

*Bob Judge, Government Loan Solutions, Editor*



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

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- 504 Debenture Speeds
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- Default Rate Rises

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## 7A CPRs RISE ABOVE 6%

After breaching the 5% barrier last month, prepayment speeds rose above the 6% level this month, reaching 6.16% in June.

This reading represents the second time this year

we have breached the 6% barrier and is the second highest CPR this year, with January leading the way at 6.20%.

In comparing prepayment speeds for the first six months of 2012 to the

same period for 2011, 2012 is currently 7.36% lower than last year. Specifically, 2012 has an average speed of 5.52% to date, versus 5.96% for

*Continued on page 2*

## 20 YEAR DEBENTURE SPEEDS FALL 5%

In July, 20 year debenture speeds fell by 4.61% to CPR 7.77% from 8.15% in June. This represents the lowest prepayment reading for 20s since February of this year.

The main cause of this decrease was a 27% drop in defaults (CDR) this month to 2.95%, the first reading below 3% since January, 2009. As for voluntary prepayments (CRR), they jumped by 17%

to 4.82%, the fifth month in a row of +4% readings and the second highest this year. As for 10 year debentures, the CPR jumped by 183% to

*Continued on page 3*

## SMA: RECORD MONTH IN JULY

*By Jordan Blanchard*

### Volume

Fifty-three loans were pooled in July for a total of \$53,107,449 in guaranteed interests. That

represents over \$66,000,000 in gross loans. July set new records for the number of loans pooled and dollar amount pooled.

To date, 445 loans in 113 pools

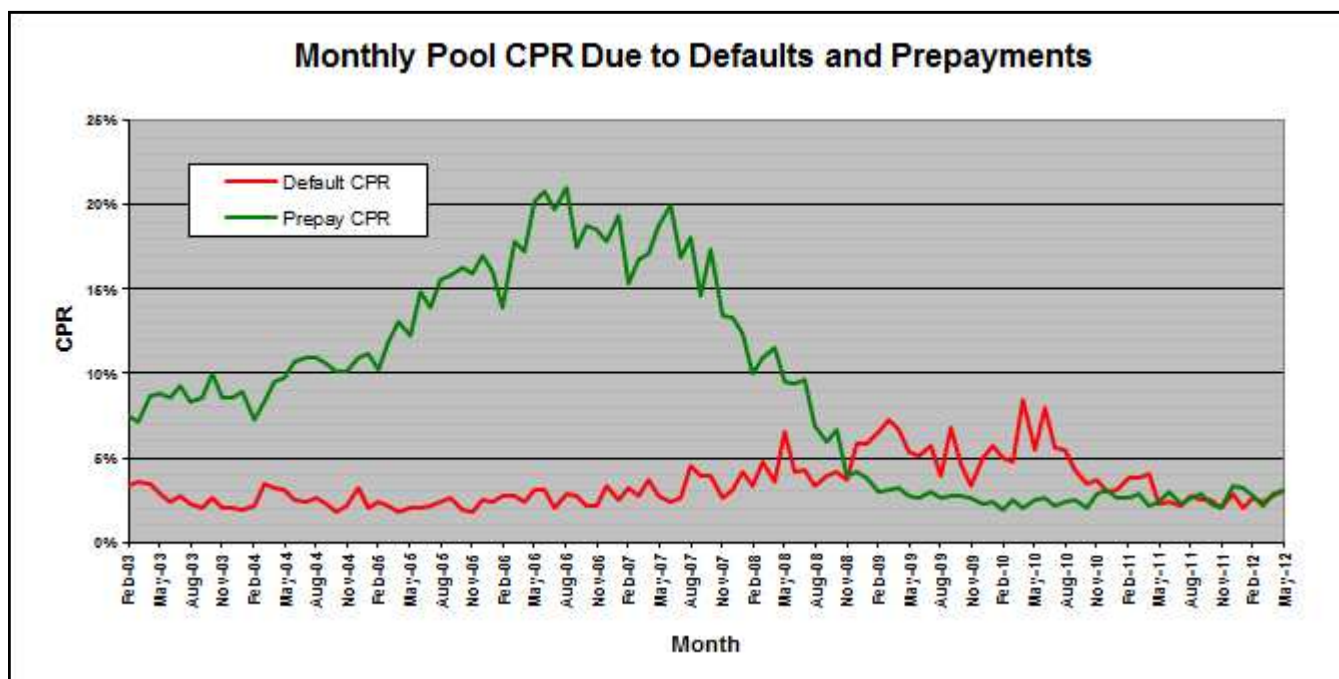
have been issued for a total \$483,860,104 in guaranteed interests, or \$604,825,130 in gross loans. The program has been operational for 22 months

*Continued on page 6*

## SMALL BUSINESS FACT OF THE MONTH

As of 2010, D&B estimates, there were about 23 million small businesses in the United States, employing nearly 81 million workers.

## PREPAYMENT SPEEDS...CONTINUED



the first six months of 2011.

As for the largest sector of the market, 20+ years to maturity, prepayment speeds rose 22% to 5.18% from 4.25%.

Turning to the CPR breakdown, the default CPR rose by 13% to 3.05%, the first time in a year that it has been above 3%.

Regarding voluntary prepayments, they also rose, increasing by 6% to 3.11%, moving above 3% for the first time since February.

As previously stated, overall speeds came in at 6.36%, a 10% increase from May's reading of 5.62%. This month continues the unbroken streak of 21 consecutive

months of sub-7% prepay speeds.

As for next month, preliminary data from Colson suggests a decrease back into the 5% range as we head into the second half of 2012.

Turning to the default/voluntary prepayment breakdown, the **Voluntary Prepay CPR** (green line) rose to 3.11% from 2.93%, a 6% increase from May.

While the VCPR remained rose above 3%, the **Default CPR** (red line) rose by 13% to 3.05% from 2.70% the previous month.

In June, prepayment speeds rose in three out of the six maturity

categories. Increases were seen, by order of magnitude, in the 8-10 sector (+43% to CPR 11.23%), 20+ (+22% to CPR 5.18%) and 10-13 (+13% to 7.59%).

Decreases were seen, by order of magnitude, in <8 (-43% to 9.68%), 16-20 (-32% to 5.06%) and 13-16 (-16% to 6.81%).

While this month's speeds showed an uptick above 6%, expect a drop back into the 5% range next month.

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

Data on page 19-21

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***"This reading represents the second time this year we have breached the 6% barrier and is the second highest CPR this year, with January leading the way at 6.20%."***

## 504 DEBENTURE SPEEDS...CONTINUED

14.04% from 4.96% in May. Both defaults and voluntaries rose significantly over the same two month period. The CDR for July rose by 177% to 11.15% from 4.96% and the CRR jumped to 2.89% from 0.94% in May. The extreme volatility in 10 year

prepayment speeds is mostly due to the low outstanding balance in any given period, which totaled \$171 million in July.

Please refer to pages 4 and 5 for the actual data over the past 5 years.



A Breakthrough Tool for Underwriters and SBA Investors

Finally a Web-based Loan Analytics Portal  
7(a) and 504 loan performance information  
through a user friendly, searchable database.

7(a) default and prepayment data going back to 2000.

504 default data going back to 1959.

Monthly subscribers will have access to customized searches using criteria  
such as:

- **Structural:** reset frequency, guaranty percentage, interest rate, gross margin, maturity, cohort year, and loan size
- **Industry:** NAICS or SIC codes, SIC major groups, or SIC division
- **Franchise:** franchise code or franchise name
- **Geography:** state, county, or MSA as well as area type (urban or rural)

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

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

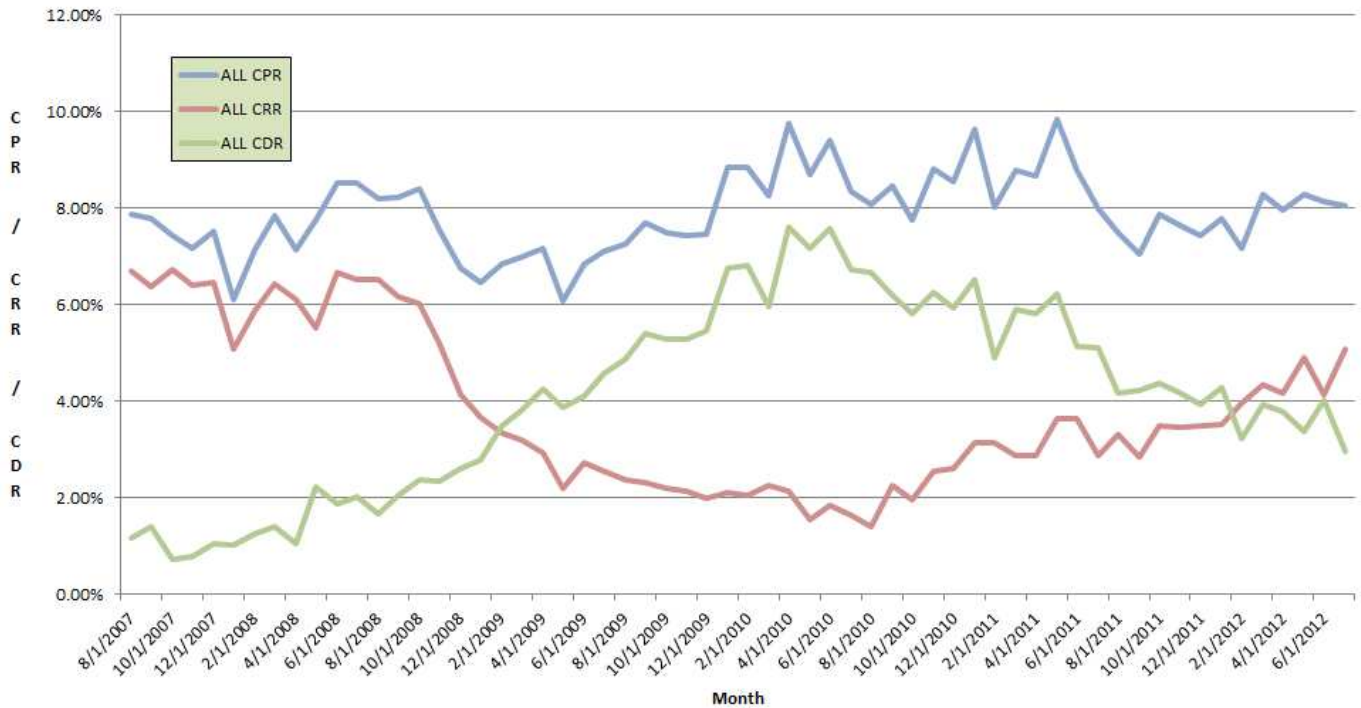
For more information, please call Scott Evans or Bob Judge at 216-456-2480  
or visit the website [www.sbla.us](http://www.sbla.us)

## 504 DCPC PREPAY SPEEDS - LAST 5 YEARS

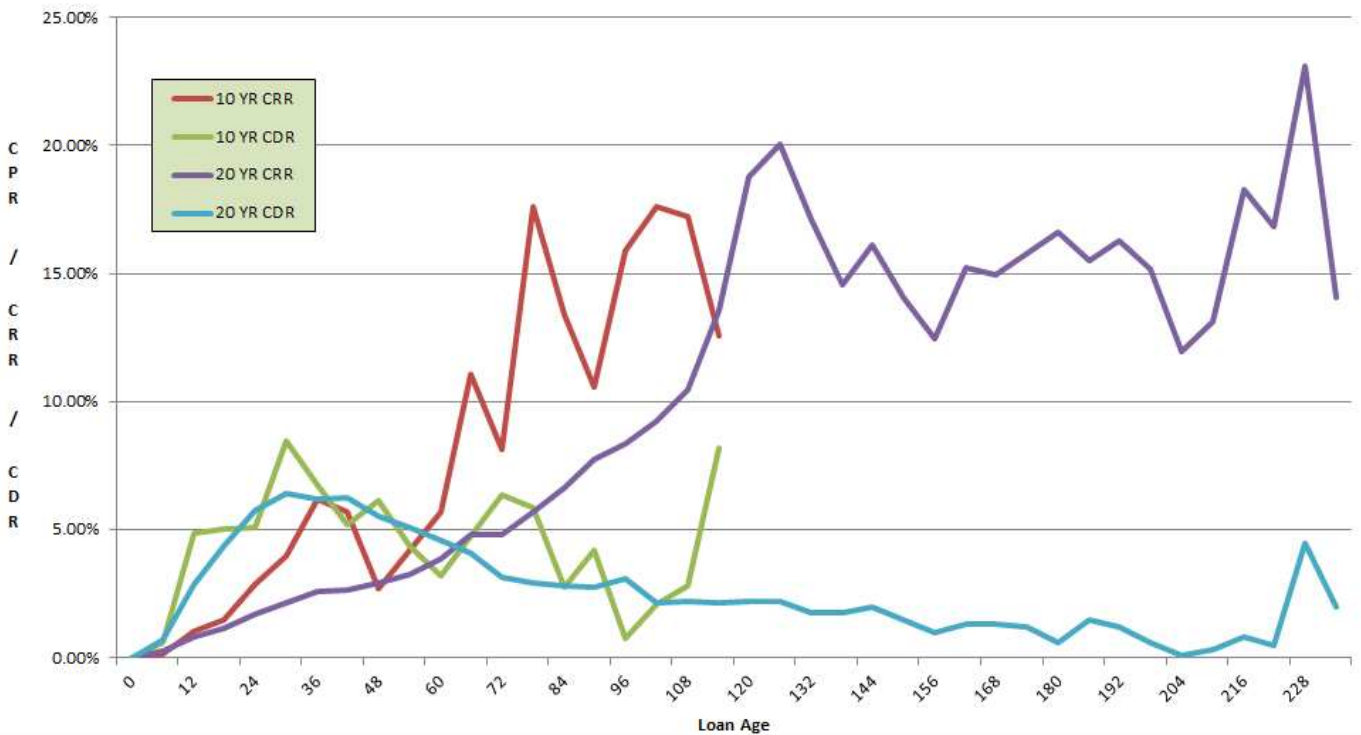
DATE	20 YR. CPR	20 YR. CRR	20 YR. CDR	10 YR. CPR	10 YR. CRR	10 YR. CDR	ALL CPR	ALL CRR	ALL CDR
8/1/2007	7.86%	6.69%	1.17%	NA	NA	NA	7.86%	6.69%	1.17%
9/1/2007	7.77%	6.42%	1.35%	8.05%	4.74%	3.30%	7.78%	6.37%	1.41%
10/1/2007	7.43%	6.71%	0.72%	NA	NA	NA	7.43%	6.71%	0.72%
11/1/2007	7.20%	6.47%	0.73%	5.99%	3.66%	2.33%	7.17%	6.39%	0.78%
12/1/2007	7.51%	6.46%	1.05%	NA	NA	NA	7.51%	6.46%	1.05%
1/1/2008	6.23%	5.19%	1.04%	2.72%	1.73%	0.99%	6.10%	5.07%	1.03%
2/1/2008	7.12%	5.87%	1.25%	NA	NA	NA	7.12%	5.87%	1.25%
3/1/2008	7.90%	6.50%	1.40%	6.43%	4.48%	1.95%	7.86%	6.44%	1.42%
4/1/2008	7.15%	6.10%	1.05%	NA	NA	NA	7.15%	6.10%	1.05%
5/1/2008	7.66%	5.51%	2.15%	10.57%	6.20%	4.37%	7.75%	5.53%	2.22%
6/1/2008	8.53%	6.65%	1.87%	NA	NA	NA	8.53%	6.65%	1.87%
7/1/2008	8.48%	6.52%	1.96%	9.55%	6.20%	3.35%	8.52%	6.50%	2.01%
8/1/2008	8.20%	6.52%	1.68%	NA	NA	NA	8.20%	6.52%	1.68%
9/1/2008	8.32%	6.23%	2.08%	5.43%	4.11%	1.32%	8.21%	6.16%	2.06%
10/1/2008	8.39%	6.03%	2.37%	NA	NA	NA	8.39%	6.03%	2.37%
11/1/2008	7.58%	5.26%	2.32%	6.31%	3.51%	2.80%	7.54%	5.20%	2.33%
12/1/2008	6.76%	4.15%	2.61%	NA	NA	NA	6.76%	4.15%	2.61%
1/1/2009	6.41%	3.72%	2.69%	8.08%	2.57%	5.50%	6.47%	3.68%	2.79%
2/1/2009	6.84%	3.35%	3.49%	NA	NA	NA	6.84%	3.35%	3.49%
3/1/2009	6.96%	3.15%	3.81%	7.80%	4.12%	3.68%	6.99%	3.18%	3.81%
4/1/2009	7.18%	2.93%	4.25%	NA	NA	NA	7.18%	2.93%	4.25%
5/1/2009	6.12%	2.24%	3.87%	5.07%	1.34%	3.73%	6.08%	2.21%	3.87%
6/1/2009	6.83%	2.73%	4.11%	NA	NA	NA	6.83%	2.73%	4.11%
7/1/2009	7.09%	2.62%	4.47%	7.71%	0.45%	7.26%	7.11%	2.54%	4.57%
8/1/2009	7.24%	2.37%	4.87%	NA	NA	NA	7.24%	2.37%	4.87%
9/1/2009	7.59%	2.34%	5.25%	10.52%	1.46%	9.07%	7.70%	2.31%	5.40%
10/1/2009	7.48%	2.21%	5.28%	NA	NA	NA	7.48%	2.21%	5.28%
11/1/2009	7.49%	2.16%	5.33%	5.41%	1.74%	3.67%	7.42%	2.15%	5.27%
12/1/2009	7.46%	1.99%	5.47%	NA	NA	NA	7.46%	1.99%	5.47%
1/1/2010	8.72%	2.09%	6.63%	12.44%	2.37%	10.07%	8.85%	2.10%	6.76%
2/1/2010	8.86%	2.05%	6.81%	NA	NA	NA	8.86%	2.05%	6.81%
3/1/2010	8.28%	2.24%	6.03%	7.24%	2.90%	4.35%	8.24%	2.27%	5.97%
4/1/2010	9.76%	2.15%	7.61%	NA	NA	NA	9.76%	2.15%	7.61%
5/1/2010	8.83%	1.56%	7.26%	4.98%	0.85%	4.12%	8.69%	1.54%	7.15%
6/1/2010	9.41%	1.84%	7.57%	NA	NA	NA	9.41%	1.84%	7.57%
7/1/2010	8.30%	1.58%	6.71%	9.73%	2.86%	6.87%	8.35%	1.63%	6.72%
8/1/2010	8.08%	1.42%	6.66%	NA	NA	NA	8.08%	1.42%	6.66%
9/1/2010	8.38%	2.22%	6.16%	10.61%	3.38%	7.23%	8.46%	2.27%	6.20%
10/1/2010	7.76%	1.95%	5.81%	NA	NA	NA	7.76%	1.95%	5.81%
11/1/2010	8.65%	2.43%	6.22%	13.45%	6.11%	7.34%	8.82%	2.56%	6.26%
12/1/2010	8.54%	2.61%	5.93%	NA	NA	NA	8.54%	2.61%	5.93%
1/1/2011	9.68%	3.10%	6.58%	8.76%	3.75%	5.02%	9.65%	3.12%	6.52%
2/1/2011	8.03%	3.14%	4.89%	NA	NA	NA	8.03%	3.14%	4.89%
3/1/2011	8.71%	2.77%	5.94%	10.61%	5.49%	5.13%	8.79%	2.88%	5.91%
4/1/2011	8.67%	2.87%	5.80%	NA	NA	NA	8.67%	2.87%	5.80%
5/1/2011	9.53%	3.37%	6.16%	17.64%	10.06%	7.58%	9.84%	3.63%	6.21%
6/1/2011	8.78%	3.65%	5.13%	NA	NA	NA	8.78%	3.65%	5.13%
7/1/2011	7.92%	2.87%	5.05%	9.69%	3.01%	6.68%	7.99%	2.87%	5.12%
8/1/2011	7.49%	3.31%	4.18%	NA	NA	NA	7.49%	3.31%	4.18%
9/1/2011	6.83%	2.76%	4.07%	12.27%	4.53%	7.74%	7.06%	2.83%	4.23%
10/1/2011	7.87%	3.50%	4.36%	NA	NA	NA	7.87%	3.50%	4.36%
11/1/2011	7.81%	3.52%	4.29%	3.07%	1.88%	1.19%	7.62%	3.46%	4.17%
12/1/2011	7.43%	3.50%	3.94%	NA	NA	NA	7.43%	3.50%	3.94%
1/1/2012	7.76%	3.48%	4.27%	8.39%	4.13%	4.25%	7.78%	3.51%	4.27%
2/1/2012	7.17%	3.95%	3.22%	NA	NA	NA	7.17%	3.95%	3.22%
3/1/2012	8.17%	4.23%	3.94%	10.74%	7.05%	3.69%	8.28%	4.35%	3.93%
4/1/2012	7.96%	4.17%	3.79%	NA	NA	NA	7.96%	4.17%	3.79%
5/1/2012	8.43%	4.95%	3.48%	4.96%	4.02%	0.94%	8.29%	4.91%	3.37%
6/1/2012	8.15%	4.13%	4.02%	NA	NA	NA	8.15%	4.13%	4.02%
7/1/2012	7.77%	4.82%	2.95%	14.04%	11.15%	2.89%	8.04%	5.09%	2.95%

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

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

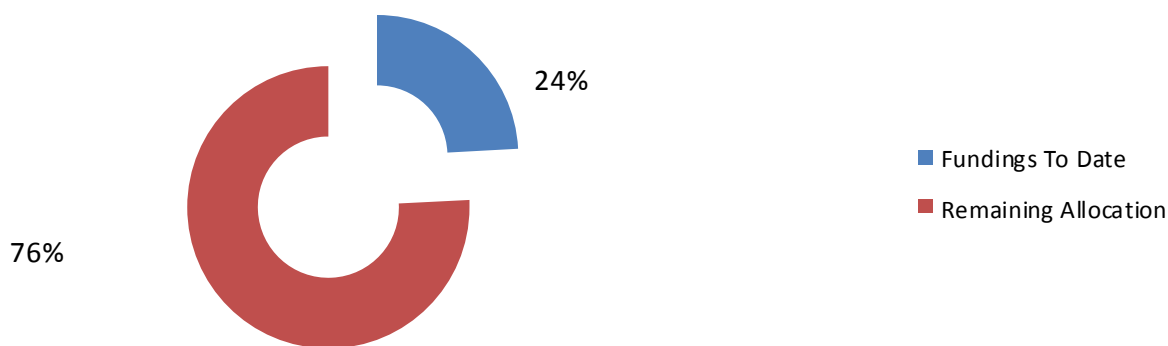


### 504 DCPC Prepayment Speeds by Loan Age - Last 5 Years



## SECONDARY MARKET ACCESS...CONTINUED

### First Mortgage Pool Program Through July 2012



with two months remaining. Roughly half of the total dollar amount settled for the program to date has been settled in the last 10 months.

Additional statistics by pool originator can be found later in this article.

#### Legislative Update

We now know the FMLP program will certainly terminate in September. Could an extension be approved by Congress during the lame-duck session? It's possible, but not probable. Senator Mary Landrieu tried to introduce a small business bill in July. This bill contained an extension for 504 Debt Refi, but no mention of FMLP. The bill failed to advance in the Senate. With legislators out for summer recess, there is little possibility of a small business bill advancing prior to the sunset dates for both 504 Debt Refi and FMLP. If this specific bill does pass during the lame-duck session, the challenge will be recruit a senator willing to sponsor an amendment that extends FMLP for at least one year.

Given that there is at least a bill that contains a provision to extend Debt Refi, odds are 50/50 that Debt Refi will be extended. But since FMLP is not any current or proposed bill, odds are likely 25/75 for FMLP will be extended.

Secondary Market Access is working diligently to provide a FMLP-like substitute to the 504 first mortgage market. Any progress on this front will be communicated in future editions of the CPR Report. Hopefully the original intent of the FMLP program to bridge the time frame from virtually no secondary market for 504 first mortgages in 2009 to a healthy, fully functional, secondary market going forward will be realized.

#### Pool Originator Statistics

There are over 30 approved pool originators, but only 19 have issued at least one pool. The top 5 pool originators have issued 63% of all pools to date. The following table shows the ranking and volume for the top 5 pool originators through July, 2012.

*Continued on the next page*

Pool Originator	# of Loan Pooled	Guaranteed Interest \$(000)	% Of Market
Pacific Enterprise Bank	67	\$78,236	16%
Bank Of America	51	\$70,720	15%
Zions Bank	73	\$57,980	12%
Coastal Securities	53	\$50,161	10%
Southwest Capital Bank	31	\$48,316	10%

## SECONDARY MARKET ACCESS...CONTINUED

MO / WAM BUCKET	<192 Mos.	192-263 Mos.	264-288 Mos.	289+ Mos.	Total by Month
Jan-11	0.00%	0.00%	0.12%	0.00%	0.09%
Feb-11	0.00%	0.00%	0.00%	0.00%	0.00%
Mar-11	0.00%	0.00%	0.00%	0.00%	0.00%
Apr-11	0.00%	0.00%	0.00%	0.00%	0.00%
May-11	0.00%	0.00%	11.49%	3.49%	9.28%
Jun-11	1.04%	0.00%	0.00%	0.00%	0.06%
Jul-11	0.00%	0.00%	0.00%	0.00%	0.00%
Aug-11	0.00%	0.00%	0.00%	0.13%	0.03%
Sep-11	0.00%	0.00%	0.00%	0.00%	0.00%
Oct-11	0.00%	0.00%	0.00%	0.09%	0.02%
Nov-11	0.00%	0.00%	15.67%	0.00%	9.78%
Dec-11	0.00%	0.00%	0.00%	0.00%	0.00%
Jan-12	0.00%	0.00%	23.69%	0.00%	11.66%
Feb-12	0.00%	0.00%	0.00%	0.00%	0.00%
Mar-12	0.00%	0.00%	0.00%	0.00%	0.00%
Apr-12	0.00%	0.00%	0.00%	0.00%	0.00%
May-12	0.00%	0.00%	0.00%	0.00%	0.00%
Jun-12	0.00%	0.00%	0.01%	0.00%	0.00%
Jul-12	0.00%	0.00%	0.00%	0.00%	0.00%
Total	0.02%	0.00%	3.11%	0.08%	1.55%

RESET TYPE	FIXED RATE	FHLB VARIOUS	PRIME RATE	5 YR LIBOR SWAP	3 MO LIBOR	5 YR CMT	Total by Month
Jan-11	0.16%	0.00%	0.00%	0.13%	0.00%	0.00%	0.09%
Feb-11	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Mar-11	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Apr-11	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
May-11	34.52%	0.00%	0.00%	1.88%	0.00%	0.00%	9.28%
Jun-11	0.00%	0.00%	0.15%	0.00%	0.00%	0.00%	0.06%
Jul-11	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Aug-11	0.00%	0.00%	0.06%	0.00%	0.00%	0.00%	0.03%
Sep-11	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Oct-11	0.00%	0.00%	0.00%	0.06%	0.00%	0.00%	0.02%
Nov-11	0.00%	0.00%	0.00%	27.92%	0.00%	0.00%	9.78%
Dec-11	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Jan-12	0.00%	1.24%	21.92%	0.00%	0.00%	0.00%	11.66%
Feb-12	0.00%	0.00%	0.00%	0.00%	0.03%	0.00%	0.00%
Mar-12	0.00%	0.00%	0.00%	0.00%	0.03%	0.00%	0.00%
Apr-12	0.00%	0.00%	0.00%	0.00%	0.02%	0.00%	0.00%
May-12	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Jun-12	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Jul-12	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Total	1.90%	0.09%	1.72%	1.53%	0.01%	0.00%	1.55%

### FMLP Tips...

It is quite common for promissory notes to have to be modified prior to pooling to correct dates or clarify vague language. Colson Services must insert specific dates, indices, spreads, caps, floors, etc. in to their system. If any of this very specific information is not contained in the note, Colson will require a modification. Since September will be such a high volume month, lenders are encouraged to have their promissory notes reviewed by their pool originator early in August so that there is sufficient time to make any necessary corrections.

### FMLP Prepayment Analysis

By Robert Judge

For the sixth month in a row, the Program saw zero prepayments, pushing the overall average CPR from 1.74% to 1.55% since January, 2011. Performance has been stellar in the FMLP as we close in on the end of the Program. Unfortunately, an extension looks to be out of the question.

### Secondary Market Access

Secondary Market Access (SMA) is an Ohio-based corporation whose main goal is to provide secondary market solutions for 504 first mortgage lenders.

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

### Our Role

SMA has a solution for every lender and pool originator need related to FMLP, 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.

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

# SECONDARY MARKET ACCESS



**“The source for all things FMLP and  
Community Advantage.”**

**[www.SMA504.com](http://www.SMA504.com)**

**Providing expertise in all areas of the SBA 504 First Lien Pool Guaranty and  
the new Community Advantage programs.**

## **504 1st Lien Lenders**

- **Outsourced Servicing**
- **Bid Procurement for the 85% portion of eligible loans**
- **Servicing Rights Valuation, Gain-On-Sale calculation and Initial Accounting Entries**
- **Assistance with becoming a Pool Originator**

## **504 1st Lien Pool Originators**

- **Program Documentation Preparation (2401, 2403 and Purchaser's Confirmation)**
- **Bid Procurement for the pooled security**
- **Help with on-line data entry**
- **Servicing Rights Valuation, Gain-On-Sale calculation and Initial Accounting Entries**
- **Sourcing of eligible 504 1st lien loans**

## **Community Advantage Lenders**

- **Loan Packaging**
- **Outsourced Servicing, including Colson 1502 Reporting**
- **Help with sourcing capital and warehouse line of credit**
- **Sale of the guaranteed portion, including settlement services**
- **Servicing Rights Valuation, Gain-On-Sale calculation and Initial Accounting Entries**

**For more information regarding SMA Services, please contact:**

**Bob Judge, GLS, at (216) 456-2480 ext. 133 or via e-mail at**

**[bob.judge@gl solutions.us](mailto:bob.judge@gl solutions.us)**



# Morgan Stanley

## SBA 504 FIRST MORTGAGE PROGRAM Loan Premiums

### INTEREST RATE PAR SPREADS

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

- Each 0.25% in rate above the par rate earns 1% in premium
- The initial rate will be the interest rate floor
- Swap rates are published under Libor Swaps (USD) at:  
[http://online.wsj.com/mdc/public/page/2\\_3020-moneyrate.html?mod=topnav\\_2\\_3010](http://online.wsj.com/mdc/public/page/2_3020-moneyrate.html?mod=topnav_2_3010)

### PREPAYMENT PENALTY OPTIONS

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

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

### PREMIUM EXAMPLE FOR \$1 MILLION SBA 504 FIRST MORTGAGE LOAN

DESCRIPTION	OPTION	PREMIUM
Interest Rate	10-year swap + 4.40%	4.00%
Prepayment Penalty	10%, 9%, 8%, 7%, 6%, 5%, 4%, 3%, 2%,	1.00%
Total Premium	1%	5.00%

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

#### FOR MORE INFORMATION CONTACT:

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

## 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.**

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## GLS 7(a) Settlement & Sales Strategies Tip #46 – Pipeline or bottleneck?

If your loan pipeline is full but seems to be dripping rather flowing, it might be time to make a push to rectify the situation. With loan prices and servicing multiples at levels we have not seen in the last ten years, it's certainly solid motivation to convert originations into sold assets. The near term outlook is still great for lenders looking to sell so the cliché advice here is to strike while the iron remains hot.

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



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## DEFAULT RATE RISES AGAIN

In June, the theoretical default rate rose by 13% to 3.16%, moving above 3% for the first time in five months.

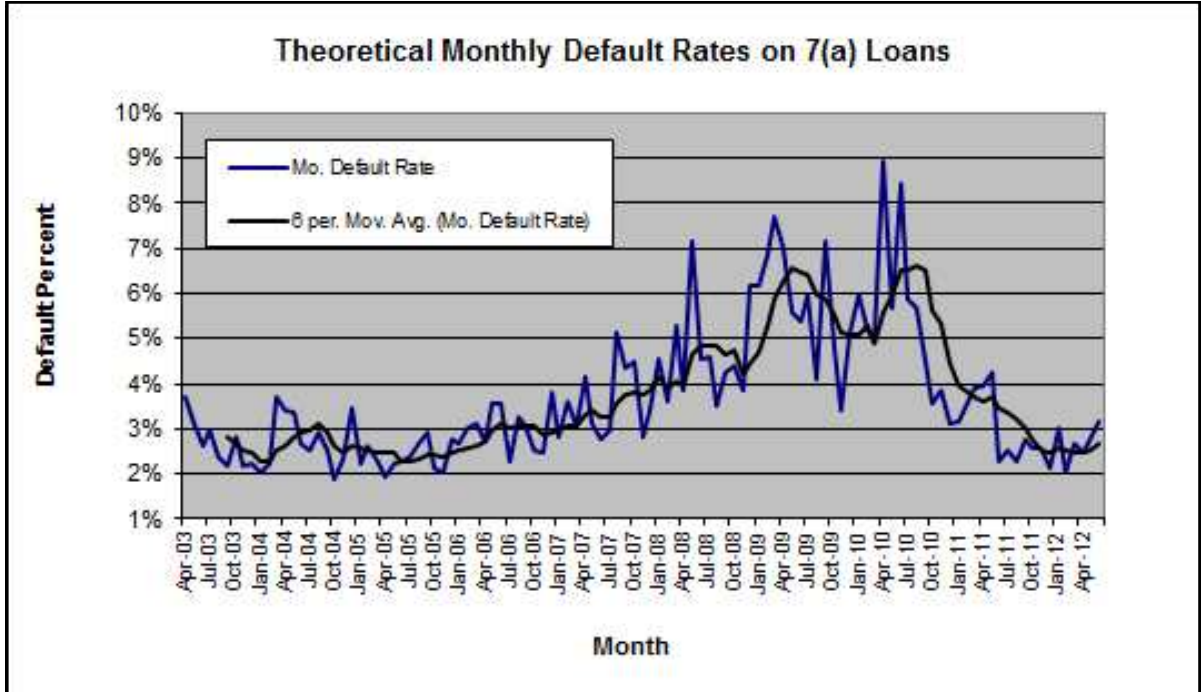
For the last two months, we have witnessed a 27% increase in the default rate. While two months does not a trend make, it bears watching to see if we stay above 3% for a prolonged period of time.

With the economic recovery stalled in the sub-2% range so far this year, it is not surprising that we are witnessing some pressure on small business defaults.

Moving on to next month, we expect a decrease in overall

prepayment speeds. Hopefully we will also witness a decrease in the default rate, as well.

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



## DEFAULT-CURTAILMENT RATIOS

In our Default-Curtailment Ratios (DCR) we witnessed increases in the both the 7a and 504 ratios.

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

### SBA 7(a) Default Ratios

Last month, the 7a DCR rose slightly, but stayed below 50% for the second consecutive month. Overall, the ratio increased by 3% to 49.48% from 47.94% the previous month.

This month, both defaults and voluntary prepayments rose, with defaults increasing by a greater percentage than voluntaries, increasing the ratio.

Turning to actual dollar amounts, defaults increased by 14% to \$105 million from \$92 million. As for voluntary prepayments, they rose by 8% to \$108 million versus \$100 million the previous month.

### SBA 504 Default Ratios

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

Specifically, the dollar amount of defaults increased by \$12 million to \$87 million (+17%). As for voluntary prepayments, they decreased by \$21 million to \$94 million (-18%).

### Summary

After some steady decreases in both ratios over the past few months, both DCRs took a pause in June on their march toward lower percentages.

*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 24*

## GLS VALUE INDICES DECREASE

In May, the GLS Value Indices came in lower in four out of six sectors.

The Base Rate / Libor spread fell by 2 basis points to +2.81%. As for the prepayment element, CPRs were higher in five out of six sub-indices.

By the end of May, the secondary market was significantly higher in the 10 to 15 year maturity range, rising over 3/4 of a point, reaching the 113 area for fully-priced loans.

Turning to the specifics, the largest decrease was seen in the GLS VI-3, which

fell by 33% to 76 basis points. The other decreases, by order of magnitude, were: VI-5 (-20% to 128), VI-4 (-18% to 132) and VI-6 (-15% to 170).

Increases were seen in VI-2 (+3% to 113) and VI-1 (+3% to 81).

While the long-end rose only slightly in price in May, the short-end caught fire and rose significantly over a single month.

Expect more of the same over the months to come.

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

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

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

Maturity	Gross Margin	Net Margin	Servicing	This Month Price	Last Month Price	3-Mos. Ago Price	6-Mos. Ago Price	1-Yr. Ago Price
10 yrs.	2.75%	1.075%	1.00%	112.75	111.625	112.0625	111.25	111.125
15 yrs.	2.75%	1.075%	1.00%	113.125	112.50	112.75	111.75	111.325
20 yrs.	2.75%	1.075%	1.00%	114.25	114.125	114.50	113.75	113.50
25 yrs.	2.75%	1.075%	1.00%	115.0625	115.00	115.375	114.75	114.20



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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
Dec-08	12.37%	11.77%	10.45%	9.45%	11.08%	11.41%
Jan-09	12.86%	11.51%	10.42%	9.29%	10.61%	10.40%
Feb-09	12.30%	11.26%	10.35%	8.39%	9.99%	9.30%
Mar-09	12.96%	11.93%	10.56%	8.57%	10.47%	8.79%
Apr-09	13.23%	12.30%	11.22%	8.75%	9.81%	8.55%
May-09	13.12%	11.85%	11.79%	8.68%	9.92%	7.98%
Jun-09	13.18%	11.85%	12.35%	8.57%	8.73%	8.02%
Jul-09	12.40%	12.00%	12.51%	8.56%	8.23%	7.36%
Aug-09	13.34%	12.49%	12.36%	8.01%	7.34%	7.21%
Sep-09	12.74%	11.01%	11.83%	7.48%	6.70%	6.89%
Oct-09	12.45%	11.03%	11.31%	7.25%	7.85%	6.79%
Nov-09	12.11%	10.89%	11.01%	6.96%	7.13%	6.32%
Dec-09	11.33%	11.20%	10.55%	7.09%	7.80%	5.75%
Jan-10	11.16%	10.69%	10.30%	6.99%	8.00%	5.75%
Feb-10	10.05%	9.97%	10.00%	7.33%	8.84%	5.71%
Mar-10	9.90%	10.73%	10.07%	7.12%	8.75%	5.75%
Apr-10	9.96%	10.45%	9.72%	7.34%	8.12%	5.32%
May-10	10.56%	11.09%	10.28%	7.88%	8.53%	5.86%
Jun-10	10.94%	11.18%	10.41%	7.83%	8.53%	6.38%
Jul-10	10.32%	11.15%	10.57%	7.13%	8.59%	7.48%
Aug-10	10.45%	11.02%	10.16%	7.38%	8.25%	7.60%
Sep-10	11.29%	10.76%	10.54%	7.48%	8.01%	7.70%
Oct-10	11.35%	10.06%	10.28%	7.27%	7.29%	7.84%
Nov-10	10.55%	9.24%	8.82%	7.05%	6.45%	7.21%
Dec-10	10.89%	8.48%	8.45%	7.30%	5.61%	7.11%
Jan-11	11.99%	8.87%	7.84%	7.49%	5.03%	5.96%
Feb-11	11.22%	9.01%	7.57%	7.22%	4.91%	5.53%
Mar-11	10.43%	8.86%	7.07%	7.20%	5.13%	5.37%
Apr-11	10.60%	9.69%	7.38%	6.90%	4.95%	5.17%
May-11	10.82%	9.75%	7.26%	6.11%	5.51%	5.45%
Jun-11	10.25%	9.69%	6.81%	5.39%	5.70%	5.12%
Jul-11	10.02%	9.51%	6.38%	4.94%	6.11%	5.12%
Aug-11	10.25%	8.86%	6.16%	5.14%	6.04%	4.88%
Sep-11	10.23%	9.18%	6.13%	5.00%	5.15%	4.69%
Oct-11	10.29%	8.59%	5.53%	4.77%	5.77%	4.57%
Nov-11	9.94%	8.22%	5.59%	4.85%	5.75%	4.20%
Dec-11	9.74%	7.83%	5.62%	4.78%	5.59%	4.12%
Jan-12	9.00%	8.29%	6.20%	5.23%	5.04%	4.15%
Feb-12	9.17%	9.19%	6.18%	5.11%	4.64%	4.35%
Mar-12	8.53%	8.57%	6.34%	5.16%	5.14%	4.30%
Apr-12	8.52%	8.55%	6.18%	5.46%	4.65%	4.20%
May-12	10.19%	8.24%	6.31%	6.03%	4.86%	4.28%

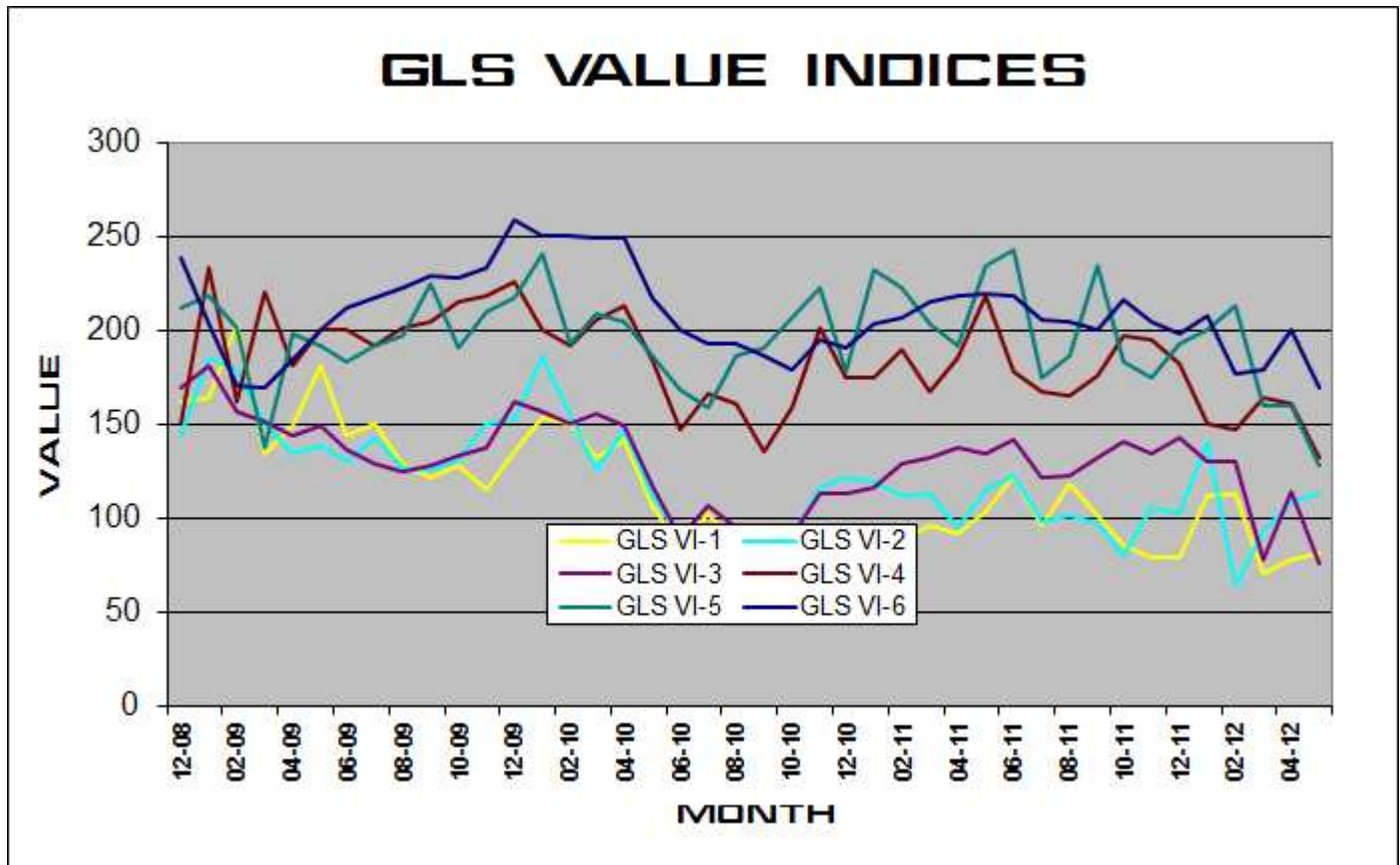
Rolling six-month CPR speeds for all maturity buckets. Source: Colson Services

# 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	
Dec-08	1.64%	3.89%	2.25%	162.2	144.9	170.3	151.0	212.5	238.6		
Jan-09	1.11%	3.25%	2.14%	164.8	185.5	181.7	233.2	218.3	204.4		
Feb-09	1.15%	3.25%	2.10%	203.6	179.5	157.4	162.9	201.5	171.3		
Mar-09	1.06%	3.25%	2.19%	135.3	150.3	151.6	220.4	138.0	169.7		
Apr-09	0.96%	3.28%	2.32%	149.4	134.8	144.3	182.0	198.3	184.5		
May-09	0.70%	3.26%	2.57%	182.1	138.7	149.6	200.3	192.4	200.8		
Jun-09	0.55%	3.25%	2.70%	144.8	130.3	137.3	200.2	183.8	212.8		
Jul-09	0.48%	3.25%	2.77%	150.9	143.8	129.1	191.9	192.4	217.4		
Aug-09	0.39%	3.25%	2.86%	129.7	127.4	125.7	201.7	197.3	222.8		
Sep-09	0.29%	3.25%	2.96%	122.0	126.5	128.3	205.5	225.3	229.6		
Oct-09	0.26%	3.25%	2.99%	128.2	131.3	133.9	216.0	191.2	228.8		
Nov-09	0.26%	3.25%	2.99%	115.3	150.9	138.0	219.2	210.8	234.2		
Dec-09	0.25%	3.25%	3.00%	136.1	153.4	162.0	226.3	218.0	259.6		
Jan-10	0.25%	3.24%	2.99%	153.9	186.5	157.2	201.0	240.6	250.7		
Feb-10	0.25%	3.23%	2.99%	150.8	155.1	150.4	192.3	193.0	250.7		
Mar-10	0.26%	3.25%	2.99%	133.1	126.0	155.8	206.4	209.5	249.2		
Apr-10	0.29%	3.25%	2.96%	142.1	147.5	149.3	213.6	205.1	250.0		
May-10	0.41%	3.25%	2.84%	107.5	112.1	117.5	184.4	187.2	218.1		
Jun-10	0.52%	3.25%	2.73%	85.9	90.9	90.1	147.5	168.7	200.4		
Jul-10	0.46%	3.26%	2.80%	102.7	81.0	106.7	167.0	159.5	193.5		
Aug-10	0.33%	3.26%	2.93%	85.6	91.6	95.4	161.6	186.6	193.2		
Sep-10	0.28%	3.25%	2.97%	74.1	95.3	94.0	135.6	190.8	187.2		
Oct-10	0.28%	3.25%	2.97%	79.8	89.7	91.3	159.8	207.2	179.5		
Nov-10	0.27%	3.25%	2.98%	70.5	117.2	113.5	202.0	223.5	195.4		
Dec-10	0.29%	3.25%	2.96%	79.7	121.8	113.3	175.5	178.1	191.3		
Jan-11	0.29%	3.25%	2.96%	77.0	119.8	117.3	175.2	232.3	203.7		
Feb-11	0.29%	3.25%	2.96%	88.9	112.9	129.8	190.4	222.9	207.6		
Mar-11	0.30%	3.25%	2.95%	96.8	113.5	132.3	167.8	203.4	216.0		
Apr-11	0.27%	3.25%	2.98%	92.5	95.9	137.6	186.2	192.5	218.8		
May-11	0.24%	3.25%	3.01%	104.3	116.1	134.3	219.2	235.1	220.2		
Jun-11	0.23%	3.24%	3.01%	123.1	123.0	141.8	178.1	243.7	218.4		
Jul-11	0.24%	3.25%	3.01%	96.8	98.4	121.7	167.9	175.4	206.5		
Aug-11	0.27%	3.24%	2.97%	118.6	101.5	122.8	165.8	186.4	205.3		
Sep-11	0.32%	3.25%	2.93%	101.6	98.0	132.7	176.2	234.9	200.5		
Oct-11	0.34%	3.24%	2.90%	85.5	80.8	141.1	197.4	183.4	216.3		
Nov-11	0.41%	3.25%	2.84%	79.1	106.3	134.9	195.8	175.2	204.9		
Dec-11	0.50%	3.25%	2.75%	79.6	103.0	143.8	182.6	193.6	198.5		
Jan-12	0.44%	3.25%	2.81%	112.1	141.1	130.7	151.0	201.1	208.5		
Feb-12	0.41%	3.25%	2.84%	113.5	65.0	130.5	148.1	214.0	177.6		
Mar-12	0.44%	3.25%	2.81%	71.5	93.3	78.5	164.3	160.2	179.3		
Apr-12	0.42%	3.25%	2.83%	78.7	109.6	114.6	161.0	160.2	200.8		
May-12	0.43%	3.24%	2.81%	81.3	113.4	76.4	132.5	128.0	169.8		

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
Jan-12	8.58%	10.72%	7.83%	6.85%	2.98%	5.37%	6.20%
Feb-12	8.34%	11.36%	5.10%	6.11%	3.07%	4.85%	5.23%
Mar-12	6.22%	5.31%	8.24%	5.16%	5.91%	3.98%	5.28%
Apr-12	12.23%	8.27%	4.76%	6.21%	4.98%	3.87%	4.61%
May-12	17.10%	7.97%	6.73%	8.11%	7.40%	4.25%	5.62%
Jun-12	9.68%	11.23%	7.59%	6.81%	5.06%	5.18%	6.16%
Grand Total	10.42%	9.19%	6.72%	6.54%	4.93%	4.58%	5.52%

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

Table 4:

POOL AGE	<8	8 - 10	10 - 13	13 - 16	16 - 20	20+	ALL
Jan-12	25 Mos.	35 Mos.	34 Mos.	65 Mos.	48 Mos.	49 Mos.	45 Mos.
Feb-12	25 Mos.	36 Mos.	34 Mos.	66 Mos.	48 Mos.	49 Mos.	45 Mos.
Mar-12	25 Mos.	37 Mos.	34 Mos.	67 Mos.	48 Mos.	49 Mos.	45 Mos.
Apr-12	26 Mos.	37 Mos.	35 Mos.	67 Mos.	49 Mos.	49 Mos.	45 Mos.
May-12	26 Mos.	36 Mos.	34 Mos.	68 Mos.	48 Mos.	49 Mos.	45 Mos.
Jun-12	26 Mos.	36 Mos.	35 Mos.	69 Mos.	49 Mos.	48 Mos.	45 Mos.

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

## YEAR-TO-DATE CPR DATA

Table 5:

< 8 BY AGE	0-12 Mos.	13-24 Mos.	25-36 Mos.	37-48 Mos.	48+ Mos.
Jan-12	4.61%	10.56%	11.52%	8.08%	9.00%
Feb-12	0.62%	8.06%	18.49%	9.44%	9.94%
Mar-12	6.41%	7.45%	5.74%	3.48%	5.81%
Apr-12	6.62%	10.67%	23.99%	6.82%	12.01%
May-12	28.92%	16.66%	8.73%	3.58%	14.15%
Jun-12	0.88%	16.05%	8.50%	6.76%	17.59%
Grand Total	8.66%	11.32%	12.88%	6.43%	11.55%

10-13 BY AGE	0-12 Mos.	13-24 Mos.	25-36 Mos.	37-48 Mos.	48+ Mos.
Jan-12	4.98%	13.62%	11.17%	8.87%	4.67%
Feb-12	2.23%	8.94%	8.43%	5.94%	3.39%
Mar-12	13.56%	5.97%	8.58%	9.41%	4.63%
Apr-12	2.39%	3.07%	8.48%	4.01%	6.43%
May-12	1.38%	11.76%	10.66%	8.24%	5.67%
Jun-12	7.21%	11.80%	7.84%	6.17%	5.42%
Grand Total	5.36%	9.29%	9.19%	7.21%	5.06%

16-20 BY AGE	0-12 Mos.	13-24 Mos.	25-36 Mos.	37-48 Mos.	48+ Mos.
Jan-12	0.00%	0.00%	10.01%	0.83%	3.98%
Feb-12	1.78%	0.33%	0.00%	0.54%	5.52%
Mar-12	0.00%	0.00%	10.43%	19.56%	6.01%
Apr-12	4.43%	6.18%	14.80%	0.00%	3.42%
May-12	2.10%	9.62%	9.97%	12.97%	6.81%
Jun-12	0.00%	0.00%	9.03%	8.84%	6.91%
Grand Total	1.39%	3.18%	9.03%	7.33%	5.47%

## YEAR-TO-DATE CPR DATA

Table 5:

8-10 BY AGE	0-12 Mos.	13-24 Mos.	25-36 Mos.	37-48 Mos.	48+ Mos.
Jan-12	5.92%	18.80%	12.03%	6.23%	8.78%
Feb-12	2.64%	15.16%	17.87%	8.30%	7.31%
Mar-12	2.89%	8.57%	5.56%	3.42%	4.94%
Apr-12	10.49%	1.45%	15.15%	6.87%	5.71%
May-12	0.23%	10.39%	12.68%	7.19%	6.40%
Jun-12	1.55%	14.98%	14.97%	16.50%	7.61%
Grand Total	3.88%	11.91%	13.07%	7.97%	6.79%

13-16 BY AGE	0-12 Mos.	13-24 Mos.	25-36 Mos.	37-48 Mos.	48+ Mos.
Jan-12	10.25%	0.00%	22.29%	0.00%	5.87%
Feb-12	8.14%	20.32%	0.00%	0.00%	4.64%
Mar-12	0.00%	6.22%	4.96%	7.71%	5.84%
Apr-12	3.16%	12.59%	6.20%	42.15%	4.25%
May-12	0.00%	8.07%	36.75%	0.00%	4.63%
Jun-12	0.00%	0.00%	21.04%	0.00%	6.89%
Grand Total	4.37%	7.78%	16.07%	9.41%	5.35%

20+ BY AGE	0-12 Mos.	13-24 Mos.	25-36 Mos.	37-48 Mos.	48+ Mos.
Jan-12	3.34%	5.45%	10.66%	7.13%	4.76%
Feb-12	3.49%	5.92%	5.67%	7.27%	4.68%
Mar-12	1.77%	5.65%	5.18%	5.46%	4.04%
Apr-12	0.02%	3.88%	4.72%	6.94%	4.95%
May-12	0.96%	6.24%	4.07%	7.02%	4.66%
Jun-12	0.04%	2.93%	8.80%	9.29%	6.78%
Grand Total	1.65%	4.98%	6.52%	7.16%	4.99%

## GLOSSARY AND DEFINITIONS: PART 1

### Default-Curtailment Ratio

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

The default ratio is calculated using the following formula:

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

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

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

### Theoretical Default Rate

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

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

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

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

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

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

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

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

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

#### **The Process**

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

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

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

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

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

### GLS Long Value Indices

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

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

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

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

## GLOSSARY AND DEFINITIONS: PART 2

### Prepayment Calculations

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

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

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

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

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

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### SBA Libor Base Rate

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

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

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### Risk Types

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

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

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

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

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

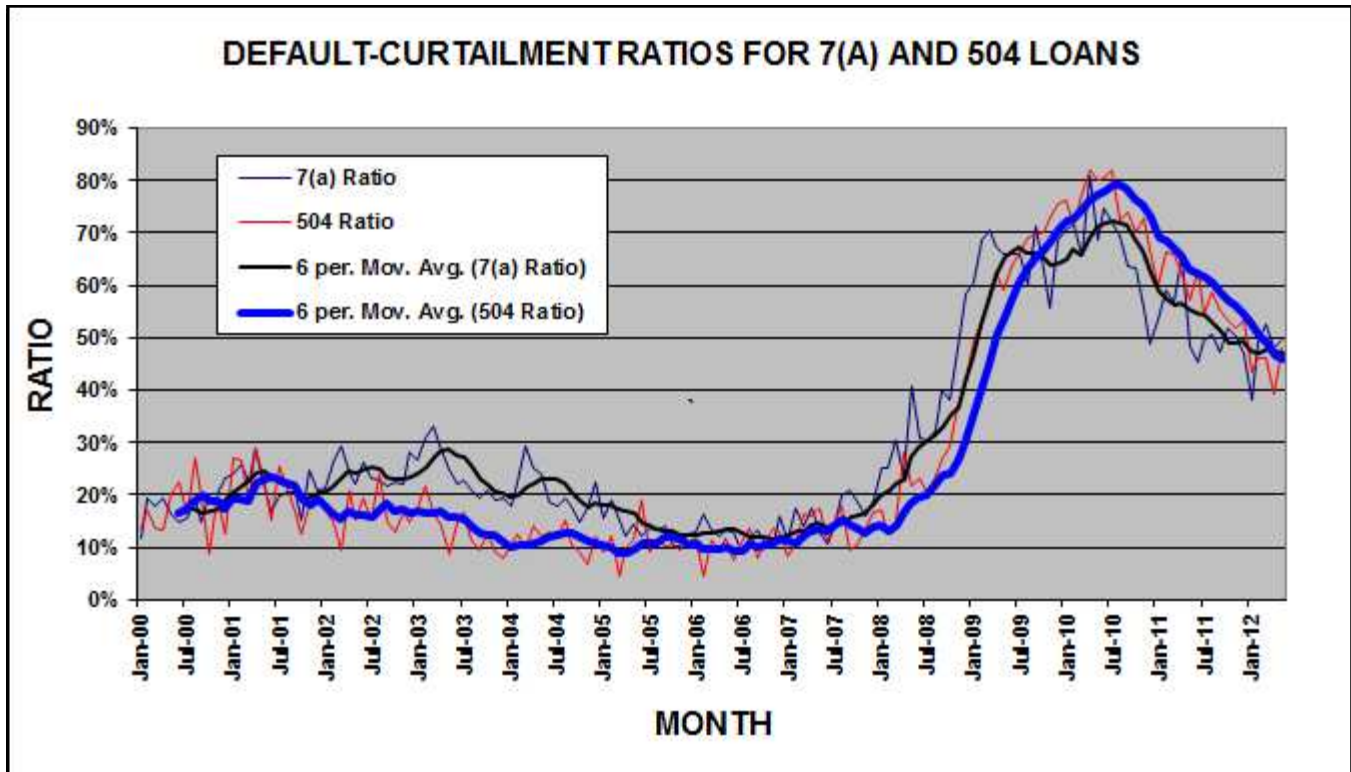
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### Secondary Market First Lien Position 504 Loan Pool Guarantee Program

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

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

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



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