Questions & Answers: The Lender Perspective

In August 1999, the SBA announced the highly successful initial sale of purchased guaranteed 7(a) loans to the private sector. Bids were received for Sale #1 on August 17, 1999, and closings occurred in September 1999. The loans to be sold in the second sale have been selected, and SBA is actively marketing this portfolio. Sale #2 is scheduled to close in August 2000. Finally, SBA has identified certain SBA and lender-serviced purchased guaranteed 7(a) loans to be sold in Sale #3. It is anticipated that Sale #3 will close in December 2000.

These loan sales are a part of an innovative sales program that is designed to reduce the number of direct and purchased guaranty loans that SBA has acquired. The SBA plans to sell up to $9 billion in loans over the next three years, and to establish a mechanism to sell approximately $500 million in loans every year, thereafter.

The structure of the SBA's Asset Sales Program provides lenders with an opportunity to sell their remaining interest in a given purchased guaranteed 7(a) loan when the SBA sells its portion. Lenders may bid on the pool containing the loans in which they had an ownership interest. This will allow lenders to develop their own workout, restructuring, packaging, and collection strategies to pursue a profit opportunity.

The following information is presented in response to prior questions from lenders:

(1) How does the loan sale program work?
(2) How can lenders include their portion of section 7(a) loans in the sale?
(3) How will lenders get paid for their participation in the sold loan?
(4) How can lenders purchase loans being sold by SBA?

How does the Loan Sale Program Work?

1. Why is SBA selling its portfolio of direct loans and purchased guaranteed loans?

The Small Business Administration is reengineering to become a federal agency of the 21st Century. SBA intends to reallocate staff away from some direct loan management functions. This will allow the staff to oversee and monitor the lender's process of originating and servicing loans and the quality of the loans that are created. Loan asset sales are one part of the reengineering process. The Administration's last three budgets have included an express mandate for SBA asset sales.

2. What was the result of the first sale?

In Sale #1, 4,060 small business loans that SBA had either made directly or had previously guaranteed for private sector lenders were sold. The unpaid principal balance of the loans included in the sale totalled approximately $332 million, with about half the loans classified as non-performing or under-performing.

The loans were divided into 26 different loan pools to maximize value. SBA received 135 bids from 25 different bidders. The winning bids varied widely based on the characteristics of the various loan pools. The criteria used to pool the loans included: loan status, collateral type, lien position, loan to value ratios, location of collateral, SBA loan program and environmental issues. SBA realized $195 million in total in proceeds from the sale of these loans, a $90 million premium over the $105 million that the government estimated it would receive, if it held the loans to maturity or disposed of the loans through historical liquidation methods.

3. What loans will be sold in Sale 3? Will lender-serviced Section 7(a) loans be sold?

SBA plans to sell both performing and non-performing direct loans and purchased guaranteed Section 7(a) and Development Company loans in Sale 3. The largest portion of the Section 7(a) "SBA-owned portfolio" is now lender-serviced because the SBA has moved more of the servicing responsibilities for purchased guaranteed Section 7(a) loans to the lenders in recent years,. In order to implement the mandate from the U.S. Congress to sell all SBA-owned loans, the Agency must sell these loans.

4. What happens to the lender's interest in Section 7(a) loans that is sold by the SBA?

It makes economic sense to sell the entire loan, i.e. both the SBA and lender interest, in a single sale. The SBA believes that sale of the entire loan will result in a greater return to both the agency and the lender. Therefore, the SBA will seek lender approval to sell the entire loan.

5. What happens if a lender does not want to sell its interest in a purchased Section 7(a) Loan?

SBA prefers to sell the whole loan. The agency believes that awhole loan salewill result in higher proceeds to both SBA and the lenders. However, at some point the Agency will seek the lender's consent to sell only its participated share. At that time to maximize value, separate pools of participated loans containing only the SBA's interest will be created.

6. How can lenders be assured that the loan sales will be conducted in a commercially reasonable manner?

SBA conducts competitive solicitations and engages the best qualified sales contractors that are available in the private sector. A Program Financial Advisor has been retained to oversee development and implementation of a consistent sales program. A Transaction Financial Advisor is hired for each sale to market and sell each specific pool of loans. A Due Diligence Contractor is employed to provide full disclosure to potential investors, and a Legal Advisor is retained to assist in developing legal documents and addressing legal issues associated with selling loans. These sales contractors are experienced in both private sector and federal government loan sales.

7. Can a lender purchase the SBA portion of loans in which the lender also owns a portion before the loans are offered for sale?

Lenders can purchase the SBA portion at par at any time prior to the bid date. Absent that, the SBA believes that a full, open, and competitive sale will generate the best overall return. SBA will not sell the loans to the lender at a discount except through a competitive bidding process.

8. Will borrowers have an opportunity to purchase their own loans at a discount prior to the SBA offering the loans for sale?

No. SBA believes that a full, open, and competitive sale will generate the best overall return. During the due diligence process, borrowers will be notified that they may prevent their loan from being sold by paying the full outstanding principal balance plus accrued interest.

9. Will SBA be seeking the approval of lenders, including the Certified Development Companies, to sell the Section 502 and 504 loans?

No. The Development Company loans are structured differently than the Section 7(a) loans. Rather than one loan made by the lender and guaranteed by the SBA, there are two distinct obligations. The lender has a senior lien on the collateral securing their loan and the Development Company has the junior lien. The Development Company obligation carries the SBA guarantee and once the guarantee has been honored, there is no ownership interest by the Development Company. The SBA-owned debt can then be sold without any further approvals from the parties. In rare instances where the Development Company retains an ownership interest, the Development Company's consent to sell the loan will be requested.

How Can Lenders Include Their Section 7(a) Loans in the Asset Sales Program?

10. How will lenders know if SBA plans to sell a loan in which the lender owns an interest?

Over time, the SBA plans to sell all its purchased guaranteed 7(a) loans. Once the lender has granted consent, the agency intends to include as many Section 7(a) loans in an upcoming sale, as possible. The SBA will send two different notices to lenders who own a portion of the Section 7 (a) loans in the upcoming sale. The first notice will identify the SBA serviced loans, and the second one will list the lender serviced loans in the sale.

These letters will provide a deadline by which the lender must send a signed agreement to SBA to authorize sale of the entire loan, including the lender's portion.

11. How should a lender notify SBA if it wants the sale to include its portion of the Section 7(a) loans that the SBA has identified for sale?

The letters that request the lender consent to sell its loans contain either a SBA Serviced Consent Agreement or a Lender Serviced Consent Agreement. The lender should sign the appropriate agreement and return it to SBA by the date indicated in the letter. The letter also will include the name and phone number of a member of the SBA Asset Sales Team to contact with questions, or the lender may e-mail the SBA at: lenderquestions@sba.gov.

12. What happens if the lender does not want the sale to include its portion of the Section 7(a) loans that the SBA has identified for sale?

The SBA will seek the lender’s consent to sell the portion of the loan that SBA owns at a later date. This alternative is likely to result in lower proceeds from the sale than would be generated by selling the whole loan. SBA hopes the lenders understand the financial and asset management advantages of contributing their portion of a loan to the sale.

13. Can a lender volunteer loans to Sale #3?

The SBA plans to sell its direct loan and purchased guaranteed loan portfolio. The loans to be sold in Sale #3 are not limited to the loans listed on Schedule A of the Lenders Consent Agreement. Lenders are encouraged to contribute any development company loan or purchased guaranteed 7(a) loan with an unpaid principal balance of more than $10,000 in which they have an interest.

How Will Participating Lenders Get Paid?

14. When will lenders get paid for their portion of Section 7(a) loans that SBA sells?

There can be multiple successful bidders in a SBA asset sale. Closings will be scheduled as expeditiously as possible, generally within 30 to 60 days of the bid date. Promptly, after the last closing with the final successful bidder and transfer of loan servicing, SBA will remit the lender's share of the proceeds.

15. How much will lenders get paid for their portion of Section 7(a) loans that SBA sells?

In each loan sale, the loans are divided into loan pools in order to maximize value. The criteria used to pool the loans includes: performing vs. non-performing, real estate collateral vs. business assets, secured vs. non-secured, lien position, loan to value ratios, location of collateral and environmental issues.

Lenders will be paid their net pro-rata share of the proceeds from the loan pool(s) in which their loans were sold based on the following:

(1) the unpaid principal balance of the loans in which the lender has an interest, expressed as a fraction of the total unpaid principal balance of the sold pool of loans, and
(2) the total sales price of the sold pool of loans,
(3) net of the direct costs of that particular sale.

SBA will cover the overhead costs associated with the Asset Sales Program. Lenders will not bear the costs of the Program Financial Advisor or SBA staff. SBA will deduct the direct cost of each sale, including the cost of the Transaction Financial Advisor, outside legal, and due diligence contractor costs against the gross sale proceeds.

How Can Lenders Purchase Loans from SBA's Asset Sales Program?

16. Why do lenders want to buy non-performing SBA loans?

Non-performing Section 7(a) loans have value that can be optimized by experienced small business lenders. Many lenders already employ capable workout staff for their own business loan portfolios. When a lender purchases loans sold by SBA, the lender may workout the loans according to its own business practices (subject only to certain post-sale servicing requirements that may be a part of the loan sale agreement). Some lenders have indicated to the SBA that they wish to purchase specific types of small business loans that fit their special capabilities or the geographic markets they serve.

17. Can lenders purchase <u>only</u> their own loans in the sale (meaning those loans in which the lender owns a portion)?

No. Lenders who are qualified bidders may bid on any pool of loans, including a pool that contains the lender’s loans. However, they must purchase the entire pool of loans, not just a portion of a pool.

18. How will lenders know of scheduled SBA loan sales?

SBA retains financial advisors to promote market interest in each sale. Lenders and all potential bidders will be noticed through advertisements and announcements in the media and trade publications. In addition, firms that are included on the SBA Investor Database will receive a direct marketing brochure. Finally, the date of each sale will be posted on the SBA Asset Sales website at http://www.sba.gov/assets.

To get on the SBA Investor Database, contact the Asset Sales Team at buyassets@sba.gov or send a letter to:

Small Business Administration
C/O Asset Sales Program
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