

*Bob Judge, Government Loan Solutions, Editor*



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## PREPAYS RISE SLIGHTLY

In October, prepays moved slightly above September levels, recording the second consecutive month below 8%.

This month's reading represents the 6th month in a row of 7% or higher prepays.

This month saw a single-digit increase in voluntary prepayments, combined with a single-digit decrease in defaults.

These opposing moves essentially offset each other, leading to a small upward move in the overall CPR.

As for the detail, overall prepayments rose 1.37% to 7.11% from 7.01% in September.

In comparing prepayment speeds for the first ten months

*Article continued on page 5, graphs on page 2 and data on pages 24-26.*

## SECONDARY MARKET CAN PROVIDE THE ESCAPE VELOCITY FOR 504 PROGRAM

*By Vasu Srinivasan  
Guest Contributor*

After World War II, quasi-government agencies were set up to facilitate the American

dream of "Home Ownership". That experiment succeeded in that it encouraged financial institutions of all types, be it banks, credit unions, or savings & loans, to make home loans available to consumers. Banks

were happy to participate as they had a ready secondary market available to purchase these loans while leaving them with the customer relationship,

*Continued on page 7*

## SBI: LARGE RETURNS IN NOVEMBER

In late November, we witnessed significant increases in the secondary market, which pushed both the pool and IO strip indexes higher. While the six month numbers are still negative, the stability and upward

bias to the market should lead to positive returns in the months to come.

The results of these price increases can be seen in the Rich/Cheap analysis on page 11. The short maturity line has

re-entered the Fair Value Band for the first time since September. The long maturity sector remains in the Cheap part of the graph, but is closing in on

*Continued on page 10*

## SMALL BUSINESS FACT OF THE MONTH

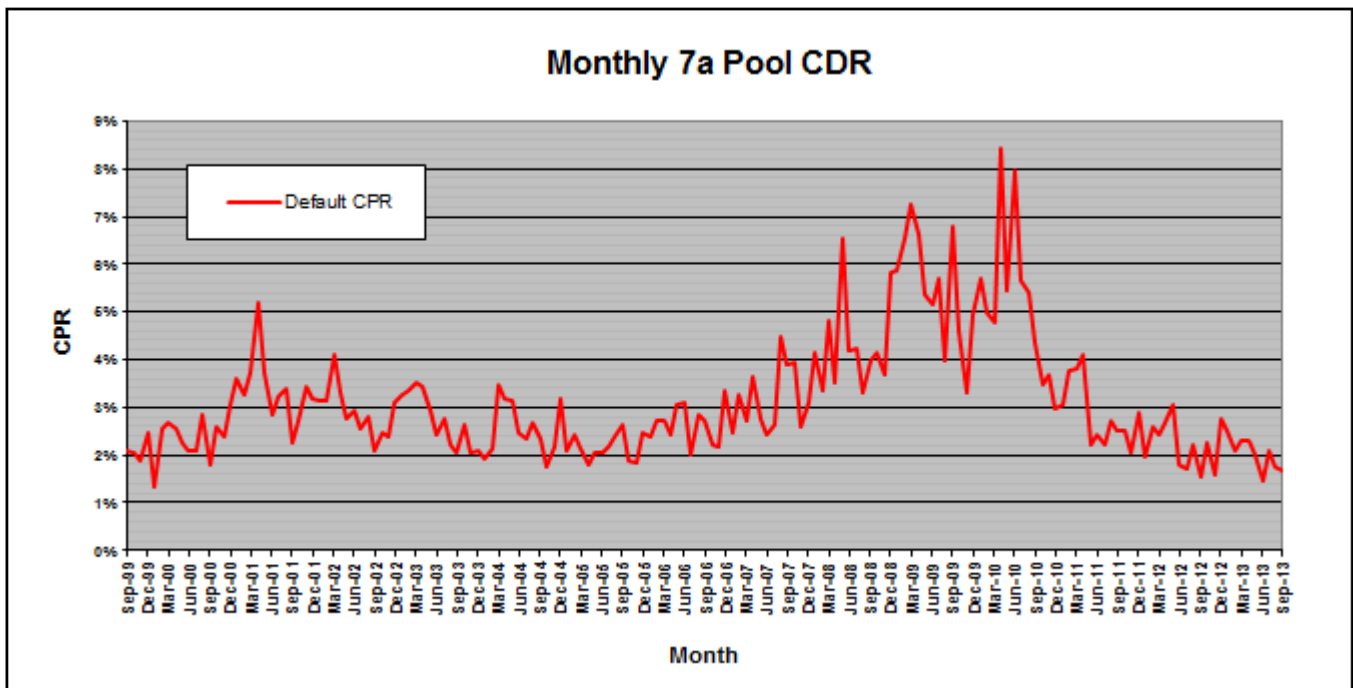
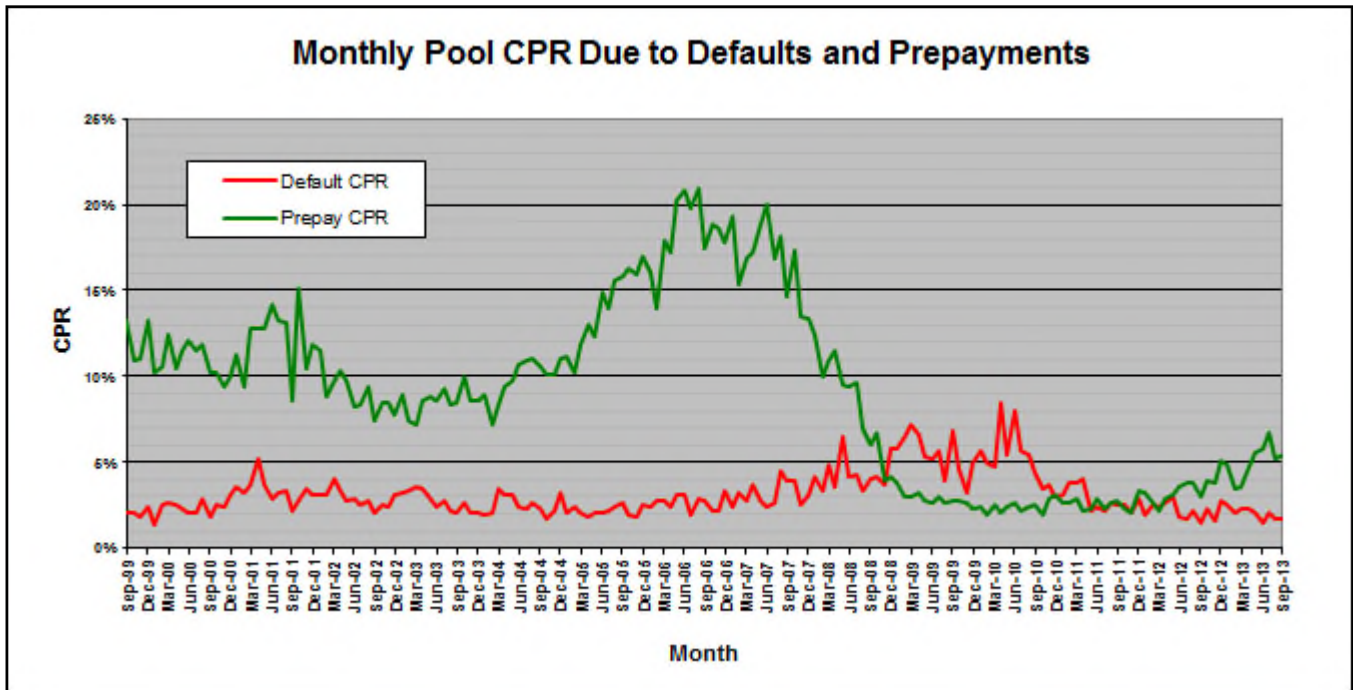
Firms with ESOPs laid off workers at a rate of just 2.6% in 2010, compared with 12.1% at companies without such plans.

**"LUCK IS WHERE OPPORTUNITY MEETS PREPARATION."**

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## PREPAYMENT SPEEDS...CONTINUED



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## PREPAYMENT SPEEDS...CONTINUED

of 2013 to the same period in 2012, we see that this year is now running 31% ahead of last year, with YTD CPRs at 7.16% versus 5.46%.

As for the largest sector of the market, 20+ years to maturity, prepayment speeds rose by 9% to 6.71% from 6.13%.

Turning to the CPR break-down, the default CPR fell by 5% to 1.68% from 1.77%. This level is the fifth lowest since September, 1999 when our records began.

Regarding voluntary prepayments, they remain in the 5-6% range, coming in at 5.43% from 5.25% in September.

Preliminary data for next month suggests that voluntary prepayments will move above 6%, but

defaults could set an all-time low, keeping the overall CPRs near 7% for the third month in a row.

Turning to the default/voluntary prepayment break-down, the **Voluntary Prepay CPR** (green line) rose to 5.43% from 5.25%, a 4% increase.

While the VCPR remained below 6%, the **Default CPR** (red line) decreased by 5% to 1.68% from 1.77% the previous month.

Prepayment speeds rose in three out of six maturity categories. Increases were seen, by order of magnitude, in the 13-16 year sector (+22% to CPR 7.82%), 20+ (+9% to CPR 6.71%) and 10-13 (+6% to CPR 8.37%).

Decreases were seen, also by order of magnitude, in the 8-10 year sector (-44% to CPR 6.23%), 16-20 (-37% to CPR 6.44%) and <8 (-28% to CPR 7.42%).

As we near the end of 2013, two facts stand out this year. One, defaults continue to decrease, even from record low levels. Two, voluntary prepayments are nudging higher, but still remain depressed, when compared to historical levels.

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

***"As we near the end of 2013, two facts stand out this year.***

***One, defaults continue to decrease, even from record low levels. Two, voluntary prepayments are nudging higher, but still remain depressed, when compared to historical levels."***

*Data on pages 24-26*



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## NOW A SECONDARY MARKET OUTLET FOR NON GUARANTEED RURAL LOANS

Thomas USAF Group is now offering Banks the opportunity to sell their 504 first mortgages or other conventional loans to "Essential Rural Businesses" and Businesses catering to the "Agricultural Sector." This is a Nationwide program for Existing Businesses. USDA's definition of Rural shall be utilized to determine eligibility.

**Targeted Rural Businesses must be Essential to Rural Communities. Examples of Businesses Essential to Rural Communities include:** a) Health Care b) Eldercare c) Housing d) Community Facilities

**Businesses Catering to or Involved in the Agriculture Sector** can be located in either rural or urban areas. Examples of Businesses Involved in or Catering to Agriculture Sector include a) Agriculture Production b) Agriculture Manufacturing c) Healthcare, Production and Distribution d) Businesses Utilizing Ag Products or catering to Ag Sector

### PREMIUMS PAID

**Debt Service Coverage:** Loans must demonstrate a current global DSC not less than 1.20x

**Term:** Up to 20 years with up to a 30 year Amortization—depending on collateral

**General Rates:** Rates as low as 5% can be structured flexibly—ranging from quarterly adjust to adjusting every 3,5,7,10 or 15 years. Fixed rate options available.

**Loan Size:** Preferred Loan Size is \$5,000,000 and up. Minimum Loan Size: \$ 2,500,000

**Loan to Value:** Up to 90% on SBA 504 loans and typically up to 75% on conventional loans

**Strong Prepayment Penalty** as is customary in 504 debentures preferred

**Exclusions:** Rural Businesses generally excluded from this program: Hospitality, Restaurants, Gas stations, Car Washes, Start-ups and Turnarounds, Faith-based projects, Big Box businesses and projects involving Environmental Sensitivity. Borrowers involved in Agriculture may qualify for exceptions

**Customer Relationships:** Lenders can continue to maintain the customer relationships.

**Secondary Market Takeout:** TUSAF can purchase up to 100% of the loan through table funding

**Advantages of the Program:** Ability to sell obviates need to balance sheet the loan. This minimizes capital set aside requirements arising from the additional volume of business. In addition to liquidity, Lenders can make premium income depending on the rate, whilst retaining client and depositary relationship. Additional product line offering to customers. Could solve legal lending limit and concentration issues. Table Funding Option available.

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Mike Thomas at 404-365-2042 /[mike@thomasusaf.com](mailto:mike@thomasusaf.com)



## ESCAPE VELOCITY FOR 504 PROGRAM...CONTINUED

a service fee in the form of annuity and no balance sheet exposure. This experiment was a precursor to what was to follow decades later i.e. development of the capital markets. In the 1980's Wall Street got busy creating securities backed by different collateral (i.e. credit card receivables, car loans, etc.) and selling these securities to investors. What made the securities saleable was the stamp of approval from "Rating Agencies" who spent countless hours slicing and dicing up cash flows from these securities and stress testing them to figure out which tranche of the securities are less likely to default and therefore deserving of a higher rating. The judgment of the "Rating Agencies" went unquestioned, for the most part, until the crisis of 2008. Today, these opinions continue to be a central part of the investment decision making process at banks, pension funds, insurance companies, money management firms and other institutional investors ultimately investing in rated securities.

It was in the 1980's that the efficiencies of the capital markets were brought to the "small business loans" sector. The U.S. Government guarantee on SBA 7A loans made pooling possible, created investor interest, and fostered the ability to raise institutional money at risk free rates. The creation of the Secondary Market provided a means to sell off the guaranteed portion efficiently, translating into higher premiums for lenders involved in the aggregation process. The ability to pool loans efficiently was partially responsible for the bidding war that ensued in the secondary market due to the arbitrage between the buy side pricing, paid by borrowers on duration based loans, and sell side pricing based on a short duration investment (most 7A loans adjust at 30 to 90 day intervals). The frenzy reached a point where premiums exceeded 20% in the early 90's, and the income from these loans exceeded the residual risk on lenders balance sheet, since 7A loans were 85-90% guaranteed at that time. That was untenable, and the SBA instituted a 50% split on premiums in excess of 10% to curb the frenzy. The 50% split with the SBA continues to this day. The advent of the conduit markets in the mid 90's increased voluntary prepaids, temporarily slowing investor interest. The response to this phenomena was the institution of a 5, 3, 1 prepayment penalty, which provided some disincentive for borrowers to prepay and helped to revive investor demand in these securities.

As the secondary market grew and evolved over the past 20 years, 7A lending became more popular with small business lenders, increasing the size and breadth of the program. **This historical link between the growth of a secondary market and growth in the underlying program is a lesson we should heed as we look for ways to increase 504 loan volume.**

Twenty years ago the SBA 504 program was probably 1/4 the size it is today with perhaps a half dozen active buyers of the first liens. Zions Bank was one of the pioneers of the 504 1<sup>st</sup> lien secondary market and is now the last man standing. Over time, the likes of Bank of the West, Sterling, GE, etc. entered than exited the market, mostly due to low volume, decreasing profits and changing business models. Early on, approximately \$2 billion in first mortgage loans were being originated annually. Zions, with its balance sheet capacity and Bank of the West (subsequently taken over by Banque Paribas with Libor based funding), with its appetite for

Prime based assets to capture the Prime/Libor spread, provided lenders an outlet to participate in the 504 program. At the time, the 7A program had a much smaller maximum loan size of perhaps \$1.5 to 2 million. For this reason, larger loans that did not fit the 7A loan size limitations gravitated to 504 program at that time, boosting its volume.

Today the 7A program can compete more broadly with 504. With its \$5 million max loan size, active secondary market, pooling efficiencies and zero-subsidy governmental funding, 7A program has captured much of the sub-\$5 million small business market. The 504 program, however, can be very competitive with the 7A program on fixed rate loans where pooling efficiencies may not exist.

Come 2008, the public private partnership model for economic development generated enthusiasm for the 504 Program when the FMLP Program (First Mortgage Lien Pooling Program) was briefly in place. The FMLP Program was intended to increase job creation through the 504 program by offering 504 lenders an incentive to originate more 504 loans through the establishment of a 7a type secondary market. The FMLP program allowed a pool originator (a secondary market buyer) to securitize, with an SBA guarantee, 80% of a pool of 504 1<sup>st</sup> liens, while holding 5% on the balance sheet. This secondary market option generated a significant level of enthusiasm amongst the active market participants to make 504 loans. Alas, that enthusiasm was short lived as the FMLP program expired in September 2012 and did not get renewed. The 75 bps fee paid to SBA under FMLP on the first mortgage was effectively a significant loan loss reserve, but politics triumphed over economics when it came to renewing this successful job creation program. Dysfunction in Washington and other budgetary issues like the debt ceiling, sequestration and the Affordable Care Act took over the conversation. The need to "create jobs" took a back seat, as validated by subsequent unemployment numbers.

NADCO has announced its desire to double the volume of 504 loans in the coming years. Making debt refinancing permanent, operating the 504 program at zero subsidy, and keeping borrower fees unchanged are certainly prerequisites. **But as history has shown, the real incentive to make these loans is going to be driven by the availability of a deep, liquid secondary market.**

While Chase, Wells, and larger regional banks do participate in the 504 program, community banks and select non-bank lenders do the heavy lifting. The secondary market for 504 first mortgage loans available to community banks has whittled down to a handful of players today seeking only the highest quality loans: Zions Bank, who is currently doing only a fraction of what they did a decade ago, Morgan Stanley, who participates for CRA reasons, and One West, who is only in CA. Considering the size of the 504 program, the secondary market options available between these participants covers less than 5% of the potential 504 first lien market served by community banks and non-bank lenders.

The good news is that some active participants under the now defunct FMLP program are emerging with products as a private market alternative e.g. the Pennant 504 Fund, a closed-end mutual fund

*Continued on next page*

## ESCAPE VELOCITY FOR 504 PROGRAM...CONTINUED

that will invest in 504 1<sup>st</sup> liens, created by GLS and Pennant Management and the Thomas USAF Rural Lending program. But even with the addition of these two new market entrants, less than 10 to 15% of the first mortgage loans originated by community banks and non-bank lenders will find a home in the secondary market. For NADCO to meet its goal and for the 504 program to meet its objectives of economic development/job creation, more liquidity needs to be generated in the secondary market. The alternative of holding on balance sheet has shown some promise with a handful of banks that have excess liquidity, but constraints imposed by regulators as well as capital adequacy exams will leave limited room for this alternative.

After being berated for the Financial Crisis, the rating agencies have naturally become gun shy about rating an asset class that has not recently been securitized and/or from an issuer without a track record. Preliminary conversations with rating agencies indicate that while they are willing to consider the merits of a low LTV first mortgage, the 504 first lien product, initially at least, is not likely to command the same execution as other "lower quality" collateral backed asset classes that possess a track record and performance statistics to back up their analysis. The irony is that Income producing real estate collateral, valued after the crisis, has a much lower downside at 50% LTV compared to other collateral currently being securitized. 504 first lien loans, with their diverse nature and lack of a true secondary market, have no repository for historical performance that can be reviewed by rating agencies. The performance of the debenture as a proxy is the closest we can come to historical statistics, and the issue of subsidy as part of an ongoing discussion to make the debt refinancing program permanent creates a cloud of uncertainty. While the stats on the debenture give us some benchmark in terms of probability of default, it does not give us a measure of severity, i.e. loss given default. The performance data available through GLS does give us an idea of the better performing sectors, which should have the eventual potential for better execution.

Nowhere is the disconnect between demand for loans and the supply of money more apparent than in the "special purpose collateral" segment. As an example, the hotel sector alone has billions of dollars in loans maturing and coming due for refinance each year over the next several years. The refinance alternatives are limited to the slowly recovering conduit markets functioning at a fraction of their pre-crisis levels, or banks with limited balance sheet appetite. For example, regulators have imposed restrictions on the amount of construction loans that banks can have on their balance sheet, limiting the options available to handle projects that involve construction. Likewise, banks are also restricted in terms of long term loans they can hold onto the balance sheet, not to mention the criticism they attract from regulators for asset liability mismatches. Small wonder banks prefer to divert lending opportunities to the 7A program due to the efficiency of execution and greater profitability. **The reality is that the 7A and 504 programs together cannot meet but a fraction of the demand for refinancing of special purpose collateral that is coming due on bridge acquisition loans taken just prior to the crisis.**

The 504 program does attract larger-sized loans that do not fit into

the 7A program, especially "Green" projects. Larger sized loans are likely to go through increased level of scrutiny and underwriting, which should be good news for the 504 program over the long-run.

**Lower defaults equate to fewer losses, making the program less expensive for all participants.**

For the 504 program to ultimately succeed, all participants should have something to gain.

1. Borrowers should be happy with the rate and terms they have to live with in the long run. Here, the fixed rate on the debenture helps.
2. The Lenders have to be able to recycle their liquidity and make a reasonable return on their efforts after covering costs, including BDO compensation.
3. The Institutional investors purchasing the rated portion of the securities have to get market returns on a risk adjusted basis.
4. The B piece holders of the securitization or other investors funding the risk portion have to make an acceptable yield to attract private capital.

**The critical path goes through the institutional investors.** The willingness of institutional investors to purchase these securities is dependent on the stamp of approval from the Rating Agencies. The execution based on the ratings of different tranches will determine the yield available to B piece holders and the attractiveness for lenders/private capital who wish to enter this space. Without institutional investors and private capital, the secondary market outlets will remain limited to balance sheet capacity.

Securitization of 504 first liens could eventually help lower the balance sheet exposure for lenders below that which is required on 7A loans, recycle liquidity, and create meaningful returns, making it attractive for lenders to consider this program as an equally good first choice. **Securitization of this asset class can provide the escape velocity necessary to put the program into orbit or at least serve as a "booster rocket" to get the program to the next stage.** The lessons of the past include declining investor interest in these programs when conduit markets start functioning at equilibrium levels. Thanks to the rating agencies, the good news for the 504 program, at least temporarily, is that the conduit markets are taking their time to recover. Better news is that the high LTV on a combined basis would make refinancing through conduits unattractive to borrowers who will have to come out of pocket. In the world of shrinking fixed income alternatives and the hunt for yield, there exists an attractive high quality "niche" product that should garner investor support. It is our job to make the case to institutional investors for a program that is otherwise relatively small by Wall Street standards. **The hold on "balance sheet" strategy has its limitations as a source of liquidity in the Basel III world and is like a flat tire. We cannot go anywhere unless it is changed.**

Priority, Bias for Action and Good Data are required if we are to get serious about securitization as a tool for economic development and job creation. We have to prioritize our collective efforts to generate some interest with rating agencies and investment banks

*Continued on next page*



## ESCAPE VELOCITY FOR 504 PROGRAM...CONTINUED

to consider this asset class for securitization, starting with education on how this asset class can provide attractive risk adjusted yields to institutional investors. There still persists the issue of the "B" piece, where the private sector has to take the residual risk on tranches that remain unrated and the warehousing challenges associated with an uncertain take out.

As the saying goes, even a journey of 10,000 miles starts with a single step. Over time, the better the execution, the smaller that "B" piece should become and the greater the economic incentive for the private market participants to get involved. **The economic incentive for the B piece holders can let loose the ingenuity of private markets for which we need the best execution possible in terms of ratings, resulting in an "attractive risk adjusted yield" on rated tranches for institutional investors.**

*Mr. Srinivasan is the President of the Thomas USAF Group, LLC. He can be reached at [vasu@thomasusaf.com](mailto:vasu@thomasusaf.com), or at (404) 365-2030.*



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## SMALL BUSINESS INDEXES...CONTINUED

the "Fair Value" range quickly.

### SBI Index Results

For the third month in a row, returns for both pool and strips were positive. Specifically, the pool index that has all eligible pools between 10 and 25 years, returned +.46% for equal weighting and +.49% for actual weighting. The 3 month numbers were +.80% and +.89%, respectively.

As for the IO strip indexes, the 10 to 25 year IO strips indexes returned +4.61% for equal weighting and +4.66% for actual weighting in November. The three month numbers moved back

into positive territory, coming in at +6.95% and +7.65%, respectively.

With the secondary market heading higher, expect positive returns in the months to come.

If you wish to further delve into the SBI Indexes, please visit our website at [www.sbindexes.com](http://www.sbindexes.com). Registration is currently free and it contains a host of information relating to these indexes, as well as indexing in general.

*Data and Charts begin on page 11*

## DEBENTURE SPEEDS: 20s STAY ABOVE 9%

In November, 20 year debenture prepayment speeds decreased by 3% to CPR 9.29%, but stayed above CPR 9% for the second month in a row.

Again, like the theme surrounding the 7a program, defaults fell and voluntary prepayments rose. As for the numbers, defaults fell by 27% to CDR 1.44%, the second lowest reading this year. As for voluntaries, they rose by 3% to CRR 7.85%, the highest reading since the beginning of the credit crisis.

As for the 10 year sector, overall CPRs fell by 20%, with decreases in defaults leading the way. Turning to the actual numbers, defaults fell by 59% to CDR 0.83% and voluntary prepayments decreased by 9% to CRR 6.40%.

Same story. Decreasing defaults accompanied by rising voluntary prepayments.

*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 and Charts begin on page 15*



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SB Indexes, LLC

**Through the joint venture of Ryan ALM, Inc. and GLS, both companies have brought their unique capabilities together to create the first Total Return Indexes for SBA 7(a) Pools and SBA 7(a) Interest-Only Strips, with a history going back to January 1st, 2000.**

**Using the "Ryan Rules" for index creation, the SBI indexes represent best practices in both structure and transparency.**

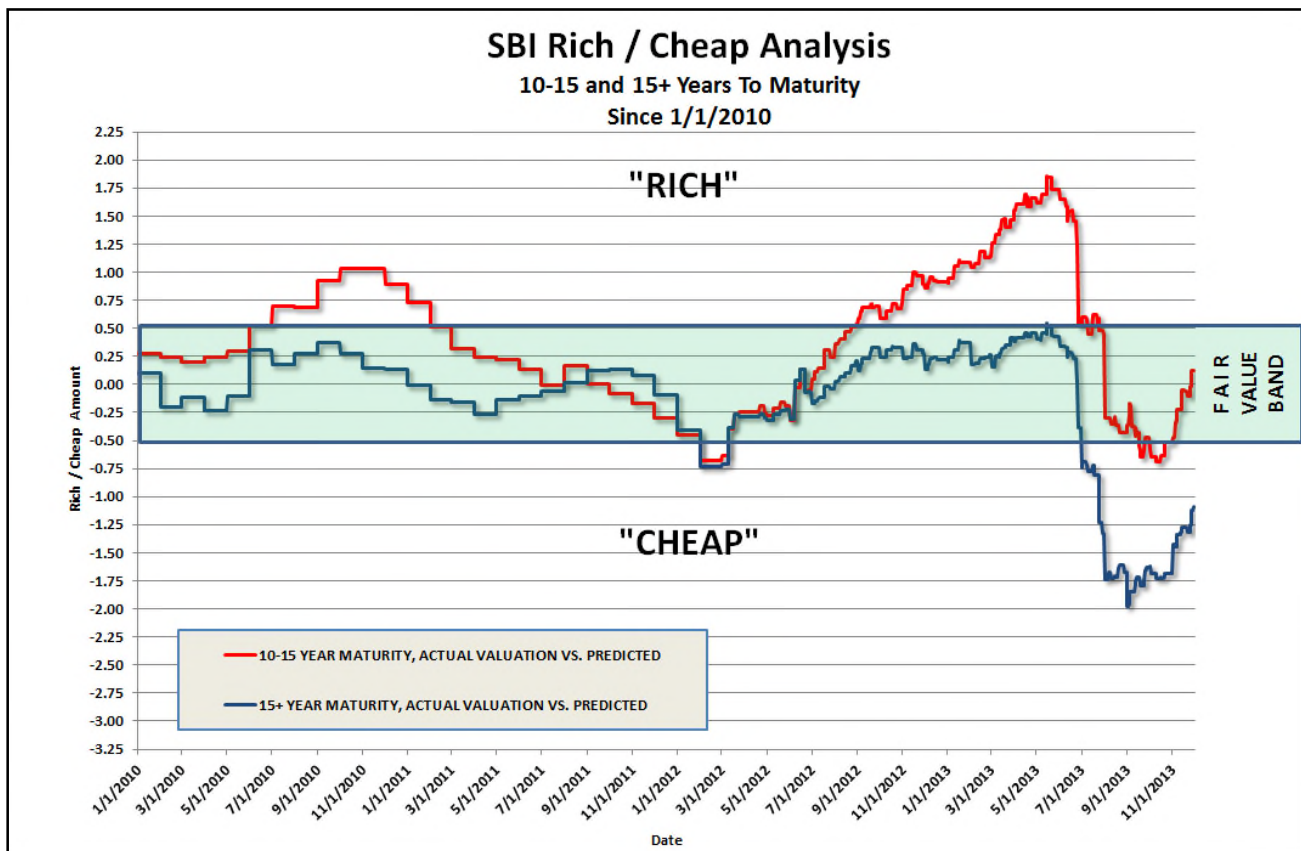
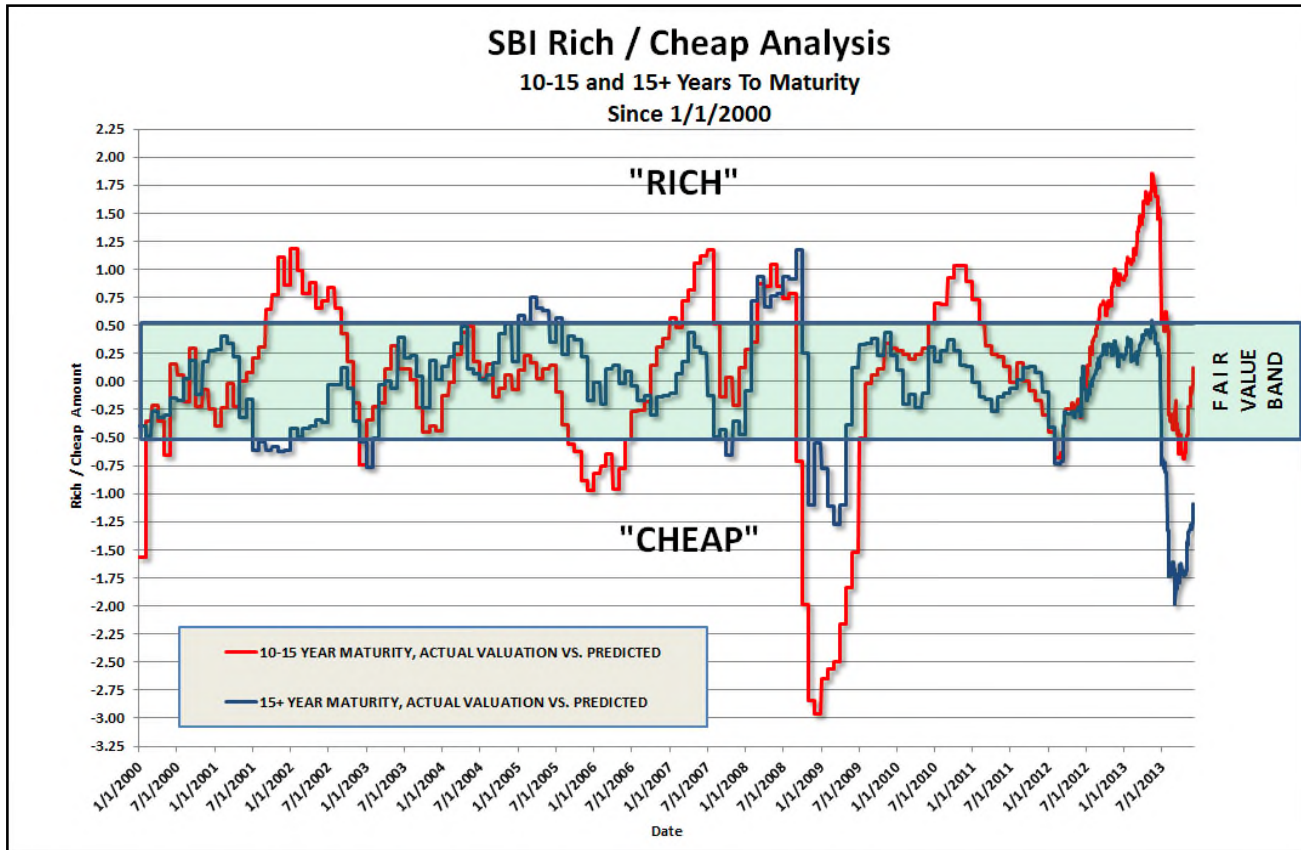
#### Principals:

Ronald J. Ryan, CFA, Founder and CEO of Ryan ALM, Inc. Ron has a long history of designing bond indexes, starting at Lehman Brothers, where he designed most of the popular Lehman bond indexes. Over his distinguished career, Ron and his team have designed hundreds of bond indexes and ETFs.

Bob Judge, Partner, GLS. Bob, a recognized expert in the valuation of SBA-related assets as well as the SBA Secondary Market and is the editor of The CPR Report, a widely-read monthly publication that tracks SBA loan defaults, prepayment and secondary market activity.

**For more information, please visit our website: [www.SBIndexes.com](http://www.SBIndexes.com)**

## SMALL BUSINESS INDEXES...CONTINUED





## SMALL BUSINESS INDEXES...CONTINUED

| END DATE: 11/30/2013                | SBI POOL INDEX TOTAL RETURN |         |         |         |         |         |          |           |
|-------------------------------------|-----------------------------|---------|---------|---------|---------|---------|----------|-----------|
| INDEX TYPE                          | 1 MONTH                     | 3 MONTH | 6 MONTH | 1 YEAR  | 3 YEAR  | 5 YEAR  | 10 YEAR  | INCEPTION |
| POOL, ALL EQUAL INDEX               | 0.46%                       | 0.80%   | (0.41%) | 0.74%   | 12.07%  | 35.78%  | 76.05%   | 117.44%   |
| POOL, ALL ACTUAL INDEX              | 0.49%                       | 0.89%   | (0.44%) | 0.81%   | 9.03%   | 24.87%  | 56.15%   | 92.36%    |
| POOL, LONG EQUAL INDEX              | 0.40%                       | 0.83%   | (0.23%) | 0.97%   | 14.13%  | 42.31%  | 88.35%   | 132.97%   |
| POOL, LONG ACTUAL INDEX             | 0.43%                       | 0.91%   | (0.27%) | 1.02%   | 10.23%  | 28.18%  | 62.80%   | 100.80%   |
| POOL, SHORT EQUAL INDEX             | 0.62%                       | 0.73%   | (0.93%) | 0.11%   | 7.13%   | 21.43%  | 48.45%   | 81.96%    |
| POOL, SHORT ACTUAL INDEX            | 0.69%                       | 0.81%   | (0.95%) | 0.18%   | 6.12%   | 17.60%  | 41.68%   | 73.26%    |
| POOL, ALL EQUAL INCOME INDEX        | 0.23%                       | 0.66%   | 1.30%   | 2.54%   | 14.17%  | 34.01%  | 93.40%   | 141.35%   |
| POOL, ALL ACTUAL INCOME INDEX       | 0.24%                       | 0.68%   | 1.34%   | 2.61%   | 10.97%  | 23.17%  | 70.69%   | 112.07%   |
| POOL, LONG EQUAL INCOME INDEX       | 0.21%                       | 0.59%   | 1.17%   | 2.29%   | 15.02%  | 38.60%  | 102.79%  | 152.93%   |
| POOL, LONG ACTUAL INCOME INDEX      | 0.22%                       | 0.62%   | 1.22%   | 2.38%   | 11.01%  | 24.76%  | 74.18%   | 116.28%   |
| POOL, SHORT EQUAL INCOME INDEX      | 0.29%                       | 0.84%   | 1.66%   | 3.25%   | 12.26%  | 24.04%  | 72.84%   | 117.58%   |
| POOL, SHORT ACTUAL INCOME INDEX     | 0.30%                       | 0.86%   | 1.70%   | 3.32%   | 11.11%  | 20.09%  | 64.43%   | 106.06%   |
| POOL, ALL EQUAL PRICE INDEX         | 0.31%                       | 0.39%   | (1.19%) | (0.80%) | 0.35%   | 4.28%   | (1.27%)  | 0.06%     |
| POOL, ALL ACTUAL PRICE INDEX        | 0.33%                       | 0.45%   | (1.27%) | (0.82%) | 0.41%   | 4.30%   | (1.23%)  | 0.06%     |
| POOL, LONG EQUAL PRICE INDEX        | 0.26%                       | 0.45%   | (0.97%) | (0.53%) | 0.84%   | 4.66%   | (0.64%)  | 0.79%     |
| POOL, LONG ACTUAL PRICE INDEX       | 0.28%                       | 0.50%   | (1.07%) | (0.58%) | 0.87%   | 4.63%   | (0.61%)  | 0.78%     |
| POOL, SHORT EQUAL PRICE INDEX       | 0.45%                       | 0.24%   | (1.79%) | (1.55%) | (0.92%) | 3.20%   | (2.86%)  | (2.27%)   |
| POOL, SHORT ACTUAL PRICE INDEX      | 0.50%                       | 0.29%   | (1.87%) | (1.53%) | (0.82%) | 3.26%   | (2.83%)  | (2.27%)   |
| POOL, ALL EQUAL PREPAY INDEX        | (0.05%)                     | (0.16%) | (0.32%) | (0.58%) | (1.19%) | (1.55%) | (5.81%)  | (7.62%)   |
| POOL, ALL ACTUAL PREPAY INDEX       | (0.05%)                     | (0.15%) | (0.31%) | (0.57%) | (1.16%) | (1.52%) | (5.41%)  | (7.06%)   |
| POOL, LONG EQUAL PREPAY INDEX       | (0.04%)                     | (0.15%) | (0.29%) | (0.51%) | (0.98%) | (1.15%) | (5.31%)  | (7.10%)   |
| POOL, LONG ACTUAL PREPAY INDEX      | (0.05%)                     | (0.15%) | (0.28%) | (0.50%) | (0.94%) | (1.10%) | (4.82%)  | (6.46%)   |
| POOL, SHORT EQUAL PREPAY INDEX      | (0.07%)                     | (0.18%) | (0.41%) | (0.78%) | (1.72%) | (2.51%) | (7.20%)  | (9.10%)   |
| POOL, SHORT ACTUAL PREPAY INDEX     | (0.06%)                     | (0.17%) | (0.39%) | (0.78%) | (1.72%) | (2.51%) | (6.99%)  | (8.72%)   |
| POOL, ALL EQUAL DEFAULT INDEX       | (0.01%)                     | (0.04%) | (0.08%) | (0.17%) | (0.47%) | (0.71%) | (1.42%)  | (1.85%)   |
| POOL, ALL ACTUAL DEFAULT INDEX      | (0.01%)                     | (0.04%) | (0.08%) | (0.17%) | (0.45%) | (0.70%) | (1.35%)  | (1.74%)   |
| POOL, LONG EQUAL DEFAULT INDEX      | (0.01%)                     | (0.04%) | (0.07%) | (0.15%) | (0.38%) | (0.50%) | (1.17%)  | (1.59%)   |
| POOL, LONG ACTUAL DEFAULT INDEX     | (0.01%)                     | (0.04%) | (0.07%) | (0.15%) | (0.36%) | (0.47%) | (1.08%)  | (1.46%)   |
| POOL, SHORT EQUAL DEFAULT INDEX     | (0.02%)                     | (0.04%) | (0.10%) | (0.23%) | (0.69%) | (1.22%) | (2.05%)  | (2.51%)   |
| POOL, SHORT ACTUAL DEFAULT INDEX    | (0.01%)                     | (0.04%) | (0.10%) | (0.24%) | (0.69%) | (1.23%) | (2.03%)  | (2.44%)   |
| POOL, ALL EQUAL VOL PREPAY INDEX    | (0.04%)                     | (0.12%) | (0.24%) | (0.41%) | (0.73%) | (0.84%) | (4.46%)  | (5.88%)   |
| POOL, ALL ACTUAL VOL PREPAY INDEX   | (0.04%)                     | (0.12%) | (0.23%) | (0.40%) | (0.71%) | (0.82%) | (4.12%)  | (5.41%)   |
| POOL, LONG EQUAL VOL PREPAY INDEX   | (0.03%)                     | (0.12%) | (0.22%) | (0.36%) | (0.61%) | (0.66%) | (4.19%)  | (5.60%)   |
| POOL, LONG ACTUAL VOL PREPAY INDEX  | (0.03%)                     | (0.11%) | (0.21%) | (0.35%) | (0.58%) | (0.63%) | (3.79%)  | (5.07%)   |
| POOL, SHORT EQUAL VOL PREPAY INDEX  | (0.05%)                     | (0.14%) | (0.30%) | (0.55%) | (1.04%) | (1.30%) | (5.26%)  | (6.76%)   |
| POOL, SHORT ACTUAL VOL PREPAY INDEX | (0.04%)                     | (0.13%) | (0.29%) | (0.54%) | (1.04%) | (1.30%) | (5.07%)  | (6.44%)   |
| POOL, ALL EQUAL SCHED PRIN INDEX    | (0.03%)                     | (0.09%) | (0.18%) | (0.38%) | (1.01%) | (1.30%) | (2.11%)  | (2.54%)   |
| POOL, ALL ACTUAL SCHED PRIN INDEX   | (0.03%)                     | (0.09%) | (0.18%) | (0.38%) | (1.01%) | (1.30%) | (2.08%)  | (2.46%)   |
| POOL, LONG EQUAL SCHED PRIN INDEX   | (0.02%)                     | (0.06%) | (0.12%) | (0.25%) | (0.63%) | (0.74%) | (1.28%)  | (1.62%)   |
| POOL, LONG ACTUAL SCHED PRIN INDEX  | (0.02%)                     | (0.06%) | (0.13%) | (0.25%) | (0.62%) | (0.72%) | (1.20%)  | (1.51%)   |
| POOL, SHORT EQUAL SCHED PRIN INDEX  | (0.05%)                     | (0.17%) | (0.36%) | (0.74%) | (1.99%) | (2.69%) | (4.71%)  | (5.86%)   |
| POOL, SHORT ACTUAL SCHED PRIN INDEX | (0.06%)                     | (0.17%) | (0.36%) | (0.76%) | (2.02%) | (2.72%) | (4.65%)  | (5.74%)   |
| POOL, ALL EQUAL TOTAL PRIN INDEX    | (0.08%)                     | (0.25%) | (0.50%) | (0.96%) | (2.18%) | (2.83%) | (7.80%)  | (9.96%)   |
| POOL, ALL ACTUAL TOTAL PRIN INDEX   | (0.08%)                     | (0.24%) | (0.49%) | (0.95%) | (2.15%) | (2.80%) | (7.38%)  | (9.35%)   |
| POOL, LONG EQUAL TOTAL PRIN INDEX   | (0.06%)                     | (0.21%) | (0.41%) | (0.76%) | (1.60%) | (1.89%) | (6.52%)  | (8.61%)   |
| POOL, LONG ACTUAL TOTAL PRIN INDEX  | (0.07%)                     | (0.21%) | (0.41%) | (0.75%) | (1.56%) | (1.81%) | (5.97%)  | (7.87%)   |
| POOL, SHORT EQUAL TOTAL PRIN INDEX  | (0.12%)                     | (0.35%) | (0.76%) | (1.51%) | (3.68%) | (5.14%) | (11.58%) | (14.42%)  |
| POOL, SHORT ACTUAL TOTAL PRIN INDEX | (0.11%)                     | (0.34%) | (0.75%) | (1.53%) | (3.70%) | (5.16%) | (11.32%) | (13.96%)  |



**"Victory is the child of preparation and determination."**

Sean Hampton

**SBLA. COME PREPARED.**

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## SMALL BUSINESS INDEXES...CONTINUED

| END DATE: 11/30/2013                 | SBI STRIP INDEX TOTAL RETURN |         |          |          |          |          |          |           |
|--------------------------------------|------------------------------|---------|----------|----------|----------|----------|----------|-----------|
| INDEX TYPE                           | 1 MONTH                      | 3 MONTH | 6 MONTH  | 1 YEAR   | 3 YEAR   | 5 YEAR   | 10 YEAR  | INCEPTION |
| STRIP, ALL EQUAL INDEX               | 4.61%                        | 6.95%   | (13.85%) | (4.73%)  | 51.38%   | 355.77%  | 87.02%   | 394.22%   |
| STRIP, ALL ACTUAL INDEX              | 4.66%                        | 7.65%   | (13.31%) | (3.02%)  | 52.55%   | 300.51%  | 59.36%   | 323.92%   |
| STRIP, LONG EQUAL INDEX              | 3.20%                        | 7.91%   | (9.37%)  | 1.19%    | 74.36%   | 463.45%  | 175.50%  | 674.48%   |
| STRIP, LONG ACTUAL INDEX             | 3.06%                        | 8.40%   | (9.01%)  | 2.49%    | 70.22%   | 347.46%  | 104.97%  | 474.36%   |
| STRIP, SHORT EQUAL INDEX             | 7.55%                        | 5.08%   | (21.59%) | (14.69%) | 18.73%   | 223.10%  | 6.53%    | 101.77%   |
| STRIP, SHORT ACTUAL INDEX            | 8.11%                        | 6.08%   | (21.03%) | (12.70%) | 26.15%   | 224.62%  | 13.59%   | 144.99%   |
| STRIP, ALL EQUAL INCOME INDEX        | 1.10%                        | 3.23%   | 6.44%    | 13.16%   | 71.34%   | 204.32%  | 669.47%  | 2,038.24% |
| STRIP, ALL ACTUAL INCOME INDEX       | 1.12%                        | 3.25%   | 6.45%    | 13.09%   | 64.11%   | 156.66%  | 489.49%  | 1,522.26% |
| STRIP, LONG EQUAL INCOME INDEX       | 1.25%                        | 3.65%   | 7.43%    | 15.42%   | 86.58%   | 277.85%  | 929.01%  | 2,808.23% |
| STRIP, LONG ACTUAL INCOME INDEX      | 1.28%                        | 3.70%   | 7.52%    | 15.53%   | 76.78%   | 196.83%  | 606.60%  | 1,873.21% |
| STRIP, SHORT EQUAL INCOME INDEX      | 0.79%                        | 2.38%   | 4.53%    | 9.11%    | 48.57%   | 124.82%  | 393.19%  | 1,145.20% |
| STRIP, SHORT ACTUAL INCOME INDEX     | 0.78%                        | 2.31%   | 4.33%    | 8.60%    | 45.05%   | 110.37%  | 355.21%  | 1,046.72% |
| STRIP, ALL EQUAL PRICE INDEX         | 4.64%                        | 7.31%   | (13.23%) | (4.07%)  | 23.70%   | 172.40%  | 38.56%   | 133.41%   |
| STRIP, ALL ACTUAL PRICE INDEX        | 4.58%                        | 7.68%   | (13.17%) | (3.12%)  | 28.30%   | 181.96%  | 44.80%   | 149.24%   |
| STRIP, LONG EQUAL PRICE INDEX        | 2.80%                        | 7.20%   | (10.91%) | (3.25%)  | 18.62%   | 127.52%  | 30.22%   | 128.89%   |
| STRIP, LONG ACTUAL PRICE INDEX       | 2.61%                        | 7.35%   | (11.06%) | (2.93%)  | 20.17%   | 126.31%  | 32.79%   | 137.40%   |
| STRIP, SHORT EQUAL PRICE INDEX       | 8.53%                        | 7.65%   | (17.22%) | (5.52%)  | 32.16%   | 240.23%  | 55.47%   | 102.91%   |
| STRIP, SHORT ACTUAL PRICE INDEX      | 8.88%                        | 8.40%   | (16.94%) | (3.55%)  | 42.17%   | 262.35%  | 66.17%   | 145.44%   |
| STRIP, ALL EQUAL PREPAY INDEX        | (0.67%)                      | (2.16%) | (4.10%)  | (7.24%)  | (15.68%) | (27.61%) | (71.93%) | (82.61%)  |
| STRIP, ALL ACTUAL PREPAY INDEX       | (0.60%)                      | (1.95%) | (3.72%)  | (6.70%)  | (14.84%) | (27.39%) | (70.29%) | (81.73%)  |
| STRIP, LONG EQUAL PREPAY INDEX       | (0.57%)                      | (2.07%) | (3.70%)  | (6.34%)  | (13.14%) | (22.72%) | (72.11%) | (82.99%)  |
| STRIP, LONG ACTUAL PREPAY INDEX      | (0.56%)                      | (1.86%) | (3.35%)  | (5.73%)  | (12.11%) | (22.12%) | (70.84%) | (82.39%)  |
| STRIP, SHORT EQUAL PREPAY INDEX      | (0.88%)                      | (2.36%) | (4.85%)  | (8.85%)  | (19.79%) | (34.13%) | (69.35%) | (78.43%)  |
| STRIP, SHORT ACTUAL PREPAY INDEX     | (0.70%)                      | (2.12%) | (4.45%)  | (8.47%)  | (19.24%) | (33.98%) | (67.78%) | (77.16%)  |
| STRIP, ALL EQUAL DEFAULT INDEX       | (0.16%)                      | (0.53%) | (1.04%)  | (2.20%)  | (6.60%)  | (15.42%) | (27.80%) | (34.88%)  |
| STRIP, ALL ACTUAL DEFAULT INDEX      | (0.14%)                      | (0.47%) | (0.95%)  | (2.03%)  | (6.27%)  | (15.48%) | (27.35%) | (34.57%)  |
| STRIP, LONG EQUAL DEFAULT INDEX      | (0.14%)                      | (0.50%) | (0.94%)  | (1.91%)  | (5.42%)  | (12.28%) | (25.92%) | (33.40%)  |
| STRIP, LONG ACTUAL DEFAULT INDEX     | (0.13%)                      | (0.45%) | (0.85%)  | (1.73%)  | (5.00%)  | (12.09%) | (25.38%) | (33.06%)  |
| STRIP, SHORT EQUAL DEFAULT INDEX     | (0.21%)                      | (0.57%) | (1.24%)  | (2.71%)  | (8.52%)  | (19.60%) | (29.68%) | (34.88%)  |
| STRIP, SHORT ACTUAL DEFAULT INDEX    | (0.17%)                      | (0.51%) | (1.14%)  | (2.60%)  | (8.31%)  | (19.66%) | (29.31%) | (34.42%)  |
| STRIP, ALL EQUAL VOL PREPAY INDEX    | (0.51%)                      | (1.64%) | (3.09%)  | (5.15%)  | (9.70%)  | (14.38%) | (61.02%) | (73.20%)  |
| STRIP, ALL ACTUAL VOL PREPAY INDEX   | (0.46%)                      | (1.48%) | (2.80%)  | (4.76%)  | (9.13%)  | (14.05%) | (59.02%) | (71.99%)  |
| STRIP, LONG EQUAL VOL PREPAY INDEX   | (0.44%)                      | (1.57%) | (2.79%)  | (4.51%)  | (8.15%)  | (11.88%) | (62.24%) | (74.36%)  |
| STRIP, LONG ACTUAL VOL PREPAY INDEX  | (0.43%)                      | (1.42%) | (2.52%)  | (4.07%)  | (7.47%)  | (11.39%) | (60.81%) | (73.59%)  |
| STRIP, SHORT EQUAL VOL PREPAY INDEX  | (0.67%)                      | (1.79%) | (3.65%)  | (6.30%)  | (12.29%) | (18.02%) | (56.33%) | (66.79%)  |
| STRIP, SHORT ACTUAL VOL PREPAY INDEX | (0.54%)                      | (1.61%) | (3.34%)  | (6.01%)  | (11.89%) | (17.77%) | (54.34%) | (65.08%)  |
| STRIP, ALL EQUAL SCHED PRIN INDEX    | (0.43%)                      | (1.30%) | (2.63%)  | (5.28%)  | (15.19%) | (24.46%) | (36.65%) | (42.62%)  |
| STRIP, ALL ACTUAL SCHED PRIN INDEX   | (0.41%)                      | (1.23%) | (2.50%)  | (5.04%)  | (14.84%) | (24.23%) | (36.38%) | (42.25%)  |
| STRIP, LONG EQUAL SCHED PRIN INDEX   | (0.27%)                      | (0.81%) | (1.61%)  | (3.18%)  | (9.23%)  | (15.35%) | (25.10%) | (30.96%)  |
| STRIP, LONG ACTUAL SCHED PRIN INDEX  | (0.26%)                      | (0.76%) | (1.51%)  | (3.00%)  | (8.77%)  | (14.63%) | (23.96%) | (29.80%)  |
| STRIP, SHORT EQUAL SCHED PRIN INDEX  | (0.77%)                      | (2.30%) | (4.56%)  | (9.02%)  | (24.42%) | (36.52%) | (54.17%) | (62.65%)  |
| STRIP, SHORT ACTUAL SCHED PRIN INDEX | (0.75%)                      | (2.23%) | (4.44%)  | (8.79%)  | (24.12%) | (36.21%) | (52.95%) | (61.67%)  |
| STRIP, ALL EQUAL TOTAL PRIN INDEX    | (1.11%)                      | (3.44%) | (6.64%)  | (12.17%) | (28.54%) | (45.40%) | (82.29%) | (90.07%)  |
| STRIP, ALL ACTUAL TOTAL PRIN INDEX   | (1.02%)                      | (3.17%) | (6.15%)  | (11.43%) | (27.53%) | (45.07%) | (81.18%) | (89.50%)  |
| STRIP, LONG EQUAL TOTAL PRIN INDEX   | (0.85%)                      | (2.87%) | (5.27%)  | (9.34%)  | (21.19%) | (34.63%) | (79.17%) | (88.30%)  |
| STRIP, LONG ACTUAL TOTAL PRIN INDEX  | (0.81%)                      | (2.62%) | (4.82%)  | (8.58%)  | (19.84%) | (33.56%) | (77.88%) | (87.67%)  |
| STRIP, SHORT EQUAL TOTAL PRIN INDEX  | (1.65%)                      | (4.62%) | (9.23%)  | (17.13%) | (39.48%) | (58.32%) | (86.06%) | (92.01%)  |
| STRIP, SHORT ACTUAL TOTAL PRIN INDEX | (1.45%)                      | (4.32%) | (8.72%)  | (16.57%) | (38.82%) | (58.02%) | (84.94%) | (91.32%)  |



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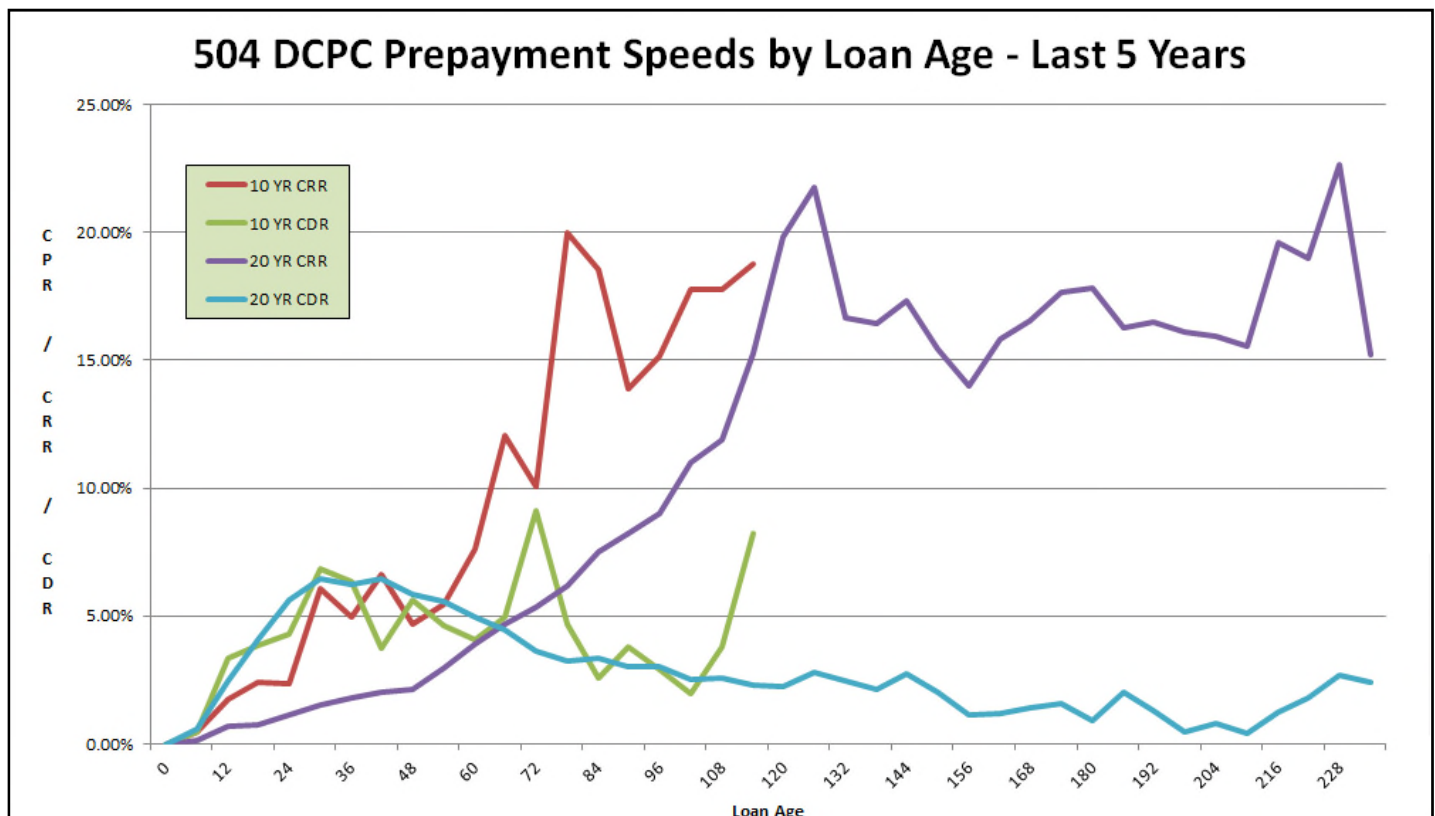
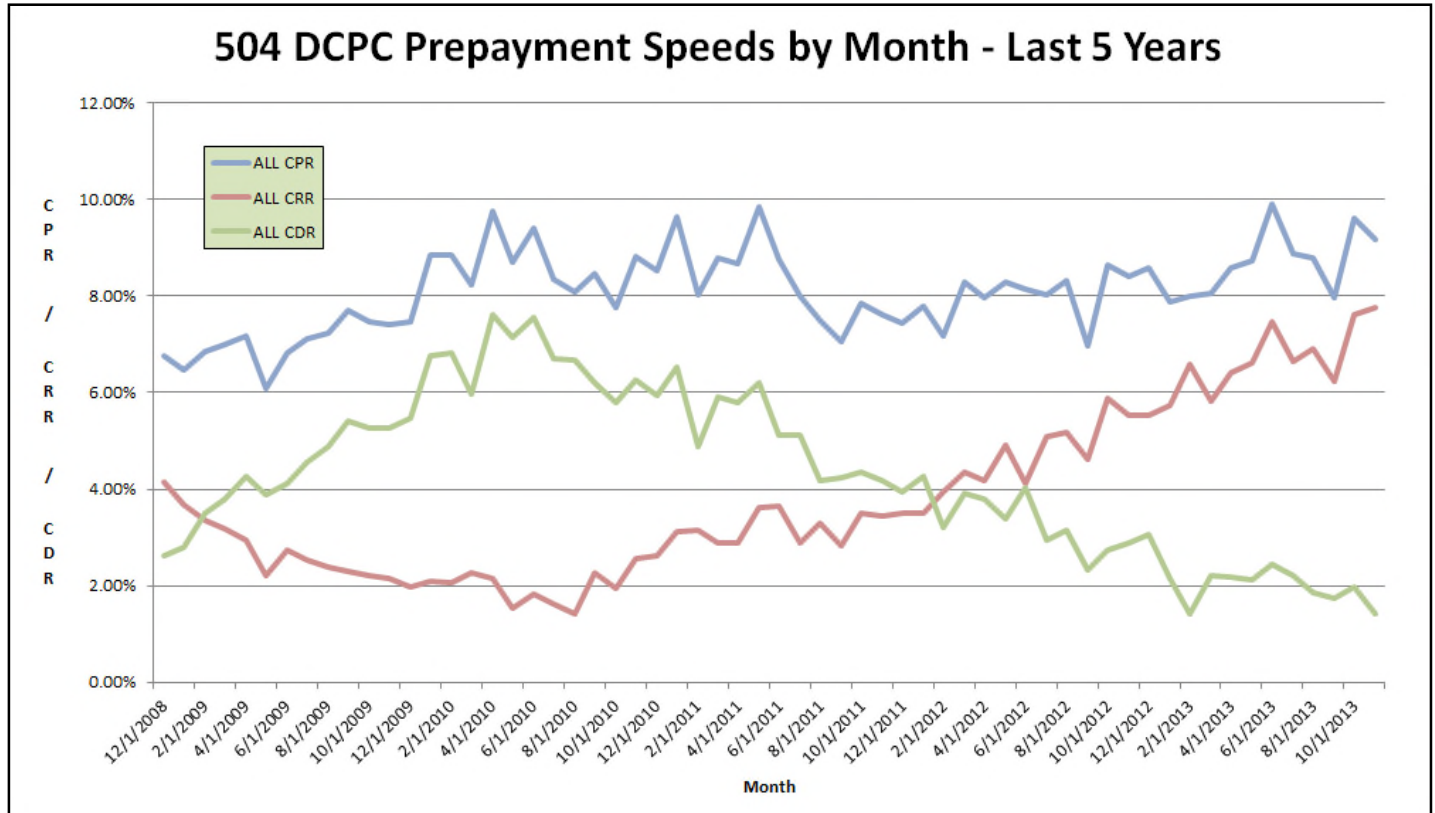




## 504 DCPC PREPAY SPEEDS - LAST 5 YEARS

| 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 |
|-----------|------------|------------|------------|------------|------------|------------|---------|---------|---------|
| 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%   |
| 8/1/2012  | 8.31%      | 5.18%      | 3.13%      | NA         | NA         | NA         | 8.31%   | 5.18%   | 3.13%   |
| 9/1/2012  | 6.94%      | 4.61%      | 2.34%      | 7.35%      | 5.18%      | 2.17%      | 6.96%   | 4.63%   | 2.33%   |
| 10/1/2012 | 8.63%      | 5.89%      | 2.74%      | NA         | NA         | NA         | 8.63%   | 5.89%   | 2.74%   |
| 11/1/2012 | 8.45%      | 5.49%      | 2.95%      | 7.80%      | 6.22%      | 1.58%      | 8.42%   | 5.53%   | 2.89%   |
| 12/1/2012 | 8.59%      | 5.53%      | 3.06%      | NA         | NA         | NA         | 8.59%   | 5.53%   | 3.06%   |
| 1/1/2013  | 7.79%      | 5.61%      | 2.18%      | 9.85%      | 8.72%      | 1.13%      | 7.88%   | 5.75%   | 2.14%   |
| 2/1/2013  | 8.00%      | 6.59%      | 1.42%      | NA         | NA         | NA         | 8.00%   | 6.59%   | 1.42%   |
| 3/1/2013  | 8.16%      | 5.88%      | 2.27%      | 5.92%      | 4.85%      | 1.07%      | 8.05%   | 5.83%   | 2.22%   |
| 4/1/2013  | 8.59%      | 6.42%      | 2.17%      | NA         | NA         | NA         | 8.59%   | 6.42%   | 2.17%   |
| 5/1/2013  | 8.89%      | 6.75%      | 2.13%      | 5.61%      | 3.77%      | 1.83%      | 8.72%   | 6.61%   | 2.12%   |
| 6/1/2013  | 9.91%      | 7.46%      | 2.44%      | NA         | NA         | NA         | 9.91%   | 7.46%   | 2.44%   |
| 7/1/2013  | 9.04%      | 6.79%      | 2.25%      | 5.07%      | 3.81%      | 1.26%      | 8.87%   | 6.66%   | 2.21%   |
| 8/1/2013  | 8.79%      | 6.92%      | 1.86%      | NA         | NA         | NA         | 8.79%   | 6.92%   | 1.86%   |
| 9/1/2013  | 7.91%      | 6.19%      | 1.72%      | 9.01%      | 7.00%      | 2.00%      | 7.96%   | 6.23%   | 1.73%   |
| 10/1/2013 | 9.60%      | 7.63%      | 1.97%      | NA         | NA         | NA         | 9.60%   | 7.63%   | 1.97%   |
| 11/1/2013 | 9.29%      | 7.85%      | 1.44%      | 7.22%      | 6.40%      | 0.83%      | 9.18%   | 7.78%   | 1.41%   |

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





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## GLS 7(a) Settlement & Sales Strategies Tip #59 – WWRD?...

WWRD (What would Ralphie do?)

Everyone has surely seen A Christmas Story and this being our report for December, it seems only fitting to include such an iconic figure as Ralphie in our settlement tips. While Christmas ended well for Ralphie, he narrowly dodged catastrophe when he wound up at the end of the line to see Santa at the department store. So what does that have to do with selling loans? Not much other than it's a great allegory for what can happen to those who wind up at the back of the line to sell loans in front of Christmas and year end. Premiums and liquidity almost always decline and sometimes, sales even are timed such that they don't make the year end cutoff. The moral? Don't be the Ralphie of loan sales this holiday season. Get to the front of the line by selling loans early in the month and avoid the Christmas rush! FYI, December 18th should be the last day to sell and still get year end settlement guaranteed. December 20th would be an absolute drop dead date and no guarantees can be made that loans will still get settled by year end if sold on the 20th.

*Scott Evans is a partner at GLS. Mr. Evans has over 25 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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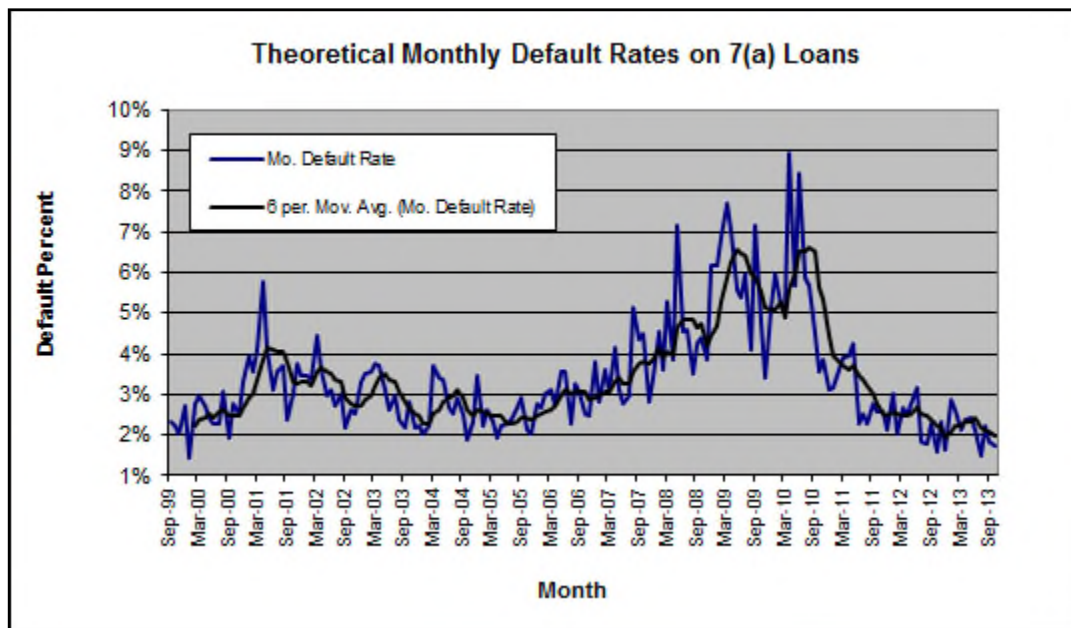
## DEFAULT RATE FALLS 5%

In October, the theoretical default rate fell by 5% to 1.74% from 1.84% in September. This reading is the fifth lowest on record, going back to 1999.

For the second month in a row, the 7a Program has reported a default rate below 2%. This fact, combined with our expectation of a record low reading next month, defaults continue to come in at record-low levels as we near the end of 2013.

It will be interesting to see how low the default rate can go in 2014. This, only 3 years removed from record high default numbers during the Credit Crisis.

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



**"It is better to look ahead and prepare than to look back and regret."**

Jackie Joyner-Kersey

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## DEFAULT-CURTAILMENT RATIOS

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

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

### SBA 7(a) Default Ratios

Last month, the 7(a) DCR fell 6%, hitting 23.58% from 25.19% in September. This represents the fifth month in a row of sub-30% readings, as defaults continue to decrease and voluntary prepayments move higher.

This month, defaults fell by a greater percentage than voluntary prepayments, caus-

ing the overall ratio to decrease.

Turning to actual dollar amounts, defaults decreased by 10% to \$59 million from \$66 million. As for voluntary prepayments, they fell by 2% to \$193 million versus \$196 million.

### SBA 504 Default Ratios

For October, the 504 DCR witnessed a 5% decrease to 20.13% from 21.12% in September. With voluntaries rising by a greater percentage than defaults, the ratio decreased.

Specifically, the dollar amount of defaults increased by \$.3 million to \$42.4 million (+.71%). As for voluntary prepayments, they rose by \$11 million to \$168 million (+7%).

### Summary

Both ratios are entrenched in the sub-20% area, a sure sign of low defaults and rising voluntary prepayments.

*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 27*

## GLS VALUE INDICES MOSTLY LOWER

In October, the GLS Value Indices fell in five out of six sub-indices, as secondary market pricing continued its recovery from June lows.

The Base Rate / Libor spread was higher by two basis points at +3.02% while the prepayment element rose in 4 out of 6 categories.

By the end of October, the secondary market was higher in the long end as well as the 10 year sector, but lower in other maturity ranges.

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

fell by 11% to 122 basis points. The other decreases, by order of magnitude, were: VI-4 (-2% to 191), VI-5 (-2% to 197) VI-1 (-1% to 92) and VI-2 (-.3% to 119).

The lone increase was seen in VI-6, which rose by 1% to 175.

After trading sideways for a few months, the secondary market seems to have found a bid, which should push the indices lower in the months to come.

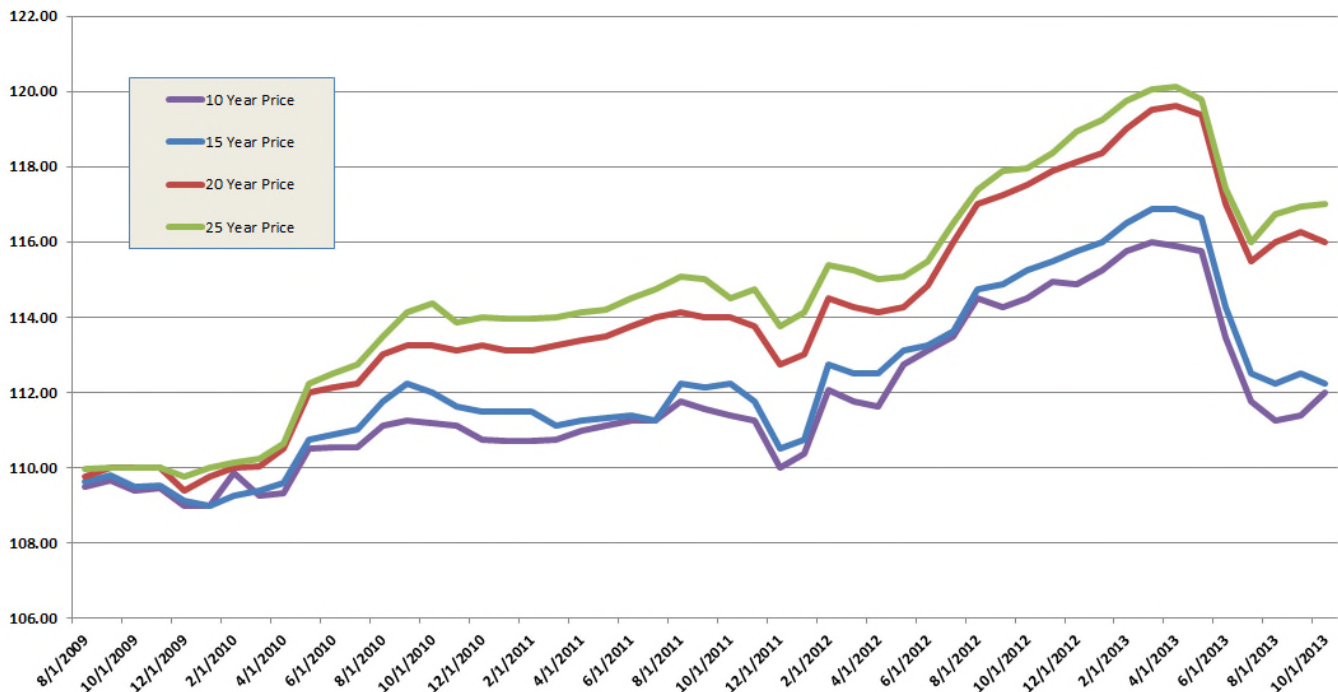
*For further information on the terminology and concepts used in this article, please refer to the "Glossary and Definitions" at the end of the report.*

*Data & Graphs on the following pages*

### 7(a) Secondary Market Pricing Grid: October 2013

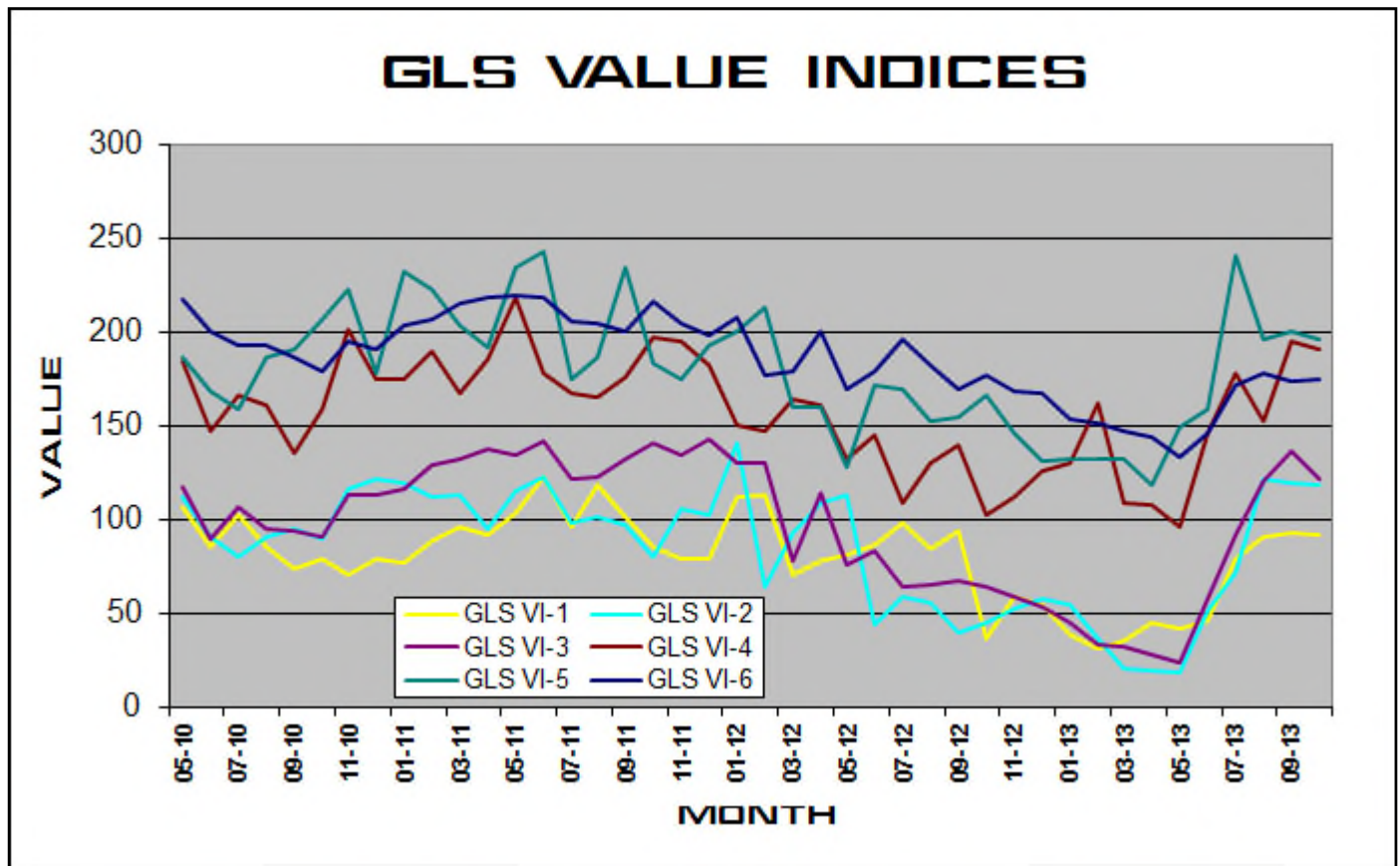
| Maturity | Gross Margin | Net Margin | Servicing | This Month Price | Last Month Price | 3-Mos. Ago Price | 6-Mos. Ago Price | 1-Yr. Ago Price |
|----------|--------------|------------|-----------|------------------|------------------|------------------|------------------|-----------------|
| 10 yrs.  | 2.75%        | 1.075%     | 1.00%     | 112.00           | 111.40           | 111.75           | 115.875          | 114.50          |
| 15 yrs.  | 2.75%        | 1.075%     | 1.00%     | 112.25           | 112.50           | 112.50           | 116.875          | 115.25          |
| 20 yrs.  | 2.75%        | 1.075%     | 1.00%     | 116.00           | 116.25           | 115.50           | 119.625          | 117.50          |
| 25 yrs.  | 2.75%        | 1.075%     | 1.00%     | 117.00           | 116.95           | 116.00           | 120.125          | 117.95          |

### CPR Report Secondary Market Levels





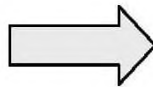
## GLS VALUE INDICES DECREASE



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Typical  
Bank  
Report  
(Old)

| Pymt Cust Number | Pymt Cust Zip Code | Note Officer Name | Note Account Number | Note Bank Share Ledger Balance |
|------------------|--------------------|-------------------|---------------------|--------------------------------|
| 12414            | 28449              | MICHAEL SETZER    | 000010000171        | 2,950.53                       |
| 2892             | 28409              | KEVIN HUDSON      | 00001000033         | 0.00                           |
| 24865            | 28403              | MICHAEL SETZER    | 00001000082         | 21,541.33                      |
| 26062            | 28480              | MICHAEL SETZER    | 00001000108         | 0.00                           |
| 25121            | 28443              | MICHAEL SETZER    | 00001000161         | 903.07                         |
| 26229            | 28411              | KEVIN HUDSON      | 00001000215         | 0.00                           |
| 9514             | 28412              | KEVIN HUDSON      | 00001000272         | 1,960.28                       |
| 24863            | 28405              | MICHAEL SETZER    | 00001000322         | 3,756.01                       |
| 16496            | 28480              | DAVID BARLOW      | 00001000337         | 0.00                           |
| 22806            | 28405              | ASHLEY MIRANDA    | 00001000436         | 456.27                         |
| 22806            | 28405              | ASHLEY MIRANDA    | 00001000789         | 456.55                         |
| 24322            | 28403              | KEVIN HUDSON      | 00001000884         | 454.10                         |
| 16496            | 28409              | DAVID BARLOW      | 00001000975         | 0.00                           |
| 13322            | 28480              | DAVID BARLOW      | 00001001015         | 0.00                           |
| 13320            | 28480              | DAVID BARLOW      | 00001001043         | 0.00                           |
| 26801            | 28409              | KEVIN HUDSON      | 00001001304         | 0.00                           |



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## GLS VALUE INDICES: SUPPORTING DATA

Table 1:

| MONTH  | BUCKET<br>1 CPR | BUCKET<br>2 CPR | BUCKET<br>3 CPR | BUCKET<br>4 CPR | BUCKET<br>5 CPR | BUCKET<br>6 CPR |
|--------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| May-10 | w               | 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%           |
| Jun-12 | 10.42%          | 9.19%           | 6.72%           | 6.54%           | 4.93%           | 4.58%           |
| Jul-12 | 10.78%          | 8.90%           | 6.50%           | 6.63%           | 5.55%           | 4.40%           |
| Aug-12 | 11.30%          | 8.23%           | 6.67%           | 7.18%           | 5.97%           | 4.40%           |
| Sep-12 | 12.35%          | 8.72%           | 6.85%           | 6.90%           | 6.46%           | 4.44%           |
| Oct-12 | 11.44%          | 8.16%           | 7.16%           | 6.52%           | 6.34%           | 4.40%           |
| Nov-12 | 11.31%          | 8.21%           | 7.15%           | 6.16%           | 6.19%           | 4.62%           |
| Dec-12 | 10.87%          | 7.49%           | 7.26%           | 5.99%           | 5.74%           | 4.49%           |
| Jan-13 | 10.83%          | 7.82%           | 7.82%           | 5.83%           | 6.36%           | 4.90%           |
| Feb-13 | 10.54%          | 7.81%           | 8.55%           | 5.20%           | 6.47%           | 5.17%           |
| Mar-13 | 9.73%           | 7.46%           | 8.01%           | 5.81%           | 6.54%           | 5.28%           |
| Apr-13 | 10.37%          | 8.50%           | 8.08%           | 5.90%           | 6.50%           | 5.52%           |
| May-13 | 8.84%           | 9.12%           | 8.56%           | 5.97%           | 6.42%           | 5.57%           |
| Jun-13 | 9.66%           | 10.04%          | 8.76%           | 6.24%           | 7.14%           | 5.93%           |
| Jul-13 | 11.26%          | 9.24%           | 8.76%           | 5.75%           | 6.87%           | 5.84%           |
| Aug-13 | 11.45%          | 9.23%           | 8.70%           | 5.97%           | 7.97%           | 6.14%           |
| Sep-13 | 11.88%          | 10.04%          | 9.00%           | 5.90%           | 8.14%           | 6.33%           |
| Oct-13 | 11.43%          | 9.26%           | 9.19%           | 6.49%           | 8.53%           | 6.58%           |

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 |  |
|--------|------------|-----------|----------------|----------|----------|----------|----------|----------|----------|----------------|--|
|        |            |           |                |          |          |          |          |          |          |                |  |
| 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    |                |  |
| Jun-12 | 0.41%      | 3.23%     | 2.83%          | 87.1     | 44.0     | 83.7     | 145.5    | 172.0    | 179.8    |                |  |
| Jul-12 | 0.39%      | 3.25%     | 2.86%          | 98.4     | 59.0     | 65.0     | 109.0    | 169.6    | 196.7    |                |  |
| Aug-12 | 0.36%      | 3.25%     | 2.89%          | 85.4     | 56.2     | 65.8     | 130.4    | 152.5    | 182.2    |                |  |
| Sep-12 | 0.33%      | 3.25%     | 2.91%          | 93.9     | 40.0     | 68.1     | 140.7    | 155.1    | 169.7    |                |  |
| Oct-12 | 0.30%      | 3.25%     | 2.95%          | 37.4     | 46.0     | 64.8     | 102.8    | 166.5    | 177.2    |                |  |
| Nov-12 | 0.29%      | 3.25%     | 2.95%          | 59.8     | 53.4     | 59.1     | 112.8    | 146.0    | 168.4    |                |  |
| Dec-12 | 0.29%      | 3.25%     | 2.96%          | 55.0     | 58.2     | 54.5     | 126.4    | 131.2    | 167.6    |                |  |
| Jan-13 | 0.28%      | 3.25%     | 2.97%          | 39.6     | 55.4     | 45.9     | 130.4    | 133.1    | 154.3    |                |  |
| Feb-13 | 0.26%      | 3.24%     | 2.98%          | 31.5     | 36.6     | 34.1     | 162.7    | 133.1    | 152.2    |                |  |
| Mar-13 | 0.26%      | 3.25%     | 2.99%          | 36.3     | 21.0     | 32.7     | 108.8    | 132.7    | 147.7    |                |  |
| Apr-13 | 0.26%      | 3.25%     | 2.99%          | 45.3     | 20.5     | 29.0     | 107.8    | 118.9    | 144.9    |                |  |
| May-13 | 0.26%      | 3.25%     | 2.99%          | 42.6     | 19.4     | 24.4     | 96.7     | 149.8    | 133.8    |                |  |
| Jun-13 | 0.26%      | 3.25%     | 2.99%          | 46.2     | 51.6     | 58.2     | 146.9    | 158.9    | 146.5    |                |  |
| Jul-13 | 0.25%      | 3.25%     | 2.99%          | 79.9     | 72.5     | 92.0     | 178.4    | 241.1    | 172.5    |                |  |
| Aug-13 | 0.25%      | 3.25%     | 3.00%          | 91.2     | 122.1    | 120.5    | 152.7    | 196.6    | 178.0    |                |  |
| Sep-13 | 0.23%      | 3.24%     | 3.00%          | 92.9     | 119.7    | 137.1    | 195.8    | 200.3    | 173.7    |                |  |
| Oct-13 | 0.23%      | 3.25%     | 3.02%          | 91.9     | 119.3    | 121.7    | 191.1    | 197.0    | 175.2    |                |  |

GLS VI values for all maturity buckets for last 42 months.



## YTD PREPAYMENT SPEEDS

Table 3:

| CPR/MO.     | <8     | 8 - 10 | 10 - 13 | 13 - 16 | 16 - 20 | 20+   | ALL   |
|-------------|--------|--------|---------|---------|---------|-------|-------|
| Jan-13      | 10.53% | 11.19% | 9.82%   | 6.56%   | 10.45%  | 6.64% | 7.84% |
| Feb-13      | 9.77%  | 7.31%  | 10.53%  | 5.92%   | 6.33%   | 6.37% | 7.43% |
| Mar-13      | 7.76%  | 6.29%  | 6.01%   | 6.78%   | 9.09%   | 4.92% | 5.57% |
| Apr-13      | 10.44% | 11.01% | 7.11%   | 4.25%   | 4.11%   | 5.19% | 5.86% |
| May-13      | 7.54%  | 11.99% | 9.57%   | 6.45%   | 6.06%   | 5.85% | 7.00% |
| Jun-13      | 11.85% | 12.36% | 9.45%   | 7.47%   | 6.79%   | 6.58% | 7.59% |
| Jul-13      | 19.88% | 6.28%  | 9.74%   | 3.58%   | 8.77%   | 6.09% | 7.29% |
| Aug-13      | 10.96% | 7.16%  | 10.13%  | 7.27%   | 12.81%  | 8.11% | 8.83% |
| Sep-13      | 10.34% | 11.12% | 7.90%   | 6.40%   | 10.19%  | 6.13% | 7.01% |
| Oct-13      | 7.42%  | 6.23%  | 8.37%   | 7.82%   | 6.44%   | 6.71% | 7.11% |
| Grand Total | 10.71% | 9.15%  | 8.87%   | 6.25%   | 8.12%   | 6.27% | 7.16% |

2013 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-13   | 27 Mos. | 37 Mos. | 36 Mos. | 70 Mos. | 51 Mos. | 48 Mos. | 46 Mos. |
| Feb-13   | 27 Mos. | 37 Mos. | 36 Mos. | 67 Mos. | 51 Mos. | 48 Mos. | 46 Mos. |
| Mar-13   | 27 Mos. | 38 Mos. | 36 Mos. | 68 Mos. | 49 Mos. | 48 Mos. | 45 Mos. |
| Apr-13   | 26 Mos. | 38 Mos. | 37 Mos. | 69 Mos. | 49 Mos. | 48 Mos. | 46 Mos. |
| May-13   | 26 Mos. | 38 Mos. | 36 Mos. | 69 Mos. | 50 Mos. | 48 Mos. | 45 Mos. |
| Jun-13   | 27 Mos. | 38 Mos. | 37 Mos. | 68 Mos. | 50 Mos. | 48 Mos. | 46 Mos. |
| Jul-13   | 27 Mos. | 39 Mos. | 36 Mos. | 66 Mos. | 51 Mos. | 49 Mos. | 46 Mos. |
| Aug-13   | 27 Mos. | 39 Mos. | 37 Mos. | 66 Mos. | 51 Mos. | 49 Mos. | 46 Mos. |
| Sep-13   | 27 Mos. | 38 Mos. | 37 Mos. | 66 Mos. | 52 Mos. | 50 Mos. | 46 Mos. |
| Oct-13   | 28 Mos. | 39 Mos. | 37 Mos. | 67 Mos. | 52 Mos. | 49 Mos. | 46 Mos. |

2013 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-13      | 4.23%     | 10.46%     | 21.01%     | 5.03%      | 7.88%    |
| Feb-13      | 5.13%     | 14.47%     | 10.00%     | 8.51%      | 12.07%   |
| Mar-13      | 2.30%     | 13.48%     | 4.27%      | 11.71%     | 11.20%   |
| Apr-13      | 10.36%    | 9.54%      | 12.97%     | 8.51%      | 9.90%    |
| May-13      | 8.98%     | 3.90%      | 7.18%      | 8.98%      | 8.61%    |
| Jun-13      | 11.50%    | 18.24%     | 5.26%      | 9.08%      | 14.44%   |
| Jul-13      | 9.69%     | 28.31%     | 34.36%     | 10.13%     | 13.32%   |
| Aug-13      | 4.98%     | 6.78%      | 19.08%     | 21.17%     | 4.99%    |
| Sep-13      | 9.71%     | 17.82%     | 2.48%      | 11.34%     | 6.80%    |
| Oct-13      | 3.74%     | 1.94%      | 16.61%     | 12.42%     | 4.65%    |
| Grand Total | 7.22%     | 12.80%     | 13.86%     | 11.18%     | 9.46%    |

| 10-13 BY AGE | 0-12 Mos. | 13-24 Mos. | 25-36 Mos. | 37-48 Mos. | 48+ Mos. |
|--------------|-----------|------------|------------|------------|----------|
| Jan-13       | 5.19%     | 12.57%     | 19.73%     | 12.31%     | 6.09%    |
| Feb-13       | 8.78%     | 10.25%     | 15.47%     | 12.80%     | 8.92%    |
| Mar-13       | 3.44%     | 10.36%     | 7.47%      | 4.15%      | 4.91%    |
| Apr-13       | 0.43%     | 12.11%     | 8.65%      | 10.71%     | 6.77%    |
| May-13       | 5.32%     | 16.18%     | 9.86%      | 10.40%     | 7.71%    |
| Jun-13       | 2.78%     | 15.61%     | 17.54%     | 6.42%      | 6.76%    |
| Jul-13       | 4.33%     | 13.56%     | 9.70%      | 19.26%     | 8.03%    |
| Aug-13       | 3.95%     | 11.01%     | 14.50%     | 20.11%     | 8.12%    |
| Sep-13       | 3.76%     | 6.15%      | 13.78%     | 12.18%     | 7.25%    |
| Oct-13       | 4.48%     | 10.38%     | 13.79%     | 10.22%     | 6.48%    |
| Grand Total  | 4.24%     | 11.92%     | 13.19%     | 12.10%     | 7.11%    |

| 16-20 BY AGE | 0-12 Mos. | 13-24 Mos. | 25-36 Mos. | 37-48 Mos. | 48+ Mos. |
|--------------|-----------|------------|------------|------------|----------|
| Jan-13       | 0.00%     | 28.18%     | 23.26%     | 8.62%      | 2.87%    |
| Feb-13       | 0.00%     | 1.11%      | 11.33%     | 2.94%      | 10.08%   |
| Mar-13       | 0.00%     | 17.98%     | 11.11%     | 10.10%     | 8.05%    |
| Apr-13       | 0.00%     | 9.11%      | 5.42%      | 4.14%      | 3.55%    |
| May-13       | 2.82%     | 1.40%      | 2.45%      | 13.92%     | 8.25%    |
| Jun-13       | 1.66%     | 8.74%      | 7.66%      | 14.04%     | 6.45%    |
| Jul-13       | 0.00%     | 20.32%     | 14.61%     | 23.48%     | 2.01%    |
| Aug-13       | 1.63%     | 1.10%      | 47.38%     | 0.55%      | 4.30%    |
| Sep-13       | 0.00%     | 0.97%      | 20.15%     | 21.48%     | 9.72%    |
| Oct-13       | 4.59%     | 0.24%      | 17.23%     | 10.58%     | 4.27%    |
| Grand Total  | 1.05%     | 10.00%     | 18.36%     | 11.30%     | 5.99%    |

## YEAR-TO-DATE CPR DATA

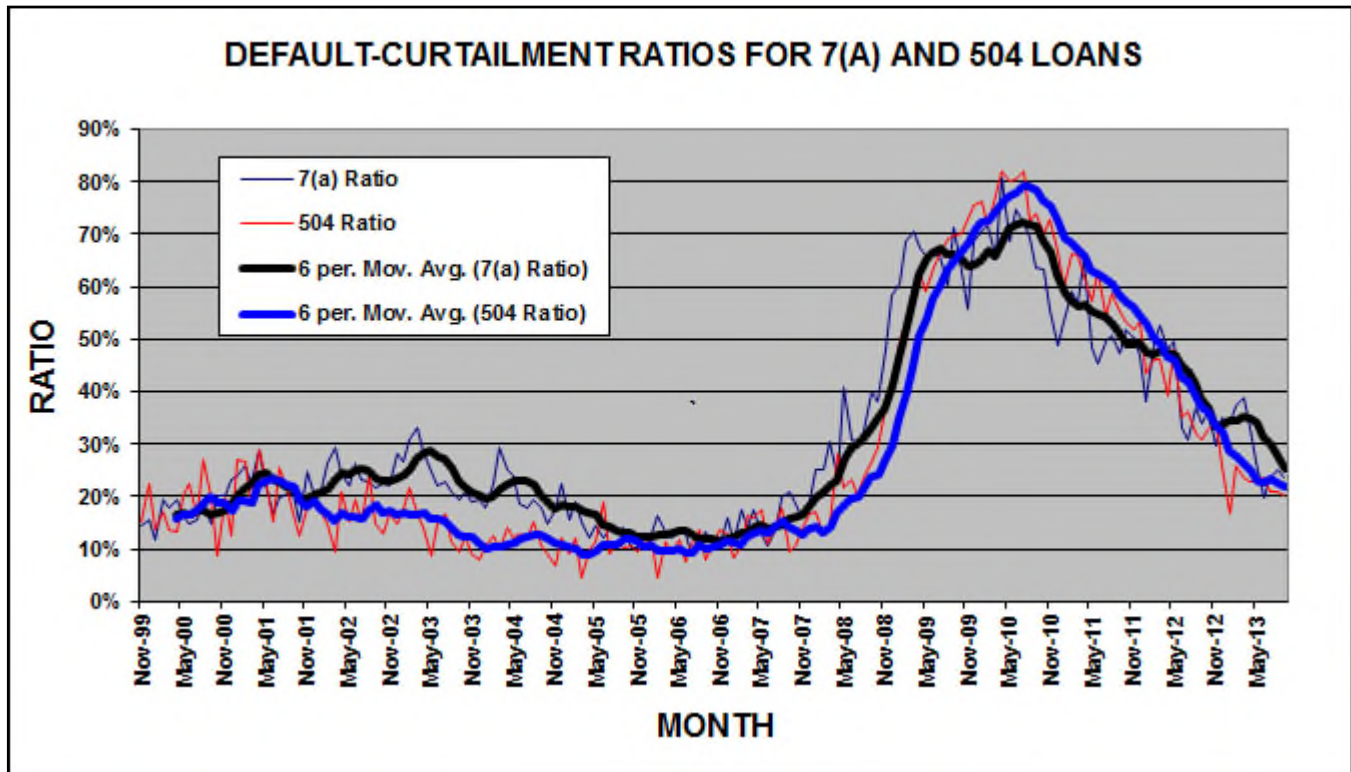
Table 5:

| 8-10 BY AGE | 0-12 Mos. | 13-24 Mos. | 25-36 Mos. | 37-48 Mos. | 48+ Mos. |
|-------------|-----------|------------|------------|------------|----------|
| Jan-13      | 12.95%    | 16.91%     | 20.38%     | 3.82%      | 7.33%    |
| Feb-13      | 1.59%     | 8.12%      | 6.14%      | 7.78%      | 10.91%   |
| Mar-13      | 10.17%    | 6.99%      | 4.61%      | 3.05%      | 6.45%    |
| Apr-13      | 6.84%     | 20.19%     | 17.91%     | 6.97%      | 9.82%    |
| May-13      | 26.91%    | 5.64%      | 10.01%     | 6.37%      | 9.09%    |
| Jun-13      | 8.36%     | 35.76%     | 11.20%     | 6.49%      | 7.42%    |
| Jul-13      | 3.54%     | 10.52%     | 7.56%      | 3.02%      | 6.23%    |
| Aug-13      | 3.80%     | 9.36%      | 3.21%      | 11.76%     | 6.83%    |
| Sep-13      | 16.32%    | 8.08%      | 13.31%     | 4.78%      | 11.88%   |
| Oct-13      | 4.18%     | 12.76%     | 3.85%      | 5.15%      | 5.40%    |
| Grand Total | 9.95%     | 13.63%     | 10.07%     | 5.91%      | 8.15%    |

| 13-16 BY AGE | 0-12 Mos. | 13-24 Mos. | 25-36 Mos. | 37-48 Mos. | 48+ Mos. |
|--------------|-----------|------------|------------|------------|----------|
| Jan-13       | 0.00%     | 4.32%      | 1.34%      | 2.31%      | 8.68%    |
| Feb-13       | 0.00%     | 0.00%      | 19.17%     | 4.12%      | 6.13%    |
| Mar-13       | 0.00%     | 9.49%      | 19.94%     | 11.28%     | 4.68%    |
| Apr-13       | 0.00%     | 3.14%      | 0.00%      | 0.00%      | 6.31%    |
| May-13       | 0.00%     | 0.00%      | 20.89%     | 0.27%      | 6.88%    |
| Jun-13       | 0.00%     | 21.08%     | 4.23%      | 14.13%     | 6.46%    |
| Jul-13       | 0.00%     | 0.00%      | 4.92%      | 0.23%      | 5.42%    |
| Aug-13       | 0.00%     | 0.00%      | 9.12%      | 12.79%     | 9.23%    |
| Sep-13       | 0.00%     | 0.00%      | 0.00%      | 20.29%     | 8.08%    |
| Oct-13       | 0.00%     | 21.65%     | 7.62%      | 30.11%     | 3.86%    |
| Grand Total  | 0.00%     | 5.48%      | 8.79%      | 10.04%     | 6.60%    |

| 20+ BY AGE  | 0-12 Mos. | 13-24 Mos. | 25-36 Mos. | 37-48 Mos. | 48+ Mos. |
|-------------|-----------|------------|------------|------------|----------|
| Jan-13      | 0.79%     | 8.14%      | 11.73%     | 8.28%      | 7.05%    |
| Feb-13      | 1.23%     | 6.19%      | 11.91%     | 11.04%     | 6.38%    |
| Mar-13      | 3.28%     | 4.60%      | 5.73%      | 6.27%      | 5.39%    |
| Apr-13      | 0.96%     | 7.28%      | 10.77%     | 7.00%      | 4.29%    |
| May-13      | 2.28%     | 7.08%      | 6.58%      | 9.37%      | 6.08%    |
| Jun-13      | 1.23%     | 8.29%      | 10.50%     | 11.47%     | 5.84%    |
| Jul-13      | 0.36%     | 6.39%      | 10.94%     | 14.82%     | 4.54%    |
| Aug-13      | 5.35%     | 5.79%      | 16.67%     | 10.59%     | 6.30%    |
| Sep-13      | 1.04%     | 4.40%      | 10.51%     | 12.69%     | 5.64%    |
| Oct-13      | 1.73%     | 9.74%      | 10.39%     | 10.28%     | 5.54%    |
| Grand Total | 1.83%     | 6.79%      | 10.73%     | 10.36%     | 5.70%    |





## GOVERNMENT LOAN SOLUTIONS

The nationwide leader in the valuation of SBA and USDA assets.

GLS provides valuations for:

- SBA 7(a), 504 1st mortgage and USDA servicing rights
- SBA 7(a) and 504 1st mortgage pools
- Guaranteed and non-guaranteed 7(a) loan portions Interest-only portions of SBA and USDA loans

In these times of market uncertainty, let GLS help you in determining the value of your SBA and USDA related-assets.

For further information, please contact Bob Judge at (216) 456-2480 ext. 133 or at [bob.judge@gl solutions.us](mailto:bob.judge@gl solutions.us)

## GLOSSARY AND DEFINITIONS: PAGE 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: PAGE 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.



## GLOSSARY AND DEFINITIONS: PAGE 3

### SBA 504 Program and Debenture Funding

To support small businesses and to strengthen the economy Congress created the U.S. Small Business Administration (SBA) in 1953 to provide a range of services to small businesses including financing. In 1958 Congress passed the Small Business Investment Act which established what is known today as the SBA 504 loan program.

The 504 loan program provides financing for major fixed assets, such as owner-occupied real estate and long-term machinery and equipment. A 504 project is funded by a loan from a bank secured with a first lien typically covering 50% of the project's cost, a loan from a CDC secured with a second lien (backed by a 100% SBA-guaranteed debenture) covering a maximum of 40% of the cost, and a contribution of at least 10% of the project cost from the small business being financed. The SBA promotes the 504 program as an economic development tool because it is a small-business financing product that generates jobs.

Each debenture is packaged with other CDC debentures into a national pool and is sold on a monthly basis to underwriters. Investors purchase interests in debenture pools and receive certificates representing ownership of all or part of a debenture pool. SBA uses various agents to facilitate the sale and service of the certificates and the orderly flow of funds among the parties involved. The debenture sales are broken into monthly sales of 20 year debentures and bi-monthly sales of 10 year debentures.

It is the performance of these debenture pools that we track in the CPR Report on a monthly basis.

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### Cloud Computing and the Banking Industry

#### **What is Cloud Computing?**

For many people and organizations, the term "cloud computing" is new and unfamiliar. However, it is a technology that has been used consistently since the 1950s. Many of us use cloud computing every day without even realizing it. Whenever we login to Facebook, send an email from a Gmail account, or use an enterprise planning systems, such as Oracle and Salesforce.com, we are accessing the cloud.

In simple terms, cloud computing means using hardware and software resources delivered as a service over a network. Most frequently, the network used is the Internet. Cloud-based applications are accessed through a web browser such as Microsoft's Internet Explorer and Google's Chrome, while data is stored on secure servers in custom designed data centers located throughout the United States and around the world. Businesses that use cloud computing enjoy many advantages, including an ability to get services and employees up and running faster because there is no software that needs to be downloaded and installed. Maintenance of cloud computing applications is easier, because the software does not need to be installed on each user's computer and can be accessed from multiple computers and devices. Proper cloud deployment can also provide the benefits of cost savings, better IT services, less maintenance, and higher levels of reliability.

#### **Cloud Banking**

As the banking industry evolves and adapts to changes in the competitive environment, banks will find it advantageous to move their data into the cloud. In fact, many banks are already in the cloud and just don't realize it, with data stored on Jack Henry and FIS systems.

The combination of the cloud's low cost and high scalability will help improve customer service, day-to-day operations, regulatory compliance, and the speed at which banks can operate, while reducing technology equipment and management costs.

Quite simply, cloud banking allows financial institutions to provide a more affordable and customized dialogue with their customers, regulators, employees and business partners.

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### SBI Pool and IO Strip Indexes

Through a joint venture called Small Business Indexes, Inc. or SBI, GLS and Ryan ALM introduced a group of total return indexes for SBA 7a pools and I/O strips with history going back to 1/1/2000.

Why did we do this?

Indexes have been around since 1896 when the Dow Jones Industrial Average was introduced. They have grown in importance to the financial markets, whereby today \$6 trillion are invested in Index Funds throughout the world.

Continued on the following pages.

## GLOSSARY AND DEFINITIONS: PAGE 4

### SBI Pool and IO Strip Indexes...Continued

The reasons for having investment indexes are fivefold:

1. **Asset Allocation Models:** Asset Allocation usually accounts for over 90% of a client's total return and becomes the most critical asset decision. Such models use 100% index data to calculate their asset allocations. Bond index funds are the best representation of the intended risk/reward of fixed income asset classes.
2. **Transparency:** Most bond index benchmarks publish daily returns unlike active managers who publish monthly or even quarterly returns usually with a few days of delinquency. Such transparency should provide clients with more information on the risk/reward behavior of their assets so there are no surprises at quarterly asset management review meetings.
3. **Performance Measurement:** Creates a benchmark for professional money managers to track their relative performance.
4. **Dictates Risk/Reward Behavior:** By analyzing historical returns of an index, an investor can better understand how an asset class will perform over long periods of time, as well as during certain economic cycles.
5. **Hedging:** An investment index can provide a means for hedging the risk of a portfolio that is comprised of assets tracked by the index. An example would be hedging a 7a servicing portfolio using the SBI I/O Strip Index.

By creating investment indexes for SBA 7a pool and IO strips, these investments can become a recognized asset class by pension funds and other large investors who won't consider any asset class in their asset allocation models that does not have a benchmark index.

An additional use for the I/O index could be to allow 7a lenders to hedge servicing portfolios that are getting large due to production and the low prepayment environment. This increase in exposure to 7a IO Strips would be welcome by IO investors who are constrained by the amount of loans that are stripped prior to being pooled.

#### How are the indexes calculated?

The rules for choosing which outstanding pools are eligible for both the pool and IO indexes are the following:

##### Pool Size:

- \$5 million minimum through 1/1/2005.
- \$10 million minimum after 1/1/2005.

##### Pool Structure:

- Minimum of 5 loans inside the pool.
- Minimum average loan size of \$250,000.

##### Pool Maturity:

- Minimum of 10 years of original maturity.
- Sub indices for 10-15 years and 15-25 year maturities.

The rules for remaining in the indices are the following:

##### Pool Size:

- Minimum pool factor of .25
- Factor Updates in the Indices are on the first of the month, based on the Colson Factor Report that is released in the middle of the previous month.

##### Pool Structure:

- Minimum of 5 loans inside the pool.

We have produced two weightings for each pool in the various indexes, "Actual" and "Equal":

##### "Actual" weighted Indices:

- The actual original balance of each pool is used to weight the pool in the index.
- An index for all eligible pools, as well as one for 10-15 years and one for 15-25 years of original maturity.
- A total of 3 actual weighted sub-indices.

##### "Equal" weighted Indices:

- An original balance of \$10 million is assigned to each pool, regardless of its true size.
- An index for all eligible pools, as well as one for 10-15 years and one for 15-25 years of original maturity
- A total of 3 equal weighted sub-indices.

## GLOSSARY AND DEFINITIONS: PAGE 5

### SBI Pool and IO Strip Indexes...Continued

This equates to a total of (6 ) Pool sub-indices. We will refer to them on a go-forward basis as the following:

#### **Actual Weighting:**

- All 10-25 year in original maturity pools "All Actual"
- 10-15 year in original maturity pools "Short Actual"
- 15-25 year in original maturity pools "Long Actual"

#### **Equal Weighting:**

- All 10-25 year in original maturity pools "All Equal"
- 10-15 year in original maturity pools "Short Equal"
- 15-25 year in original maturity pools "Long Equal"

#### **Return Calculations**

Each index is tracked by its value on a daily basis, as well as the components of return.

#### **Income Component**

- Daily return is calculated for the contribution of interest earned.

#### **Mark-to-Market Component**

- Daily return is calculated for the contribution of Mark-To-Market changes.

#### **Scheduled Principal Component**

- Daily return is calculated for the contribution of normal principal payments. Only impacts the first of the month.

#### **Prepaid Principal Component**

- Daily return is calculated for the contribution of prepaid principal payments. Only impacts the first of the month.
- We have also added a Default Principal Component and a Voluntary Principal Component that, together, equate to the Prepaid Principal Component. This also only impacts the first of the month.

#### **Total Principal Component**

- Daily return is calculated for the contribution of all principal payments. Only impacts the first of the month.

The formula for Total Daily Return is as follows:

$$\text{Total Daily Return} = \text{Income Return} + \text{MTM Return} + \text{Principal Return}$$

The Principal Return is generated using the following formula:

$$\text{Principal Return} = \text{Prepaid Principal Return} + \text{Scheduled Principal Return}$$

The I/O Strip Indexes are a bit more involved, since we have to calculate the pricing multiple, as well as the breakdown between income earned and return of capital from interest accruals and payments. Here are the specific rules for the I/O Strip Indexes:

- The I/O Strip Indices utilize the same pools as the Pool Indices.
- Each pool is synthetically "stripped" upon entering the I/O Indices.
- For the equal and actual weighted indices and the maturity sub-indices (10-15 and 15-25), the pools are split into two even buckets utilizing the pool reset margins. The bucket with the higher margins we refer to as the "Upper Bucket" and the lower margin pools are in the "Lower Bucket".
- The weighted average reset margin and pool MTM is calculated for each bucket. The MTM is the same one utilized in the pool indices.
- The weighted average price of the Lower Bucket is subtracted from the Upper Bucket. The same thing is done for the weighted average reset margin.
- The MTM difference is divided by the reset margin difference, giving us the pricing multiple by maturity and weighting.
- The end result is a pricing multiple for equal and actual weighting for 10-15 year pools and 15-25 year pools, totaling (4 ) distinct multiples.
- Not all interest received is considered earned income, therefore interest received by the stripped pools is divided into earnings and return of capital, utilizing OID accounting rules.

## GLOSSARY AND DEFINITIONS: PAGE 6

### SBI Pool and IO Strip Indexes...Continued

- The OID accounting rule create a straight-line return of capital upon entry into the index and the difference between the return of capital and interest received is earned income.
- Fundamentally, high prepayments can push more received interest into return of capital, thus limiting earned income. Excellent prepayment performance can generate large amounts of earned income over time.

Once the return percentages are determined for each day, it is then applied to the previous day's index level, in order to calculate the index levels for that day.

#### **Supporting Calculations**

To aid in the analysis of the indexes, we track (22) distinct calculations for each of the (6) sub-indices:

##### **Size**

- Pool count and total outstanding balance

##### **Structure**

- Weighted average issue date, maturity date, reset date, maturity months, remaining months, age, coupon, reset margin, strip percent (strip indexes only).

##### **Price and Yield**

- Weighted average pool price, bond-equivalent yield, strip discount rate, multiple and strip pricing (strip indexes only)

##### **Other Calculations**

- CPR assumption, weighted average life, modified duration, index duration, strip duration and strip return of capital average life.

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### SBI Rich / Cheap Analysis

The SBI Rich /Cheap Analysis is an attempt to create a "fair value" pricing model, based on 13 years of historical index pricing. We then compare the fair value price to current market levels, as represented by the GLS pricing models. We do this for 10 to 15 year maturity index-eligible pools and for 15+ maturity ones, effectively creating two separate calculations.

The first step was to create a fair value pricing algorithm for each maturity bucket, which is based on the following historical inputs:

#### **Fundamental Inputs:**

- The rolling 12-month historical CPR for all pools, including non-eligible ones, inside each maturity bucket.
- The previous month's 1 month CPR for the same population and maturity bucket.
- We used all pools, since the GLS pricing models do not differentiate between eligible and non-eligible pools.
- Weighted average pool coupon.

We chose the prepayment inputs in order to provide a directional element for pool prepayments. For instance, when the 1 month CPR is lower than the 12 month one, than the trend for prepayments is lower and when it is higher, the trend is toward higher prepayments.

We added the coupon input to add market level interest rates to the analysis. Since we are only using floating-rate SBA 7a pools that reset monthly or quarterly, this input is a proxy for the base rate on the pricing date.

#### **Structural Inputs:**

- Weighted average pool net margin to the base rate.
- Weighted average remaining months to maturity.
- Weighted average pool age.



## GLOSSARY AND DEFINITIONS: PAGE 7

### SBI Rich / Cheap Analysis...Continued

The structural inputs put the weighted average index price into context, based on the amount and number of interest payments into the future.

The algorithm will be re-calibrated on an annual basis with the addition of the previous year's pricing data and then applied to the next year's pricing data to calculate the fair value price.

#### **Methodology**

We used multiple regression for the analysis and achieved an r-squared of .80 for the 10-15 year maturity bucket and .95 for the 15+ maturity bucket. We then subtracted the fair value price from the index pricing level to find the difference between these two pricing elements. Basically, when the index pricing level is higher than the fair value price, the index price is, to varying degrees, "rich" and when it is below the fair value price, it is "cheap".

Additionally, we determined that a "Fair Value Band" was necessary for the analysis. We decided that when the two pricing components are within +.50 and -.50 of each other (green portion of the accompanying graph), the index pricing level was fairly valued as per the model.

When the index price rose above the fair value band, the market for SBA pools is considered "Rich", or expensive compared to historical pricing and when it is below the band, it is "Cheap" or inexpensive as compared to our fair value price.

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