

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.

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INSIDE THIS ISSUE:

Special points of interest:

- SBA Libor Base Rate
- TALF: Will it Help?
- FASB 140 Proposed Changes
- Prepays Rise Slightly

Libor Base Rate	1, 4 & 7
TALF	1, 8 & 16
November CPR	2
Sale & Settle Tip	2
FASB 140 Changes	3 & 14
GovGex Corner	4
Value Indices	9 & 11-13
Default Rate	10
Default Ratios	10 & 17

THE NEW SBA LIBOR BASE RATE: SHOULD YOU SWITCH?

By Bob Judge

Now that the new **SBA Libor Base Rate** is effective, should you move your loan production away from Prime?

To begin, let's review the basics of the new peg rate:

1. The **SBA Libor Base Rate** is calculated on the first business day of the month utilizing 1-month Libor plus 3%
2. The SBA's maximum 7(a) interest rate continues to apply. 2.25% above the base rate for maturi-

ties under 7 years and 2.75% for loans greater than 7 years. Rates of 2% higher for loans less than \$25K and 1% higher for loans between \$25K and \$50K also still apply.

What are the advantages of Libor over Prime as the basis for a peg rate?

Most SBA pool investors fund themselves at a spread to Libor.

For many years, the Prime/Libor spread stayed within a very narrow range. Spread differ-

ences would occur when Libor would rise or fall in anticipation of a change in the Fed Funds target rate. Since the Prime Rate is currently set at the Fed Funds target rate plus 3%, the market would experience short time periods of varying spreads between Libor and Prime. Up until recently, Libor would always converge with the Fed Funds target after the expected rate action occurred.

Due to this expected convergence, investors did not see the Prime/Libor

Continued on page 4

TALF: WILL IT HELP? SOME PRELIMINARY THOUGHTS...

By Bob Judge

In this space, I originally had written an editorial about the likelihood of a government intervention into the 7(a) secondary market. As luck would have it, just prior to publishing

this month's report, the Fed, Treasury and SBA announced the **Term Asset-Backed Securities Loan Facility**, or TALF.

Since the government has decided to intervene in the

Continued on top of page 8

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NOVEMBER CPR: PREPAYS RISE SLIGHTLY TO CPR 10.85%

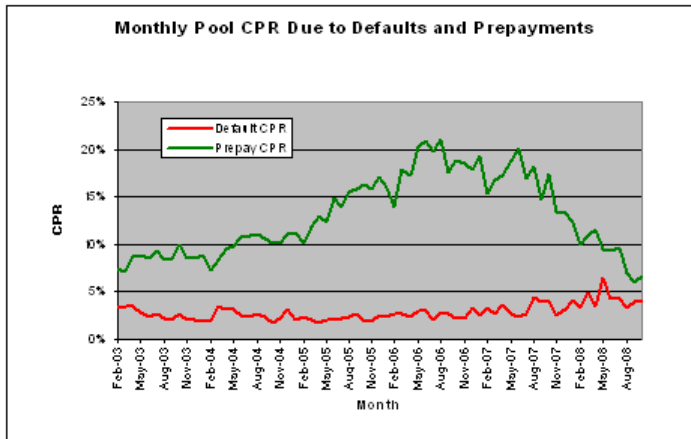
For the third month in a row, prepayment speeds on SBA pools recorded a sub-11% overall CPR.

Continuing the trend from last June, CPR due to voluntary curtailments (VCPR) continues to fall, bringing overall CPR to levels unseen in the last four years.

Last month, the VCPR continues to remain under CPR 7%, with a reading showing a small uptick to CPR 6.72% from CPR 6.01% in October.

Prepayments due to default (DCPR) increased slightly, which was not unexpected considering the current economic conditions, to CPR 4.13% from CPR 3.99%.

Turning to last month's data, four out of six sectors displayed increasing prepayment speeds, led by the 8-10 sector increasing by 48.64%. While that is a significant increase, this sector has shown a great deal of volatility over the past few months with



20%+ monthly changes not unusual.

The bellwether long sector increased by 9.58% to CPR 11.09% from CPR 10.12% in October.

The largest decrease was seen in the 16-20 year sector, which fell by 10.62% to CPR 9.38%, the second lowest reading of the year for this maturity group.

Overall, the current prepayment story remains very similar

to what we have been saying for the past six months. Slowly increasing defaults combined with rapidly falling voluntary curtailments leading to lower overall pool prepayment speeds.

As for the future, we see more of the same.

Data on pages 13-14

“In order to achieve a reasonable return, investors either required a larger net margin, or a lower price, on the Prime-based pools they were willing to purchase.”

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GLS 7(A) SALE & SETTLEMENT TIP OF THE MONTH
BY SCOTT EVANS

Settlement and Sales Strategies Tip #4 – Check your data, then check it again...

Double check the information on your settlement documents and cross reference them before sending onto the FTA. This may seem obvious but is often skipped, leading to much longer settlement times, costs and headaches to the selling institution. Look for simple mistakes of omission or inconsistencies between data that appears in multiple places such as the 529 Authorization and 147 Note.

This easy step takes only a few minutes but can save days or even weeks on your loan settlements.

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

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PROPOSED CHANGES TO FASB 140: COULD HURT 7(A) GUARANTEED LOAN SALES

By Bill McGaughey

On September 15, 2008 the Financial Accounting Standards Board issued an exposure draft "Proposed Statement of Financial Accounting Standards, Accounting for Transfers of Financial Assets, an amendment of FASB Statement No. 140." ("Proposed Statement") The Proposed Statement expands the definition of a participating interest. If the transfer of a portion of an individual financial asset meets the definition of a participating interest, the lender will treat the transaction as a sale. If the transfer does not meet the definition, the transfer will be treated as a secured borrowing.

The Proposed Statement states "A participating interest has the following characteristics:

1. It represents a **proportionate ownership interest** in an entire individual financial asset...
2. All cash flows received from the asset are **divided among the participating interests in proportion** to the share of ownership represented by each...
3. The **rights of each participating interest holder have the same priority**, and that priority does not change in the event of bankruptcy or other receivership ... Participating interest holders have no recourse...
4. No party has the right to **pledge or exchange the entire financial asset.**"

The above characteristics create some possible challenges to lenders who sell the guaranteed portions of SBA 7(a) loans.

- The payment of the guarantee by the SBA to the buyer of the guaranteed portion in the event of a default by the borrower could be considered a **priority distribution (violates bullet point 3 above)**.
- Also, if the loan is sold for a premium, the warranty period requirement for the lender to rebate the premium if the loan is prepaid during the first 90 days after the sale or if the borrower misses one of the first three payments after the sale and subsequently defaults on the loan within 275 days, could be considered **recourse**.

Continued on bottom of page 14

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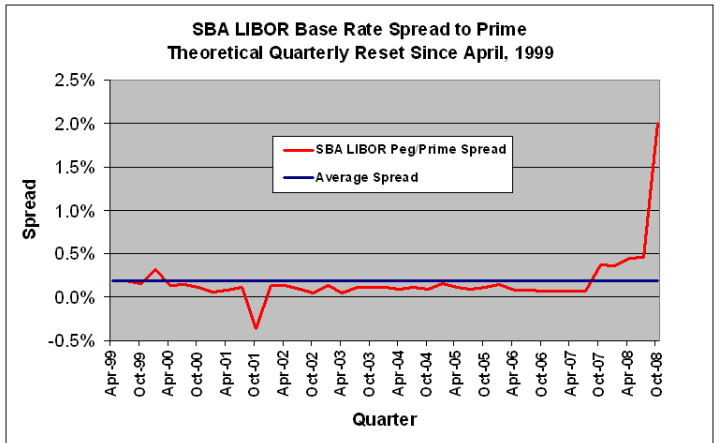
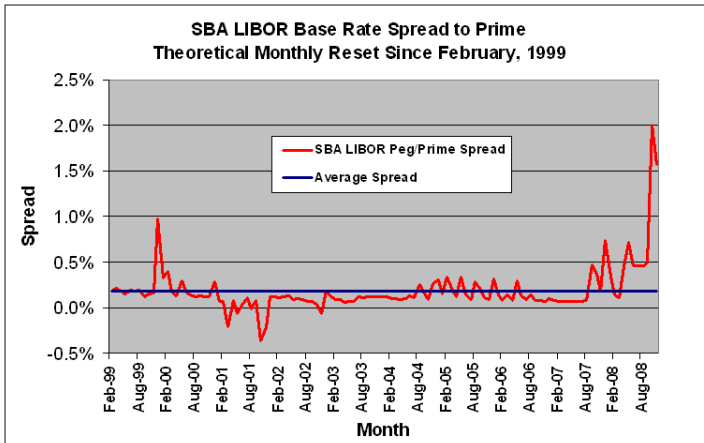
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SBA LIBOR BASE RATE...CONTINUED

Graph 1:

Graph 2:



spread as a potential risk to investing in SBA pools.

Since they did not perceive a risk, they did not expect a yield premium for owning floating-rate SBA pools. In trading parlance, this type of risk is referred to as “basis risk”.

Beginning on August 8th, 2007, investors began to get an education in the risks inherent in the Prime/Libor relationship. As Libor rose in relation to Prime, the spread earned by a Libor-funded investor contracted, and even turned negative for a period of time in early October, 2008.

In order to achieve a reasonable return, investors either required a larger net margin, or a lower price, on the Prime-based pools they were willing to purchase.

For the past 14 months, this “basis risk” has been a major contributor to the difficulties facing the pool assembler community in finding buyers for their Prime-based loan and pool inventories.

By removing the “basis risk” Libor-based pools are more attractive to investors.

A pool that is indexed to the SBA Libor Base Rate removes the basis risk of owning float-

ing-rate SBA pools for Libor-funded investors. When you make an investment less risky for an investor, it stands to reason that they would be willing to pay more for it, in the form of a lower net margin or a higher price, all else being equal.

While there are other considerations for investors in determining a bid price, such as trading levels of alternative investments, Libor-based pools are a welcome development in the SBA industry.

Let’s assume for the moment that the SBA Libor Base Rate has existed since January, 1999. If that were the case, how would the monthly and quarterly resets compare to Prime over the past ten years?

A monthly-reset based on 1-month Libor + 3% would exceed Prime 95% of the time over the past 10 years.

During the past 118 months, Prime exceed 1-Mo. Libor +3% only six times. Five of the six occasions fell between March, 2001 and November, 2001.

What was occurring in the economy during this time-frame? According to the National Bureau of Economic Research, the US was in recession

for those eight months (in fact, the entire recession was dated from 3/01 to 11/01). As is the case in recessions, the Federal Reserve loosens monetary policy and decreases interest rates to stimulate the economy. The 2001 recession was no different.

During the eight months of the recession, the Prime Rate fell from 8.5% to 5%. Prior to the first rate cut on 3/21/01, 1-Mo. Libor actually began to fall on 2/19/01, almost a full month prior to the actual rate cut.

Since Libor was falling in expectation of a rate cut, the Prime/Libor spread widened to 321 basis points by 3/1/01, the date a monthly pool would be reset. In this case, a pool indexed to 1-Mo. Libor + 3% would have had a lower peg than Prime by 21 basis points.

By the date of the first cut, the Prime/Libor spread had moved down to 294 basis points, or 7 bps above it’s historical spread. This process of anticipating rate cuts would repeat itself over the subsequent seven rate cuts.

The final month of Prime exceeding 1-Mo. Libor + 3% was in November, 2002. This period was a continuation of the Fed rate cutting that began in

2001 and followed a similar pattern of decreasing Libor in expectation of a Fed rate cut.

The average difference between a 1-Mo. Libor +3% and a Prime monthly reset was 18.9 basis points, in favor of Libor.

Let’s now turn to an examination of quarterly resets over the past ten years.

A quarterly-reset based on 1-month Libor +3% would exceed Prime 97% of the time over the past 10 years.

Since February, 1999 we have witnessed 39 quarterly resets. In only one quarter would a Prime reset exceed a 1-Mo. Libor +3%.

Not surprisingly, the one quarter was during the 2001 recession and occurred on 10/1/2001. Again, Libor ran ahead of the Fed and anticipated the subsequent rate cut that occurred on 10/3/01.

The average difference between a 1-Mo. Libor +3% and a Prime quarterly reset was 18.1 basis points, again in favor of Libor.

Over the past ten years, resets utilizing 1-Mo. Libor +3% also

Continued on top of page 7

THE GOVGEX CORNER

Three-month trailing average for high bids: September-October-November 2008

Maturity	Prime + 1%	Prime + 2%
10 years	101.80	103.32
25 years	101.41	102.36

In November a record number of Lenders leveraged **GovGex's** large network of buyers – with an 85% increase in the number of loans for sale this month over last. Sellers are turning to **GovGex** to reach as many buyers as possible. Buyers continue to be selective as the credit crisis continues...

On any given week, for any given loan, a seller may receive bids from different Buyers. Real bidding per loan continues to remain soft, with the active bid to pass ratio at 1:10.

The three-month trailing average for high-bid now fully reflects the credit-crisis which took full effect in September. Though actual sales at these bid levels remain low, loans are still being closed at these levels, offering tremendous buying opportunities for some.

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SHOULD YOU SWITCH?...CONTINUED

offer a rate advantage to investors, as well as offsetting the basis risk between Prime and Libor.

Other thoughts on how to increase the value of SBA loans.

I believe that monthly SBA Libor Base Rate resets will be more popular than quarterly resets. Investors, would fund themselves on a daily basis to Libor, prefer more frequent resets to offset the risk of rate movements between reset dates. Once again, lower risk equates to more value to investors.

Secondly, more frequent resets are beneficial to investors during periods of rising interest rates. Since the current Fed Funds target rate equals the all-time low of 1%, we haven't much further to fall and eventually, rates will begin to rise.

Lastly, lenders should continue the trend toward higher borrower margins. Credit spreads throughout the economy are at all-time highs and SBA loans should not be any different. With access to credit being more of an issue than the cost, borrowers should be cognizant of the fact that they are receiving a very competitive rate, as compared to borrowing costs for non-SBA borrowers.

Conclusion

While we believe that lenders should move toward originating loans that float off of the new Libor peg rate, this change will not fix the secondary market all by itself.

The overhang of large pool assembler inventories, combined with historically high credit spreads for competing asset classes, is weighing heav-

ily on the secondary market. Once these issues have been worked out and a critical mass of Libor loans have reached the secondary market, the qualitative advantages of Libor-based lending will lead to higher premiums over their Prime equivalents.

Editor's Note: Please take the time to vote on your intentions relating to the new Libor peg rate. The poll is confidential and the link can be found on the lower portion of our website (www.glsolutions.us), in the CPR Report section.

For further information on the analysis, please refer to the "Glossary and Definitions" at the end of the report.

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TALF...CONTINUED

SBA market and made my analysis moot, I have chosen instead to provide a preliminary analysis of what the TALF could mean to the SBA lending industry.

To begin, let's review what we do know about the TALF:

1. TALF is a Federal Reserve credit facility that will provide up to \$200 billion in loans, fully secured by AAA-rated asset-backed securities (ABS), including SBA pools, to eligible investors.
2. The US Treasury will provide \$20 billion of credit-protection to the Federal Reserve.
3. Eligible Collateral must be: **"...all or substantially all of the credit exposures underlying eligible ABS must be newly or recently originated exposures to US-domiciled obligors."** What this means is that the loans inside the securities must be relatively new.
4. All US persons (citizens, businesses) can participate in TALF.
5. Eligible collateral must not be backed by loans originated by the borrower, or by an affiliate of the borrower.
6. TALF loans will have a one-year term with monthly interest payments and will be non-recourse, meaning that the Fed cannot seek out further compensation from the borrower beyond the value of the underlying collateral.
7. The term of the TALF loan may be lengthened later, if appropriate.
8. TALF loans will not be subject to mark-to-market or re-margining requirements. What this means is if the value of the underlying ABS decreases during the loan term, the borrower does not have to put-up more funds to maintain the TALF loan.
9. "Haircuts", or the capital requirement from the borrower, will be determined by the Fed based on the price volatility of the asset used to secure the TALF loan.
10. TALF loans will be awarded on a monthly-basis, using a sealed bid auction process.
11. The Fed will assess a non-recourse loan fee at the inception of the transaction.
12. Originators of the credit exposures underlying the eligible ABS must comply with executive compensation standards consistent with the US Treasury's TARP program.

The important thing to remember here is that SBA pools are eligible as collateral for one-year term loans from the Fed. Each investor wishing to access the TALF must bid for the loans on a monthly basis.

What we don't know is:

1. What **"newly or recently originated..."** (bullet point 3, above) means in terms of an initial cut-off

date for loans and/or pools. This is important because it will tell us which existing loans and pools are TALF-eligible and which are not.

2. Are all **"US persons"** truly eligible, including pool assemblers and lenders? Bullet point 4, above, suggests limitations on this possibility.
3. **Due to the one-year term, what happens if the TALF borrower cannot line-up new funding after the loan term expires?** I inquired with the Fed on this question and received the following response:

"Thank you for your recent inquiry regarding terms and conditions of the Term Asset-Backed Securities Loan Facility.

The terms and conditions are

subject to change based on discussions with market participants in the coming weeks.

Under a non-recourse loan, if the borrower does not repay the loan for any reason, the Federal Reserve will take the collateral instead. Since no new loans will be made after the end of 2009, there does not appear to be much scope for rolling over or extending loans at the end of the one-year term."

In other words, the Fed will take the collateral if the investor cannot, or will not, pay back the loan.

4. **What haircut will apply to SBA pools?** If the Fed takes the collateral because the investor can't, or won't, it suggests that the collateral is worth less than the outstanding balance of the TALF loan.

Continued on bottom of page 16

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VALUE INDICES FALL DRAMATICALLY IN OCTOBER

Due to the historic rise in Libor rates in October, The GLS Value Indices fell into the negative spread to Libor range for all but one of the six components.

The only component that stayed in positive spread territory was the GLS VI-1, which represents loans with maturities of less than 8 years, and registered a meager +2.3 basis points spread to Libor in October.

Turning to the impact of the rise in Libor rates, the trade weighted average spread between Prime and Libor was 12 basis points in October, an astounding 188 basis point decrease from the previous low of 200 bps, registered the previous month. To review, the more narrow the spread between Prime and Libor, the lower the Libor spread for Prime-based SBA loans trading in a particular month. The lower the Libor spread, the lower the indices,

since they are meant to measure the weighted average Libor spread for loans trading in the secondary market, broken out by maturity and month of execution.

The carnage was wide ranging, with all components falling between 73% and 160%. The VI-6, which measures 20+ maturity loans, fell by 114% to -12.9 basis points from +94.2 bps. The largest decrease was seen in the VI-5 (16-20), which fell by 160% to -51 bps from +85.2 bps.

While prices remained low in the secondary market, they were not low enough to offset the Libor spike. The secondary market correctly perceived that this spike would be short-lived and unsustainable, as Libor began its correction in mid-October.

As for the prepayment element of the index, it continued to fall, helping the overall

yield on loans trading at a premium. However, nothing could overcome the sudden move in Libor rates in October.

In November, we expect the indices to rebound, since Libor has recovered much of its October spike, prepayments remain subdued and secondary market prices continue to remain low.

For further information on the GLS Value Indices, please refer to the "Glossary and Definitions" at the end of the report.

Data on pages 11-12, Graph on page 13

7(a) Secondary Market Pricing Grid: October 2008

Maturity	Gross Margin	Fees	Servicing	10/31/2008 Price	Last Month Price	Net Margin
10 yrs.	2.00%	0.6750%	1.0000%	102.25	102	0.325%
15 yrs.	1.50%	0.6750%	1.0000%	101.75	101	-0.175%
20 yrs.	1.50%	0.6750%	1.0000%	101.50	102	-0.175%
25 yrs.	1.50%	0.6750%	1.0000%	101.50	102	-0.175%

Content Contributors

The editors of the "CPR Report" would like to thank the following secondary market participants for contributing to this month's report:



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DEFAULT RATE RISES SLIGHTLY TO 4.39%

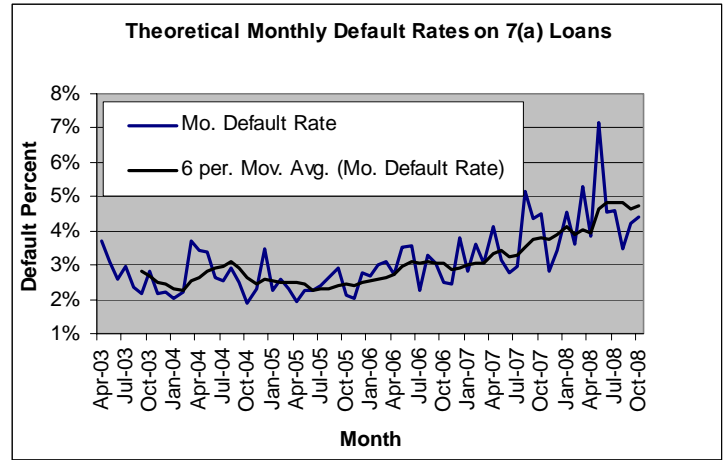
Last month, the 7(a) default rate rose slightly to 4.39% from 4.23% in October.

Considering the current dire economic circumstances in the US, this small uptick is more than acceptable, but also not likely to remain as muted in the near future.

As economic conditions continue to worsen, we would expect the default rate to exceed the high of 7.17% recorded in May sometime within the next six months.

Turning to the actual data, the dollar amount of defaults was \$91.2 million, down slightly from \$92.1 million. While the dollar amount of defaults actually fell, the default rate rose due to a lower assumed balance of outstanding loans, as estimated from SBA pool data.

The bottom line is that the default rate continues to be surprisingly low, but we feel that this reprieve will be short-lived.



Expect higher defaults in the future and be thankful for any month that show below record numbers.

DEFAULT RATIOS: 504 DEFAULTS SET NEW RECORD

November default ratios continue the trend of recession-level readings of 30%+ for 7(a) and 20%+ for 504 loans that began in May of this year.

The 7(a) default ratio moved down slightly to 38.05% from 39.90% in October while the 504 default ratio set another record, hitting 29.52%.

Below we attempt to analyze these results:

SBA 7(a) Default Ratios

For the sixth month in a row, the 7(a) default ratio exceeded 30%, well above our recessionary hurdle rate of 20%.

The dollar amount of defaults fell slightly to \$91.2 million from \$92.1 million in October while voluntary prepayments rose by \$10 million during the same period.

The slight fall in defaults, in combination with a small uptick in voluntary prepayments, decreased 7(a) default ratio by 4.65% in November.

As stated previously, the combination of high defaults and low voluntary prepayments add up to high default ratios and weakness in the 7(a) small business sector.

SBA 504 Default Ratios

For the seventh month in a row, the 504 default ratio came in above 20%, which is our threshold for recessionary conditions in the 504 small business sector.

The 29.52% default ratio represents a ten-year record, which also happens to be the extent of our database. The dollar amount of defaults was \$45.7 million, also the highest on record.

As with 7(a) loans, 504 loans continue to suffer the ill-effects of the US recession.

Summary

The current economic environment continues to take its toll

Graph on page 17

on the 7(a) and 504 loans. Default ratios continue to be elevated with the actual dollar amount of defaults at, or near, all-time highs. Additionally, there is no reason to believe that any relief is in sight as the recession continues to deepen.

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NEW 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
May-05	15.18%	14.94%	14.38%	11.67%	13.67%	13.65%
Jun-05	15.62%	15.50%	13.99%	11.77%	14.06%	14.09%
Jul-05	15.61%	16.08%	14.64%	11.77%	13.92%	14.71%
Aug-05	16.37%	16.11%	14.70%	12.30%	13.76%	15.32%
Sep-05	17.20%	17.05%	15.74%	12.73%	13.54%	16.40%
Oct-05	17.68%	17.57%	16.44%	13.09%	14.19%	17.27%
Nov-05	18.35%	18.05%	16.56%	13.35%	15.23%	17.93%
Dec-05	18.52%	17.42%	17.58%	13.93%	14.55%	18.65%
Jan-06	18.48%	17.14%	16.95%	13.99%	16.33%	19.23%
Feb-06	19.11%	17.71%	16.26%	14.05%	17.38%	19.73%
Mar-06	17.77%	17.57%	15.15%	14.19%	17.91%	19.51%
Apr-06	18.11%	17.27%	14.15%	14.36%	19.55%	20.04%
May-06	18.84%	17.05%	13.80%	14.99%	19.00%	20.39%
Jun-06	19.80%	18.23%	13.34%	15.88%	19.57%	21.59%
Jul-06	20.48%	19.32%	13.77%	16.88%	19.58%	22.41%
Aug-06	19.27%	19.32%	14.15%	17.76%	20.10%	23.06%
Sep-06	20.33%	19.89%	14.29%	18.83%	20.84%	24.55%
Oct-06	19.72%	19.72%	14.32%	19.17%	20.42%	24.51%
Nov-06	18.17%	19.54%	14.82%	19.32%	20.91%	24.83%
Dec-06	16.78%	18.62%	14.44%	18.97%	20.67%	24.48%
Jan-07	16.44%	17.36%	13.95%	18.23%	20.89%	24.14%
Feb-07	17.47%	17.00%	13.86%	17.95%	21.81%	24.21%
Mar-07	16.07%	16.65%	13.54%	17.22%	20.95%	23.23%
Apr-07	16.21%	16.49%	13.55%	17.99%	19.52%	23.13%
May-07	18.09%	17.35%	13.47%	18.38%	19.68%	22.95%
Jun-07	18.39%	17.03%	13.89%	18.96%	20.60%	22.97%
Jul-07	18.52%	17.35%	14.00%	19.55%	20.25%	23.25%
Aug-07	17.72%	17.15%	13.56%	19.48%	18.01%	23.10%
Sep-07	19.18%	17.10%	14.19%	19.85%	18.61%	23.98%
Oct-07	18.14%	17.04%	14.59%	19.16%	18.57%	23.85%
Nov-07	17.68%	16.02%	14.82%	18.87%	18.32%	24.16%
Dec-07	17.14%	15.38%	14.42%	17.22%	17.99%	23.23%
Jan-08	15.70%	14.68%	13.96%	16.44%	17.45%	22.00%
Feb-08	15.91%	13.98%	14.19%	16.20%	17.53%	21.19%
Mar-08	15.58%	13.42%	13.27%	15.08%	15.41%	19.34%
Apr-08	16.16%	13.40%	13.05%	14.59%	15.19%	18.74%
May-08	15.49%	12.93%	12.65%	13.77%	14.33%	17.33%
Jun-08	15.29%	13.36%	12.96%	14.75%	13.62%	17.14%
Jul-08	15.70%	13.03%	12.78%	14.40%	12.49%	16.59%
Aug-08	15.45%	13.28%	12.87%	13.73%	12.24%	15.89%
Sep-08	14.03%	12.49%	12.77%	13.28%	12.36%	15.20%
Oct-08	12.98%	11.67%	12.16%	12.13%	11.97%	14.06%

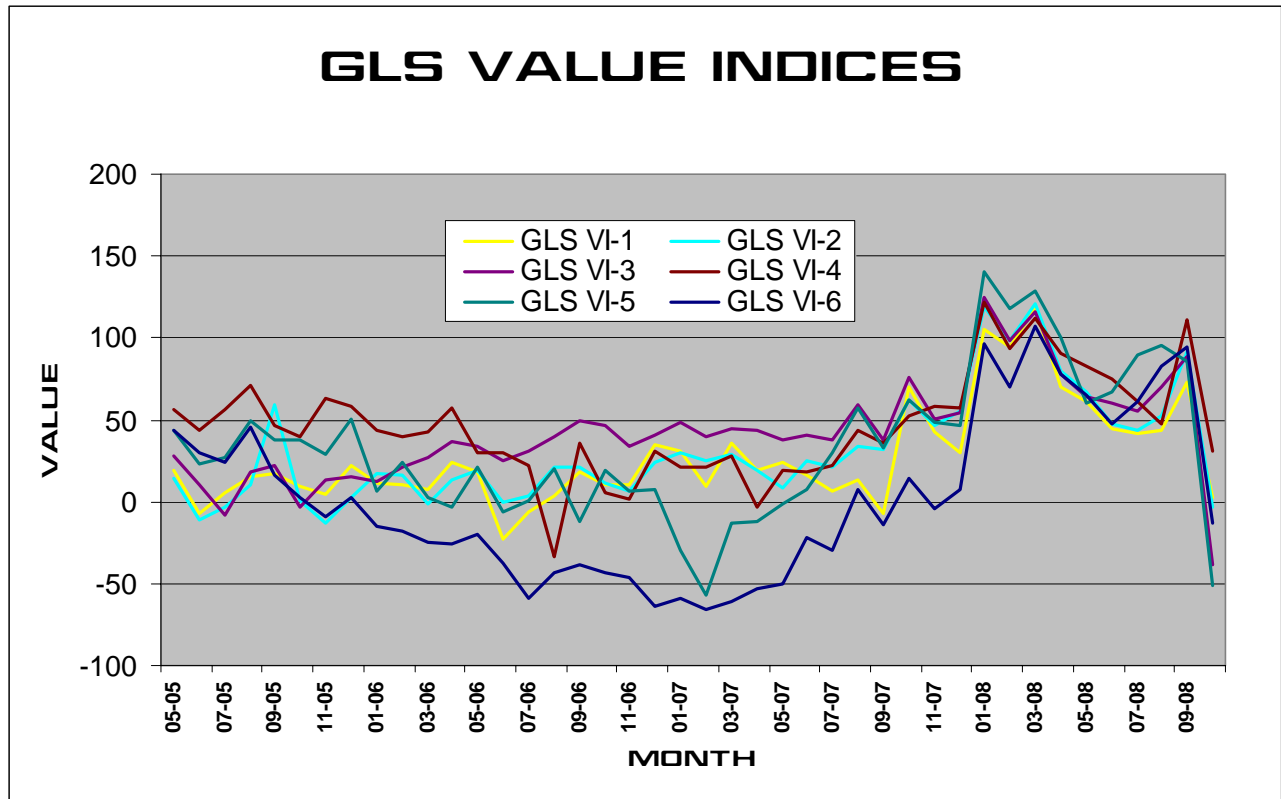
Rolling six-month CPR speeds for all maturity buckets. Source: Colson Services

NEW VALUE INDICES: HISTORICAL VALUES

Table 2:

MONTH	WAVG LIBOR	WAVG PRIME	PRIME LIBOR SPD	GLS VI-1	GLS VI-2	GLS VI-3	GLS VI-4	GLS VI-5	GLS VI-6	INDICES LEGEND	
											HIGHEST READING
May-05	3.26%	6.00%	2.74%	19.3	14.3	27.6	56.4	43.6	43.6		
Jun-05	3.41%	6.06%	2.65%	-7.0	-11.5	10.6	43.3	22.8	30.4		
Jul-05	3.59%	6.25%	2.66%	5.4	-2.9	-8.1	56.1	26.6	24.4		
Aug-05	2.66%	5.44%	2.79%	15.6	10.8	18.2	70.7	49.3	45.5		
Sep-05	3.39%	6.14%	2.74%	16.9	59.1	22.1	46.5	38.0	16.7		
Oct-05	4.16%	6.75%	2.59%	9.9	0.6	-3.3	40.1	37.3	2.3		
Nov-05	4.33%	7.00%	2.67%	4.1	-12.6	12.9	63.5	28.5	-9.1		
Dec-05	4.45%	7.06%	2.61%	21.8	2.6	15.0	58.3	51.0	2.5		
Jan-06	4.58%	7.28%	2.70%	11.0	17.2	12.7	43.5	6.1	-15.3		
Feb-06	4.74%	7.50%	2.76%	10.0	16.3	21.3	39.5	23.7	-18.3		
Mar-06	4.89%	7.56%	2.66%	7.0	-1.4	27.0	42.5	3.1	-25.0		
Apr-06	5.03%	7.75%	2.72%	24.2	13.1	36.4	57.6	-3.6	-25.5		
May-06	5.18%	7.94%	2.76%	18.4	18.8	33.5	30.2	21.0	-19.5		
Jun-06	5.37%	8.03%	2.66%	-22.8	-0.1	25.0	29.6	-6.4	-37.9		
Jul-06	5.48%	8.25%	2.77%	-5.9	3.6	31.2	22.0	0.9	-59.1		
Aug-06	5.40%	8.25%	2.85%	3.8	21.4	39.8	-33.9	19.7	-43.5		
Sep-06	5.37%	8.25%	2.88%	17.8	21.0	49.8	36.2	-12.4	-38.1		
Oct-06	5.37%	8.25%	2.88%	10.0	11.3	46.3	5.4	19.1	-43.5		
Nov-06	5.37%	8.25%	2.88%	10.9	7.0	33.7	1.4	6.2	-46.7		
Dec-06	5.36%	8.25%	2.89%	34.6	24.0	41.1	31.0	8.0	-63.8		
Jan-07	5.35%	8.25%	2.90%	31.0	29.8	48.6	21.3	-30.1	-59.4		
Feb-07	5.36%	8.25%	2.89%	9.2	25.4	39.4	21.3	-57.0	-65.7		
Mar-07	5.34%	8.25%	2.91%	35.9	28.9	45.0	28.5	-12.7	-60.9		
Apr-07	5.35%	8.25%	2.90%	18.8	19.4	43.4	-2.9	-12.5	-53.0		
May-07	5.35%	8.25%	2.90%	24.5	8.5	37.6	18.9	-1.4	-50.0		
Jun-07	5.36%	8.25%	2.89%	16.3	25.2	40.6	18.6	7.0	-22.1		
Jul-07	5.35%	8.25%	2.90%	6.8	20.9	38.1	22.2	30.1	-29.9		
Aug-07	5.48%	8.25%	2.77%	12.9	33.5	59.8	43.6	57.8	7.0		
Sep-07	5.70%	8.21%	2.51%	-7.3	32.2	38.1	36.3	33.3	-14.1		
Oct-07	5.05%	7.74%	2.69%	70.2	61.9	75.6	52.2	61.9	14.6		
Nov-07	4.96%	7.50%	2.54%	42.6	46.7	50.5	57.8	48.7	-4.3		
Dec-07	5.02%	7.35%	2.33%	30.4	55.2	54.4	57.0	46.7	7.9		
Jan-08	3.77%	6.86%	3.09%	105.1	118.6	124.7	121.4	140.1	96.8		
Feb-08	3.10%	6.00%	2.90%	94.4	98.7	98.6	93.3	118.0	69.9		
Mar-08	2.90%	5.95%	3.05%	118.1	120.5	116.2	112.0	128.8	107.4		
Apr-08	2.81%	5.25%	2.44%	69.9	79.5	77.4	90.6	100.8	77.4		
May-08	2.78%	5.15%	2.37%	61.2	66.7	64.1	82.9	60.5	65.1		
Jun-08	2.67%	5.00%	2.33%	44.1	47.4	59.8	74.6	66.9	47.2		
Jul-08	2.75%	5.00%	2.25%	41.7	43.4	55.3	60.8	89.1	61.6		
Aug-08	2.74%	5.02%	2.27%	44.0	52.5	70.1	47.4	95.8	83.1		
Sep-08	3.00%	5.00%	2.00%	73.3	91.2	88.5	111.3	85.2	94.2		
Oct-08	4.43%	4.56%	0.12%	2.3	-3.1	-38.6	30.5	-51.0	-12.9		

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



YTD PREPAYMENT SPEEDS

Table 3:

CPR/MO.	<8	8 - 10	10 - 13	13 - 16	16 - 20	20+	ALL
Jan-08	11.03%	12.51%	11.24%	15.18%	18.38%	18.89%	16.43%
Feb-08	15.67%	11.46%	13.20%	16.46%	14.08%	18.64%	16.55%
Mar-08	18.97%	14.93%	10.50%	11.87%	9.16%	14.87%	13.38%
Apr-08	16.66%	15.53%	13.87%	14.85%	12.86%	17.00%	15.76%
May-08	18.10%	11.68%	14.36%	12.74%	12.32%	16.15%	15.02%
Jun-08	11.18%	13.96%	14.35%	17.26%	14.76%	17.17%	16.06%
Jul-08	13.77%	10.59%	10.36%	13.02%	11.66%	15.62%	13.59%
Aug-08	14.20%	13.02%	13.65%	12.57%	12.53%	14.52%	13.94%
Sep-08	10.57%	10.11%	10.12%	8.69%	9.98%	10.50%	10.21%
Oct-08	10.21%	10.59%	10.20%	7.72%	10.49%	10.12%	10.01%
Nov-08	12.48%	15.74%	10.04%	8.81%	9.38%	11.09%	10.85%
Grand Total	13.87%	12.75%	11.98%	12.83%	12.35%	15.05%	13.83%

2008 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-08	18 Mos.	29 Mos.	19 Mos.	51 Mos.	41 Mos.	44 Mos.	38 Mos.
Feb-08	18 Mos.	28 Mos.	19 Mos.	51 Mos.	40 Mos.	44 Mos.	37 Mos.
Mar-08	18 Mos.	28 Mos.	19 Mos.	52 Mos.	40 Mos.	44 Mos.	38 Mos.
Apr-08	19 Mos.	28 Mos.	19 Mos.	53 Mos.	40 Mos.	45 Mos.	38 Mos.
May-08	19 Mos.	27 Mos.	20 Mos.	53 Mos.	40 Mos.	45 Mos.	38 Mos.
Jun-08	19 Mos.	27 Mos.	20 Mos.	54 Mos.	39 Mos.	43 Mos.	37 Mos.
Jul-08	18 Mos.	27 Mos.	20 Mos.	54 Mos.	39 Mos.	44 Mos.	37 Mos.
Aug-08	19 Mos.	28 Mos.	20 Mos.	55 Mos.	39 Mos.	43 Mos.	37 Mos.
Sep-08	19 Mos.	28 Mos.	21 Mos.	56 Mos.	40 Mos.	44 Mos.	37 Mos.
Oct-08	19 Mos.	27 Mos.	21 Mos.	56 Mos.	40 Mos.	44 Mos.	38 Mos.
Nov-08	20 Mos.	27 Mos.	22 Mos.	57 Mos.	41 Mos.	45 Mos.	38 Mos.

2008 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-08	8.80%	14.89%	12.99%	6.73%	7.88%
Feb-08	12.82%	20.62%	13.35%	15.23%	14.24%
Mar-08	14.53%	18.65%	13.13%	33.04%	42.16%
Apr-08	19.63%	14.72%	18.26%	9.97%	11.68%
May-08	25.17%	11.34%	11.05%	11.18%	26.35%
Jun-08	10.15%	9.49%	12.09%	13.64%	21.31%
Jul-08	9.85%	16.47%	14.72%	21.23%	18.24%
Aug-08	17.49%	10.46%	12.79%	9.43%	14.97%
Sep-08	11.17%	11.46%	9.37%	7.25%	8.45%
Oct-08	7.57%	9.50%	20.70%	4.30%	7.21%
Nov-08	15.36%	10.54%	9.95%	10.98%	14.24%
Grand Total	13.81%	13.56%	13.47%	12.97%	17.79%

8-10 BY AGE	0-12 Mos.	13-24 Mos.	25-36 Mos.	37-48 Mos.	48+ Mos.
Jan-08	5.02%	20.82%	8.17%	19.29%	12.90%
Feb-08	5.33%	13.65%	11.26%	13.26%	17.62%
Mar-08	17.33%	8.95%	15.62%	14.06%	16.59%
Apr-08	15.15%	14.04%	15.92%	26.16%	10.36%
May-08	6.77%	17.96%	16.19%	9.19%	11.84%
Jun-08	9.02%	22.12%	9.59%	14.71%	17.95%
Jul-08	10.81%	7.36%	10.11%	11.25%	13.05%
Aug-08	8.43%	20.68%	12.48%	9.65%	16.27%
Sep-08	10.83%	10.52%	10.35%	7.02%	10.44%
Oct-08	5.94%	11.62%	15.27%	16.80%	10.83%
Nov-08	11.32%	25.62%	15.83%	11.17%	15.07%
Grand Total	9.72%	16.18%	12.79%	13.77%	13.95%

10-13 BY AGE	0-12 Mos.	13-24 Mos.	25-36 Mos.	37-48 Mos.	48+ Mos.
Jan-08	6.44%	15.16%	15.42%	18.87%	15.44%
Feb-08	9.18%	17.83%	14.32%	13.99%	16.81%
Mar-08	8.00%	12.31%	10.83%	21.45%	11.35%
Apr-08	11.47%	17.81%	18.01%	12.47%	6.21%
May-08	10.18%	20.28%	13.34%	15.59%	13.17%
Jun-08	9.73%	18.74%	18.49%	18.76%	11.57%
Jul-08	9.88%	13.24%	6.12%	4.88%	12.98%
Aug-08	12.20%	18.13%	8.29%	14.32%	13.92%
Sep-08	8.67%	12.65%	7.86%	8.11%	13.30%
Oct-08	6.96%	13.68%	11.10%	6.98%	12.08%
Nov-08	8.50%	10.36%	12.37%	6.24%	11.16%
Grand Total	9.23%	15.48%	11.95%	12.74%	12.56%

13-16 BY AGE	0-12 Mos.	13-24 Mos.	25-36 Mos.	37-48 Mos.	48+ Mos.
Jan-08	7.45%	0.00%	14.04%	19.36%	15.09%
Feb-08	0.00%	0.00%	12.78%	24.15%	17.15%
Mar-08	15.18%	0.00%	11.58%	18.40%	9.33%
Apr-08	15.85%	17.86%	14.50%	7.62%	17.50%
May-08	8.12%	0.00%	19.24%	14.03%	10.17%
Jun-08	16.01%	0.00%	20.43%	13.31%	19.03%
Jul-08	0.00%	0.00%	19.45%	4.70%	16.51%
Aug-08	0.00%	45.27%	14.48%	9.16%	12.15%
Sep-08	0.00%	9.39%	3.65%	7.41%	11.00%
Oct-08	6.38%	4.00%	0.00%	9.26%	6.97%
Nov-08	0.00%	0.42%	1.75%	8.84%	10.18%
Grand Total	6.27%	9.36%	14.81%	11.86%	13.30%

16-20 BY AGE	0-12 Mos.	13-24 Mos.	25-36 Mos.	37-48 Mos.	48+ Mos.
Jan-08	0.86%	35.14%	19.43%	29.84%	22.03%
Feb-08	7.44%	12.34%	6.24%	28.45%	21.04%
Mar-08	4.17%	4.70%	24.50%	4.12%	11.11%
Apr-08	11.02%	18.57%	17.46%	14.93%	9.22%
May-08	6.30%	11.23%	22.61%	20.02%	12.32%
Jun-08	5.76%	4.54%	9.10%	27.31%	27.59%
Jul-08	5.53%	9.45%	6.57%	13.82%	20.17%
Aug-08	13.44%	13.04%	10.14%	15.82%	10.94%
Sep-08	11.53%	2.30%	0.81%	14.42%	13.63%
Oct-08	7.79%	14.49%	18.02%	8.51%	8.95%
Nov-08	8.74%	8.23%	8.24%	24.60%	5.84%
Grand Total	7.65%	12.35%	13.56%	18.08%	15.10%

20+ BY AGE	0-12 Mos.	13-24 Mos.	25-36 Mos.	37-48 Mos.	48+ Mos.
Jan-08	5.30%	18.07%	18.93%	27.24%	24.37%
Feb-08	5.20%	17.29%	18.80%	26.11%	24.41%
Mar-08	6.37%	11.96%	12.11%	18.84%	21.37%
Apr-08	9.30%	16.82%	15.07%	20.87%	21.08%
May-08	6.01%	13.50%	12.93%	18.46%	24.22%
Jun-08	6.96%	15.64%	18.59%	17.11%	23.80%
Jul-08	8.50%	12.15%	18.42%	23.11%	17.37%
Aug-08	8.32%	11.60%	15.73%	14.86%	19.56%
Sep-08	4.08%	5.01%	8.90%	12.19%	17.47%
Oct-08	7.85%	9.42%	12.39%	7.05%	12.14%
Nov-08	7.94%	10.17%	14.41%	7.47%	12.98%
Grand Total	6.90%	13.27%	15.12%	17.32%	20.08%

2008 YTD CPR by maturity and age bucket. Source: Colson Services

FASB 140...CONTINUED

NAGGL and several SBA lenders submitted comment letters requesting clarification of these issues or exclusions for SBA 7(a) guaranteed loan sales. If the issues are not resolved, SBA 7(a) lenders might have to start recording the participations as secured borrowings, unless the participation agreement form 1086 can be amended to meet the characteristics of a participating interest.

Bill Hoving, an executive with **Crowe Horwath LLP**, stated in a recent article in NAGGL's "In Focus":

"For sales of the guaranteed portions of SBA 7(a) loans, the proposed amendments could have a negative impact on capital ratios of banks... The current message form Washington, D.C., is for banks to get busy making loans, and regulatory agencies' hot topic is liquidity. SBA lenders are particularly concerned the proposed amendments of SFAS 140 might impede their ability to make new loans or to sell their current loans because of the additional regulatory capital that would be required."

*Mr. McGaughey is the Executive Vice President and Director of Capital Markets at Excel National Bank. Bill is the author of **Accounting for SBA Loans Sold in the Secondary Market**, published by NAGGL in 2008. He is a former member of NAGGL's board of directors.*

Bill has a B.S. in accounting from the University of Northern Colorado, holds a State of Colorado CPA certificate, holds the designation of CFA, and is a graduate of Pacific Coast Banking School.

GLOSSARY AND DEFINITIONS: PART 1

Default Ratios

Default ratios, or the percentage of secondary loan prepayments 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 default ratios 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 default ratio 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 ratio 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) default ratios and 15% or greater on 504 default ratios 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: PART 2

Prepayment Calculations

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

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

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

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

$$\text{Total Pool CPR} = \text{VCPR} + \text{DCPR}$$

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

TALF...CONTINUED

If this is the case, how much exposure does the investor have to their initial capital investment? In other words, the lower the haircut, the less risk to the investor at the end of the loan term. What this boils down to is that the lower the haircut, the more impact TALF will have on the secondary market.

5. **How will the value of the collateral be determined? What pricing source(s) will be utilized?** Due to the small size and relative illiquidity of the SBA pool market, accurate pool pricing can be difficult for large pricing services. If the prices are too low, than the investors are hurt because they cannot borrow as much as they would like, or need. If the price is

too high, then the Fed is at risk of owning over-priced assets if the investor does not return the funds at the end of the loan term. Pricing accuracy will be paramount for TALF.

6. **How will the initial fee be calculated?** Any and all fees need to be considered in the price paid for the pool.
7. **How aggressive will ABS investors be when bidding for TALF loans?** Because of the government guarantee, SBA pools will have some of the lowest yields of eligible ABS. Will lower yields limit the ability of SBA pool investors to bid high enough to receive TALF loans? On the plus side, SBA pools should have one of the lowest

haircuts. This will help in calculating the risks of leaving the collateral in the hands of the Fed at the end of the term of the loan.

Summary

Once the industry receives the answers to the above questions lenders, pool assemblers and investors will be able to quantify the value of TALF-eligible SBA pools.

Moving to current market conditions, if you are considering selling loans into the secondary market prior to learning more about the TALF, I would recommend caution.

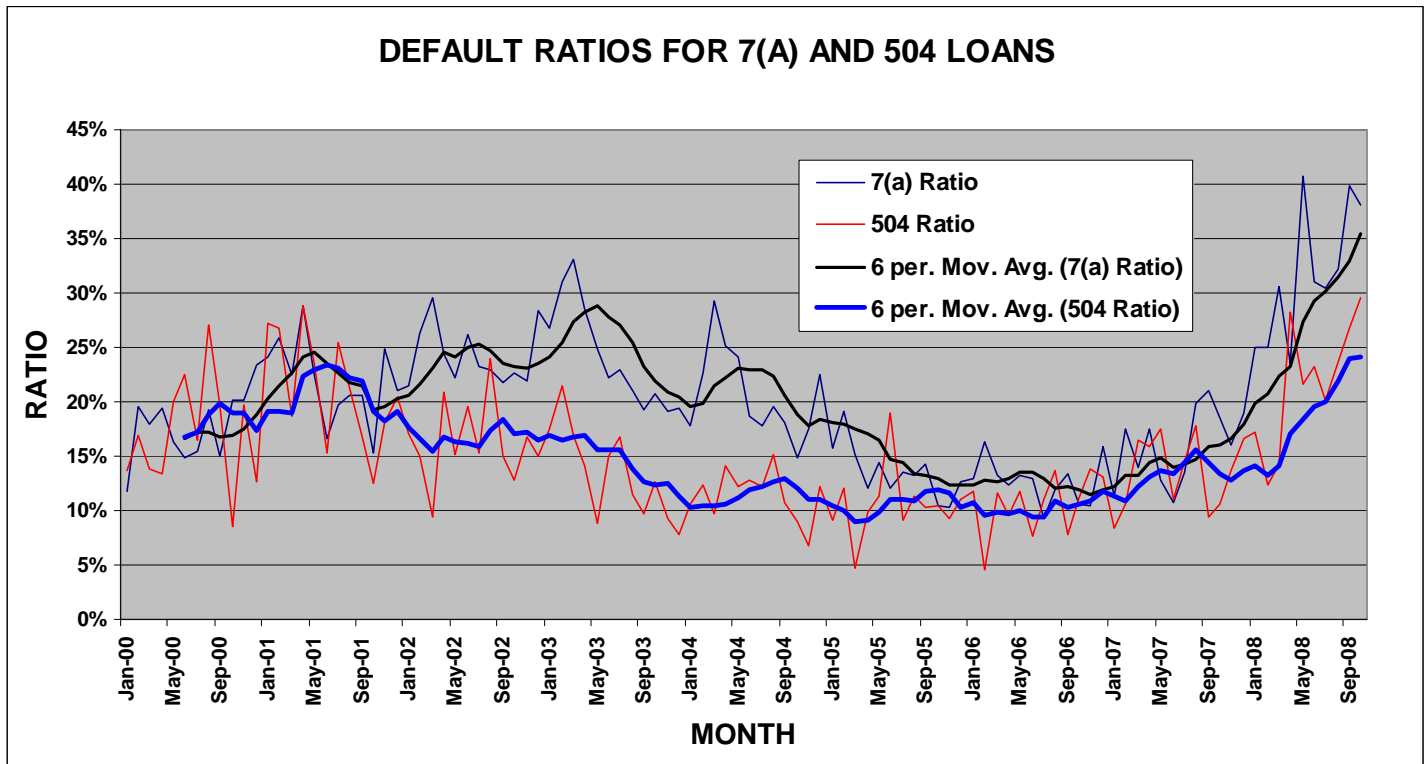
The risk is that you may be unknowingly selling TALF-eligible loans that will be worth considerably more than current market levels if they were originated after the initial cut-off date and TALF is structured effectively.

Due to the 90-day warranty period, you will effectively be protecting the pool assembler from prepayments until they can form a TALF-eligible pools beginning in January or February.

TALF-eligible pools could well be worth more than current market prices due to the cheap funding provided by the Fed.

However, if you have to sell, you have to sell. If this is the case, make sure to follow any SBA, NAGGL and GLS updates regarding the TALF.

The latest information will help you make the most informed decisions possible in the ever-changing economic environment that we all live in.



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

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

Services available include:**Lenders:**

- *Manage loan sales to the secondary market*
- *Process loan settlements via our electronic platform, E-Settle*
- *Third-Party servicing and non-guaranteed asset valuation*
- *Model Validation*
- *Specialized research projects*
- *Mortgage Servicing Valuation*

Pool Assemblers:

- *Manage loan settlements and pool formation*
- *Loan and IO accounting*
- *Loan, Pool and IO Mark-To-Market*
- *Specialized research projects*

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