

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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## PREPAYMENT SPEEDS STAY LOW AS WE BEGIN 2011

For the first month of 2011, prepayments picked up where they left off last year, falling 7% from December to 6.13%. This represents the fourth month in a row of sub-7% CPRs for 7a loans.

A notable accomplishment occurred in January:

The Default CPR went below the Voluntary CPR for the first time since November, 2008, which was two short months after the Lehman Brothers bankruptcy.

As for the default CPR, it fell below 3% for the first time since November, 2007. At the same time, the voluntary CPR

moved slightly above 3%, for the first time since April, 2009.

Specifically, defaults fell by 19% from December to DCPR 2.99%, the sixth decline in the past seven months. Voluntary prepayments edged up 7%, reaching 3.14%, the

*Continued on page 2*

## SMA UPDATE: 504 REFINANCE

**Pricing Alert:** SMA has new, updated pricing. Please see our grid inside the report

By Jordan Blanchard

#### 504 Refinance

SBA will begin accepting applications on February 28<sup>th</sup>. All loans must be approved by September 27<sup>th</sup>, 2012.

Major highlights are as follows:

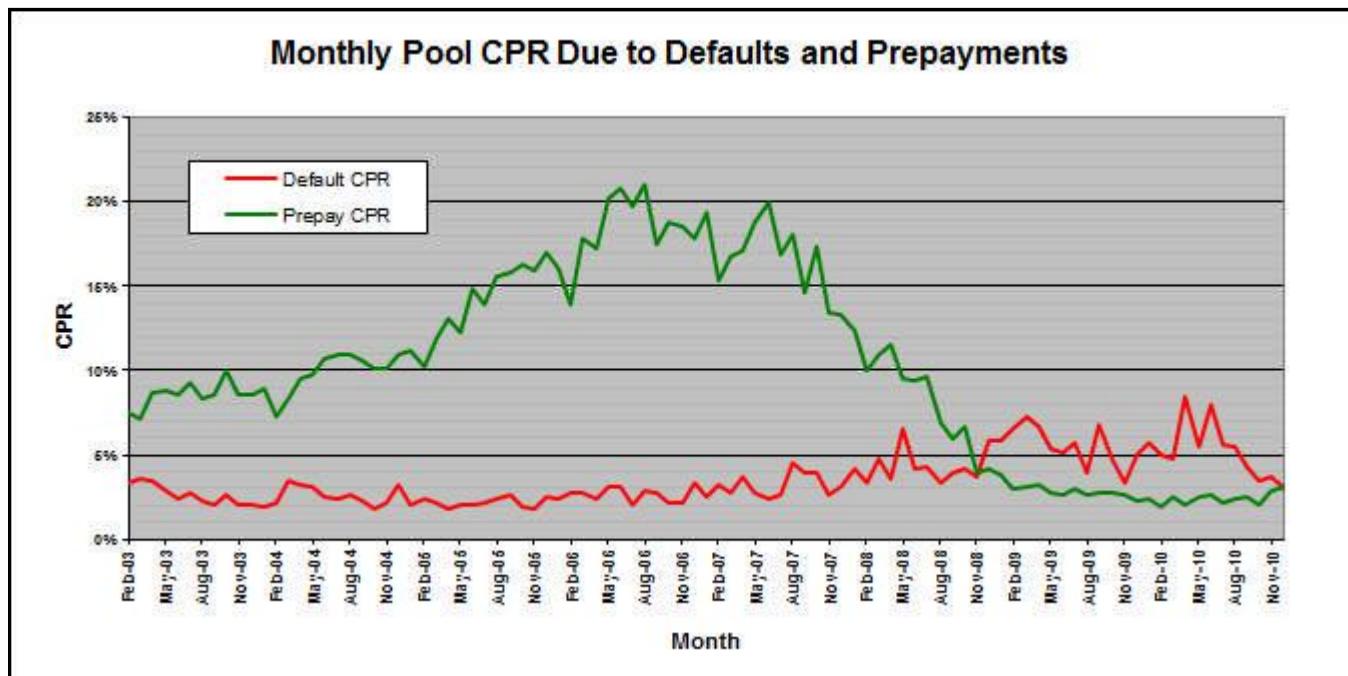
*Continued on page 4*

The regulations can be viewed at the following link:

<http://frwebgate1.access.gpo.gov/cgi-bin/PDFgate.cgi?WAISdocID=VJRC9C/35/2/0&WAISaction=retrieve>



## PREPAYMENT SPEEDS...CONTINUED



third consecutive monthly increase.

As for next month, preliminary data from Colson suggests a continued favorable prepay environment, with readings around the 6% level for February.

Turning to the specifics, the prepayment speed for January came in at CPR 6.13% a 7% decrease from December.

January YOY comparison to 2010 shows us starting off on a good note, with last month being 15% lower than last January.

Turning to the default/voluntary prepayment breakdown, the **Voluntary Prepay**

**CPR** (green line) rose from 2.92% in December to 3.14%. This result ends a 19-month string of sub-3% VCPR readings for 7a loans.

While the VCPR broke above 3%, the **Default CPR** (red line) moved below 3%, hitting 2.99%, a 19% decrease from December's reading of 3.70%.

Last month, prepayment speeds fell in four out of the six maturity categories. The largest decrease was seen in the 13-16 maturity bucket, which fell by 20% to CPR 6.85%. Other decreases were seen in 16-20 sector, which fell by 14% to

CPR 3.82%, the 10-13 sector (-9% to CPR 6.94%) and 20+ bucket (-8% to CPR 5.26%).

Increases were seen in the <8 sector (+10% to CPR 14.30%) and the 8-10 bucket (+7% to CPR 9.08%).

Prepayment fundamentals are very favorable as we begin 2011. With defaults falling and voluntary prepayments rising at a controlled pace, we should remain in the 6% to 8% range through the first half of this 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 17-18*

***"Prepayment fundamentals are very favorable as we begin 2011. With defaults falling and voluntary prepayments rising at a controlled pace, we should remain in the 6% to 8% range through the first half of this year."***

# BANKS

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## SECONDARY MARKET ACCESS...CONTINUED

The program will allow the refinance of conventional owner occupied real estate loans with an impending maturity.

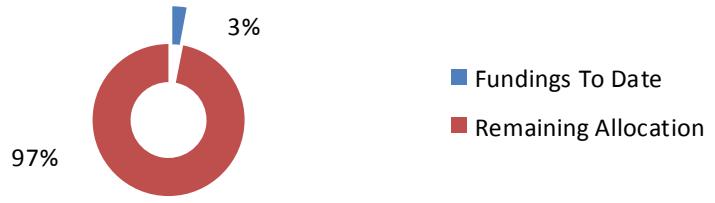
Initially, SBA will only accept applications where the debt matures by 12/31/2012. The SBA is putting in this restriction to deal with most urgent situations. At a later date, SBA will consider loans with a maturity date after 12/31/2012.

The debt must have been originated 2 years or longer from the date of application.

- The debt must have been current for the previous 12 months prior to application (no 30 day late loans).
- At least 85% of the loan proceeds must be used to refinance debt that was originally used for SBA 504 qualified purposes. This means that the debt must have been used to purchase real estate or equipment.
- Up to 15% of the new loan can be used to refinance debt that was used for non-SBA qualified debt, but was still used for business expenses.
- The loan must be disbursed within 6 months of SBA approval or the loan approval will be canceled by SBA.
- The maximum loan-to-value ratio is 90% on all property types, not just multi-purpose.
- The first mortgage loan must be at least 50% of the fair market value.
- A current appraisal is required.
- Institutions can refinance their own debt subject to proper documentation and certifications.
- The interim final rules note that if a lender refinances its own debt, the first mortgage cannot be sold through the SBA 504 pool guarantee program; however, a lender can refinance their own debt and sell 100% of the first mortgage to a third party. That third party could sell the first through the FMP program.

The 504 refinance program does not allow refinancing any government guaranteed debt (SBA 7a or USDA) or a 504 transaction.

### First Mortgage Pool Program Through January, 2011



The SBA is delaying implementation of two key issues contained in the original legislation:

**Cash out** – the legislation allowed for a portion of the loan proceeds to be cash out to the borrower. SBA has stated that it needs time to develop the policies and controls. SBA should be applauded for not holding up the program overall in order to deal with this issue.

**125% LTV** – the legislation allowed for up to 125% LTV on projects, but the SBA has decided to finalize that portion of the program at a later date.

#### Volume

There were no pools issued in January, 2011. The total FMP volume through January 2011 stands at \$92,284,783.

#### Warehouse Financing

Are you a bank or non-bank lender that needs warehouse financing on the first or interim second mortgage? There is a robust market to fund the interim second until funding of the Debenture. But there are also firms considering financing up to 85% of the first mortgage until FMP pool settlement date. If you are interested in learning more, please contact Jordan Blanchard at [jblanchard@cdcloans.com](mailto:jblanchard@cdcloans.com).

#### FMP Tips...

- The investment market for the guaranteed interest is less desirous of loans that are initially fixed then adjust to another fixed rate period (for example, a 5 year reset). What is preferred are loans that convert to adjustable after the initial fixed period. If this becomes a competitive disadvantage, lenders are

*Continued on next page*

## SECONDARY MARKET ACCESS...CONTINUED

encouraged lengthen the initial fixed rate period (for example, to 7 years).

- The FMP program allows only one first mortgage and one SBA second mortgage on the subject property. Transactions that involved more than one SBA second are not allowed. Transactions where the third party loan is subordinate to the SBA are also not eligible.

### Secondary Market Access

Secondary Market Access (SMA) is a network of CDC's and financial companies whose main goal is to provide secondary market solutions for 504 first mortgage lenders.

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

### Our Role

SMA has a solution for every lender need related to the new program, including:

- Sale of the 85% participation interest for premium and servicing income.
- Sale of the 80% participation interest for those banks who desire to be the Seller and the Pool Originator.
- Sale of the whole loan in situations where the lender is unable to retain any long term portion.

### Who we Are

GLS is a leading consulting, outsourcing and financial asset valuation company to the small business lending community. GLS is a nationwide leader in the valuation of small business loans, servicing rights and securities. For more information about our services, please contact us at (216) 456-2480, or at [info@glssolutions.us](mailto:info@glssolutions.us).

**Note:** Please take the time to look at our new pricing matrix inside this report. Questions and comments are encouraged relating to pricing and the overall program details.



## 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).**

## SECONDARY MARKET ACCESS



**www.SMASO4.COM**

**“The source for accessing the SBA 504 Secondary Market Pooling Program.”**

**Providing expertise in all areas of the new SBA 504 First Lien Pool Guaranty program, including:**

- **Pricing bids for existing loans**
- **Pricing strategies for new loans**
- **Accepting loan tapes for bid on 85% of eligible loans**
- **Whole loan sale option**
- **Assistance with becoming a Pool Originator**

**If you are 504 lender and wish to discuss how we can help you access the 504 secondary market, please contact:**

- **Rob Herrick, GLS, at (216) 456-2480 ext. 144 or via e-mail at [rob.herrick@glssolutions.us](mailto:rob.herrick@glssolutions.us)**



## SECONDARY MARKET ACCESS

504 FMLP Rate Guidance - 85% Loan Interest Sale

**Applies To New Loans Only. Existing Loans Custom Quoted**

NEW LOANS ONLY	90 Day Adjustable (LIBOR)			Quarterly Adjustable (Prime)			3 Yr Fixed			
	PAR RATE = 3 Mo LIBOR + spread calculated below			PAR RATE = WSJ Prime + spread calculated below			PAR RATE = 3-yr Swap + Spread Resets: Q at 3-Mo. Libor + Spread			
Credit	Multi	Hosp	Other SP	Multi	Hosp	Other SP	Multi	Hosp	Other SP	
Base	+ 2.950%	+ 3.050%	+ 3.700%	+ 0.450%	+ 0.600%	+ 1.050%	+ 3.400%	+ 3.600%	+ 4.200%	
LTV > 55%	+ 0.375%	+ 0.375%	+ 0.800%	+ 0.375%	+ 0.375%	+ 0.800%	+ 0.375%	+ 0.375%	+ 0.800%	
DCR < 1.2	+ 0.375%	+ 0.375%	+ 0.375%	+ 0.375%	+ 0.375%	+ 0.375%	+ 0.375%	+ 0.375%	+ 0.375%	
DCR < 1.0	+ 0.625%	+ 0.625%	+ 0.625%	+ 0.625%	+ 0.625%	+ 0.625%	+ 0.625%	+ 0.625%	+ 0.625%	
FICO < 680	+ 0.125%	+ 0.125%	+ 0.125%	+ 0.125%	+ 0.125%	+ 0.125%	+ 0.125%	+ 0.125%	+ 0.125%	
Biz < 1 Yr	+ 0.250%	+ 0.500%	+ 0.750%	+ 0.250%	+ 0.500%	+ 0.750%	+ 0.250%	+ 0.500%	+ 0.750%	
Rate Floor	4.000%	4.125%	4.750%	4.250%	4.375%	4.750%	5.500%	5.750%	6.250%	
Reset Mgn	n/a	n/a	n/a	n/a	n/a	n/a	initial	initial	initial	
NEW LOANS ONLY	5 Year Fixed			10 Year Fixed			Fixed for Life			
	PAR RATE = 5-yr Swap + Spread			PAR RATE = 10-yr Swap + Spread			PAR RATE = 10-yr Swap + spread calculated below			
	Resets: Q at 3-Mo. Libor + Spread			Resets: Q at 3-Mo. Libor + Spread						
Credit	Multi	Hosp	Other SP	Multi	Hosp	Other SP	Multi	Hosp	Other SP	
Base	+ 3.400%	+ 3.600%	+ 4.200%	+ 3.550%	+ 3.700%	+ 4.250%	+ 3.450%	+ 3.600%	+ 4.200%	
LTV > 55%	+ 0.375%	+ 0.375%	+ 0.800%	+ 0.375%	+ 0.375%	+ 0.800%	+ 0.375%	+ 0.375%	+ 0.800%	
DCR < 1.2	+ 0.375%	+ 0.375%	+ 0.375%	+ 0.375%	+ 0.375%	+ 0.375%	+ 0.125%	+ 0.125%	+ 0.125%	
DCR < 1.0	+ 0.625%	+ 0.625%	+ 0.625%	+ 0.625%	+ 0.625%	+ 0.625%	+ 7.625%	+ 7.750%	+ 8.375%	
FICO < 680	+ 0.125%	+ 0.125%	+ 0.125%	+ 0.125%	+ 0.125%	+ 0.125%	+ 3.800%	+ 4.950%	+ 5.200%	
Biz < 1 Yr	+ 0.250%	+ 0.500%	+ 0.750%	+ 0.250%	+ 0.500%	+ 0.750%	+ 0.000%	+ 0.000%	+ 0.000%	
Rate Floor	+ 6.375%	+ 6.625%	+ 7.125%	+ 7.250%	+ 7.500%	+ 8.000%	+ 7.625%	+ 7.750%	+ 8.375%	
Reset Mgn	initial	initial	initial	initial	initial	initial	n/a	n/a	n/a	
Maximum Loan Balance (\$MM)			Rate Floors			Loan Exclusions				
Credit	Multi	Hosp	Other SP							
LTV > 55%	\$8 MM	\$6 MM	\$5 MM				An LTV in excess of 70%, Guarantor average FICOs less than 650 and a history of delinquency in the last 12 months are excluded from bids.			
DCR < 1.2	\$0 MM	\$0 MM	\$0 MM							
DCR < 1.0	\$0 MM	\$0 MM	\$0 MM							
FICO < 680	\$0 MM	\$0 MM	\$0 MM							
Biz < 1 Yr	-\$1 MM	-\$1 MM	-\$1 MM							
Biz < 1 Yr	\$0 MM	\$0 MM	\$0 MM							

		<b>SECONDARY MARKET ACCESS</b> <b>504 FMLP Rate Guidance - 85% Loan Interest Sale</b> <b>Applies To New Loans Only. Existing Loans Custom Quoted</b>
<b>Each +0.25% added to Note Rate provides 1.00% in YSP. Max 6% premium.</b>		<b>Other Pricing Notes</b>
<b>Prepay Penalty Premium Calc</b>		<b>Interest Rate Accrual:</b> Pricing assumes 365/360 interest rate accrual. Premium will be adjusted downward if 365/360 accrual is not obtained.
<b>Adjustable</b>		<b>Servicing:</b> All pricing options included at least .50% servicing income to the Seller as mandated by SBA. This amount is paid on the entire 85% loan interest sold.
No Prepay Penalty      -1.00% 5,4,3,2,1      + 0.00% 5,5,5,5,5      + 1.00% 7,6,5,4,3,2,1      + 1.50% 10,9,8,7,6,5,4,3,2,1      + 2.00%		<b>Excess Servicing:</b> For those loans priced above the maximum premium payout, the excess interest rate will be passed through as 'Excess Servicing' on the entire 85% of the loan amount sold to the Pool Originator. For example, if the premium cap is based on a rate of 7% but the note rate is 7.50%, the servicing income would equal 1.00% on the entire 85% loan interest. Please confer with accounting experts on the sales treatment for loans sold with servicing above the .50% minimum.
<b>5-yr Fixed</b>		<b>Additional Pricing Factors:</b> SMA and its partners reserve the right to adjust pricing based on other factors, including management experience and industry type.
No Prepay Penalty      -1.00% 5,4,3,2,1      + 0.00% 5,5,5,5,5      + 1.00% 7,6,5,4,3,2,1      + 1.50% 10,9,8,7,6,5,4,3,2,1      + 2.00%		<b>Rate Reset:</b> Fixed rate pricing guidance assumes loan will convert to a 90-day adjustable based on 90 day LIBOR + the original spread. A fixed rate reset is possible but will negatively affect the premium.
<b>7-yr Fixed</b>		<b>New Loans Only:</b> This Rate Guidance Sheet is for the purposes of structuring new loans only and does not apply to existing loans or existing loan pools. Sellers wishing to sell existing loans should contact Government Loan Solutions (GLS) at 216-456-2480 or info@glssolutions.us for loan tape submission and indicative pricing.
No Prepay Penalty      -1.50% 5,4,3,2,1      + 0.00% 5,5,5,5,5      + 1.00% 7,6,5,4,3,2,1      + 1.50% 10,9,8,7,6,5,4,3,2,1      + 2.00%		<b>Self Pool Originators:</b> This rate sheet is for Sellers wishing to sell 85% loan interests individual loans to Pool Originator buyers. Sellers wishing to become Self Pool Originators should contact Government Loan Solutions (GLS) for additional information.
<b>10-yr Fixed</b>		<b>Other Pricing Options:</b> This Rate Guidance Sheet is intended to maximize value for the Seller. Any rate, prepayment penalty, interest rate accrual or other pricing factor can be considered but must be priced individually. Please contact GLS for a custom loan quote.
<b>Up to 20% of principal paid per year without penalty is subject to a .50% reduction in premium.</b>		<b>Disclosures</b>
<b>Rate Guidance:</b> Rate guidance is being provided by Secondary Market Access as a benefit to 504 first mortgage lenders wishing to sell 85% loan interests to Pool Originator buyers. SMA provides this Rate Guidance Sheet after consulting various Pool Originator buyers who wish to disclose this information. It is not intended to be a premium quote for any specific Pool Originator buyer. Neither SMA nor GLS is a Pool Originator buyer and cannot offer a formal bid. This rate guidance is subject to current understanding of the program and could change subject to further clarification by SBA or Pool Originator buyers.		
<b>FAS 166:</b> Neither SMA nor GLS offers an opinion as to sales treatment accounting in a situation of excess servicing. Please contact your CPA for guidance.		



## THE LEGAL BEAT

### BEST PRACTICES: AVOIDING REPAIRS THROUGH PROPER SERVICING

By Ethan W. Smith

The burden of compliance with the myriad SBA regulations, statutes and standard operating procedures can sometimes seem daunting to SBA lenders. Often lenders focus their SBA compliance efforts on underwriting and closing related issues – indeed many SBA lenders have devoted a great deal of time and resources to setting up entire SBA departments to originate, underwrite and close their SBA loans. But what happens after the closing? Many of these same lenders will then transfer their SBA loans to their servicing departments to be serviced with the rest of their commercial loan portfolio. While the SBA loans may have been properly originated, underwritten and closed, the servicing department's unfamiliarity with the nuances of SBA servicing requirements can lead to costly guaranty repairs, or in some instances, denials.

Many of the top reasons for servicing-related repairs are not specific to SBA, and rather reflect a general weakness in a lender's servicing policies and procedures. Issues such as failing to renew a UCC lien on business personal property pursuant to the requirements of Article 9 of the Uniform Commercial Code (financing statements must be continued within 6 months of their lapse), or failing to ensure that business liability and hazard insurance remain in full force and effect, are not unique to the SBA world. Yet, these issues are often the basis for recommendations for repairs or denials.

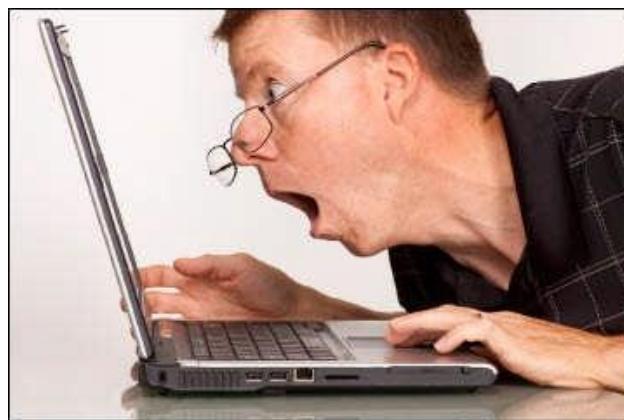
Other, more SBA-specific servicing related issues that frequently result in repairs include:

- Lender's release or subordination of its lien on collateral without a sufficiently documented business justification;
- Lender's release of a guarantor without SBA approval
- Lender's failure to monitor, and if needed, to maintain life insurance on a key individual that subsequently dies
- Lender's servicing actions that create a preference for its non-SBA guaranteed loan(s) to a borrower, which act to the detriment of its SBA guaranteed loans to the same borrower (i.e.: preferred collateral positions on non-SBA loans, preferred application of payments to conventional financing over SBA financing, etc.).

One way for lender's to minimize their risk of repairs and denials from servicing related actions is to make sure their servicing departments have copies of, and are familiar with, the SBA 7(a) Servicing and Liquidation Action Matrix (the "Matrix") which can be found here. The Matrix is designed to address the most common servicing and liquidation related issues and to provide

instruction and guidance to lenders as to what notice to, or approval from, SBA, if any, is required for a particular action. The most important issue to remember in using the Matrix is that even when a servicing action is delegated to the lender and does not require notice to the SBA, this does not mean that the lender can do whatever it wants with regard to the contemplated action. The lender must still follow prudent lending standards and must document and justify each material servicing action it takes. Failure to do so will expose the lender's actions to scrutiny by the SBA and can lead to costly repairs.

Preserve and protect your SBA guaranty through all phases of your SBA loan and remember that a lender's obligation to comply with SBA regulations does not end at the closing table. For more information on SBA-related servicing issues, contact Ethan at 215-542-7070, or [esmith@starfieldsmith.com](mailto:esmith@starfieldsmith.com).



### MY SBA GUARANTY WAS DENIED!?

Don't let a repair or denial  
of your SBA guaranty take  
you by surprise.  
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## GLS 7(a) Sale & Settlement Tip of the Month: The New 1086

Out with the old, in with new...

Effective January 28, 2011, the SBA has officially launched a revised 1086 agreement. This is the first significant revision in quite some time and has some rather significant implications for both sellers and buyers of SBA 7(a) loans. The purpose of this article is to provide some clarity on what changes have occurred and what they mean for the secondary market for SBA 7(a) loans. Effective February 14th, 2011, all secondary market 7(a) loan sales will use the new form to effectuate settlement. Colson will no longer accept prior versions as good delivery.

The 1086 Form, also known as the Secondary Participation Guaranty Agreement is the document used to effectuate and document transfers of the guaranteed portions of SBA 7(a) loans in the secondary market. The document delineates terms of transfer including warranties and responsibilities of the participating parties.

The latest revision brings some meaningful changes to market participants, most notably, the elimination of the warranty period for loans sold at a premium. The warranty provided some protection to buyers by requiring lenders to return any premium they received in the sale should the sold loan payoff early. While not typically needed by dealers on most sales, the warranty created problems for lenders upon the adoption of FAS 166. The new FASB directive required lenders, amongst other things, to defer the recognition of any gain on sale until the expiration of the warranty period. Not only did this defer gains, it also served to increase the lenders required capital as loan sales did not satisfy the definition of true sale until such time as there was no longer a contingency such as the warranty. The elimination of

the warranty now allows loan sellers to immediately recognize gains on 7(a) loan sales provided the lender retain no more than 1% servicing so that the sale meets the FAS166 definition of a participation.

On the buy side, the elimination of the warranty removes some of the buyer's protection against the loss of premium should a loan payoff early. As a result, buyers have begun reducing bid levels as they price in this added risk. The impact is much more pronounced on larger transactions and older deals. One could certainly argue that some payment history (aging) is actually favorable in this new environment but currently, the street has not factored that into pricing. It remains to be seen where prices ultimately settle in, but it is fairly safe to say that it is we are likely to see some stratification of the market based upon perceived credit quality of the loans being sold.

The SBA, realizing that immediate implementation would be difficult, provided the marketplace with a two week window in which to settle pending sales. Any sale not settled at the end would need to be looked at by Colson and the SBA for an exception on a case by case basis. By the time of the release of this report, it is unlikely that any further exceptions/extensions will be granted by Colson and the SBA, and any pending sales done on the old documents will need to be rebid and submitted on the new forms.

Please note that the new forms should show an expiration date of 12/31/2013 at the top of page one and (2/2011) at the bottom of each page. The revised form can be found on the Colson Services Corp. website at:  
[http://www.colsonservicescorp.com/main/f\\_n\\_r\\_main.shtml](http://www.colsonservicescorp.com/main/f_n_r_main.shtml)



## Looking For Warehouse Funding For Your Inventory Of SBA Loans & Pools?

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### Contact:

# MARK A. ELSTE, CFA

414.359.1446 [melste@pennantmanagement.com](mailto:melste@pennantmanagement.com)



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## GLS VALUE INDICES FALL IN DECEMBER

As 2010 came to an end, the value indices were flat to slightly down in most categories. While four sectors moved by less than 1%, two showed significant decreases in December.

The Base Rate / Libor spread decreased by 2 basis point, again having little impact on the indices. The prepayment speed element displayed increases in 5 out of the 6 buckets, creating a slight bias toward lower returns and index results.

As we begin 2011, the removal of the 90-day warranty is causing secondary market

pricing to decrease. The decrease varies according to loan size and age, with the minimum decrease being in the 1/4 point range for low-balance, newly originated loans. The April report will likely show increasing indices due to this market phenomena.

Turning to the specifics, the largest decrease was seen in the GLS VI-4, which fell by 15% to 173 basis points. The other decreases, by order of magnitude, were: VI-6 (-9% to 177), VI-3 (-1% to 113) and VI-1 (-1% to 70). Both VI-5 (224) and VI-2 (117) were unchanged in December.

With the impact from the warranty removal yet to be reflected in the indices, expect increases in the April report.

*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 14-15, Graph on page 16*

### 7(a) Secondary Market Pricing Grid: December 2010

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%	110.75	111.125	111.25	110.55	109.00
15 yrs.	2.75%	1.075%	1.00%	111.50	111.625	112.25	110.875	109.125
20 yrs.	2.75%	1.075%	1.00%	113.25	113.125	113.25	112.125	109.375
25 yrs.	2.75%	1.075%	1.00%	114.00	113.875	114.125	112.50	109.75



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## DEFAULT RATE FALLS AGAIN

As we begin 2011, the default rate continued its return to normalized, or non-recessionary, levels falling 19% to 3.09%. As we can see in the chart to the right, defaults have fallen precipitously since last July when it went above 8% for the second, and hopefully last, time.

In the past six months, the default rate has fallen by an impressive 63%.

Based on preliminary data from Colson, we believe that defaults could fall below 3% in February, yet more evidence of economic growth in the small business sector.

At this time last year, defaults were in the 5% range and rising, even though we were theoretically out of recession.

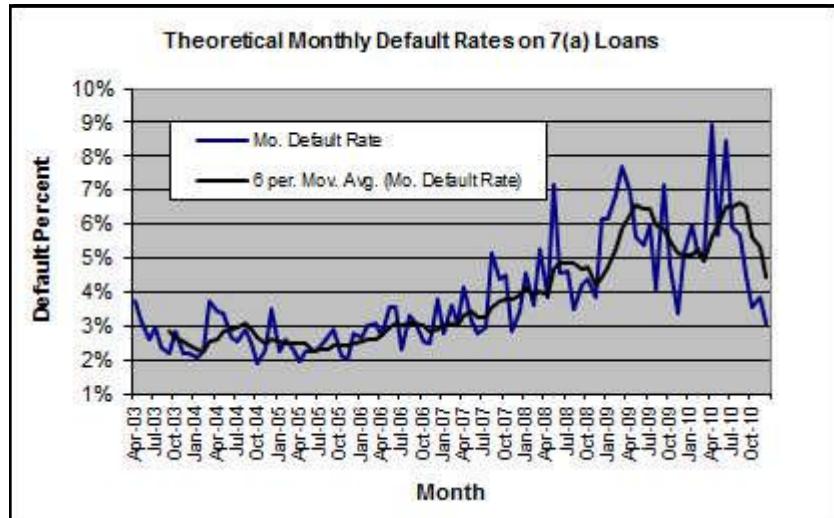
What has changed?

It would seem that the economic recovery has finally reached the small business sector.

US consumers are spending and unemployment, while not getting progressively better, is not getting worse.

Generally speaking, small business owners have learned to survive in a low growth US economy.

They keep expenses low, employment minimized and find creative ways to finance their businesses.



The evidence would suggest that they have exited "Survival Mode" and begun to go on offense, albeit very carefully.

## DEFAULT-CURTAILMENT RATIOS

In our Default-Curtailment Ratios (DCR) we witnessed a decrease in both the 7a and 504 measures 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

The 7(a) DCR registered the first sub-50% reading since December 2008, coming in at 48.77%, a decrease of 13% from the previous reading of 55.83%.

A slight rise in defaults, combined with a greater rise in the voluntary prepayment component, led to another decrease in the 7a DCR.

Turning to actual dollar amounts, defaults rose by 7% to \$90 million from \$84 million. As for voluntary prepayments, they rose by 42% to \$95 million versus \$67 million in the previous month.

### SBA 504 Default Ratios

For the 504 DCR, both voluntary prepayments and defaults rose, with voluntaries increasing by a greater percentage, decreasing the ratio.

Specifically, the dollar amount of defaults rose by \$19 million to \$130 million (+17%). As for voluntary prepayments, they increased by \$23 million to \$65 million (+55%).

### Summary

While the dollar amount of defaults rose, we saw significant increases in voluntary prepayments, which had the effect of decreasing the Default Ratios for both the 7a and 504 programs.

While it's never welcome to see the dollar amount of defaults rise, the amount of outstanding 7a loans is increasing due to new production and low overall prepayments over the past two years.

So, on a percentage basis, defaults continue to decrease while voluntary prepayments return to healthier levels.

*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 21*

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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
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%
Nov-09	12.16%	10.89%	11.05%	6.96%	7.13%	6.32%
Dec-09	11.38%	11.20%	10.59%	7.09%	7.80%	5.75%
Jan-10	11.20%	10.69%	10.34%	6.99%	8.00%	5.75%
Feb-10	10.06%	9.97%	10.05%	7.33%	8.84%	5.71%
Mar-10	9.92%	10.73%	10.11%	7.12%	8.75%	5.75%
Apr-10	9.97%	10.45%	9.73%	7.34%	8.12%	5.32%
May-10	10.58%	11.09%	10.29%	7.88%	8.53%	5.86%
Jun-10	10.95%	11.18%	10.42%	7.83%	8.53%	6.38%
Jul-10	10.33%	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	10.89%	8.48%	8.45%	7.30%	5.61%	7.11%
Dec-10	11.35%	8.77%	9.04%	7.01%	6.67%	7.45%

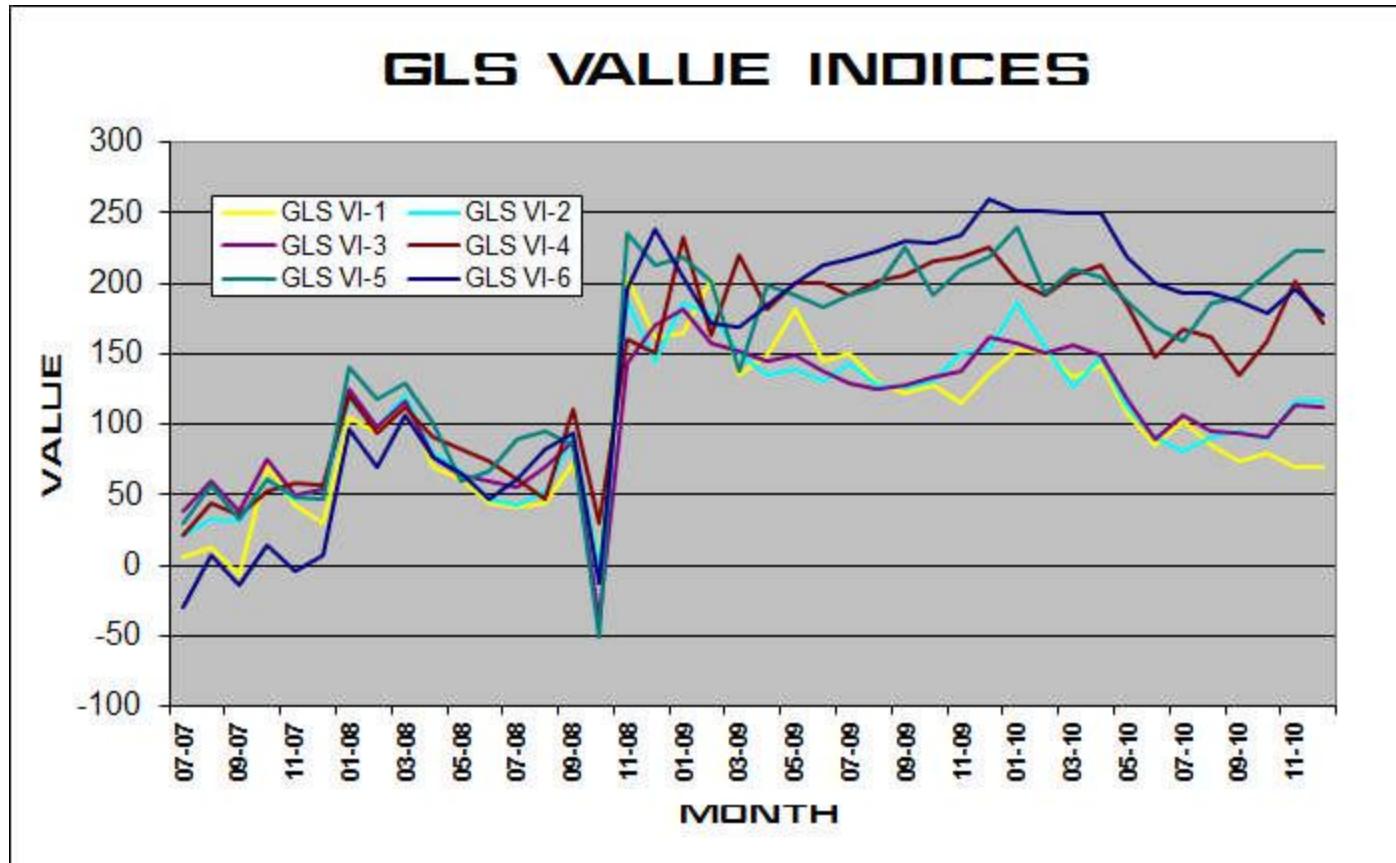
Rolling six-month CPR speeds for all maturity buckets. Source: Colson Services

# 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
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	
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%	70.0	117.2	112.7	172.6	223.5	177.2	

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-11</b>	14.30%	9.08%	6.94%	6.85%	3.82%	5.26%	<b>6.13%</b>
<b>Grand Total</b>	14.30%	9.08%	6.94%	6.85%	3.82%	5.26%	<b>6.13%</b>

2011 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-11</b>	22 Mos.	31 Mos.	32 Mos.	67 Mos.	49 Mos.	50 Mos.	<b>45 Mos.</b>

2011 pool age broken out by maturity sector. Source: Colson Services

## YEAR-TO-DATE CPR DATA

Table 5:

<b>&lt; 8 BY AGE</b>	<b>0-12 Mos.</b>	<b>13-24 Mos.</b>	<b>25-36 Mos.</b>	<b>37-48 Mos.</b>	<b>48+ Mos.</b>
<b>Jan-11</b>	8.14%	24.87%	18.55%	10.61%	14.45%
<b>Grand Total</b>	<b>8.14%</b>	<b>24.87%</b>	<b>18.55%</b>	<b>10.61%</b>	<b>14.45%</b>

<b>10-13 BY AGE</b>	<b>0-12 Mos.</b>	<b>13-24 Mos.</b>	<b>25-36 Mos.</b>	<b>37-48 Mos.</b>	<b>48+ Mos.</b>
<b>Jan-11</b>	4.90%	6.31%	12.35%	6.54%	5.14%
<b>Grand Total</b>	<b>4.90%</b>	<b>6.31%</b>	<b>12.35%</b>	<b>6.54%</b>	<b>5.14%</b>

<b>16-20 BY AGE</b>	<b>0-12 Mos.</b>	<b>13-24 Mos.</b>	<b>25-36 Mos.</b>	<b>37-48 Mos.</b>	<b>48+ Mos.</b>
<b>Jan-11</b>	0.00%	7.24%	8.01%	2.83%	2.85%
<b>Grand Total</b>	<b>0.00%</b>	<b>7.24%</b>	<b>8.01%</b>	<b>2.83%</b>	<b>2.85%</b>

<b>8-10 BY AGE</b>	<b>0-12 Mos.</b>	<b>13-24 Mos.</b>	<b>25-36 Mos.</b>	<b>37-48 Mos.</b>	<b>48+ Mos.</b>
<b>Jan-11</b>	2.09%	10.85%	12.52%	4.62%	11.81%
<b>Grand Total</b>	<b>2.09%</b>	<b>10.85%</b>	<b>12.52%</b>	<b>4.62%</b>	<b>11.81%</b>

<b>13-16 BY AGE</b>	<b>0-12 Mos.</b>	<b>13-24 Mos.</b>	<b>25-36 Mos.</b>	<b>37-48 Mos.</b>	<b>48+ Mos.</b>
<b>Jan-11</b>	0.00%	30.56%	5.65%	0.00%	5.93%
<b>Grand Total</b>	<b>0.00%</b>	<b>30.56%</b>	<b>5.65%</b>	<b>0.00%</b>	<b>5.93%</b>

<b>20+ BY AGE</b>	<b>0-12 Mos.</b>	<b>13-24 Mos.</b>	<b>25-36 Mos.</b>	<b>37-48 Mos.</b>	<b>48+ Mos.</b>
<b>Jan-11</b>	2.78%	5.44%	6.82%	9.07%	4.80%
<b>Grand Total</b>	<b>2.78%</b>	<b>5.44%</b>	<b>6.82%</b>	<b>9.07%</b>	<b>4.80%</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:

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

---

### 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.

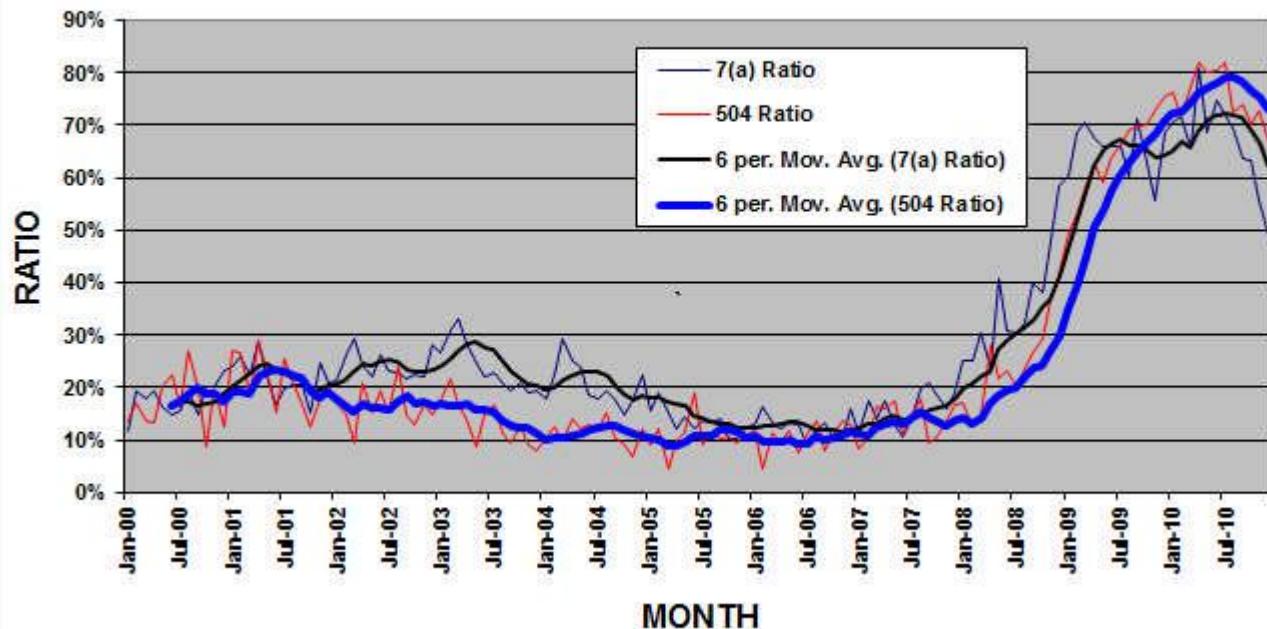
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### Secondary Market First Lien Position 504 Loan Pool Guarantee Program

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, and prior to February 16, 2011. The total guarantee allocation is \$3 Billion. HR 5297 provides for a two-year extension from the first pooling month.

**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 .167%.

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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 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."*

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