



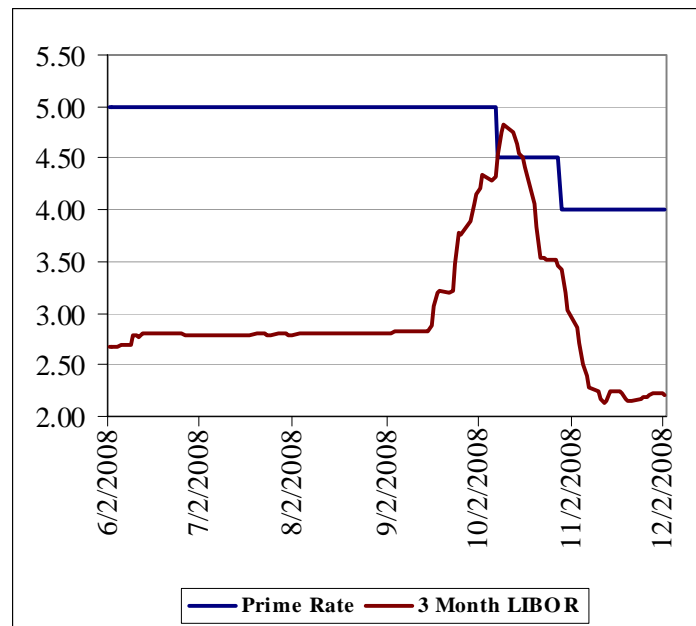
State of the SBA Market

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The effects of the global financial crisis have rocked the financial markets and have taken their toll across various asset classes. The SBA 7 (a) secondary market is no exception. The current financial climate presents opportunities to those institutions with liquidity to take advantage of the lowest prices we have seen in this market in almost a decade.

Cash is king. Banks with adequate liquidity are in an envious position. Ragged balance sheets, loan problems and general uncertainty have



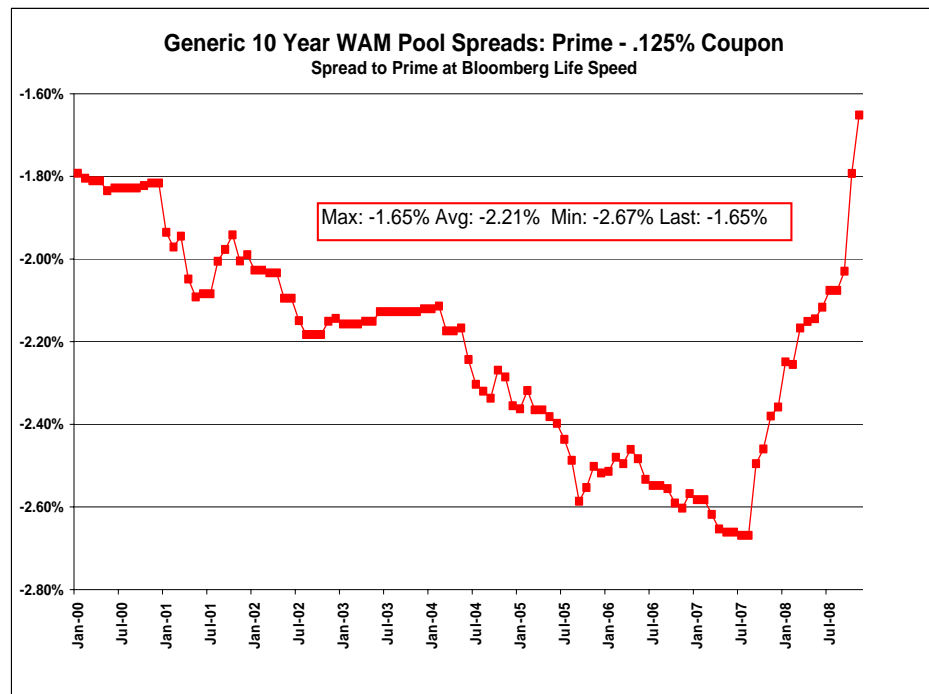
slowed lending and led to the elevation of LIBOR. In late September, the Prime vs. LIBOR spread was the tightest we have seen in recent years but has begun to widen again since mid October. Banks that have a LIBOR based cost of funds have seen the

spread over LIBOR on Prime indexed adjustable rate SBA pools deteriorate and actually become negative in some instances. As would be expected, many of these investors are sitting on the sidelines waiting for this spread to return to its historical level. Many cash strapped banks have put a halt on investments leading to lower demand in the SBA secondary market. Banks looking to sell their poolable SBA loans are being met with scaled back bids or, in many cases, no bids at all. Banks and other SBA lenders have tightened their credit standards and shrunk their SBA lending programs partially because of the credit crunch and partially because of the inability to sell into the secondary market at prices that will cover their origination costs. The Wall Street Journal

reports that SBA lending in October 2008 was down 50% year over year.

Complicating the situation even more is deterioration of the housing market. Risk averse banks with little excess liquidity have tightened lending standards and raised mortgage rates. The average interest rate on a 30 year fixed rate mortgage has gone from 5.04% on January 23rd of this year to 6.51% on October 30th. As of December 1st it is back down to 5.09%. Some investors consider the current higher yields on mortgage backed securities a more attractive asset than SBA pools. This belief, though, does not consider two facts: (1) fixed rate mortgages are dramatically longer in duration than SBA pools and (2) mortgage rates are most likely closer to cyclical lows than highs.

Opportunistic investors take note! With an extremely slow SBA market in terms of supply and demand, what does this mean for investors? **An outstanding total return opportunity!** Value oriented investors are encouraged to consider investing in Full Faith & Credit SBA pools while prices are at ten year lows. Looking at the graph below, one can see that SBA adjustable rate 10 year WAM pools with a coupon of Prime - .125 were trading to yield Prime - 2.67 in September 2007 and are now offered to yield Prime - 1.65, a pick up in spread of **102 basis points for an uncapped, short floater!** **This spread has not been seen since January 2000!**



All investors are not equal. Important to note is the fact that not all investors are LIBOR funded. Recent levels have encouraged former participants (not LIBOR based) to re-enter this sector. Over the last few years, some of these participants have been at a disadvantage due to their

higher funding costs. This disadvantage was apparent during “normal” rate relationships but has basically disappeared in the current environment.

Once the Prime/LIBOR spread returns closer to historical levels and the credit markets begin to loosen, we believe prices will rise again, albeit probably not to the levels seen during the past few years. Historically, we have seen fewer numbers of investors purchasing significant block sizes of the SBA pool product. We feel that, once the current market conditions return closer to former levels, these investors will re-enter the market and the opportunity for new investors to take advantage of spreads available today will evaporate.

Buy and hold investors are rewarded with a government guaranteed asset with a 0% risk based capital weighting. Furthermore, all major prepayment drivers on SBA pools are well off the maximum incentives seen in the 2006-2007 period, most important being the shape of the yield curve. The current steeper yield curve, caused mainly by the Fed easing, has removed most of the Floating to Fixed refinancing among SBA borrowers and CPRs have dropped dramatically in 2008.

Lenders should consider becoming buyers. With declining secondary market demand for new loans, sale premiums significantly down and bank liquidity high, why aren't the traditional originators and sellers of SBA loans buyers of this product? If these SBA loan sellers would become buyers in this “buyers’ market”, they could bring much needed liquidity back to the secondary market while at the same time taking advantage of the much higher than normal spreads currently available. There is also the possibility of lenders swapping current loans for like amounts of SBA pools. This allows for the institution to book premium dollars on their sales and purchase full faith and credit securities with approximately the same yields. (See our **SWAP PROPOSAL** article dated November 18, 2008 at www.coastalsecurities.com for further details.)

The last word. We feel that SBA pools offer a great value for investors in a position to take advantage of the current market phenomenon. We welcome the opportunity to discuss the history of this market, Coastal's proprietary sector analytics and the current opportunity now available. Contact your Coastal Securities representative for current offerings or Greg Putman, Head Financial Strategist for more detailed information greg.putman@coastalsecurities.com.

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