

Bob Judge, Government Loan Solutions, Editor



Bob Judge is a partner at Government Loan Solutions.

Government Loan Solutions is a provider of valuation services, pre-payment analytics and operational support for the SBA marketplace.

Bob has 25 years of experience in the fixed income markets. He holds a B.A. in Economics from Vassar College and an M.B.A. in Finance from NYU Stern School of Business.

### INSIDE THIS ISSUE:

#### Special points of interest:

- Prepayments Below 8%
- SMA Update
- Default Rate Falls
- Value Indices Lower

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## JUNE CPR: PREPAYMENT SPEEDS FALL BACK BELOW 8%

Prepayments in June fell back below 8%, after a one month period above 10%. This reading is more in line with what we have been seeing in the first half of this year.

After a spike in defaults in May that pushed the default CPR (DCPR) above 8%, June saw a

return to a default rate below 6%, which led the overall CPR below 8%.

While we are pleased that the number of defaults fell back in June, preliminary data from Colson suggests that defaults will rise in July, but not to the level seen in May.

Turning to the numbers,

the prepayment speed for June came in at CPR 7.91%, 24% lower than the May reading of CPR 10.45%.

YTD for 2010 fell slightly, reaching CPR 7.99%, which still compares favorably to the CPR 9.56% recorded in the first six months of 2009.

*Continued on page 2*

## SMA UPDATE: PROGRAM UPDATE AND H.R. 5297

By Jordan Blanchard

*Editor's note: Please take the time to visit our website: [www.SMA504.com](http://www.SMA504.com). It has a wealth of information relating to the new 504 pooling program.*

#### Program Update

The First Mortgage Pool (FMP) program is nearing program launch. There are now 12 approved Pool Originators ranging from community banks to Bank of America (represented

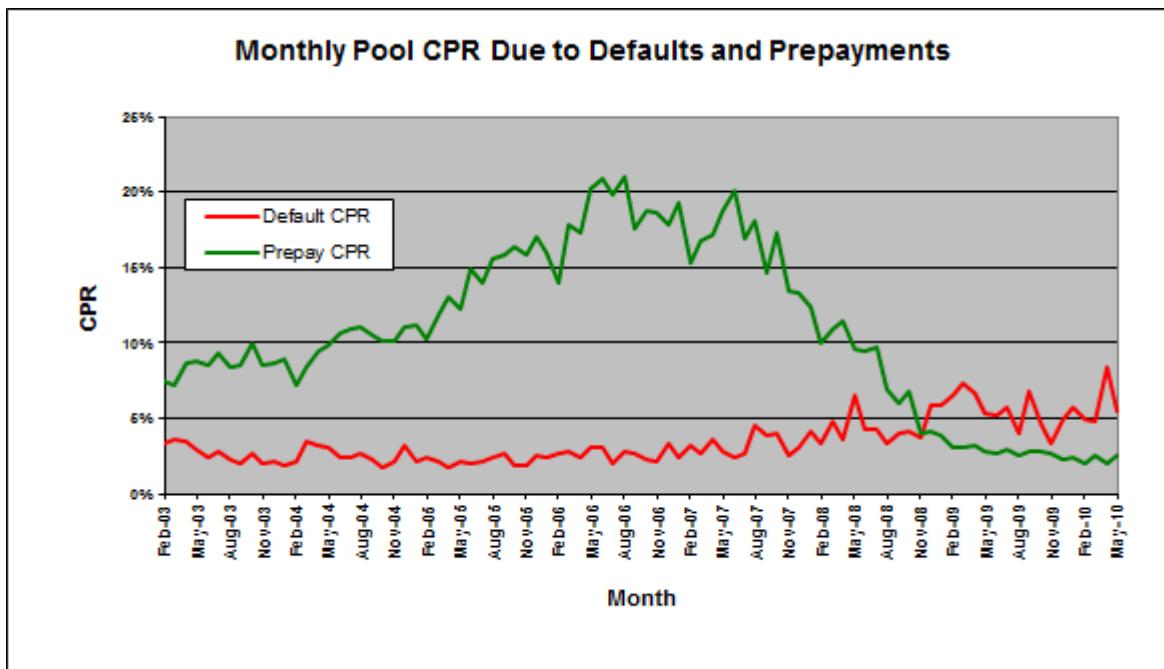
by CDC Direct Capital and a consortium of national CDC's). Many more Pool Originator applications are expected to be approved over the coming weeks.

possible. SBA is still on pace to process the first pool guarantee and loan pool sale sometime in early to mid August. SBA expects to provide more guidance and clarification over the next

*Continued on page 4*



## JUNE CPR...CONTINUED



Turning to the default/voluntary prepayment breakdown, the **Voluntary Prepay CPR** (green line) rose from 2.01% in May to 2.47% in June. This sub-3% reading is consistent with what we have been seeing for the past year and should continue well into the future.

While the VCPR remained below 3%, the **Default CPR** (red line) moved below 6% to 5.43%. This reading is also more consistent with what we have been used to seeing over the past year, as the rolling 12-month average is currently 5.33%.

Specifically, prepayment speeds fell in five out of the six maturity categories. The largest decrease was seen in the 10-13 maturity bucket, which fell 34% to CPR 9.78%.

Other decreases were seen in the 13-16 (-30% to CPR 7.02%), 20+ (-21% to CPR 6.36%), 8-10 (-18% to CPR 12.88%) and 1<8 (-16% to CPR 10.99%).

The lone increase was in the 16-20 maturity category, which rose by 15% to CPR 9.37%.

The good news this month was the return to the prepayment and default trends we have become used to for the past

year. Next month, we will see if these trends will hold.

Voluntary prepayments of sub 3%, combined with default rates between 5% and 6 create a very favorable environment for investors, which should support continued secondary market pricing in excess of 110.

*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 16-18*

***"Voluntary prepayments of sub 3%, combined with default rates between 5% and 6% create a very favorable environment for investors, which should support continued secondary market pricing in excess of 110."***

Bob Judge can be reached at  
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[bob.judge@glsolutions.us](mailto:bob.judge@glsolutions.us)

# 2010 SBA Secondary Market Forum

We first met in New York City in 2008. Our timing was infamous as the secondary market crashed that day. Two years later we are gathering in Washington, DC to discuss: what have we learned?

With the economy still in recession, this conference will cover the current changing work of the SBA Secondary Market as it relates to current and new programs. Especially, how the 504-pooling program will affect 7(a) pools and how lenders can pros-



per and succeed during these difficult times.

The purpose of the forum is to bring together lenders, pool assemblers, investors, and regulators to address SBA Secondary Market, investing in SBA pools, and the Treasury Direct Purchase Program of SBA securities. The conference is an avenue for a free-flow exchange of ideas on where we are today and what we would like to see from the secondary market and governmental programs that support SBA lending.

## Who should attend:

- SBA Bank and Non-Bank Lenders
- CDC Officials
- Broker-Dealers
- Governmental Agencies
- Investors

## What you will learn:

- 7(a) prepayment trends
- Current 7(a) pricing trends – where are they headed?
- Status and future of the new 504-pooling program
- New FASB accounting rules
- The USDA B&I Secondary Market

## AGENDA

**Monday, September 20th:** 6:00 p.m. to 7:30 p.m.  
Reception

**Tuesday, September 21st:** 8:30 a.m. to 9:00 a.m.  
Registration and continental breakfast

**Status of 7(a) Secondary Market:** 9:00 a.m. to 10:00 a.m.  
Chris LaPorte, Bob Judge

**Status of 504 Secondary Market:** 10:15 a.m. to 11:15 a.m.  
Jon Winick, Bob Judge, Jordan Blanchard, Matthew Hunt

**Status of USDA B&I Secondary Market:** 11:15 a.m. to 11:45 a.m.  
Mike Thomas

**Luncheon:** 12:00 p.m. to 1:30 p.m.  
Keynote Speaker - TBA

**FAS 166 and True Sale Accounting:** 1:30 p.m. to 2:00 p.m.  
Bill McGaughey

**Open Discussion Session:** 2:00 p.m. to 3:30 p.m.

## CONFERENCE DETAILS

Tuesday, September 21, 2010  
Washington, DC

Reception, Monday, September 20th  
Bingham McCutchen, LLP  
2020 K Street, NW (11th floor)  
Washington, DC 20006

The forum will take place at Bingham McCutchen, LLP, a law firm in Washington, DC.

They are located at:  
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## SECONDARY MARKET ACCESS...CONTINUED

few weeks which will pave the way for more loan pool sales.

### Legislative Update

The legislative activity that would affect SBA is touch-and-go right now. The Senate version of HR 5297 includes many program enhancements to both 7A and 504. The 504 program enhancements are as follows:

- Increase the maximum 504 Debenture to \$5,000,000 for regular applications and \$5,500,000 for manufacturers or projects that meet SBA's designation as 'green'
- Allow for a two year period the ability to refinance owner-occupied, non SBA debt to a loan-to-value ratio of 90%
- Provide for a two year extension to the FMP program from the date of first pool issuance

All of these provisions would be extremely helpful to the 504 lending community. The first two would greatly expand the number and size of eligible transactions, and the last provision would allow more lenders to commit to the 504 program knowing that there will be a secondary market for the foreseeable future.

As this article goes to press (July 20, 2010), it looks like HR 5297's prospects are iffy at best. But there is broad support for HR 5297 from a host of industries. Hopefully this support will lead to bill passage.

If legislation to extend the program does not pass, a final option would be for SBA to amend the eligibility parameters from Debenture funding to Debenture approval. SBA has given some endorsement of this idea, but would most likely require final pool settlement sometime in May of 2011. That short extension would provide some value but would not result in a significant increase in volume because the program life would still be relatively short.

### Eligibility Workaround Tip

First mortgage loans are already being submitted to Pool Originators for price indications and sale. Activity leads to questions and unforeseen issues. One question is how to address ineligible proceeds in an otherwise FMP eligible loan.

A prime example of this potential situation is a 504 first mortgage that was used to finance a hotel that included a swimming pool. The proceeds used to finance the swimming pool 'may' not be eligible to be included as part of an eligible FMP loan. The reason

is that FMP program was part of the ARRA bill (AKA the Stimulus bill), which expressly prohibited Stimulus bill proceeds from financing golf courses, gambling related entities, aquariums, zoos, and any property with a swimming pool. Quite a few 504 first mortgages were used to finance hospitality properties that included swimming pools – which was acceptable before the Stimulus bill was passed.

There are other situations where a 504 first mortgage could contain 504 ineligible proceeds. One example is if a 504 allowed for the payoff of ineligible debt as part of the 504 transaction (which can occur). That portion of the debt would not be eligible to be included in a 504 first mortgage loan that was to be pooled.

You may need to contact the participating CDC to determine how much of a first mortgage contained ineligible proceeds, if any. For instance, if a property with a swimming pool was financed using an SBA 504 loan structure, only the applicable percentage of the first mortgage multiplied by the cost allocation of the swimming pool would be considered ineligible. On the other hand, if ineligible debt was paid off by the 504 first mortgage, then ALL of that debt would be considered ineligible. Again, advice from the participating CDC or from CDC Direct Capital (866-938-4232) may be required.

So what is the solution? Thankfully SBA has provided some initial guidance.

### Scenario 1

If the ineligible portion of the first mortgage is equal to or less than the borrower contribution (the down payment), then there is no issue and the loan can be pooled normally.

### Scenario 2

If the ineligible portion of the first mortgage exceeds the borrower contribution, then that overage must be retained by the Seller. But if the overage is less than the Seller's required retainage of 15%, then there is no issue and the loan can be pooled accordingly.

### Scenario 3

If the overage above and beyond the borrower's contribution exceeds the Seller's required retainage of 15%, then the amount of overage will be added to the Seller's retainage. This will result in the retainage being higher than 15%. Please see the following example for illustrative purposes:

## SECONDARY MARKET ACCESS...CONTINUED

Consider that a \$1,000,000 loan includes \$500,000 of ineligible proceeds. Assume the original down payment was \$200,000. The Seller's normal required retainage would be \$150,000, or 15% of the first mortgage. A full \$400,000 (\$200M borrower contribution + \$150M in seller retainage) of ineligible proceeds would be protected (allowed to be included in the pool), but the Seller's retainage would increase to \$250,000 (\$150M normal retainage plus \$100M additional retainage).

### 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 (as described above).
- 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.
- Sale of the 15% Seller Loan Interest for those lenders that wish to sell 85% of each loan to the Pool Originator and

then subsequently sell the remaining 15% to an unaffiliated third party.

- SMA is working on, but has yet to formalize, a solution for excess servicing. Please stay tuned.

SMA is currently looking for eligible funded loans in order to build efficiently-sized loan pools that result in the maximum price paid to the selling lender. If you have loans where the debenture funded on or after February of 2009 (includes first liens funded in 2008), please contact either Bob Judge of Government Loan Solutions or Jordan Blanchard of CDC Small Business Finance Corp. The interested Seller will be sent a loan tape to complete and return. The SMA member will then issue loan bids and coordinate sale for all interested sellers.

### Who we Are

CDC Small Business Finance is the nation's leading SBA 504 Lender and is involved in various other community lending programs. CDC's 504 loan portfolio is comprised of over 3,800 loans totaling \$2B. CDC is a leading innovator in providing solutions to its banking partners and small business borrowers. Jordan Blanchard can be reached at [jblanchard@cdcloans.com](mailto:jblanchard@cdcloans.com), or 951-552-4157.

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

## TALF Tracker

The **TALF Tracker**, created by GLS, the same firm that brought you the widely-used "TALF Calculator", is meant to help the TALF investor understand the complexities of their SBA 7a TALF investments.

### Highlights of the TALF Tracker include:

- Track past, present and future payments.
- Create "What-If" scenarios and see their impact on total and net returns.
- See the impact of potential sales prior to the end of the TALF loan period.
- Track investor fees and the net return to investment clients.

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

## SECONDARY MARKET ACCESS



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

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

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

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

- **Bob Judge, GLS, at (216) 456-2480 ext. 133 or via e-mail at [bob.judge@glssolutions.us](mailto:bob.judge@glssolutions.us)**



## SECONDARY MARKET ACCESS

### 504 FMLP Rate Guidance - 85% Loan Interest Sale

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

NEW LOANS ONLY	90 Day Adjustable (LIBOR)			Quarterly Adjustable (Prime)			5 Yr Fixed		
	PAR RATE = 3 Mo LIBOR + spread calculated below			PAR RATE = WSJ Prime + spread calculated below			PAR RATE = 5-yr Swap + Spread Resets: Q at 3-Mo. Libor + Spread		
Credit	Multi	Hosp	Other SP	Multi	Hosp	Other SP	Multi	Hosp	Other SP
Base	+ 3.25%	+ 4.00%	+ 4.00%	+ 0.50%	+ 1.25%	+ 1.25%	+ 3.25%	+ 3.75%	+ 3.75%
LTV > 55%	+ 0.25%	+ 0.50%	+ 0.75%	+ 0.25%	+ 0.50%	+ 0.75%	+ 0.25%	+ 0.50%	+ 0.75%
DCR < 1.2	+ 0.25%	+ 0.50%	+ 0.75%	+ 0.25%	+ 0.50%	+ 0.75%	+ 0.25%	+ 0.50%	+ 0.75%
DCR < 1.0	+ 0.50%	+ 0.75%	+ 1.00%	+ 0.50%	+ 0.75%	+ 1.00%	+ 0.50%	+ 0.75%	+ 1.00%
FICO < 680	+ 0.25%	+ 0.50%	+ 0.75%	+ 0.25%	+ 0.50%	+ 0.75%	+ 0.25%	+ 0.50%	+ 0.75%
FICO < 620	+ 0.75%	+ 1.00%	+ 1.25%	+ 0.75%	+ 1.00%	+ 1.25%	+ 0.75%	+ 1.00%	+ 1.25%
Biz < 1 Yr	+ 0.25%	+ 0.50%	+ 0.75%	+ 0.25%	+ 0.50%	+ 0.75%	+ 0.25%	+ 0.50%	+ 0.75%
Rate Floor	5.75%	5.75%	5.75%	5.75%	5.75%	5.75%	6.25%	6.25%	6.25%
Reset Mgn	n/a	n/a	n/a	n/a	n/a	n/a	initial	initial	initial
NEW LOANS ONLY	7 Year Fixed PAR RATE = 5-yr Swap + Spread Resets: Q at 3-Mo. Libor + Spread			10 Year Fixed PAR RATE = 10-yr Swap + Spread Resets: Q at 3-Mo. Libor + Spread			Each +0.25% added to Note Rate provides 1.00% in YSP. Max 5% premium.		
							Prepay Penalty Premium Calc		
Credit	Multi	Hosp	Other SP	Multi	Hosp	Other SP	Adjustable		
Base	+ 3.50%	+ 4.00%	+ 4.00%	+ 3.75%	+ 4.25%	+ 4.25%	No Prepay Penalty		
LTV > 55%	+ 0.25%	+ 0.50%	+ 0.75%	+ 0.25%	+ 0.50%	+ 0.75%	5,4,3,2,1		
DCR < 1.2	+ 0.25%	+ 0.50%	+ 0.75%	+ 0.25%	+ 0.50%	+ 0.75%	5,5,5,5,5		
DCR < 1.0	+ 0.50%	+ 0.75%	+ 1.00%	+ 0.50%	+ 0.75%	+ 1.00%	7,6,5,4,3,2,1		
FICO < 680	+ 0.25%	+ 0.50%	+ 0.75%	+ 0.25%	+ 0.50%	+ 0.75%	10,9,8,7,6,5,4,3,2,1		
FICO < 620	+ 0.75%	+ 1.00%	+ 1.25%	+ 0.75%	+ 1.00%	+ 1.25%			
Biz < 1 Yr	+ 0.25%	+ 0.50%	+ 0.75%	+ 0.25%	+ 0.50%	+ 0.75%	5-yr Fixed		
Rate Floor	+ 6.50%	+ 6.50%	+ 6.50%	+ 7.00%	+ 7.00%	+ 7.00%	No Prepay Penalty		
Reset Mgn	initial	initial	initial	initial	initial	initial	-1.00%		
	Maximum Loan Balance (\$MM)			Other Pricing Notes			5,4,3,2,1		
Credit	Multi	Hosp	Other SP	Pricing assumes 365/360.			-+ 1.00%		
LTV > 55%	\$5 MM	\$4 MM	\$3 MM	Servicing assumed at 50 bps.			5,5,5,5,5		
DCR < 1.2	-\$1 MM	-\$1 MM	-\$1 MM	Excess servicing possible on 85%.			7,6,5,4,3,2,1		
DCR < 1.0	-\$2 MM	-\$2 MM	-\$2 MM				10,9,8,7,6,5,4,3,2,1		
FICO < 680	-\$1 MM	-\$1 MM	-\$1 MM	Note: This pricing is for 85% portions of 504 FMLP and is for indicative purposes only. For more info, please call SMA.			Up to 20% of principal paid per year with- out penalty is subject to a .50% reduction in premium.		
FICO < 620	-\$2 MM	-\$2 MM	-\$2 MM						
Biz < 1 Yr	-\$1 MM	\$0 MM	\$0 MM						



## THE LEGAL BEAT

### BEST PRACTICES: THE ELIGIBLE PASSIVE COMPANY (EPC) RULE

By Ethan W. Smith

The SBA's Eligible Passive Company (EPC) rules and regulations can be both complex and confusing for lenders. SBA lenders often ask when a loan must be structured as an EPC/OC loan. Additionally, the particular facts and requirements of some transactions and certain Borrowers do not fit into the EPC requirements. Accordingly, SBA lenders must take care to ensure that they are using the EPC structure appropriately and in compliance with SBA requirements.

Generally, it is important for lenders to remember that the EPC rule is an exception to the SBA's general prohibition against making SBA loans to passive entities or to finance assets held for passive income or investment purposes. Because the EPC rule is an exception to an eligibility rule, it is interpreted strictly by the SBA, and failure to comply will result in a recommendation for a denial of the SBA guaranty.

A few guidelines to keep in mind for loans with an EPC/OC structure:

- an EPC can take any legal form or ownership structure, including corporations, LLC's, partnerships, trusts or joint ownership such as a Tenancy in Common. Multiple EPCs in one transaction are not permitted (although a Tenancy in Common, while comprised of multiple individuals, is considered one legal form for this purpose);
- an EPC must use loan proceeds to acquire or lease, and/or improve or renovate real or personal property (including eligible refinancing) that it leases to one or more Operating Companies (OC) for conducting the OC's business. If the purpose of your loan is not for the listed purposes (i.e.: working capital), an EPC/OC structure is not required;
- The EPC (with the exception of a trust) and the OC each must be small under the appropriate SBA size standards;
- The EPC must lease the 100% of the rentable project property directly to the OC and:
  - (1) The lease must be in writing;
  - (2) The lease must be subordinated to the Lender's lien on the property;
  - (3) The lease must have a term, including options to renew exercisable solely by the OC, at least equal to the term of the loan;
  - (4) The EPC must assign all rents paid under the lease

as collateral for the Loan;

(5) The rent or lease payments cannot exceed the amount necessary to make the loan payment to the lender, and an additional amount to cover the EPC's expenses of holding the property, such as maintenance, insurance and property taxes.

Again, because the EPC rule is an exception to SBA eligibility policy, it is strictly enforced. Avoid costly mistakes by ensuring that all of the requirements for the EPC rule have been satisfied. Failure to ensure that all of the conditions have been met for the EPC rule could result in a complete denial of your SBA guaranty.

For more information on the EPC rule and other SBA eligibility issues, contact Ethan Smith at: 215-542-7070 or [esmith@starfieldsmith.com](mailto:esmith@starfieldsmith.com).



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

### Settlement & Sales Strategies Tip #23 – Consistency is the key...

While this can be applied to many situations in life, I am referring to process management. Settling SBA loans, while not difficult, is a very detailed oriented process which requires hands on experience. If you find that your loans sales are infrequent, or that you have turnover in your back office staff, consider outsourcing this function.

Outsourcing provides a means to leverage both staff and experience in a cost effective manner which provides for a consistent process, greater productivity, and shorter settlements.

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 DECLINE

For May, The GLS Value Indices displayed decreases in all six maturity categories versus April readings.

A contributing factor to this decrease was a decrease in the Base Rate / Libor spread, which fell by 12 basis points to 2.84% from 2.96%. Additionally, the prepayment element of the indices increased in all six categories, lowering the return and thus the Libor spread.

With loan prices rising by an unprecedented 1% to 1.50% in May, there was no stopping the indices from decreasing by double-digit percentages. The competition

for loans among pool assemblers was acute all month, as rumor had it that the U.S. Treasury was purchasing 7a pools to support the secondary market.

Whatever the reason, lenders are benefiting from the increased demand for loans as secondary market prices exceeded 112 for 2.75%, 25 year loans.

Turning to the specifics, the largest decrease was seen in the GLS VI-1, which fell by 24% to 107.5 basis points. The other decreases were, by order of magnitude, VI-2 (-24% to 112.1), VI-3 (-21% to 117.5), VI-4 (-14% to 184.4) and VI-6 (-

13% to 218.1).

With secondary market prices in June still in the 112 range for the long-end of the market, we expect similar readings 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 pages 13-14, Graph on page 15*

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

Maturity	Gross Margin	Fees	Servicing	4/30/2010 Price	Last Month Price	3-Mos. Ago Price	6-Mos. Ago Price	Net Margin
10 yrs.	2.75%	0.6750%	1.00%	110.50	109.32	108.875	109.45	1.075%
15 yrs.	2.75%	0.6750%	1.00%	110.75	109.60	109.25	109.53	1.075%
20 yrs.	2.75%	0.6750%	1.00%	112.00	110.50	110.00	110.00 / 1.00%	1.075%
25 yrs.	2.75%	0.6750%	1.00%	112.25	110.65	110.125	110.00 / 1.08%	1.075%



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## DEFAULT RATE FALLS BELOW 6%

After one month in excess of 8%, the theoretical default rate returned below 6%, in-line with the readings for the past year.

While we expect next month's reading to go above 6%, it should not reach record levels seen in April.

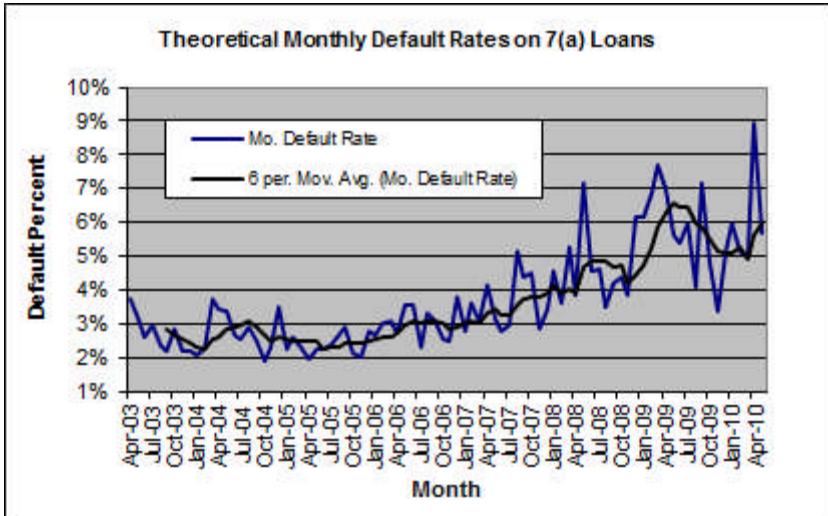
On a quarterly basis, the rolling 3-month rate rose to 6.52% from 6.36% in April. For 2010, the average default rate remains below 6% at 5.70%.

Lately, we have been seeing more volatility in the monthly default numbers, but they still remain in

the 6% range over the 3 and 6 month averages.

While the increased volatility may be a harbinger of higher default rates in the future, this month's reading provides us with at least a temporary reprieve.

Check back next month to see where we stand as we head into the Summer of 2010.



*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) both the 7a and 504 loan types showed decreases for May. While both remain elevated due to low voluntary prepayment activity, a leveling off of defaults brought both DCRs off of the highs seen in April. Please note that an increase in the DCR does not necessarily mean that the default rate is rising, only that the percentage of early curtailments attributable to defaults has increased.

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

### SBA 7(a) Default Ratios

For the 25th month in a row, the 7(a) DCR exceeded 30%, coming in at 68.73%, a decrease of 15% from April's record high of 81.91%.

As stated above, the 7a DCR remains elevated due to a continued low voluntary prepayment percentage that continues to hover around 2% to 3%. While defaults fell in May, they remain on the high end of

the range since the recession began.

Turning to actual dollar amounts, defaults fell by a sizable \$77 million, or 33%, to \$157 million. As for voluntary prepayments, they rose by \$16 million (+28%) to \$71.3 million.

### SBA 504 Default Ratios

Also for the 25th month in a row, the 504 DCR came in above 20%, falling 2% to 80.11%, the second month in a row of +80%. Both voluntary prepayments and defaults rose by \$6 million in May, which had little impact on the 504 DCR.

Specifically, the dollar amount of defaults rose by \$5.9 million to \$159.9 million (+4%). As for voluntary prepayments, they also rose, increasing by \$5.7 million to \$39.7 million (+17%).

### Summary

In summary, low voluntary prepayments

continue to keep both DCRs elevated as we head into the second-half of 2010. Don't expect much change as small business continues to suffer in this economy.

*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 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
<b>Dec-06</b>	16.78%	18.62%	14.44%	18.97%	20.67%	24.48%
<b>Jan-07</b>	16.44%	17.36%	13.95%	18.23%	20.89%	24.14%
<b>Feb-07</b>	17.47%	17.00%	13.86%	17.95%	21.81%	24.21%
<b>Mar-07</b>	16.07%	16.65%	13.54%	17.22%	20.95%	23.23%
<b>Apr-07</b>	16.21%	16.49%	13.55%	17.99%	19.52%	23.13%
<b>May-07</b>	18.09%	17.35%	13.47%	18.38%	19.68%	22.95%
<b>Jun-07</b>	18.39%	17.03%	13.89%	18.96%	20.60%	22.97%
<b>Jul-07</b>	18.52%	17.35%	14.00%	19.55%	20.25%	23.25%
<b>Aug-07</b>	17.72%	17.15%	13.56%	19.48%	18.01%	23.10%
<b>Sep-07</b>	19.18%	17.10%	14.19%	19.85%	18.61%	23.98%
<b>Oct-07</b>	18.14%	17.04%	14.59%	19.16%	18.57%	23.85%
<b>Nov-07</b>	17.68%	16.02%	14.82%	18.87%	18.32%	24.16%
<b>Dec-07</b>	17.14%	15.38%	14.42%	17.22%	17.99%	23.23%
<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%

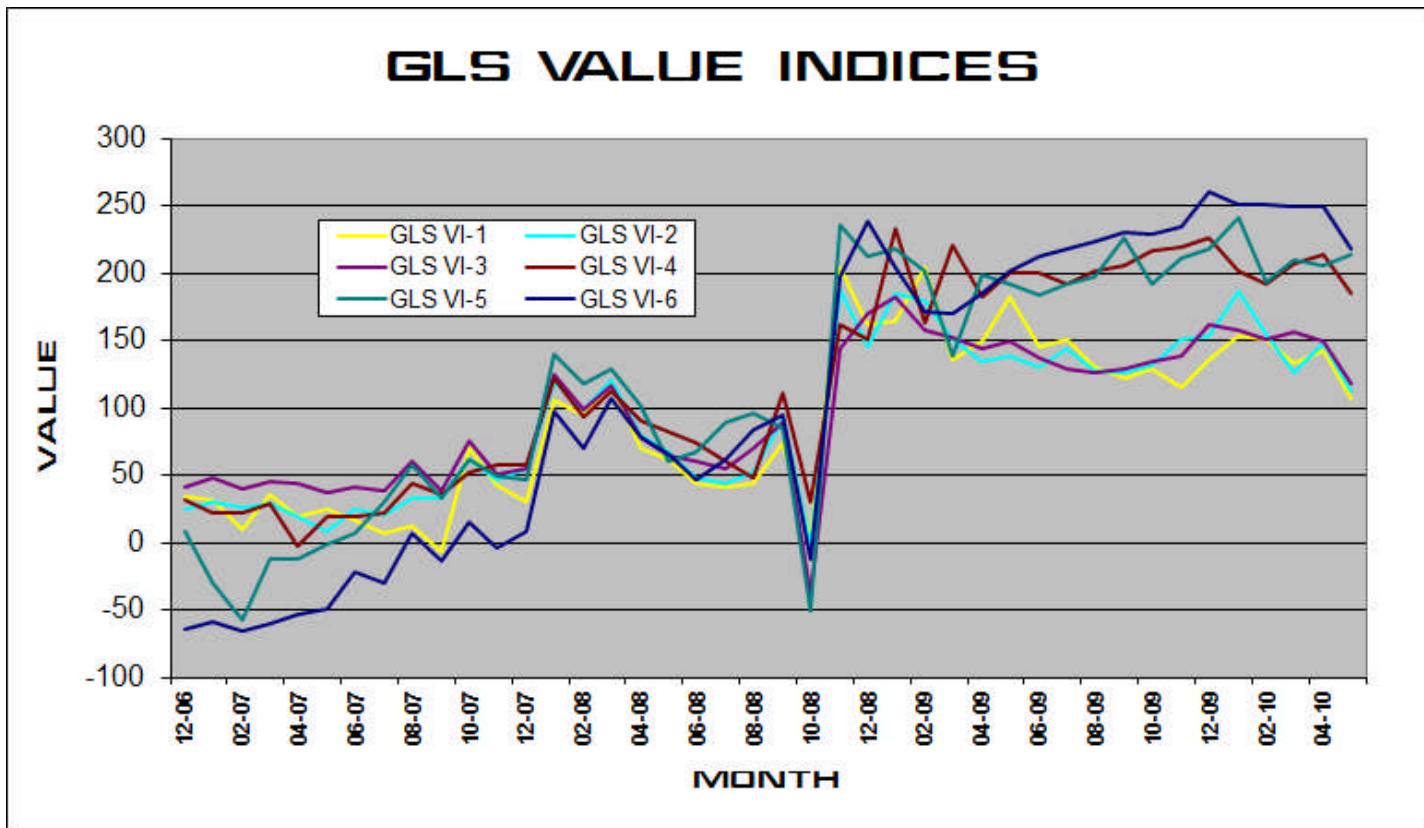
Rolling six-month CPR speeds for all maturity buckets. Source: Colson Services

# GLS VALUE INDICES: HISTORICAL VALUES

Table 2:

MONTH	WAVG LIBOR	WAVG BASE	BASE LIBOR SPD	GLS VI-1	GLS VI-2	GLS VI-3	GLS VI-4	GLS VI-5	GLS VI-6	INDICES LEGEND	
										HIGHEST READING	LOWEST READING
Dec-06	5.36%	8.25%	2.89%	34.6	24.0	41.1	31.0	8.0	-63.8		
Jan-07	5.35%	8.25%	2.90%	31.0	29.8	48.6	21.3	-30.1	-59.4		
Feb-07	5.36%	8.25%	2.89%	9.2	25.4	39.4	21.3	-57.0	-65.7		
Mar-07	5.34%	8.25%	2.91%	35.9	28.9	45.0	28.5	-12.7	-60.9		
Apr-07	5.35%	8.25%	2.90%	18.8	19.4	43.4	-2.9	-12.5	-53.0		
May-07	5.35%	8.25%	2.90%	24.5	8.5	37.6	18.9	-1.4	-50.0		
Jun-07	5.36%	8.25%	2.89%	16.3	25.2	40.6	18.6	7.0	-22.1		
Jul-07	5.35%	8.25%	2.90%	6.8	20.9	38.1	22.2	30.1	-29.9		
Aug-07	5.48%	8.25%	2.77%	12.9	33.5	59.8	43.6	57.8	7.0		
Sep-07	5.70%	8.21%	2.51%	-7.3	32.2	38.1	36.3	33.3	-14.1		
Oct-07	5.05%	7.74%	2.69%	70.2	61.9	75.6	52.2	61.9	14.6		
Nov-07	4.96%	7.50%	2.54%	42.6	46.7	50.5	57.8	48.7	-4.3		
Dec-07	5.02%	7.35%	2.33%	30.4	55.2	54.4	57.0	46.7	7.9		
Jan-08	3.77%	6.86%	3.09%	105.1	118.6	124.7	121.4	140.1	96.8		
Feb-08	3.10%	6.00%	2.90%	94.4	98.7	98.6	93.3	118.0	69.9		
Mar-08	2.90%	5.95%	3.05%	118.1	120.5	116.2	112.0	128.8	107.4		
Apr-08	2.81%	5.25%	2.44%	69.9	79.5	77.4	90.6	100.8	77.4		
May-08	2.78%	5.15%	2.37%	61.2	66.7	64.1	82.9	60.5	65.1		
Jun-08	2.67%	5.00%	2.33%	44.1	47.4	59.8	74.6	66.9	47.2		
Jul-08	2.75%	5.00%	2.25%	41.7	43.4	55.3	60.8	89.1	61.6		
Aug-08	2.74%	5.02%	2.27%	44.0	52.5	70.1	47.4	95.8	83.1		
Sep-08	3.00%	5.00%	2.00%	73.3	91.2	88.5	111.3	85.2	94.2		
Oct-08	4.43%	4.56%	0.12%	2.3	-3.1	-38.6	30.5	-51.0	-12.9		
Nov-08	2.06%	4.00%	1.94%	203.9	187.0	143.2	161.1	236.0	196.6		
Dec-08	1.64%	3.89%	2.25%	162.2	144.9	170.3	151.0	212.5	238.6		
Jan-09	1.11%	3.25%	2.14%	164.8	185.5	181.7	233.2	218.3	204.4		
Feb-09	1.15%	3.25%	2.10%	203.6	179.5	157.4	162.9	201.5	171.3		
Mar-09	1.06%	3.25%	2.19%	135.3	150.3	151.6	220.4	138.0	169.7		
Apr-09	0.96%	3.28%	2.32%	149.4	134.8	144.3	182.0	198.3	184.5		
May-09	0.70%	3.26%	2.57%	182.1	138.7	149.6	200.3	192.4	200.8		
Jun-09	0.55%	3.25%	2.70%	144.8	130.3	137.3	200.2	183.8	212.8		
Jul-09	0.48%	3.25%	2.77%	150.9	143.8	129.1	191.9	192.4	217.4		
Aug-09	0.39%	3.25%	2.86%	129.7	127.4	125.7	201.7	197.3	222.8		
Sep-09	0.29%	3.25%	2.96%	122.0	126.5	128.3	205.5	225.3	229.6		
Oct-09	0.26%	3.25%	2.99%	128.2	131.3	133.9	216.0	191.2	228.8		
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		

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-10</b>	11.09%	7.10%	9.64%	10.02%	6.92%	5.69%	<b>7.22%</b>
<b>Feb-10</b>	9.89%	10.00%	10.52%	5.73%	8.62%	6.88%	<b>8.06%</b>
<b>Mar-10</b>	10.13%	10.05%	8.43%	5.37%	8.69%	5.75%	<b>6.93%</b>
<b>Apr-10</b>	10.37%	11.13%	9.06%	8.81%	9.44%	5.50%	<b>7.26%</b>
<b>May-10</b>	13.03%	15.79%	14.85%	9.97%	8.15%	8.07%	<b>10.45%</b>
<b>Jun-10</b>	10.99%	12.88%	9.78%	7.02%	9.37%	6.36%	<b>7.91%</b>
<b>Grand Total</b>	<b>10.95%</b>	<b>11.18%</b>	<b>10.42%</b>	<b>7.83%</b>	<b>8.53%</b>	<b>6.38%</b>	<b>7.99%</b>

2010 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-10</b>	23 Mos.	27 Mos.	29 Mos.	64 Mos.	46 Mos.	49 Mos.	<b>43 Mos.</b>
<b>Feb-10</b>	23 Mos.	27 Mos.	30 Mos.	63 Mos.	46 Mos.	49 Mos.	<b>43 Mos.</b>
<b>Mar-10</b>	23 Mos.	27 Mos.	30 Mos.	63 Mos.	46 Mos.	49 Mos.	<b>43 Mos.</b>
<b>Apr-10</b>	22 Mos.	27 Mos.	30 Mos.	63 Mos.	47 Mos.	49 Mos.	<b>43 Mos.</b>
<b>May-10</b>	21 Mos.	28 Mos.	30 Mos.	64 Mos.	47 Mos.	49 Mos.	<b>43 Mos.</b>
<b>Jun-10</b>	21 Mos.	28 Mos.	31 Mos.	65 Mos.	47 Mos.	49 Mos.	<b>44 Mos.</b>

2010 pool age broken out by maturity sector. Source: Colson Services

## YEAR-TO-DATE CPR DATA

**Table 5:**

<b>&lt; 8 BY AGE</b>	<b>0-12 Mos.</b>	<b>13-24 Mos.</b>	<b>25-36 Mos.</b>	<b>37-48 Mos.</b>	<b>48+ Mos.</b>
<b>Jan-10</b>	7.89%	14.51%	11.18%	11.74%	11.13%
<b>Feb-10</b>	11.68%	10.80%	12.71%	3.42%	3.84%
<b>Mar-10</b>	5.02%	13.90%	11.15%	16.45%	4.27%
<b>Apr-10</b>	6.20%	14.99%	10.87%	10.88%	13.92%
<b>May-10</b>	12.39%	17.01%	15.16%	6.56%	11.57%
<b>Jun-10</b>	8.07%	20.25%	14.24%	4.13%	8.02%
<b>Grand Total</b>	<b>8.66%</b>	<b>15.09%</b>	<b>12.61%</b>	<b>9.11%</b>	<b>8.92%</b>

<b>10-13 BY AGE</b>	<b>0-12 Mos.</b>	<b>13-24 Mos.</b>	<b>25-36 Mos.</b>	<b>37-48 Mos.</b>	<b>48+ Mos.</b>
<b>Jan-10</b>	7.65%	13.02%	10.39%	6.83%	7.40%
<b>Feb-10</b>	6.43%	13.46%	15.61%	4.65%	6.75%
<b>Mar-10</b>	4.40%	13.33%	9.29%	8.42%	4.18%
<b>Apr-10</b>	4.32%	13.93%	10.20%	6.87%	9.22%
<b>May-10</b>	6.04%	21.50%	19.99%	11.41%	13.25%
<b>Jun-10</b>	5.48%	15.92%	12.96%	5.45%	8.44%
<b>Grand Total</b>	<b>5.69%</b>	<b>15.04%</b>	<b>13.10%</b>	<b>7.34%</b>	<b>8.40%</b>

<b>16-20 BY AGE</b>	<b>0-12 Mos.</b>	<b>13-24 Mos.</b>	<b>25-36 Mos.</b>	<b>37-48 Mos.</b>	<b>48+ Mos.</b>
<b>Jan-10</b>	0.00%	22.97%	4.97%	4.83%	2.78%
<b>Feb-10</b>	2.63%	10.96%	11.70%	15.55%	5.80%
<b>Mar-10</b>	6.12%	11.16%	12.46%	14.22%	4.07%
<b>Apr-10</b>	3.64%	0.00%	17.22%	12.88%	8.66%
<b>May-10</b>	16.91%	19.75%	0.00%	3.31%	5.92%
<b>Jun-10</b>	15.77%	0.00%	7.93%	11.00%	9.90%
<b>Grand Total</b>	<b>7.78%</b>	<b>12.06%</b>	<b>9.23%</b>	<b>10.50%</b>	<b>6.25%</b>

## YEAR-TO-DATE CPR DATA

**Table 5:**

<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-10</b>	7.02%	8.82%	4.18%	2.36%	9.14%
<b>Feb-10</b>	8.69%	11.77%	17.07%	9.41%	4.48%
<b>Mar-10</b>	13.38%	12.23%	8.03%	4.54%	5.46%
<b>Apr-10</b>	7.54%	19.56%	7.19%	8.07%	10.84%
<b>May-10</b>	19.15%	19.00%	17.83%	7.57%	8.01%
<b>Jun-10</b>	12.96%	18.84%	14.20%	9.65%	6.20%
<b>Grand Total</b>	<b>11.49%</b>	<b>14.93%</b>	<b>12.03%</b>	<b>7.01%</b>	<b>7.39%</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-10</b>	0.00%	8.61%	17.67%	0.00%	10.39%
<b>Feb-10</b>	0.00%	7.81%	0.00%	9.61%	6.50%
<b>Mar-10</b>	3.99%	0.00%	7.18%	8.23%	5.52%
<b>Apr-10</b>	9.54%	34.85%	20.78%	0.00%	7.32%
<b>May-10</b>	0.00%	0.00%	40.85%	5.72%	10.51%
<b>Jun-10</b>	7.14%	7.33%	6.17%	0.00%	7.38%
<b>Grand Total</b>	<b>3.84%</b>	<b>10.50%</b>	<b>14.11%</b>	<b>3.61%</b>	<b>7.96%</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-10</b>	0.35%	6.75%	10.22%	4.75%	6.16%
<b>Feb-10</b>	4.11%	11.32%	10.98%	4.80%	6.19%
<b>Mar-10</b>	1.63%	5.84%	10.60%	6.58%	5.43%
<b>Apr-10</b>	5.04%	6.76%	7.02%	5.07%	4.93%
<b>May-10</b>	3.85%	15.27%	15.36%	6.79%	5.67%
<b>Jun-10</b>	1.91%	15.28%	8.95%	4.68%	5.71%
<b>Grand Total</b>	<b>2.85%</b>	<b>10.17%</b>	<b>10.57%</b>	<b>5.45%</b>	<b>5.67%</b>

## 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.

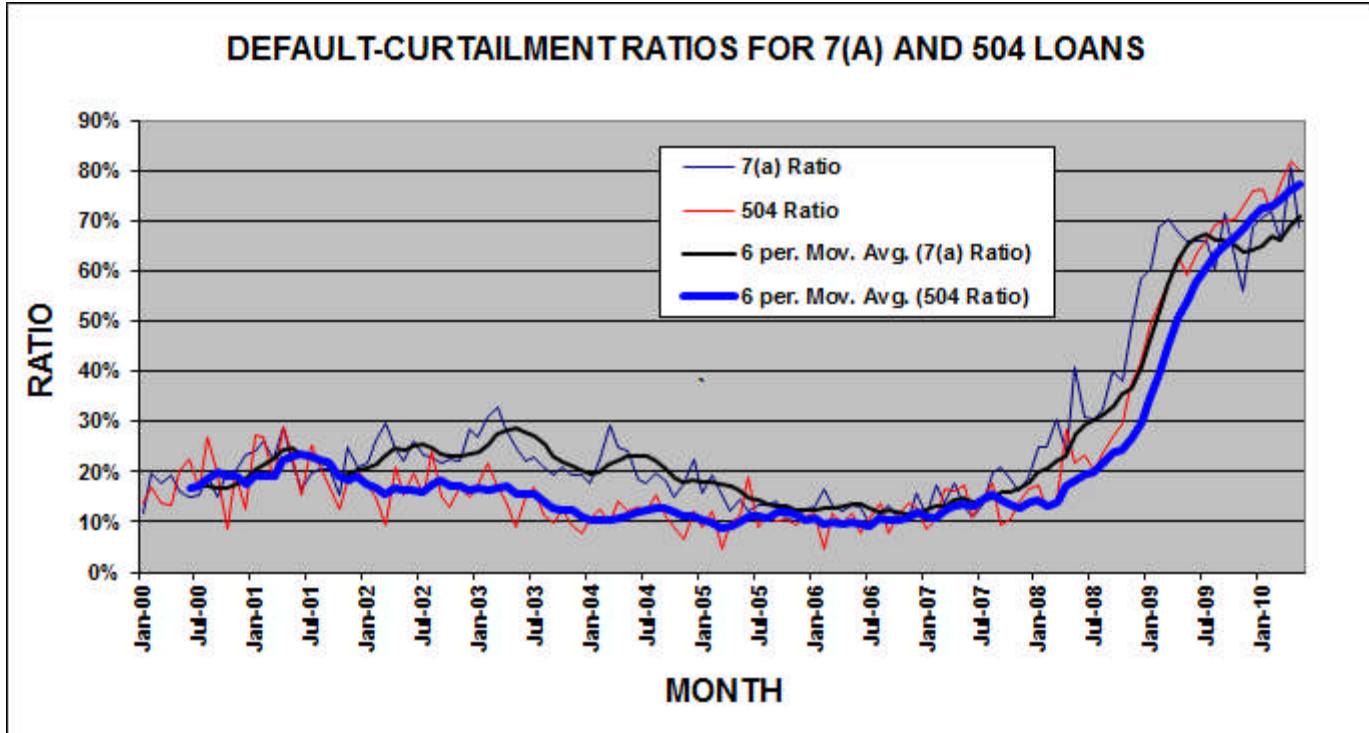
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### Secondary Market First Lien Position 504 Loan Pool Guarantee Program

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.

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

For the purposes of the program, a pool is defined as 2 or more loans. A pool must be either fixed (for life) or adjustable (any period adjustment including 5 or 10 years). If the pool is comprised of adjustable rate loans, all loans must have the same base rate (e.g. Prime, LIBOR, LIBOR Swaps, FHLB, etc.). Finally, each loan must be current for the lesser of 6 months or from the time of loan funding. Congress mandated that this be a **zero subsidy program to the SBA** (and the US taxpayer). The SBA has determined the program cost (management and expected losses) can be covered by an ongoing subsidy fee of .167%.



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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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**Government Loan Solutions, Inc. (GLS)** was founded by three former Bond Traders in Cleveland, OH. Scott Evans, Rob Herrick and Bob Judge possess a combined 70 years experience in the institutional fixed income markets, 40 of which are in the loan securitization business. GLS formally began operations in January, 2007. Our mission is as follows:

*"The purpose of Government Loan Solutions is to bring greater efficiency, productivity and transparency to the financial markets. Through the use of proprietary technology, we intend to aid lenders in all aspects of their commercial lending, help loan securitizers be more productive in their operational procedures and provide quality research to the investor community."*

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