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## Government Loan Solutions' CPR Report

Providing the most detailed monthly SBA 7(a) and 504 prepayment, default and market information

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

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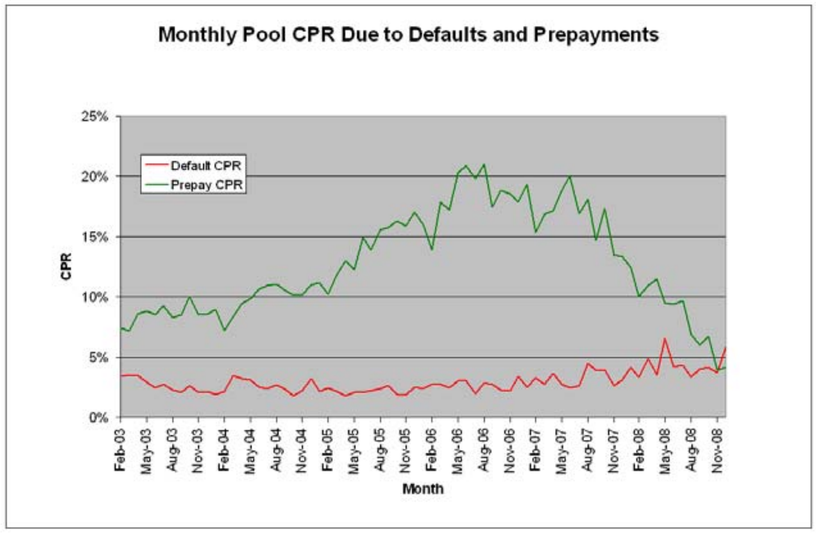
**INSIDE THIS ISSUE:**

**Special points of interest:**

- Prepayments stay below 10%
- TALF and the Stimulus Bill
- Value Indices Stay Elevated
- Default Ratios set Record Highs



# January CPR: Prepays Rise, But Stay Below 10%




**P**repayment speeds moved back to the CPR 10% range in January, primarily due to increases in loan defaults.

For January, the prepayment rate came in at CPR 9.94%, a 30% increase over the decade low of CPR 7.65% recorded last month.

While voluntary prepayments rose slightly, it was the 57% increase in defaults that caused prepayments to rise.

In fact, January was the first month this decade where defaults actually exceeded voluntary prepayments.

The above chart displays this phenomena, with **Default CPR** (red line)

*Continued on top of page 2*

# TALF and the Stimulus Bill

*By Bob Judge*

While we all wait anxiously for the final details of the TALF, I thought it might be useful to review how the TALF, the House and Senate versions of the stimulus package may impact the secondary market.

Currently, the House has approved their version of the bill and the Senate version is in development. Once the Senate approves their version, both bills will have to be combined and voted on by both houses of Congress. Until we

*Continued on top of page 3*

# JANUARY CPR...CONTINUED

exceeding **Prepay CPR** (green line) for the first time in our 10 year database.

For at least the past ten years, voluntary prepayments have been the major cause of high pool prepayment speeds.

This has now changed.

Due to the severe US recession, we have now entered a period where defaults will represent the majority of SBA loan prepayments.

What does this mean to prepayment speeds over the next few years?

While no one wishes to see increasing defaults, this phenomena should keep speeds low for a significant period of time.

Theorizing for moment, if Default CPR eventually doubles from here (CPR 5.81%) and the Prepay CPR (CPR 4.13%) falls by half, then we are looking at a maximum of around CPR 14% for the next few years. This is significantly better than the CPR 20%+ levels seen during the prepayment spike of 2005-2007.

Turning to last month's data, the worst performing sector was the long-end (20+), which increased 57% to CPR 9.67%. Other sectors that performed poorly were the 13-16 sector that increased by 39%, <8 (+29%) and 10-13 (+23%).

We saw two sectors decrease in speed, with the 16-20 sector decreasing by 29% and the 8-10 falling by 15%.

While we are entering an economically destructive phase of increasing defaults, investors in guaranteed portions of SBA loans and pools will benefit from low overall prepayments for a multi-year period.

*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 11-12*

*"Due to the severe US recession, we have now entered a period where defaults will represent the majority of SBA loan prepayments."*

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

### BY SCOTT EVANS

### Settlement and Sales Strategies Tip #6 – Sell when the time is right...

This may seem rather obvious but with the TALF on the very near horizon, it may pay off to be patient. Some lenders need to sell for capital purposes but for those that don't, you may be well served to hold off until we see TALF related buy interest. Increased interest on the part of investors is the main reason behind the TALF. An increase in investor demand should translate into higher pricing for lenders.

*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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# TALF AND THE STIMULUS...CONTINUED

know what the final law contains, the following discussion is subject to change.

I will begin with a look at the 7(a) secondary market and finish with a look at the 504 program.

**7(a) Secondary Market**

**Term Asset-Backed Securities Loan Facility**

There hasn't been anything concrete issued by the Fed since the December 19th, 2008 update to the TALF terms and conditions.

However, rumor has it that we should hear something by the end of the first week of February. Possible changes could include pushing back the pool eligibility date to January 1st, 2008 (high probability) and a Fed Funds Target floating-rate loan option (low to mid probability).

Whatever the final terms look like, the TALF is meant to create investor demand for SBA pools via low funding costs from the Federal Reserve. By creating investor demand, the pool assembler community will be able to liquidate its excess inventory of pools and loans, allowing them to purchase new loans for securitization.

**US House Version and 7(a) Secondary Market**

The House version of the stimulus bill will allow the SBA to finance loan positions with "systemically important" pool assemblers at a low interest rate. While on first blush this provision may seem in conflict with the TALF, it is in fact complimentary.

While the TALF is meant to help pool assemblers sell SBA pools, this provision will allow them to purchase and finance loans from lenders ***prior to securitization***.

The pool assemblers will then place these loans into pools and sell them to investors via the TALF. By offering a lower funding cost to pool assemblers, the theory goes that they will purchase more loans and earn larger profits from those acquisitions. Low funding costs can make holding loans more profitable prior to securitization, thus allowing pool assemblers the ability to raise their bids in order to maximize the amount of loans they purchase.

Additionally, this funding ability is set to last for 2 years, which is one year longer than TALF, as currently conceived. If TALF does in fact end after 2009, this provision may allow the secondary market additional time to repair itself before being left to its own devices.

**US Senate Version and 7(a) Secondary Market**

The Senate version attacks the problems in the secondary market by eliminating the SBA Annual Fee that is currently 55 basis points (.55%) until September 30th, 2010.

By eliminating this fee, the interest rate earned by the secondary market investor is immediately increased by 55 basis points. This interest rate increase raises the value of any given loan sold in the secondary market. Each loan is worth more because a pool assembler can afford to increase his/her bid and still receive the same, or higher yield on the loan. We would expect that this benefit will somehow be split between the lender and the pool assembler on a loan-by-loan basis.

Again, with the pool assembler community being able to purchase loans with higher yields, they can increase their profit margin from securitization. These newly formed pools could then be sold to TALF-funded investors.

As with the House version, this feature is meant to exceed the TALF timeframe, allowing for additional time for the market to correct.

**7(a) Summary**

All three proposals attack the problems in the secondary market from a different angle. All three proposals can work in complementary fashion to help bring the secondary market back into equilibrium.

Hopefully, both the House and Senate provisions make it into the final bill, giving the SBA significant latitude to help the secondary market.

**504 Secondary Market**

I will begin my discussion of the 504 secondary market with the House Bill proposals:

**US House Version and 504 Secondary Market**

The House Bill allows "private sector entities" to apply for a Federal guarantee on pools of 1st lien 504 loans to be sold to "third-party" investors. The authority is for $3 billion in guarantees and will last for 2 years.

The benefit, to my mind, is that by providing a US government guarantee on a pool of 504 loans, the resulting security would become ***TALF eligible.*** Up until this point, private 504 securitizations have not been seen as TALF eligible and without cheap government funding, it is not possible to create a 504 securitization and sell the securities at a profit.

Clearly, TALF eligibility will create investor demand for securities based on 504 1st lien loans, creating a new exit strategy for lenders that prefer to sell their loans. By

*Continued on page 6*

# THE GOVGEX CORNER

## Three-month trailing average for high bids: November - December 2008 - January 2009

| Maturity | Prime + 1% | Prime + 2% |
|---|---|---|
| **10 years** | 100.974 | 102.062 |
| **25 years** | 99.8903 | 101.5336 |

The month of January continued to reflect a lack of demand for government guaranteed loans. Selling volume remained low in January and brought minimal change to the three-month moving average for premiums at the benchmark margins over prime (see table below). Buyers continued to look at deals but hesitate to make offers, with a bid to pass ratio of 1:5.

**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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# TALF & Stimulus...Continued

creating a true government guaranteed security out of 504 1st liens, investors can more easily access securities generated by the program.

The TALF eligibility aspect lowers the cost of funding the 504 pooled securities, thus allowing for lower interest rates and higher prices, on 504 1st lien loans.

**US Senate Version and 504 Secondary Market**

Much like the 7(a) provisions, the Senate version discusses the elimination of 504 loan fees until September 30th, 2010.

While waving fees will help borrowers and lenders, the Senate version will not help the 504 1st lien secondary market as much as the House version. The need for a uniform pooling structure with a government guarantee is essential to generate investor interest in 504 1st liens in today's capital markets environment.

**TALF and 504 Secondary Market**

As mentioned above, the key here is the House provision allowing for a government guaranteed pool structure for 504 1st liens. Additionally, the 504 pool will likely have to be a true security that has a cusip number and can be settled through DTC (Depository Trust Company). This structure would mimic 7(a) pools and allow settlement of the 504 pool through a Primary Dealer in government securities according to the terms and conditions of the TALF.

**504 Summary**

As with the 7(a) program, both the House and the Senate versions of the stimulus package help the 504 market in different ways. However, for the TALF to be effective for the 504 secondary market, it will be essential that the House provision be part of the final version of the bill.

# Value Indices Remain Elevated in December

In December, the Value Indices remained at, or near, all-time highs. Supporting these high levels was another increase in the Base Rate/Libor spread, from 194 basis points to 225 basis points. This spread is now within 36 basis points of the 42-month average.

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.

Additionally, December saw two all-time highs, with GLS VI-3 (10-13 year loans) recording 170.3, 27 points higher than the November record of 143.2. The long-end also recorded another record high, reaching 238.6, 42 points higher than the previous month's record of 196.6.

The other four indices all displayed modest decreases, ranging from a 23% decline in the 8-10 sector to 6% decline in the 13-16 sector.

As expected, the prepayment element displayed across-the-board decreases due to another month of sub-10% prepayment speeds. Falling prepayment speeds support higher indices for premium-priced loans due to the longer average-life of the loan.

With conditions still weak in the secondary market and Libor remaining under control, expect continued elevated levels for the value indices to be reported next month.

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

*Data on pages 9-10, Graph on page 11*

## 7(a) Secondary Market Pricing Grid: December 2008

| Maturity | Gross Margin | Fees | Servicing | 12/31/2008 Price | Last Month Price | Net Margin |
|---|---|---|---|---|---|---|
| 10 yrs. | 2.00% | 0.6750% | **1.0000%** | **102.375** | **102.50** | 0.325% |
| 15 yrs. | 1.50% | 0.6750% | **1.0000%** | **101** | **101.50** | -0.175% |
| 20 yrs. | 1.50% | 0.6750% | **1.0000%** | **100.25** | **101.00** | -0.175% |
| 25 yrs. | 1.50% | 0.6750% | **1.0000%** | **100.50** | **101.00** | -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:

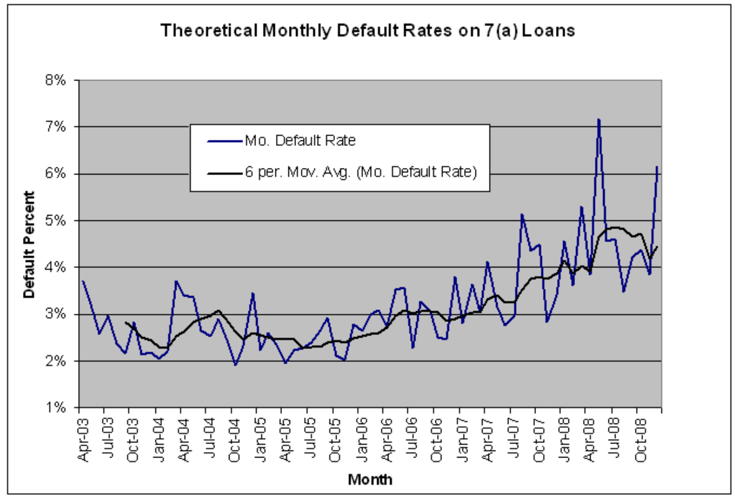
# Default Rate Rise to 6.15%

Last month, the 7(a) default rate jumped 60% to 6.15%, the second highest reading in our ten-year database.

Considering the deterioration in the US economy over the past year, default rates have grown at a slower pace than we would have expected. While we had a period of slowing defaults after the high of 7.17% in May, the upward trend seems to have returned.

Turning to the actual data, the dollar amount of defaults was $136.1 million, a significant increase from last month's reading of $86.8 million. This reading is also the second highest on record, exceeded only by last May's $144.6 million.

As mentioned in previously in this report, last month was the first time this decade that defaults exceeded voluntary prepayments, which totaled $96.8 million. We expect this trend to continue as the weak economy continues to take its toll on small businesses in the United States.




# Default Ratios: 7(a) Goes Above 50%

January default ratios continued 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 set a record high of 58.44%, the first reading above 50% this decade and significantly higher than the previous month's reading of 48.14%.

The 504 default ratio also set another record, hitting 41.69%, the first ever reading above 40%.

Below we attempt to analyze these results:

### SBA 7(a) Default Ratios

For the eighth 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 significantly to $136.1 million from $86.6 million in December. While voluntary prepayments increased slightly by 3.5%, it was not enough to keep the default rate below 50%.

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

### SBA 504 Default Ratios

For the eighth 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 41.69% default ratio represents another ten-year record, which also happens to be the extent of our database. The dollar amount of defaults rose 7% to $51.2 million from $48 million, also the highest on record.

### Summary

As we have stated in the past, economic conditions continue to take their toll on the 7(a) and 504 loans. As one would expect, our default ratios continue to move higher and will likely continue to do so through 2009.

*Graph on page 15*

# 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 |
|---|---|---|---|---|---|---|
| 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% |
| 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% |

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

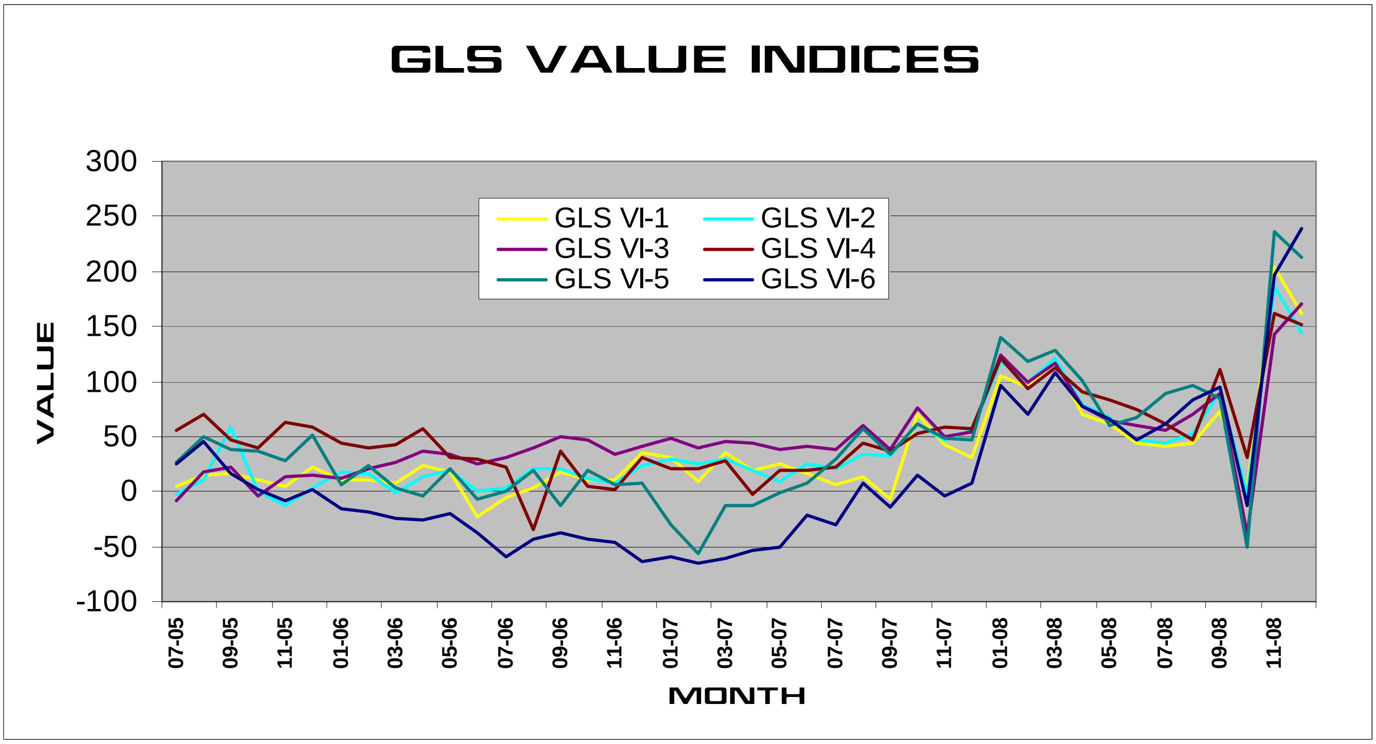
# NEW VALUE INDICES: HISTORICAL VALUES

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 |
|---|---|---|---|---|---|---|---|---|---|
| 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 |
| 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 |

| INDICES LEGEND | |
|---|---|
| (green) | HIGHEST READING |
| (red) | LOWEST READING |

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%** |
| **Grand Total** | 16.67% | 9.11% | 10.27% | 10.30% | 8.75% | 9.67% | **9.94%** |

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-09** | 21 Mos. | 27 Mos. | 23 Mos. | 59 Mos. | 42 Mos. | 47 Mos. | **39 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-09 | 7.35% | 31.58% | 10.94% | 15.95% | 2.41% |
| Grand Total | **7.35%** | **31.58%** | **10.94%** | **15.95%** | **2.41%** |

| 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% |
| Grand Total | **9.56%** | **13.20%** | **7.40%** | **8.64%** | **8.76%** |

| 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% |
| Grand Total | **5.25%** | **6.38%** | **17.21%** | **6.73%** | **10.29%** |

| 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% |
| Grand Total | **7.89%** | **12.32%** | **8.52%** | **3.96%** | **12.50%** |

| 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% |
| Grand Total | **0.00%** | **9.70%** | **0.00%** | **10.03%** | **11.28%** |

| 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% |
| Grand Total | **10.77%** | **12.40%** | **10.16%** | **7.43%** | **8.21%** |

2008 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:

*Defaults / (Defaults + 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:

*Pool Prepay Percentage = Pool Prepayments / 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:

*((Secondary Loan Defaults * Pool Prepay Percentage) / 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:

*Total Pool CPR = VCPR + 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.

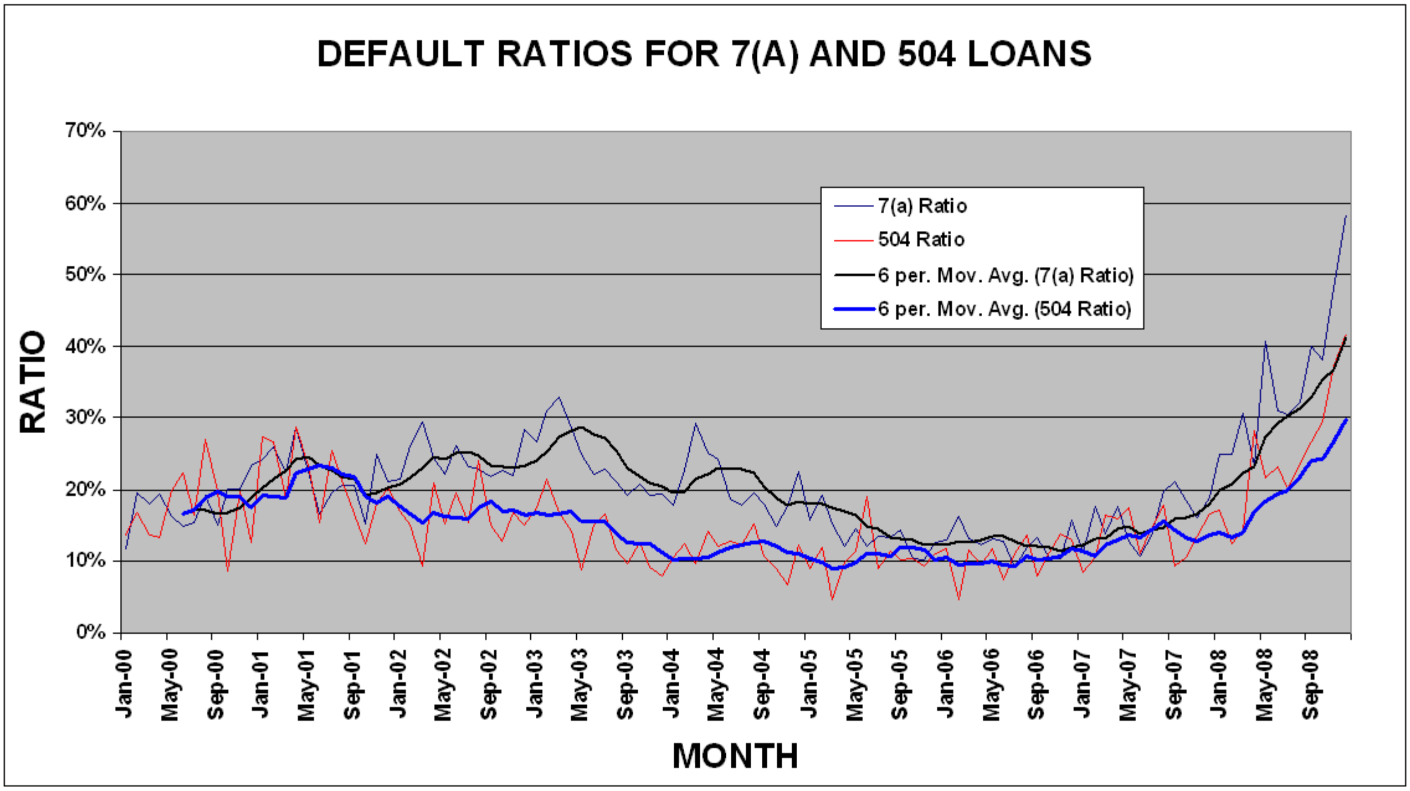
## TALF

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.

An important update was released by the Federal Reserve on December 19th, 2008.

The Federal Reserve Bank of New York will make up to $200 billion 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 $20 billion of credit protection to the Federal Reserve in connection with the TALF.

SBA Pools issued in 2009, which contain loans originated in 2008 and beyond are considered eligible securities.


DEFAULT RATIOS FOR 7(A) AND 504 LOANS
RATIO
70%
60%
50%
40%
30%
20%
10%
0%
7(a) Ratio
504 Ratio
6 per. Mov. Avg. (7(a) Ratio)
6 per. Mov. Avg. (504 Ratio)
Jan-00
May-00
Sep-00
Jan-01
May-01
Sep-01
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- *Process loan settlements via our electronic platform, E-Settle*
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- *Model Validation*
- *Specialized research projects*
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