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Special Report

April, 2012

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FMLP & 504 Temporary Refinance: Sunset on the Horizon

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Jordan Blanchard is the founder and president of Wholesale 504 Lending Consultants, LLC . W504's mission is to help bank and non-bank lenders fund SBA 504 loan transactions. He recently joined forces with Government Loan Solutions and co-founded Secondary Market Access. SMA's purpose is to facilitate an active secondary market for SBA 504 first mortgage by assisting sellers and buyers. SMA's focus has been the 504 First Mortgage Lien Pool program. SMA, or its principals, have assisted with the settlement of more than 60% of all pools issued to date.

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By Tom Wallace, Jordan Blanchard and Bob Judge

The First Mortgage Lien Pool (FMLP) and the 504 Temporary Refinance programs are specific responses to a problem faced by small business concerns in the aftermath of the 2008 meltdown of the financial markets[1]. Absent a legislative extension, both programs are scheduled to cease operating in September of 2012.

The problem faced by small businesses was, and remains, the unavailability of long term financing for owner occupied commercial real estate. While this is a problem for a small business looking to expand into a recovering economy, it is a potential catastrophe for a small business with a maturing mortgage which needs to be refinanced. The inability to refinance a maturing real estate obligation creates an immediate crisis for a small business, as a long term balance sheet problem becomes an immediate operational issue. This effectively chokes off cash flow and closes out other credit availability, endangering the very existence of the small business.

Prior to 2008, such needs were met, for creditworthy customers, by conventional commercial bank financing. Banks had the capital and capacity to hold these obligations as assets on their balance sheet, or the ability to securitize them into a functioning secondary market. Even three years after the onset of the credit crisis, these options are still no longer widely available.

Banks are under greater, and in some cases, less clear regulatory pressure regarding their commercial real estate exposure[2]. This regulatory pressure continues impacting the willingness of commercial banks to provide needed commercial mortgage rollover financing.

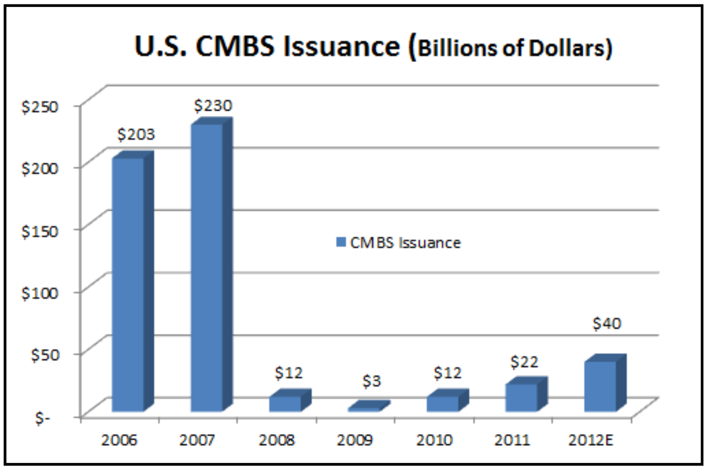
Footnotes

[1] FMLP was created by American Recovery and Reinvestment Act of 2009 and 504 Temporary Refinance was created by the Small Business Jobs Act of 2010.

[2] U.S. Government Accountability Office Report GAO-11-480. "Banking Regulation: Enhanced Guidance on Commercial Real Estate Risks Needed" & Federal Reserve Bank Governor Elizabeth A. Duke's speech; 13 January 2012, Bank President's Seminar, California Bankers Association, "Opportunities to Reduce Regulatory Burden and Improve Credit Availability".

SUNSET ON THE HORIZON…CONTINUED

Chart 1: CMBS Issuance, 2006-2012E



Source: Commercial Mortgage Alert

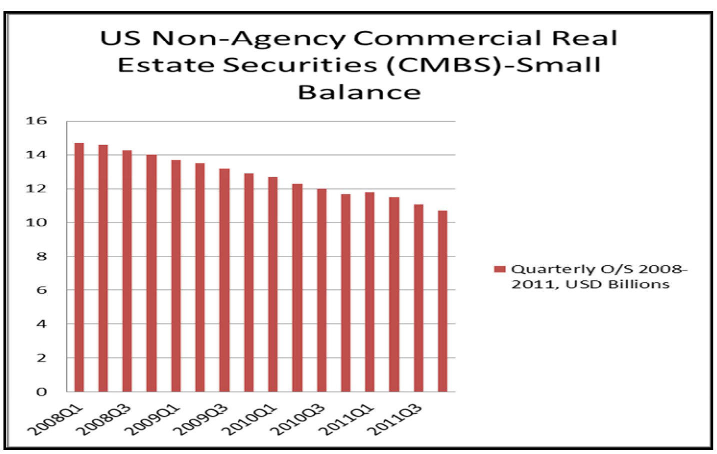
As we enter 2012, the secondary market for commercial mortgages remains crippled, functioning at levels some 80% below 2006-2007 (Chart 1, above).

Turning to small-balance CMBS as a proxy for small business real-estate securitization, we see a continued decrease in the balance of existing bonds. For this to occur, new issuance is nowhere near enough to offset the run-off of existing securities (Chart 2, right).

The expected total CMBS issuance for all of 2012 is $40 billion with approximately $5 billion of it in small-balance loans. However, in 2012 alone, it is estimated that as much as $362 billion in commercial real estate mortgages will mature, with a like amount pending in 2013[3]. If historical averages hold, some $36 billion of the maturing CRE debt in 2012 will be in small-balance loans, which have been distributed between bank balance sheets (+/-35%) and securitized into CMBS (+/-25%) with the remaining balance held by insurance companies in whole-loan form and by the GSEs. Under the current regulatory environment, it is unlikely that such a volume of small-balance commercial loans will find their way onto the balance sheets of financial institutions over the next two years[4] and as shown above and elsewhere the secondary market currently lacks the necessary capacity[5].

FMLP, in combination with the 504 Temporary Refinance Program, is providing critical lending capacity to small businesses. FMLP allows lenders to form loan pools from loans refinanced under the 504 Temporary Refinance Program for sale into the secondary market using an SBA guarantee to facilitate the sale. The combination frees

Chart 2: CMBS Small-Balance Outstanding, 2008-2011



Source: Securities Industry Financial Markets Association

"The problem faced by small businesses was and remains the unavailability of long-term financing for owner occupied commercial real estate."

Footnotes

[3] "$362B of Commercial Debt Matures in 2012" REALTOR© Mag, 27 March 2012, National Association of REALTORS©, quoting Trepp, LLC Research.

[4] Federal Reserve Bank, "Senior Lender Opinion Survey on Bank Lending Practices" January 2012.

[5] Federal Reserve Bank of San Francisco, "Economic Newsletter" 18 July 2011, James A. Wilcox.

SUNSET ON THE HORIZON...CONTINUED

Chart 3: FMLP Loans Pooled by Month, 09-2010 To 03-2012

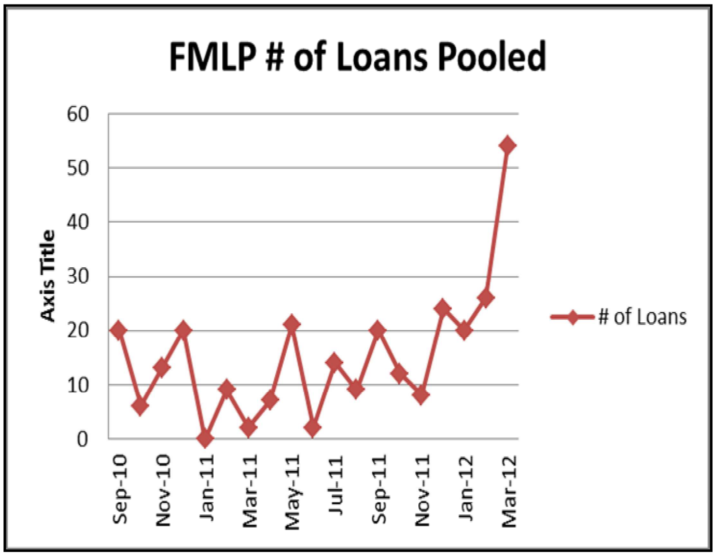
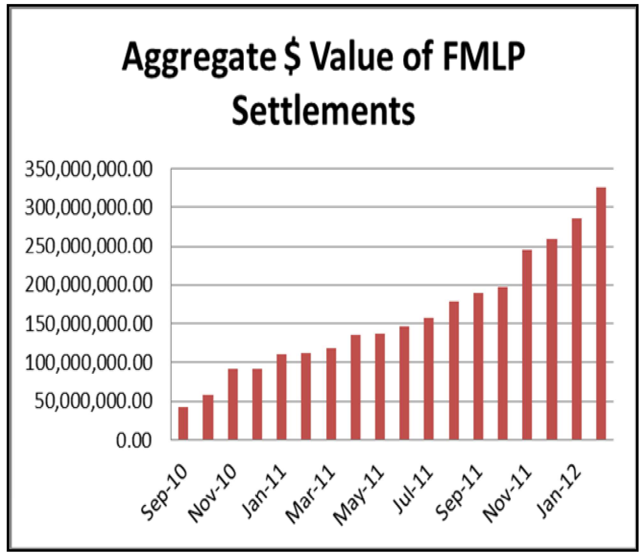


Chart 5: FMLP Dollar Value of Settlements, 09-2010 To 03-2012



Sources: Wholesale 504 Lending Consultants, Inc. and SBA

considerable liquidity and capital for the benefit of small business concerns.

FMLP, as shown in Chart 3 above, was slow to start, due to two factors: firstly, SBA had to create the program from scratch; and secondly, product in the form of first position 504 loans capable of being pooled had to be underwritten and committed.

The second factor, the supply of first position 504 loans capable of being pooled, was seriously limited by the 504 program's historical restriction against refinancing. This was addressed by legislation in September 2010, however, the Final Rule from SBA, which included several critical regulatory changes was not in place until October of 2011. As can be seen from the three charts on this page, with the full process now assembled, the market appears to have spoken, with loan approvals and subsequent loan pool formation accelerating greatly after the October 2011 promulgation of definitive regulations.

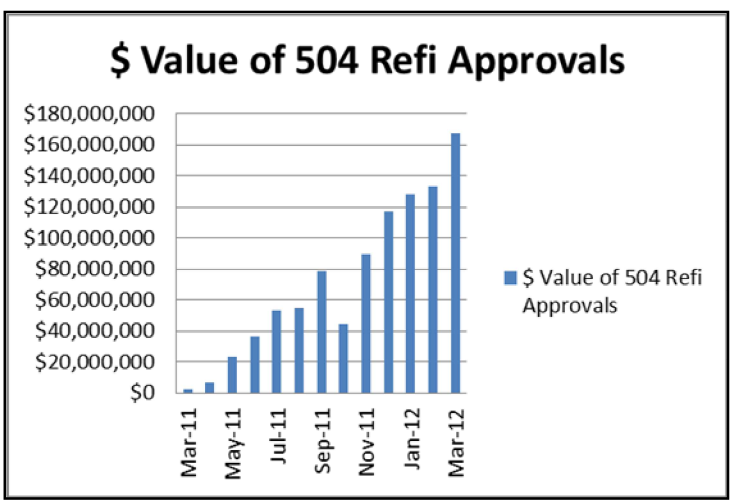
The dollar value of loans pooled in in the last four months, an accurate period for measuring the impact of the full process being in place, is almost 2.5x the monthly volume of the preceding fifteen months and the number of small business being assisted monthly has effectively tripled.

After an extended gestation; Congress, SBA and the SBA's lending partners have finally pulled together the full spectrum of a product process to help solve the lack of commercial real estate refinance capacity for small businesses.

FMLP and the 504 Temporary Refinance programs are two sides of the same coin. They address a common specific problem, the lack of a functioning securitization market in the face of colossal commercial real estate refinancing needs for small businesses. The programs are scheduled to sunset in September of this year, and at this writing no legislation is pending. When lawmakers understand these solutions are without specific cost to the taxpayer and already in place, there is rarely any opposition to an extension. The most common complaint from legislators is that they rarely hear from anyone on the program, so they take that to be a lack of interest.

In the coming weeks, we hope to see NADCO and NAGGL bring this issue to greater notice and to work together to support a legislative effort to extend the FMLP and the 504 Temporary Refinance programs.

Chart 4: 504 Refinance Program Approvals, 03-2011 To 03-2012



Source: National Association of Development Companies, and SBA