

COASTAL SECURITIES, INC.



Advantages of Investing in Small Business Administration - SBA 7(a) Adjustable Rate Guaranteed Loans

Financial Strategies

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■ SBA 7(a) LENDING PROGRAM

The SBA 7(a) loan guarantee program provides long term financing for small businesses not normally available through conventional commercial lending channels. This program provides the nation's small business community with manageable long-term debt service. These guarantees are issued to qualified credit worthy borrowers whose loan applications meet the criteria of both the lending institution and the Small Business Administration. Loans have a maximum guaranteed amount of \$3,750,000.

■ SAFETY

Loans guaranteed by the SBA, represented by Guaranteed Interest Certificates, are unconditionally guaranteed as to principal and accrued interest by the full faith and credit of the United States Government.

■ YIELD

SBA loans historically have provided yields, which outperform most short term and many long-term investments. The variable rate feature virtually eliminates interest rate risk while providing the opportunity to earn attractive yields. Many purchasers view SBA loans as comparable to 30 or 90 day notes offering a historically generous yield spread over short term paper and internally generated commercial loans.

■ LIQUIDITY & MARKETABILITY

While SBA adjustable rate loans are attractive self-managing assets in your loan portfolio, their unique characteristics also enhance marketability and liquidity. The adjustable rate feature creates a more stable market value less dependent on prevailing interest rates. Relative price stability enhances the liquidity of SBA loans and growing investor demand in a national secondary market increases their marketability.

■ CASH FLOW

SBA loans provide regularly scheduled (usually monthly) payments of principal and interest. This cash flow creates the opportunity for monthly reinvestment and compounding. Payments are remitted on the 15th of each month by the fiscal and transfer agent. Owners of multiple loans receive a single check along with accounting details for each loan.

■ RATE SENSITIVITY

SBA adjustable rate loans are normally indexed to the prime rate as quoted in the Wall Street Journal, the one month LIBOR rate + 300bp or the SBA peg rate and usually adjust either monthly or quarterly. Since GAP management addresses the ratio between the pricing of assets and the pricing of liabilities, there are obvious advantages to positioning funds in products repricing on a 30 or 90 day basis.

■ PLEDGEABILITY

While regulatory accounting treatment may vary, SBA loan certificates are generally booked as loans and may be pledged as collateral for Public Funds, Federal Reserve Bank advances, Federal Home Loan Bank advances and Treasury Tax and Loan Accounts. The pledgeability varies from time to time therefore, we recommend checking with regulatory authorities for specifics.

■ RISK BASED CAPITAL

Under Risk Based Capital Guidelines for depository institutions SBA loans are assigned a twenty percent weight factor. Please contact your regulatory authorities for specific risk based capital classification.

PRIME RATE SPREADS

SBA full faith and credit guaranteed investments continue to increase in popularity with institutional investors. The reasons for purchasing these securities are more compelling than ever.

While analyzing alternative investments we examine their different features and determine the spread a particular security offers over others. With adjustable securities we compare their indices. Then we examine historical spreads and typically assume that future spreads will be approximately the same. The chart below illustrates the prime rate spread over other short-term indices during the past five years.

Recently banks have had increasing pressure from regulatory authorities and shareholders to increase earnings. This has been complicated by economic conditions, which have caused much greater losses than normal in the business, foreign, consumer and real estate loan sectors. Competitive pressures are at an all time high as mutual funds, credit unions and others battle for traditional bank deposits and banks struggle against each other for a dwindling supply of quality loans. These problems, coupled with constantly rising overhead costs and F.D.I.C. insurance expenses, have placed a tremendous burden on bank earnings.

Because of these and other factors, the banking industry will be forced to maintain higher than normal spreads between prime rate and other short term indices in the future to offset the growing pressures on their margins. Banks will also look less to traditional type investments (i.e., Fed Funds, Treasuries, etc.) and diversify into new products to bolster their returns. This seems to be essential in order for banks to maintain the profitable basis to which they have become accustomed. Depository institutions simply will not be able to loan money profitably in the future, at rates of prime or lower, based on historical spreads. Therefore, lenders will continue to force prime rate to higher levels over other short-term markets in order to maintain their profitability.

With the foregoing concepts in mind, we feel that now is the opportune time to invest in an adjustable rate product tied to prime rate. The attached graph illustrates the spread between prime and other selected short-term rates.

AVERAGE PRIME SPREADS TO OTHER SHORT TERM INDICES

		Prime Rate	3 Mo T-Bill	3 Mo LIBOR	Fed Funds Effective Rate
9/30/2006 - 9/30/2011	5 Years	4.83%	+ 333 bp	+ 266 bp	+300 BP
9/30/2009 - 9/30/2011	2 Years	3.25%	+ 315 bp	+ 294 bp	+300 BP
9/30/2010 - 9/30/2011	1 Year	3.25%	+ 316 bp	+ 296 bp	+300 BP
3/31/2011 - 9/30/2011	6 Mo.	3.25%	+ 321 bp	+ 305 bp	+300 BP

Small Business Administration (SBA) adjustable rate loans and pools typically adjust either monthly or quarterly to prime. Secondary market SBAs are unconditionally guaranteed as to principal and interest by the full faith and credit of the United States Government. SBA pools have been placed in the zero percent risk-based capital category, while loans are either zero or twenty percent depending on your regulatory agency. In most cases, both are pledgeable assets. They are relatively liquid instruments trading in an active secondary market. For more information, contact your Coastal Securities representative.

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