

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.

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- Prepayments Fall Back
- SMA Update: Biz Strategies
- Default Rate Falls
- Value Indices Mostly Higher

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## PREPAYMENT SPEEDS MOVE BELOW 5%

By any measure, June was a stellar month for 7a prepayments, as CPRs fell below 5% for the first time on record. The previous low of 5.46% was set in November, 2010.

Even with weak economic conditions in the US, defaults led the way to lower prepay, coming in

at a 4 1/2 year low. As has been the case for the better part of the past two years, voluntary prepayments remained below 3%.

Now that I have gotten your attention, let's move to the numbers. Last month, overall speeds came in at 4.58%, a 27% decrease from May's

reading of 6.22%. As an aside, June represents the 9th month in a row of sub-7% prepay speeds.

Quite frankly, we find the low default CPR for June surprising considering the near-recessionary conditions that have existed in the US for the first six months of 2011.

*Continued on page 2*

## SMA UPDATE: POOL ORIGINATOR BUSINESS STRATEGIES

By Jordan Blanchard

\$3,601,695. The smallest was \$573,670.

#### Volume

Five pools closed in July for a total of \$9,096,696 (80% guaranteed interest). There were a total of 14 loans pooled during the month. The Bank of Las Vegas (headquartered in Las Vegas, New Mexico) issued three of the five pools – which now ties them for second as the most active pool originator. The largest pool was

Total FMP volume through July, 2011, stands at \$145,595,529. There have been 24 pools issued to date with an average guaranteed interest of just over \$6,000,000. The total number of loans pooled stands at 114 with a gross loan average of \$1,596,442.

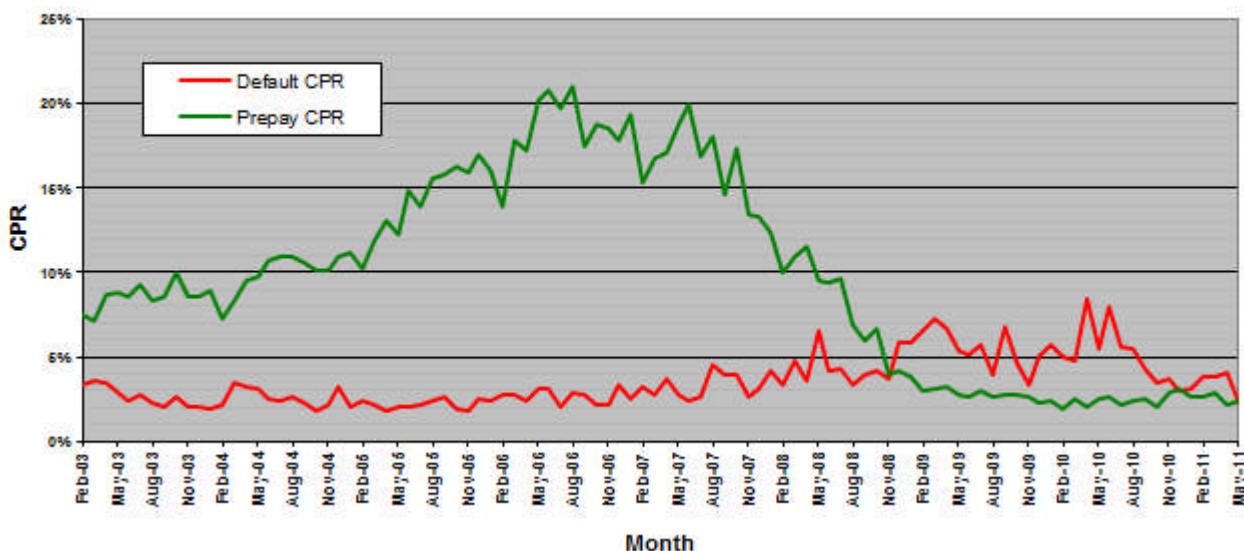
The average pool size is declining, but the average loan size is

increasing. This is reflective of banks and non-bank lenders discovering the benefits of using the FMP program to fund loans that have historically been more difficult to approve simply because of their size. This is especially beneficial for those small businesses that would have been denied financing if not for the FMP program.

*Continued on page 5*

## PREPAYMENT SPEEDS...CONTINUED

Monthly Pool CPR Due to Defaults and Prepayments



Perhaps the sub-1% growth for the first half of 2011 will catch up with the small business sector during the second half of the year, but today things are looking good.

Turning to specifics, defaults fell by an astounding 46% to 2.22%, the lowest reading since November, 2006.

As for voluntary prepayments, they rose by 11% to 2.35% from 2.13%, remaining below 3% for yet another month.

As for next month, preliminary data from Colson suggests a slight increase in overall prepayments, but they shouldn't exceed 6%. As for how the breakdown between defaults

and voluntary prepayments, we expect slightly higher readings for both.

The YOY comparison to 2010 continues to show 2011 significantly below last year, with YTD prepayment speeds in 2011 at 5.96% versus 2010 at 7.99%.

Turning to the default/voluntary prepayment breakdown, the **Voluntary Prepay CPR** (green line) rose to 2.35% from 2.13%, remaining in a stable trend between 2% and 3% for yet another month.

While the VCPR remained below 3%, the **Default CPR** (red line) fell below the VCPR, reaching 2.22% from 4.09%. In

May.

Last month, prepayment speeds fell in four out of the six maturity categories. Decreases were seen, by order of magnitude, in the 20+ sector (-36% to CPR 3.82%), 8-10 (-31% to CPR 8.08%), 16-20 (-12% to CPR 5.60%) and 10-13 (-12% to CPR 4.95%).

Increases were seen, also by order of magnitude, in 13-16 (+5% to CPR 4.33%) and <8 (+.50% to CPR 9.57%).

*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.*

***“Perhaps the sub-1% growth for the first half of 2011 will catch up with the small business sector during the second half of the year, but today things are looking good.”***

*Data on pages 20-22*

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# Don't Miss the 4th Annual 2011 SBA Secondary Market Forum



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## SECONDARY MARKET ACCESS...CONTINUED

### Two Kinds Of Pool Originators

There are approximately 30 approved pool originators, 90% of which are banks. The vast majority of these banks became pool originators in order to sell loans produced in-house. In other words, their business model is similar to funding SBA 7A loans: fund two or more loans; go through the pooling process; and then sell 80% of the loan pool in the secondary market for premium and servicing income. A pool originator selling their own loans is required to maintain the 15% of each loan as the seller and 5% as the pool originator.

The other type of pool originator is primarily interested in pooling third party loans – loans funded by a third party bank or non-bank lender and then sold through a pool originator. In this structure, the selling lender maintains 15% of the loan, and the pool originator funds 5%. The pool originator is required to keep the 5% for the life of the loan. There are 3 or 4 pool originators (of the 30) whose primary focus is to settle third party loans. This may seem like a small number, but it is equal to the number of whole loan buyers (Morgan Stanley, Zions Bank, and Horizon West Partners), and the number of pool originators focusing on third party loans is expected to grow over time.

### A Different Kind Of Pool Originator

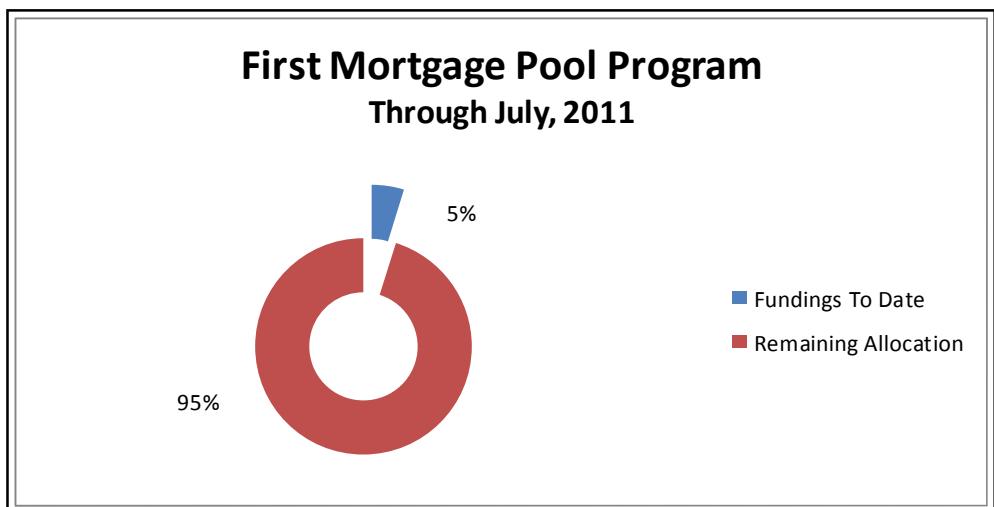
Bank of America/Merrill Lynch (BAML) is the most active third party pool originator in terms of pools formed, loans settled, and dollar volume settled. BAML helped pioneer the FMP program by working closely with SBA to form and issue the first pool. They continue to work closely with SBA to refine and enhance the FMP program in order to make it more user friendly for all.

There are three things that sets BAML apart from any other pool originator:

#### 1. *Issuance of a rate guidance sheet*

The FMP secondary market is complicated. Unlike the 7A program, there are an infinite number of pricing parameters that can be considered including amortization, term, index, prepayment penalty, starting rate, adjustment rate, etc. BAML has attempted to standardize the market by issuing a finite set of parameters to follow. If sellers follow this rate guidance sheet, they can obtain a very reliable premium estimate.

The FMP secondary market is also fluid. Premiums can change



from one month to the next, especially for fixed rate loans that are subject to investor's opinions of how quickly interest rates will rise or fall. BAML is large enough to absorb some market movement and maintain semi-stable premium estimates.

The rate guidance sheet should not be looked as absolute, and all price quotations are subject to formal approval of the loan and a loan specific bid, but the rate guidance sheet is invaluable to lenders looking for guidance when negotiating with their borrower.

#### 2. *Premium lock*

BAML is willing to lock in the seller's premium for 90 days from the closing of the first mortgage loan. This window provides a sufficient amount of time for the Debenture to fund – at which point BAML will purchase or settle the 85% portion.

Many sellers have not considered the necessity of a premium lock because fixed rates have remained stable, and because interest rate movement risk is not an issue for SBA 7A loans or USDA B&I loans. The reason is interest rate movement is an issue in the FMP program is because of the SBA requirement that the Debenture must be funded prior to pooling of the first mortgage. During this 60 to 90 day time frame, interest rates can rise (sometimes significantly) which causes a corresponding decrease in premiums. BAML's premium lock will become extremely popular once fixed rates begin to rise.

#### 3. *Purchase 85% prior to pooling*

BAML is the only pool originator willing to purchase 85% prior to pooling. Other pool originators decline to purchase prior to pooling because they then have 85% of the risk of each loan rather than just 5%.

*Continued on next page*

## SECONDARY MARKET ACCESS...CONTINUED

Why would a lender be interested in this feature? Liquidity and interest rate protection. As mentioned above, BAML is willing to offer a premium lock for 90 days, but actually selling 85% of the loan provides even further and longer protection.

BAML's purchase agreement includes a put-back provision in case the loan cannot be pooled. What would cause a loan not be pooled on time? One 30 day late payment during the hold period. This put-back provision means that a lender cannot obtain "true-sale" treatment until the loan is pooled. For this reason, the majority of sellers have elected to hold their loans until pool settlement rather than sell 85% of the loan to BAML at debenture funding. But the sellers may be missing the point – pre-selling 85% of the loan is not to consummate the sale, but to offload the interest rate risk and replenish liquidity for those sellers that may need it.

*Sellers wishing to learn more about selling to BAML are encouraged to contact Jordan Blanchard ([jblanchard@cdcloans.com](mailto:jblanchard@cdcloans.com)) or Ken Rosenthal ([krosenthal@cdcloans.com](mailto:krosenthal@cdcloans.com)).*

### FMP Tips...

- Some lenders are structuring first mortgage notes to charge one rate prior to pooling and then converting to a different rate at pooling. This is completely acceptable to SBA and Colson; however, please note that the permanent terms must be set no later than one week prior to pool settlement so that Colson can update their system.
- Lenders are encouraged to use the same index throughout the life of the loan. Loans have been submitted to Colson with the rate prior to pooling based on Prime and the rate after pooling based on LIBOR or some other index. While this is technically acceptable, it does cause confusion and delays processing of loan pools.

- Ask your CDC for concurrent signing of the SBA second mortgage loan documents at the closing of the first mortgage. This will condense the time frame of SBA funding to approximately 60 days rather than the typical 90 to 120 days. The first mortgage cannot be sold or settled until the Debenture is funded, so this is one easy way to speed up the process.

### 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@glsolutions.us](mailto:info@glsolutions.us).

## 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@glsolutions.us](mailto:bob.judge@glsolutions.us).**

## SECONDARY MARKET ACCESS



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- **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**

		<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%	<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.
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>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>7-yr Fixed</b>		<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.
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>10-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 <a href="mailto:info@glssolutions.us">info@glssolutions.us</a> for loan tape submission and indicative pricing.
No Prepay Penalty	++ 2.00%	
5,4,3,2,1	++ 1.00%	
5,5,5,5,5	+ 0.00%	
7,6,5,4,3,2,1	+ 1.00%	
10,9,8,7,6,5,4,3,2,1	+ 2.00%	
<b>Up to 20% of principal paid per year without penalty is subject to a .50% reduction in premium.</b>		<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>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>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.		



## 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%

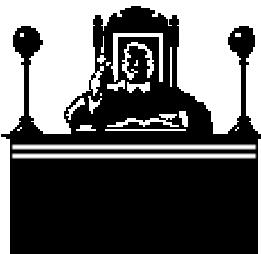
- The premium cannot exceed the first year's prepayment penalty %.
- A 365/360 rate accrual basis is required. The premium will be reduced by .50% if another basis is used.
- Only banks, thrifts and other regulated lenders are eligible to earn loan premiums.

#### FOR MORE INFORMATION CONTACT:

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## THE LEGAL BEAT

### REQUIRING CALIFORNIA LIMITED PARTNERSHIPS AND REVOCABLE TRUSTS TO GUARANTY SBA LOANS

By Chris Evans, Esq.

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 dAs many lenders who participate in the SBA's 7(a) loan program are aware, each holder of at least 20% of the borrower, operating company, or eligible passive company must guarantee an SBA loan. If either the borrower, eligible passive company, or operating company is a trust or limited partnership, in many cases the lender will be required by SBA regulations to have the trustor (or settlor) or general partner guarantee the loan and execute SBA's Form 148 Unlimited Guarantee. In the context of an SBA loan for which California real estate is pledged as collateral, the enforceability of the guarantee of a trustee of a California revocable trust or the general partner of a California limited partnership may present complex questions involving a complicated intersection of California law and SBA regulations.

California law is notoriously complex in the context of pursuing remedies against borrowers or guarantors when California real property is taken as collateral, especially if a lender elects to pursue a nonjudicial foreclosure. Section 726 of the California Code of Civil Procedure (the "One Action Rule"), Sections 580 (a), 580(b), and 580(d) of the California Code of Civil Procedure (which contain California's anti-deficiency laws), contain provisions related to the enforcement of obligations secured by real property, including provisions that relate to and specify the procedures for the sale of encumbered property, the application of proceeds, and the calculation, availability and procedures for obtaining a deficiency judgment. In many cases, California law provides for statutory waivers by guarantors of the rights and defenses in California Civil Code Sections 2787 to 2855 as well as rights which a guarantor may have because the Loan is secured by real property, including any rights or defenses based upon Section 580(a), 580(b), 580(d), or 726 of the California Code of Civil Procedure. In fact, the 7(a) Loan Authorization Boilerplate includes a form waiver of those rights as a requirement for inclusion in any guarantee where the guarantor is a resident of California.

Unfortunately, these statutory waivers have been found to be unenforceable where the guarantor is considered subject to "unlimited liability" for the underlying debt because of its status as the "alter ego" of another obligor. In such cases, courts have found there to be no "true guarantor" and have considered the guarantee a "sham guarantee". Where the general partner of a limited partnership guarantees a loan either extended to or guaranteed by the limited partnership either the above-referenced waivers or the guaranty itself, or both, may be unenforceable. *Riddle v. Lushing*, 203 Cal.App.2d 831, 832-34 (1962). In addition, California courts have held that where an individual guarantor was also the trustor (or settlor), and beneficiary of a California trust which was also the borrower, the guarantee was found to be unenforceable on the grounds that the rights and defenses referenced above could not be effectively waived as the guarantor was the alter-ego of the borrower. *Torrey Pines Bank v. Hoffman*, 231 Cal.App.3d 308 (1991).

On the other hand, California's One Action Rule, as well California's anti-deficiency and other laws which could limit the enforceability of a guarantee, might be subject to federal preemption in the context of an SBA loan. A series of federal case law opinions, including *U.S. v. Yazell*, 382 US 341 (1966), *U.S. v. Stewart*, 523 F.2d 1070 (1975), *U.S. v. MacKenzie*, 510 F.2d 39 (9th Cir. 1975), *U.S. v. Gish*, 559 F.2d 572 (1977), *United States v. Kimbell Foods*, 440 U.S. 715 (1979), provides little consistent guidance on the question of whether or not a 7(a) lender seeking to pursue remedies against a California guarantor who is the general partner of a limited partnership, or the trustor (or settlor) of a revocable trust, may be prohibited from enforcing the guarantee if the lender has already pursued other remedies. It is worth noting that federal law at 13 CFR 101.106(d) currently states that "[n]o person, corporation, or organization that applies for and receives any benefit or assistance from SBA, or that offers any assurance or security upon which SBA relies for the granting of such benefit or assistance, is entitled to claim or assert any local or state law to defeat the obligation incurred in obtaining or assuring such Federal benefit or assistance." Furthermore, the following language is included in all documents evidencing or securing the obligations under an SBA loan: "When SBA is the holder, the Note and this Guarantee will be construed and enforced under federal law, including SBA regulations. lender or SBA may use state or local procedures for filing papers, recording documents, giving notice, foreclosing liens, and other purposes. By using such procedures, SBA does not waive any federal

## THE LEGAL BEAT... CONTINUED

immunity from state or local control, penalty, tax, or liability. As to this Guarantee, Guarantor may not claim or assert any local or state law against SBA to deny any obligation, defeat any claim of SBA, or preempt federal law." Accordingly, lenders should be mindful of the fact that enforcement of its California guarantees may be subject to challenge in certain circumstances; lenders should always seek the guidance of SBA-experienced counsel when closing, servicing, and liquidating an SBA loan, in addition to engaging experienced local counsel when pursuing any remedies under the terms of the relevant loan documents.

For more information on this and other issues related to SBA rules, policies, and regulations, contact the author at [cevans@starfieldsmith.com](mailto:cevans@starfieldsmith.com) or 215-542-7070.



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# The 4th Annual 2011 SBA Secondary Market Forum

A day long discussion about the current state, trends and future of the secondary market for SBA 7a, 504 and USDA loans. Whether you are a seller, buyer or investor in government guaranteed commercial loans, you owe it to yourself to attend this Forum.

### What you will take away from this event:

- Meet the key players in the industry.
- Hear about pricing, prepayment and structural trends in the secondary market.
- Discuss market strategies with your colleagues, partners and competitors.
- Find out about new opportunities in these markets.

### When:

- Thursday, September 22, 2011. 9 am to 3 pm.
- A reception is scheduled for the prior evening.

### Where:

- The DC offices of Bingham McCutcheon, LLP.  
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11th Floor  
Washington, DC 20006

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## GLS 7(a) Sale & Settlement Tip # 35— Don't be afraid to ask...

I'm not a believer in the "there are no dumb questions" theory, I parent teens, enough said. When it comes to price discovery on SBA loan sales, however, sometimes the best and easiest way to know where the market is trading is to simply ask.

Doing so can not only generate valuable information for the lender but can avoid the reputational risk that can come from soliciting bids to simply determine market conditions. Armed with the knowledge of current market pricing, the lender can evaluate sale economics prior to bid and better evaluate the quality of bids received once loans have been shown to the street.

*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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## GLS VALUE INDICES RISE

In May, the GLS Value Indices came in mostly higher for the fourth month in a row, with five out of six indices rising and one falling.

The Base Rate / Libor spread was 3 basis point higher at +3.01% and the prepayment element decreased in three out of six maturity categories, aiding the overall rise in the indices.

As can be seen from the chart below, the secondary market continues to move higher, whereby a 2.75% margin, long-end loans commands a premium well into the 14% range.

Turning to the specifics, the largest increase was seen in the GLS VI-5, which rose by 22% to 235 basis points. The other increases, by order of magnitude, were: VI-2 (+21% to 116), VI-4 (+18% to 219), VI-1 (+13% to 104) and VI-6 (+1% to 220).

The one decrease was seen in VI-3 (-2% to 134).

With continued strong fundamentals around prepayment speeds and a stable Prime/Libor relationship, the secondary market remains well bid.

After another month of record low prepayments, pricing should remain at, or above, current levels as we head into the second half of 2011.

*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, Graph on page 19*

### 7(a) Secondary Market Pricing Grid: May 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%	111.125	110.97	110.70	111.125	110.50
15 yrs.	2.75%	1.075%	1.00%	111.325	111.25	111.50	111.625	110.75
20 yrs.	2.75%	1.075%	1.00%	113.50	113.375	113.125	113.125	112.00
25 yrs.	2.75%	1.075%	1.00%	114.20	114.125	113.95	113.875	112.25



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## DEFAULT RATE FALLS SIGNIFICANTLY

After four months of increases, the default rate fell to a level not seen since 2006. All told, it decreased by 46% to 2.28% from 4.23% in May.

As the chart to the right displays, the default rate, after a brief period of increases, has fallen precipitously. While this month may be an anomaly that we frequently see when looking at monthly data, there is no mistaking the downward trend for default rates from the depths of the recession.

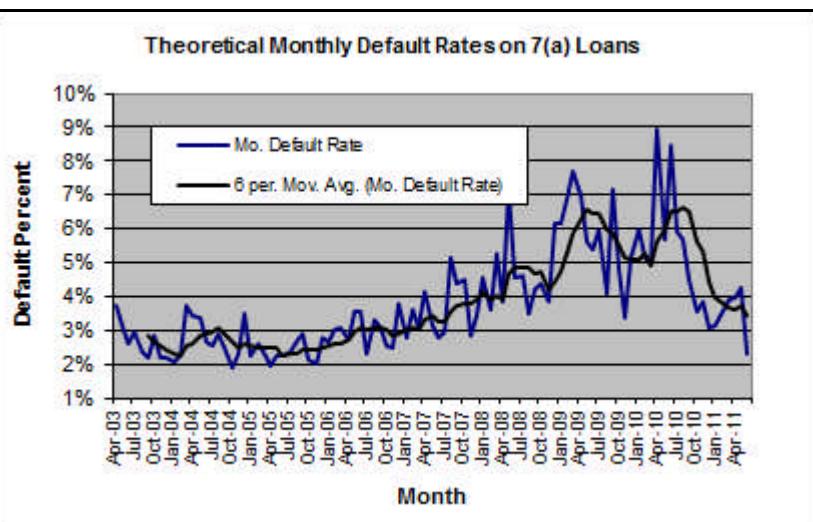
As mentioned in our prepayment article, we are surprised that the default rate has continued falling, considering the anemic growth during the first six months of 2011.

While we will gladly accept lower default rates on small business

loans, we wouldn't be surprised if the default rate began rising back to the 4-5% range over the next few months.

We come to this conclusion from the fact that we typically associate 2-3% default rates with economic growth of 3%+, not the sub-1% we see today.

Therefore, a higher default rate of 4-5% should be associated with the continued sub-standard economic growth of the first 6 months of 2011.



The question remains if the small business sector has the resources to tread water until economic growth accelerates, at which time we can expect 2-3% default rates on a regular basis.

## DEFAULT-CURTAILMENT RATIOS

In our Default-Curtailment Ratios (DCR) we saw decreases in 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

For the first time this year, the 7a DCR broke below 50%, reaching 48.57% from 65.78% the previous month.

A precipitous decrease in defaults, combined with a slight increase in the voluntary prepayment component, led to the double-digit decrease in the ratio this month.

Turning to actual dollar amounts, defaults fell by 43% to \$75 million from \$132 million. As for voluntary prepayments, they rose by 15% to \$79 million versus \$69 million the previous month.

### SBA 504 Default Ratios

While the 7a DCR was the story for the month, the 504 DCR also recorded a decrease. For June, the 504 DCR fell by 8% to 57.35% from 62.09% in May.

Both voluntary prepayments and defaults decreased, with defaults falling by a greater margin than voluntary prepayments, lowering the ratio.

Specifically, the dollar amount of defaults decreased by \$28 million to \$109 million (-20%). As for voluntary prepayments, they fell by \$2 million to \$81 million (-3%).

### Summary

Overall, a good month for both 7a and 504 loans. The trend continues to be towards lower DCRs, which suggests falling defaults and stable to increasing voluntary prepayments.

The one danger zone is the weak economy, which could untrack the recovery of

both asset classes and send the ratios rising back into the 70% to 80% range.

*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 25*

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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
<b>Dec-07</b>	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
<b>Jan-08</b>	15.70%	14.68%	13.96%	16.44%	17.45%	22.00%
<b>Feb-08</b>	15.91%	13.98%	14.19%	16.20%	17.53%	21.19%
<b>Mar-08</b>	15.58%	13.42%	13.27%	15.08%	15.41%	19.34%
<b>Apr-08</b>	16.16%	13.40%	13.05%	14.59%	15.19%	18.74%
<b>May-08</b>	15.49%	12.93%	12.65%	13.77%	14.33%	17.33%
<b>Jun-08</b>	15.29%	13.36%	12.96%	14.75%	13.62%	17.14%
<b>Jul-08</b>	15.70%	13.03%	12.78%	14.40%	12.49%	16.59%
<b>Aug-08</b>	15.45%	13.28%	12.87%	13.73%	12.24%	15.89%
<b>Sep-08</b>	14.03%	12.49%	12.77%	13.28%	12.36%	15.20%
<b>Oct-08</b>	12.98%	11.67%	12.16%	12.13%	11.97%	14.06%
<b>Nov-08</b>	12.08%	12.36%	11.45%	11.49%	11.49%	13.22%
<b>Dec-08</b>	12.37%	11.81%	10.46%	9.79%	11.08%	11.41%
<b>Jan-09</b>	12.86%	11.55%	10.45%	9.29%	10.61%	10.40%
<b>Feb-09</b>	12.30%	11.30%	10.36%	8.39%	9.99%	9.30%
<b>Mar-09</b>	12.96%	11.97%	10.58%	8.57%	10.47%	8.79%
<b>Apr-09</b>	13.23%	12.34%	11.23%	8.75%	9.81%	8.55%
<b>May-09</b>	13.12%	11.89%	11.80%	8.68%	9.92%	7.98%
<b>Jun-09</b>	13.18%	11.85%	12.36%	8.57%	8.73%	8.02%
<b>Jul-09</b>	12.40%	12.00%	12.51%	8.56%	8.23%	7.36%
<b>Aug-09</b>	13.38%	12.49%	12.36%	8.01%	7.34%	7.21%
<b>Sep-09</b>	12.79%	11.01%	11.83%	7.48%	6.70%	6.89%
<b>Oct-09</b>	12.50%	11.03%	11.35%	7.25%	7.85%	6.79%
<b>Nov-09</b>	12.16%	10.89%	11.05%	6.96%	7.13%	6.32%
<b>Dec-09</b>	11.38%	11.20%	10.59%	7.09%	7.80%	5.75%
<b>Jan-10</b>	11.20%	10.69%	10.34%	6.99%	8.00%	5.75%
<b>Feb-10</b>	10.06%	9.97%	10.05%	7.33%	8.84%	5.71%
<b>Mar-10</b>	9.92%	10.73%	10.11%	7.12%	8.75%	5.75%
<b>Apr-10</b>	9.97%	10.45%	9.73%	7.34%	8.12%	5.32%
<b>May-10</b>	10.58%	11.09%	10.29%	7.88%	8.53%	5.86%
<b>Jun-10</b>	10.95%	11.18%	10.42%	7.83%	8.53%	6.38%
<b>Jul-10</b>	10.33%	11.15%	10.57%	7.13%	8.59%	7.48%
<b>Aug-10</b>	10.45%	11.02%	10.16%	7.38%	8.25%	7.60%
<b>Sep-10</b>	11.29%	10.76%	10.54%	7.48%	8.01%	7.70%
<b>Oct-10</b>	11.35%	10.06%	10.28%	7.27%	7.29%	7.84%
<b>Nov-10</b>	10.89%	8.48%	8.45%	7.30%	5.61%	7.11%
<b>Dec-10</b>	11.35%	8.77%	9.04%	7.01%	6.67%	7.45%
<b>Jan-11</b>	12.00%	8.87%	7.84%	7.49%	5.03%	5.96%
<b>Feb-11</b>	11.23%	9.01%	7.57%	7.22%	4.91%	5.53%
<b>Mar-11</b>	10.44%	8.86%	7.07%	7.20%	5.13%	5.37%
<b>Apr-11</b>	10.62%	9.69%	7.38%	6.90%	4.95%	5.17%
<b>May-11</b>	10.03%	10.23%	7.04%	6.16%	5.29%	5.22%

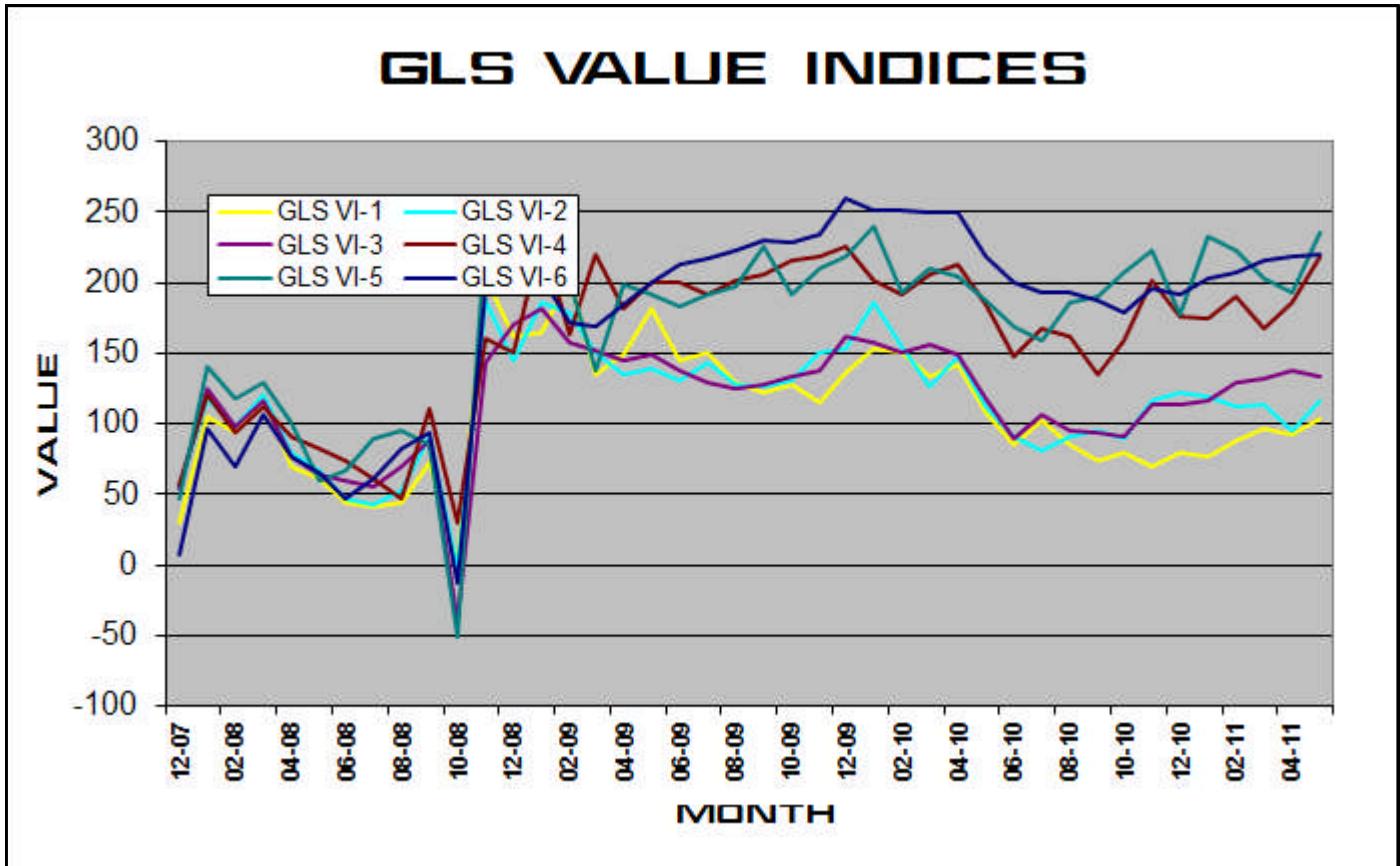
Rolling six-month CPR speeds for all maturity buckets. Source: Colson Services

# 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
	5.02%	7.35%	2.33%	30.4	55.2	54.4	57.0	46.7	7.9	HIGHEST READING
Jan-08	3.77%	6.86%	3.09%	105.1	118.6	124.7	121.4	140.1	96.8	LOWEST READING
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%	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	

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>Feb-11</b>	5.96%	9.95%	6.43%	5.52%	5.78%	5.02%	<b>5.74%</b>
<b>Mar-11</b>	10.25%	7.41%	7.63%	5.62%	8.43%	5.47%	<b>6.40%</b>
<b>Apr-11</b>	11.80%	11.75%	9.34%	5.83%	4.09%	5.21%	<b>6.70%</b>
<b>May-11</b>	9.52%	11.76%	5.61%	4.11%	6.39%	5.98%	<b>6.22%</b>
<b>Jun-11</b>	9.57%	8.08%	4.95%	4.33%	5.60%	3.82%	<b>4.58%</b>
<b>Grand Total</b>	<b>10.26%</b>	<b>9.69%</b>	<b>6.81%</b>	<b>5.39%</b>	<b>5.70%</b>	<b>5.12%</b>	<b>5.96%</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>
<b>Feb-11</b>	22 Mos.	30 Mos.	32 Mos.	66 Mos.	50 Mos.	51 Mos.	<b>45 Mos.</b>
<b>Mar-11</b>	23 Mos.	31 Mos.	33 Mos.	66 Mos.	50 Mos.	50 Mos.	<b>45 Mos.</b>
<b>Apr-11</b>	23 Mos.	31 Mos.	33 Mos.	67 Mos.	49 Mos.	49 Mos.	<b>45 Mos.</b>
<b>May-11</b>	24 Mos.	32 Mos.	33 Mos.	66 Mos.	47 Mos.	49 Mos.	<b>44 Mos.</b>
<b>Jun-11</b>	24 Mos.	32 Mos.	32 Mos.	66 Mos.	47 Mos.	49 Mos.	<b>44 Mos.</b>

2011 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-11	8.14%	24.87%	18.55%	10.61%	14.45%
Feb-11	6.33%	2.69%	5.40%	4.49%	12.63%
Mar-11	10.15%	5.53%	11.73%	7.38%	19.55%
Apr-11	5.53%	13.80%	17.17%	7.29%	21.62%
May-11	14.98%	4.94%	12.68%	4.43%	6.04%
Jun-11	6.42%	10.83%	14.67%	8.20%	10.02%
<b>Grand Total</b>	<b>8.58%</b>	<b>10.35%</b>	<b>13.49%</b>	<b>7.15%</b>	<b>14.28%</b>

10-13 BY AGE	0-12 Mos.	13-24 Mos.	25-36 Mos.	37-48 Mos.	48+ Mos.
Jan-11	4.90%	6.31%	12.35%	6.54%	5.14%
Feb-11	4.49%	10.85%	8.56%	4.39%	5.93%
Mar-11	7.41%	10.03%	9.38%	7.84%	4.86%
Apr-11	8.89%	8.78%	13.52%	9.57%	7.32%
May-11	4.50%	7.16%	7.62%	6.84%	3.52%
Jun-11	2.25%	7.21%	7.85%	4.76%	4.91%
<b>Grand Total</b>	<b>5.38%</b>	<b>8.34%</b>	<b>10.00%</b>	<b>6.67%</b>	<b>5.26%</b>

16-20 BY AGE	0-12 Mos.	13-24 Mos.	25-36 Mos.	37-48 Mos.	48+ Mos.
Jan-11	0.00%	7.24%	8.01%	2.83%	2.85%
Feb-11	0.00%	4.73%	9.77%	14.87%	1.78%
Mar-11	3.22%	4.01%	19.91%	8.32%	7.84%
Apr-11	0.00%	7.38%	4.96%	2.08%	5.51%
May-11	4.45%	0.00%	14.05%	5.83%	7.33%
Jun-11	0.79%	1.51%	2.16%	17.40%	3.91%
<b>Grand Total</b>	<b>1.52%</b>	<b>4.13%</b>	<b>10.20%</b>	<b>8.81%</b>	<b>4.90%</b>

## YEAR-TO-DATE CPR DATA

Table 6:

<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>Feb-11</b>	0.48%	18.09%	9.47%	9.90%	7.17%
<b>Mar-11</b>	1.99%	9.13%	8.29%	6.50%	9.50%
<b>Apr-11</b>	10.70%	16.95%	10.14%	9.51%	8.34%
<b>May-11</b>	5.71%	17.44%	17.75%	8.12%	6.48%
<b>Jun-11</b>	8.38%	7.41%	8.88%	11.83%	4.77%
<b>Grand Total</b>	<b>4.80%</b>	<b>13.42%</b>	<b>11.30%</b>	<b>8.69%</b>	<b>8.08%</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>Feb-11</b>	15.31%	2.76%	12.71%	9.95%	3.99%
<b>Mar-11</b>	0.00%	2.77%	24.05%	17.31%	5.19%
<b>Apr-11</b>	1.76%	2.81%	0.00%	12.38%	6.51%
<b>May-11</b>	0.00%	6.90%	0.00%	0.00%	4.54%
<b>Jun-11</b>	0.46%	0.00%	0.00%	0.00%	5.76%
<b>Grand Total</b>	<b>2.97%</b>	<b>6.75%</b>	<b>7.98%</b>	<b>7.51%</b>	<b>5.32%</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>Feb-11</b>	2.22%	8.00%	5.69%	5.72%	4.78%
<b>Mar-11</b>	2.82%	5.10%	11.55%	6.27%	5.18%
<b>Apr-11</b>	1.86%	4.97%	6.44%	8.12%	5.74%
<b>May-11</b>	0.72%	7.45%	7.97%	7.60%	7.04%
<b>Jun-11</b>	0.41%	4.62%	6.99%	4.97%	4.15%
<b>Grand Total</b>	<b>1.74%</b>	<b>5.93%</b>	<b>7.65%</b>	<b>6.96%</b>	<b>5.29%</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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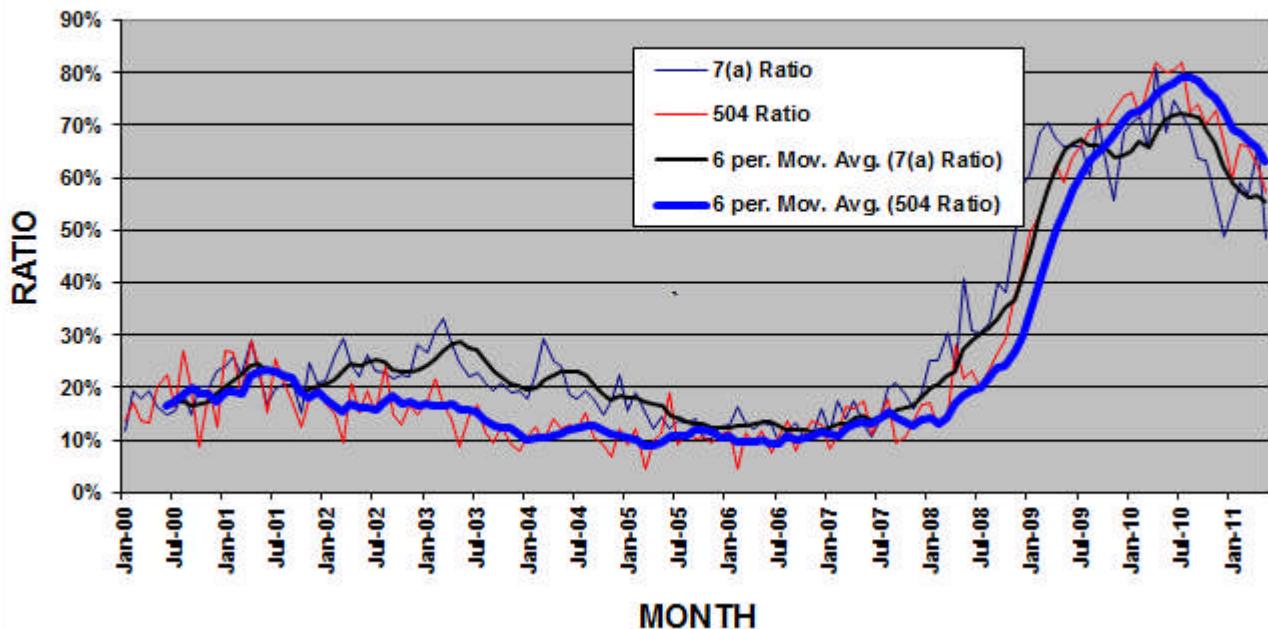
### Secondary Market First Lien Position 504 Loan Pool Guarantee Program

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, 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%.

### DEFAULT-CURTAILMENT RATIOS FOR 7(A) AND 504 LOANS



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

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*"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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