

Bob Judge, Government Loan Solutions, Editor



Bob Judge is a partner at Government Loan Solutions.

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

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## 7A CPRs FALL 24%

In October, prepaids hit a 2012 low as they went below 5% for the second time this year. As for the details, prepayments fell 24% to 4.52% from 5.99%, and took out the previous low for this year of 4.61% seen in April.

In comparing prepayment speeds for the first ten months of 2012 to the same period for 2011, 2012 is currently 2.63% below last year. Specifically, 2012 has an average speed of 5.46% to date, versus 5.61% for the same period in 2011.

As for the largest sector of the market, 20+ years to maturity, prepayment speeds fell by 13% to 3.67% from 4.23%.

Article continued on page 3, Charts on page 2

## SMALL BUSINESS INDEXES: INTRODUCING SBA 7A POOL AND I/O STRIP INDEXES

At the 5th Annual SBA Secondary Market Forum held last week in DC, GLS and Ryan ALM, Inc., through a joint venture called Small Business Indexes, Inc. or SBI, introduced a

group of total return indexes for SBA 7a pools and I/O strips with history going back to 1/1/2000.

Indexes have been around since 1896 when the Dow Jones Industrial Average was introduced. They have grown in

### Why did we do this?

Continued on page 4-9

## SECONDARY MARKET ACCESS: 504 1ST LIEN SECONDARY MARKET UPDATE

By Jordan Blanchard

The 504 section of the CPR report will be written on a semi-regular basis as news or products dictate. The November edition will focus on the efforts

of the former FMLP industry participants to create an expanded secondary market for SBA 504 first liens.

The FMLP program demonstrated that an expanded secondary market provides capital

to those businesses most able to create jobs. The existing 504 secondary market buyers by and large focus on mature businesses residing in multi-purpose properties. An expanded sec-

Continued on page 10

## THE TECHNOLOGY CENTER: BANKING IN THE CLOUD—PART 2

By Pullen Daniel, EVP, nCino

### Benefits of Using a Cloud-Based Bank Operating System

Cloud computing can substantially enhance operations and profitability at a bank. The

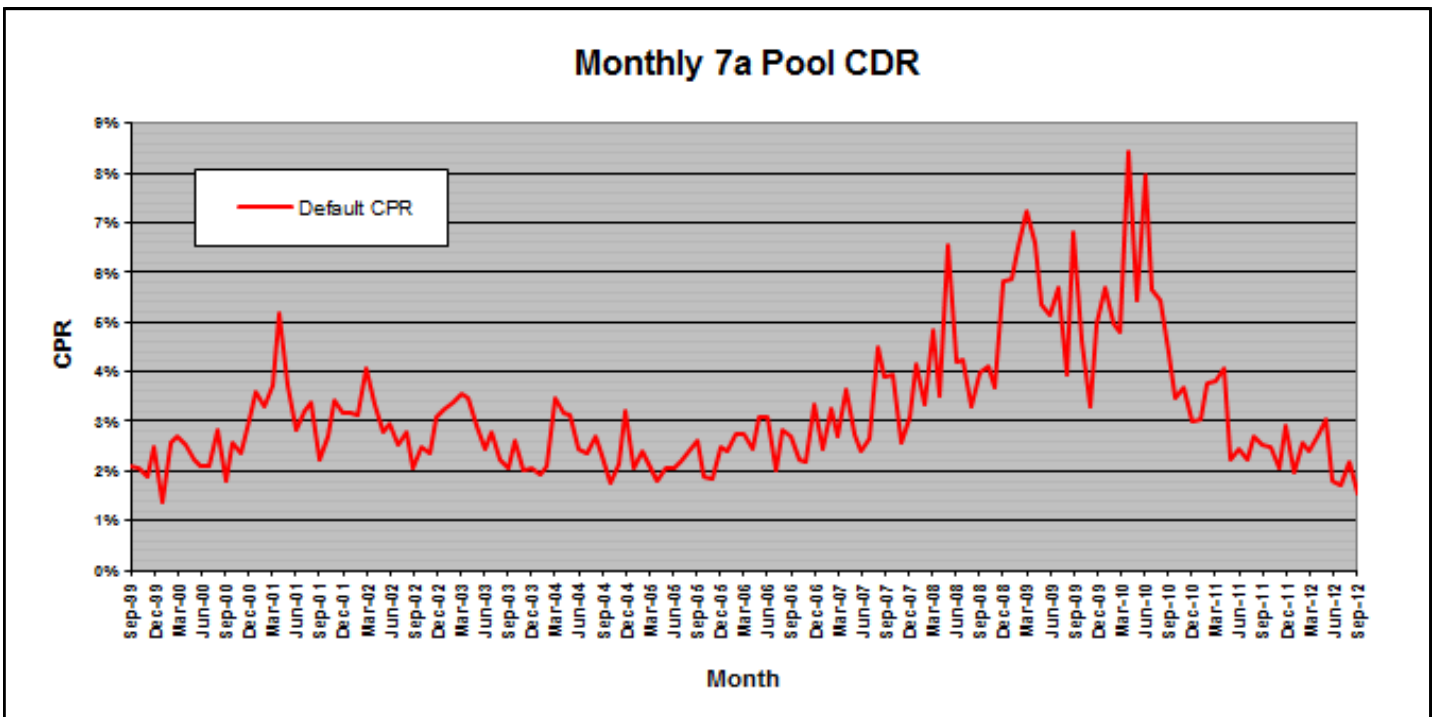
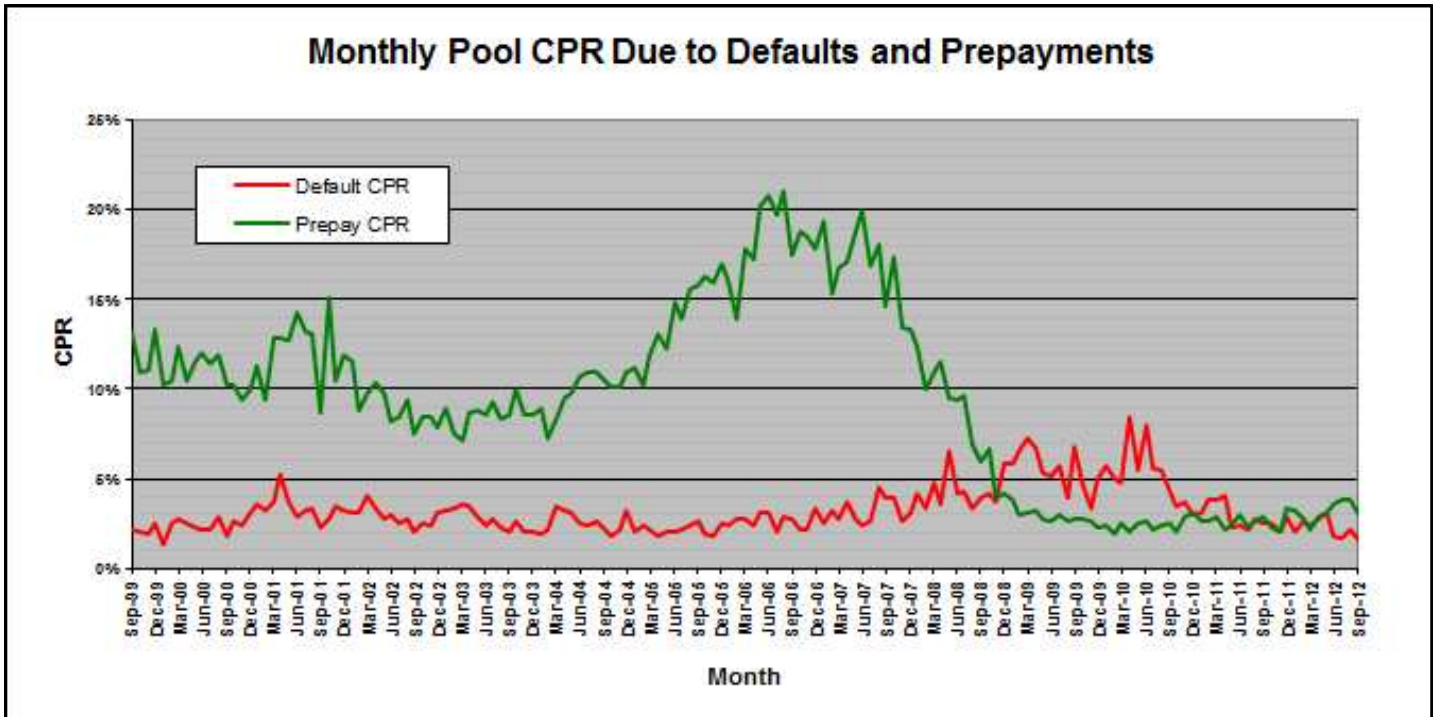
traditional commercial loan process is a long one, characterized by lots of paper pushing, hunting for documents, and waiting for approvals.

Customers rarely have a clear view of exactly the loan is in the process, because when they call

a bank to ask, the lender on the other end of the line is unsure as well. Hundreds of pages of financial statements have to be compiled, copied, distributed to various departments within the bank, and physically stored in a

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# PREPAYMENT SPEEDS...CONTINUED



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## PREPAYMENT SPEEDS...CONTINUED

Turning to the CPR break-down, the default CPR fell by 30% to 1.54%. This reading represents the second 12-year low established this year, the other being July's reading of 1.73%.

Regarding voluntary prepayments, they decreased by 21% to 2.98%, the first visit below 3% since April. While we have witnessed a trend to higher voluntary prepayments, this month represents a return to what we have seen for the past three years.

As previously stated, overall speeds came in at 4.52%, a 24% decrease from September. This month continues the unbroken streak of 25 consecutive months of sub-7% prepay speeds.

As for next month, preliminary data from Colson suggests a significant rise with CPRs possibly going above 6%.

Turning to the default/voluntary prepayment break-down, the **Voluntary Prepay CPR (green line)** fell to 2.98% from 3.78%, a 21% decrease. While the VCPR fell below 3%, the **Default CPR (red line)** fell by 30% to 1.54% from 2.21% the previous month.

Prepayment speeds fell in five out of the six maturity categories. Decreases were seen, by order of magnitude, in the 16-20 sector (-51% to CPR 4.28%), <8 (-48% to CPR 6.50%), 8-10 (-43% to CPR 4.82%), 10-13 (-28% to CPR

6.68%) and 20+ (-13% to CPR 3.67%).

Increases were seen in 13-16 (+19% to CPR 3.76%).

While we saw falling voluntaries lead the way to sub-7% CPRs over the past few years, its now decreasing defaults that have taken up the mantle of leadership in keeping pre-pays low. Expect that formula to continue well into next year.

*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.*

***“While we saw falling voluntaries lead the way to sub-7% CPRs over the past few years, its now decreasing defaults that have taken up the mantle of leadership in keeping pre-pays low.”***

*Data on page 25-27*



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## SMALL BUSINESS INDEXES...CONTINUED

importance to the financial markets, whereby today \$6 trillion are invested in Index Funds throughout the world.

The reasons for having investment indexes are fivefold:

1. **Asset Allocation Models:** Asset Allocation usually accounts for over 90% of a client's total return and becomes the most critical asset decision. Such models use 100% index data to calculate their asset allocations. Bond index funds are the best representation of the intended risk/reward of fixed income asset classes.
2. **Transparency:** Most bond index benchmarks publish daily returns unlike active managers who publish monthly or even quarterly returns usually with a few days of delinquency. Such transparency should provide clients with more information on the risk/reward behavior of their assets so there are no surprises at quarterly asset management review meetings.
3. **Performance Measurement:** Creates a benchmark for professional money managers to track their relative performance.
4. **Dictates Risk/Reward Behavior:** By analyzing historical returns of an index, an investor can better understand how an asset class will perform over long periods of time, as well as during certain economic cycles.
5. **Hedging:** An investment index can provide a means for hedging the risk of a portfolio that is comprised of assets tracked by the index. An example would be hedging a 7a servicing portfolio using the SBI I/O Strip Index.

By creating investment indexes for SBA 7a pool and IO strips, these investments can become a recognized asset class by pension funds and other large investors who won't consider any asset class in their asset allocation models that does not have a benchmark index.

An additional use for the I/O index could be to allow 7a lenders to hedge servicing portfolios that are getting large due to production and the low prepayment environment. This increase in exposure to 7a IO Strips would be welcome by IO investors who are constrained by the amount of loans that are stripped prior to being pooled.

### How are the indexes calculated?

The rules for choosing which outstanding pools are eligible for both the pool and IO indexes are the following:

#### Pool Size:

- \$5 million minimum through 1/1/2005.
- \$10 million minimum after 1/1/2005.

#### Pool Structure:

- Minimum of 5 loans inside the pool.
- Minimum average loan size of \$250,000.

#### Pool Maturity:

- Minimum of 10 years of original maturity.
- Sub indices for 10-15 years and 15-25 year maturities.

The rules for remaining in the indices are the following:

#### Pool Size:

- Minimum pool factor of .25
- Factor Updates in the Indices are on the first of the month, based on the Colson Factor Report that is released in the middle of the previous month.

#### Pool Structure:

- Minimum of 5 loans inside the pool.

We have produced two weightings for each pool in the various indexes, "Actual" and "Equal":

#### "Actual" weighted Indices:

- The actual original balance of each pool is used to weight the pool in the index.
- An index for all eligible pools, as well as one for 10-15 years and one for 15-25 years of original maturity.
- A total of 3 actual weighted sub-indices.

#### "Equal" weighted Indices:

- An original balance of \$10 million is assigned to each pool, regardless of its true size.
- An index for all eligible pools, as well as one for 10-15 years and one for 15-25 years of original maturity
- A total of 3 equal weighted sub-indices.

This equates to a total of (6) Pool sub-indices. We will refer to them on a go-forward basis as the following:

#### Actual Weighting:

- All 10-25 year in original maturity pools "All Actual"
- 10-15 year in original maturity pools "Short Actual"
- 15-25 year in original maturity pools "Long Actual"

#### Equal Weighting:

- All 10-25 year in original maturity pools "All Equal"
- 10-15 year in original maturity pools "Short Equal"
- 15-25 year in original maturity pools "Long Equal"

### Return Calculations

Each index is tracked by its value on a daily basis, as well as the components of return.

*Continued on next page*

## SMALL BUSINESS INDEXES...CONTINUED

### Income Component

- Daily return is calculated for the contribution of interest earned.

### Mark-to-Market Component

- Daily return is calculated for the contribution of Mark-To-Market changes.

### Scheduled Principal Component

- Daily return is calculated for the contribution of normal principal payments. Only impacts the first of the month.

### Prepaid Principal Component

- Daily return is calculated for the contribution of prepaid principal payments. Only impacts the first of the month.

### Total Principal Component

- Daily return is calculated for the contribution of all principal payments. Only impacts the first of the month.

The formula for Total Daily Return is as follows:

$$\text{Total Daily Return} = \text{Income Return} + \text{MTM Return} + \text{Principal Return}$$

The Principal Return is generated using the following formula:

$$\text{Principal Return} = \text{Prepaid Principal Return} + \text{Scheduled Principal Return}$$

The I/O Strip Indexes are a bit more involved, since we have to calculate the pricing multiple, as well as the breakdown between income earned and return of capital from interest accruals and payments. Here are the specific rules for the I/O Strip Indexes:

- The I/O Strip Indices utilize the same pools as the Pool Indices.
- Each pool is synthetically “stripped” upon entering the I/O Indices.
- For the equal and actual weighted indices and the maturity sub-indices (10-15 and 15-25), the pools are split into two even buckets utilizing the pool reset margins. The bucket with the higher margins we refer to as the “Upper Bucket” and the lower margin pools are in the “Lower Bucket”.
- The weighted average reset margin and pool MTM is calculated for each bucket. The MTM is the same one utilized in the pool indices.
- The weighted average price of the Lower Bucket is subtracted from the Upper Bucket. The same thing is done for the weighted average reset margin.
- The MTM difference is divided by the reset margin difference, giving us the pricing multiple by maturity and weighting.
- The end result is a pricing multiple for equal and actual weighting for 10-15 year pools and 15-25 year pools, totaling (4) distinct multiples.
- Not all interest received is considered earned income, therefore interest received by the stripped pools is divided into earnings and return of capital, utilizing OID accounting rules.

- The OID accounting rule create a straight-line return of capital upon entry into the index and the difference between the return of capital and interest received is earned income.
- Fundamentally, high prepayments can push more received interest into return of capital, thus limiting earned income. Excellent prepayment performance can generate large amounts of earned income over time.

Once the return percentages are determined for each day, it is then applied to the previous day's index level, in order to calculate the index levels for that day.

### Supporting Calculations

To aid in the analysis of the indexes, we track (22) distinct calculations for each of the (6) sub-indices:

#### Size

- Pool count and total outstanding balance

#### Structure

- Weighted average issue date, maturity date, reset date, maturity months, remaining months, age, coupon, reset margin, strip percent (strip indexes only).

#### Price and Yield

- Weighted average pool price, bond-equivalent yield, strip discount rate, multiple and strip pricing (strip indexes only)

#### Other Calculations

- CPR assumption, weighted average life, modified duration, index duration, strip duration and strip return of capital average life.

Now that we have discussed how the indexes are populated, returns calculated and what supporting calculations are produced, let's turn to the results, when compared to the risk-free option of US Treasury Strips.

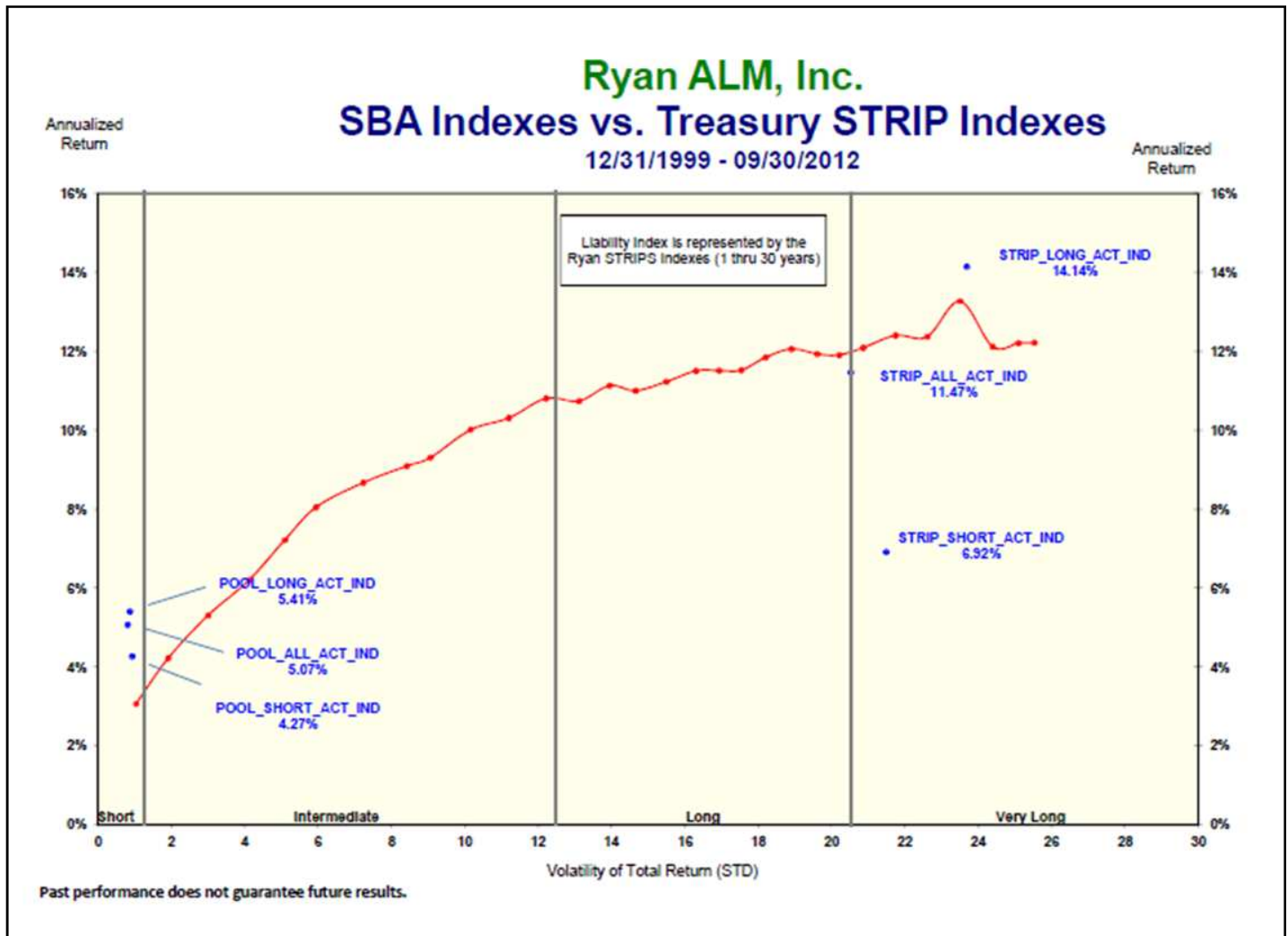
### Performance Results

On the following page, we display a chart that shows how the actual indexes performed, as compared to Ryan Treasury Strips Indexes. The returns since 12/31/1999 for the strip indexes, by volatility of return, are represented by the red line. For Treasury strips, volatility is highly correlated with the duration and maturity of the strip.

Basically, if the returns for an asset class with a similar volatility is below the red line, simply buying a treasury strip was a better investment over the time horizon. In other words, the investor gave

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## SMALL BUSINESS INDEXES...CONTINUED



up return for the specific asset as opposed to buying treasury strips.

Conversely, if the asset is above the red line, the investor was rewarded with excess return over treasuries.

Quite simply, above red line good, below bad.

### Actual Weighted Indexes

Looking to the left hand portion of the chart on the following page, we see the returns for the pool indexes as compared to treasuries. This is the sector of low volatility, such as a 3-month Treasury Bill.

In all three Actual cases (All, Short and Long indexes), the returns on SBA 7a pools was greater than treasuries, suggesting that these investments provided additional returns when compared to a treasury strip with the same volatility of returns.

As for the I/O Strip indexes, we have to move further out to the right, where volatility of returns increases. This is the sector of 20+ maturity Treasury Strips.

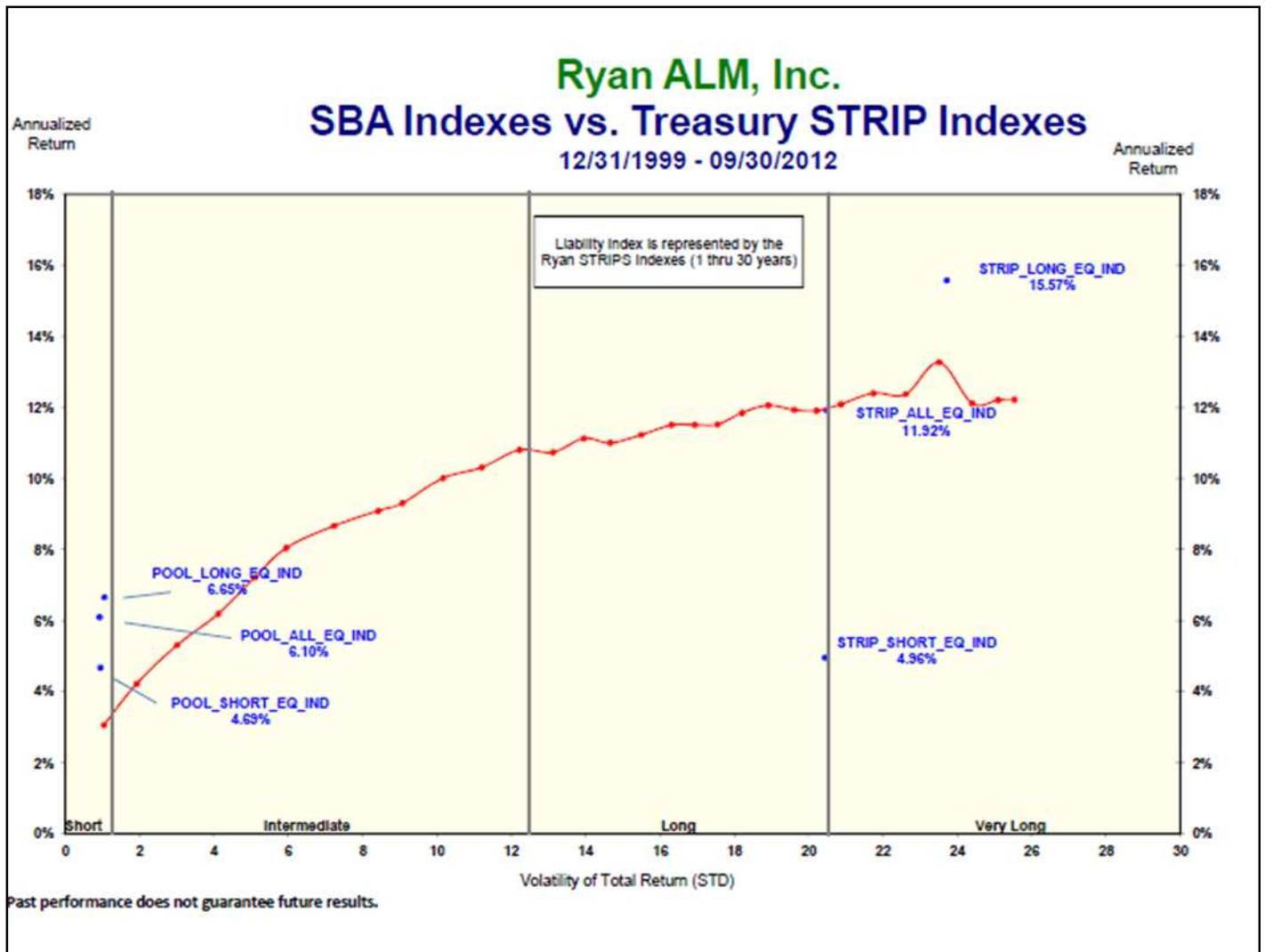
Here, we see that the "All Actual" and "Short Actual" are below the red line, suggesting that these two indexes underperformed treasuries. However, the "Long Actual" did outperform treasuries, suggesting additional returns for similar risk.

The conclusion in the case of the Actual series of indexes is that all 10-25 year SBA 7a pools and 15-25 year I/O Strips provide additional return over the default choice of investing in Treasury Strips with similar volatility of returns.

Now, we will turn to the Equal weighted index returns.

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## SMALL BUSINESS INDEXES...CONTINUED



### Equal Weighted Indexes

Above, we see the same type of chart as the previous page, but using the equal weighted indexes instead of the actual weightings.

In the equal weighting, we see similar results for the Pool indexes. In all three sub-indexes, SBA 7a pools outperformed treasury strips with a similar risk profile, since 12/31/1999.

As for the strip indexes, we see better performance for the All index and Long indexes and worse for the Short one.

All told, four of the equal weighted indexes outperformed treasuries, one equaled them and one underperformed.

The following page shows the index histories since 1/1/2000 for the Pool and Strip All Equal indexes.

The pool index shows a consistent increase in the index level, except for a hiccup in late 2008 when pricing collapsed due to the

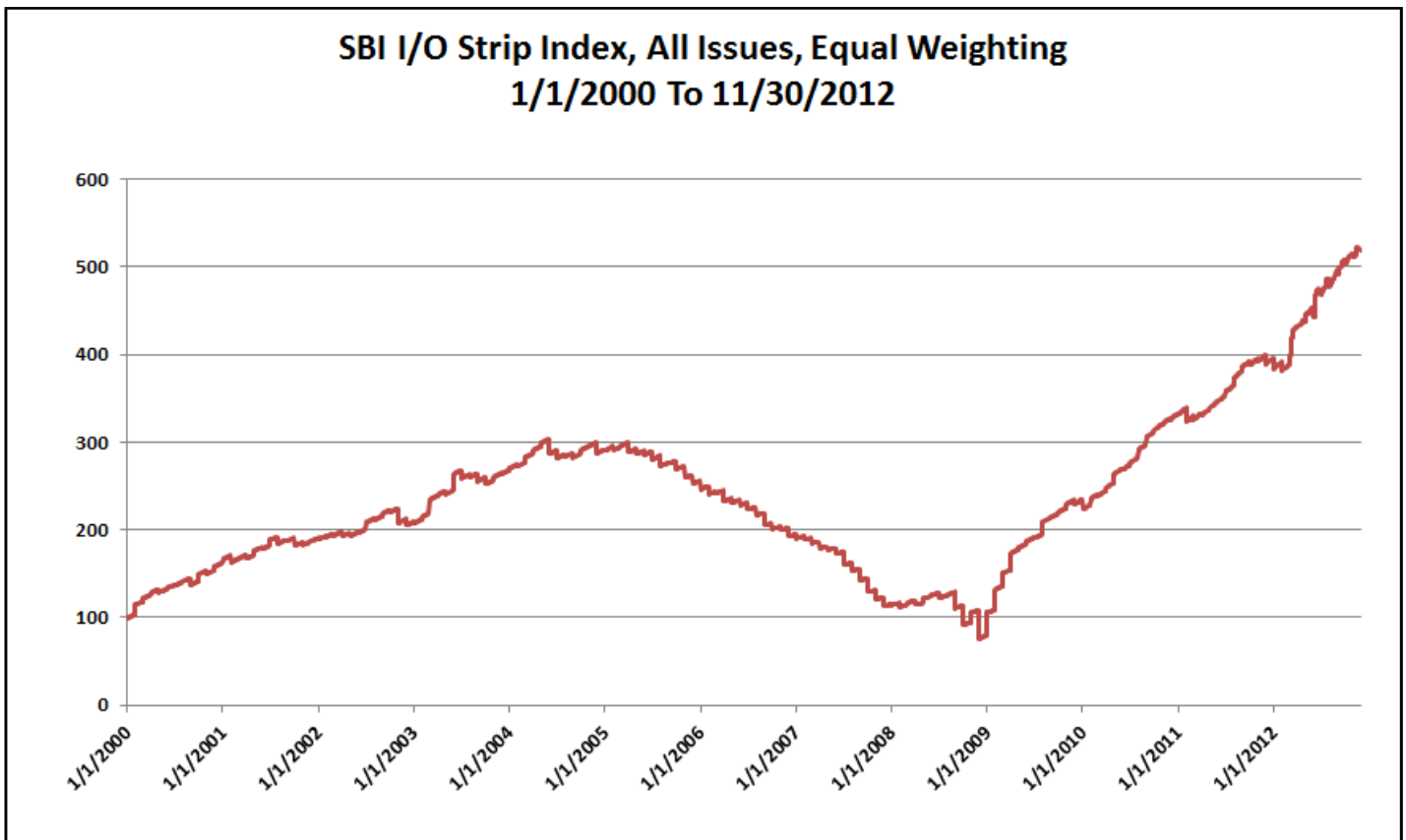
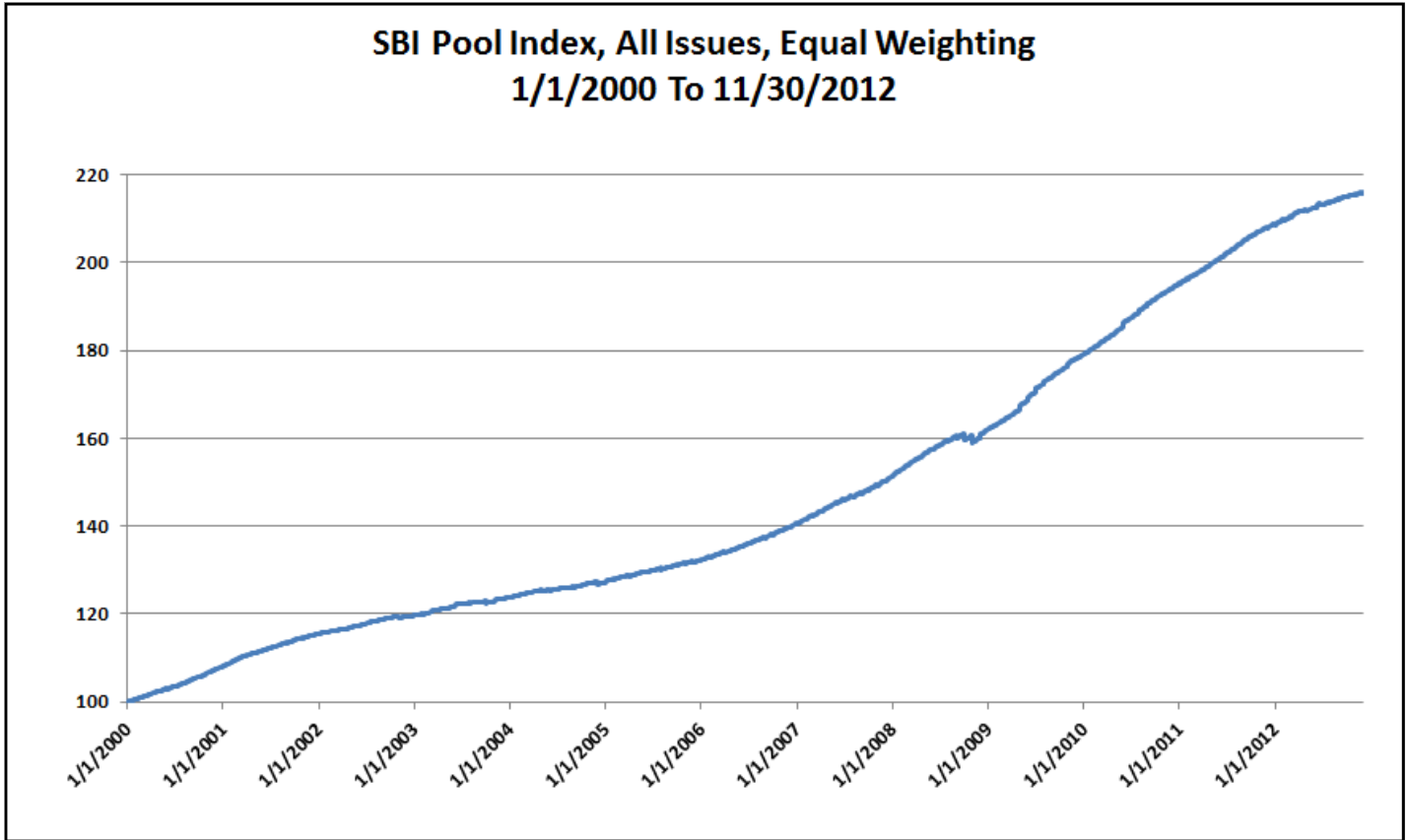
Credit Crisis. The market quickly recovered and the combination of increased pricing and low prepayments more than made up for the period of negative returns.

The strip index better reflects certain periods over the past 12 years which would impact returns, both good and bad. Here is a quick review of those episodes:

### High Prepayments, 2005-2007

During this time period, CPRs exceeded 20% for the first time in the history of SBA lending. High prepayment speeds are anathema to IO strip investors. This is reflected in the fact that the strip index fell from the 300s to just above 100, which was the starting level on 12/31/1999.

*Continued on next page*





## SMALL BUSINESS INDEXES...CONTINUED

### Pricing Collapse, late 2008 to early 2009

This period began with the collapse of Lehman Brothers, which drove all non-treasury fixed income pricing down significantly. SBA 7a pools and IO Strips were no exception. This turned an index recovery for much of 2008 into a rout and index values into the mid-70s.

### Pricing to New Highs, 12/2008 to Today

From the depths of despair, was the opportunity of a lifetime. From December of 2008 to today, we have witnessed unprecedented increases in SBA 7a loan, pool and IO strip pricing. This occurred during the same period of record low prepayment speeds, which only added to returns. From the low of 76.15 on 12/1/2008, the Equal All Strip Index has reached 519.12 as of 11/30/2012, a total return of 582% in approximately 4 years.

Not bad if you had the prescience to take advantage of the opportunity.

### Conclusion

As we can see, the pool indices are much less risky and could be considered cash-equivalents for many investors. The IO Strip indexes act more like long duration fixed income, possess more volatility and thus greater potential for profits and losses, especially during certain economic circumstances.

For more information about SBI and the above indexes, please contact Bob Judge at bob.judge@gl solutions.us, or by phone at 216-456-2480 ext. 133. Ron Ryan can be contacted at rryan@ryanalm.com or by phone at 561-656-2014. More information can also be found on our website at [www.sbindexes.com](http://www.sbindexes.com). Currently, registration is free.



SB Indexes, LLC.

**Through the joint venture of Ryan ALM, Inc. and GLS, both companies have brought their unique capabilities together to create the first Total Return Indexes for SBA 7(a) Pools and SBA 7(a) Interest-Only Strips, with a history going back to January 1st, 2000.**

**Using the "Ryan Rules" for index creation, the SBI indexes represent best practices in both structure and transparency.**

**For more information, please visit our website:**

**[www.SBIndexes.com](http://www.SBIndexes.com)**

Principals:

Ronald J. Ryan, CFA, Founder and CEO of Ryan ALM, Inc. Ron has a long history of designing bond indexes, starting at Lehman Brothers, where he designed most of the popular Lehman bond indexes. Over his distinguished career, Ron and his team have designed hundreds of bond indexes and ETFs.

Bob Judge, Partner, GLS. Bob, a recognized expert in the valuation of SBA-related assets as well as the SBA Secondary Market and is the editor of The CPR Report, a widely-read monthly publication that tracks SBA loan defaults, prepayment and secondary market activity.

## SECONDARY MARKET ACCESS...CONTINUED

secondary market will focus on growing businesses with a wide diversity of property types.

### The Coleman/GLS Secondary Market Conference – 2012

The annual Coleman/GLS sponsored secondary market conference was recently held in Washington D. C. The one day session was split roughly in half between SBA 7A and SBA 504 related topics. The 504 topics were centered on the development of an expanded 504 secondary market and the various models that many of the participants are working on. Models discussed include:

- Single bank balance sheet (the current model for Zions, Morgan and One West)
- Multi-bank participation of loans
- Bank co-op for lending
- Mutual fund (in various forms)
- Securitization

All of the models have their various challenges, and none are easy or they would have already been accomplished. But tangible progress is being made, and the potential of one or more of these options coming to fruition is positive. While most attendees are or will be competitors in this industry, there is a definite feeling of cooperation and teamwork to bring at least one viable alternative in the market.

If you could not make it to this year's Coleman/GLS secondary market conference, you are encouraged to attend this annual event in the future. The subject matter is much more detailed than a typical NAGGL or NADCO event.

### Secondary Market Access Models-In-Process

Secondary Market Access (SMA), a subsidiary of GLS, is actively working on two potential 504 secondary market alternatives: a mutual fund and a securitization.

#### **Mutual Fund**

SMA is working with Pennant Management ([www.pennantmanagement.com](http://www.pennantmanagement.com)) on the development of a 504 first lien closed-end mutual fund. Most SBA industry participants have never heard of Pennant Management, but Pennant makes available significant daily liquidity to the SBA 7A secondary market by providing warehouse financing for market-makers, pool assemblers and hedge funds. Pennant has been providing this warehouse space for close to 25 years. On any given day, Pennant can have up to \$750,000,000 outstanding to the broker dealers that buy the guaranteed interest in SBA 7A loans. Pennant desires to provide funding for an active 504 secondary market through the creation and management of a mutual fund. SMA would work in partnership with Pennant by providing production, packaging, underwriting, and servicing.

The proposed mutual fund would purchase whole loans for premium (ideal for banks), or 85% interests for servicing (ideal for non-bank lenders). Investors should expect to receive a yield that is commensurate with bank C&I or prime customer lending – without the cost of origination. The fund will be listed on a major exchange such as NYSE which will provide potential daily liquidity. Since the fund will invest only in 504 first liens at low loan-to-value ratios, the fund managers believe that investment is a good fit for risk adverse investors.

#### **Securitization**

SMA is also working on a potential securitization program with Credit Suisse (CS). CS is one of two underwriters for the SBA 504 second mortgage debenture program, so it is only natural that CS would want to expand to the 504 first mortgage market. SMA and CS have been working in earnest over the last six months on a proposed program that would purchase 85% interests in 504 first liens – similar to the FMLP program. SMA and CS have received initial pro-forma ratings from one of the major rating agencies, and expect to receive final pro-forma ratings in early January. Initial indications are that the economics of the securitization are sufficient to be successful – no easy task as the securitization market takes baby steps out of the financial crisis.

#### **Both Models**

Both the mutual fund model and the securitization model are expected to have certain similar characteristics or requirements. A partial listing is as follows:

- Only newly or recently originated transactions with current appraisals will be considered
- Wide geographic diversity
- Property type diversity
- Capped percentage of any property type within the portfolio
- Adjustable rate or short fixed rate mortgages to avoid long-term fixed rate exposure
- Complete re-underwriting of all transactions
- Multiple approvals required (lender, buyer, CDC, SBA)
- Standardized underwriting criteria

#### **Conclusion**

SMA and GLS will endeavor to keep the reader informed as to the state of an expanded 504 secondary market, regardless of whether SMA is involved in the new model or models. SMA's overall goal is the facilitation of more SBA 504 lending. If you are interested in learning more, or participating in, any of the opportunities listed above, please contact Jordan Blanchard ([jblanchard@sma504.com](mailto:jblanchard@sma504.com)).

## SECONDARY MARKET ACCESS...FMLP UPDATE

MO / WAM BUCKET	<192 Mos.	192-263 Mos.	264-288 Mos.	289+ Mos.	Total by Month
Jan-11	0.00%	0.00%	0.12%	0.00%	<b>0.09%</b>
Feb-11	0.00%	0.00%	0.00%	0.00%	<b>0.00%</b>
Mar-11	0.00%	0.00%	0.00%	0.00%	<b>0.00%</b>
Apr-11	0.00%	0.00%	0.00%	0.00%	<b>0.00%</b>
May-11	0.00%	0.00%	11.49%	3.49%	<b>9.28%</b>
Jun-11	1.04%	0.00%	0.00%	0.00%	<b>0.06%</b>
Jul-11	0.00%	0.00%	0.00%	0.00%	<b>0.00%</b>
Aug-11	0.00%	0.00%	0.00%	0.13%	<b>0.03%</b>
Sep-11	0.00%	0.00%	0.00%	0.00%	<b>0.00%</b>
Oct-11	0.00%	0.00%	0.00%	0.09%	<b>0.02%</b>
Nov-11	0.00%	0.00%	15.67%	0.00%	<b>9.78%</b>
Dec-11	0.00%	0.00%	0.00%	0.00%	<b>0.00%</b>
Jan-12	0.00%	0.00%	23.69%	0.00%	<b>11.66%</b>
Feb-12	0.00%	0.00%	0.00%	0.00%	<b>0.00%</b>
Mar-12	0.00%	0.00%	0.00%	0.00%	<b>0.00%</b>
Apr-12	0.00%	0.00%	0.00%	0.00%	<b>0.00%</b>
May-12	0.00%	0.00%	0.00%	0.00%	<b>0.00%</b>
Jun-12	0.00%	0.00%	0.01%	0.00%	<b>0.00%</b>
Jul-12	0.00%	0.00%	0.00%	0.00%	<b>0.00%</b>
Aug-12	0.00%	0.00%	0.17%	0.00%	<b>0.04%</b>
Sep-12	0.00%	0.05%	0.00%	0.00%	<b>0.01%</b>
Oct-12	0.00%	0.00%	0.00%	0.00%	<b>0.00%</b>
Nov-12	0.13%	0.00%	0.00%	0.00%	<b>0.03%</b>
<b>Total</b>	<b>0.03%</b>	<b>0.01%</b>	<b>2.30%</b>	<b>0.04%</b>	<b>0.95%</b>

RESET TYPE	FIXED RATE	FHLB VARIOUS	PRIME RATE	5 YR LIBOR SWAP	3 MO LIBOR	5 YR CMT	Total by Month
Jan-11	0.16%	0.00%	0.00%	0.13%	0.00%	0.00%	<b>0.09%</b>
Feb-11	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	<b>0.00%</b>
Mar-11	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	<b>0.00%</b>
Apr-11	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	<b>0.00%</b>
May-11	34.52%	0.00%	0.00%	1.88%	0.00%	0.00%	<b>9.28%</b>
Jun-11	0.00%	0.00%	0.15%	0.00%	0.00%	0.00%	<b>0.06%</b>
Jul-11	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	<b>0.00%</b>
Aug-11	0.00%	0.00%	0.06%	0.00%	0.00%	0.00%	<b>0.03%</b>
Sep-11	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	<b>0.00%</b>
Oct-11	0.00%	0.00%	0.00%	0.06%	0.00%	0.00%	<b>0.02%</b>
Nov-11	0.00%	0.00%	0.00%	27.92%	0.00%	0.00%	<b>9.78%</b>
Dec-11	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	<b>0.00%</b>
Jan-12	0.00%	1.24%	21.92%	0.00%	0.00%	0.00%	<b>11.66%</b>
Feb-12	0.00%	0.00%	0.00%	0.00%	0.03%	0.00%	<b>0.00%</b>
Mar-12	0.00%	0.00%	0.00%	0.00%	0.03%	0.00%	<b>0.00%</b>
Apr-12	0.00%	0.00%	0.00%	0.00%	0.02%	0.00%	<b>0.00%</b>
May-12	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	<b>0.00%</b>
Jun-12	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	<b>0.00%</b>
Jul-12	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	<b>0.00%</b>
Aug-12	0.43%	0.00%	0.00%	0.00%	0.00%	0.00%	<b>0.04%</b>
Sep-12	0.00%	0.00%	0.00%	0.02%	0.00%	0.00%	<b>0.01%</b>
Oct-12	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	<b>0.00%</b>
Nov-12	0.00%	0.00%	0.00%	0.07%	0.00%	0.00%	<b>0.03%</b>
<b>Total</b>	<b>1.32%</b>	<b>0.07%</b>	<b>1.07%</b>	<b>0.91%</b>	<b>0.00%</b>	<b>0.00%</b>	<b>0.95%</b>

### FMLP Update

As for the forgotten FMLP, we continue to track its performance and it has been excellent. Last month, we witnessed a small overall CPR of .03%, pushing the overall CPR for the program to a microscopic .95%.

For those paying attention, the FMLP is an excellent proxy for the expected prepayment behavior for any of the 504 1st lien secondary market options discussed in the SMA article beginning on page 1.

Almost 2 years into the FMLP, the overall CPR has remained low, as one would expect from underlying loans that, for the most part, have at least five years of prepayment protection.

I would hope and expect investors to take notice that 504 1st lien loans, as well as the securities and investments created from

them, are attractive investments, even if they do not possess an SBA guarantee.

### Secondary Market Access

Secondary Market Access (SMA) is an Ohio-based corporation whose main goal is to provide secondary market solutions for 504 first mortgage lenders.

For more information about SMA, please contact either Bob Judge ([bob.judge@glsolutions.us](mailto:bob.judge@glsolutions.us)) or Jordan Blanchard ([jblanchard@wholesale504.com](mailto:jblanchard@wholesale504.com)).

## SMALL BUSINESS FACT OF THE MONTH

It takes just 6 days to start a business in the US, compared to a whopping 38 days in China.

# TECHNOLOGY CENTER...CONTINUED

file room. If one page is missing, the approval process is delayed. With a cloud-based banking system, documents are stored electronically and it is easy to determine which information is missing. Several people can view a file online at one time instead of having to walk around the bank searching for the one document they are looking for. Loan applications can be submitted online or electronically at a loan officer's desk with financials attached. After the application is submitted, financial statements are electronically converted into spreads, and credit memos are automatically generated. Alerts go out after a stage in the workflow is complete and loan committee members receive notification when a file is ready for approval. Since the process is more standardized, the notification process is automatic, and all documents are readily accessible, the approval process is much smoother both for bank employees and bank customers. The benefits of using a cloud-based bank operating system extend far beyond day-to-day operations in the loan ops department. Those in the C-Suite have real-time access to all loan activity and volume each time they login to the system. After taking a quick look at a dashboard, a CEO will know how many loans are in the pipeline and how many loans each loan officer is assigned to. Staffing resources can be allocated more efficiently, as there is a clearer picture of overall operations. Regulator visits are more streamlined, as all loan documentation is readily accessible and transparent.

## Choosing a Cloud Vendor

When choosing a cloud vendor, banks should evaluate the internal controls a vendor has in place. These internal controls can be validated and assessed by third party data security reports and certification. These include two widely recognized standards; SOC-2 Type 1 and Type II (Service Organization Controls) as well as SAS 70 (Statement on Auditing Standards).

After choosing the right vendor and determining which type of cloud configuration should be deployed, banks will enjoy the increased profitability, efficiency, and improved communication that the cloud provides. Banks are not going to be profitable if they continue to do things the way that they have always been done before.

Implementing a cloud-based bank operating system can differentiate your bank and provide a true competitive advantage. If you have questions about cloud banking or would like to learn more about nCino's Bank Operating System, please visit [www.ncino.com](http://www.ncino.com).

*Pullen Daniel has over 10 years of experience in the financial services and banking industries. As executive vice president of nCino he is responsible for all aspects of product design and strategy and played a pivotal role in the initial founding of nCino. Prior to joining nCino, Pullen served as director and vice president for Live Oak Bank, the nation's third largest originator of small business loans. In addition, Pullen's prior work experience includes serving as a Financial Analyst for S1 Corporation.*



nCino's Bank Operating System is a comprehensive solution created by bankers, for banks, to drive **increased profitability, productivity gains, regulatory compliance, and operating transparency** at all organizational levels and across all lines of business.

Typical Bank Report (Old)

Pmy Cust Number	Pmy Cust Zip Code	Note Officer Name	Note Account Number	Note Bank Share Ledger Balance
1244	28449	MICHAEL SETZER	00001000017	2,960.53
2682	28409	KEVIN HUDSON	00001000033	0.00
24869	28403	MICHAEL SETZER	00001000082	21,541.33
26062	28480	MICHAEL SETZER	00001000108	0.00
2532	28443	MICHAEL SETZER	00001000176	903.07
2823	28411	KEVIN HUDSON	00001000216	0.00
9514	28412	KEVIN HUDSON	00001000272	1,960.28
24863	28405	MICHAEL SETZER	00001000322	3,756.01
16436	28480	DAVID BARLOW	00001000337	0.00
22806	28405	ASHLEY MIRANDA	00001000436	456.27
22806	28405	ASHLEY MIRANDA	00001000785	436.55
24322	28403	KEVIN HUDSON	00001000884	454.10
18456	28409	DAVID BARLOW	00001000975	0.00
13322	28480	DAVID BARLOW	00001001075	0.00
13320	28480	DAVID BARLOW	00001001043	0.00
2680	28409	KEVIN HUDSON	00001001304	0.00



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## 20 YEAR DEBENTURE SPEEDS FALL BY 2%

This month, 20 year debenture speeds fell by 2%, dropping to 8.45% from 8.63% in October. As for 10 year debentures, they rose by 6% from September.

Returning to 20s, defaults (CDR) rose while voluntary prepayments (CRR) declined. The CDR increased by 7.67%, going from 2.74% to 2.95%. Even with that increase, this reading stayed below 3% for the fourth time in five months.

The CRR fell by 6% to 5.49% from 5.89%. By contrast, this latest reading is the second highest one since October, 2008.

Typical of an economic recovery, we see falling defaults accompanied by rising voluntary prepayments. As mentioned previously, we

are seeing this same phenomena in the sister program of 504, the 7a program. I would expect more of the same in the months to come.

For the data and charts, please refer to the following 2 pages of the Report.

*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.*



### A Breakthrough Tool for Underwriters and SBA Investors

Finally a Web-based Loan Analytics Portal for 7(a) and 504 loan performance, accessible through a user friendly, searchable database.

7(a) default and prepayment data going back to 2000

504 default data going back to 1959.

Monthly subscribers will have access to customized searches using criteria such as:

- **Structural:** Reset Frequency, Guarantee Percentage, Interest Rate, Gross Margin, Maturity, Cohort Year, and Loan Size
- **Industry:** NAICS or SIC codes, SIC Major Groups, or SIC Division
- **Franchise:** Franchise Code or Franchise Name
- **Geography:** State, County, MSA and Urban versus Rural area.
- **Demographics:** County income as a Percentage of State or National income levels, Woman or Veteran owned business.

Armed with this information, users can refine their decision making process based on empirical data and in turn, enhance revenues and returns from their government guaranteed lending and investing activities.

For more information, please call Bob Judge at 216-456-2480 x133 or visit the website at: [www.sbla.us](http://www.sbla.us)

**Subscribe at the website**

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nCino's nCommercial software solution was created by bankers to drive increased profitability, productivity, and regulatory compliance. Sitting alongside a bank's core, it provides the security of a SAS 70 Type II cloud architecture, the most advanced data security platform in the world. And the real-time portfolio management tools, reports, and dashboards provide complete operating transparency and features 1502 reporting.

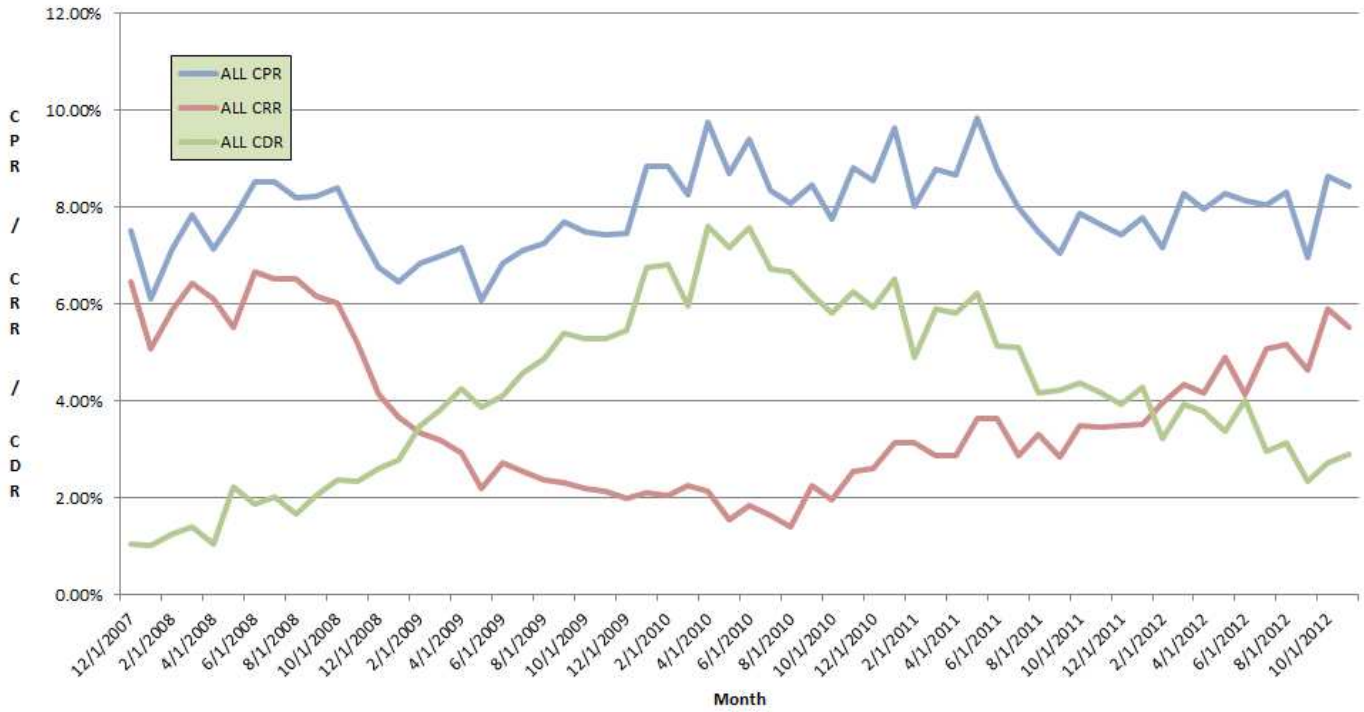
See how these banks are already experiencing the benefits at <http://ncino.com>



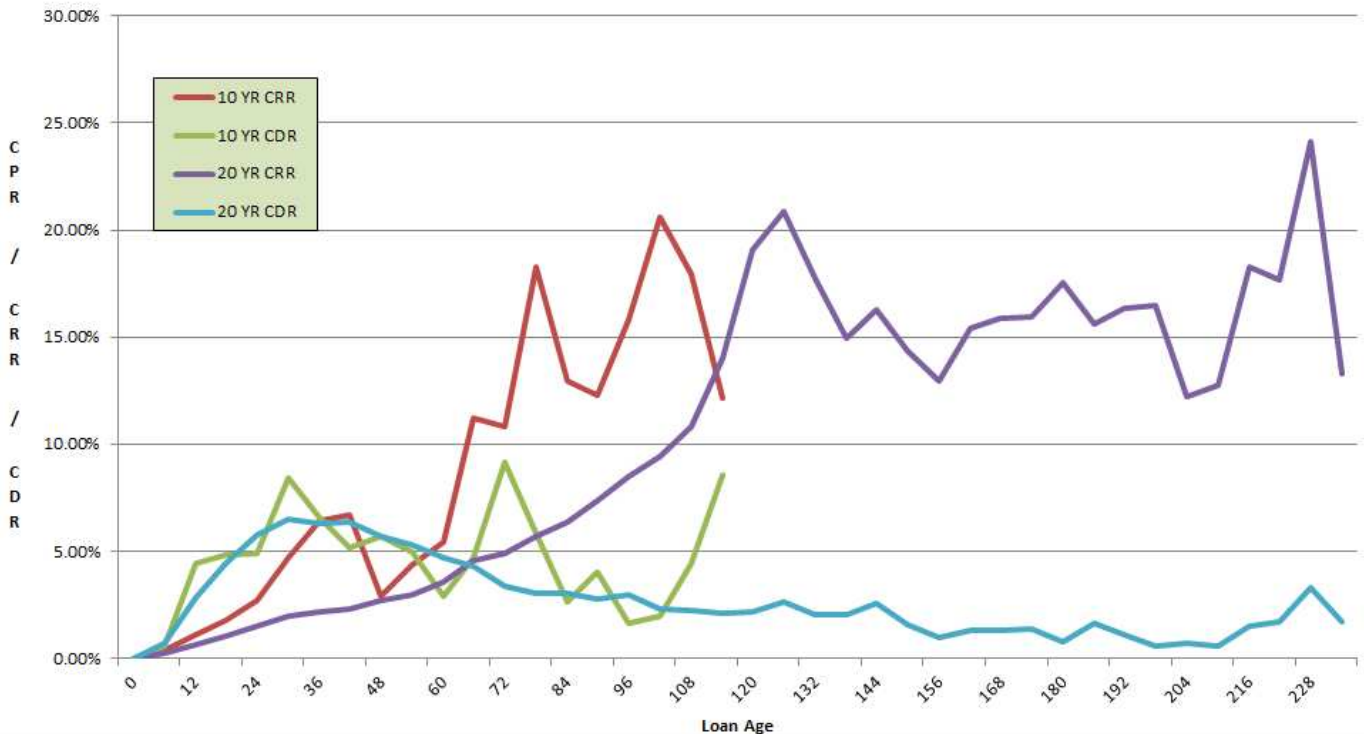
## 504 DCPC PREPAY SPEEDS - LAST 5 YEARS

DATE	20 YR. CPR	20 YR. CRR	20 YR. CDR	10 YR. CPR	10 YR. CRR	10 YR. CDR	ALL CPR	ALL CRR	ALL CDR
12/1/2007	7.51%	6.46%	1.05%	NA	NA	NA	7.51%	6.46%	1.05%
1/1/2008	6.23%	5.19%	1.04%	2.72%	1.73%	0.99%	6.10%	5.07%	1.03%
2/1/2008	7.12%	5.87%	1.25%	NA	NA	NA	7.12%	5.87%	1.25%
3/1/2008	7.90%	6.50%	1.40%	6.43%	4.48%	1.95%	7.86%	6.44%	1.42%
4/1/2008	7.15%	6.10%	1.05%	NA	NA	NA	7.15%	6.10%	1.05%
5/1/2008	7.66%	5.51%	2.15%	10.57%	6.20%	4.37%	7.75%	5.53%	2.22%
6/1/2008	8.53%	6.65%	1.87%	NA	NA	NA	8.53%	6.65%	1.87%
7/1/2008	8.48%	6.52%	1.96%	9.55%	6.20%	3.35%	8.52%	6.50%	2.01%
8/1/2008	8.20%	6.52%	1.68%	NA	NA	NA	8.20%	6.52%	1.68%
9/1/2008	8.32%	6.23%	2.08%	5.43%	4.11%	1.32%	8.21%	6.16%	2.06%
10/1/2008	8.39%	6.03%	2.37%	NA	NA	NA	8.39%	6.03%	2.37%
11/1/2008	7.58%	5.26%	2.32%	6.31%	3.51%	2.80%	7.54%	5.20%	2.33%
12/1/2008	6.76%	4.15%	2.61%	NA	NA	NA	6.76%	4.15%	2.61%
1/1/2009	6.41%	3.72%	2.69%	8.08%	2.57%	5.50%	6.47%	3.68%	2.79%
2/1/2009	6.84%	3.35%	3.49%	NA	NA	NA	6.84%	3.35%	3.49%
3/1/2009	6.96%	3.15%	3.81%	7.80%	4.12%	3.68%	6.99%	3.18%	3.81%
4/1/2009	7.18%	2.93%	4.25%	NA	NA	NA	7.18%	2.93%	4.25%
5/1/2009	6.12%	2.24%	3.87%	5.07%	1.34%	3.73%	6.08%	2.21%	3.87%
6/1/2009	6.83%	2.73%	4.11%	NA	NA	NA	6.83%	2.73%	4.11%
7/1/2009	7.09%	2.62%	4.47%	7.71%	0.45%	7.26%	7.11%	2.54%	4.57%
8/1/2009	7.24%	2.37%	4.87%	NA	NA	NA	7.24%	2.37%	4.87%
9/1/2009	7.59%	2.34%	5.25%	10.52%	1.46%	9.07%	7.70%	2.31%	5.40%
10/1/2009	7.48%	2.21%	5.28%	NA	NA	NA	7.48%	2.21%	5.28%
11/1/2009	7.49%	2.16%	5.33%	5.41%	1.74%	3.67%	7.42%	2.15%	5.27%
12/1/2009	7.46%	1.99%	5.47%	NA	NA	NA	7.46%	1.99%	5.47%
1/1/2010	8.72%	2.09%	6.63%	12.44%	2.37%	10.07%	8.85%	2.10%	6.76%
2/1/2010	8.86%	2.05%	6.81%	NA	NA	NA	8.86%	2.05%	6.81%
3/1/2010	8.28%	2.24%	6.03%	7.24%	2.90%	4.35%	8.24%	2.27%	5.97%
4/1/2010	9.76%	2.15%	7.61%	NA	NA	NA	9.76%	2.15%	7.61%
5/1/2010	8.83%	1.56%	7.26%	4.98%	0.85%	4.12%	8.69%	1.54%	7.15%
6/1/2010	9.41%	1.84%	7.57%	NA	NA	NA	9.41%	1.84%	7.57%
7/1/2010	8.30%	1.58%	6.71%	9.73%	2.86%	6.87%	8.35%	1.63%	6.72%
8/1/2010	8.08%	1.42%	6.66%	NA	NA	NA	8.08%	1.42%	6.66%
9/1/2010	8.38%	2.22%	6.16%	10.61%	3.38%	7.23%	8.46%	2.27%	6.20%
10/1/2010	7.76%	1.95%	5.81%	NA	NA	NA	7.76%	1.95%	5.81%
11/1/2010	8.65%	2.43%	6.22%	13.45%	6.11%	7.34%	8.82%	2.56%	6.26%
12/1/2010	8.54%	2.61%	5.93%	NA	NA	NA	8.54%	2.61%	5.93%
1/1/2011	9.68%	3.10%	6.58%	8.76%	3.75%	5.02%	9.65%	3.12%	6.52%
2/1/2011	8.03%	3.14%	4.89%	NA	NA	NA	8.03%	3.14%	4.89%
3/1/2011	8.71%	2.77%	5.94%	10.61%	5.49%	5.13%	8.79%	2.88%	5.91%
4/1/2011	8.67%	2.87%	5.80%	NA	NA	NA	8.67%	2.87%	5.80%
5/1/2011	9.53%	3.37%	6.16%	17.64%	10.06%	7.58%	9.84%	3.63%	6.21%
6/1/2011	8.78%	3.65%	5.13%	NA	NA	NA	8.78%	3.65%	5.13%
7/1/2011	7.92%	2.87%	5.05%	9.69%	3.01%	6.68%	7.99%	2.87%	5.12%
8/1/2011	7.49%	3.31%	4.18%	NA	NA	NA	7.49%	3.31%	4.18%
9/1/2011	6.83%	2.76%	4.07%	12.27%	4.53%	7.74%	7.06%	2.83%	4.23%
10/1/2011	7.87%	3.50%	4.36%	NA	NA	NA	7.87%	3.50%	4.36%
11/1/2011	7.81%	3.52%	4.29%	3.07%	1.88%	1.19%	7.62%	3.46%	4.17%
12/1/2011	7.43%	3.50%	3.94%	NA	NA	NA	7.43%	3.50%	3.94%
1/1/2012	7.76%	3.48%	4.27%	8.39%	4.13%	4.25%	7.78%	3.51%	4.27%
2/1/2012	7.17%	3.95%	3.22%	NA	NA	NA	7.17%	3.95%	3.22%
3/1/2012	8.17%	4.23%	3.94%	10.74%	7.05%	3.69%	8.28%	4.35%	3.93%
4/1/2012	7.96%	4.17%	3.79%	NA	NA	NA	7.96%	4.17%	3.79%
5/1/2012	8.43%	4.95%	3.48%	4.96%	4.02%	0.94%	8.29%	4.91%	3.37%
6/1/2012	8.15%	4.13%	4.02%	NA	NA	NA	8.15%	4.13%	4.02%
7/1/2012	7.77%	4.82%	2.95%	14.04%	11.15%	2.89%	8.04%	5.09%	2.95%
8/1/2012	8.31%	5.18%	3.13%	NA	NA	NA	8.31%	5.18%	3.13%
9/1/2012	6.94%	4.61%	2.34%	7.35%	5.18%	2.17%	6.96%	4.63%	2.33%
10/1/2012	8.63%	5.89%	2.74%	NA	NA	NA	8.63%	5.89%	2.74%
11/1/2012	8.45%	5.49%	2.95%	7.80%	6.22%	1.58%	8.42%	5.53%	2.89%

### 504 DCPC Prepayment Speeds by Month - Last 5 Years



### 504 DCPC Prepayment Speeds by Loan Age - Last 5 Years







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## GLS 7(a) Settlement & Sales Strategies Tip #50 – Carpentry for lenders...

Measure twice, cut once. At some point in time, most of us have probably learned the value of this advice the hard way. Preparing data for loan sales and valuation should really be no different.

Always take the extra minute to double check data and supporting documents for both accuracy and completeness PRIOR to submitting them for analysis or bid. This will greatly reduce the error rate and in the case of loan sales, will consistently expedite settlement times meaning you get you money faster!

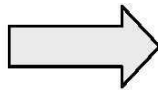
Scott Evans is a partner at GLS. Mr. Evans has over 18 years of trading experience and has been involved in the SBA secondary markets for the last eight of those years. Mr. Evans has bought, sold, settled, and securitized nearly 20,000 SBA loans and now brings some of that expertise to the CPR Report 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.



*nCino's Bank Operating System is a comprehensive solution created by bankers, for banks, to drive **increased profitability, productivity gains, regulatory compliance, and operating transparency** at all organizational levels and across all lines of business.*

Typical Bank Report (Old)

Prmp Cust Number	Prmp Cust Zip Code	Note Officer Name	Note Account Number	Note Bank Share Ledger Balance
12414	28443	MICHAEL SETZER	000010000174	2,360.59
2662	28403	KEVIN HUDSON	00001000033	0.00
24885	28403	MICHAEL SETZER	00001000092	21,541.33
26962	28480	MICHAEL SETZER	00001000109	0.00
26121	28443	MICHAEL SETZER	00001000116	909.07
2623	28411	KEVIN HUDSON	00001000216	0.00
3514	28412	KEVIN HUDSON	00001000272	1,960.26
24863	28405	MICHAEL SETZER	00001000322	3,756.01
18498	28480	DAVID BARLOW	00001000331	0.00
22808	28405	ASHLEY MIRANDA	00001000436	436.27
22808	28405	ASHLEY MIRANDA	00001000785	436.55
24322	28403	KEVIN HUDSON	00001000894	454.10
16456	28403	DAVID BARLOW	00001000975	0.00
13322	28480	DAVID BARLOW	00001001015	0.00
13322	28480	DAVID BARLOW	00001001043	0.00
2680	28403	KEVIN HUDSON	00001001304	0.00



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- 22% Increases in Staff Efficiency
- Complete Operating Transparency
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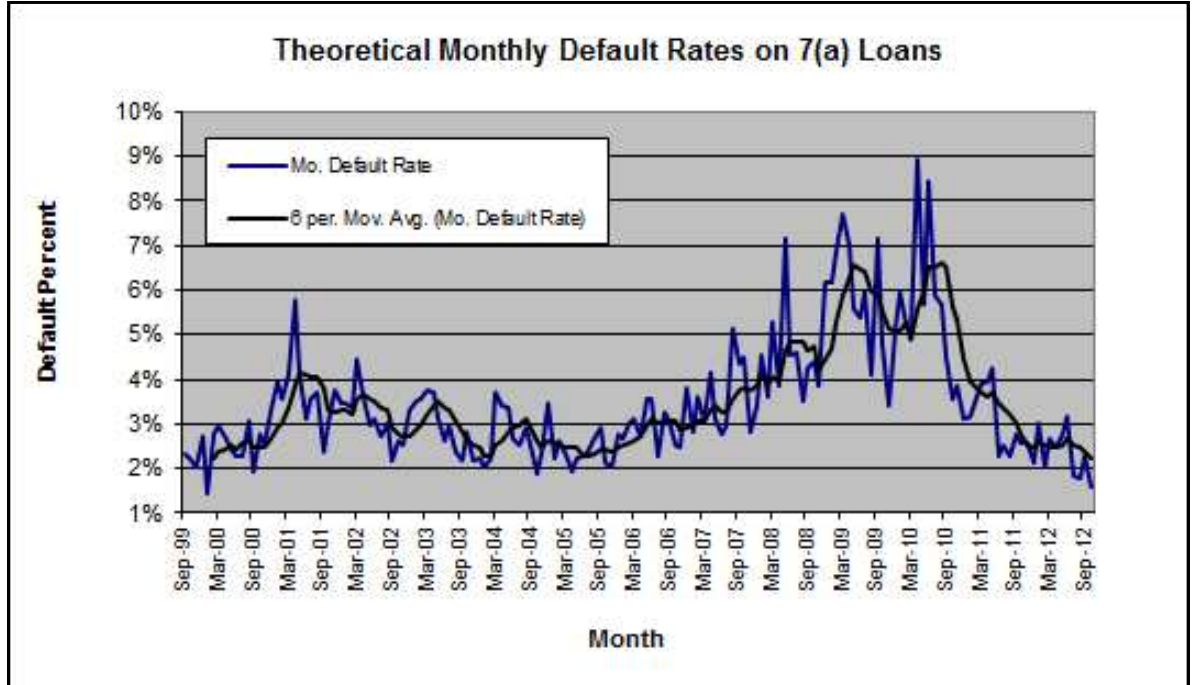
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## DEFAULT RATE HITS ANOTHER 12-YEAR LOW

In October, the theoretical default rate fell by 31% to 1.58% from 2.28%, which represents the lowest level since January, 2000 and the second lowest in our 13-year database. This reading is also the second 12-year low in the past 3 months.

This month provides yet more evidence that we are in a cyclical low for defaults in the 7a Program that could keep prepayment speeds low for a significant period of time.

Preliminary data from Colson suggests an increase near the level we saw in September, which still represents a very low default level, from an historical perspective.



The future should hold similar near 2% readings as we move into 2013.

*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.*

## DEFAULT-CURTAILMENT RATIOS

In our Default-Curtailment Ratios (DCR) we witnessed single-digit decreases in both the 504 and the 7(a) ratios last month.

Please note that an increase in the DCR does not necessarily mean that the default rate is rising, only that the percentage of early curtailments attributable to defaults has increased.

### SBA 7(a) Default Ratios

Last month, the 7(a) DCR fell back below 35%, as it continues its move to levels below 30%. Overall, the ratio decreased by 7% to 34.07% from 36.83%.

This month, both defaults and voluntary prepayments fell. Since defaults decreased by a greater degree than voluntaries, the ratio moved lower.

Turning to actual dollar amounts, defaults

decreased by 36% to \$53 million from \$82 million. As for voluntary prepayments, they fell by 31% to \$102 million versus \$141 million.

### SBA 504 Default Ratios

The 504 DCR hit a four-year low as it also approaches the 20s. With voluntaries rising by a greater percentage than defaults, the ratio decreased.

Specifically, the dollar amount of defaults increased by \$1 million to \$54 million (+2%). As for voluntary prepayments, they rose by \$8 million to \$120 million (+7%).

### Summary

It seems inevitable that both ratios will fall below 30% in the near future. The last

time that happened, the Credit Crisis was about to begin.

*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.*

*Graph on page 28*

## GLS VALUE INDICES MOSTLY HIGHER

In September, the GLS Value Indices came in mostly higher, with four out of six sub-indices increasing.

The Base Rate / Libor spread rose by another 2 basis points to +2.91%. As for the prepayment element, CPRs were slightly higher in five out of six sub-indices.

By the end of September, the secondary market moved higher by .50% in the long-end and was mixed in the shorter maturity sectors.

The long-end continued its rise, nearing 118 for full-priced loans. Slight increases were seen between 15 and 20 years, with the 10 year sector actually lower by .25%.

Turning to the specifics, the largest increase was seen in the GLS VI-1, which rose by 10% to 94 basis points. The other increases, by order of magnitude, were: VI-4 (+8% to 141), VI-3 (+3% to 68) and VI-5 (+2% to 155).

Decreases were seen, also by order of magnitude, in VI-2 (-29% to 40) and VI-6

(-1% to 170).

Expect the long-end to breach the 118 barrier in the months to come.

*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 22-23, Graph on page 24*

### 7(a) Secondary Market Pricing Grid: September 2012

Maturity	Gross Margin	Net Margin	Servicing	This Month Price	Last Month Price	3-Mos. Ago Price	6-Mos. Ago Price	1-Yr. Ago Price
10 yrs.	2.75%	1.075%	1.00%	114.25	114.50	113.125	111.75	111.55
15 yrs.	2.75%	1.075%	1.00%	114.875	114.75	113.25	112.50	112.125
20 yrs.	2.75%	1.075%	1.00%	117.25	117.00	114.85	114.25	114.00
25 yrs.	2.75%	1.075%	1.00%	117.875	117.375	115.50	115.25	115.00




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## GLS 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
Apr-09	13.23%	12.30%	11.22%	8.75%	9.81%	8.55%
May-09	13.12%	11.85%	11.79%	8.68%	9.92%	7.98%
Jun-09	13.18%	11.85%	12.35%	8.57%	8.73%	8.02%
Jul-09	12.40%	12.00%	12.51%	8.56%	8.23%	7.36%
Aug-09	13.34%	12.49%	12.36%	8.01%	7.34%	7.21%
Sep-09	12.74%	11.01%	11.83%	7.48%	6.70%	6.89%
Oct-09	12.45%	11.03%	11.31%	7.25%	7.85%	6.79%
Nov-09	12.11%	10.89%	11.01%	6.96%	7.13%	6.32%
Dec-09	11.33%	11.20%	10.55%	7.09%	7.80%	5.75%
Jan-10	11.16%	10.69%	10.30%	6.99%	8.00%	5.75%
Feb-10	10.05%	9.97%	10.00%	7.33%	8.84%	5.71%
Mar-10	9.90%	10.73%	10.07%	7.12%	8.75%	5.75%
Apr-10	9.96%	10.45%	9.72%	7.34%	8.12%	5.32%
May-10	10.56%	11.09%	10.28%	7.88%	8.53%	5.86%
Jun-10	10.94%	11.18%	10.41%	7.83%	8.53%	6.38%
Jul-10	10.32%	11.15%	10.57%	7.13%	8.59%	7.48%
Aug-10	10.45%	11.02%	10.16%	7.38%	8.25%	7.60%
Sep-10	11.29%	10.76%	10.54%	7.48%	8.01%	7.70%
Oct-10	11.35%	10.06%	10.28%	7.27%	7.29%	7.84%
Nov-10	10.55%	9.24%	8.82%	7.05%	6.45%	7.21%
Dec-10	10.89%	8.48%	8.45%	7.30%	5.61%	7.11%
Jan-11	11.99%	8.87%	7.84%	7.49%	5.03%	5.96%
Feb-11	11.22%	9.01%	7.57%	7.22%	4.91%	5.53%
Mar-11	10.43%	8.86%	7.07%	7.20%	5.13%	5.37%
Apr-11	10.60%	9.69%	7.38%	6.90%	4.95%	5.17%
May-11	10.82%	9.75%	7.26%	6.11%	5.51%	5.45%
Jun-11	10.25%	9.69%	6.81%	5.39%	5.70%	5.12%
Jul-11	10.02%	9.51%	6.38%	4.94%	6.11%	5.12%
Aug-11	10.25%	8.86%	6.16%	5.14%	6.04%	4.88%
Sep-11	10.23%	9.18%	6.13%	5.00%	5.15%	4.69%
Oct-11	10.29%	8.59%	5.53%	4.77%	5.77%	4.57%
Nov-11	9.94%	8.22%	5.59%	4.85%	5.75%	4.20%
Dec-11	9.74%	7.83%	5.62%	4.78%	5.59%	4.12%
Jan-12	9.00%	8.29%	6.20%	5.23%	5.04%	4.15%
Feb-12	9.17%	9.19%	6.18%	5.11%	4.64%	4.35%
Mar-12	8.53%	8.57%	6.34%	5.16%	5.14%	4.30%
Apr-12	8.52%	8.55%	6.18%	5.46%	4.65%	4.20%
May-12	10.19%	8.24%	6.31%	6.03%	4.86%	4.28%
Jun-12	10.42%	9.19%	6.72%	6.54%	4.93%	4.58%
Jul-12	10.78%	8.90%	6.50%	6.63%	5.55%	4.40%
Aug-12	11.30%	8.23%	6.67%	7.18%	5.97%	4.40%
Sep-12	12.35%	8.72%	6.85%	6.90%	6.46%	4.44%

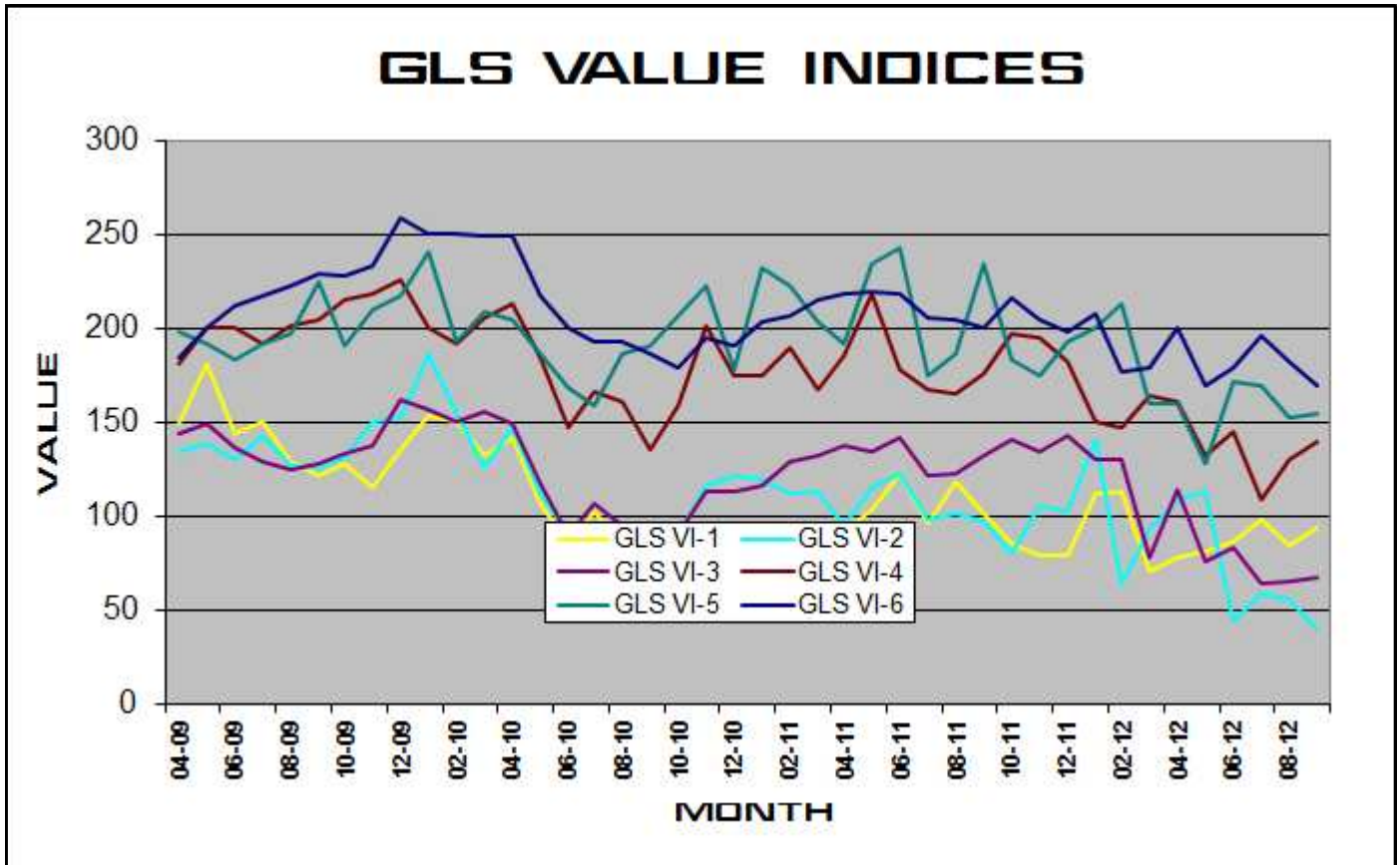
Rolling six-month CPR speeds for all maturity buckets. Source: Colson Services

# GLS 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	LOWEST READING
Apr-09	0.96%	3.28%	2.32%	149.4	134.8	144.3	182.0	198.3	184.5		
May-09	0.70%	3.26%	2.57%	182.1	138.7	149.6	200.3	192.4	200.8		
Jun-09	0.55%	3.25%	2.70%	144.8	130.3	137.3	200.2	183.8	212.8		
Jul-09	0.48%	3.25%	2.77%	150.9	143.8	129.1	191.9	192.4	217.4		
Aug-09	0.39%	3.25%	2.86%	129.7	127.4	125.7	201.7	197.3	222.8		
Sep-09	0.29%	3.25%	2.96%	122.0	126.5	128.3	205.5	225.3	229.6		
Oct-09	0.26%	3.25%	2.99%	128.2	131.3	133.9	216.0	191.2	228.8		
Nov-09	0.26%	3.25%	2.99%	115.3	150.9	138.0	219.2	210.8	234.2		
Dec-09	0.25%	3.25%	3.00%	136.1	153.4	162.0	226.3	218.0	259.6		
Jan-10	0.25%	3.24%	2.99%	153.9	186.5	157.2	201.0	240.6	250.7		
Feb-10	0.25%	3.23%	2.99%	150.8	155.1	150.4	192.3	193.0	250.7		
Mar-10	0.26%	3.25%	2.99%	133.1	126.0	155.8	206.4	209.5	249.2		
Apr-10	0.29%	3.25%	2.96%	142.1	147.5	149.3	213.6	205.1	250.0		
May-10	0.41%	3.25%	2.84%	107.5	112.1	117.5	184.4	187.2	218.1		
Jun-10	0.52%	3.25%	2.73%	85.9	90.9	90.1	147.5	168.7	200.4		
Jul-10	0.46%	3.26%	2.80%	102.7	81.0	106.7	167.0	159.5	193.5		
Aug-10	0.33%	3.26%	2.93%	85.6	91.6	95.4	161.6	186.6	193.2		
Sep-10	0.28%	3.25%	2.97%	74.1	95.3	94.0	135.6	190.8	187.2		
Oct-10	0.28%	3.25%	2.97%	79.8	89.7	91.3	159.8	207.2	179.5		
Nov-10	0.27%	3.25%	2.98%	70.5	117.2	113.5	202.0	223.5	195.4		
Dec-10	0.29%	3.25%	2.96%	79.7	121.8	113.3	175.5	178.1	191.3		
Jan-11	0.29%	3.25%	2.96%	77.0	119.8	117.3	175.2	232.3	203.7		
Feb-11	0.29%	3.25%	2.96%	88.9	112.9	129.8	190.4	222.9	207.6		
Mar-11	0.30%	3.25%	2.95%	96.8	113.5	132.3	167.8	203.4	216.0		
Apr-11	0.27%	3.25%	2.98%	92.5	95.9	137.6	186.2	192.5	218.8		
May-11	0.24%	3.25%	3.01%	104.3	116.1	134.3	219.2	235.1	220.2		
Jun-11	0.23%	3.24%	3.01%	123.1	123.0	141.8	178.1	243.7	218.4		
Jul-11	0.24%	3.25%	3.01%	96.8	98.4	121.7	167.9	175.4	206.5		
Aug-11	0.27%	3.24%	2.97%	118.6	101.5	122.8	165.8	186.4	205.3		
Sep-11	0.32%	3.25%	2.93%	101.6	98.0	132.7	176.2	234.9	200.5		
Oct-11	0.34%	3.24%	2.90%	85.5	80.8	141.1	197.4	183.4	216.3		
Nov-11	0.41%	3.25%	2.84%	79.1	106.3	134.9	195.8	175.2	204.9		
Dec-11	0.50%	3.25%	2.75%	79.6	103.0	143.8	182.6	193.6	198.5		
Jan-12	0.44%	3.25%	2.81%	112.1	141.1	130.7	151.0	201.1	208.5		
Feb-12	0.41%	3.25%	2.84%	113.5	65.0	130.5	148.1	214.0	177.6		
Mar-12	0.44%	3.25%	2.81%	71.5	93.3	78.5	164.3	160.2	179.3		
Apr-12	0.42%	3.25%	2.83%	78.7	109.6	114.6	161.0	160.2	200.8		
May-12	0.43%	3.24%	2.81%	81.3	113.4	76.4	132.5	128.0	169.8		
Jun-12	0.41%	3.23%	2.83%	87.1	44.0	83.7	145.5	172.0	179.8		
Jul-12	0.39%	3.25%	2.86%	98.4	59.0	65.0	109.0	169.6	196.7		
Aug-12	0.36%	3.25%	2.89%	85.4	56.2	65.8	130.4	152.5	182.2		
Sep-12	0.33%	3.25%	2.91%	93.9	40.0	68.1	140.7	155.1	169.7		

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



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## YTD PREPAYMENT SPEEDS

Table 3:

CPR/MO.	<8	8 - 10	10 - 13	13 - 16	16 - 20	20+	ALL
Jan-12	8.58%	10.72%	7.83%	6.85%	2.98%	5.37%	6.20%
Feb-12	8.34%	11.36%	5.10%	6.11%	3.07%	4.85%	5.23%
Mar-12	6.22%	5.31%	8.24%	5.16%	5.91%	3.98%	5.28%
Apr-12	12.23%	8.27%	4.76%	6.21%	4.98%	3.87%	4.61%
May-12	17.10%	7.97%	6.73%	8.11%	7.40%	4.25%	5.62%
Jun-12	9.68%	11.23%	7.59%	6.81%	5.06%	5.18%	6.16%
Jul-12	10.75%	9.06%	6.52%	7.46%	6.76%	4.25%	5.39%
Aug-12	11.50%	7.44%	6.11%	9.48%	5.66%	4.82%	5.60%
Sep-12	12.62%	8.38%	9.24%	3.17%	8.79%	4.23%	5.99%
Oct-12	6.50%	4.82%	6.68%	3.76%	4.28%	3.67%	4.52%
Grand Total	10.41%	8.49%	6.89%	6.34%	5.52%	4.44%	5.46%

2012 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-12	25 Mos.	35 Mos.	34 Mos.	65 Mos.	48 Mos.	49 Mos.	45 Mos.
Feb-12	25 Mos.	36 Mos.	34 Mos.	66 Mos.	48 Mos.	49 Mos.	45 Mos.
Mar-12	25 Mos.	37 Mos.	34 Mos.	67 Mos.	48 Mos.	49 Mos.	45 Mos.
Apr-12	26 Mos.	37 Mos.	35 Mos.	67 Mos.	49 Mos.	49 Mos.	45 Mos.
May-12	26 Mos.	36 Mos.	34 Mos.	68 Mos.	48 Mos.	49 Mos.	45 Mos.
Jun-12	26 Mos.	36 Mos.	35 Mos.	69 Mos.	49 Mos.	48 Mos.	45 Mos.
Jul-12	26 Mos.	35 Mos.	35 Mos.	68 Mos.	48 Mos.	48 Mos.	45 Mos.
Aug-12	26 Mos.	35 Mos.	35 Mos.	69 Mos.	48 Mos.	49 Mos.	45 Mos.
Sep-12	26 Mos.	35 Mos.	35 Mos.	68 Mos.	49 Mos.	48 Mos.	45 Mos.
Oct-12	27 Mos.	36 Mos.	36 Mos.	69 Mos.	49 Mos.	49 Mos.	45 Mos.

2012 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-12	4.61%	10.56%	11.52%	8.08%	9.00%
Feb-12	0.62%	8.06%	18.49%	9.44%	9.94%
Mar-12	6.41%	7.45%	5.74%	3.48%	5.81%
Apr-12	6.62%	10.67%	23.99%	6.82%	12.01%
May-12	28.92%	16.66%	8.73%	3.58%	14.15%
Jun-12	0.88%	16.05%	8.50%	6.76%	17.59%
Jul-12	16.34%	9.46%	5.95%	7.86%	10.74%
Aug-12	12.91%	8.90%	12.84%	6.25%	13.54%
Sep-12	9.40%	14.17%	12.62%	6.88%	19.12%
Oct-12	4.53%	8.39%	6.86%	3.96%	8.42%
<b>Grand Total</b>	<b>9.61%</b>	<b>10.95%</b>	<b>11.39%</b>	<b>6.35%</b>	<b>12.21%</b>

10-13 BY AGE	0-12 Mos.	13-24 Mos.	25-36 Mos.	37-48 Mos.	48+ Mos.
Jan-12	4.98%	13.62%	11.17%	8.87%	4.67%
Feb-12	2.23%	8.94%	8.43%	5.94%	3.39%
Mar-12	13.56%	5.97%	8.58%	9.41%	4.63%
Apr-12	2.39%	3.07%	8.48%	4.01%	6.43%
May-12	1.38%	11.76%	10.66%	8.24%	5.67%
Jun-12	7.21%	11.80%	7.84%	6.17%	5.42%
Jul-12	3.00%	10.42%	10.85%	6.63%	4.93%
Aug-12	5.71%	5.60%	11.13%	7.19%	4.45%
Sep-12	5.72%	12.89%	12.13%	5.57%	8.77%
Oct-12	1.90%	11.93%	8.60%	5.19%	5.75%
<b>Grand Total</b>	<b>4.88%</b>	<b>9.69%</b>	<b>9.85%</b>	<b>6.89%</b>	<b>5.46%</b>

16-20 BY AGE	0-12 Mos.	13-24 Mos.	25-36 Mos.	37-48 Mos.	48+ Mos.
Jan-12	0.00%	0.00%	10.01%	0.83%	3.98%
Feb-12	1.78%	0.33%	0.00%	0.54%	5.52%
Mar-12	0.00%	0.00%	10.43%	19.56%	6.01%
Apr-12	4.43%	6.18%	14.80%	0.00%	3.42%
May-12	2.10%	9.62%	9.97%	12.97%	6.81%
Jun-12	0.00%	0.00%	9.03%	8.84%	6.91%
Jul-12	0.00%	12.88%	19.54%	0.00%	4.88%
Aug-12	2.30%	4.67%	20.20%	6.42%	4.09%
Sep-12	4.48%	9.77%	12.28%	19.43%	7.48%
Oct-12	2.42%	0.00%	9.74%	16.26%	3.57%
<b>Grand Total</b>	<b>1.70%</b>	<b>5.01%</b>	<b>11.60%</b>	<b>8.46%</b>	<b>5.28%</b>

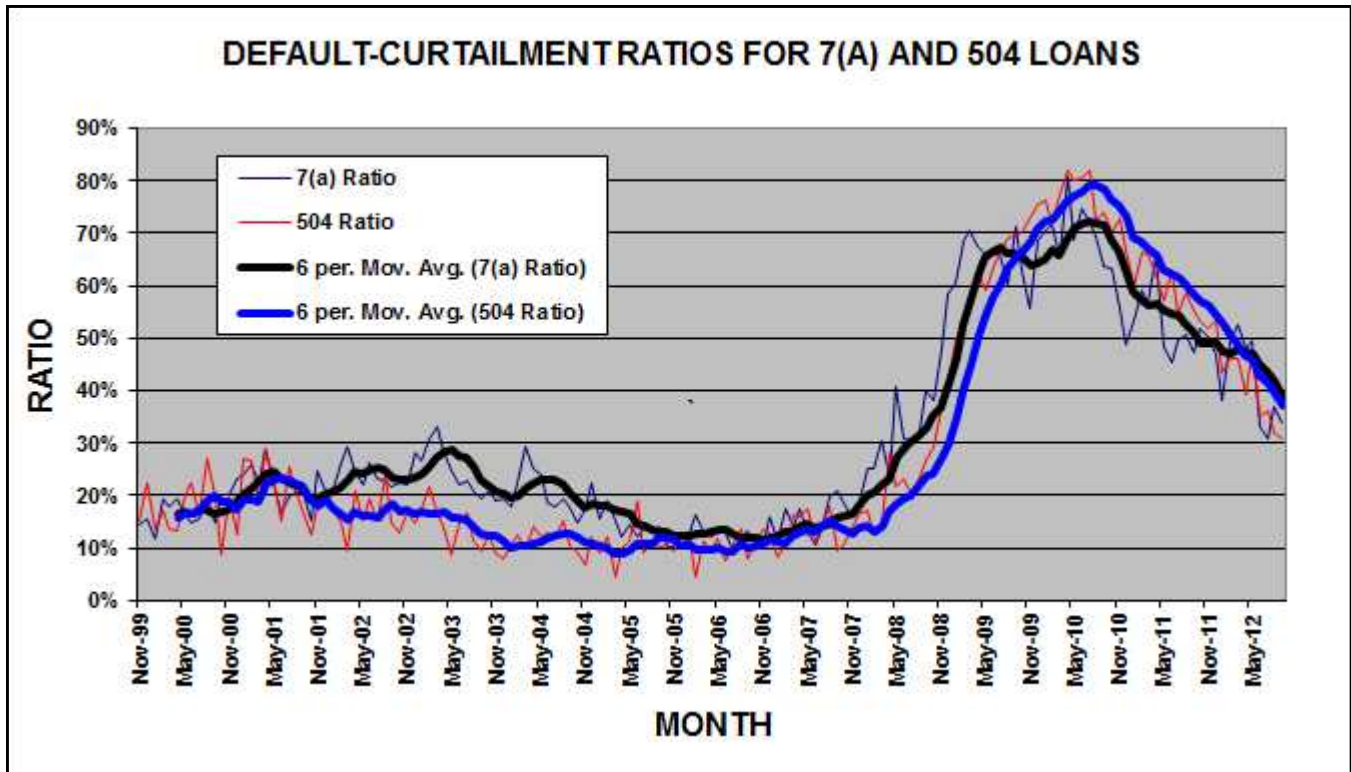
## YEAR-TO-DATE CPR DATA

Table 5:

8-10 BY AGE	0-12 Mos.	13-24 Mos.	25-36 Mos.	37-48 Mos.	48+ Mos.
Jan-12	5.92%	18.80%	12.03%	6.23%	8.78%
Feb-12	2.64%	15.16%	17.87%	8.30%	7.31%
Mar-12	2.89%	8.57%	5.56%	3.42%	4.94%
Apr-12	10.49%	1.45%	15.15%	6.87%	5.71%
May-12	0.23%	10.39%	12.68%	7.19%	6.40%
Jun-12	1.55%	14.98%	14.97%	16.50%	7.61%
Jul-12	1.82%	13.74%	13.50%	11.02%	6.56%
Aug-12	9.07%	11.62%	6.54%	2.75%	7.73%
Sep-12	10.45%	4.68%	6.49%	10.64%	8.10%
Oct-12	2.89%	7.67%	8.80%	1.35%	4.53%
<b>Grand Total</b>	<b>5.14%</b>	<b>11.07%</b>	<b>11.83%</b>	<b>7.36%</b>	<b>6.76%</b>

13-16 BY AGE	0-12 Mos.	13-24 Mos.	25-36 Mos.	37-48 Mos.	48+ Mos.
Jan-12	10.25%	0.00%	22.29%	0.00%	5.87%
Feb-12	8.14%	20.32%	0.00%	0.00%	4.64%
Mar-12	0.00%	6.22%	4.96%	7.71%	5.84%
Apr-12	3.16%	12.59%	6.20%	42.15%	4.25%
May-12	0.00%	8.07%	36.75%	0.00%	4.63%
Jun-12	0.00%	0.00%	21.04%	0.00%	6.89%
Jul-12	0.00%	10.73%	13.65%	20.32%	6.85%
Aug-12	23.84%	5.27%	34.77%	0.00%	4.36%
Sep-12	0.00%	5.17%	6.57%	0.00%	2.88%
Oct-12	0.00%	6.72%	1.12%	0.00%	4.14%
<b>Grand Total</b>	<b>5.39%</b>	<b>7.40%</b>	<b>15.40%</b>	<b>7.02%</b>	<b>5.07%</b>

20+ BY AGE	0-12 Mos.	13-24 Mos.	25-36 Mos.	37-48 Mos.	48+ Mos.
Jan-12	3.34%	5.45%	10.66%	7.13%	4.76%
Feb-12	3.49%	5.92%	5.67%	7.27%	4.68%
Mar-12	1.77%	5.65%	5.18%	5.46%	4.04%
Apr-12	0.02%	3.88%	4.72%	6.94%	4.95%
May-12	0.96%	6.24%	4.07%	7.02%	4.66%
Jun-12	0.04%	2.93%	8.80%	9.29%	6.78%
Jul-12	1.79%	2.69%	5.74%	6.24%	5.32%
Aug-12	3.92%	2.99%	6.70%	7.59%	5.06%
Sep-12	1.75%	4.43%	2.09%	8.55%	5.29%
Oct-12	1.08%	1.86%	7.74%	4.39%	4.31%
<b>Grand Total</b>	<b>1.83%</b>	<b>4.08%</b>	<b>6.11%</b>	<b>6.96%</b>	<b>4.99%</b>



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## GLOSSARY AND DEFINITIONS: PAGE 1

### Default-Curtailment Ratio

The Default-Curtailment Ratio (DCR), or the percentage of secondary loan curtailments 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 DCRs 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 DCR 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 DCR 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) DCRs and 15% or greater on 504 DCRs suggest economic weakness in these small business borrower groups.

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### 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.

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### 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: PAGE 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:

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

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### 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.)

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### 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.

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### Secondary Market First Lien Position 504 Loan Pool Guarantee Program

As part of the American Recovery and Reinvestment Act (AKA the Stimulus Bill), Congress authorized the SBA to create a temporary program that provides a guarantee on an eligible pool of SBA 504 first liens. The program was authorized for a period of two years from the date of bill passage – February, 2009. The eligibility of each loan is dependent on the date of the SBA Debenture funding. To be eligible, the Debenture must have been funded on or after February 17, 2009. The total guarantee allocation is \$3 Billion. HR 5297 provides for a two-year extension from the first pooling month, so that the end date of the program is now **September, 2012**.

**The SBA announced that they will begin issuing the first pool guarantees in September, 2010 for early October settlement.**

For the purposes of the program, a pool is defined as 2 or more loans. A pool must be either fixed (for life) or adjustable (any period adjustment including 5 or 10 years). If the pool is comprised of adjustable rate loans, all loans must have the same base rate (e.g. Prime, LIBOR, LIBOR Swaps, FHLB, etc.). Finally, each loan must be current for the lesser of 6 months or from the time of loan funding. Congress mandated that this be a **zero subsidy program to the SBA** (and the US taxpayer). The SBA has determined the program cost (management and expected losses) can be covered by an ongoing subsidy fee of .744% for fiscal year 2012.

## GLOSSARY AND DEFINITIONS: PAGE 3

### SBA 504 Program and Debenture Funding

To support small businesses and to strengthen the economy Congress created the U.S. Small Business Administration (SBA) in 1953 to provide a range of services to small businesses including financing. In 1958 Congress passed the Small Business Investment Act which established what is known today as the SBA 504 loan program.

The 504 loan program provides financing for major fixed assets, such as owner-occupied real estate and long-term machinery and equipment. A 504 project is funded by a loan from a bank secured with a first lien typically covering 50% of the project's cost, a loan from a CDC secured with a second lien (backed by a 100% SBA-guaranteed debenture) covering a maximum of 40% of the cost, and a contribution of at least 10% of the project cost from the small business being financed. The SBA promotes the 504 program as an economic development tool because it is a small-business financing product that generates jobs.

Each debenture is packaged with other CDC debentures into a national pool and is sold on a monthly basis to underwriters. Investors purchase interests in debenture pools and receive certificates representing ownership of all or part of a debenture pool. SBA uses various agents to facilitate the sale and service of the certificates and the orderly flow of funds among the parties involved. The debenture sales are broken into monthly sales of 20 year debentures and bi-monthly sales of 10 year debentures.

It is the performance of these debenture pools that we track in the CPR Report on a monthly basis.

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### Cloud Computing and the Banking Industry

#### **What is Cloud Computing?**

For many people and organizations, the term "cloud computing" is new and unfamiliar. However, it is a technology that has been used consistently since the 1950s. Many of us use cloud computing every day without even realizing it. Whenever we login to Facebook, send an email from a Gmail account, or use an enterprise planning systems, such as Oracle and Salesforce.com, we are accessing the cloud.

In simple terms, cloud computing means using hardware and software resources delivered as a service over a network. Most frequently, the network used is the Internet. Cloud-based applications are accessed through a web browser such as Microsoft's Internet Explorer and Google's Chrome, while data is stored on secure servers in custom designed data centers located throughout the United States and around the world. Businesses that use cloud computing enjoy many advantages, including an ability to get services and employees up and running faster because there is no software that needs to be downloaded and installed. Maintenance of cloud computing applications is easier, because the software does not need to be installed on each user's computer and can be accessed from multiple computers and devices. Proper cloud deployment can also provide the benefits of cost savings, better IT services, less maintenance, and higher levels of reliability.

#### **Cloud Banking**

As the banking industry evolves and adapts to changes in the competitive environment, banks will find it advantageous to move their data into the cloud. In fact, many banks are already in the cloud and just don't realize it, with data stored on Jack Henry and FIS systems.

The combination of the cloud's low cost and high scalability will help improve customer service, day-to-day operations, regulatory compliance, and the speed at which banks can operate, while reducing technology equipment and management costs.

Quite simply, cloud banking allows financial institutions to provide a more affordable and customized dialogue with their customers, regulators, employees and business partners.

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### SBI Pool and IO Strip Indexes

Through a joint venture called Small Business Indexes, Inc. or SBI, GLS and Ryan ALM introduced a group of total return indexes for SBA 7a pools and I/O strips with history going back to 1/1/2000.

Why did we do this?

Indexes have been around since 1896 when the Dow Jones Industrial Average was introduced. They have grown in importance to the financial markets, whereby today \$6 trillion are invested in Index Funds throughout the world.

Continued on the following pages.

## GLOSSARY AND DEFINITIONS: PAGE 4

### SBI Pool and IO Strip Indexes...Continued

The reasons for having investment indexes are fivefold:

1. **Asset Allocation Models:** Asset Allocation usually accounts for over 90% of a client's total return and becomes the most critical asset decision. Such models use 100% index data to calculate their asset allocations. Bond index funds are the best representation of the intended risk/reward of fixed income asset classes.
2. **Transparency:** Most bond index benchmarks publish daily returns unlike active managers who publish monthly or even quarterly returns usually with a few days of delinquency. Such transparency should provide clients with more information on the risk/reward behavior of their assets so there are no surprises at quarterly asset management review meetings.
3. **Performance Measurement:** Creates a benchmark for professional money managers to track their relative performance.
4. **Dictates Risk/Reward Behavior:** By analyzing historical returns of an index, an investor can better understand how an asset class will perform over long periods of time, as well as during certain economic cycles.
5. **Hedging:** An investment index can provide a means for hedging the risk of a portfolio that is comprised of assets tracked by the index. An example would be hedging a 7a servicing portfolio using the SBI I/O Strip Index.

By creating investment indexes for SBA 7a pool and IO strips, these investments can become a recognized asset class by pension funds and other large investors who won't consider any asset class in their asset allocation models that does not have a benchmark index.

An additional use for the I/O index could be to allow 7a lenders to hedge servicing portfolios that are getting large due to production and the low prepayment environment. This increase in exposure to 7a IO Strips would be welcome by IO investors who are constrained by the amount of loans that are stripped prior to being pooled.

#### **How are the indexes calculated?**

The rules for choosing which outstanding pools are eligible for both the pool and IO indexes are the following:

##### **Pool Size:**

- \$5 million minimum through 1/1/2005.
- \$10 million minimum after 1/1/2005.

##### **Pool Structure:**

- Minimum of 5 loans inside the pool.
- Minimum average loan size of \$250,000.

##### **Pool Maturity:**

- Minimum of 10 years of original maturity.
- Sub indices for 10-15 years and 15-25 year maturities.

The rules for remaining in the indices are the following:

##### **Pool Size:**

- Minimum pool factor of .25
- Factor Updates in the Indices are on the first of the month, based on the Colson Factor Report that is released in the middle of the previous month.

##### **Pool Structure:**

- Minimum of 5 loans inside the pool.

We have produced two weightings for each pool in the various indexes, "Actual" and "Equal":

##### **"Actual" weighted Indices:**

- The actual original balance of each pool is used to weight the pool in the index.
- An index for all eligible pools, as well as one for 10-15 years and one for 15-25 years of original maturity.
- A total of 3 actual weighted sub-indices.

##### **"Equal" weighted Indices:**

- An original balance of \$10 million is assigned to each pool, regardless of its true size.
- An index for all eligible pools, as well as one for 10-15 years and one for 15-25 years of original maturity
- A total of 3 equal weighted sub-indices.



## GLOSSARY AND DEFINITIONS: PAGE 5

### SBI Pool and IO Strip Indexes...Continued

This equates to a total of (6) Pool sub-indices. We will refer to them on a go-forward basis as the following:

#### **Actual Weighting:**

- All 10-25 year in original maturity pools "All Actual"
- 10-15 year in original maturity pools "Short Actual"
- 15-25 year in original maturity pools "Long Actual"

#### **Equal Weighting:**

- All 10-25 year in original maturity pools "All Equal"
- 10-15 year in original maturity pools "Short Equal"
- 15-25 year in original maturity pools "Long Equal"

#### **Return Calculations**

Each index is tracked by its value on a daily basis, as well as the components of return.

#### **Income Component**

- Daily return is calculated for the contribution of interest earned.

#### **Mark-to-Market Component**

- Daily return is calculated for the contribution of Mark-To-Market changes.

#### **Scheduled Principal Component**

- Daily return is calculated for the contribution of normal principal payments. Only impacts the first of the month.

#### **Prepaid Principal Component**

- Daily return is calculated for the contribution of prepaid principal payments. Only impacts the first of the month.

#### **Total Principal Component**

- Daily return is calculated for the contribution of all principal payments. Only impacts the first of the month.

The formula for Total Daily Return is as follows:

$$\text{Total Daily Return} = \text{Income Return} + \text{MTM Return} + \text{Principal Return}$$

The Principal Return is generated using the following formula:

$$\text{Principal Return} = \text{Prepaid Principal Return} + \text{Scheduled Principal Return}$$

The I/O Strip Indexes are a bit more involved, since we have to calculate the pricing multiple, as well as the breakdown between income earned and return of capital from interest accruals and payments. Here are the specific rules for the I/O Strip Indexes:

- The I/O Strip Indices utilize the same pools as the Pool Indices.
- Each pool is synthetically "stripped" upon entering the I/O Indices.
- For the equal and actual weighted indices and the maturity sub-indices (10-15 and 15-25), the pools are split into two even buckets utilizing the pool reset margins. The bucket with the higher margins we refer to as the "Upper Bucket" and the lower margin pools are in the "Lower Bucket".
- The weighted average reset margin and pool MTM is calculated for each bucket. The MTM is the same one utilized in the pool indices.
- The weighted average price of the Lower Bucket is subtracted from the Upper Bucket. The same thing is done for the weighted average reset margin.
- The MTM difference is divided by the reset margin difference, giving us the pricing multiple by maturity and weighting.
- The end result is a pricing multiple for equal and actual weighting for 10-15 year pools and 15-25 year pools, totaling (4) distinct multiples.
- Not all interest received is considered earned income, therefore interest received by the stripped pools is divided into earnings and return of capital, utilizing OID accounting rules.
-

## GLOSSARY AND DEFINITIONS: PAGE 6

### SBI Pool and IO Strip Indexes...Continued

- The OID accounting rule create a straight-line return of capital upon entry into the index and the difference between the return of capital and interest received is earned income.
- Fundamentally, high prepayments can push more received interest into return of capital, thus limiting earned income. Excellent prepayment performance can generate large amounts of earned income over time.

Once the return percentages are determined for each day, it is then applied to the previous day's index level, in order to calculate the index levels for that day.

#### **Supporting Calculations**

To aid in the analysis of the indexes, we track (22) distinct calculations for each of the (6) sub-indices:

#### **Size**

- Pool count and total outstanding balance

#### **Structure**

- Weighted average issue date, maturity date, reset date, maturity months, remaining months, age, coupon, reset margin, strip percent (strip indexes only).

#### **Price and Yield**

- Weighted average pool price, bond-equivalent yield, strip discount rate, multiple and strip pricing (strip indexes only)

#### **Other Calculations**

- CPR assumption, weighted average life, modified duration, index duration, strip duration and strip return of capital average life.
-

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

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