Coleman

Government Loan Solutions' CPR Report

Providing the most detailed monthly SBA 7(a) and 504 prepayment, default and market information

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Bob Judge, Government Loan Solutions, Editor

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

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INSIDE THIS ISSUE:

Special points of interest:

- Record Low Prepays
- SMA: G-Fee Too High?
- Default Rate at 6-Year Low
- Value Indices Lower

Prepayment Speeds Fall To Another All-Time Low

Another month, another all-time low in 7a prepayment speeds.

While the previous low was reached in June at 4.58%, August prepayment speeds fell by 17% from July, reaching the latest all-time low of 4.46%.

Another interesting fact from August was seen in the 20+ maturity category, which fell below 4% for the first time, sinking to 3.65%.

For the third month in a row, the default CPR stayed below 3%, a seemingly counterintuitive reading considering the weakness in the US economy.

Continued on page 2

SMA: Is the New Guarantee Fee Too High?

By Bob Judge

With the announcement that the SBA guarantee fee for the FMLP program for fiscal year 2012 is tripling from 24.5 basis points to 74.4 basis points, many in the industry are wondering how this complex calculation is performed.

How could the OMB, which performs the guarantee fee calculation, foresee such a large, negative change in default and/or recovery rates on 504 1st liens in the space of one year?

This combination of events is the only explanation at hand for such a large increase.

Let's examine each in turn:

Have defaults spiked recently?

The accompanying graph on page 4, "504 2nd Defaults" (data source: Colson Services), which shows the dollar amount of defaults on 504 debentures, would suggest otherwise.

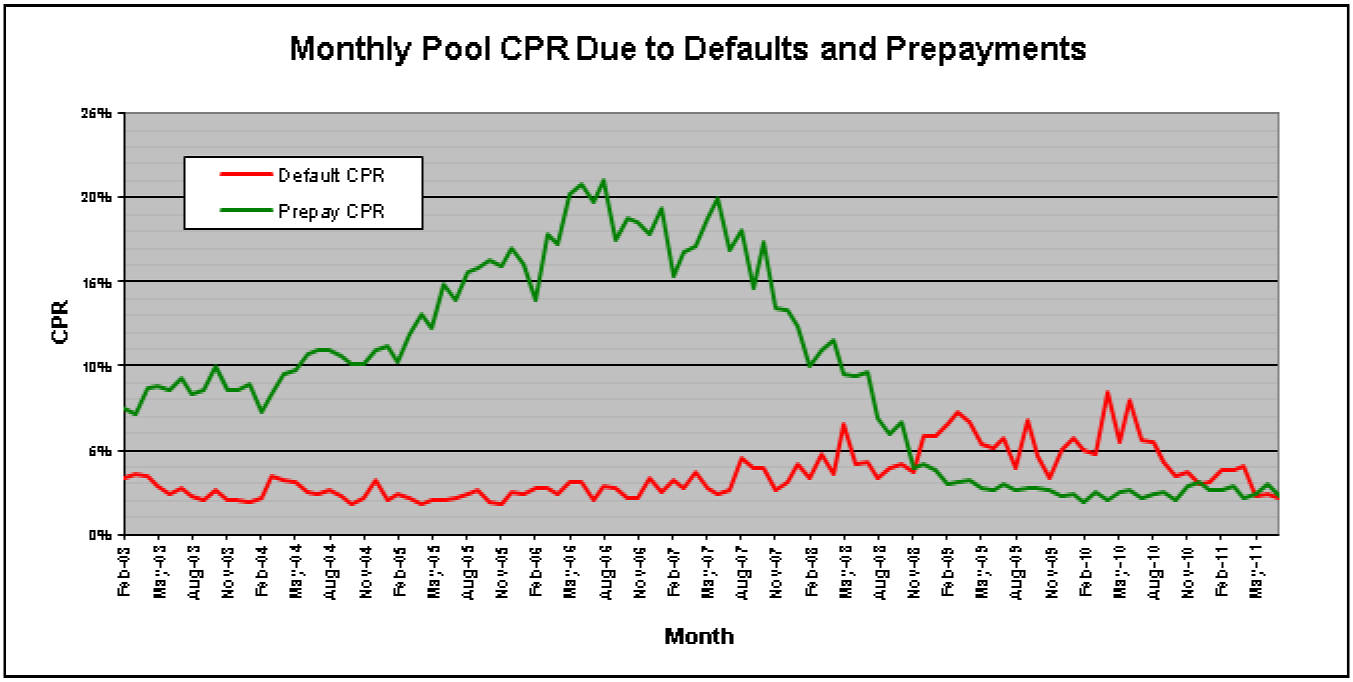
As you can see, defaults have been falling since a peak of $159.9 million in May, 2010. A similar pattern is also visible in the 7a data. If defaults are falling in 504 2nds, you can bet they are also down for the first liens.

Continued on page 4

SMALL BUSINESS FACT OF THE MONTH

According to a Kauffman Foundation study, start-ups are now being launched with an average of 4.9 employees, down from 7.5 in the 1990s. The spread of on-line tools and other resources enables new companies to do more with fewer employees.

PREPAYMENT SPEEDS...CONTINUED



With voluntary prepays staying below 3% for yet another month, the combination of sub-3% defaults and voluntary prepayments continues to keep overall prepayments below 6%.

Turning to the specifics, overall speeds came in at 4.46%, a 17% decrease from July reading of 5.37%. August continues the unbroken streak of 11 consecutive months of sub-7% prepay speeds.

As for next month, preliminary data from Colson suggests a slight rise, but prepays should remain below 6% for the 12th month in a row.

The YOY comparison to 2010 continues to show 2011 significantly below last year, with YTD prepayment speeds in 2011 at 5.69% versus 2010 at 8.31%.

Turning to the default/voluntary prepayment breakdown, the **Voluntary Prepay CPR** (green line) fell to 2.25% from 2.94%, maintaining a stable trend between 2% and 3%.

While the VCPR remained below 3%, the **Default CPR** (red line) stayed below the VCPR for the 3rd month in a row, falling to 2.21% from 2.44% in July.

Last month, prepayment speeds fell in four out of the six maturity categories. Decreases were seen, by order of magnitude, in the <8 sector (-44% to CPR 7.28%), 20+ (-30% to CPR 3.65%), 8-10 (-25% to 5.92%) and 16-20 (-14% to CPR 5.46%).

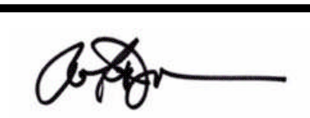
Increases were seen, also by order of magnitude, in 13-16 (+64% to CPR 6.80%) and 10-13 (+18% to CPR 5.15%).

Another month, another record low CPR.

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

Data on pages 19-21

"Another interesting fact from August was seen in the 20+ maturity category, which fell below 4% for the first time, sinking to 3.65%."



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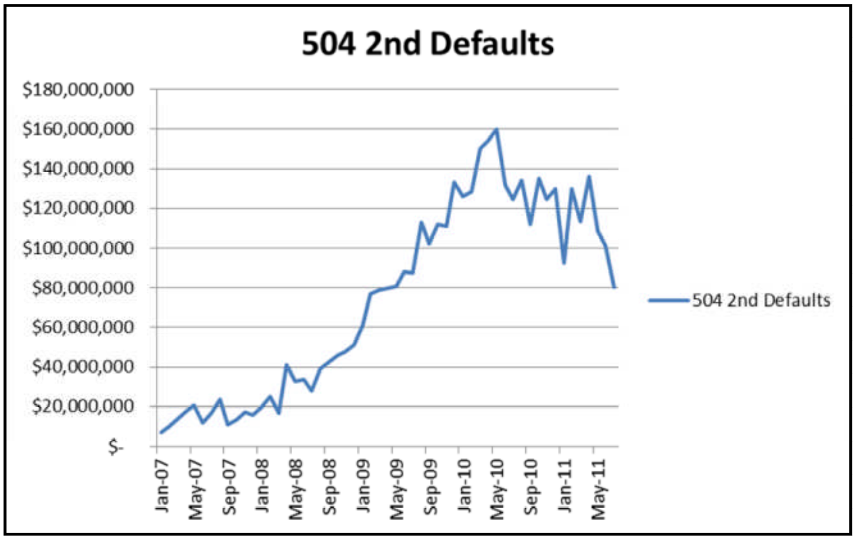
SECONDARY MARKET ACCESS...CONTINUED

Have recoveries fallen over the past year?

There is not much data on this topic, but with commercial real estate prices having fallen by 49% since they peaked in 2007 (source: Moody's/REAL Commercial Property Price Index, June 2011), how much further down can they go?

While recoveries on 504 1st liens originated prior to 2008 have witnessed losses, they are not eligible for this program. It's also important to note that the FMLP, especially going forward, will be comprised of primarily new loans, which mostly represent the purchase of existing commercial real estate at significantly discounted prices. Due to the short timeframe of the program, construction lending is not viable, so most loans represent the purchase of existing properties at 2011 prices.



For these new loans to show losses on the 1st lien, commercial real estate prices would ***have to drop at least another 50%***. Many think that unlikely, which would suggest recoveries on 504 1st liens to be in excess of 90%, if not 100% in most cases.

With these questions in mind, I have humbly embarked on an attempt to create a subsidy model for FMLP utilizing data on 504 lending at my disposal. If for no other reason, it may help us understand how the OMB reached their conclusion.

To begin creating the necessary assumptions, I utilized a database on 504 2nd liens that I created from data received from a FOIA request from the SBA in late 2010. After a painstaking analysis, this database now holds detailed loan characteristics and default information on 107,636 504 2nd lien loans going back to July, 1959.

While this database can't tell me much about the recovery experience on 1st liens, it is a very useful tool to calculate default rates on both the 1st and 2nd lien. Why both the 1st and 2nd liens? Because it is unlikely that the 1st lien would survive much past the 2nd lien after it has defaulted. Therefore, the correlation between default rates on 2nd lien and 1st lien 504 loans should be very high.

Author's Note: For those in a hurry, or who do not desire to read the fine prose describing my assumptions in painstaking detail, please skip to the "Model Assumptions" section where I outline them in bullet points. For all others, please read on…

FMLP To Date

I began by assuming that the existing balance of previously issued pools is $160 million, as of October 1st, 2011 with a weighted average guarantee fee of 22.3 basis points. In analyzing all pools done to date, I estimate that the SBA has collected $238,000 in guarantee fees through the end of September. Since I don't know if any loans have defaulted through August, I have assumed that no payments have come out of the guarantee fee funding account.

FMLP Underlying Loan Assumptions

Having been involved in a number of FMLP pools over the past year, I have noticed that a high percentage of loans are hotels, and to a lesser extent, restaurants. For this reason, I have assumed that all loans, past, present and future, are 75% from NAICS Industry 72, which holds all industry codes for hotels and restaurants. Since 1959, Industry 72 has defaulted at a rate of 160.43% of the universe of 2nd lien loans in our database. The other 25% of loans is assumed to be distributed across all other industries at the same rate they occur in our database. That 25% is assumed to default at a rate of 87.18% of the universe of 2nd liens.

I have also assumed that 75% of all underlying loans have a maturity of 25 years and 25% have maturities of 10 years and that $30 million in pools will be issued per month over the next 12 months of the program. Additionally, I assumed all loans have a 6% interest rate.

Default Assumptions

Since 1959, NAICS Industry 72 has a default rate of 14.35%, according to my database. All other industries have defaulted at a rate of 7.80%. The weighted average, utilizing the above loan breakdown, is 12.71%. This is an important number in that it represents all 504 2nd lien lending over the last 52 years, 8 recessions, 11 presidents and 4 wars.

Another important element of any default analysis is determining when defaults occur during the lifetime of a loan. For this reason, financial modelers create "***default timing curves***", whereby the default amounts are distributed over the life of the loan.

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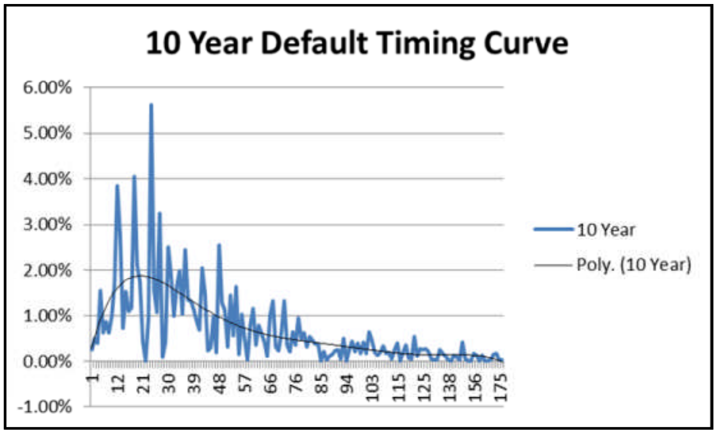
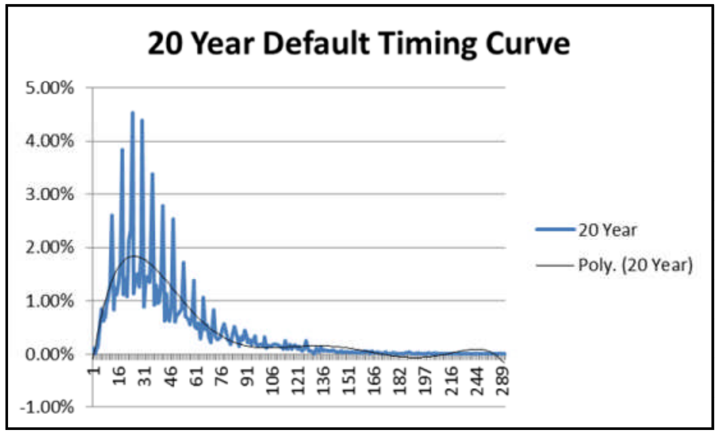
Secondary Market Access...Continued





Since we do not know which loans will default or when, we "default" a small portion of the loan each month so that, when summed, it equals the original loan amount multiplied by the assumed lifetime default rate. So, a default timing curve is a bunch of percentages that add up to 100% over the total period of the curve which distributes the default amount over the lifetime of the loan.

For this assumption, I created loss timing curves for 10 year and 20 year loans from my full database of 504 2nd liens. In order to take out the "choppiness" of the data, I applied a polynomial regression to "smooth" the curve for the model. Both the underlying data and the curve smoothing are graphically presented above.

Recovery Assumptions

As for recoveries, I allowed common sense to prevail, as well as test different recovery percentages to see the impact as they decline. For a "base case" I will utilize 90% for all existing, as well as future, loans inside FMLP pools. A 90% recovery rate suggests a 55% loss on the underlying property for 1st liens with debenture dates after February, 2009. This after a 50% decline in commercial real estate prices since 2007.

While some of the loans inside this program will last for the next 25 to 30 years, I assume that eventually, commercial real estate prices will begin to rise once again. When that occurs, the recovery rate on loans between 2009 and 2012 will only benefit over time. Therefore, it is my opinion that a 90% recovery rate is extremely conservative for the FMLP. Additionally, I assumed that the recovery period for each default is 12 months.

Voluntary Prepayment Assumptions

As for voluntary prepayments on 504 1st liens, I turned to the Colson data that provides the dollar amount of defaults and prepayments on 504 2nd liens going back to November, 1999. Since that date, for every $1 in default on 2nd liens, $1.97 has voluntarily prepaid. Therefore, for the voluntary prepayment element, I used that same ratio for each monthly calculation.

Ironically, a high voluntary prepayment rate ***increases*** the necessary guarantee fee percentage, all other things being equal. Why? Because when the voluntary prepayment rate rises, the "successful" loans disappear sooner, along with their future guarantee fee payments. In the case of voluntary prepayments, success hurts.

Since the beginning of 2010, the ratio of defaults to voluntary prepayments has fallen to the extent that for every $1 of defaults, only 50 cents has voluntarily prepayed. This ratio would be much more beneficial to the guarantee fee calculation, but for the sake of being conservative, we will go with the long-run historical number, as stated above.

Other Assumptions

Since the nature of a guaranteed program frequently requires outlays in excess of guarantee fees collected early in the program, the SBA will have to "borrow" funds for any early defaults. I assume that the cost of these funds to the SBA is 5%. At the same time, positive amounts in the guarantee fee fund account are assumed to earn zero interest.

The following section goes over all assumptions in bullet form:

Model Assumptions

1. The maturity breakdown for all pools for the life of the program is assumed to be 75% in 25 year maturities and 25% in 10 year maturities. This includes already issued pools.
2. 75% of all loans are in NAICS Industry 72 (Accommodation and food services), which includes hotels and restaurants. This also includes already issued pools.
3. The remaining 25% of loans are distributed across all other industries at the same percentage occurrence in our 504 database of 2nd lien originations. This also includes already issued pools.
4. The default rate on 504 1st liens is highly correlated to 2nd liens.
5. The default percentage for NAICS Industry 72 is 160.43% of the overall default percentage of all 504 2nd lien loans in our

Continued on next page

Secondary Market Access...Continued

BREAK-EVEN GUARANTEE FEE											
DEF %/ REC %	50%	55%	60%	65%	70%	75%	80%	85%	90%	95%	100%
9.00%	0.804%	0.721%	0.638%	0.555%	0.472%	0.389%	0.306%	0.223%	0.140%	0.056%	0.000%
10.00%	0.939%	0.843%	0.748%	0.653%	0.557%	0.462%	0.367%	0.271%	0.176%	0.080%	0.000%
11.00%	1.082%	0.974%	0.865%	0.757%	0.648%	0.540%	0.431%	0.323%	0.214%	0.106%	0.000%
12.00%	1.236%	1.113%	0.991%	0.868%	0.746%	0.623%	0.501%	0.378%	0.256%	0.133%	0.011%
12.71%	1.400%	1.263%	1.125%	0.988%	0.850%	0.713%	0.575%	0.438%	0.300%	0.163%	0.025%
14.00%	1.578%	1.424%	1.270%	1.117%	0.963%	0.809%	0.655%	0.502%	0.348%	0.194%	0.040%
15.00%	1.769%	1.598%	1.427%	1.255%	1.084%	0.913%	0.742%	0.571%	0.399%	0.228%	0.057%
16.00%	1.976%	1.786%	1.596%	1.406%	1.215%	1.025%	0.835%	0.645%	0.455%	0.265%	0.075%
17.00%	2.200%	1.990%	1.779%	1.569%	1.358%	1.147%	0.937%	0.726%	0.516%	0.305%	0.095%
18.00%	2.445%	2.212%	1.979%	1.746%	1.513%	1.280%	1.047%	0.814%	0.582%	0.349%	0.116%
19.00%	2.712%	2.455%	2.197%	1.940%	1.683%	1.425%	1.168%	0.911%	0.653%	0.396%	0.139%
20.00%	3.004%	2.720%	2.436%	2.152%	1.868%	1.584%	1.300%	1.016%	0.732%	0.448%	0.164%

database.

6. The base default rate utilizes data from actual 504 2nd lien experience inside our database. Utilizing the above distribution by industry and maturity, the baseline lifetime default rate is assumed to be 12.71%.
7. All other industries default at 87.18% of the overall default percentage of all 504 2nd liens.
8. The default characteristics of 504 1st lien loans are assumed to follow the default characteristics of 504 2nd liens.
9. Default timing curves where created for 10 year and 25 year loan types based on actual 504 2nd lien experience inside our database.
10. Since November, 1999, for each $1 of defaults, $1.97 has voluntarily prepaid. We applied this ratio to the voluntary prepayment element of the model.
11. The existing balance of previously issued pools is $160 million, as of October, 2011 with a weighted average guarantee fee of 22.3 basis points.
12. The existing balance is assumed to follow the above loan distribution by maturity and industry and is assumed to have a weighted average loan age of 18 months, as of October, 2011.
13. $30 million in pools will be issued per month through the sunset of the program in September, 2012, using the above loan distribution. It is assumed that the loans are 6 months old when they are securitized.
14. All loans have a borrower interest rate of 6%.
15. The recovery period for all loans is 12 months.
16. The base recovery rate for FMLP is assumed to be 90%.
17. The SBA has collected $238,000 in guarantee fees during the first 12 months of the program.
18. The SBA cost for default advances is assumed to be 5% when they exceed the balance of the guarantee fee fund account.
19. The SBA receives no interest on excess funds in the guarantee fee fund account.
20. There has been one default to date that has already been fully recovered.

Results

The results of the model are shown in the table called **"BREAK-EVEN GUARANTEE FEE"**, above. The guarantee fee shown is that fee level where the fees collected, including existing loans, exactly equals the losses plus interest costs to the SBA. Using the base case of a default rate of 12.71% and a recovery rate of 90%, the break-even guarantee fee is 30 basis points.

What should it be? Well, if one wanted to build in a cushion, a guarantee fee between 30 and 50 basis points would accomplish that task. A 50 basis point guarantee fee would equate to a 14% default rate with a recovery percentage of 85%, or a 17% default rate and a recovery of 90%. Both of those scenarios would seem highly conservative and unlikely to be tested, unless one subscribes to the possibility of another deep US recession, if not an actual depression.

Where does a 74.4 basis point guarantee fee fall? We would have to witness a default rate of 15% along with a recovery percentage of 80%, or a 12% default rate and recoveries coming in at 70%. I will leave it to the reader to determine if either of these scenarios is realistic.

FMLP Prepayment Analysis

By Robert Judge

Prepayments continue to look good in the FMLP program, as the year to date total CPR stands at 1.06%.

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SECONDARY MARKET ACCESS...CONTINUED

FMLP Pool Prepayments for YTD 2011

MO/WAM BUCKET	<192 Mos.	192-263 Mos.	264-288 Mos.	289+ Mos.	Total by Month
Jan-11	0.00%	0.00%	0.12%	0.00%	**0.09%**
Feb-11	0.00%	0.00%	0.00%	0.00%	**0.00%**
Mar-11	0.00%	0.00%	0.00%	0.00%	**0.00%**
Apr-11	0.00%	0.00%	0.00%	0.00%	**0.00%**
May-11	0.00%	0.00%	11.49%	3.49%	**9.28%**
Jun-11	1.04%	0.00%	0.00%	0.00%	**0.06%**
Jul-11	0.00%	0.00%	0.00%	0.00%	**0.00%**
Aug-11	0.00%	0.00%	0.00%	0.13%	**0.03%**
Sep-11	0.00%	0.00%	0.00%	0.00%	**0.00%**
Total	**0.26%**	**0.00%**	**1.41%**	**0.37%**	**1.06%**

CPR by Month and Weighted Average Maturity Bucket, 2011

MO/WAM BUCKET	FIXED RATE	FHLB VARIOUS	PRIME RATE	5 YR LIBOR SWAP	Total by Month
Jan-11	0.16%	0.00%	0.00%	0.13%	**0.09%**
Feb-11	0.00%	0.00%	0.00%	0.00%	**0.00%**
Mar-11	0.00%	0.00%	0.00%	0.00%	**0.00%**
Apr-11	0.00%	0.00%	0.00%	0.00%	**0.00%**
May-11	34.52%	0.00%	0.00%	1.88%	**9.28%**
Jun-11	0.00%	0.00%	0.15%	0.00%	**0.06%**
Jul-11	0.00%	0.00%	0.00%	0.00%	**0.00%**
Aug-11	0.00%	0.00%	0.06%	0.00%	**0.03%**
Sep-11	0.00%	0.00%	0.00%	0.00%	**0.00%**
Total by Reset	**4.56%**	**0.00%**	**0.03%**	**0.22%**	**1.06%**

CPR by Month and Reset Type, 2011

Since this is only the second month of this dataset, let me review my methodology:

- I have chosen to break out the 504 pool data by WAM buckets, since that is more relevant to the maturity of the pool than the actual final maturity date. Since there are no maturity constraints on an FMLP pool, the final maturity date can be deceiving when making assumptions regarding the underlying loans.
- Additionally, I have broken the pools by reset type, as defined in the Colson data. With the various, different types of underlying indices, this would seem a natural way to look at the prepayments.

Since we remain in the first year of the program, there isn't much more to say about prepayments to date, except that they are low.

This would be expected when one considers the relatively young age of the underlying loans and the current prepayment atmosphere of small business lending.

Secondary Market Access

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

Our website can be found at **www.SMA504.com**.

Our Role

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

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

Who we Are

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

Secondary Market Access

"The source for all things FMLP and Community Advantage."

www.SMA504.com

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

504 1st Lien Lenders

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

504 1st Lien Pool Originators

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

Community Advantage Lenders

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

For more information regarding SMA Services, please contact:

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Direct Capital
SBA 504 Secondary Market Solutions

Morgan Stanley

SBA 504 FIRST MORTGAGE PROGRAM
Loan Premiums

INTEREST RATE PAR SPREADS

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

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

PREPAYMENT PENALTY OPTIONS

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

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

PREMIUM EXAMPLE FOR $1 MILLION SBA 504 FIRST MORTGAGE LOAN

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

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

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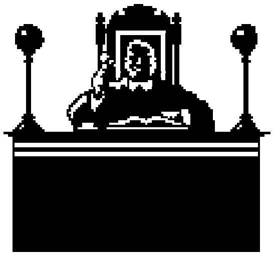


The Legal Beat

Commercial Real Estate Appraisal Requirements

By Kimberlee S. Knopf, Esq.

As part of the underwriting process for most SBA loans, lenders are required to obtain appraisals on real estate, equipment and/or a business as a going concern. It is imperative that lenders comply with the appraisal requirements described in the SOP and critically evaluate the results. Otherwise, the SBA loan guaranty will be jeopardized, either at the time of guaranty purchase or when the Office of the Inspector General conducts a post purchase review, which review can occur up to six (6) years after the SBA purchase date.

The SOP requires an appraisal of commercial real estate if the value of such property is greater than $250,000. In the event the commercial real estate is estimated to be $250,000 or less, an appraisal may be required if further evaluation of the collateral is required in order to make an informed credit decision or if a lender's regulatory requirements otherwise require an appraisal.

In all instances, the appraisal must be requested by and prepared for the lender and the appraisal should be addressed to both the lender and the SBA. A recent existing appraisal may be updated and extended to the lender and the SBA; however, if an appraiser is unwilling to update or extend the appraisal in this manner then the lender is required to obtain either a new appraisal or a review of the existing appraisal by a different appraiser.

The appraiser must be independent and without conflict of interest and either State-licensed or State-certified, (if the estimated value of the commercial real estate is in excess of $1,000,000, the appraiser is required to be State-certified.) The appraisal itself should be in compliance with Uniform Standards of Professional Appraisal Practice and be delivered in either a self-contained or summary appraisal format.

If the loan proceeds will be used to finance new construction or substantially renovate (renovations are greater than 1/3 of the purchase price or fair market value of the real estate) an existing building, the appraisal must estimate the market value of the commercial real estate upon completion of construction, as set forth in the plans and specifications. Upon completion of construction, the appraiser must submit a statement to the lender that the building was built with only minor (if any) deviation from the plans and specifications that formed the basis of the market value appraisal. If the appraiser will not issue this statement, then the loan can not be closed without the prior written permission of the SBA.

If the loan proceeds are to fund the purchase of an existing building not requiring renovation or other construction, the appraiser should estimate the market value of the commercial real estate on an "as is" basis or, if the appraiser utilizes another basis for valuation, then the narrative must explain the rationale for such alternate valuation.

In September 2008, the Office of Inspector General issued a report based upon an audit of six (6) SBA guaranteed loans of a PLP lender where the Inspector General recommended full denial of the guaranty due to "Inadequate Appraisal". In this instance, the loan authorization required a real estate appraisal showing a fair market value of at least $1,650,000 and the lender's files contained an "as-is" market value appraisal of $1,750,000. Approximately $265,000 of the "as-is" value was attributable to the going concern value of the real property which therefore reduced the amount allocated to the real estate to $1,485,000. In addition to this deficiency, the real estate sold for $925,000 approximately two years after the date of the appraisal which provided further support for the Inspector General's assertion that the appraisal was significantly overstated. See U.S. Small Business Administration, Office of Inspector General, Audit of Six SBA Guaranteed Loans, Report Number: 8-18, issued September 8, 2008, at pages 9-10.

For a business acquisition, and so long as it is not contrary to a lender's policies and procedures, a lender may perform its own valuation of the business being sold if the amount of the loan (including any 7(a), 504, seller, or other financing) less the appraised value of the real estate and/or equipment being financed, is less than or equal to $250,000. In the event the amount of the loan (including any 7(a), 504, seller, or other financing) less the appraised value of real estate and/or equipment being financed, is greater than $250,000 or it is not an arm's length transaction (i.e. the buyer and seller are related or are current business partners), then the lender must obtain an independent business valuation. In this instance, the appraiser must allocate separate values to the various components of the transaction including land, building, equipment and business (including goodwill and other intangible assets).

The Legal Beat...Continued

Recently, the Office of Inspector General reviewed four early-defaulted loans and found an improper payment of $37,696 by the SBA due to inadequate business valuations. The Office of Inspector General determined that the borrower paid more for the business than it was worth and reiterated that "determining the value of a business is a key component to the analysis of any loan application for a change in ownership." In this case, the lender obtained a combined real estate appraisal and business valuation that valued the land at $775,000 and the business at $160,000. As the total project cost was $1,032,000 there was an obvious deficiency of $97,000. The loan officer ignored the independent appraisal and claimed that the appraiser was too conservative in its approach and therefore relied upon its in-house valuation. Interestingly, two days after approval of this loan, an executive vice president of the lender accepted the independent appraisal and specifically acknowledged that the in-house valuation was overstated, providing further support for the Office of Inspector General's conclusion that there was an inadequate business valuation. See U.S. Small Business Administration, Office of Inspector General, Material Deficiencies Identified in Four 7(A) Recovery Act Loans Resulted in $3.2 Million of Questioned Costs, Report Number: ROM 11-05, issued June 29, 2011, at page 6.

As the above examples illustrate, SBA lenders must carefully analyze appraisals in order to assure that the results conform to the Loan Authorization and the SBA's rules and regulations.

For more information on SBA's appraisal requirements, contact Kimberlee at 215-542-7070, or knopf@starfieldsmith.com.

Non-Traditional 504 Loan Referral Program

If you have a 504-eligible transaction that you are unable to fund for whatever reason, GLS can match you with another, non-competing lender looking to fund non-traditional 504 loans. This allows you to earn referral fees, while preserving the business relationship with the borrower.

Program Overview:

- ⇒ **An outlet for those transactions that you typically would not fund.**
- ⇒ **All commercial property types are eligible.**
- ⇒ **Can accommodate projected income and inferior credit.**
- ⇒ **Loan amounts up to $10 million with 30-year loan terms.**
- ⇒ **Rate terms are quarterly adjustable, with a 5-year fixed rate option available.**
- ⇒ **A referral fee for you on the first mortgage portion.**

For more information, please contact Bob Judge, GLS, at (216) 456-2480 ext. 133 or at bob.judge@glsolutions.us.

GLS 7(a) Sale & Settlement Tip # 37— Know your Secondary Market...

Make it a point to know all the potential buyers (including new market participants) and look for bids from as many as possible on each and every sale. Stay connected to whose in, whose out, and who has an appetite for certain types of loans, as well.

Knowing who you can turn to in any market environment is important to best execution.

To quote a familiar lending portal…"when [brokers] compete, you win".

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

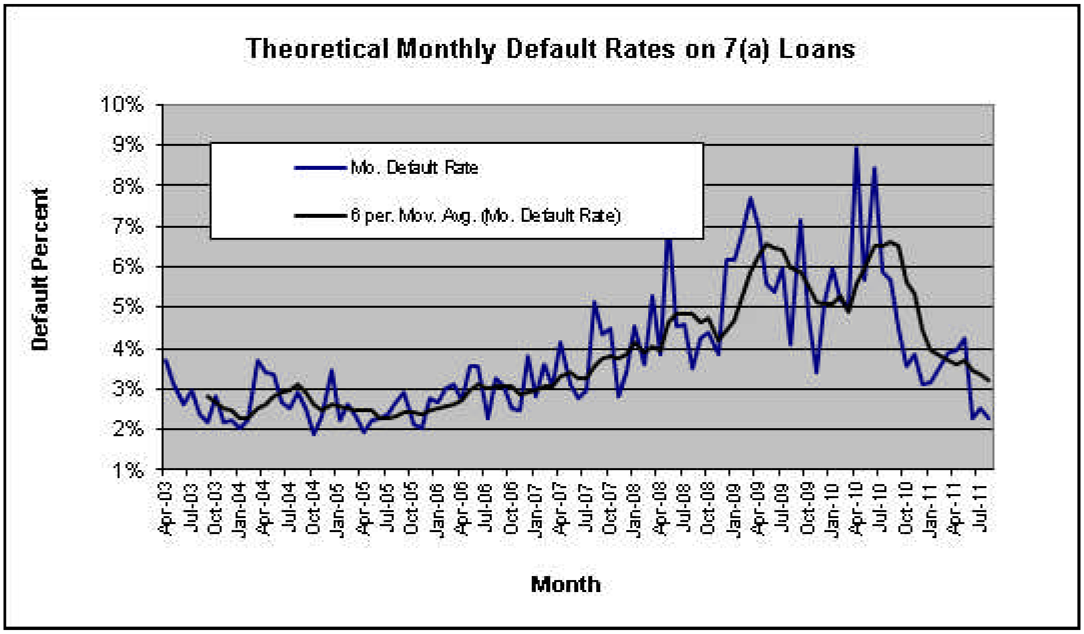
DEFAULT RATE HITS SIX YEAR LOW

For the third month in a row, the theoretical default rate remained below 3%, levels not consistently seen since 2006.

In fact, the default rate hit a six year low of 2.26% in July. The last time the default rate was this low was in November, 2005.

The chart at the right graphically shows the continued return to normalized default rates since the summer of 2010.

Since hitting 8% last June, the default rate has steadily decreased, except for a brief period of increases in February through April of this year.



While we listen to doom and gloom from most economists regarding the US economy, the small business sector seems to be holding its own against business failure. The resiliency of the entrepreneur continues to be one of the bright spots in an otherwise weak economic recovery.

DEFAULT-CURTAILMENT RATIOS

In our Default-Curtailment Ratios (DCR) we witnessed a rise in 7a and a significant decrease in the 504 ratio.

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

While the 7a DCR did stay below 50% for the third month in a row, it just made it under that magic number, registering 49.58% in July.

This month, both defaults and voluntaries fell, with the largest decrease seen in voluntary prepayments. This differential between the two components increased the DCR by 9% over the previous period.

Turning to actual dollar amounts, defaults fell by 9% to $72 million from $78 million. As for voluntary prepayments, they decreased by 23% to $73 million versus $94 million the previous month.

SBA 504 Default Ratios

While the 7a DCR rose, the 504 DCR registered a double digit decrease for the first time in quite a while. For July, the 504 DCR fell by 13% to 54.66% from 63.01% in June.

Voluntary prepayments rose and defaults fell, leading the ratio to its lowest level since March, 2009.

Specifically, the dollar amount of defaults decreased by $21 million to $80 million (-21%). As for voluntary prepayments, they rose by $7 million to $67 million (+12%).

Summary

The 504 ratio continues to move down, as defaults fall and voluntary prepayments remain steady. As defaults continue to steadily decrease, we should go sub-50% in the not to distant future.

As for 7a, a pause in the rapid decrease in the ratio was seen in July, but continues to hold most the decreases seen in the past year. Sub-50% readings should continue to be the future for the 7a DCR.

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

Graph on page 24

GLS VALUE INDICES LOWER ACROSS THE BOARD

In July, the GLS Value Indices came in lower across the board, after a five month run of mostly higher readings.

The Base Rate / Libor spread was unchanged +3.01% and the prepayment element decreased in four out of six maturity categories, partially offsetting price increases in the secondary market.

Speaking of price increases, the secondary market continues moving higher, as can be seen from the chart below. In fact, by the end of July, a 2.75% margin, long-end loan was a stone's throw away from 115.

Turning to the specifics, the largest decrease was seen in the GLS VI-5, which fell by 28% to 175 basis points. The other decreases, by order of magnitude, were: VI-1 (-21% to 97), VI-2 (-20% to 98), VI-3 (-14% to 122), VI-4 (-6% to 168) and VI-6 (-5% to 207).

Again, strong fundamentals around prepayment expectations are providing support to high premiums in the secondary market.

However, as I mentioned last month, keep an eye on Libor. While still low in absolute terms, it has continued to creep higher over the past few months due to concern over the European banking sector. Don't be caught off guard if things continue to go south in the "Old Country".

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

Data on pages 16-17, Graph on page 18

7(a) Secondary Market Pricing Grid: July 2011

Maturity	Gross Margin	Net Margin	Servicing	This Month Price	Last Month Price	3-Mos. Ago Price	6-Mos. Ago Price	1-Yr. Ago Price
10 yrs.	2.75%	1.075%	**1.00%**	**111.25**	**111.25**	**110.97**	**110.70**	**110.55**
15 yrs.	2.75%	1.075%	**1.00%**	**111.25**	**111.40**	**111.25**	**111.50**	**111.00**
20 yrs.	2.75%	1.075%	**1.00%**	**114.00**	**113.75**	**113.375**	**113.125**	**112.25**
25 yrs.	2.75%	1.075%	**1.00%**	**114.75**	**114.50**	**114.125**	**113.95**	**112.75**

GLS Value Indices: Supporting Data

Table 1:

MONTH	BUCKET 1 CPR	BUCKET 2 CPR	BUCKET 3 CPR	BUCKET 4 CPR	BUCKET 5 CPR	BUCKET 6 CPR
Feb-08	15.91%	13.98%	14.17%	16.20%	17.53%	21.19%
Mar-08	15.58%	13.42%	13.25%	15.08%	15.41%	19.34%
Apr-08	16.16%	13.36%	13.02%	14.59%	15.19%	18.74%
May-08	15.48%	12.88%	12.65%	13.77%	14.33%	17.33%
Jun-08	15.28%	13.32%	12.96%	14.46%	13.62%	17.14%
Jul-08	15.69%	12.99%	12.78%	13.81%	12.49%	16.59%
Aug-08	15.44%	13.24%	12.86%	13.14%	12.24%	15.89%
Sep-08	14.02%	12.45%	12.75%	12.67%	12.36%	15.20%
Oct-08	12.97%	11.67%	12.14%	11.50%	11.97%	14.06%
Nov-08	12.08%	12.36%	11.44%	10.85%	11.49%	13.22%
Dec-08	12.37%	11.77%	10.45%	9.45%	11.08%	11.41%
Jan-09	12.86%	11.51%	10.42%	9.29%	10.61%	10.40%
Feb-09	12.30%	11.26%	10.35%	8.39%	9.99%	9.30%
Mar-09	12.96%	11.93%	10.56%	8.57%	10.47%	8.79%
Apr-09	13.23%	12.30%	11.22%	8.75%	9.81%	8.55%
May-09	13.12%	11.85%	11.79%	8.68%	9.92%	7.98%
Jun-09	13.18%	11.85%	12.35%	8.57%	8.73%	8.02%
Jul-09	12.40%	12.00%	12.51%	8.56%	8.23%	7.36%
Aug-09	13.34%	12.49%	12.36%	8.01%	7.34%	7.21%
Sep-09	12.74%	11.01%	11.83%	7.48%	6.70%	6.89%
Oct-09	12.45%	11.03%	11.31%	7.25%	7.85%	6.79%
Nov-09	12.11%	10.89%	11.01%	6.96%	7.13%	6.32%
Dec-09	11.33%	11.20%	10.55%	7.09%	7.80%	5.75%
Jan-10	11.16%	10.69%	10.30%	6.99%	8.00%	5.75%
Feb-10	10.05%	9.97%	10.00%	7.33%	8.84%	5.71%
Mar-10	9.90%	10.73%	10.07%	7.12%	8.75%	5.75%
Apr-10	9.96%	10.45%	9.72%	7.34%	8.12%	5.32%
May-10	10.56%	11.09%	10.28%	7.88%	8.53%	5.86%
Jun-10	10.94%	11.18%	10.41%	7.83%	8.53%	6.38%
Jul-10	10.32%	11.15%	10.57%	7.13%	8.59%	7.48%
Aug-10	10.45%	11.02%	10.16%	7.38%	8.25%	7.60%
Sep-10	11.29%	10.76%	10.54%	7.48%	8.01%	7.70%
Oct-10	11.35%	10.06%	10.28%	7.27%	7.29%	7.84%
Nov-10	10.55%	9.24%	8.82%	7.05%	6.45%	7.21%
Dec-10	10.89%	8.48%	8.45%	7.30%	5.61%	7.11%
Jan-11	11.99%	8.87%	7.84%	7.49%	5.03%	5.96%
Feb-11	11.22%	9.01%	7.57%	7.22%	4.91%	5.53%
Mar-11	10.43%	8.86%	7.07%	7.20%	5.13%	5.37%
Apr-11	10.60%	9.69%	7.38%	6.90%	4.95%	5.17%
May-11	10.82%	9.75%	7.26%	6.11%	5.51%	5.45%
Jun-11	10.25%	9.69%	6.81%	5.39%	5.70%	5.12%
Jul-11	10.02%	9.51%	6.38%	4.94%	6.11%	5.12%

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

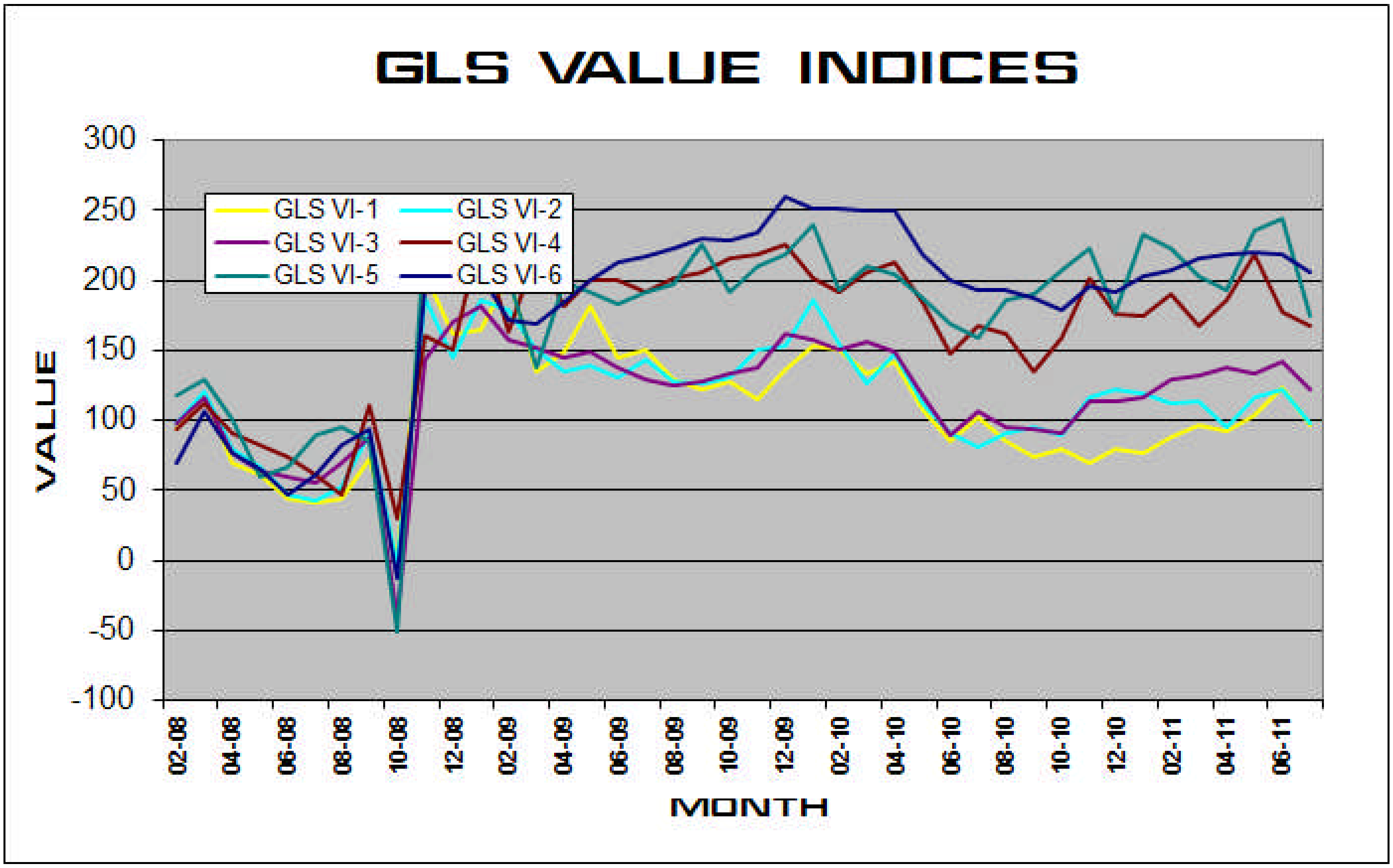
GLS VALUE INDICES: HISTORICAL VALUES

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
Feb-08	3.10%	6.00%	2.90%	94.4	98.7	98.6	93.3	118.0	69.9
Mar-08	2.90%	5.95%	**3.05%**	118.1	120.5	116.2	112.0	128.8	107.4
Apr-08	2.81%	5.25%	2.44%	69.9	79.5	77.4	90.6	100.8	77.4
May-08	2.78%	5.15%	2.37%	61.2	66.7	64.1	82.9	60.5	65.1
Jun-08	2.67%	5.00%	2.33%	44.1	47.4	59.8	74.6	66.9	47.2
Jul-08	2.75%	5.00%	2.25%	41.7	43.4	55.3	60.8	89.1	61.6
Aug-08	2.74%	5.02%	2.27%	44.0	52.5	70.1	47.4	95.8	83.1
Sep-08	3.00%	5.00%	2.00%	73.3	91.2	88.5	111.3	85.2	94.2
Oct-08	4.43%	4.56%	**0.12%**	**2.3**	**-3.1**	**-38.6**	**30.5**	**-51.0**	**-12.9**
Nov-08	2.06%	4.00%	1.94%	**203.9**	**187.0**	143.2	161.1	236.0	196.6
Dec-08	1.64%	3.89%	2.25%	162.2	144.9	170.3	151.0	212.5	238.6
Jan-09	1.11%	3.25%	2.14%	164.8	185.5	**181.7**	**233.2**	218.3	204.4
Feb-09	1.15%	3.25%	2.10%	203.6	179.5	157.4	162.9	201.5	171.3
Mar-09	1.06%	3.25%	2.19%	135.3	150.3	151.6	220.4	138.0	169.7
Apr-09	0.96%	3.28%	2.32%	149.4	134.8	144.3	182.0	198.3	184.5
May-09	0.70%	3.26%	2.57%	182.1	138.7	149.6	200.3	192.4	200.8
Jun-09	0.55%	3.25%	2.70%	144.8	130.3	137.3	200.2	183.8	212.8
Jul-09	0.48%	3.25%	2.77%	150.9	143.8	129.1	191.9	192.4	217.4
Aug-09	0.39%	3.25%	2.86%	129.7	127.4	125.7	201.7	197.3	222.8
Sep-09	0.29%	3.25%	2.96%	122.0	126.5	128.3	205.5	225.3	229.6
Oct-09	0.26%	3.25%	2.99%	128.2	131.3	133.9	216.0	191.2	228.8
Nov-09	0.26%	3.25%	2.99%	115.3	150.9	138.0	219.2	210.8	234.2
Dec-09	0.25%	3.25%	3.00%	136.1	153.4	162.0	226.3	218.0	**259.6**
Jan-10	0.25%	3.24%	2.99%	153.9	186.5	157.2	201.0	240.6	250.7
Feb-10	0.25%	3.23%	2.99%	150.8	155.1	150.4	192.3	193.0	250.7
Mar-10	0.26%	3.25%	2.99%	133.1	126.0	155.8	206.4	209.5	249.2
Apr-10	0.29%	3.25%	2.96%	142.1	147.5	149.3	213.6	205.1	250.0
May-10	0.41%	3.25%	2.84%	107.5	112.1	117.5	184.4	187.2	218.1
Jun-10	0.52%	3.25%	2.73%	85.9	90.9	90.1	147.5	168.7	200.4
Jul-10	0.46%	3.26%	2.80%	102.7	81.0	106.7	167.0	159.5	193.5
Aug-10	0.33%	3.26%	2.93%	85.6	91.6	95.4	161.6	186.6	193.2
Sep-10	0.28%	3.25%	2.97%	74.1	95.3	94.0	135.6	190.8	187.2
Oct-10	0.28%	3.25%	2.97%	79.8	89.7	91.3	159.8	207.2	179.5
Nov-10	0.27%	3.25%	2.98%	70.5	117.2	113.5	202.0	223.5	195.4
Dec-10	0.29%	3.25%	2.96%	79.7	121.8	113.3	175.5	178.1	191.3
Jan-11	0.29%	3.25%	2.96%	77.0	119.8	117.3	175.2	232.3	203.7
Feb-11	0.29%	3.25%	2.96%	88.9	112.9	129.8	190.4	222.9	207.6
Mar-11	0.30%	3.25%	2.95%	96.8	113.5	132.3	167.8	203.4	216.0
Apr-11	0.27%	3.25%	2.98%	92.5	95.9	137.6	186.2	192.5	218.8
May-11	0.24%	3.25%	3.01%	104.3	116.1	134.3	219.2	235.1	220.2
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

INDICES LEGEND	
(green)	HIGHEST READING
(red)	LOWEST READING

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


GLS VALUE INDICES
GLS VI-1
GLS VI-2
GLS VI-3
GLS VI-4
GLS VI-5
GLS VI-6
VALUE
300
250
200
150
100
50
0
-50
-100
02-08
04-08
06-08
08-08
10-08
12-08
02-09
04-09
06-09
08-09
10-09
12-09
02-10
04-10
06-10
08-10
10-10
12-10
02-11
04-11
06-11
MONTH

YTD Prepayment Speeds

Table 3:

CPR/MO.	<8	8 - 10	10 - 13	13 - 16	16 - 20	20+	ALL
Jan-11	14.22%	9.08%	6.94%	6.85%	3.82%	5.26%	**6.12%**
Feb-11	5.96%	9.95%	6.43%	5.52%	5.78%	5.02%	**5.74%**
Mar-11	10.25%	7.41%	7.63%	5.62%	8.43%	5.47%	**6.40%**
Apr-11	11.80%	11.75%	9.34%	5.83%	4.09%	5.21%	**6.70%**
May-11	9.52%	11.76%	5.61%	4.11%	6.39%	5.98%	**6.22%**
Jun-11	9.57%	8.08%	4.95%	4.33%	5.60%	3.82%	**4.58%**
Jul-11	12.92%	7.89%	4.37%	4.16%	6.35%	5.26%	**5.37%**
Aug-11	7.28%	5.92%	5.15%	6.80%	5.46%	3.65%	**4.46%**
Grand Total	**10.22%**	**9.03%**	**6.29%**	**5.41%**	**5.75%**	**4.95%**	**5.69%**

2011 monthly prepayment speeds broken out by maturity sector. Source: Colson Services

Table 4:

POOL AGE	<8	8 - 10	10 - 13	13 - 16	16 - 20	20+	ALL
Jan-11	22 Mos.	31 Mos.	32 Mos.	67 Mos.	49 Mos.	50 Mos.	**45 Mos.**
Feb-11	22 Mos.	30 Mos.	32 Mos.	66 Mos.	50 Mos.	51 Mos.	**45 Mos.**
Mar-11	23 Mos.	31 Mos.	33 Mos.	66 Mos.	50 Mos.	50 Mos.	**45 Mos.**
Apr-11	23 Mos.	31 Mos.	33 Mos.	67 Mos.	49 Mos.	49 Mos.	**45 Mos.**
May-11	24 Mos.	32 Mos.	33 Mos.	66 Mos.	47 Mos.	49 Mos.	**44 Mos.**
Jun-11	24 Mos.	32 Mos.	32 Mos.	66 Mos.	47 Mos.	49 Mos.	**44 Mos.**
Jul-11	24 Mos.	33 Mos.	33 Mos.	67 Mos.	47 Mos.	49 Mos.	**44 Mos.**
Aug-11	24 Mos.	33 Mos.	33 Mos.	67 Mos.	46 Mos.	48 Mos.	**44 Mos.**

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

YEAR-TO-DATE CPR DATA

Table 5:

< 8 BY AGE	0-12 Mos.	13-24 Mos.	25-36 Mos.	37-48 Mos.	48+ Mos.
Jan-11	7.95%	24.87%	18.55%	10.61%	14.45%
Feb-11	6.33%	2.69%	5.40%	4.49%	12.63%
Mar-11	10.15%	5.53%	11.73%	7.38%	19.55%
Apr-11	5.53%	13.80%	17.17%	7.29%	21.62%
May-11	14.98%	4.94%	12.68%	4.43%	6.04%
Jun-11	6.42%	10.83%	14.67%	8.20%	10.02%
Jul-11	8.20%	16.38%	8.80%	12.41%	20.45%
Aug-11	0.20%	12.80%	5.54%	7.10%	10.54%
Grand Total	**7.68%**	**11.60%**	**12.14%**	**7.91%**	**14.62%**

10-13 BY AGE	0-12 Mos.	13-24 Mos.	25-36 Mos.	37-48 Mos.	48+ Mos.
Jan-11	4.90%	6.31%	12.35%	6.54%	5.14%
Feb-11	4.49%	10.85%	8.56%	4.39%	5.93%
Mar-11	7.41%	10.03%	9.38%	7.84%	4.86%
Apr-11	8.89%	8.78%	13.52%	9.57%	7.32%
May-11	4.50%	7.16%	7.62%	6.84%	3.52%
Jun-11	2.25%	7.21%	7.85%	4.76%	4.91%
Jul-11	2.88%	6.80%	4.83%	5.15%	3.35%
Aug-11	4.45%	6.74%	6.23%	5.83%	3.95%
Grand Total	**4.94%**	**7.90%**	**9.15%**	**6.38%**	**4.81%**

16-20 BY AGE	0-12 Mos.	13-24 Mos.	25-36 Mos.	37-48 Mos.	48+ Mos.
Jan-11	0.00%	7.24%	8.01%	2.83%	2.85%
Feb-11	0.00%	4.73%	9.77%	14.87%	1.78%
Mar-11	3.22%	4.01%	19.91%	8.32%	7.84%
Apr-11	0.00%	7.38%	4.96%	2.08%	5.51%
May-11	4.45%	0.00%	14.05%	5.83%	7.33%
Jun-11	0.79%	1.51%	2.16%	17.40%	3.91%
Jul-11	0.50%	0.74%	19.78%	8.74%	6.31%
Aug-11	0.00%	15.43%	17.18%	3.79%	3.82%
Grand Total	**1.11%**	**5.06%**	**12.01%**	**8.14%**	**4.95%**

2011 YTD CPR by maturity and age bucket. Source: Colson Services

YEAR-TO-DATE CPR DATA

Table 6:

8-10 BY AGE	0-12 Mos.	13-24 Mos.	25-36 Mos.	37-48 Mos.	48+ Mos.
Jan-11	2.09%	10.85%	12.52%	4.62%	11.81%
Feb-11	0.48%	18.09%	9.47%	9.90%	7.17%
Mar-11	1.99%	9.13%	8.29%	6.50%	9.50%
Apr-11	10.70%	16.95%	10.14%	9.51%	8.34%
May-11	5.71%	17.44%	17.75%	8.12%	6.48%
Jun-11	8.38%	7.41%	8.88%	11.83%	4.77%
Jul-11	13.04%	3.19%	7.54%	7.15%	8.55%
Aug-11	1.32%	10.84%	8.62%	1.61%	4.82%
Grand Total	**5.46%**	**12.27%**	**10.39%**	**7.54%**	**7.75%**

13-16 BY AGE	0-12 Mos.	13-24 Mos.	25-36 Mos.	37-48 Mos.	48+ Mos.
Jan-11	0.00%	30.56%	5.65%	0.00%	5.93%
Feb-11	15.31%	2.76%	12.71%	9.95%	3.99%
Mar-11	0.00%	2.77%	24.05%	17.31%	5.19%
Apr-11	1.76%	2.81%	0.00%	12.38%	6.51%
May-11	0.00%	6.90%	0.00%	0.00%	4.54%
Jun-11	0.46%	0.00%	0.00%	0.00%	5.76%
Jul-11	0.00%	3.40%	0.00%	0.00%	5.14%
Aug-11	0.00%	22.11%	0.00%	0.00%	6.46%
Grand Total	**2.19%**	**8.19%**	**6.32%**	**5.68%**	**5.43%**

20+ BY AGE	0-12 Mos.	13-24 Mos.	25-36 Mos.	37-48 Mos.	48+ Mos.
Jan-11	2.78%	5.44%	6.82%	9.07%	4.80%
Feb-11	2.22%	8.00%	5.69%	5.72%	4.78%
Mar-11	2.82%	5.10%	11.55%	6.27%	5.18%
Apr-11	1.86%	4.97%	6.44%	8.12%	5.74%
May-11	0.72%	7.45%	7.97%	7.60%	7.04%
Jun-11	0.41%	4.62%	6.99%	4.97%	4.15%
Jul-11	1.41%	6.22%	11.75%	4.88%	5.56%
Aug-11	0.93%	3.78%	4.51%	7.69%	3.68%
Grand Total	**1.57%**	**5.68%**	**7.82%**	**6.79%**	**5.12%**

2011 YTD CPR by maturity and age bucket. Source: Colson Services

GLOSSARY AND DEFINITIONS: PART 1

Default-Curtailment Ratio

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

The default ratio is calculated using the following formula:

Defaults / (Defaults + 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:

Pool Prepay Percentage = Pool Prepayments / 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:

((Secondary Loan Defaults * Pool Prepay Percentage) / Pool Opening Balance) * 12

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

GLS Long Value Indices

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

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

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

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

GLOSSARY AND DEFINITIONS: PART 2

Prepayment Calculations

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

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

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

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

Total Pool CPR = VCPR + DCPR

SBA Libor Base Rate

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

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

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.

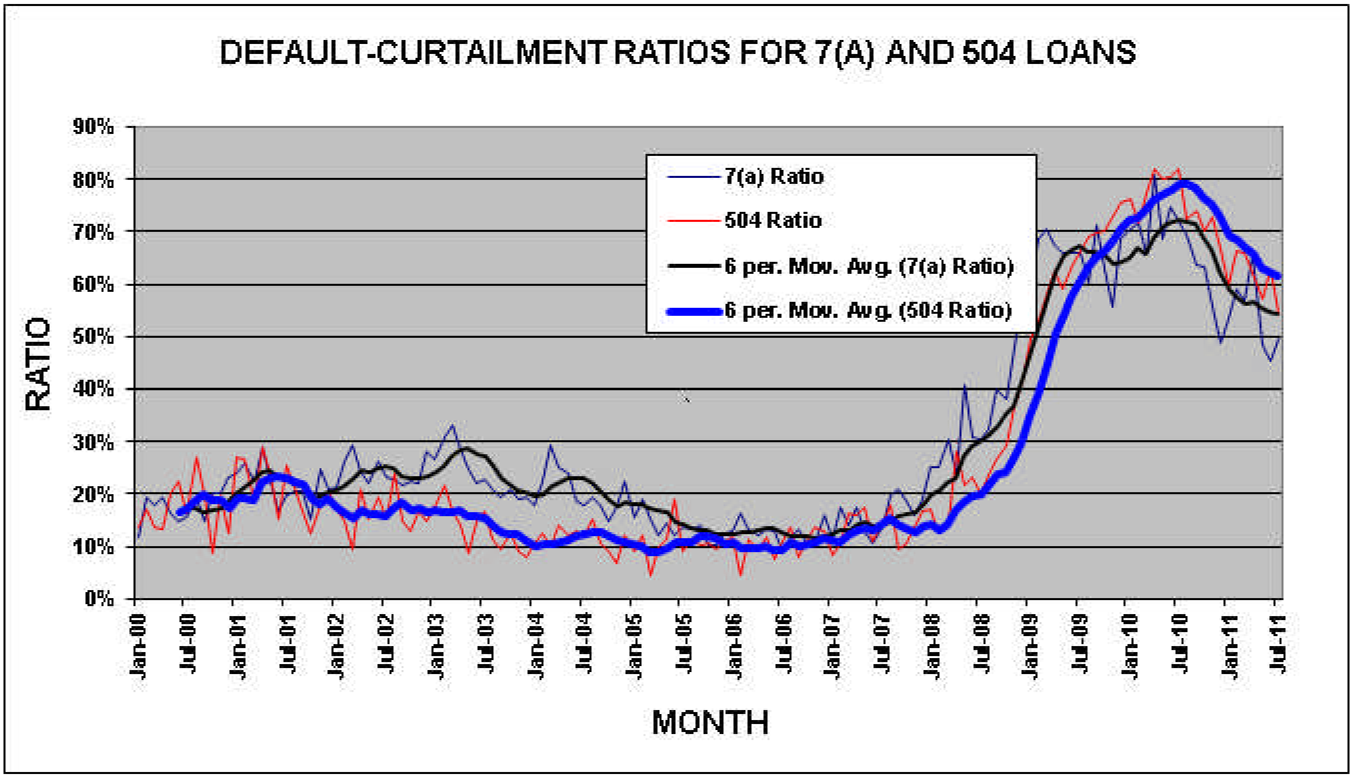
Credit Risk: Losses experienced due to the default of collateral underlying a security. Since SBA loans and pools are guaranteed by the US government, this risk is very small.

Secondary Market First Lien Position 504 Loan Pool Guarantee Program

As part of the American Recovery and Reinvestment Act (AKA the Stimulus Bill), Congress authorized the SBA to create a temporary program that provides a guarantee on an eligible pool of SBA 504 first liens. The program was authorized for a period of two years from the date of bill passage – February, 2009. The eligibility of each loan is dependent on the date of the SBA Debenture funding. To be eligible, the Debenture must have been funded on or after **February 17, 2009**, and prior to **February 16, 2011**. The total guarantee allocation is $3 Billion. HR 5297 provides for a two-year extension from the first pooling month, 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 .245%.


DEFAULT-CURTAILMENT RATIOS FOR 7(A) AND 504 LOANS
7(a) Ratio
504 Ratio
6 per. Mov. Avg. (7(a) Ratio)
6 per. Mov. Avg. (504 Ratio)
RATIO
90%
80%
70%
60%
50%
40%
30%
20%
10%
0%
Jan-00
Jul-00
Jan-01
Jul-01
Jan-02
Jul-02
Jan-03
Jul-03
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Jan-06
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Jan-11
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- *Model Validation*
- *Specialized research projects*
- *Mortgage Servicing Valuation*

Loan Securitizers:

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- *Loan and IO accounting*
- *Loan, Pool and IO Mark-To-Market*
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