

Bob Judge, Government Loan Solutions, Editor



Bob Judge is a partner at Government Loan Solutions.

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

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

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## PREPAYS DOWN 10%

In December, prepays fell below 7% for the first time since April, finishing the year on a positive note.

While we finished 2013 with a print below 7%, this is only the third monthly reading below that benchmark recorded

last year. For comparison purposes, all twelve months of 2012 were below 7%.

After recording the first default CPR below 1% since 1999, this month increased by 85%, but still recorded the second lowest on record. The

fact that the default CPR can increase by this amount and still be the second best ever shows how low defaults have fallen since peaking in April, 2010.

*Article continued on page 5, graphs on page 2 and data on pages 23-25.*

## FIXED RATE POOL PREPAYMENT SPEEDS

By Bob Judge, Editor

For most of 30 year history of 7a pooling, fixed rate pools have been a true rarity. However, since the increase in the maximum allowable fixed rate

on 7a loans announced in October 2009, we have seen a steady increase in both the origination of fixed rate loans and the creation of fixed rate pools. While it still pales in comparison to the \$20 billion in out-

standing floating rate 7a pools, the trend points to higher fixed rate balances, especially with the expectation for rising interest rates over the next few years.

*Continued on page 7*

## SBI: POSITIVE RETURNS IN JANUARY

Much like last month, January saw consistent returns throughout the month, as the secondary market continued its upward trend.

This month pushed all pool return measures into the black,

as the one-year returns show a +1% return over the past 12 months.

The results of these steady price increases can be seen in the Rich/Cheap analysis on page 10. The short maturity line

continues to rise inside the Fair Value Bank and is near to entering the "Rich" part of the graph.

*Continued on page 9*

## SMALL BUSINESS FACT OF THE MONTH

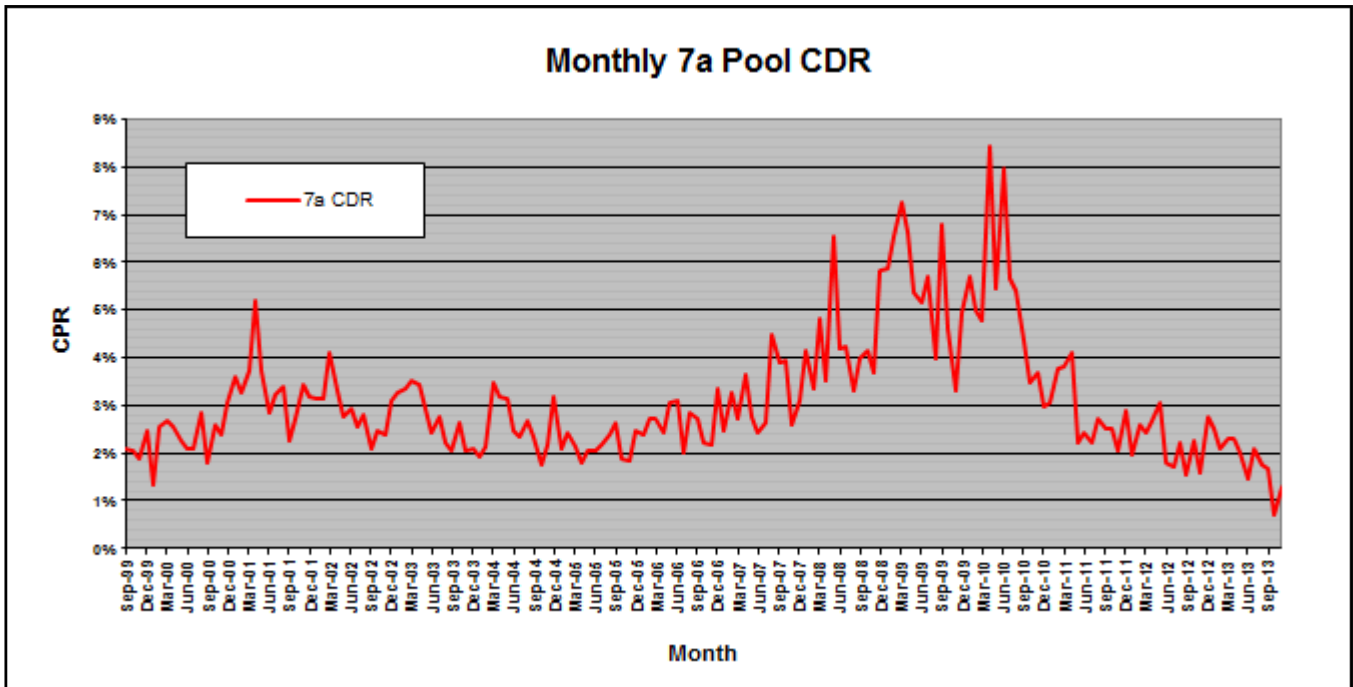
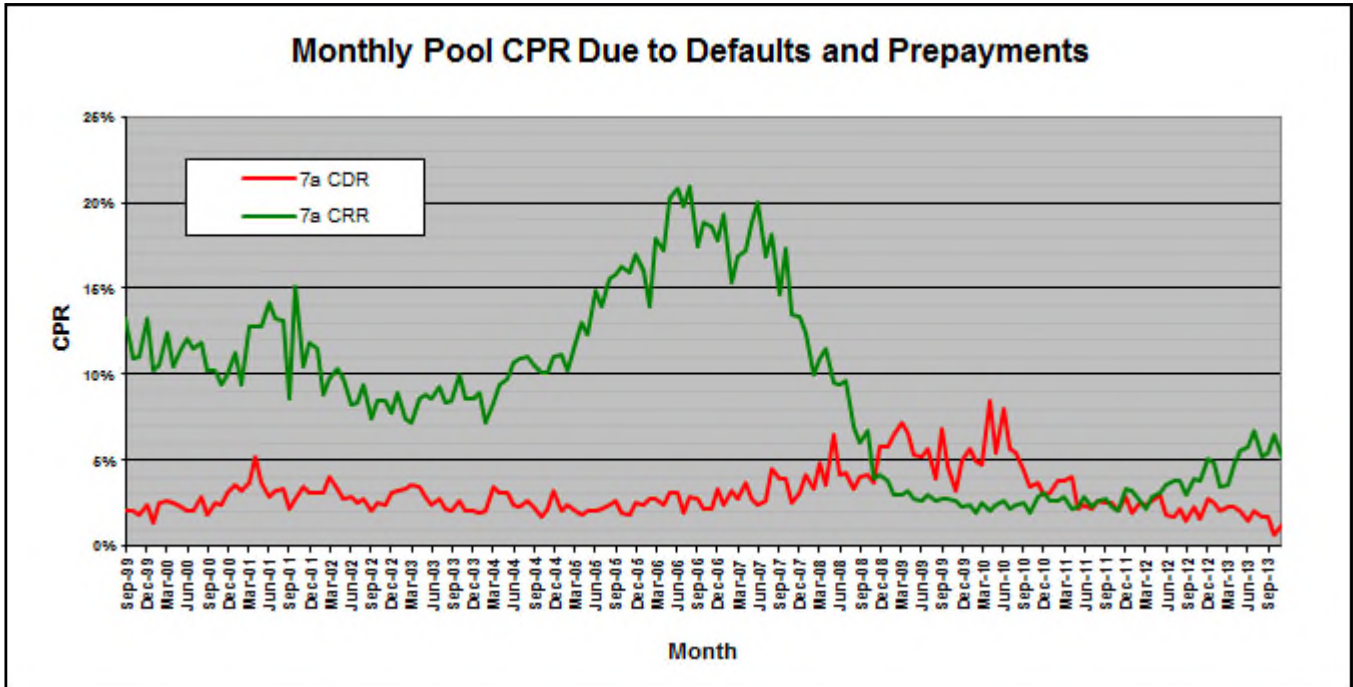
According to the National Small Business Association, 43% of small companies use cloud-computing technologies.

**"I NEVER ASK IF A PLAYER HAS THE WILL TO WIN. I ASK IF HE HAS THE WILL TO PREPARE."**

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# PREPAYMENT SPEEDS...CONTINUED



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## PREPAYMENT SPEEDS...CONTINUED

As has been the storyline for all of 2013, we continue to see defaults at record lows combined with rising voluntary prepayments.

As for the detail, overall prepayments fell 10% to 6.50% from 7.23% in November. In comparing prepayment speeds for all of 2013 to all of 2012, we see that last year ran 29% higher than the previous year, coming in at 7.11% versus 5.52%.

As for the largest sector of the market, 20+ years to maturity, prepayment speeds fell by 27% to 5.67% from 7.80%.

Turning to the CPR breakdown, the default CPR rose by 85% to 1.29% from 0.70%. As mentioned earlier, this level is the second lowest since Sep-

tember, 1999 when our records began.

Regarding voluntary prepayments, they fell back below 6% barrier after one month above it, coming in at 5.21% versus 6.53% in November.

Preliminary data for next month suggests that voluntary prepayments will move back above 8%, as we begin 2014 above where we began 2013.

Turning to the default/voluntary prepayment breakdown, the **Voluntary Prepay CPR (green line)** fell to 5.21% from 6.53%, a 20% decrease.

While the VCPR fell back below 6%, the **Default CPR (red line)** increased by 85% to 1.29% from 0.70% the previous month.

Prepayment speeds rose in four out of six maturity categories. Increases were seen, by order of magnitude, in the 16-20 year sector (+106% to CPR 9.99%), 13-16 (+34% to CPR 5.34%), 10-13 (+25% to 8.17%) and 8-10 (+10% to CPR 7.02%).

Decreases were seen, also by order of magnitude, in the <8 year sector (-28% to CPR 6.41%) and 20+ (-27% to CPR 5.67%).

While 2013 finished on a positive note, the trend to higher prepayment speeds, led by voluntaries, should continue into 2014.

***“While 2013 finished on a positive note, the trend to higher prepayment speeds, led by voluntaries, should continue into 2014.”***

*Data on pages 23-25*



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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)



## FIXED RATE PREPAYMENT SPEEDS...CONTINUED

Having said that, I thought I would take a look to see how these pools are performing, both in absolute terms and compared to their floating rate brethren. The chart on the following page shows the monthly fixed and floating rate CPRs over the past 36 months, including outstanding balances, in order to put the results into perspective.

If you asked most lending professionals, the general consensus would be that fixed rate loans have both a lower default rate and voluntary prepayment speed. The lower default rate would be the result of the borrower having the credit worthiness to negotiate a fixed rate over the lender-preferred floating rate. As to the likelihood of voluntary prepayment, the certainty around a fixed rate loan would outweigh a lower floating rate refinancing opportunity for most borrowers. Higher voluntary prepayments could come from greater success of fixed rate borrowers, but during the past three years, this is probably a small contributing factor. Unfortunately, we aren't able to test these possibilities, but can look at the overall differences between the two loan types.

In doing this analysis, we were surprised to find that, contrary to popular belief, floating rate pools have had a lower overall prepayment speed over the past three years. Of course, with such relatively small outstanding balances of fixed rate pools, the comparison is not entirely "fair" at this stage, but does represent an interesting result.

Turning to the data on the next page, fixed rate pools have pre-paid at a 28% faster rate than floating rate pools. Over this 3 year time horizon, floating rate pools had a 6.06% versus a 7.78% rate for fixed rate ones. However, this difference has shrunk as the balances of fixed rate pools have increased.

As the balances of fixed rate pools grow in the future, it will be interesting to track the differences and see if the trends converge, or possibly reverse. In fact, we are beginning to see this convergence, at least in 2013.

Last year, the CPR difference was only 9.98% (CPR 7.82% versus CPR 7.11%), so we do see some convergence as fixed rate balances grow. Regarding balance growth, fixed rate balances grew by 103% last year versus 7.31% in floating rate balances. At that rate, our comparison will be more relevant in the year's to come.

I will leave it there, and allow the reader to draw there own conclusions relating to fixed rate performance.

*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 the next page*



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**FIXED RATE PREPAYMENT SPEEDS...CONTINUED**

<b>CPR/MO</b>	<b>Fixed Balance</b>	<b>Fixed Rate CPR</b>	<b>Floating Balance</b>	<b>Floating Rate CPR</b>	<b>Diff</b>
Jan-11	\$8,662,902	0.33%	\$15,876,891,621	6.12%	-5.79%
Feb-11	\$8,414,883	23.48%	\$16,014,618,825	5.74%	17.74%
Mar-11	\$8,356,960	0.00%	\$16,121,877,860	6.40%	-6.40%
Apr-11	\$8,298,775	0.00%	\$16,371,637,416	6.70%	-6.70%
May-11	\$28,897,925	12.29%	\$16,716,426,821	6.22%	6.07%
Jun-11	\$36,120,659	0.00%	\$16,891,077,764	4.58%	-4.58%
Jul-11	\$35,985,032	0.00%	\$16,993,338,747	5.37%	-5.37%
Aug-11	\$51,219,715	0.00%	\$17,333,881,684	4.46%	-4.46%
Sep-11	\$51,050,154	0.00%	\$17,538,641,677	5.34%	-5.34%
Oct-11	\$60,102,099	3.93%	\$17,652,068,829	5.33%	-1.40%
Nov-11	\$68,573,354	21.11%	\$17,752,509,137	4.81%	16.30%
Dec-11	\$68,353,236	0.00%	\$17,825,694,298	4.10%	-4.10%
Jan-12	\$73,580,968	8.97%	\$17,801,202,105	6.20%	2.77%
Feb-12	\$77,618,889	6.47%	\$18,030,943,916	5.23%	1.24%
Mar-12	\$76,616,256	11.29%	\$18,148,089,354	5.28%	6.01%
Apr-12	\$77,956,406	0.00%	\$18,125,049,691	4.61%	-4.61%
May-12	\$83,906,005	12.62%	\$18,528,349,239	5.62%	7.00%
Jun-12	\$85,716,605	11.32%	\$18,620,604,446	6.16%	5.16%
Jul-12	\$84,128,335	16.89%	\$18,834,689,929	5.39%	11.50%
Aug-12	\$83,110,186	8.69%	\$18,883,931,442	5.60%	3.09%
Sep-12	\$81,476,965	13.64%	\$19,128,581,694	5.99%	7.65%
Oct-12	\$90,464,684	1.62%	\$19,132,310,984	4.52%	-2.90%
Nov-12	\$89,964,205	2.71%	\$19,257,286,800	6.24%	-3.53%
Dec-12	\$89,016,690	8.39%	\$19,317,516,697	5.39%	3.00%
Jan-13	\$108,694,677	0.00%	\$19,529,368,113	7.84%	-7.84%
Feb-13	\$108,294,526	0.76%	\$19,681,986,136	7.43%	-6.67%
Mar-13	\$122,625,804	6.08%	\$19,919,803,325	5.57%	0.51%
Apr-13	\$146,152,848	12.46%	\$19,995,683,246	5.86%	6.60%
May-13	\$147,956,747	12.83%	\$20,309,131,697	7.00%	5.83%
Jun-13	\$146,436,556	3.47%	\$20,285,845,633	7.59%	-4.12%
Jul-13	\$161,702,474	0.61%	\$20,351,433,674	7.29%	-6.67%
Aug-13	\$179,051,066	0.19%	\$20,253,432,436	8.83%	-8.63%
Sep-13	\$177,857,935	15.32%	\$20,336,071,871	7.01%	8.31%
Oct-13	\$182,039,455	9.09%	\$20,587,575,276	7.11%	1.98%
Nov-13	\$182,306,659	15.74%	\$20,538,221,052	7.23%	8.51%
Dec-13	\$180,295,921	8.93%	\$20,729,799,282	6.50%	2.43%
<b>Grand Total</b>	<b>\$180,295,921</b>	<b>7.78%</b>	<b>\$20,729,799,282</b>	<b>6.06%</b>	<b>1.72%</b>



## SMALL BUSINESS INDEXES...CONTINUED

The long maturity sector entered the Fair Value Band this month and now both maturity sectors are trading at reasonable premiums.

### SBI Index Results

For the fifth 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 +.41% for equal weighting and +.40% for actual weighting. The 3 month numbers were +1.14% and +1.18%, respectively.

As for the IO strip indexes, the 10 to 25 year IO strips indexes returned +3.50% for equal weighting and +3.59% for actual

weighting in January. The three month numbers came in at 10.63% and 10.71% and six month returns were 5.99% and 6.91%, respectively. We are still in negative territory over 1 year, but with continued stability in the secondary market, we should be back in the black within a few months.

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 the next page*

## DEBENTURE SPEEDS: 20s FALL SLIGHTLY

In January, 20 year debenture prepayment speeds decreased by 1% to CPR 9.46%, staying above CPR 9% for the fourth month in a row.

Once again, we saw defaults decrease, reaching a five-year low of CDR 1.36%, a 1% decrease from December. As for voluntaries, they also fell by 1%, but stayed above 8% at CRR 8.10%.

As for 10s, we witnessed a 53% decrease in CPR over November, coming in at CPR 3.35%. The primary reason was a 60% drop in voluntary prepayments (6.40% to 2.57%) and a 6% decrease in defaults (.83% to .78%).

This month represents yet another data point providing evidence that voluntary prepayments are rising and defaults are decreasing.

*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 14*



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

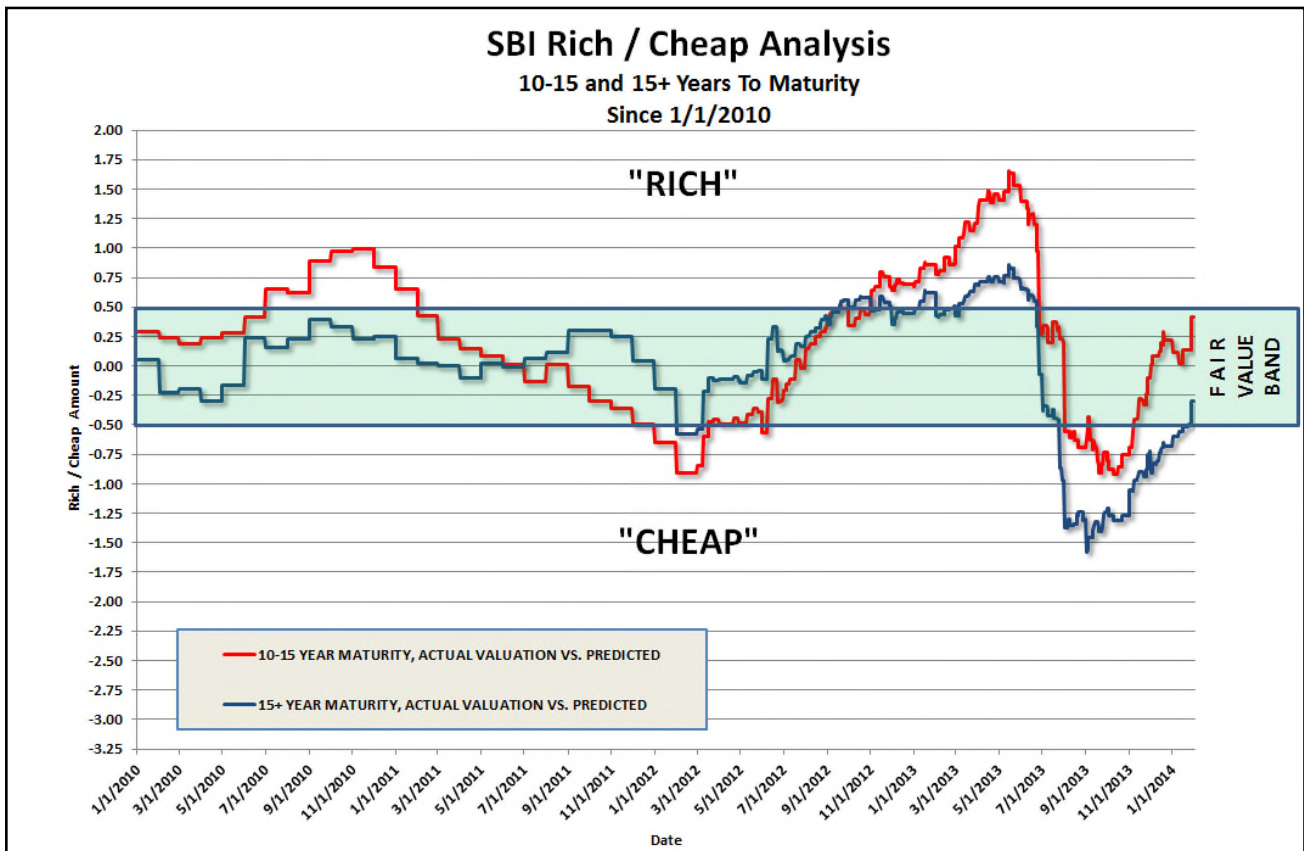
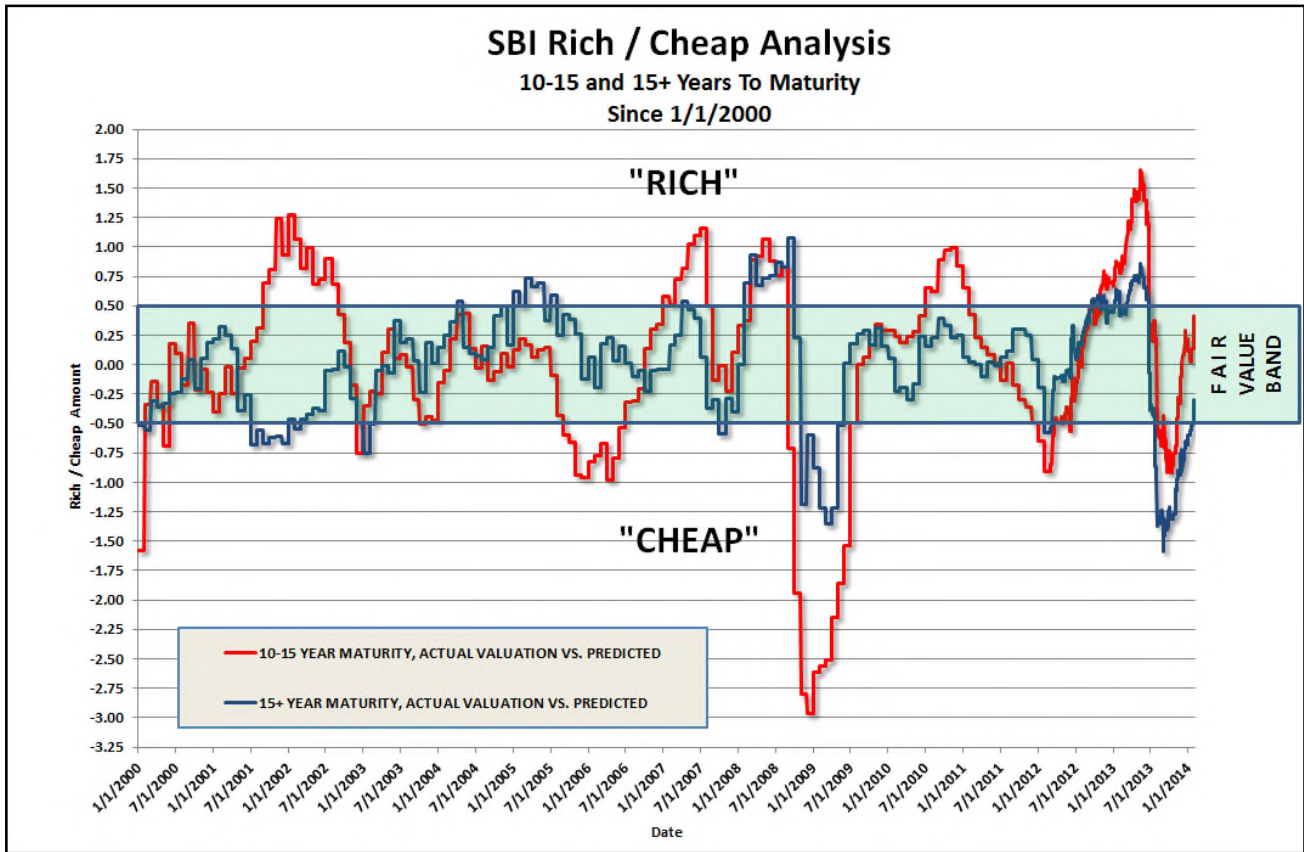
#### Principals:

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: 01/31/2014	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	0.41%	1.14%	1.16%	1.00%	11.52%	34.25%	76.30%	118.93%
POOL, ALL ACTUAL INDEX	0.40%	1.18%	1.27%	1.04%	8.95%	24.01%	56.39%	93.69%
POOL, LONG EQUAL INDEX	0.43%	1.11%	1.38%	1.23%	13.34%	40.31%	88.68%	134.63%
POOL, LONG ACTUAL INDEX	0.40%	1.12%	1.46%	1.23%	10.01%	27.04%	63.06%	102.18%
POOL, SHORT EQUAL INDEX	0.33%	1.22%	0.55%	0.36%	7.08%	20.78%	48.45%	83.07%
POOL, SHORT ACTUAL INDEX	0.41%	1.40%	0.69%	0.50%	6.35%	17.25%	41.77%	74.48%
POOL, ALL EQUAL INCOME INDEX	0.23%	0.65%	1.30%	2.55%	13.22%	32.60%	93.05%	142.39%
POOL, ALL ACTUAL INCOME INDEX	0.23%	0.67%	1.34%	2.63%	10.53%	22.46%	70.42%	113.00%
POOL, LONG EQUAL INCOME INDEX	0.21%	0.59%	1.18%	2.30%	13.80%	36.75%	102.35%	153.91%
POOL, LONG ACTUAL INCOME INDEX	0.21%	0.61%	1.22%	2.40%	10.43%	23.84%	73.85%	117.15%
POOL, SHORT EQUAL INCOME INDEX	0.29%	0.84%	1.67%	3.27%	11.95%	23.54%	72.67%	118.78%
POOL, SHORT ACTUAL INCOME INDEX	0.30%	0.86%	1.71%	3.35%	11.00%	19.84%	64.29%	107.23%
POOL, ALL EQUAL PRICE INDEX	0.26%	0.73%	0.36%	(0.53%)	0.76%	4.35%	(0.92%)	0.48%
POOL, ALL ACTUAL PRICE INDEX	0.25%	0.75%	0.41%	(0.58%)	0.82%	4.34%	(0.88%)	0.48%
POOL, LONG EQUAL PRICE INDEX	0.30%	0.73%	0.63%	(0.24%)	1.30%	4.74%	(0.23%)	1.26%
POOL, LONG ACTUAL PRICE INDEX	0.25%	0.71%	0.65%	(0.35%)	1.29%	4.63%	(0.23%)	1.21%
POOL, SHORT EQUAL PRICE INDEX	0.15%	0.71%	(0.41%)	(1.35%)	(0.65%)	3.23%	(2.77%)	(2.01%)
POOL, SHORT ACTUAL PRICE INDEX	0.23%	0.87%	(0.31%)	(1.27%)	(0.44%)	3.36%	(2.65%)	(1.91%)
POOL, ALL EQUAL PREPAY INDEX	(0.05%)	(0.15%)	(0.31%)	(0.61%)	(1.24%)	(1.64%)	(5.81%)	(7.71%)
POOL, ALL ACTUAL PREPAY INDEX	(0.05%)	(0.15%)	(0.31%)	(0.60%)	(1.21%)	(1.61%)	(5.42%)	(7.15%)
POOL, LONG EQUAL PREPAY INDEX	(0.05%)	(0.15%)	(0.30%)	(0.56%)	(1.05%)	(1.26%)	(5.32%)	(7.20%)
POOL, LONG ACTUAL PREPAY INDEX	(0.05%)	(0.15%)	(0.29%)	(0.54%)	(1.01%)	(1.20%)	(4.83%)	(6.55%)
POOL, SHORT EQUAL PREPAY INDEX	(0.06%)	(0.16%)	(0.34%)	(0.76%)	(1.74%)	(2.57%)	(7.16%)	(9.18%)
POOL, SHORT ACTUAL PREPAY INDEX	(0.06%)	(0.16%)	(0.34%)	(0.76%)	(1.75%)	(2.59%)	(6.98%)	(8.82%)
POOL, ALL EQUAL DEFAULT INDEX	(0.01%)	(0.03%)	(0.06%)	(0.17%)	(0.45%)	(0.72%)	(1.41%)	(1.86%)
POOL, ALL ACTUAL DEFAULT INDEX	(0.01%)	(0.03%)	(0.06%)	(0.16%)	(0.44%)	(0.71%)	(1.35%)	(1.75%)
POOL, LONG EQUAL DEFAULT INDEX	(0.01%)	(0.03%)	(0.06%)	(0.15%)	(0.37%)	(0.51%)	(1.17%)	(1.61%)
POOL, LONG ACTUAL DEFAULT INDEX	(0.01%)	(0.03%)	(0.06%)	(0.14%)	(0.36%)	(0.49%)	(1.07%)	(1.47%)
POOL, SHORT EQUAL DEFAULT INDEX	(0.01%)	(0.03%)	(0.07%)	(0.21%)	(0.66%)	(1.23%)	(2.04%)	(2.52%)
POOL, SHORT ACTUAL DEFAULT INDEX	(0.01%)	(0.03%)	(0.07%)	(0.21%)	(0.66%)	(1.24%)	(2.02%)	(2.46%)
POOL, ALL EQUAL VOL PREPAY INDEX	(0.04%)	(0.12%)	(0.25%)	(0.45%)	(0.79%)	(0.92%)	(4.46%)	(5.96%)
POOL, ALL ACTUAL VOL PREPAY INDEX	(0.04%)	(0.12%)	(0.24%)	(0.44%)	(0.77%)	(0.90%)	(4.13%)	(5.50%)
POOL, LONG EQUAL VOL PREPAY INDEX	(0.04%)	(0.12%)	(0.24%)	(0.41%)	(0.68%)	(0.75%)	(4.20%)	(5.68%)
POOL, LONG ACTUAL VOL PREPAY INDEX	(0.04%)	(0.12%)	(0.23%)	(0.40%)	(0.66%)	(0.72%)	(3.80%)	(5.16%)
POOL, SHORT EQUAL VOL PREPAY INDEX	(0.04%)	(0.13%)	(0.27%)	(0.54%)	(1.09%)	(1.36%)	(5.23%)	(6.83%)
POOL, SHORT ACTUAL VOL PREPAY INDEX	(0.05%)	(0.13%)	(0.27%)	(0.55%)	(1.10%)	(1.37%)	(5.06%)	(6.52%)
POOL, ALL EQUAL SCHED PRIN INDEX	(0.03%)	(0.09%)	(0.18%)	(0.38%)	(1.02%)	(1.36%)	(2.13%)	(2.60%)
POOL, ALL ACTUAL SCHED PRIN INDEX	(0.03%)	(0.09%)	(0.18%)	(0.38%)	(1.02%)	(1.36%)	(2.11%)	(2.52%)
POOL, LONG EQUAL SCHED PRIN INDEX	(0.02%)	(0.06%)	(0.12%)	(0.25%)	(0.64%)	(0.79%)	(1.29%)	(1.66%)
POOL, LONG ACTUAL SCHED PRIN INDEX	(0.02%)	(0.06%)	(0.12%)	(0.26%)	(0.64%)	(0.77%)	(1.22%)	(1.55%)
POOL, SHORT EQUAL SCHED PRIN INDEX	(0.06%)	(0.17%)	(0.34%)	(0.73%)	(2.01%)	(2.79%)	(4.75%)	(5.97%)
POOL, SHORT ACTUAL SCHED PRIN INDEX	(0.06%)	(0.18%)	(0.35%)	(0.75%)	(2.05%)	(2.82%)	(4.70%)	(5.85%)
POOL, ALL EQUAL TOTAL PRIN INDEX	(0.08%)	(0.24%)	(0.49%)	(0.99%)	(2.25%)	(2.98%)	(7.83%)	(10.11%)
POOL, ALL ACTUAL TOTAL PRIN INDEX	(0.08%)	(0.24%)	(0.48%)	(0.97%)	(2.22%)	(2.95%)	(7.41%)	(9.49%)
POOL, LONG EQUAL TOTAL PRIN INDEX	(0.07%)	(0.21%)	(0.43%)	(0.81%)	(1.69%)	(2.04%)	(6.54%)	(8.74%)
POOL, LONG ACTUAL TOTAL PRIN INDEX	(0.07%)	(0.21%)	(0.42%)	(0.80%)	(1.64%)	(1.96%)	(5.99%)	(8.00%)
POOL, SHORT EQUAL TOTAL PRIN INDEX	(0.12%)	(0.33%)	(0.68%)	(1.48%)	(3.72%)	(5.29%)	(11.57%)	(14.60%)
POOL, SHORT ACTUAL TOTAL PRIN INDEX	(0.12%)	(0.34%)	(0.69%)	(1.50%)	(3.76%)	(5.34%)	(11.35%)	(14.16%)



"Forewarned, forearmed; to be prepared is half the victory."

Miguel de Cervantes

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## SMALL BUSINESS INDEXES...CONTINUED

END DATE: 01/31/2014	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	3.50%	10.63%	5.99%	(2.60%)	54.47%	383.01%	90.55%	422.87%
STRIP, ALL ACTUAL INDEX	3.59%	10.71%	6.91%	(1.43%)	56.90%	332.51%	61.76%	348.56%
STRIP, LONG EQUAL INDEX	3.62%	9.50%	10.77%	2.77%	76.86%	509.14%	182.34%	722.10%
STRIP, LONG ACTUAL INDEX	2.85%	8.46%	10.98%	2.99%	72.73%	384.35%	107.98%	504.64%
STRIP, SHORT EQUAL INDEX	3.26%	12.98%	(2.49%)	(11.89%)	22.06%	231.66%	6.59%	112.02%
STRIP, SHORT ACTUAL INDEX	5.14%	15.59%	(0.53%)	(9.35%)	32.67%	251.17%	14.11%	162.01%
STRIP, ALL EQUAL INCOME INDEX	1.01%	3.01%	6.36%	12.75%	67.56%	188.08%	658.43%	2,079.31%
STRIP, ALL ACTUAL INCOME INDEX	0.99%	3.01%	6.36%	12.70%	61.43%	147.81%	481.06%	1,553.14%
STRIP, LONG EQUAL INCOME INDEX	1.13%	3.39%	7.22%	14.85%	81.57%	253.63%	915.27%	2,870.74%
STRIP, LONG ACTUAL INCOME INDEX	1.13%	3.43%	7.29%	14.98%	73.48%	185.99%	597.44%	1,915.94%
STRIP, SHORT EQUAL INCOME INDEX	0.76%	2.23%	4.65%	8.90%	46.21%	115.49%	386.71%	1,163.29%
STRIP, SHORT ACTUAL INCOME INDEX	0.70%	2.12%	4.44%	8.38%	42.88%	103.03%	348.63%	1,062.27%
STRIP, ALL EQUAL PRICE INDEX	3.64%	11.01%	6.78%	(1.27%)	29.65%	203.92%	42.91%	147.60%
STRIP, ALL ACTUAL PRICE INDEX	3.65%	10.88%	7.21%	(0.91%)	34.61%	213.69%	48.79%	164.25%
STRIP, LONG EQUAL PRICE INDEX	3.44%	8.88%	9.40%	(0.60%)	24.47%	161.79%	34.77%	142.42%
STRIP, LONG ACTUAL PRICE INDEX	2.55%	7.59%	8.98%	(1.41%)	24.96%	152.62%	35.90%	148.91%
STRIP, SHORT EQUAL PRICE INDEX	4.04%	15.51%	2.26%	(2.44%)	38.42%	264.06%	57.24%	115.95%
STRIP, SHORT ACTUAL PRICE INDEX	5.99%	18.15%	4.20%	0.22%	52.20%	305.86%	69.47%	166.34%
STRIP, ALL EQUAL PREPAY INDEX	(0.68%)	(1.93%)	(4.07%)	(7.56%)	(16.05%)	(27.51%)	(71.77%)	(82.83%)
STRIP, ALL ACTUAL PREPAY INDEX	(0.62%)	(1.82%)	(3.76%)	(7.01%)	(15.18%)	(27.19%)	(70.14%)	(81.96%)
STRIP, LONG EQUAL PREPAY INDEX	(0.67%)	(1.91%)	(3.95%)	(6.94%)	(13.70%)	(22.67%)	(71.98%)	(83.21%)
STRIP, LONG ACTUAL PREPAY INDEX	(0.57%)	(1.76%)	(3.57%)	(6.28%)	(12.59%)	(21.86%)	(70.68%)	(82.60%)
STRIP, SHORT EQUAL PREPAY INDEX	(0.70%)	(1.99%)	(4.29%)	(8.68%)	(19.87%)	(33.94%)	(69.10%)	(78.67%)
STRIP, SHORT ACTUAL PREPAY INDEX	(0.73%)	(1.94%)	(4.13%)	(8.38%)	(19.40%)	(33.86%)	(67.62%)	(77.44%)
STRIP, ALL EQUAL DEFAULT INDEX	(0.14%)	(0.35%)	(0.85%)	(2.09%)	(6.32%)	(15.08%)	(27.67%)	(35.00%)
STRIP, ALL ACTUAL DEFAULT INDEX	(0.12%)	(0.32%)	(0.78%)	(1.92%)	(5.97%)	(15.10%)	(27.22%)	(34.69%)
STRIP, LONG EQUAL DEFAULT INDEX	(0.13%)	(0.33%)	(0.82%)	(1.87%)	(5.21%)	(11.93%)	(25.80%)	(33.53%)
STRIP, LONG ACTUAL DEFAULT INDEX	(0.11%)	(0.31%)	(0.73%)	(1.68%)	(4.79%)	(11.66%)	(25.25%)	(33.18%)
STRIP, SHORT EQUAL DEFAULT INDEX	(0.14%)	(0.39%)	(0.92%)	(2.47%)	(8.13%)	(19.26%)	(29.53%)	(34.99%)
STRIP, SHORT ACTUAL DEFAULT INDEX	(0.14%)	(0.36%)	(0.87%)	(2.37%)	(7.91%)	(19.32%)	(29.20%)	(34.55%)
STRIP, ALL EQUAL VOL PREPAY INDEX	(0.55%)	(1.58%)	(3.24%)	(5.59%)	(10.37%)	(14.61%)	(60.87%)	(73.49%)
STRIP, ALL ACTUAL VOL PREPAY INDEX	(0.50%)	(1.50%)	(3.00%)	(5.18%)	(9.78%)	(14.21%)	(58.87%)	(72.28%)
STRIP, LONG EQUAL VOL PREPAY INDEX	(0.54%)	(1.58%)	(3.16%)	(5.16%)	(8.94%)	(12.17%)	(62.13%)	(74.65%)
STRIP, LONG ACTUAL VOL PREPAY INDEX	(0.46%)	(1.46%)	(2.86%)	(4.67%)	(8.19%)	(11.52%)	(60.67%)	(73.86%)
STRIP, SHORT EQUAL VOL PREPAY INDEX	(0.56%)	(1.61%)	(3.39%)	(6.36%)	(12.75%)	(18.13%)	(56.06%)	(67.10%)
STRIP, SHORT ACTUAL VOL PREPAY INDEX	(0.58%)	(1.59%)	(3.29%)	(6.15%)	(12.45%)	(17.97%)	(54.17%)	(65.45%)
STRIP, ALL EQUAL SCHED PRIN INDEX	(0.44%)	(1.31%)	(2.61%)	(5.24%)	(15.17%)	(24.46%)	(36.84%)	(43.12%)
STRIP, ALL ACTUAL SCHED PRIN INDEX	(0.42%)	(1.24%)	(2.48%)	(4.99%)	(14.77%)	(24.20%)	(36.55%)	(42.73%)
STRIP, LONG EQUAL SCHED PRIN INDEX	(0.27%)	(0.82%)	(1.62%)	(3.19%)	(9.24%)	(15.35%)	(25.16%)	(31.34%)
STRIP, LONG ACTUAL SCHED PRIN INDEX	(0.26%)	(0.77%)	(1.52%)	(3.01%)	(8.77%)	(14.64%)	(24.00%)	(30.16%)
STRIP, SHORT EQUAL SCHED PRIN INDEX	(0.78%)	(2.31%)	(4.56%)	(8.98%)	(24.50%)	(36.69%)	(54.39%)	(63.23%)
STRIP, SHORT ACTUAL SCHED PRIN INDEX	(0.75%)	(2.24%)	(4.43%)	(8.74%)	(24.15%)	(36.36%)	(53.17%)	(62.25%)
STRIP, ALL EQUAL TOTAL PRIN INDEX	(1.12%)	(3.22%)	(6.59%)	(12.43%)	(28.84%)	(45.33%)	(82.25%)	(90.29%)
STRIP, ALL ACTUAL TOTAL PRIN INDEX	(1.04%)	(3.05%)	(6.16%)	(11.68%)	(27.76%)	(44.89%)	(81.13%)	(89.72%)
STRIP, LONG EQUAL TOTAL PRIN INDEX	(0.95%)	(2.71%)	(5.52%)	(9.93%)	(21.70%)	(34.59%)	(79.08%)	(88.52%)
STRIP, LONG ACTUAL TOTAL PRIN INDEX	(0.83%)	(2.52%)	(5.05%)	(9.11%)	(20.28%)	(33.34%)	(77.77%)	(87.89%)
STRIP, SHORT EQUAL TOTAL PRIN INDEX	(1.48%)	(4.27%)	(8.69%)	(16.95%)	(39.61%)	(58.31%)	(86.01%)	(92.23%)
STRIP, SHORT ACTUAL TOTAL PRIN INDEX	(1.48%)	(4.16%)	(8.41%)	(16.44%)	(38.97%)	(58.04%)	(84.94%)	(91.56%)



SB Indexes, LLC

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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.

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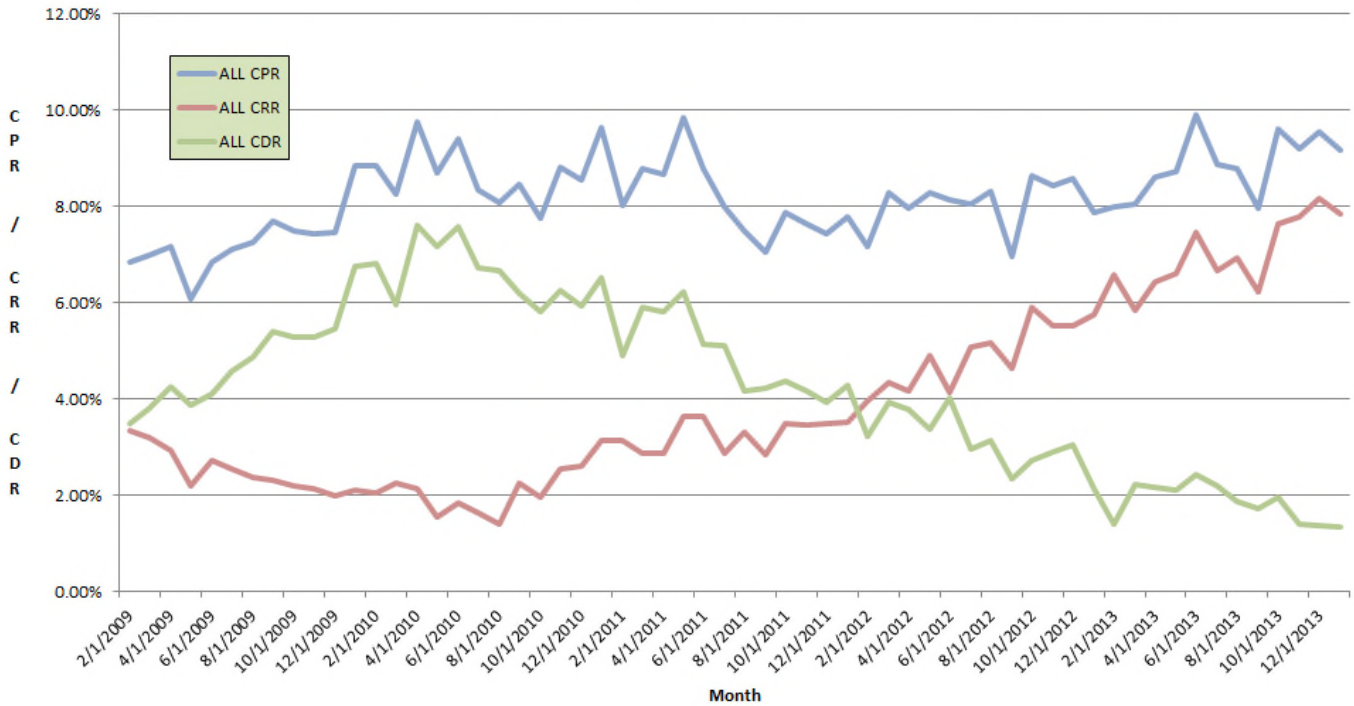


## 504 DCPC PREPAY SPEEDS - LAST 5 YEARS

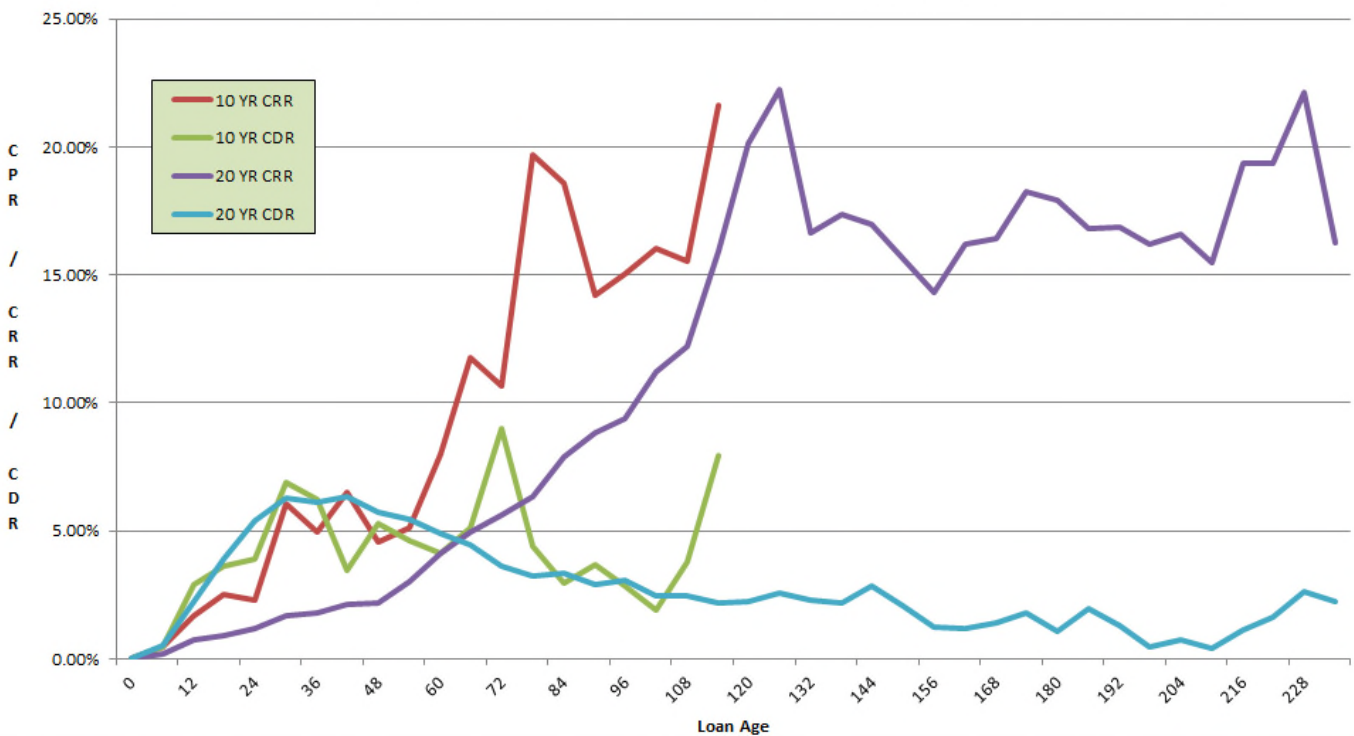
DATE	20 YR. CPR	20 YR. CRR	20 YR. CDR	10 YR. CPR	10 YR. CRR	10 YR. CDR	ALL CPR	ALL CRR	ALL CDR
2/1/2009	6.84%	3.35%	3.49%	NA	NA	NA	6.84%	3.35%	3.49%
3/1/2009	6.96%	3.15%	3.81%	7.80%	4.12%	3.68%	6.99%	3.18%	3.81%
4/1/2009	7.18%	2.93%	4.25%	NA	NA	NA	7.18%	2.93%	4.25%
5/1/2009	6.12%	2.24%	3.87%	5.07%	1.34%	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%
12/1/2013	9.55%	8.18%	1.37%	NA	NA	NA	9.55%	8.18%	1.37%
1/1/2014	9.46%	8.10%	1.36%	3.35%	2.57%	0.78%	9.18%	7.84%	1.33%

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

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



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





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## GLS 7(a) Settlement & Sales Strategies Tip #60 – Communication is the puzzle's last piece ...

When a lender uses an originate and sell approach to their SBA business model, it is absolutely critical that everyone involved in the process clearly understands the end goal.

Think of it like a giant puzzle...if even one piece is missing (the message in this case), you'll never see the whole picture. From the lending officer to credit, to sales administration and even the CFO, all employees involved in the process must not only understand the objective, but actively work towards the same goal. If things are communicated properly, the lending officer (along with credit) will strive to structure loans that not only meet the borrower's objective but deliver the best execution for the institution when sold in the secondary market.

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

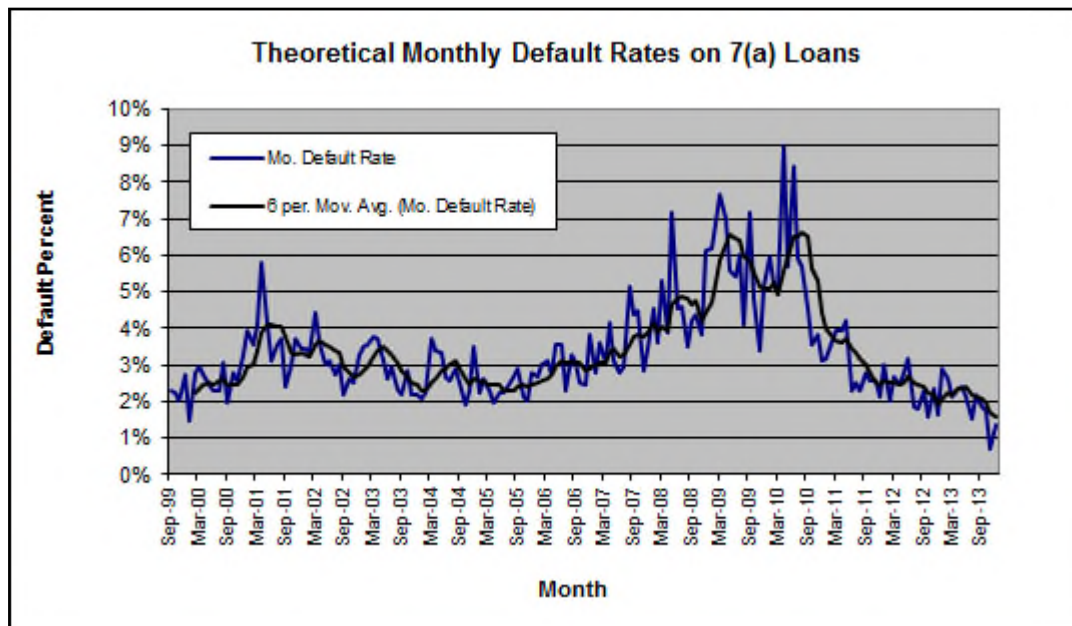
For further information, please contact Bob Judge at (216) 456-2480 ext. 133 or at [bob.judge@glsolutions.us](mailto:bob.judge@glsolutions.us)

## DEFAULT RATE OFF ALL-TIME LOW

In December, the theoretical default rate rose by 84% to 1.34% from the all-time low of 0.73% in November. While the percentage increase is high, this reading is still the second lowest on record, going back to 1999.

The fact that the default rate can rise by +80% and still be the second lowest in 16 years shows how low defaults are at this stage of the cycle.

For 2014, expect more sub-2% readings and perhaps another all-time low.



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.



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Louis Pasteur

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## DEFAULT-CURTAILMENT RATIOS

In our Default-Curtailment Ratios (DCR) we witnessed an increase in the 7a and a decrease in the 504 ratio 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 jumped back up to 19.83% from 9.66% in November. On a percentage basis this is a large rise, but since it is off the second lowest reading in 15 years, completely understandable.

The cause of the increase was higher defaults combined with lower voluntary prepayments.

Turning to actual dollar amounts, defaults rose by 83% to \$47 million from \$26 million. As for voluntary prepayments, they fell by 21% to \$188 million versus \$238 million.

### SBA 504 Default Ratios

This month, the 504 DCR fell another 6% to 14.00% from 14.91% previously. With defaults falling by a larger percentage than voluntaries, the ratio fell.

Specifically, the dollar amount of defaults decreased by \$3 million to \$31 million (-9%). As for voluntary prepayments, they fell by \$4 million to \$190 million (-2%).

### Summary

Another good month for both ratios that continue to print in the teens. Expect more such readings in 2014.

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 26

## GLS VALUE INDICES MIXED

In December, the GLS Value Indices fell in three out of six sub-indices, as secondary market pricing began to level off.

The Base Rate / Libor spread was unchanged at +3.02% while the prepayment element fell in 5 out of 6 categories.

By the end of December, the secondary market was about 1/4 point higher in all maturities, as we approached 118 in the long-end and crested 113 in the 10 year sector. While December also showed rising prices, the increase month-to-month has slowed down significantly.

Turning to the specifics, the largest decrease was seen in the GLS VI-5, which fell by 13% to 149 basis points. The other decreases, by order of magnitude, were: VI-4 (-9% to 166) and VI-3 (-.40% to 94).

As to increases, the largest rise was seen in VI-1, which increased by 23% to 95. The other increases, by order of magnitude, were seen in VI-2 (+2% to 110) and VI-6 (+2% to 162).

With 2013 in the books, we saw some significant swings in the index values, as the secondary market has swung from all-time highs in May to a 5% across-the-

board decrease in June and back to something in between by December.

With interest rates expected to increase this year, it will be interesting to track the secondary market price action, as well as the resulting index levels, in 2014.

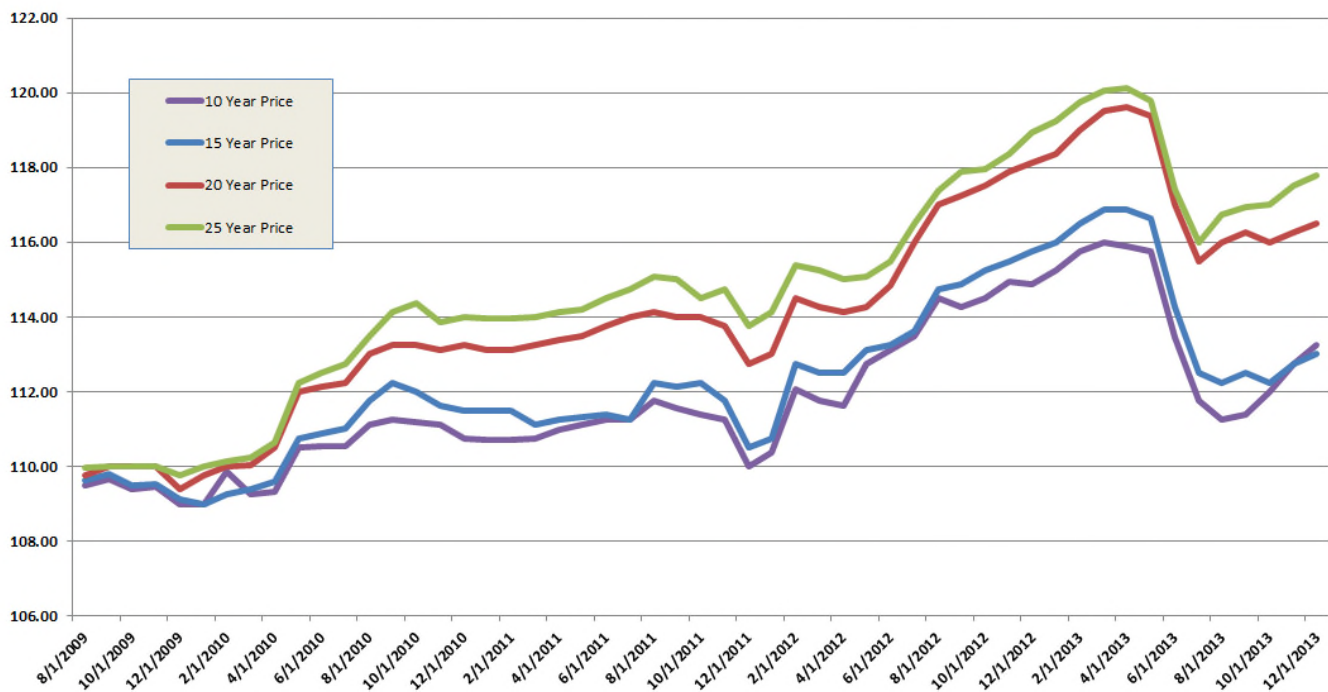
*For further information on the terminology and concepts used in this article, please refer to the "Glossary and Definitions" at the end of the report.*

*Data & Graphs on the following pages*

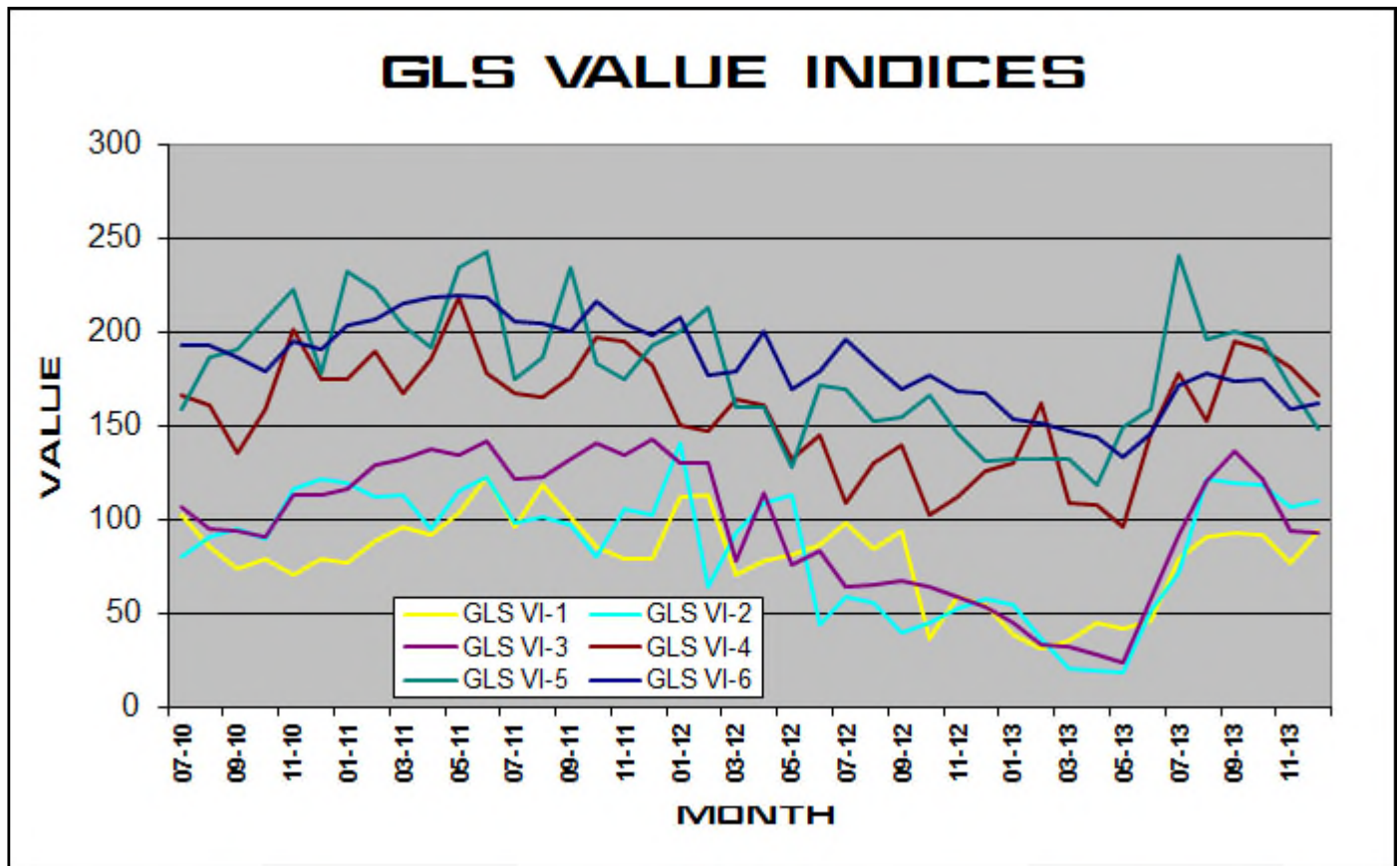
### 7(a) Secondary Market Pricing Grid: December 2013

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%	113.25	112.75	111.40	113.44	114.875
15 yrs.	2.75%	1.075%	1.00%	113.00	112.75	112.50	114.25	115.75
20 yrs.	2.75%	1.075%	1.00%	116.50	116.25	116.25	117.00	118.125
25 yrs.	2.75%	1.075%	1.00%	117.80	117.50	116.95	117.41	118.95

### CPR Report Secondary Market Levels



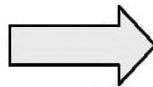
## GLS VALUE INDICES DECREASE



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*Typical  
Bank  
Report  
(Old)*

Pmpy Cust Number	Pmpy Cust Zip Code	Note Officer Name	Note Account Number	Note Bank Share Ledger Balance
12414	28449	MICHAEL SETZER	000010000171	2,350.53
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 1 CPR	BUCKET 2 CPR	BUCKET 3 CPR	BUCKET 4 CPR	BUCKET 5 CPR	BUCKET 6 CPR
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%
Nov-13	11.70%	8.32%	8.70%	6.10%	8.35%	6.91%
Dec-13	10.83%	7.39%	8.48%	5.75%	8.88%	6.75%

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	
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		
Nov-13	0.23%	3.25%	3.02%	77.0	107.5	94.2	182.1	170.8	159.2		
Dec-13	0.23%	3.25%	3.02%	94.9	110.1	93.9	166.2	149.1	162.4		

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

## YTD PREPAYMENT SPEEDS

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%
Nov-13	8.95%	6.39%	6.53%	3.98%	4.84%	7.80%	7.23%
Dec-13	6.41%	7.02%	8.17%	5.34%	9.99%	5.67%	6.50%
Grand Total	10.23%	8.76%	8.62%	6.00%	8.01%	6.35%	7.11%

2013 monthly prepayment speeds broken out by maturity sector. Source: Colson Services

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.
Nov-13	29 Mos.	39 Mos.	38 Mos.	67 Mos.	52 Mos.	49 Mos.	47 Mos.
Dec-13	28 Mos.	38 Mos.	38 Mos.	67 Mos.	53 Mos.	49 Mos.	47 Mos.

2013 pool age broken out by maturity sector. Source: Colson Services

## YEAR-TO-DATE CPR DATA

< 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%
Nov-13	14.15%	0.97%	12.62%	9.46%	5.33%
Dec-13	3.09%	6.40%	7.71%	10.95%	4.62%
Grand Total	7.45%	11.42%	13.34%	10.99%	8.74%

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%
Nov-13	2.42%	7.33%	9.83%	8.09%	6.52%
Dec-13	4.49%	11.74%	8.88%	13.92%	6.06%
Grand Total	4.11%	11.55%	12.56%	11.92%	6.97%

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%
Nov-13	0.00%	1.39%	12.18%	7.57%	4.15%
Dec-13	0.00%	25.54%	17.26%	1.72%	6.75%
Grand Total	0.88%	10.72%	17.66%	10.25%	5.90%

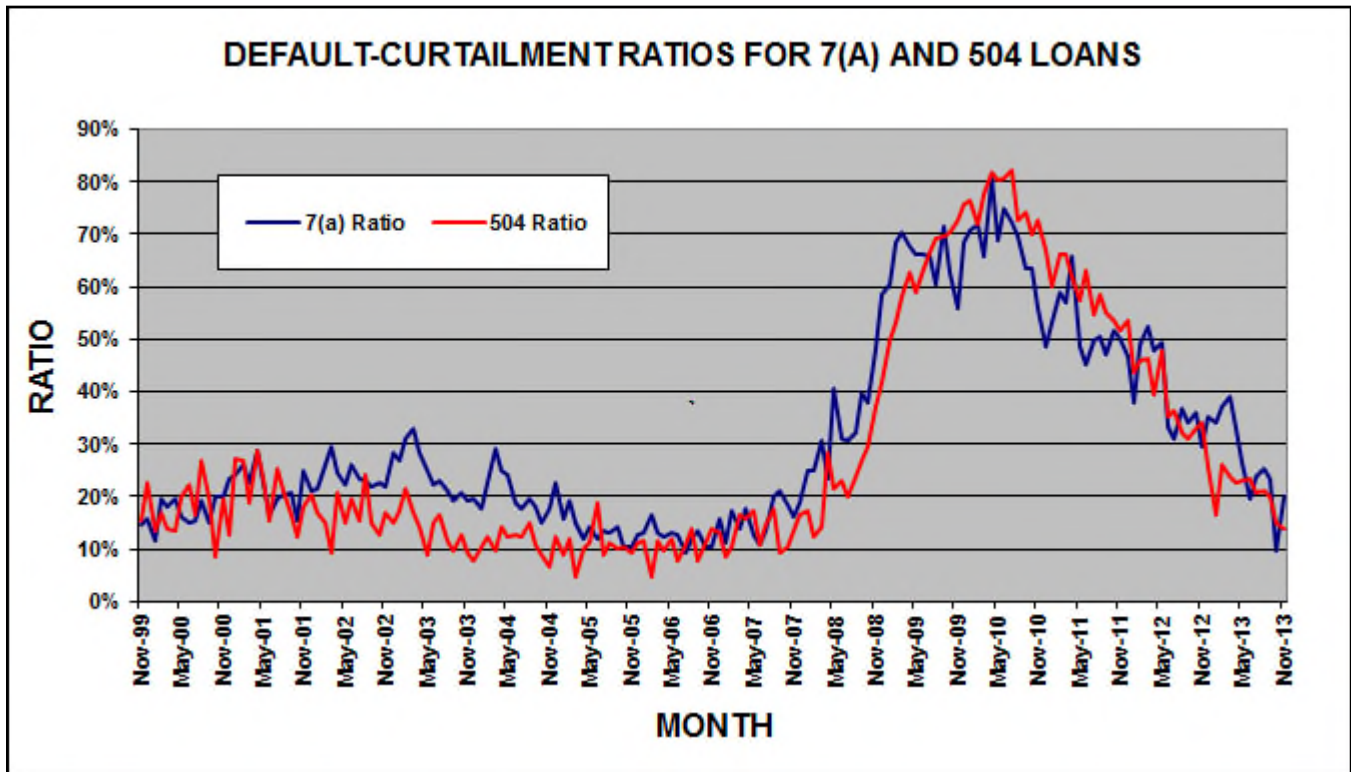


## YEAR-TO-DATE CPR DATA

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%
Nov-13	11.60%	4.54%	2.60%	2.76%	7.72%
Dec-13	6.49%	5.62%	8.38%	7.77%	7.17%
Grand Total	9.78%	12.08%	9.38%	5.84%	8.02%

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%
Nov-13	0.00%	12.39%	0.00%	11.83%	3.36%
Dec-13	0.00%	0.00%	18.23%	5.27%	3.17%
Grand Total	0.00%	5.72%	9.04%	9.77%	6.11%

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%
Nov-13	4.93%	6.61%	11.89%	11.38%	7.19%
Dec-13	2.08%	7.22%	9.24%	11.16%	4.02%
Grand Total	2.12%	6.81%	10.70%	10.52%	5.69%



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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.

---

### 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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