizing SBA 7(a) and 504 loans. He is on NAGGL's Secondary Market Committee and is a former member of NAGGL's board of directors. He has a B.S. in accounting from the University of Northern Colorado, holds a State of Colorado CPA certificate, holds the designation of CFA, and is a graduate of Pacific Coast Banking School.

### **Liabilities:**

Secured borrowing	\$972,000
Equity	<u>\$1,000,000</u>
Total Liabilities and Equity	<u>\$1,972,000</u>

### **1<sup>st</sup> Payment received:**

Cash	\$6,443
Interest Income	\$5,000
Loans	\$1,443

### **1<sup>st</sup> Payment sent to guaranteed holder:**

Secured Borrowing	\$1,930
Interest Expense	\$3,119
Cash	\$5,049

### **After the first 3 payments are received and 90 days, recognize the loan sale<sup>1</sup>:**

Servicing Asset	\$14,785
Secured Borrowing	\$966,189
Loans	\$896,085
Discount on Unguaranteed	\$7,866
Gain on Sale	\$77,023

As shown above, FAS 166 will add a new level of complexity to accounting for SBA 7a loan sales and could have a significant negative impact to a lender's capital ratios and income in 2010.

### **Footnote:**

<sup>1</sup>Information on the numbers: Value of servicing asset (995,650 x (1% - .4%) x 2.75); Cost allocation Guaranteed fair value 980,974 (secured borrowing balance 966,189 + 14,785 servicing asset) or 90.79% of the total fair value; Unguaranteed fair value (gross loan balance \$995,650 x 10%) 99,565 or 9.21% of the total fair value; Discount on unguaranteed (995,650 x 10%) - (996,650 x 9.21%) = 7,866; Gain = (servicing asset 14,785 + secured borrowing 966,189) - (Note balance 995,650 x 90.79%)

## DECEMBER TALF UPDATE

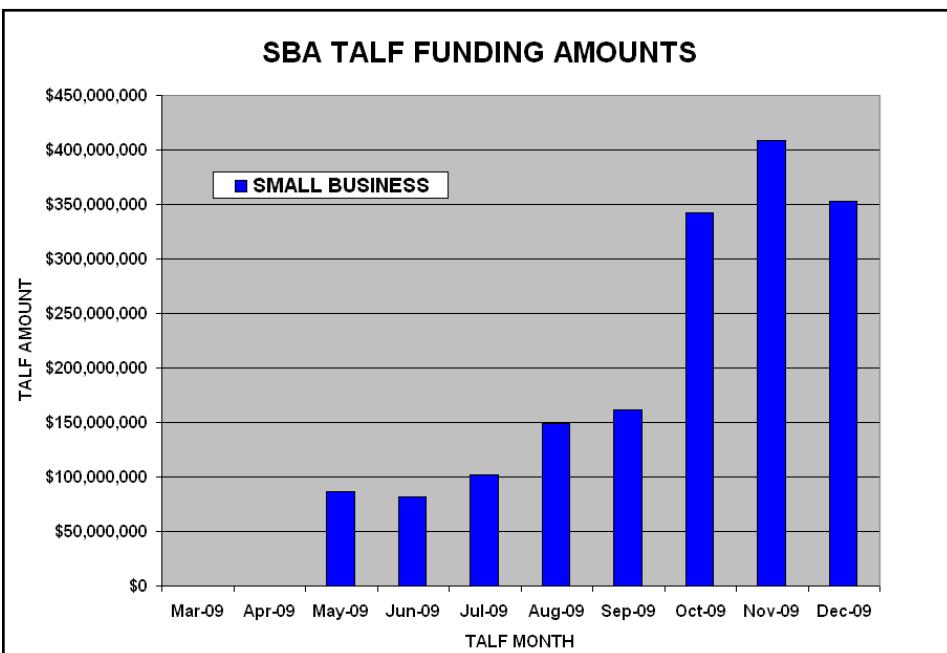
After five months of volume increases, small business ABS financed by the TALF decreased by \$55 million, or 14%, in December.

While the last few months have been dominated by 7a pool financings, we estimate that slightly less than 50% of the securities funded this month were 7a pools, with the rest being 504 debentures.

Because of their fixed-rate nature, 504 debentures are considered "riskier" assets inside the TALF, due to the uncertainty regarding future interest rates and the value of the security at the end of the TALF period. For this reason, floating-rate 7a pools possess less interest rate risk and are, generally speaking, more attractive to the average TALF investor.

With 7a pool assemblers having securitized their inventory of high gross margin, long maturity loans faster than they can replace them, we suspect the decrease was due to a lack of supply, as opposed to slackening demand for high margin, long dated pools.

SBA 7a pools continue to be popular with TALF investors, due to the return advantages over other TALF asset classes. Utilizing our assumptions for prepayment speeds and exit prices, TALF returns on 7a pools continue to be in the 8% to 10% range, as compared to sub-5% on many other TALF investment options.



With the TALF scheduled to end in March of next year, we are nearing the end of the "TALF impact" on the 7a secondary market.

Due to the fact that the last pool origination month that can go into the TALF is February, loans purchased in December, January and early February will be the last ones placed into TALF-eligible pools, barring an extension of the program.

Can the secondary market maintain the price increases seen in the past few months without TALF?

We will likely find out the answer to that question sometime in the first quarter of 2010.



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## GLS 7(a) Sale & Settlement Tip of the Month

### Sale and Settlement Strategies: Tip #16 – Don't count on miracles...

At least not when it comes to last minute settlements. While this has been mentioned more than once in this piece recently, it bears repeating – DO NOT WAIT until the last minute and expect Colson to push loans through the settlement process. If you have sold loans pending corrections, it is imperative to take immediate action to rectify the problem and communicate this to Colson and your buyers. With 166 taking effect in January, this is more important this year than any year before. Loans settling in 2010 will be subject to the new accounting rules, no ifs, ands, or buts.

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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# THE GOVGEX CORNER

The **GovGex Index™** reached a record high in the 25-year loan category during the month of November, while 10-year loans edged down slightly but remained close to October prices. Fully priced 25-year loans continued to trade at 110, with servicing becoming the playing field for bidders, reaching up to 1.3%. To account for the increased servicing fees, we updated our pricing model for November, resulting in more accurate predictions for the loans that fetch the highest premiums.

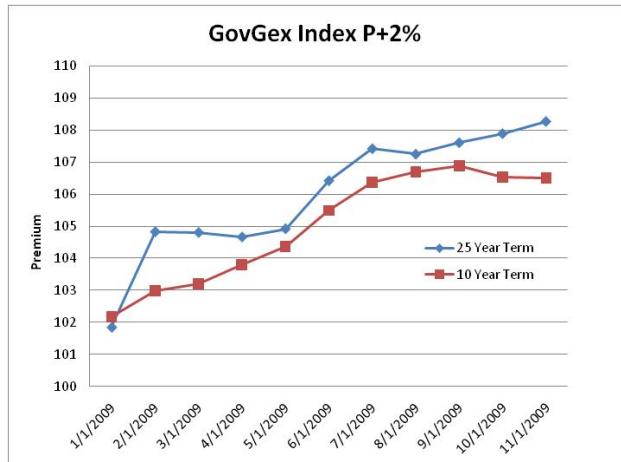
Below is recent price and trend information on SBA loan sale premiums as reported by the GovGex Independent Pricing Service. **GovGex Transactions** shows actual bids received on loans presented for sale through **GovGex**. The **GovGex Index™** shows what a Prime + 2 loan of the given term that had just been funded would sell for in each month. The GovGex Index robustly captures month-to-month pricing trends, while also controlling for factors including the age of the loan at the time of sale. For 10 year loans, the Index premium fell 10 basis points between October and November, and for 25 year loans, the premium rose a striking 40 basis points, crossing 108 for the first time.

## GovGex Transactions—Nov

Deal Term	Premium	Servicing
25	110.00%	1.30%
15	110.00%	1.23%
10	109.50%	1.00%

## GovGex Index™ P + 2%

Month	10 Year	25 Year
Sep	106.9	107.6
Oct	106.6	107.9
Nov	106.5	108.3



**Note:** the above tables represent aggregated data. Subscribers of the **GovGex Independent Pricing Service™** receive regular updates of actual transactions and bid levels on **GovGex** - including loan details and high premium and par bids. Recent reports show P+2.75 transactions at **107%** to **110%** range, with only slight changes in loan structure driving premiums. Lenders use the pricing service to structure deals in light of what the market is currently valuing. The **GovGex Independent Pricing Service** is the only service to provide *actual bid levels* based on loans presented for sale on **GovGex**.

## About GovGex.com

GovGex is the secure online exchange for selling SBA and USDA loans. GovGex works with a network of over 30 Buyers, including the leading pool assemblers who are so critical to providing liquidity to small business lenders – a vital engine for American growth. GovGex is an independent source for secondary market pricing information - built on actual bid levels as seen on GovGex. Contact GovGex for all of your secondary market needs.



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## STABILITY SEEN IN THE GLS VALUE INDICES

The GLS Value Indices remained mostly stable in October, as the short-end displayed single-digit percentage gains and the long-end single-digit percentage decreases. This result was not unexpected, as the sub-15 year maturities decreased in price in October while the long-end witnessed continued servicing bid increases.

While the movements were not as large as in past months, the prepayment element continues to decrease and the Base Rate / Libor spread continues to increase.

Specifically, the Base Rate / Libor spread rose for the eighth month in a row, reaching 299 basis points, a 3 basis point increase over September. We are now within 10 basis points of the all-time high of 309 bps seen in January, 2008. Additionally, the prepayment element decreased

in four out of six maturity sectors.

As we have seen in past few months, increasingly positive fundamentals were important in maintaining the indices, especially in the long-end where the secondary market continued to rally throughout October.

Turning to the specifics, the largest increase was in the GLS VI-4, which increased by 5.13% to 216 basis points. Other single-digit increases were recorded in VI-1 (+5.10% to 128.2), VI-3 (+4.36% to 133.9) and VI-2 (+3.79% to 131.3).

Decreases were seen in VI-5, which fell by 15.14% to 191.2 and VI-6, which decreased by 0.35% to 228.6.

Since the scheduled end of the TALF for SBA pools is in sight, it will be interesting to see the price action as we approach the

end of the first quarter of 2010.

We expect continued positive fundamentals (i.e. Base/Libor spread and prepayment speeds), but will that be enough to sustain the market?

*For further information on the GLS Value Indices, please refer to the "Glossary and Definitions" at the end of the report.*

*Data on pages 11-12, Graph on page 13*

### 7(a) Secondary Market Pricing Grid: October 2009\*

Maturity	Gross Margin	Fees	Servicing	10/30/2009 Price	Last Month Price	3-Mos. Ago Price	6-Mos. Ago Price	Net Margin
10 yrs.	2.75%	0.6750%	1.00%	109.40	109.65	109.25	NA	1.075%
15 yrs.	2.75%	0.6750%	1.00%	109.50	109.80	109.375	NA	1.075%
20 yrs.	2.75%	0.6750%	1.09%	110.00	110.00 / 1.00%	109.50	NA	0.985%
25 yrs.	2.75%	0.6750%	1.14%	110.00	110.00 / 1.07%	109.75	NA	0.935%

*\*Please note that we have changed the loan descriptions to better reflect the characteristics of loans being sold into the secondary market.*

### Content Contributors

The editors of the "CPR Report" would like to thank the following secondary market participants for contributing to this month's report:



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## DEFAULT RATE FALLS TO 4.81%

In October, the theoretical default rate fell by 33% to 4.81% from 7.16% in September. This result moves the default rate back in line with the range of 4% to 6% we have seen since the summer months.

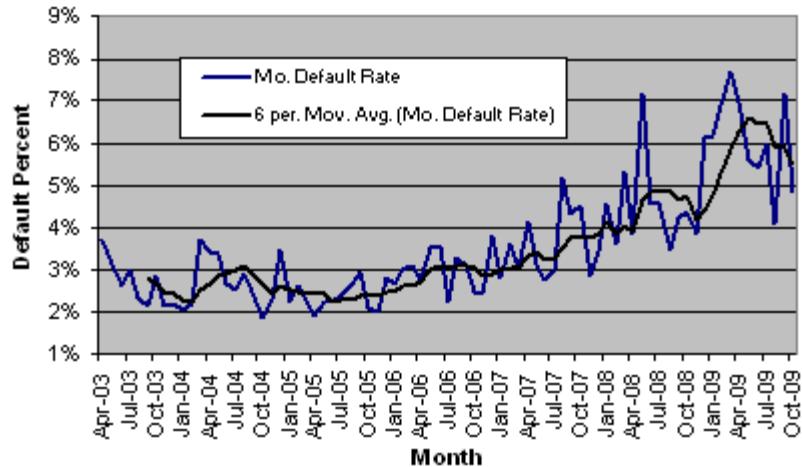
This recent range is a positive move from the 6% to 7% range from the first half of 2009.

Even though we have seen some volatility in the last three months, the average default rate in that period was 5.36%, well within recent expectation.

This return to the trend is very positive for 7a lending in particular and small business, in general. While there has been some question regarding the source and quality of economic growth seen in the

third quarter, it would seem that small business is reacting in a positive manner. While we are a

### Theoretical Monthly Default Rates on 7(a) Loans



long way from the 2% to 3% default range of earlier this decade, at least we seem to be moving in the right direction.

## DEFAULT-CURTAILMENT RATIOS

Because of another record high Default-Curtailment Ratio (DCR) reading, the 504 DCR exceeded the 7a ratio for the third time in four months.

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.

As has been the case for nearly the past year and a half, both ratios continued the trend of recession-level readings of 30%+ for 7(a) and 20%+ for 504 loans.

### SBA 7(a) Default Ratios

For the 18th month in a row, the 7(a) DCR exceeded 30%, coming in at 62.82%, which represents a 12% decrease from the previous month's record reading of 71.35%. As has been the case all year, this is both a function of low voluntary prepayments and higher defaults.

Turning to defaults, we witnessed a \$42.3 million decrease in October, falling to \$122 million. Voluntary prepayments rose slightly, moving to \$72.1 million from \$65.9 million.

### SBA 504 Default Ratios

Also for the 18th month in a row, the 504

DCR came in above 20%, having reached another all-time high of 70.23%, the first reading above 70%. This figure is once again significantly above our threshold for weakened conditions in the 504 small business sector.

Specifically, the dollar amount of defaults increased by \$9.8 million to \$111.8 million in the month of October. At the same time, voluntary prepayments also rose, increasing by \$3.1 million to \$47.4 million, but not enough to lower the 504 DCR.

### Summary

In summary, both DCRs continue to suggest weakness in the small business sector. While we are seeing some positive data regarding defaults, there is still work to be done before we can declare the recession to be over.

*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.*



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Graph on page 19

# 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
May-06	18.84%	17.05%	13.80%	14.99%	19.00%	20.39%
Jun-06	19.80%	18.23%	13.34%	15.88%	19.57%	21.59%
Jul-06	20.48%	19.32%	13.77%	16.88%	19.58%	22.41%
Aug-06	19.27%	19.32%	14.15%	17.76%	20.10%	23.06%
Sep-06	20.33%	19.89%	14.29%	18.83%	20.84%	24.55%
Oct-06	19.72%	19.72%	14.32%	19.17%	20.42%	24.51%
Nov-06	18.17%	19.54%	14.82%	19.32%	20.91%	24.83%
Dec-06	16.78%	18.62%	14.44%	18.97%	20.67%	24.48%
Jan-07	16.44%	17.36%	13.95%	18.23%	20.89%	24.14%
Feb-07	17.47%	17.00%	13.86%	17.95%	21.81%	24.21%
Mar-07	16.07%	16.65%	13.54%	17.22%	20.95%	23.23%
Apr-07	16.21%	16.49%	13.55%	17.99%	19.52%	23.13%
May-07	18.09%	17.35%	13.47%	18.38%	19.68%	22.95%
Jun-07	18.39%	17.03%	13.89%	18.96%	20.60%	22.97%
Jul-07	18.52%	17.35%	14.00%	19.55%	20.25%	23.25%
Aug-07	17.72%	17.15%	13.56%	19.48%	18.01%	23.10%
Sep-07	19.18%	17.10%	14.19%	19.85%	18.61%	23.98%
Oct-07	18.14%	17.04%	14.59%	19.16%	18.57%	23.85%
Nov-07	17.68%	16.02%	14.82%	18.87%	18.32%	24.16%
Dec-07	17.14%	15.38%	14.42%	17.22%	17.99%	23.23%
Jan-08	15.70%	14.68%	13.96%	16.44%	17.45%	22.00%
Feb-08	15.91%	13.98%	14.19%	16.20%	17.53%	21.19%
Mar-08	15.58%	13.42%	13.27%	15.08%	15.41%	19.34%
Apr-08	16.16%	13.40%	13.05%	14.59%	15.19%	18.74%
May-08	15.49%	12.93%	12.65%	13.77%	14.33%	17.33%
Jun-08	15.29%	13.36%	12.96%	14.75%	13.62%	17.14%
Jul-08	15.70%	13.03%	12.78%	14.40%	12.49%	16.59%
Aug-08	15.45%	13.28%	12.87%	13.73%	12.24%	15.89%
Sep-08	14.03%	12.49%	12.77%	13.28%	12.36%	15.20%
Oct-08	12.98%	11.67%	12.16%	12.13%	11.97%	14.06%
Nov-08	12.08%	12.36%	11.45%	11.49%	11.49%	13.22%
Dec-08	12.37%	11.81%	10.46%	9.79%	11.08%	11.41%
Jan-09	12.86%	11.55%	10.45%	9.29%	10.61%	10.40%
Feb-09	12.30%	11.30%	10.36%	8.39%	9.99%	9.30%
Mar-09	12.96%	11.97%	10.58%	8.57%	10.47%	8.79%
Apr-09	13.23%	12.34%	11.23%	8.75%	9.81%	8.55%
May-09	13.12%	11.89%	11.80%	8.68%	9.92%	7.98%
Jun-09	13.18%	11.85%	12.36%	8.57%	8.73%	8.02%
Jul-09	12.40%	12.00%	12.51%	8.56%	8.23%	7.36%
Aug-09	13.38%	12.49%	12.36%	8.01%	7.34%	7.21%
Sep-09	12.79%	11.01%	11.83%	7.48%	6.70%	6.89%
Oct-09	12.50%	11.03%	11.35%	7.25%	7.85%	6.79%

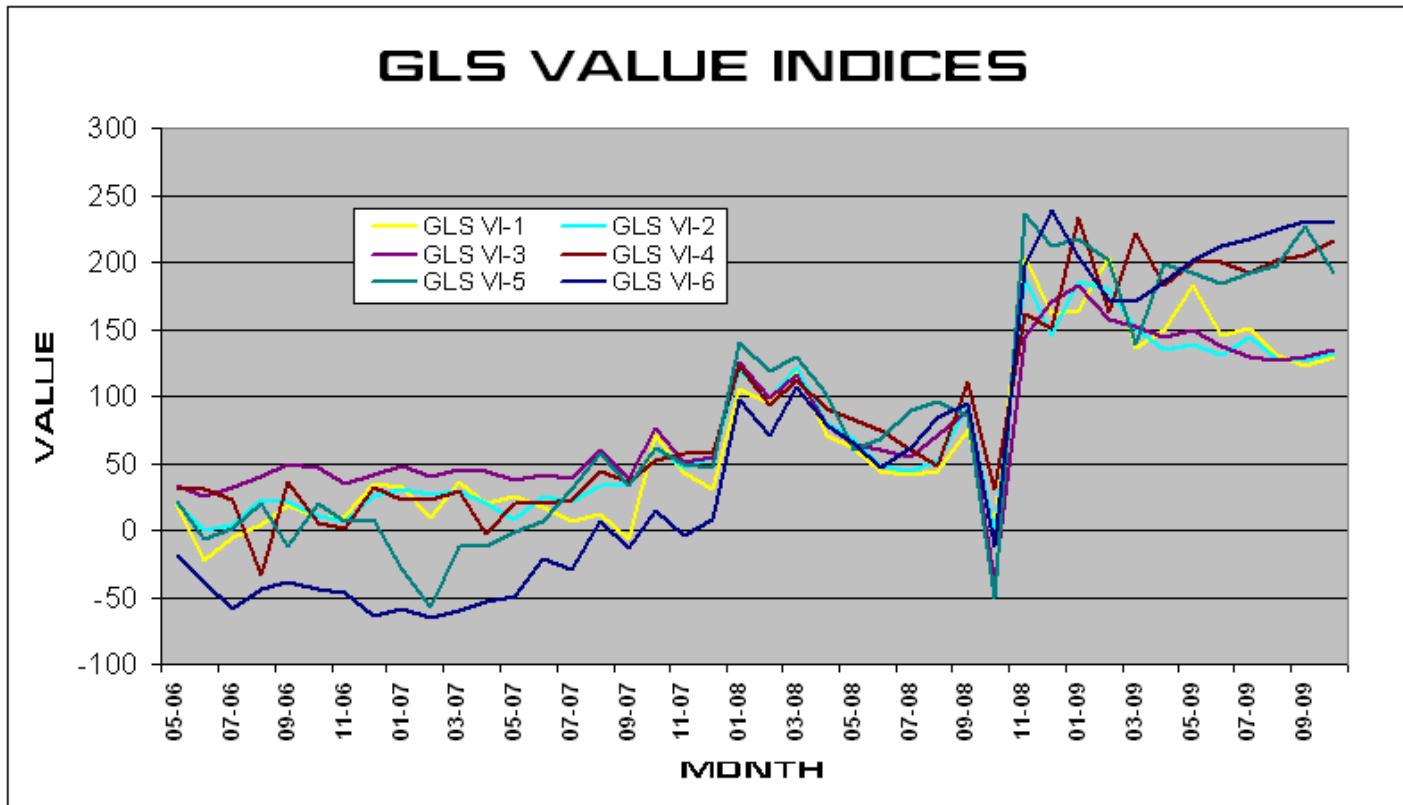
Rolling six-month CPR speeds for all maturity buckets. Source: Colson Services

# 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
May-06	5.18%	7.94%	2.76%	18.4	18.8	33.5	30.2	21.0	-19.5	
Jun-06	5.37%	8.03%	2.66%	-22.8	-0.1	25.0	29.6	-6.4	-37.9	
Jul-06	5.48%	8.25%	2.77%	-5.9	3.6	31.2	22.0	0.9	-59.1	
Aug-06	5.40%	8.25%	2.85%	3.8	21.4	39.8	-33.9	19.7	-43.5	
Sep-06	5.37%	8.25%	2.88%	17.8	21.0	49.8	36.2	-12.4	-38.1	
Oct-06	5.37%	8.25%	2.88%	10.0	11.3	46.3	5.4	19.1	-43.5	
Nov-06	5.37%	8.25%	2.88%	10.9	7.0	33.7	1.4	6.2	-46.7	
Dec-06	5.36%	8.25%	2.89%	34.6	24.0	41.1	31.0	8.0	-63.8	
Jan-07	5.35%	8.25%	2.90%	31.0	29.8	48.6	21.3	-30.1	-59.4	
Feb-07	5.36%	8.25%	2.89%	9.2	25.4	39.4	21.3	-57.0	-65.7	
Mar-07	5.34%	8.25%	2.91%	35.9	28.9	45.0	28.5	-12.7	-60.9	
Apr-07	5.35%	8.25%	2.90%	18.8	19.4	43.4	-2.9	-12.5	-53.0	
May-07	5.35%	8.25%	2.90%	24.5	8.5	37.6	18.9	-1.4	-50.0	
Jun-07	5.36%	8.25%	2.89%	16.3	25.2	40.6	18.6	7.0	-22.1	
Jul-07	5.35%	8.25%	2.90%	6.8	20.9	38.1	22.2	30.1	-29.9	
Aug-07	5.48%	8.25%	2.77%	12.9	33.5	59.8	43.6	57.8	7.0	
Sep-07	5.70%	8.21%	2.51%	-7.3	32.2	38.1	36.3	33.3	-14.1	
Oct-07	5.05%	7.74%	2.69%	70.2	61.9	75.6	52.2	61.9	14.6	
Nov-07	4.96%	7.50%	2.54%	42.6	46.7	50.5	57.8	48.7	-4.3	
Dec-07	5.02%	7.35%	2.33%	30.4	55.2	54.4	57.0	46.7	7.9	
Jan-08	3.77%	6.86%	3.09%	105.1	118.6	124.7	121.4	140.1	96.8	
Feb-08	3.10%	6.00%	2.90%	94.4	98.7	98.6	93.3	118.0	69.9	
Mar-08	2.90%	5.95%	3.05%	118.1	120.5	116.2	112.0	128.8	107.4	
Apr-08	2.81%	5.25%	2.44%	69.9	79.5	77.4	90.6	100.8	77.4	
May-08	2.78%	5.15%	2.37%	61.2	66.7	64.1	82.9	60.5	65.1	
Jun-08	2.67%	5.00%	2.33%	44.1	47.4	59.8	74.6	66.9	47.2	
Jul-08	2.75%	5.00%	2.25%	41.7	43.4	55.3	60.8	89.1	61.6	
Aug-08	2.74%	5.02%	2.27%	44.0	52.5	70.1	47.4	95.8	83.1	
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	

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-09</b>	16.67%	9.11%	10.27%	10.30%	8.75%	9.67%	9.94%
<b>Feb-09</b>	10.84%	11.48%	13.12%	7.36%	8.85%	8.09%	9.67%
<b>Mar-09</b>	14.52%	14.16%	11.41%	9.86%	12.85%	7.42%	9.52%
<b>Apr-09</b>	11.84%	12.82%	14.16%	8.76%	6.40%	8.74%	10.30%
<b>May-09</b>	11.75%	13.00%	13.47%	8.35%	9.99%	7.74%	9.79%
<b>Jun-09</b>	13.31%	10.45%	11.73%	6.60%	5.30%	6.42%	8.10%
<b>Jul-09</b>	12.14%	10.19%	11.09%	10.45%	5.69%	5.70%	7.82%
<b>Aug-09</b>	16.59%	14.28%	12.28%	3.77%	3.47%	7.18%	8.68%
<b>Sep-09</b>	11.00%	5.31%	8.01%	6.72%	9.22%	5.52%	6.55%
<b>Oct-09</b>	10.06%	12.81%	11.35%	7.47%	13.09%	8.10%	9.52%
<b>Nov-09</b>	9.72%	12.05%	11.72%	6.68%	5.69%	4.95%	7.34%
<b>Grand Total</b>	<b>12.61%</b>	<b>11.43%</b>	<b>11.71%</b>	<b>7.91%</b>	<b>8.17%</b>	<b>7.23%</b>	<b>8.85%</b>

2009 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-09</b>	21 Mos.	27 Mos.	23 Mos.	59 Mos.	42 Mos.	47 Mos.	39 Mos.
<b>Feb-09</b>	21 Mos.	27 Mos.	23 Mos.	59 Mos.	43 Mos.	47 Mos.	40 Mos.
<b>Mar-09</b>	21 Mos.	28 Mos.	24 Mos.	60 Mos.	43 Mos.	47 Mos.	40 Mos.
<b>Apr-09</b>	22 Mos.	27 Mos.	25 Mos.	61 Mos.	43 Mos.	47 Mos.	41 Mos.
<b>May-09</b>	22 Mos.	27 Mos.	26 Mos.	62 Mos.	43 Mos.	48 Mos.	41 Mos.
<b>Jun-09</b>	23 Mos.	28 Mos.	26 Mos.	62 Mos.	43 Mos.	48 Mos.	42 Mos.
<b>Jul-09</b>	23 Mos.	26 Mos.	27 Mos.	63 Mos.	44 Mos.	49 Mos.	42 Mos.
<b>Aug-09</b>	23 Mos.	26 Mos.	27 Mos.	62 Mos.	44 Mos.	49 Mos.	42 Mos.
<b>Sep-09</b>	23 Mos.	26 Mos.	28 Mos.	63 Mos.	45 Mos.	49 Mos.	42 Mos.
<b>Oct-09</b>	23 Mos.	26 Mos.	28 Mos.	63 Mos.	45 Mos.	49 Mos.	43 Mos.
<b>Nov-09</b>	23 Mos.	27 Mos.	29 Mos.	64 Mos.	45 Mos.	49 Mos.	43 Mos.

2009 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-09	7.35%	31.58%	10.94%	15.95%	2.41%
Feb-09	13.53%	10.26%	6.52%	4.50%	21.72%
Mar-09	9.36%	19.91%	14.43%	15.20%	18.36%
Apr-09	16.19%	11.44%	8.89%	5.24%	6.89%
May-09	14.49%	13.28%	6.28%	10.88%	10.10%
Jun-09	15.17%	12.41%	11.87%	18.19%	6.68%
Jul-09	10.01%	15.56%	12.53%	11.63%	2.41%
Aug-09	12.34%	24.72%	14.14%	13.62%	4.13%
Sep-09	6.94%	12.85%	15.51%	9.56%	5.18%
Oct-09	9.34%	12.72%	9.70%	1.40%	16.91%
Nov-09	7.14%	15.83%	8.03%	6.71%	7.61%
<b>Grand Total</b>	<b>11.22%</b>	<b>16.84%</b>	<b>10.85%</b>	<b>10.15%</b>	<b>9.41%</b>

10-13 BY AGE	0-12 Mos.	13-24 Mos.	25-36 Mos.	37-48 Mos.	48+ Mos.
Jan-09	9.56%	13.20%	7.40%	8.64%	8.76%
Feb-09	10.87%	16.62%	12.39%	8.83%	11.78%
Mar-09	11.51%	14.64%	9.99%	5.24%	7.45%
Apr-09	7.86%	20.69%	12.62%	15.73%	6.49%
May-09	11.87%	17.74%	12.49%	9.50%	8.90%
Jun-09	13.83%	14.17%	10.21%	7.70%	5.97%
Jul-09	9.11%	15.37%	9.97%	7.13%	7.17%
Aug-09	9.06%	16.91%	11.24%	7.60%	10.44%
Sep-09	6.98%	11.03%	7.88%	3.41%	6.51%
Oct-09	9.17%	14.66%	13.24%	7.53%	5.26%
Nov-09	6.08%	18.90%	9.56%	10.40%	6.13%
<b>Grand Total</b>	<b>9.90%</b>	<b>15.84%</b>	<b>10.66%</b>	<b>8.23%</b>	<b>7.68%</b>

16-20 BY AGE	0-12 Mos.	13-24 Mos.	25-36 Mos.	37-48 Mos.	48+ Mos.
Jan-09	5.25%	6.38%	17.21%	6.73%	10.29%
Feb-09	0.00%	13.17%	5.76%	4.81%	12.03%
Mar-09	8.52%	19.83%	4.91%	10.43%	12.05%
Apr-09	6.41%	2.64%	5.11%	0.89%	12.02%
May-09	1.01%	8.14%	14.23%	10.61%	13.93%
Jun-09	1.10%	5.73%	10.50%	0.77%	5.97%
Jul-09	0.00%	4.86%	10.76%	2.32%	7.30%
Aug-09	0.00%	2.82%	8.80%	1.93%	3.05%
Sep-09	14.33%	12.78%	7.03%	1.94%	6.72%
Oct-09	3.75%	17.13%	24.21%	10.87%	6.73%
Nov-09	3.56%	5.76%	7.05%	6.19%	5.67%
<b>Grand Total</b>	<b>4.05%</b>	<b>9.23%</b>	<b>10.96%</b>	<b>5.20%</b>	<b>8.68%</b>

## YEAR-TO-DATE CPR DATA

Table 6:

8-10 BY AGE	0-12 Mos.	13-24 Mos.	25-36 Mos.	37-48 Mos.	48+ Mos.
Jan-09	7.89%	12.32%	8.52%	3.96%	12.50%
Feb-09	11.59%	11.43%	15.08%	5.57%	12.29%
Mar-09	11.28%	22.85%	10.72%	10.13%	12.67%
Apr-09	12.82%	21.12%	11.37%	5.64%	7.08%
May-09	11.09%	21.71%	8.76%	6.27%	10.23%
Jun-09	6.57%	16.04%	8.81%	6.67%	10.70%
Jul-09	5.85%	18.36%	8.90%	5.97%	8.92%
Aug-09	14.14%	23.41%	8.80%	5.77%	9.32%
Sep-09	5.03%	6.72%	4.71%	5.23%	4.31%
Oct-09	10.56%	17.51%	16.67%	4.28%	10.54%
Nov-09	13.42%	15.68%	13.08%	6.39%	6.47%
<b>Grand Total</b>	<b>10.05%</b>	<b>17.19%</b>	<b>10.66%</b>	<b>6.07%</b>	<b>9.50%</b>

13-16 BY AGE	0-12 Mos.	13-24 Mos.	25-36 Mos.	37-48 Mos.	48+ Mos.
Jan-09	0.00%	9.70%	0.00%	10.03%	11.28%
Feb-09	20.67%	4.28%	0.00%	7.21%	7.03%
Mar-09	0.00%	2.39%	14.62%	5.15%	12.71%
Apr-09	8.89%	9.78%	0.00%	4.95%	10.55%
May-09	0.00%	32.61%	0.00%	6.13%	8.85%
Jun-09	0.00%	15.88%	0.55%	4.14%	7.32%
Jul-09	0.00%	0.00%	29.55%	11.09%	9.84%
Aug-09	0.00%	0.00%	0.00%	3.25%	4.42%
Sep-09	0.00%	5.76%	11.26%	1.25%	7.53%
Oct-09	25.31%	7.87%	5.85%	0.00%	6.71%
Nov-09	0.00%	0.00%	0.00%	41.24%	7.40%
<b>Grand Total</b>	<b>5.86%</b>	<b>7.27%</b>	<b>6.99%</b>	<b>6.63%</b>	<b>8.41%</b>

20+ BY AGE	0-12 Mos.	13-24 Mos.	25-36 Mos.	37-48 Mos.	48+ Mos.
Jan-09	10.77%	12.40%	10.16%	7.43%	8.21%
Feb-09	3.56%	6.57%	12.17%	5.72%	9.25%
Mar-09	6.12%	9.38%	7.45%	5.64%	7.61%
Apr-09	7.53%	12.23%	10.84%	5.36%	7.91%
May-09	6.47%	9.24%	10.55%	4.41%	7.66%
Jun-09	5.38%	9.05%	5.77%	1.86%	7.58%
Jul-09	3.75%	5.89%	6.95%	6.22%	5.59%
Aug-09	2.53%	9.86%	9.15%	6.66%	6.61%
Sep-09	3.39%	8.33%	6.48%	4.17%	5.04%
Oct-09	3.07%	13.70%	11.53%	6.90%	6.35%
Nov-09	2.32%	7.30%	5.99%	5.93%	4.19%
<b>Grand Total</b>	<b>5.06%</b>	<b>9.47%</b>	<b>8.96%</b>	<b>5.45%</b>	<b>6.84%</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.

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### 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:

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

---

### 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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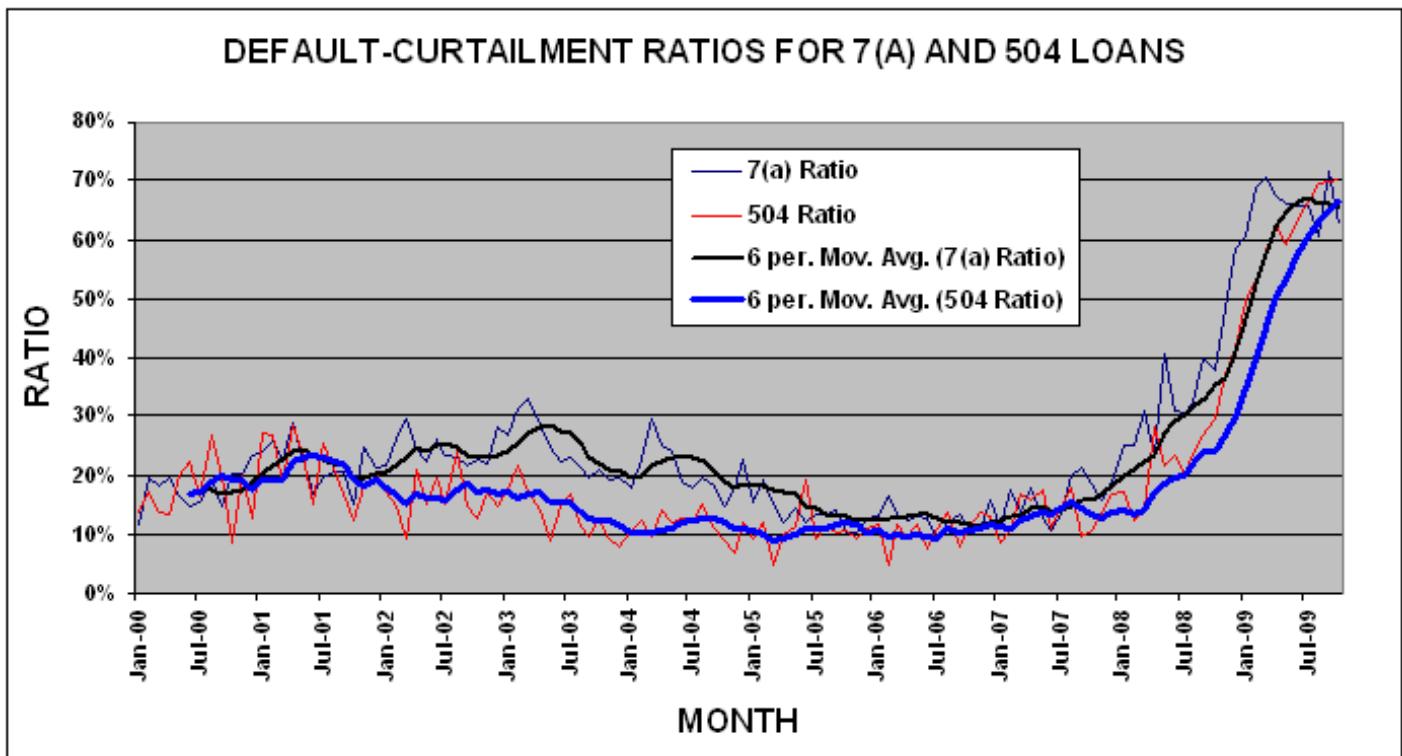
### TALF

The TALF, or **Term Asset-Backed Security Loan Facility**, was announced by the Federal Reserve Bank and the US Treasury on November 25, 2008. The purpose of the TALF is to make credit available to consumers and small businesses on more favorable terms by facilitating the issuance of asset-backed securities (ABS) and improving the market conditions for ABS more generally.

The most recent update was released by the Federal Reserve on May 19th, 2009.

The Federal Reserve Bank of New York will make up to \$1 trillion of loans under the TALF. TALF loans will have a term of three years; will be non-recourse to the borrower; and will be fully secured by eligible ABS. The US Treasury Department will provide \$100 billion of credit protection to the Federal Reserve in connection with the TALF.

SBA Pools issued in 2008 and beyond are considered eligible securities. SBA Pools are eligible for 3 or 5 year TALF loans.



## Let GLS Value your Mortgage Servicing Rights

Government Loan Solutions, the national leader in SBA servicing portfolio valuation, now offers its market-based valuation methodology to the mortgage servicing industry.

If your firm provides mortgage servicing, we can provide you with the same loan-by-loan detail and stress testing that we provide to our SBA servicing clients.

For more information, please contact Rob Herrick at 216-456-2480 ext. 144 or by e-mail at [rob.herrick@glssolutions.us](mailto:rob.herrick@glssolutions.us)

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**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 SBA 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 government lending, help pool assemblers 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*

**Pool Assemblers:**

- *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, including TALF*

*For additional information regarding our products and capabilities, please contact us at:*

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