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AN EQUILIBRIUM PRICING MODEL FOR THE SBA SECONDARY MARKET

By Bob Judge

The ultimate purpose of the TALF and the Treasury Direct Purchase Program is to increase pricing in the SBA secondary market so that lenders will be incented to make SBA loans.

The assumption of both programs is that through direct governmental purchases and/or creating incentives for investors, the excess supply of SBA loans and pools will be

removed from the market. This decrease in supply combined with increased demand will cause pricing in the secondary market for loans to increase, allowing lenders to sell loans at a profit.

The question this article will attempt to answer is:

What pricing level in the secondary market will trigger sustained lending activity?

The answer is the level where all stakeholders in the market (i.e. lenders, pool assemblers and investors) can earn a “reasonable” profit from their efforts. If all parties can earn a reasonable profit, they will dedicate resources to the SBA business that will lead to increased lending to small business.

For the sake of this article, let’s call this the “equilibrium price”.

Continued on page 6

GUEST COMMENTARY: THOUGHTS ON RECENT INITIATIVES TO HELP THE SECONDARY MARKET

BY

CHRIS LAPORTE, COASTAL SECURITIES

By Chris LaPorte

As one of the major SBA pool assemblers for almost twenty-five years, Coastal views the events of the past eighteen months as nothing short of amazing.

Very few fixed income securities have escaped the turmoil and volatility resulting from

the sub prime meltdown. Even the inherently safe haven of full faith and credit instruments has not been immune to the vagaries of this new paradigm. Wider spreads and higher yields relative to historic benchmarks are currently required on virtually every asset class.

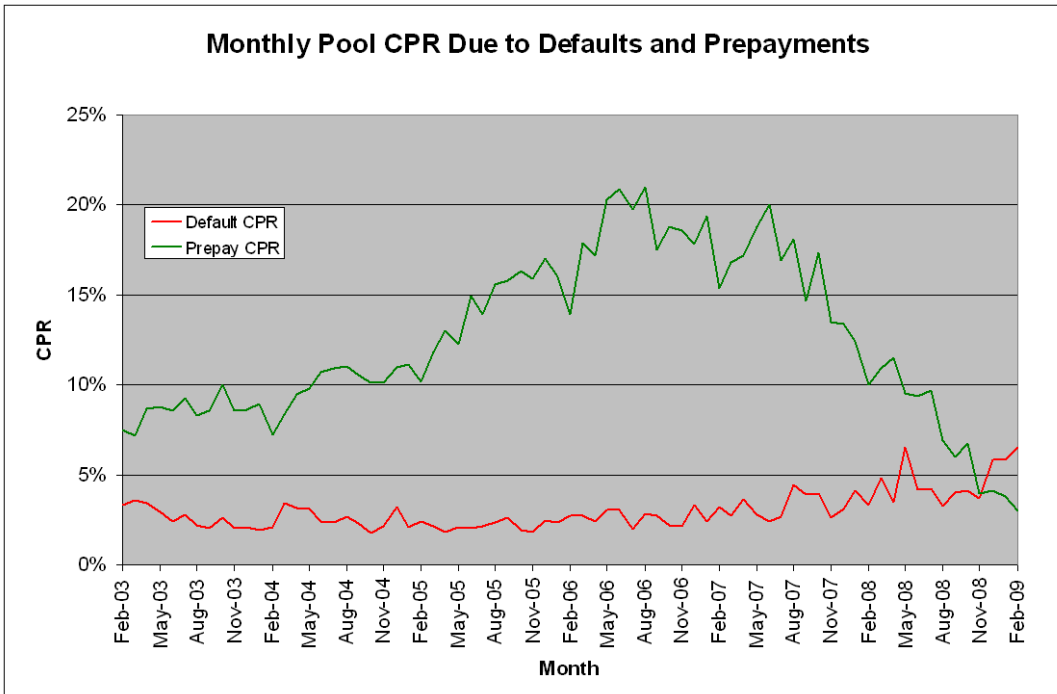
For those involved in government guaranteed loan prod-

ucts, the repercussions can be even more severe. As President Obama recently commented:

“U.S. small businesses employ about half our nation’s workers and, over the last decade, have created about 70 percent of all new jobs. But their access to credit and lending markets has dried up, mak-

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MARCH CPR: DEFAULTS RISE, BUT CPR STAYS BELOW 10%



“In summary, this month continues the trend of low prepayment speeds caused by falling voluntary prepayments that offset rising defaults.”

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Prepayment speeds fell by CPR .15% in March, staying below CPR 10% for the fourth month in a row. As we have seen in previous months, rises in **Default CPR** (red line) are being offset by decreases in the **Prepay CPR** (green line).

For March, the overall prepayment rate came in at CPR 9.52% versus CPR 9.67% in February. This represents the fourth month in a row as sub-10% prepayment speeds.

Turning to the specifics, Prepay CPR set an all-time low of CPR 2.99%, the first reading below 3% this decade. Default CPR came in at CPR 6.52%, which

was within .01% of the decade high set in May, 2008.

Within particular maturity sectors, the 10-13 year sector displayed the best performance, falling 13.06% to CPR 11.41%.

The long-end was the only other sector to show decreases, falling 8.34% to CPR 7.42%.

Four sectors rose for the month, including <8 (+33.85%), 8-10 (+23.38%), 13-16 (+33.93%) and 16-20 (+45.23%).

In summary, this month continues the trend of low prepayment speeds caused by falling

voluntary prepayments that offset rising defaults.

With the recession deepening, there is no reason to believe that this trend will abate anytime soon.

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

Data on pages 16-17

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GUEST COMMENTARY...CONTINUED

ing it harder every day for small businesses to keep their doors open and their employees working."

This comment was made in announcing another governmental program designed to aid the ailing small business sector. What had began as a sub prime issue in residential mortgages ended up impacting previously unrelated markets and products. Broker-dealers were unable to move product off their balance sheets due to a total dearth of investor interest in many asset classes, including SBA product. This forced SBA pool assemblers to either cease bidding loans from originators or bid them at very defensive levels which, in effect, stopped the flow of product into the secondary market. Lenders with active SBA lending departments stopped making SBA loans to small businesses, reduced their lending staff and, in some instances, disbanded their SBA lending departments altogether. It was this dramatic decline in liquidity that alerted both legislators and the President to issues surrounding the SBA market.

As of this writing, several initiatives have been proposed by the Federal Government to jump start the secondary market for SBAs, with only one near utilization. In other words, a "shotgun approach" is being used with very little danger of a direct hit of any substance.

The first of these initiatives broadly available to pool assemblers and investors is the Term Asset-Backed Securities Loan Facility (TALF). This lending facility, which can be utilized to finance SBA 7(a) pools, completed its initial subscription period in March. The subscription was met with a tepid reception at best with a total of only

\$4.7 Billion in loans requested for all eligible asset classes. The reception from SBA market participants was even worse – not a single SBA 7(a) pool was funded.

This program, however, does have some appeal as a funding source that can potentially provide a reasonably attractive alternative to other financing lines. What are the limiting factors? Currently, a borrower must access the TALF via a U.S. Government securities primary dealer, many of whom have their own issues and priorities. There seems to be little incentive for them to delve into the documentation and legal issues involved for firms and products with which they are not overly familiar.

Another factor that could severely limit the efficacy of the TALF program is the prohibition against borrowers pledging their own pool issuances. This requirement might be appropriate for those TALF eligible securities that have underlying credit risk, but the underlying loan collateral of SBA 7(a) pools is *full faith and credit*. As it currently stands, pool assemblers will need to pledge securities issued by other pool assemblers to utilize this facility. There seems to be no rational basis for this limiting restriction on market participants, which will create an unnecessary amount of work for Operations and Trading staff. The end result will likely be that the same pools will end up as TALF collateral, assuming any primary securities dealers chose to participate.

The second of these initiatives, created pursuant to the recent stimulus package passed by Congress, involves direct lending by the SBA to "systemically important" SBA secondary

market broker-dealers. While this program might prove beneficial for broker-dealers who would like to leverage their balance sheets to purchase more product, we have not, to date, received final details from the SBA on implementation of this program. The rate originally quoted looks attractive enough at Fed Funds + .25%; we remain hopeful something will break on this initiative soon.

The third initiative is the recently announced intention of the Treasury to purchase up to \$15 billion of securities backed by SBA 7(a) and 504 loans. The utilization of this program will be hindered significantly by the requirement that participants selling securities also grant warrants that would enable the Treasury to purchase common stock, preferred stock, or senior debt obligations. Other potential limiting factors include pricing of the securities to be purchased and the potential necessity to comply with executive compensation restrictions pursuant to the EESA. It is unlikely that many broker-dealers would have interest in selling their positions at current depressed levels. Even without these limiting factors there currently exists only \$1.5 billion of SBA 7(a) pools eligible for purchase under this program, which requires a July 1, 2008 or later issue date.

This last proposal is the only one of previously discussed initiatives that would actually allow broker-dealers to move assets off their balance sheets, freeing up liquidity for new purchases in the secondary market, but the warrant requirement, compensation issues, and market pricing will likely limit participation dra-

matically.

Coastal continues to believe in the free market system and has maintained from the onset that the markets will, in time, correct themselves. However, given the government's stated objective to jump start the SBA secondary markets to increase the flow of credit to small businesses across the country, we have counseled several government officials, congressional representatives and others on how to make these initiatives achieve that objective.

As one can discern from the foregoing discussion, it would not take significant modifications to make these currently ineffective programs much more viable.

- Allow SBA broker-dealers to access TALF directly through the government's agent, Bank of New York.
- Permit pool assemblers to borrow against their own issuances.
- Publish the final details on the SBA lending program post haste so broker-dealers and pool assemblers can begin borrowing versus their existing positions.

Dispense with the warrants requirement to sell full faith and credit SBA 7(a) pools to the Treasury at market.

Any one or a combination of these initiatives, properly functioning, would go a long way toward jump starting the markets and likely achieve the government's objectives. Hopefully, we will see progress on one or more of these in the coming weeks. Meanwhile, the markets have already come a long way on the path back to normalcy and should continue to improve each month.

THE GOVGEX CORNER

Three-month trailing average for high bids: January - February - March 2009

| Maturity | Prime + 1% | Prime + 2% |
|----------|------------|------------|
| 10 years | 99.5954 | 102.7788 |
| 25 years | 103.6756 | 104.7912 |

GovGex reports an increase in premiums and activity for the April edition of the GovGex corner. The minor improvements in premium and activity level reported in our last edition were indeed a leading indicator for March. The secondary loan market is now showing signs of improvement after a near standstill over the previous three months.

Activity on GovGex increased five-fold from February to March. The reported 3 month average for higher priced loans (Prime+2 or more) saw significant increases in premiums for both ten and twenty-five year loans. The average for premiums on (Prime+1) ten-year loans dropped (likely due to the negative impact of the Jan.-Feb. bid levels). The bid to pass ratio remained 1:3.

The chart below shows the 3 month *average* for high bids on GovGex by maturity and rate. The GovGex Independent Pricing Service™, which reports high par, premium and deal structure on *actual transactions*, reports the secondary market is valuing loans very differently in light of deal structure. Recent reports show P+2 transactions at **102%** to **106%**, with only slight changes in loan structure driving premiums (rate, index, adjustment period, maturity and amount.)

GovGex is the secure online exchange for selling SBA and USDA loans. **GovGex** works with a network of over 20 Buyers to ensure loans receive full exposure. **GovGex** is an independent source for secondary market pricing information - built on actual bid levels as seen on **GovGex** from all the Buyers. Contact **GovGex** for all of your secondary market needs.

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AN EQUILIBRIUM PRICING MODEL...CONTINUED

Instead of concentrating on finding the minimum price and/or financing terms that removes the excess supply, I propose that the Fed and the Treasury work “backwards” from a targeted pricing level in the market to determine program terms.

If pool assemblers can sell off excess inventory, purchase new loans and profitably securitize them at the equilibrium price level by tapping one or both programs, then SBA lending activity will increase and credit will get into the hands of entrepreneurs.

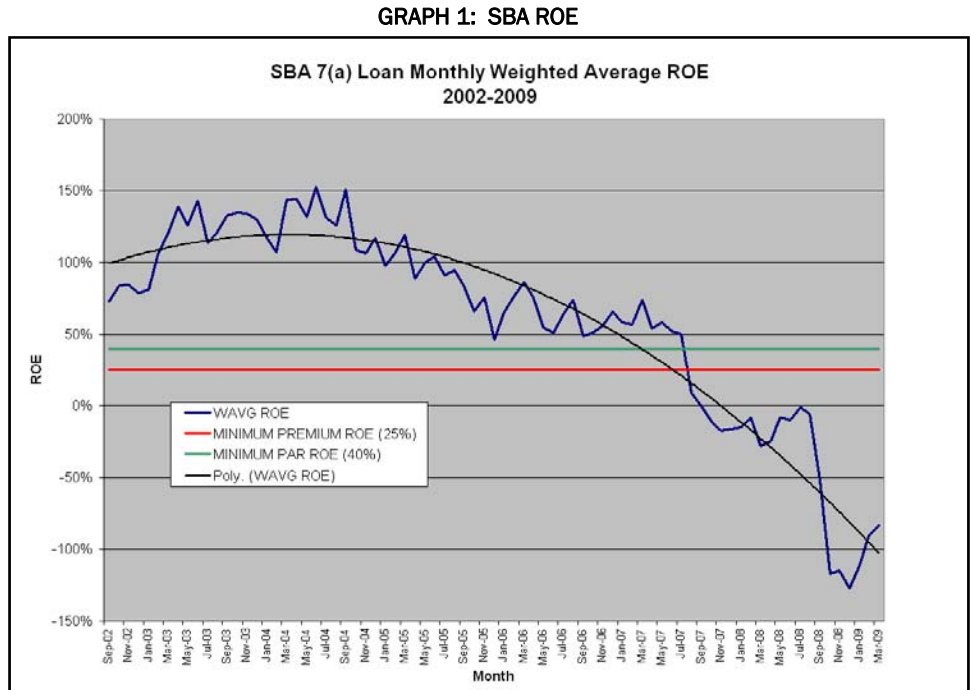
Before we begin to establish the equilibrium price, let’s examine the profitability of SBA lending.

How profitable has the SBA lending business been for the past few years?

In order to calculate lender profitability over the last few years, let’s examine the Return on Equity for loans sold into the secondary market. We will designate this measure as the SBA ROE.

To begin, let’s take a look at some historic levels for the SBA ROE. Graph 1 shows the SBA ROE since 2002. These numbers are based on the following assumptions:

1. The calculation was done for each loan in our trade database, which totals over 21,000 loan sales over the past eight years.
2. We assumed lender fixed costs as 3.25% of the total loan amount.
3. Commission payments of 3% of the total loan amount. This includes payments to the BDO and broker.
4. A capital allocation, as a percentage of the retained non-guaranteed, of 11%.
5. A contractual servicing cost of 40 basis points.
6. In order to value the net servicing rights, we assumed a discount rate of 12% and a CPR of 16%.
7. We used an SBA ROE of 25% as the profitability hurdle for lenders who sell at a premium.



8. We used an SBA ROE of 40% for lenders who sell at par, due to the fact that most of the profit in the loan is in the form of a non-cash asset, the servicing rights. Because of the larger servicing asset, par sellers are taking greater risk to achieve profitability, so they should target greater returns.

Returning to Graph 1, we see that the SBA ROE has been generally declining since peaking in June of 2004 when it averaged 161.34%. In August of 2007, the SBA ROE fell below the premium threshold of 25% for the first time, and went below zero in October, 2007 where it has stayed negative ever since.

According to our analysis, SBA lenders have sustained losses on most every loan they have sold for the past 18 months.

It is no wonder that they have been pulling back from lending activity.

Now for the hard question:

How do we determine the equilibrium price?

Equilibrium Price for Premium Sellers

In order to determine the equilibrium price for a premium sale, let’s turn to an example, displayed in Chart 1:

The loan being analyzed is a Prime-based 25-year, 2.50% gross margin 7(a) loan with 1% gross servicing asset. Many of the assumptions are the same as above, except we utilized a servicing asset discount rate of 13.5% and a CPR of 17% to better estimate current market conditions. This example would return an SBA ROE of 25% at a premium of 7.53%. For comparison purposes, a loan like this would trade today at approximately a 5.25% premium, creating an SBA ROE of -37%.

While it would seem that the current market is not terribly far away in premium terms from the equilibrium price, the returns are significantly different because the sale premium represents 81% of the gross profit on the loan at a 7.53% premium.

For this loan example, the difference between the equilibrium price and the current market is \$17,100. Considering that the Net Pre-Tax Profit at the equilibrium price is \$6,876, we can see how sensitive lender profitability is to secondary market

Continued on next page

AN EQUILIBRIUM PRICING MODEL...CONTINUED

| CHART 1: PREMIUM SALE INPUTS | EQUILIBRIUM PRICE | CURRENT MARKET |
|-----------------------------------|-------------------|----------------|
| LOAN BALANCE | \$ 1,000,000 | \$1,000,000 |
| MATURITY MONTHS | 300 Mos. | 300 Mos. |
| LOAN AGE | 0 Mos. | 0 Mos. |
| BASE RATE | 3.25% | 3.25% |
| GROSS MARGIN | 2.50% | 2.50% |
| SERVICING RETAINED | 1.00% | 1.00% |
| SERVICING COST | 0.40% | 0.40% |
| GTE PCT | 75% | 75% |
| PREMIUM | 7.530% | 5.250% |
| SERV MULT | 2.87 | 2.87 |
| SERVICING DISCOUNT RATE | 13.50% | 13.50% |
| SERVICING CPR | 17.00% | 17.00% |
| CAPITAL ALLOCATION (% OF NON-GTD) | 11% | 11% |
| FIXED COSTS (% OF TOTAL LOAN) | 3.25% | 3.25% |
| COMMISH (% OF TOTAL LOAN) | 3.00% | 3.00% |
| PREMIUM SALE OUTPUTS | VALUE | VALUE |
| NET SERVICING % | 0.600% | 0.600% |
| GTE AMOUNT | \$750,000 | \$750,000 |
| NON-GTD AMOUNT | \$250,000 | \$250,000 |
| CAPITAL ALLOCATED | \$27,500 | \$27,500 |
| PREMIUM EARNED | \$56,475 | \$39,375 |
| NET SERVICING VALUE | \$12,901 | \$12,901 |
| ALL COSTS | \$62,500 | \$62,500 |
| NET PRE-TAX PROFIT | \$6,876 | (\$10,224) |
| SBA & COLSON FEES | 0.675% | 0.675% |
| NET MARGIN FOR BUYER | 0.825% | 0.825% |
| PREMIUM SALE SBA ROE | 25% | -37% |

target SBA ROE on a par sale.

Complicating matters is the need to find the equilibrium pricing level for numerous loan structures that does not create imbalances that can be exploited to the detriment of the taxpayer. Using this pricing model, the various structures can be synchronized with the two relief programs to achieve the desired results of increased SBA lending.

On that note, let's now turn to the equilibrium price, as it applies to the TALF and the Treasury Direct Purchase Program.

Inside the TALF

| CHART 2: PAR SALE INPUTS | EQUILIBRIUM PRICE | CURRENT MARKET |
|-----------------------------------|-------------------|----------------|
| LOAN BALANCE | \$ 1,000,000 | \$1,000,000 |
| MATURITY MONTHS | 300 Mos. | 300 Mos. |
| LOAN AGE | 0 Mos. | 0 Mos. |
| BASE RATE | 3.25% | 3.25% |
| GROSS MARGIN | 2.50% | 2.50% |
| SERVICING RETAINED | 3.825% | 3.325% |
| SERVICING COST | 0.40% | 0.40% |
| GTE PCT | 75% | 75% |
| PREMIUM | 0.000% | 0.000% |
| SERV MULT | 2.87 | 2.87 |
| SERVICING DISCOUNT RATE | 13.50% | 13.50% |
| SERVICING CPR | 17.00% | 17.00% |
| CAPITAL ALLOCATION (% OF NON-GTD) | 11% | 11% |
| FIXED COSTS (% OF TOTAL LOAN) | 3.25% | 3.25% |
| COMMISH (% OF TOTAL LOAN) | 3.00% | 3.00% |
| PAR SALE OUTPUTS | VALUE | VALUE |
| NET SERVICING % | 3.425% | 2.925% |
| GTE AMOUNT | \$750,000 | \$750,000 |
| NON-GTD AMOUNT | \$250,000 | \$250,000 |
| CAPITAL ALLOCATED | \$27,500 | \$27,500 |
| PREMIUM EARNED | \$0 | \$0 |
| NET SERVICING VALUE | \$73,641 | \$62,891 |
| ALL COSTS | \$62,500 | \$62,500 |
| NET PRE-TAX PROFIT | \$11,141 | \$391 |
| SBA & COLSON FEES | 0.675% | 0.675% |
| NET MARGIN FOR BUYER | -2.000% | -1.500% |
| PAR SALE SBA ROE | 40% | 1% |

pricing levels.

Let's now turn to a par sale.

Equilibrium Price for Par Sellers

In order to determine the equilibrium price for a par sale, let's turn to the example displayed in Chart 2:

The loan terms and assumptions are the same as in the above example, except that the loan is sold at par with a servicing asset of 3.825%. This sale equates to a net margin to the pool assembler of Prime - 2% and an SBA ROE of 40%. For reference, the current market on such a loan would have a servicing asset of 3.325%, netting Prime - 1.50% to the pool assembler which equates to an SBA ROE for the lender of 1%.

Whereas 19% of the gross profit from the premium sale is the net servicing asset, for the par sale it represents 100%. Since the value of the servicing asset is a non-cash, present value calculation, profits are earned over time and not immediately, as in the case of a premium sale.

Additionally, profitability on any one loan is subject to the timing of a default or voluntary prepayment, thus increasing the volatility of earnings. This increased risk to profitability is the reason for the higher

Moving from loans to pools, we have to make some assumptions on how they would be securitized.

Let's assume the following for a pool based on the premium loan example:

1. A 1/4 point profit for the pool assembler on the premium pool.
2. Assume that each loan will have to be stripped to some extent, equating to a strip cost of 2 basis points.
3. Loans securitized after a 3 month holding period.
4. A sale price of 107.78.
5. A pool size of \$5 million.
6. A reset margin of +80.5 basis points over Prime.
7. The investor CPR is calculated using an assumption of 17%.
8. Current TALF terms are utilized to determine the average life and the investor returns.

The results can be found in Chart 3. The IRR if the investor leaves the pool with the Fed is -12.69%. If the investor takes back the pool at the end of the loan term and sells it at the purchase price less the amount of premium paid back to the Fed

over the three years, which equates to a price of 103.762, the IRR rises to 15.58%.

Neither scenario would be attractive to an investor.

Let's take a look at the current TALF conditions from the Fed's point of view:

Under current TALF terms, what is the IRR for the Federal Reserve if they keep the pool after the loan term until maturity? We are assuming that the Fed's cost of funds is the Fed Funds Target rate.

In this example, the Federal Reserve will earn an IRR of 5.13% if they keep the pool until maturity. So, by taking advantage of the non-recourse condition of the loan, the investor loses money and the Fed earns a positive return until maturity.

It would seem that there is room to make the TALF more attractive to investors while maintaining reasonable conditions for the Fed post-TALF.

Let's take this same example and adjust the TALF terms to make the program more attractive to investors. We will use the following assumptions:

1. A Fed Funds Target loan spread of .25%.
2. A haircut of 2%.

Continued on next page

AN EQUILIBRIUM PRICING MODEL...CONTINUED

| CHART 3: PREMIUM POOL @ TALF TERMS | |
|------------------------------------|-------------|
| TERMS | VALUE |
| AMOUNT | \$5,000,000 |
| PRICE | 107.78 |
| POOL ORIGINAL MATURITY | 300 Mos. |
| CURRENT POOL AGE | 3 Mos. |
| POOL RESET MARGIN | 0.805% |
| RESET INDEX VALUE | 3.25% |
| INVESTOR CPR | 17.00% |
| LOAN INPUTS | |
| TERMS | VALUE |
| TALF LOAN INDEX | 0.250% |
| TALF LOAN SPREAD | 0.750% |
| FED ADMIN FEE | 0.05% |
| LOAN LENGTH | 36 Mos. |
| AVERAGE LIFE CPR | 14.00% |
| OUTPUTS | |
| TERMS | VALUE |
| AVERAGE LIFE | 5.46 Yrs. |
| YTM | 2.151% |
| HAIRCUT | 6.00% |
| PREMIUM PAID BACK TO FED | 4.02% |
| FED KEEPS POOL NET CASHFLOW | (\$53,458) |
| FED KEEPS POOL IRR | -12.69% |
| FED RETURNS POOL NET CASHFLOW | \$113,129 |
| FED RETURNS POOL IRR | 15.58% |
| EXIT VALUE PRICE | 103.762 |
| FED IRR FROM KEEPING POOL | 5.13% |
| FED NET CASHFLOW POST TALF | \$588,238 |

What about Par Pools?

Let's assume the following for a pool based on the par loan example:

1. A 10.5 basis point profit for the pool assembler on the par pool.
2. Assume a loan strip cost of 2 basis points.
3. Loans securitized after a 3 month holding period.
4. A sale price of 100.
5. A pool size of \$5 million.
6. A reset margin of -2.125% to Prime.
7. The investor CPR is calculated using an assumption of 17%.
8. Current TALF terms are utilized to determine the average life and the investor returns.

| CHART 4: PREMIUM POOL @ ADJUSTED TALF TERMS | |
|---|-------------|
| TERMS | VALUE |
| AMOUNT | \$5,000,000 |
| PRICE | 107.78 |
| POOL ORIGINAL MATURITY | 300 Mos. |
| CURRENT POOL AGE | 3 Mos. |
| POOL RESET MARGIN | 0.805% |
| RESET INDEX VALUE | 3.25% |
| INVESTOR CPR | 17.00% |
| LOAN INPUTS | |
| TERMS | VALUE |
| TALF LOAN INDEX | 0.250% |
| TALF LOAN SPREAD | 0.250% |
| FED ADMIN FEE | 0.05% |
| LOAN LENGTH | 36 Mos. |
| AVERAGE LIFE CPR | 14.00% |
| OUTPUTS | |
| TERMS | VALUE |
| AVERAGE LIFE | 5.46 Yrs. |
| YTM | 2.151% |
| HAIRCUT | 2.00% |
| PREMIUM PAID BACK TO FED | 4.19% |
| FED KEEPS POOL NET CASHFLOW | \$123,613 |
| FED KEEPS POOL IRR | 68.57% |
| FED RETURNS POOL NET CASHFLOW | \$179,051 |
| FED RETURNS POOL IRR | 74.84% |
| EXIT VALUE PRICE | 103.591 |
| FED IRR FROM KEEPING POOL | 4.03% |
| FED NET CASHFLOW POST TALF | \$480,472 |

3. A 17% CPR on the pool until maturity.

The results can be found in Chart 4. The IRR to the investor if the Fed keeps the pool rises to 68.57%. Under this scenario, the Fed's IRR for the pool until maturity is 4.03%, assuming the Fed Funds Target rate is their cost of funds.

Note that the investor IRR is far more attractive in this scenario and would bring SBA pools into the TALF program. As an added bonus, the Fed also is likely to earn positive returns on the pools that they wind up keeping until maturity.

Why, under these more attractive investor terms, does the Fed IRR stay positive and only falls by 1.10%? Because the Fed's "cost basis" at the end of the TALF term rises by only 4%, or \$108,000 under the more attractive terms. The cost basis only rises by this amount because the Fed has already been rebated over half of the premium during the TALF loan term on premium pools brought to the TALF for financing.

The results can be found in Chart 5. The IRR if the investor leaves the pool with the Fed is -40.89%. If the investor takes back the pool at the end of the loan term and sells it at par, the IRR rises to 1.64%. The Fed, upon keeping the pool, will likely earn an IRR of 2.88% for the remaining life of the pool.

As we can see, these TALF terms are not attractive to investors. Let's now adjust the terms to equal the more attractive premium terms. To restate, the terms were as follows and the results can be found in Chart 6:

1. A Fed Funds Target loan spread of .25%.
2. A haircut of 2%.
3. A 17% CPR on the pool until maturity.

If the pool is left with the Fed, the investor can anticipate an IRR of 9.16%, with the Fed earning an IRR of 1.83%. Taking back the pool bumps up the returns to 28.14%. While these returns are better

than currently available, they will not attract many investors.

Why aren't the returns as attractive as in the premium pool scenario?

While the terms match the premium scenario, the interest spread earned by the investor on a par pool is significantly lower, not allowing enough spread earnings to overcome a 2% haircut.

Let's now adjust the terms again and see what it takes to approximately equal the returns seen in the premium example:

The new terms are as follows and can be found in Chart 7:

1. A Fed Funds Target loan spread of .25%
 2. A haircut of .75%
- A 17% CPR on the pool until maturity.

This is more like it.

Continued on next page

AN EQUILIBRIUM PRICING MODEL...CONTINUED

| CHART 5: PAR POOL @ TALF TERMS | | VALUE |
|--------------------------------|--|-------------|
| AMOUNT | | \$5,000,000 |
| PRICE | | 100.00 |
| POOL ORIGINAL MATURITY | | 300 Mos. |
| CURRENT POOL AGE | | 3 Mos. |
| POOL RESET MARGIN | | -2.125% |
| RESET INDEX VALUE | | 3.25% |
| INVESTOR CPR | | 17.00% |
| LOAN INPUTS | | VALUE |
| TALF LOAN INDEX | | 0.250% |
| TALF LOAN SPREAD | | 0.750% |
| FED ADMIN FEE | | 0.05% |
| LOAN LENGTH | | 36 Mos. |
| AVERAGE LIFE CPR | | 14.00% |
| OUTPUTS | | VALUE |
| AVERAGE LIFE | | 5.46 Yrs. |
| YTM | | 1.090% |
| HAIRCUT | | 6.00% |
| PREMIUM PAID BACK TO FED | | 0.00% |
| FED KEEPS POOL NET CASHFLOW | | (\$148,968) |
| FED KEEPS POOL IRR | | -40.89% |
| FED RETURNS POOL NET CASHFLOW | | \$11,579 |
| FED RETURNS POOL IRR | | 1.64% |
| EXIT VALUE PRICE | | 100.000 |
| FED IRR FROM KEEPING POOL | | 2.88% |
| FED NET CASHFLOW POST TALF | | \$319,700 |

jump at this offer.

Editor's Note: For further thoughts on this program, please read the article by Chris LaPorte of Coastal Securities, that can be found starting on page 1 of this report.

For this reason, it is too soon to determine if this program will be of benefit to the SBA secondary market.

What have we learned?

In order to achieve the equilibrium price, the Fed and the Treasury has to:

1. Reduce the TALF interest cost to Fed Funds Target plus 25 basis points.
2. Tier the haircuts based on the premium, not on the average life of the pool.
3. Make wholesale changes to the Treasury Direct Purchase Program if they choose not to make the necessary changes to the TALF.

The investor IRR when leaving the pool with the Fed is 64.33% and the Fed's IRR is 1.52% when held until maturity. The return if the investor takes back the pool is 70.66%.

Let's now look at the other program meant to soak up the excess supply of SBA pools.

The Treasury Direct Purchase Program

The treasury direct purchase program has one very big problem that makes it difficult to foresee any pool assembler utilizing it.

In order to purchase pools, the Treasury...

"...will receive warrants from the pool assemblers as additional consideration for the purchase of 7(a) securities."

Along with the warrants, they will only pay "reasonable" prices for the pools.

So, pool assemblers will have to give up a piece of their company, in order to receive what is likely "market level" prices for their pools. Color me a skeptic, but I don't think many pool assemblers will

Conclusion

By setting the TALF terms to make them more attractive to investors, the secondary market for SBA pools will rise until investor returns equal the lowest acceptable IRR.

If the incentives are structured properly, pool pricing will move the secondary market for loans to the equilibrium price, or higher, generating profits for lenders and pool assemblers.

Profitability means increased SBA lending, generating much needed economic growth for the US.

All of this, while maintaining a TALF profit for the Fed.

As always, I welcome your thoughts on this article...Bob

| CHART 6: PAR POOL @ PREMIUM ADJUSTED TALF TERMS | | VALUE |
|---|--|-------------|
| AMOUNT | | \$5,000,000 |
| PRICE | | 100.00 |
| POOL ORIGINAL MATURITY | | 300 Mos. |
| CURRENT POOL AGE | | 3 Mos. |
| POOL RESET MARGIN | | -2.125% |
| RESET INDEX VALUE | | 3.25% |
| INVESTOR CPR | | 17.00% |
| LOAN INPUTS | | VALUE |
| TALF LOAN INDEX | | 0.250% |
| TALF LOAN SPREAD | | 0.250% |
| FED ADMIN FEE | | 0.05% |
| LOAN LENGTH | | 36 Mos. |
| AVERAGE LIFE CPR | | 14.00% |
| OUTPUTS | | VALUE |
| AVERAGE LIFE | | 5.46 Yrs. |
| YTM | | 1.090% |
| HAIRCUT | | 2.00% |
| PREMIUM PAID BACK TO FED | | 0.00% |
| FED KEEPS POOL NET CASHFLOW | | \$14,381 |
| FED KEEPS POOL IRR | | 9.16% |
| FED RETURNS POOL NET CASHFLOW | | \$67,897 |
| FED RETURNS POOL IRR | | 28.14% |
| EXIT VALUE PRICE | | 100.000 |
| FED IRR FROM KEEPING POOL | | 1.83% |
| FED NET CASHFLOW POST TALF | | \$211,471 |

| CHART 7: PAR POOL @ PAR ADJUSTED TALF TERMS | | VALUE |
|---|--|-------------|
| AMOUNT | | \$5,000,000 |
| PRICE | | 100.00 |
| POOL ORIGINAL MATURITY | | 300 Mos. |
| CURRENT POOL AGE | | 3 Mos. |
| POOL RESET MARGIN | | -2.125% |
| RESET INDEX VALUE | | 3.25% |
| INVESTOR CPR | | 17.00% |
| LOAN INPUTS | | VALUE |
| TALF LOAN INDEX | | 0.250% |
| TALF LOAN SPREAD | | 0.250% |
| FED ADMIN FEE | | 0.05% |
| LOAN LENGTH | | 36 Mos. |
| AVERAGE LIFE CPR | | 14.00% |
| OUTPUTS | | VALUE |
| AVERAGE LIFE | | 5.46 Yrs. |
| YTM | | 1.090% |
| HAIRCUT | | 0.75% |
| PREMIUM PAID BACK TO FED | | 0.00% |
| FED KEEPS POOL NET CASHFLOW | | \$47,828 |
| FED KEEPS POOL IRR | | 64.33% |
| FED RETURNS POOL NET CASHFLOW | | \$67,897 |
| FED RETURNS POOL IRR | | 70.66% |
| EXIT VALUE PRICE | | 100.000 |
| FED IRR FROM KEEPING POOL | | 1.52% |
| FED NET CASHFLOW POST TALF | | \$177,649 |

OFF TOPIC: THOUGHTS ON THE PPIP...

By Bob Judge

Like many of you, I have given much thought to the recently announced Public-Private Investment Program.

While the idea is sound, execution may be problematic. Mostly, I am concerned that the pricing disparity between what investors will be willing to pay and where banks will be willing to sell distressed assets will remain too great to breach.

I wouldn't be surprised if we end up with numerous 20 bid, offered at 70, markets with no way of bridging the gap.

What if there was a neutral entity, sponsored by the US Treasury, that was given the responsibility of generating valuation for these assets, as a benchmark for value?

Instead of using expensive software and "black box" type financial models, they would be chal-

lenged to create flexible valuation models using only Microsoft Excel 2003 and/or OpenOffice.org software. The models would be completely open-source and released publicly; sort of a "white box" instead of a black one.

Let's call these spreadsheets "basic models" for the purpose of this discussion.

With a number of individuals who formed these securities currently unemployed, why not utilize their talents to help clean up the problem they helped to create?

Ideally, anyone with a basic spreadsheet program and a desire to invest in these assets could download these basic models and utilize them to formulate bids. Since the spreadsheets would be open to customization, these investors could make whatever adjustments they deem necessary to

participate. If nothing else, this idea would increase participation due to the availability of the basic models without going to the expense of purchasing financial engineering software and learning how to use it.

Turning to the modeling assumptions, they would be narrowed down to the bare minimum and categorized. The assumptions that would be needed to formulate the basic valuations would be determined by another group made up of market practitioners, bankers and regulators. They would determine the basic assumptions on a monthly basis.

Such assumptions as default, recovery and discount rates (to name a few) would be adjusted based on the latest market information and released publicly.

Since FASB is in the process of significantly weakening mark-

to-market accounting for distressed assets, these valuations could be the basis for how banks would value those instruments that are marked-to-market on their balance sheets.

They would not necessarily have to value the assets at these levels, but would have to explain the differences between their assumptions and those employed by the basic model.

I believe that this idea would help to move assets from the banks to investors, freeing up capital for further lending.

Instead of numerous 20-70 markets, we might have a situation whereby the basic model determines the asset to be valued at, say 40.

The psychological impact of a neutral valuation between the bid and offer may bring the parties together more readily than would otherwise be the case.



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

BY SCOTT EVANS

Settlement and Sales Strategies Tip #8 – Two for one special...

Tip#1 is simply to sell early during the month, preferably after payments have posted. Doing so allows more time for corrections if needed, and may lead to better bids as it allows pool assemblers to settle in time for that month's securitization. Settling after balance changes also avoids the time consuming claims process should one occur or at a minimum, keeps the sale and settlement balances consistent.

Tip#2 is even easier, be sure to identify Libor based loans....it does make a difference to the buyer.

*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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VALUE INDICES EDGE DOWN IN FEBRUARY

Please Note: Due to the introduction of Libor Base Rate loans into our database, we have changed the calculation from a purely Prime/Libor spread to a Base Rate/Libor spread.

Due to rising prices in the secondary market, the GLS Value Indices continued to edge down for the second month in a row. Beyond rising prices, the Base Rate/Libor spread decreased by 4 basis points due to a slow rise in Libor during the month. As a general rule, a decreasing Base Rate/Libor spread will negatively impact the indices. Offsetting the decrease in the basis was a decrease in the prepayment speed ele-

ment, which fell into the sub-10% category for the first time for three of the six indices. Lower prepayment speeds increase the value of the indices by increasing the yield on the loans sold into the secondary market.

Turning to the data, February saw five of the six indices decrease by double-digits, with GLS VI-1 (<8 year loans) showing the only increase, rising by 23.55%.

The all-important long-end index, GLS VI-6 (+20 year loans) fell by 16.18% to 171.3, the lowest reading in four months.

The largest decrease was seen in the VI-4 (13-16 year loans), which fell by 30.14% after hitting a new high in January.

While the market continues to move higher in anticipation of the TALF and the Treasury Direct Purchase Program, both programs remain flawed.

If something is not done to make these programs more attractive, expect the secondary market to begin to fall, and the indices to rise, due to unfulfilled promises by the Treasury and the Fed.

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

Data on pages 14-15, Graph on page 16

7(a) Secondary Market Pricing Grid: February 2009

| Maturity | Gross Margin | Fees | Servicing | 2/28/2009 Price | Last Month Price | Net Margin |
|----------|--------------|---------|-----------|-----------------|------------------|------------|
| 10 yrs. | 2.00% | 0.6750% | 1.0000% | 103.25 | 102.625 | 0.325% |
| 15 yrs. | 1.50% | 0.6750% | 1.0000% | 102.00 | 101.75 | -0.175% |
| 20 yrs. | 1.50% | 0.6750% | 1.0000% | 101.25 | 100.75 | -0.175% |
| 25 yrs. | 1.50% | 0.6750% | 1.0000% | 102.625 | 102.50 | -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 APPROACHES DECADE HIGH

Last month, the 7(a) default rate moved up by 11% to 6.88%, coming within 4% of the decade high of 7.17% seen in May of last year.

Due to the ongoing recession, the default rate has risen by 79% since October of last year.

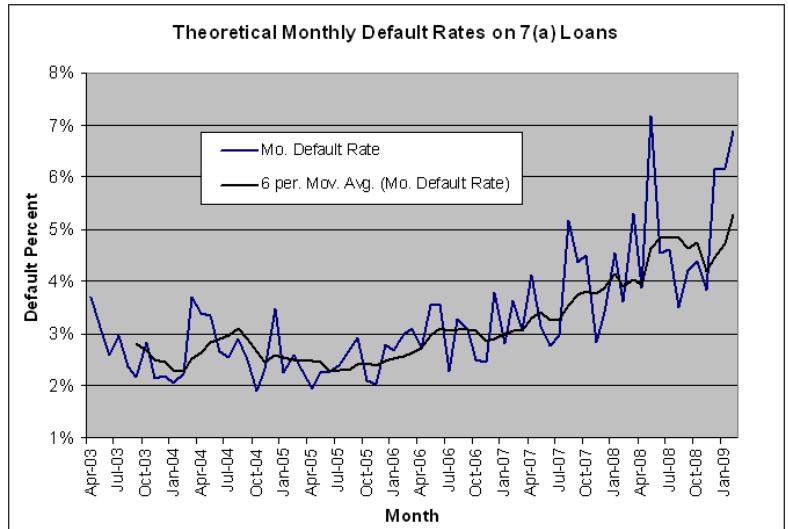
In fact, the default rate has begun to increase at an increasing rate, which leads us to believe that we have further to go before it begins to level off.

Turning to the actual data, the dollar amount of defaults actually set a decade high, coming in at \$145.7 million, a \$4.4 million increase from last month's reading

of \$141.3 million. The previous high was \$144.6 million recorded in May, 2008.

Taking a moment to look at voluntary prepayments, February set a decade low of \$66.9 million, and an astounding 27% decrease from the previous low set in January, 2009.

As the recession continues to cause problems for small business, expect continued higher defaults in the months' to come.



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

DEFAULT RATIOS: NEW HIGHS FOR 7(A) & 504

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

For the fourth month in a row, the 7(a) default ratio set a record high, reaching 68.53% from 60.51%.

The 504 default ratio also set another record, exceeding the 50% level for the first time, reaching 53.18%.

Below we attempt to analyze these results:

SBA 7(a) Default Ratios

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

The dollar amount of defaults rose 3% to \$145.7 million from \$141.3 million in January. Voluntary prepayments fell 27.44% to \$66.9 million as they continue to decrease as a percentage of overall prepayments.

Due to the current recession, we expect the default rate to remain well above 50% for the remainder of 2009.

SBA 504 Default Ratios

Also for the tenth 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 53.8% default ratio breaks the psychologically important 50% barrier, whereby defaults exceed voluntary prepayments.

With more 504 "failures" than "successes" in the marketplace, small business continues to suffer the effects of the recession.

Specifically, the dollar amount of defaults rose 26% to \$76.9 million from \$61 million, also the highest on record.

Voluntary 504 prepayments actually rose 9% to \$67.7 million from \$62 million in January. However, this increase was not enough to offset the double-digit percentage increase in defaults last month.

Summary

Economic conditions continue to cause increases in default rates in small business lending. We are now in uncharted territory and its anyone's guess how high defaults will rise until the economy turns around.

Graph on page 20

THE PLACE for up-to-date information on the Fed's TALF Program.

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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 |
|--------|--------------|--------------|--------------|--------------|--------------|--------------|
| 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% |
| Nov-08 | 12.08% | 12.36% | 11.45% | 11.49% | 11.49% | 13.22% |
| Dec-08 | 12.37% | 11.81% | 10.46% | 9.79% | 11.08% | 11.41% |
| Jan-09 | 12.86% | 11.55% | 10.45% | 9.29% | 10.61% | 10.40% |
| Feb-09 | 12.30% | 11.30% | 10.36% | 8.39% | 9.99% | 9.30% |

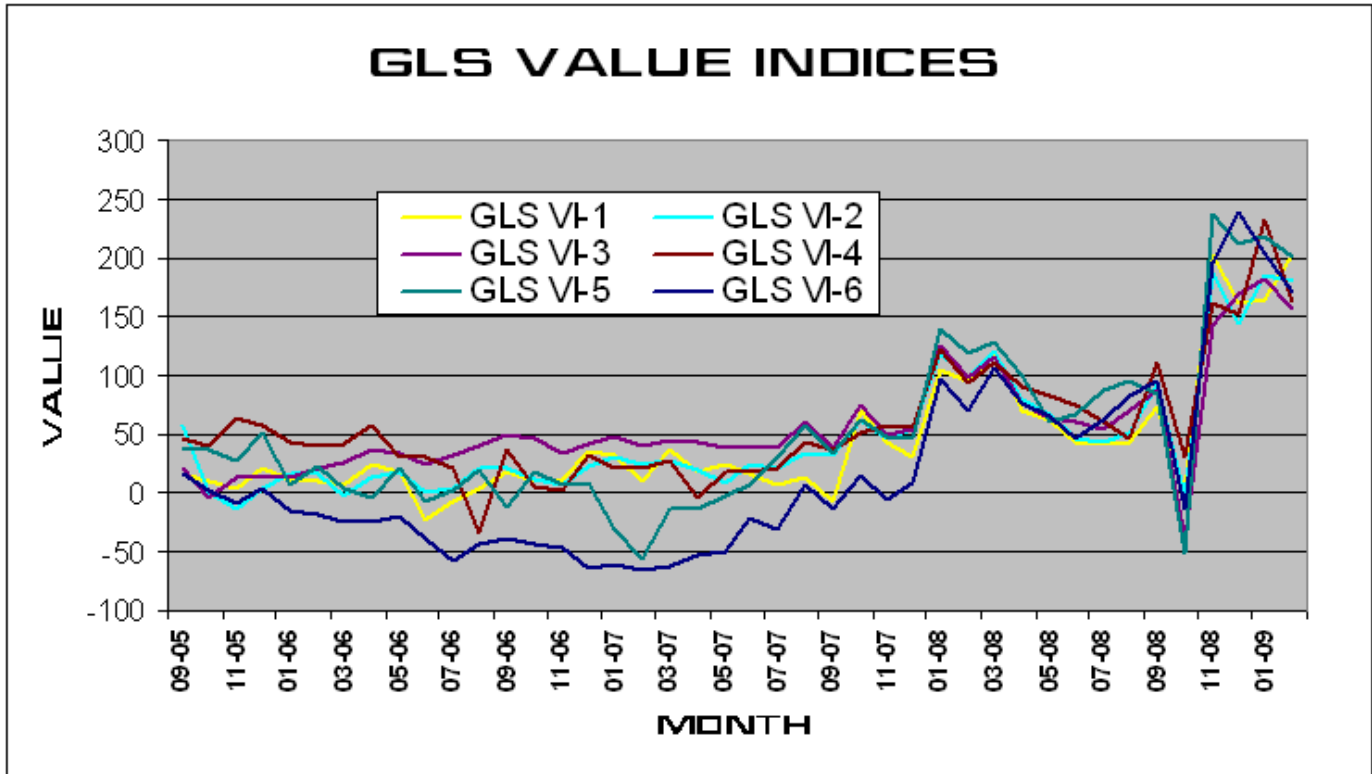
Rolling six-month CPR speeds for all maturity buckets. Source: Colson Services

NEW 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 | |
|--------|------------|-----------|----------------|----------|----------|----------|----------|----------|----------|----------------|-----------------|
| | | | | | | | | | | | HIGHEST READING |
| 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 | | |
| Nov-08 | 2.06% | 4.00% | 1.94% | 203.9 | 187.0 | 143.2 | 161.1 | 236.0 | 196.6 | | |
| Dec-08 | 1.64% | 3.89% | 2.25% | 162.2 | 144.9 | 170.3 | 151.0 | 212.5 | 238.6 | | |
| Jan-09 | 1.11% | 3.25% | 2.14% | 164.8 | 185.5 | 181.7 | 233.2 | 218.3 | 204.4 | | |
| Feb-09 | 1.15% | 3.25% | 2.10% | 203.6 | 179.5 | 157.4 | 162.9 | 201.5 | 171.3 | | |

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-09 | 16.67% | 9.11% | 10.27% | 10.30% | 8.75% | 9.67% | 9.94% |
| Feb-09 | 10.84% | 11.48% | 13.12% | 7.36% | 8.85% | 8.09% | 9.67% |
| Mar-09 | 14.52% | 14.16% | 11.41% | 9.86% | 12.85% | 7.42% | 9.52% |
| Grand Total | 14.04% | 11.59% | 11.61% | 9.19% | 10.18% | 8.39% | 9.71% |

2009 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-09 | 21 Mos. | 27 Mos. | 23 Mos. | 59 Mos. | 42 Mos. | 47 Mos. | 39 Mos. |
| Feb-09 | 21 Mos. | 27 Mos. | 23 Mos. | 59 Mos. | 43 Mos. | 47 Mos. | 40 Mos. |
| Mar-09 | 21 Mos. | 28 Mos. | 24 Mos. | 60 Mos. | 43 Mos. | 47 Mos. | 40 Mos. |

2009 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-09 | 7.35% | 31.58% | 10.94% | 15.95% | 2.41% |
| Feb-09 | 13.53% | 10.26% | 6.52% | 4.50% | 21.72% |
| Mar-09 | 9.36% | 19.91% | 14.43% | 15.20% | 18.36% |
| Grand Total | 10.11% | 21.31% | 10.79% | 12.11% | 14.80% |

| 10-13 BY AGE | 0-12 Mos. | 13-24 Mos. | 25-36 Mos. | 37-48 Mos. | 48+ Mos. |
|--------------------|---------------|---------------|---------------|--------------|--------------|
| Jan-09 | 9.56% | 13.20% | 7.40% | 8.64% | 8.76% |
| Feb-09 | 10.87% | 16.62% | 12.39% | 8.83% | 11.78% |
| Mar-09 | 11.51% | 14.64% | 9.99% | 5.24% | 7.45% |
| Grand Total | 10.60% | 14.84% | 10.00% | 7.44% | 9.33% |

| 16-20 BY AGE | 0-12 Mos. | 13-24 Mos. | 25-36 Mos. | 37-48 Mos. | 48+ Mos. |
|--------------------|--------------|---------------|--------------|--------------|---------------|
| Jan-09 | 5.25% | 6.38% | 17.21% | 6.73% | 10.29% |
| Feb-09 | 0.00% | 13.17% | 5.76% | 4.81% | 12.03% |
| Mar-09 | 8.52% | 19.83% | 4.91% | 10.43% | 12.05% |
| Grand Total | 4.73% | 13.48% | 9.32% | 7.23% | 11.47% |

| 8-10 BY AGE | 0-12 Mos. | 13-24 Mos. | 25-36 Mos. | 37-48 Mos. | 48+ Mos. |
|--------------------|---------------|---------------|---------------|--------------|---------------|
| Jan-09 | 7.89% | 12.32% | 8.52% | 3.96% | 12.50% |
| Feb-09 | 11.59% | 11.43% | 15.08% | 5.57% | 12.29% |
| Mar-09 | 11.28% | 22.85% | 10.72% | 10.13% | 12.67% |
| Grand Total | 10.13% | 15.97% | 11.58% | 6.54% | 12.49% |

| 13-16 BY AGE | 0-12 Mos. | 13-24 Mos. | 25-36 Mos. | 37-48 Mos. | 48+ Mos. |
|--------------------|--------------|--------------|--------------|--------------|---------------|
| Jan-09 | 0.00% | 9.70% | 0.00% | 10.03% | 11.28% |
| Feb-09 | 20.67% | 4.28% | 0.00% | 7.21% | 7.03% |
| Mar-09 | 0.00% | 2.39% | 14.62% | 5.15% | 12.71% |
| Grand Total | 7.14% | 5.49% | 8.55% | 7.63% | 10.36% |

| 20+ BY AGE | 0-12 Mos. | 13-24 Mos. | 25-36 Mos. | 37-48 Mos. | 48+ Mos. |
|--------------------|--------------|--------------|--------------|--------------|--------------|
| Jan-09 | 10.77% | 12.40% | 10.16% | 7.43% | 8.21% |
| Feb-09 | 3.56% | 6.57% | 12.17% | 5.72% | 9.25% |
| Mar-09 | 6.12% | 9.38% | 7.45% | 5.64% | 7.61% |
| Grand Total | 6.98% | 9.50% | 9.94% | 6.24% | 8.36% |

2009 YTD CPR by maturity and age bucket. Source: Colson Services

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 higher for SBAExpress loans.)

Risk Types

The various risk types that impact SBA pools are the following:

Basis Risk: The risk of unexpected movements between two indices. The impact of this type of risk was shown in the decrease in the Prime/Libor spread experienced in 2007 and 2008.

Prepayment Risk: The risk of principal prepayments due to borrower voluntary curtailments and defaults. Overall prepayments are expressed in CPR, or Conditional Prepayment Rate.

Interest Rate Risk: The risk of changes in the value of an interest-bearing asset due to movements in interest rates. For pools with monthly or quarterly adjustments, this risk is low.

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

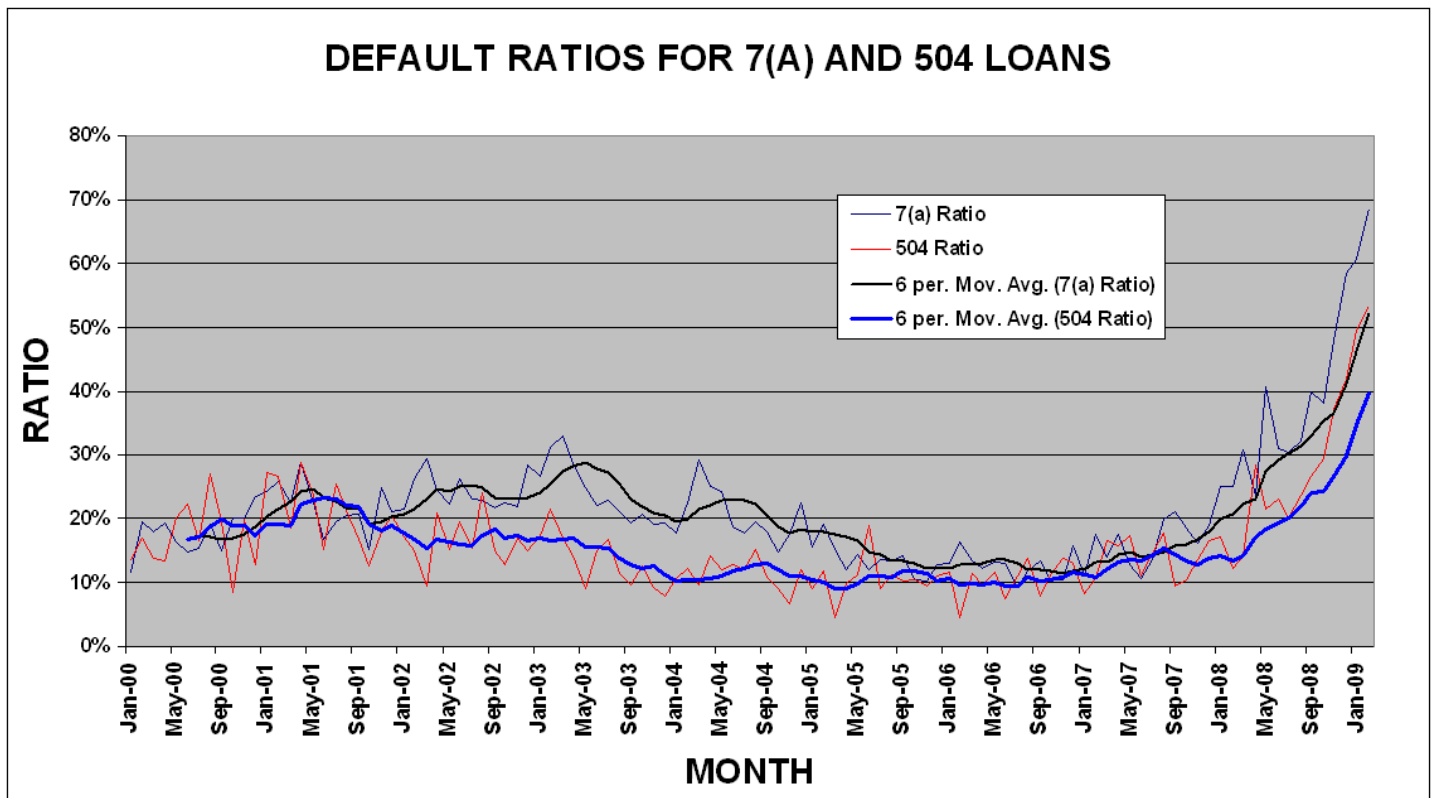
TALF

The TALF, or **Term Asset-Backed Security Loan Facility**, was announced by the Federal Reserve Bank and the US Treasury on November 25, 2008. The purpose of the TALF is to make credit available to consumers and small businesses on more favorable terms by facilitating the issuance of asset-backed securities (ABS) and improving the market conditions for ABS more generally.

The most recent update was released by the Federal Reserve on March 19th, 2009.

The Federal Reserve Bank of New York will make up to \$1 trillion of loans under the TALF. TALF loans will have a term of three years; will be non-recourse to the borrower; and will be fully secured by eligible ABS. The US Treasury Department will provide \$100 billion of credit protection to the Federal Reserve in connection with the TALF.

SBA Pools issued in 2008 and beyond are considered eligible securities.



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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:

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