

COLEMAN REPORT

The SBA Lender's Industry Information Source

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Predicting Lender Success or Failure

Agency Moves to Shift from Compliance Reviews to Financial Risk Assessments

FT. WORTH, August 19--A four-year reorganization of SBA's approach to lender oversight is nearly complete, promising to fundamentally change the relationship between the agency and lenders, a key official in the reorganization said.

Sabelhaus on Political Stump Trail, 7-8

SBA Deputy Administrator Defends Bush Administration

Correctly scoring every 7(a) and 504 loan in a lender's portfolio is a key component of the agency's quest to monitor lenders' SBA loan portfolio.

"The emphasis has been getting a solid lender oversight framework in place, and we're pretty much there," **Janet A. Taskar** told attendees at SBA's Region VI Mid-America Conference.

Taskar joined SBA in September 2000 to lead the newly created Office of Lender Oversight, which implemented a risk-based approach to lender oversight and portfolio evaluation.

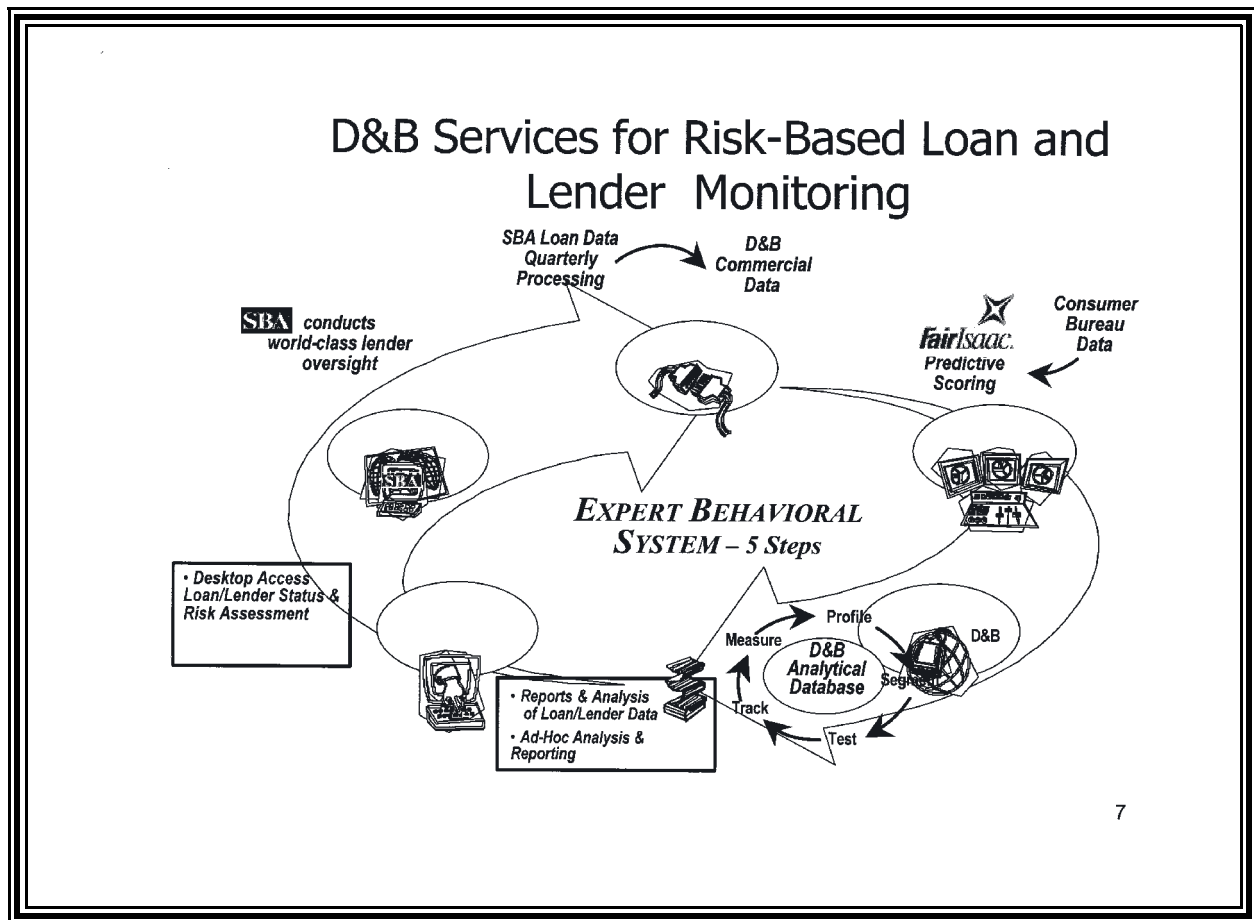
By contracting with Dun & Bradstreet, SBA has been able to implement a new system that offers significant enhancements.

The agency, with a full-year of data now compiled under the D&B contract will be conducting risk-based assessments of lenders.

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Taskar said the new system replaces a previous process that was compliance-based, static and offered a one-size-fits-all approach. The new oversight process allows the agency to conduct targeted reviews and to focus on financial risks.

The new system will allow SBA to do a credit score of its entire portfolio on a quarterly basis.

While SBA plans to review all of the lenders in its portfolio, it will target special attention on lenders with significant SBA exposure of \$10 million or more. Those lenders can ex-

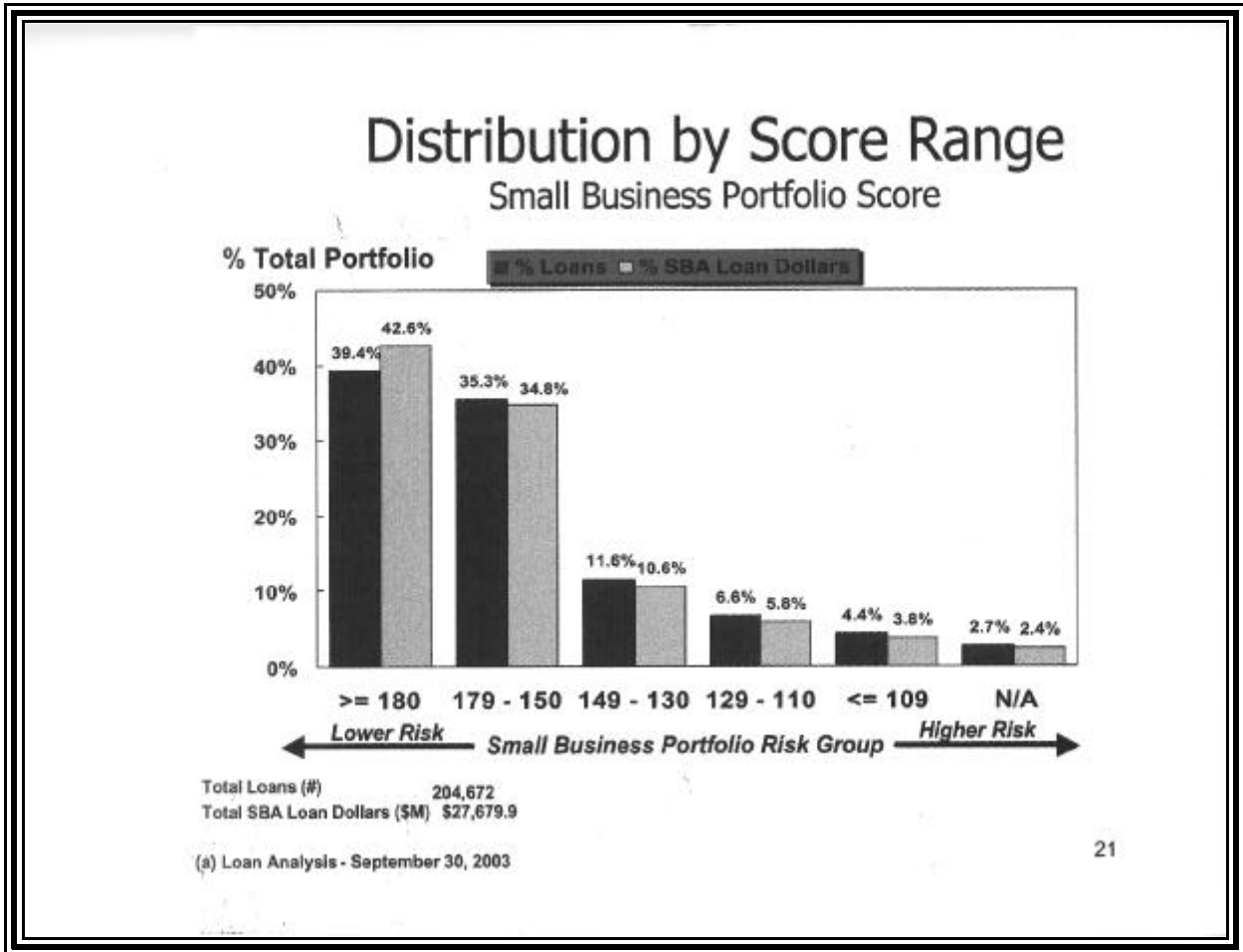
pect onsite monitoring lasting four to five days

“We want to know how they’re managing their SBA program,” **Taskar** said. “We can now look at trends and...give the lender a very clear picture of their portfolio.”

D&B Data

Under the D&B contract, SBA turned over its entire 7(a) and 504 portfolio databases. D&B added its data to the database, including information obtained from the borrower, as well as third party sources.

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Adding in consumer information on the principle or principles of the borrowing company from a separate contract with FairIssac, SBA has been able to develop blended scores ranging from zero to 300 on between 70 and 80 percent of its entire 7(a) and 504 portfolios.

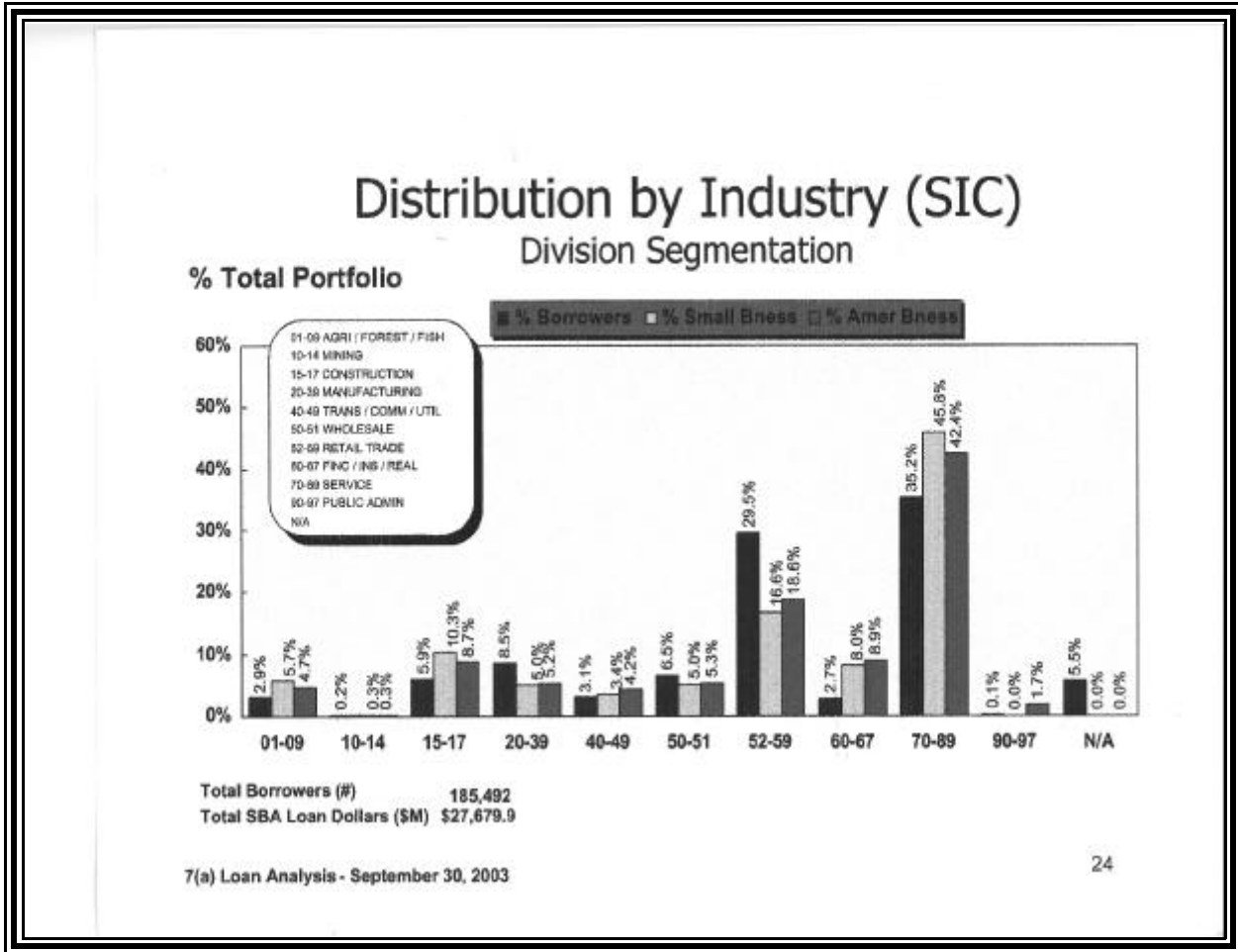
“These are not origination scores – they can find problems that might have come up after origination.” **Taskar** said. “It’s a proxy for us to start assessing the credit quality of SBA’s portfolio.”

Data Base Components

Using payment trends, public filings, consumer credit bureau scores, and consumer credit delinquencies provided by D&B, the system allows SBA to build models that can be used to predict which loans have the greatest chance of default over the next 18 to 24 months.

Loans with scores of 150 or lower are considered high risk, while scores over 180 indicate little risk.

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Taskar said its contract with D&B – which would prefer to sell information directly to lenders – does not allow SBA to share specific information with lenders, but SBA is allowed to alert lenders when loans they have made score under 150.

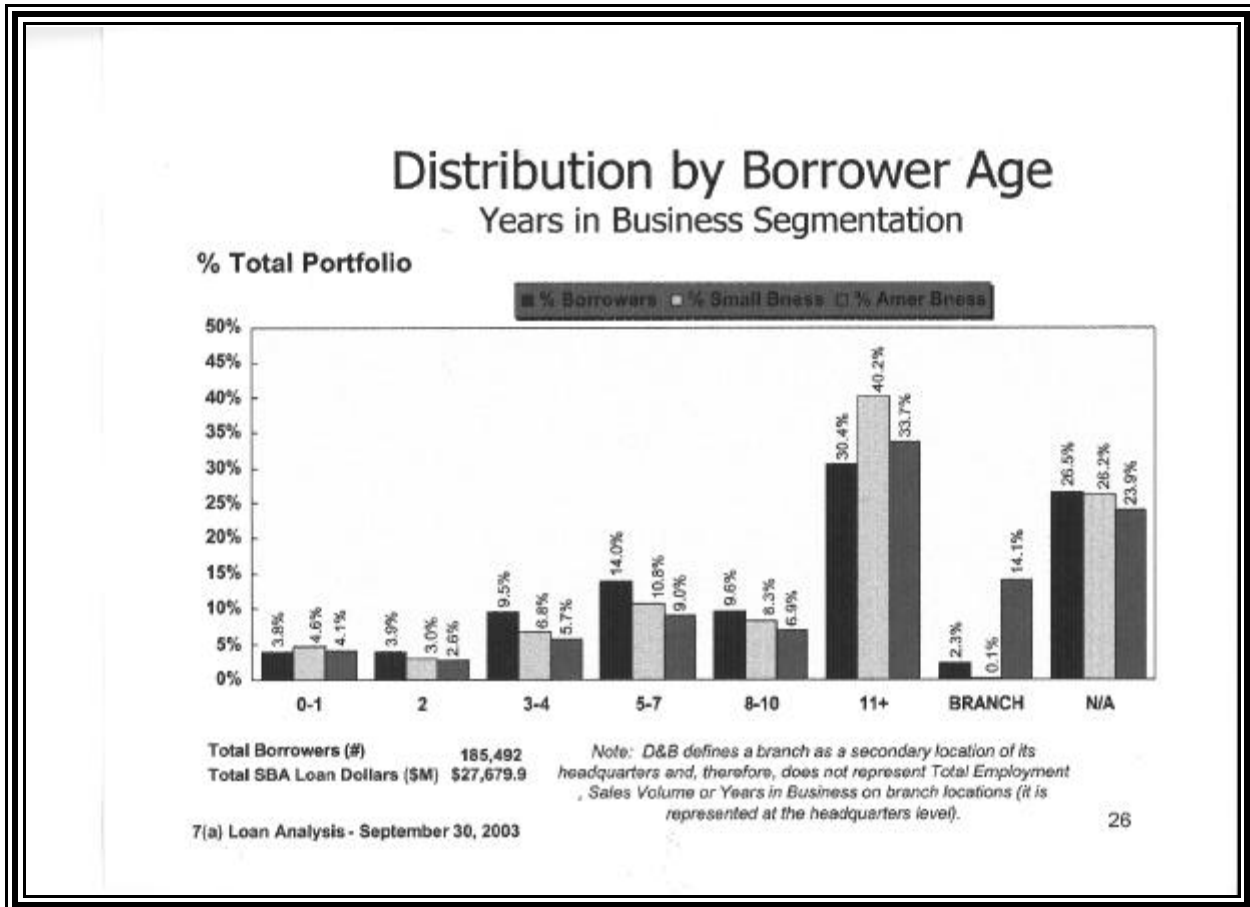
“This is not for us to come in and say you shouldn’t have made this loan,” she said. “We’re looking at the business as a whole. You may have a loan that’s performing perfectly and ask ‘how could it have a score of X?’ This is strictly a projected purchase

rate.”

Looking back, **Taskar** said, loans currently in default “clearly” had lower scores as calculated by the system. But she does not foresee SBA using the new oversight system to prevent lenders from making loans to certain industries.

She repeatedly stressed that the new system was aimed solely at getting a workable oversight framework in place.

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Review Process

One of the prime goals of the Office of Lender Oversight was to put less of an emphasis on oversight and to make it more of an operational review process.

In addition to onsite monitoring for larger lenders, the new system increases SBA's ability to do offsite monitoring of all lenders. SBA is also using the scores to compile lender rankings.

"We're trying to hit everybody the first time around," **Taskar** said. "What we wanted was a risk-based, efficient, least intrusive and completely integrated approach. We've really fundamentally changed the way SBA does oversight."

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7(a) High Level Profile Foundation for Loan Analysis

FILE RECEIVED	NUMBER OF LOANS OUTSTANDING		SBA SHARE LOAN DOLLARS OUTSTANDING	
Outstanding Loans*	219,789	100.0%	\$28,909.5	100.0%
LOAN ANALYSIS FILE				
Loans Matched to D&B File	215,599	98.1%	\$28,536.1	98.7%
Scored Loans (SBPS)	213,848	97.3%	\$28,166.5	97.4%
<i>Commercial</i>	16,497	7.7%	\$2,450.3	8.7%
<i>Blended - Derog</i>	64,273	30.1%	\$8,813.7	31.3%
<i>Blended - Non-Derog</i>	78,911	36.9%	\$10,999.3	39.1%
<i>Consumer - Derog</i>	25,338	11.8%	\$2,680.1	9.5%
<i>Consumer - Non-Derog</i>	28,829	13.5%	\$3,223.1	11.4%
INFORMATION DATES				
SBA Loan File	Mar-04			
Scores and Demographic Data	Apr-04			

* Requires Outstanding Loan Status and \$1+ SBA Share Dollars

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How it Works

Lenders selected for on-site reviews will receive six to eight weeks advance notice.

The size of the SBA team conducting the review will depend on the activity and portfolio size of the lender.

Review categories include portfolio analysis and performance, management and operations, credit administration (including origination and processing, servicing, and work-outs and liquidation) and compliance.

With the implementation of its new, lender monitoring services, SBA will become the first federal government agency to adopt such an approach for measuring and monitoring credit risk.

Before joining SBA, **Taskar** worked at HUD managing the mission oversight activities of Fannie Mae and Freddie Mac, including establishing and monitoring their affordable housing goal performance.

An implementation date has yet to be announced.

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SBA Deputy Administrator Says Transformation is on Track

SAN DIEGO--SBA Deputy Administrator **Melanie Sabelhaus** came to San Diego last month to present an update on the economy and the SBA's transformation program to more than 100 local lenders.

Sabelhaus said President Bush's economic policies were responsible for a "robust economy that's happening across the country. The economy is attributed to small businesses having more of their own money in their own pocket so they can spend it," **Sabelhaus** said.

The administrator defended the SBA's transformation program that has shifted resources and jobs away from district offices to centralized facilities, like the Herndon, Virginia, facility that will eventually handle all loan liquidation functions.

"We will have all 68 district offices on board by September, and the backlog (of cases) is close to being eliminated," she said. "Like any new process there are things we need to do better, but what we're seeing is improved turnaround. Any time you change something in the U.S. government it's like a Mack

truck being turned on a dime."

With the eventual moving of administrative functions to centralized offices, **Sabelhaus** said the district offices will be able to concentrate on "mar-

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Melanie Sabelhaus
SBA Deputy Administrator

keting and outreach, and not sitting with files up to here."

SBA San Diego District Administrator **George Chandler** said the new emphasis on training and outreach is going "all the way to the branch level, because typically the branches don't know as much as they can benefit from."

Sabelhaus also defended the administration's plan to eliminate the "one percent subsidy" by raising fees to lend-

ers and borrowers, starting in September. She said the one percent subsidy was a "huge" part of the SBA budget or more than \$600 million per year.

"We never want to have to look at small business and say we don't have the appropriation for you," **Sabelhaus** says. "We want to have a program that we can count on."

In July, the Republican controlled House of Representatives voted to add \$79 million to the 7(a) subsidy rate, against the administration's wishes.

On July 15, in *Congressional Record* remarks, House Small Business Chairman **Donald Manzullo** said, "Increasing fees on small business borrowers and lenders, particularly as interest rates are rising again, puts another barrier in access to capital and crimps our national economic recovery."

Complicating the situation, the House Appropriations Committee voted in June to eliminate funding for the 7(a) subsidy, supporting the administration's position.

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If the fee increase becomes a political football, it could affect funding for the 7(a) program, because the SBA may have to operate under a continuing resolution.

This could lead to a cap in 7(a) funding that would jeopardize operation of the program.

Sabelhaus acknowledged the opposition to the fee increases and the 7(a) zero subsidy, and added, "7(a) ran out of money because we had no appropriation.

The way Congress works, there's the authorizers (i.e., the small business committee) and the appropriators that actually give you the money.

"There are rules about how you can spend money in a continuing resolution," **Sabelhaus** said. She suggested that the agency's administrators could have gone to jail had they continued to grant loans after the funding had run out.

Chandler also defended the fee hikes. "Going back 20 years, we did 100 loans and now we're doing a thousand loans (in San Diego): fees didn't slow down the lending."

Asked about the wisdom of potentially alienating a lender community that tends to favor conservative candidates, **Sabelhaus** said, "There's no

There's no political ideology in how to run this program

Melanie Sabelhaus
SBA Deputy Administrator

political ideology in how to run this program."

After the September 2003, layoff of more than 200 employees, which was later reversed, agency morale was said to be in decline. Asked if morale is still a problem, **Sabelhaus** deferred to **Chandler**, who said, "Mine is good and the staff's is good."

Chandler added that the San Diego office, which once employed 40, is down to 14 employees, but said "I think we'll get additional people.

We've been doing more with less for over 20 years," he said. "In 1981, we did 120 loans with 40 people, this year with a staff of 14, we'll do 1,300 loans."

Sabelhaus talked up the agency's recent effort to partner with private sector companies such as **IBM**, **Office Depot**, **HP**, and **Best Buy**, with seminars where applicants can apply for loans and buy office equipment or other services.

"The bottom line is this: what we're doing right now is running the federal government like a business and demanding a return on our investment," **Sabelhaus** concluded.

Congress is expected to vote on the subsidy before going into recess this month.

Any differences in the House and Senate legislation would be resolved in a conference committee.

If President Bush does not sign the resulting bill before Oct. 1, the SBA would have to operate under a continuing resolution, and uncertainty.

