2018 SBA 7(a) Loan Market Outlook

Top SBA Lenders Focus on Technology as Key Differentiator

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WINDSOR ADVANTAGE

Introduction

Small businesses are the primary jobs engine of the U.S. economy — providing 66% of all net new jobs since the 1970s.

Welcome to our 2018 SBA 7(a) Loan Market Outlook, an annual forecast of key market dynamics based on the best data available at the time of publication. As our strategic discussions with lenders focus on the SBA loan market and trends we see unfolding in the year ahead, this report attempts to capture the same forward-looking, proactive view as a foundational tool.

Small businesses are the primary jobs engine of the U.S. economy — [1]providing 66 percent of all net new jobs since the 1970s. The Small Business Administration helps small businesses drive a healthy economy through a number of initiatives — including the flagship 7(a) loan guaranty program — designed to encourage lenders to provide loans to small businesses that are often unable to secure financing with reasonable terms elsewhere.

Four themes appear to be defining the SBA lending market in 2018:

- Dollar amount of SBA loan approvals at a record high
- Technology is playing an increasingly important role in all aspects of the SBA 7(a) loan market
- Emerging trends in volume increases among top 50 SBA 7(a) lenders
- SOP changes allow for increased Lender participation

Approved Dollar Volume Hit Record Level and Lender Participants at Lowest Level in 10 Years

The SBA achieved a record level of approved dollar volume in FY 2017, with more than $25.8 billion.

As shown in the chart below, the SBA achieved a record level of approved dollar volume in FY 2017, with more than $25.8 billion. This 5.3% increase in the dollar volume of loans represents the fifth consecutive year of growth in the financing of businesses through the 7(a) Program.

Some of the increasing volume trend may be attributed to economic expansion and permanent changes to the SBA Program. But much of this sustained increase in volume is more likely due to the increasing focus on technology by the top SBA lenders.

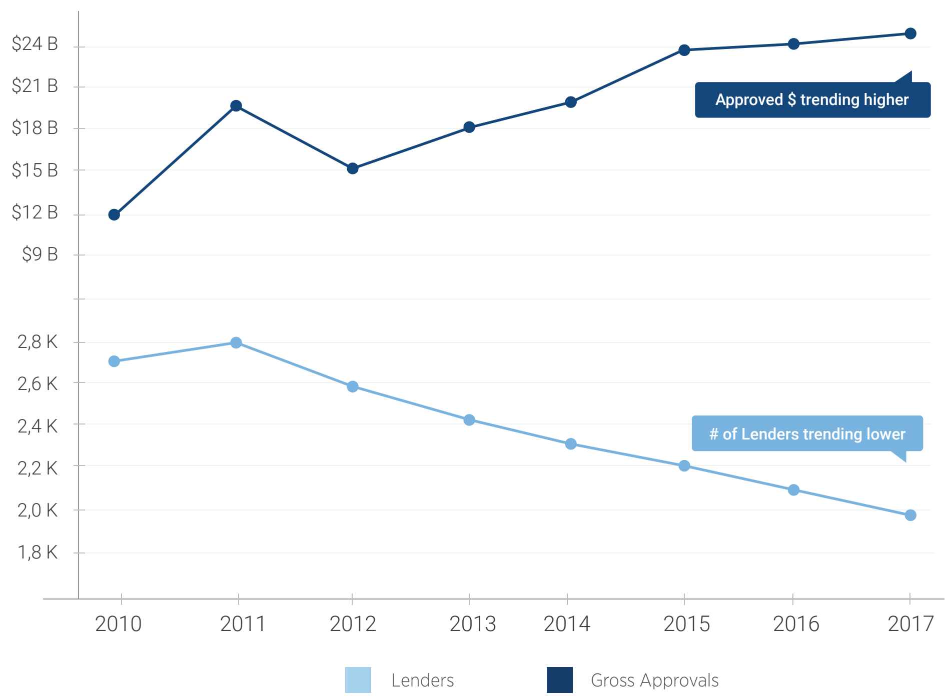
While total dollar volume hit a record high, the number of lender participants in the SBA 7(a) Loan Program continued to drop from a highpoint of 2,728 in FY 2011 to 1,978 in FY 2017 — the lowest level in ten years.

[1] *2018 Budget Justification – p. 2; Small Business Administration*

The top 50 lenders [2] by volume provided more than 53% of all SBA 7(a) loans in FY 2017. There are a decreasing number of participants at the same time the Program is funding more loans than ever. Additionally, the average loan size continued to trend upwards to $413,400, an increase of more than 8% over the prior year.

The number of lender participants in the SBA 7(a) loan program continued to decline — dropping to the lowest level in ten years.

Sophistication Gap Widening: More Volume by Fewer Lenders



SOURCE - Small Business Administration [3]

And if Q1 of FY 2018 is any indication — the three months ended December 31, 2017 — the volume trend looks likely to continue. Technological shifts such as marketing automation, marketplace lending, automated credit decisioning models and the increased focus on technology at the SBA, may also positively impact volume going forward.

[2] *Small Business Administration – SBA 7(a) Loan Data Reports*

[3] *Small Business Administration – Reflects the gross dollar amount of loans approved by fiscal year plus any subsequent loan increases that occurred in the given fiscal year*

As the SBA pointed out in the FY 2017 Agency Financial Report: **"Technology has evolved to the point that entrepreneurs have greater access to markets and more capabilities to start and expand their businesses."**

Role of Technology

The growing competitiveness within SBA 7(a) lending — dominated by a small number of lenders providing more than half of all SBA 7(a) loans — requires the remaining participants to increase their technological sophistication or potentially risk obsolescence.

To be successful, lenders must design a comprehensive approach to evaluating and implementing technology. As the SBA pointed out in the [4] FY 2017 Agency Financial Report: "Technology has evolved to the point that entrepreneurs have greater access to markets and more capabilities to start and expand their businesses." Banks must embrace the right technologies and effectively implement these technologies in order to connect to the most qualified small businesses seeking capital.

Technology already impacts all facets of SBA lending from origination of loans to portfolio management. The successful implementation of thoughtful technology by innovative lenders will continue to increase in importance, resulting in dramatic differences in lender volume and loan performance. The value of technology in financial services, and specifically commercial lending, cannot be overstated.

The Technology section of this report explores the impact of technology on each component within a well-designed SBA process.

Top 50 Lender Trends

The loan volume to be a top 50 lender has significantly increased since 2013. Five years ago, a lender had to authorize approximately $57 million in SBA 7(a) loans to rank in the top 50. The amount of volume has now grown by almost 70% to almost $99 million to make the list in 2017. A further analysis of the current top lenders provides more visibility on how some of these lenders have achieved the growth in volume.

At approximately $350,000 per loan, the top 25 have clearly focused on increasing their reach to borrowers with smaller capital needs. Lenders that have found an effective and efficient way to process and approve smaller loans have reaped the benefits. In many instances, this can be attributed to an increased investment in technology and process refinement.

[4] *2017 Agency Financial Report – p. 26; Small Business Administration*

SOP Changes

The SBA recently issued a new SOP (50 10 5 J) effective January 1, 2018. This version incorporates significant changes, clarifications, and a major re-organization. Several new rules will impact how the industry views certain transactions (including acquisitions and EPC/OC transactions) and provide further clarity for lenders to operate in compliance with the rules of the Program.

These changes, ranging from lender oversight to updates related to equity injection, attempt to mitigate risk and instill confidence in lenders new to the 7(a) Program.

Ultimately, simplified rules and processes should result in greater certainty and less confusion among lenders, creating an opportunity for increased participation in the Program. As discussed in a later section, guidelines surrounding eligibility could perhaps have the most profound effect on increasing future volume.

Topic I – Technology

Shawn T. Andrews, Managing Director

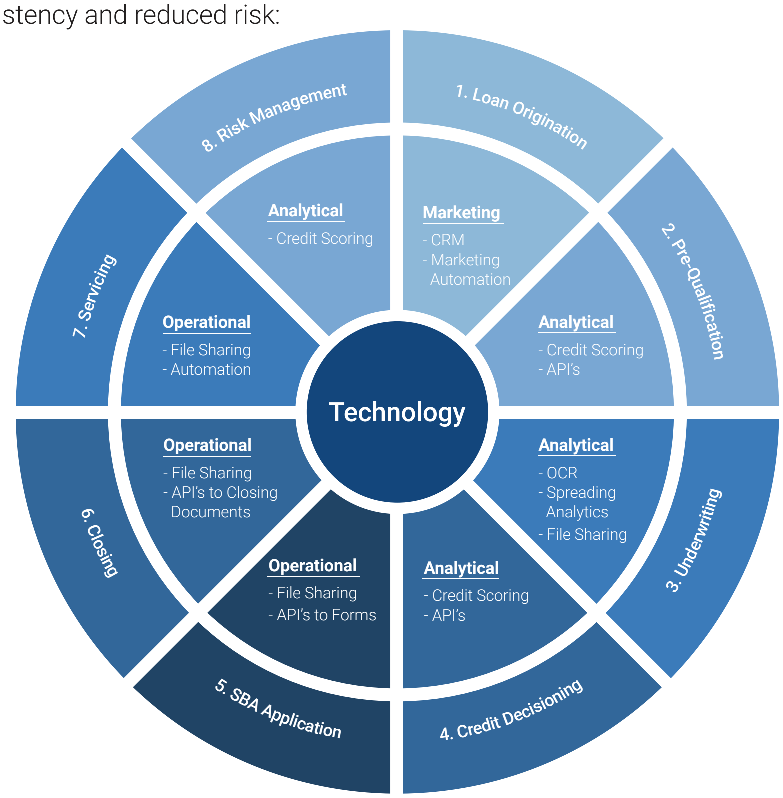
While very few banks and credit unions currently consider themselves a digitally mature leader, more than 60% aspire to be one by 2020.

The impact of technology on commercial lending over the past decade has been dramatic. Sophisticated lenders are achieving success through increased implementation of multiple technologies across all levels and functions. [5] While very few banks and credit unions currently consider themselves a digitally mature leader – an innovation-led firm in position to withstand future marketplace changes – more than 60% aspire to be one by 2020.

The technologies impacting SBA lenders can be broadly classified into three categories:

- **Marketing Technologies** — from CRM and marketing automation to social media
- **Analytical Technologies** — such as credit scoring for both origination and portfolio management
- **Operational Technologies** — from APIs, file sharing and cloud collaboration to electronic signatures

By examining SBA lending by function, it is clear that technologies can be utilized within each step of the process to achieve increased efficiencies, increased consistency and reduced risk:



[5] *Thrive or Survive? Tech Strategies Will Determine Banks' Future – p. 1; The Financial Brand*

SBA lending, with its defined rules and standard forms, provides an ideal opportunity to implement technology with consistent processes and dedicated staff.

There is large and growing inventory of existing technologies available for purchase or subscription within each of the categories. Additionally, lenders can choose to develop their own technologies or to modify existing proprietary systems. This "build or buy" variable further complicates what can appear to be an already overwhelming technology evaluation and implementation process.

Lenders can take comfort in the fact that the ultimate success of the technology is still driven by the basics of effective management.

With so many considerations, what is the best way to start implementing a technology-focused SBA initiative? Lenders can take comfort in the fact that the ultimate success of the technology is still driven by the basics of effective management:

- Setting clear goals;
- Creating and implementing efficient processes; and
- Hiring, and incentivizing, the right people for the right positions.

Once the bank's SBA strategy is set and processes have been defined, each technology should be evaluated for both tactical usefulness as well as integration within the overall technology infrastructure.

Only through the consistent implementation of these fundamental business principals can technology be the catalyst for success (growth and efficiency).

The following discussion highlights some of the most impactful "out of the box" technologies within each category currently being used by innovative SBA lenders. This list will continue to expand in 2018 and beyond, but the importance of designing a comprehensive approach to evaluating and implementing the technology will remain constant.

Marketing Technologies – Loan Origination

According to [6]American Banker, financial decision-makers at prospective borrowers have become increasingly heavy users of social media, including Twitter and LinkedIn. Social media offers banks new ways to effectively market to new customers and build an institutional brand.

[6] *Banking at the Crossroads – p. 5; Source Media and American Banker*

Examples of some of the most prevalent marketing technologies by category include:

- **Customer Relationship Management (CRM)** — Salesforce, Pipedrive, Microsoft Dynamics
- **Marketing automation** — SharpSpring, HubSpot, Marketo
- **Content distribution** — LinkedIn, Twitter, Hootsuite

Increased participation by SBA lenders in market- place platforms, or the creation of their own platforms, could be an opportunity for lenders to add additional loan volume in 2018 and beyond.

The [7] 2017 Path to Digital Leadership survey of financial services companies estimates that the percentage of revenue through digital channels is expected to increase from 22% in 2017 to 38% by 2022.

Online loan "marketplaces" are another area of potentially increasing importance for SBA lending. Marketplace lending is a term used to describe the online platforms between borrowers and lenders. This technology is driving more competition and creating more sophisticated borrowers with more choices. Marketplace lending offers both benefits and risks. Marketplace lenders can serve credit needs in markets where financial institutions would not traditionally lend, allowing small businesses to access otherwise unavailable capital. However, marketplace loans tend to carry higher interest rates than traditional bank loans.

Banks can use the same technology as many marketplace lenders to compete for the most bankable borrowers, providing better rates and terms than the non-depository competition. Increased participation by SBA lenders in marketplace platforms, or the creation of their own platforms, could be an opportunity for lenders to add additional loan volume in 2018 and beyond.

Analytical Technologies – Credit Decisioning

Most banks use the same processes and people regardless of loan product and loan size.

One of the most significant issues impacting efficient and effective SBA lending are traditional workflows at banks. Most banks use the same processes and people regardless of loan product and loan size. SBA lending provides an ideal opportunity to implement technology through consistent processes, dedicated staff and analytical technologies.

Additionally, the implementation of technology provides lenders the opportunity to reverse the increasing average loan size trend, allowing banks to help the borrowers most in need of SBA-guaranteed loans.

[7] *Path to Digital Leadership – p. 48; Roubini Thoughtlab*

As stated in a recent [8] Harvard Business School study, "offering a streamlined online application, alongside the assistance and guidance of a banker that a borrower already trusts, can be a powerful combination."

Examples of some of the most prevalent analytical technologies by category include:

- **Digital lending platform** — SageWorks, Mirador, Akouba
- **Credit scoring for origination and portfolio management** — FICO, PayNet, D&B Credit Reporter

Utilizing analytical technology to screen and pre-qualify loans can have a dramatic impact on efficiency of individual staff and departments. The efficiencies are most apparent in the SBA small loan (<$350,000) segment, where the SBA has itself embraced credit scoring. However, these same technologies can be implemented regardless of loan size to provide operating efficiencies to a bank's entire SBA strategy.

Operational Technologies – Packaging and Closing

56% of bankers expressed that the manual collection of data and back-and-forth with small business borrowers is the biggest challenge of the loan initiation phase.

Banks must identify technology solutions that can be integrated into existing processes and systems. The processes and systems must be thoughtfully designed and consistently implemented, or the technology will not provide the operational efficiencies.

According to a recent [9] Moody's Analytics survey, 56% of bankers expressed that the manual collection of data and back-and-forth with small business borrowers is the biggest challenge of the loan initiation phase. This may be the easiest category of technology to implement. It requires very little up-front investment, a small amount of customization, and generates nearly immediate efficiencies with even the most basic level of adoption by staff.

Examples of some of the most prevalent operational technologies by category include:

- **File sharing** – Citrix, SharePoint, Dropbox Business
- **Cloud collaboration** – Asana, Wrike, Clarizen
- **Electronic signatures** – Verisign, DocuSign, Adobe eSign

[8] *The State of Small Business Lending: Innovation and Technology – p. 79; Harvard Business School*

[9] *How Automation Can Improve Your Loan Origination Process – p. 2; Moody's Analytics*

Conclusion:

Increased lender focus on technology drove SBA loan growth in 2017 and will continue to be a critical factor for success in 2018.

The competitiveness of the marketplace, dominated by a small number of lenders providing more than half the loans, requires that remaining participants increase their technological sophistication to compete more effectively.

Thoughtfully combining technology with efficient processes and defined strategy is the only path to sustainable success in SBA lending.

Topic II – SBA Strategy

Shawn T. Andrews, Managing Director

To build a compliant and scalable SBA lending platform, lenders must first define their strategy — and then implement sufficient technology to achieve the strategy.

To build a compliant and scalable SBA lending platform, lenders must first define their strategy — and then implement sufficient technology to achieve the strategy. In order for the SBA to meet its objective to drive increased lending by a larger number of lender participants, it is imperative that more lenders adopt a well-defined strategy supported by technology and a compliance-focused culture.

To formulate a comprehensive strategy, lenders must answer six questions:

- Why participate?
- What type of borrower?
- Where will we lend?
- How will we originate?
- How will we compensate?
- How will we control risk?

Why Participate?

Lenders should start by asking, "Why do we want to participate in the SBA 7(a) Loan Program?" Some of the most popular reasons are to generate fee income, provide more favorable structures for borrowers (amortization, collateral coverage) and to assist underserved communities and/or achieve community reinvestment goals.

What Type of Borrower?

Next, lenders should ask, "What type of loans do we want to fund?" Responses often include geographic focus and use of proceeds (such as business acquisitions, equipment purchase, real estate purchase). Industry focus is also an important consideration. The following table summarizes the industries with the largest number of SBA loans by dollar volume for the 10 years ended December 31, 2016. These top 10 industries represent 30.4% of all SBA loans by dollar volume over this 10-year period.

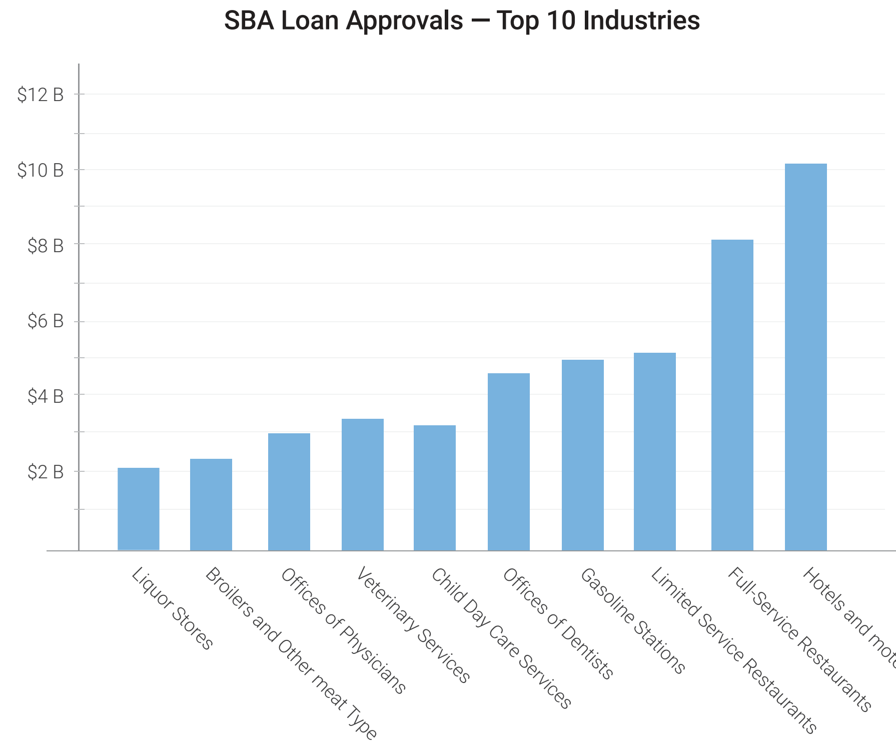
Where will we Lend?

Defining your footprint is critical as referral sources and in-bound opportunities take time to review. Geographic boundaries must be defined up front.

10-Year Total:
$151,035,477,763

Top 10 Total:
$45,945,741,898

As of September 30 2015, hotels surpassed full-service restaurants as the top industry over a ten-year period.



SOURCE - Small Business Administration [10]

How will we Originate?

Once the lender defines "why" they are participating in the program and "what" type of borrowers they seek, and "where" they are going to lend, they must ask, "How will we originate these loans?" Responses often include branch networks and internal business development, strategic partnerships, loan agents (loan brokers and investment bankers) and online or marketplace origination.

As previously mentioned, technology decisions are playing an increasingly significant role in the competitive differentiation of origination activities by SBA lenders.

How will we Compensate for SBA Volume?

Before marketing the program, the lender must define and communicate the compensation structure. Keep it simple and be consistent.

[10] *Small Business Administration – SBA 7(a) Loan Data Reports*

How will we Control Risk?

Perhaps most importantly, the lender must focus on identifying the risk, quantifying the risk and ultimately creating controls to mitigate the risk. Lenders should ask, "How will we control the risk, from both an operational and credit perspective?"

Typical risk management steps include:

- Developing a comprehensive risk assessment
- Creating detailed credit policies
- Creating detailed operational policies and procedures by function
- Establishing accountability by measuring the results and reassessing risk ongoing

Topic III – Packaging & Closing

William McClain, Director, Credit & Structuring

Application packaging and SBA-compliant loan closing is a time consuming and often frustrating process. To be successful, lenders must prepare and submit complete and accurate application packages as efficiently as possible. Understanding how the top lenders effectively drive volume and becoming familiar with the changes to the SOP, are critical components to achieving efficiencies and increasing volume.

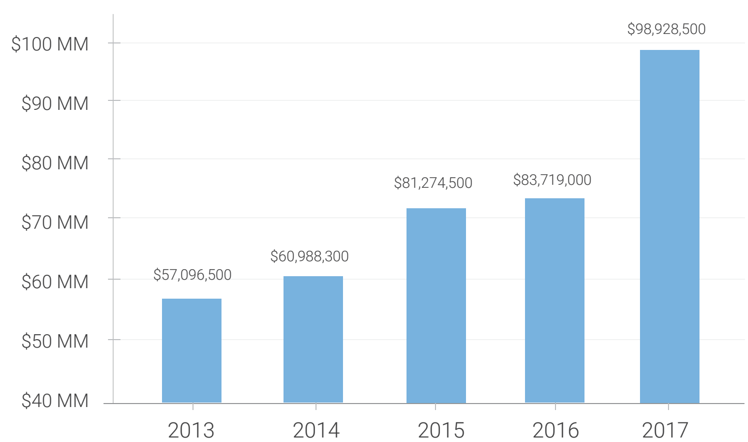
With another record year of approved loan volume, noticeable trends have started to emerge among the top 50 lenders.

Top 50 SBA Lender Trends

Five years ago, a lender had to authorize approximately $57 million in SBA 7(a) volume on an annual basis to be a top 50 lender. The amount of volume has now grown by more than 70% to almost $99 million in 2017.

The loan volume to be a top 50 lender has significantly increased since 2013. Five years ago, a lender had to authorize approximately $57 million in SBA 7(a) loans to make the list. The amount of volume has now grown by more than 70% to almost $99 million. This translates to nearly a $4.5 billion increase in total volume for the top 50 over a five year period. For a market that has increased total volume by roughly $7.5 billion, this demonstrates an increase in lender concentration while highlighting how lenders are specializing in the product. Lenders making a concerted effort to focus on refining processes and understanding the rules have driven increased volume in the market.

Volume Threshold - Top 50 Lenders



SOURCE - Small Business Administration [11]

[11] *Small Business Administration - SBA 7(a) Loan Data Reports*

A further analysis of the current top 50 provides more visibility on how some of these lenders have achieved the growth in volume. The top 25 lenders have a much smaller average loan size than that of lenders ranking in the 25-50 range.

At approximately $350,000 per loan, the top 25 have clearly focused on increasing their reach to borrowers with smaller capital needs. The second half of the top 50 funded an average loan size of almost $540,000 – 65% higher than the top group with almost five times fewer loans. Lenders that have found an effective and efficient way to process and approve smaller loans have reaped the benefits. In many instances this can be attributed to an increased investment in technology and process refinement.

While some might assume this is the result of seasoned lenders sharpening their processes, the reality is that almost 40% of the lenders in the current top 50 were not on the list in 2012. These groups were able to effectively develop both volume and processes to join the ranks of the most active lenders in the country.

SOP Changes Impacting Lender Underwriting

Providing clarity on a few key issues has opened an opportunity to increase volume for many lenders who were otherwise unfamiliar with the regulations.

Three changes to the SOP will have the greatest impact on the largest number of lenders:

- Equity Injection
- EPC/OC
- Franchise

The first major eligibility change involves the SBA requirements for equity injection. The prior version of the SOP only provided guidance on required equity for lenders using delegated authority. Lenders were left to follow internal policies or submit the loan to the processing center through the General Program for approval. The new revisions require borrowers for start-up businesses and change of ownership transactions to contribute equity of at least 10% of the total project costs. This update provides increased clarity.

Another key revision is the eligibility of stock acquisitions of Eligible Passive Companies (EPC) using loan proceeds. While utilizing a holding company to own real estate is a common practice for small businesses, the SBA has historically not allowed borrowers to utilize the Program to fund the acquisition of these entities. This created a number of eligibility issues for partner buyouts. These major changes could allow a larger population of borrowers to consider the Program for their financing needs.

The last major change to the SBA's new SOP that will affect SBA volume going forward is the new franchise process. The SBA has effectively reduced lender risk by providing a list of all of the franchise agreements that have been deemed eligible as well as the addendums that require a borrowers' signature. Furthermore, for any franchise that is not included on the list, both the process of initial review by the SBA and determining eligibility have been simplified. Refined guidelines and more intuitive processes should result in higher levels of lender participation.

Providing clarity on a few key issues will provide an opportunity to increase volume for many lenders who were otherwise unfamiliar with these regulations.

Topic IV – Intensive Servicing

Michael Breckheimer, Director, Chief Operating Officer

Non-compliance with intensive servicing requirements — for both modifications and liquidations — can result in the potential for repairs and denials of guarantees. Intensive servicing consists of interim servicing actions with proper file documentation, workout and modification support, and execution of liquidation and litigation plans.

To mitigate risk, lenders must manage this task well and ensure that all reported events are processed properly for the necessary approval and that the file is documented adequately to protect the lender in the case of liquidation. It is best practice for lenders to maintain direct relationships with the SBA and an up-to-date understanding of current SBA requirements.

Two intensive servicing themes to watch in 2018 include:

- Slight increase in purchase rates for the first time in seven years
- Charge-off rate turnaround now closely aligned with delinquency rates

Purchase Rates Increase for the First Time in Seven Years

Purchase rates – the total dollar amount of principal and interest purchased by the SBA on a guaranteed default loan – increased from $588 million, or 0.77% of unpaid principal balance (UPB) in FY 2016, to $660 million, or 0.79% of UPB in FY 2017. This is the first increase we have seen in seven years, likely, driven by the relative large increase in dollar volume that the Program has experienced. The following table illustrates the trend in loans purchased by the SBA from FY 2010 through FY 2017:

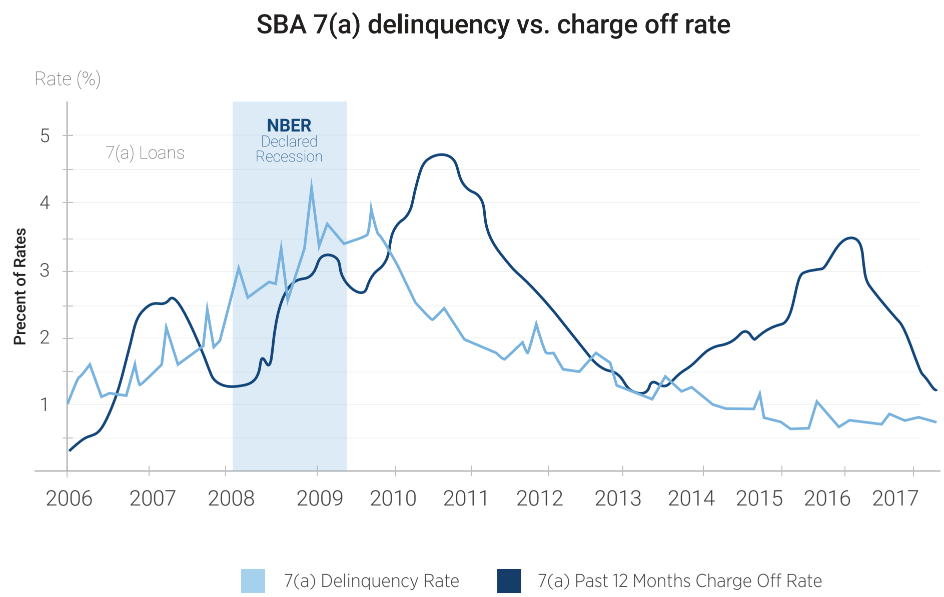
Fiscal Year	Purchased	% Change
2010	2,549,356,142	13.7%
2011	1,672,540,530	-34.4%
2012	1,282,338,644	-23.3%
2013	1,064,119,067	-17.0%
2014	828,927,188	-22.1%
2015	706,254,093	-14.8%
2016	588,484,842	-16.7%
2017	660,617,863	12.3%

Fiscal Year	Purchase Rate % UPB	% Change
2010	5.58%	10.5%
2011	3.29%	-41.0%
2012	2.37%	-28.0%
2013	1.85%	-21.9%
2014	1.33%	-28.1%
2015	1.03%	-22.6%
2016	0.77%	-25.2%
2017	0.79%	2.6%

[12] *Small Business Administration – Purchase Amount by Program*

Delinquency and Chare-Off Trends Realign

Declining delinquency rates — borrowers who are late on their payments — are an important indicator for the financial performance of any loan portfolio. Delinquency rates are a leading indicator of the SBA's charge-off rate — the rate of dollars spent to cover loans that defaulted — so they're a good metric to track for an outlook on future liabilities of the SBA and taxpayers for these programs.



SOURCE - Small Business Administration [13]

As mentioned in the SBA's 2017 Annual Financial Report, the SBA states that delinquency rates are down for all business loans, and have been steadily declining from cyclical peaks in late 2009, due to modest economic growth, strong profit performance and tighter lending standards by financial institutions during the past several years.

The rise of the 7(a) charge-offs starting in 2013 is attributable to the SBA wrapping up loans that went into liquidation during the recession. Loans not sold on the secondary market are tracked as charge-off loans only after all efforts to recover a delinquent balance and collateral have been exhausted. Beginning in FY 2016, these efforts were starting to wind down, and therefore, the charge-off rate is now more closely aligned to the delinquency rate for FY 2017.

[13] *2017 Agency Financial Report – p. 25; Small Business Administration*

Topic V – Other Trends and Statistics

Loan Secondary Market Sales

Michael Breckheimer, Director, Chief Operating Officer

Another trend going into 2018 is the sustained level of high premiums. Loan premiums are not widely published. This often makes it difficult for many lenders to ensure they are getting the highest secondary market premium. To be more competitive, lenders should prepare bid sheets and submit the opportunity to multiple investors. Only through experience can lenders gain current knowledge of the most active investors and the highest premiums based on the structure of each loan.

Premiums Remain High

Continued strong demand for quality assets and low prepayment rates have resulted in high premiums throughout FY 2017. Based on a sample of more than $370 million in SBA 7(a) loans sold in calendar 2017, the table below shows bids on 25-year loans were as high as 118.111 and bids on 10-year loans were as high as 114.60. The sustained high premiums experienced since 2012 may be an additional factor driving increased participation in the SBA 7(a) Program by certain lenders.

Term	Spread	High	Low
25 Year	P + 2.75%	118.111	114.689
10 Year	P + 2.75%	114.600	109.209

Source: Windsor Advantage 2017 Loan Sales

Lender-controlled Factors to Consider

Several factors impact the level of secondary market premiums. Market forces such as supply and demand and changes in interest rates cannot be controlled by lenders, but the following lender-controlled factors should be considered when structuring loans and estimating potential premiums:

- **Term** — Longer terms receive higher premiums. 25-year terms result in a higher premium than 10-year terms.
- **Spread over Prime** — Maximum spread over prime is 2.75% on loans over $50 thousand. Maximum spreads receive the highest premium.

- **Adjust Period** — Quarterly and monthly adjusts receive the highest premiums, versus annual adjust and fixed rate loans.
- **Size** — The size of the loan impacts the premium, with larger loans receiving less premium.
- **Seasoning** – Generally, the closer a loan is sold to its note date, the stronger secondary market premium it will generate.

According to discussions with the largest SBA loan poolers, approximately 40% of all 7(a) loans are sold into the secondary market, and 90% of the sold loans are poolable vs. non-poolable. There are slightly more 25-year loans than 10-year, and 85% adjust quarterly vs. monthly. Per the SBA, in FY 2016, $8.45 billion in loans settled (a 30%+ increase over FY2014), consisting of 15,307 loans, for total settlement proceeds of $9.41 billion, including premiums.

Servicing

Leonard Ray, Director, Servicing

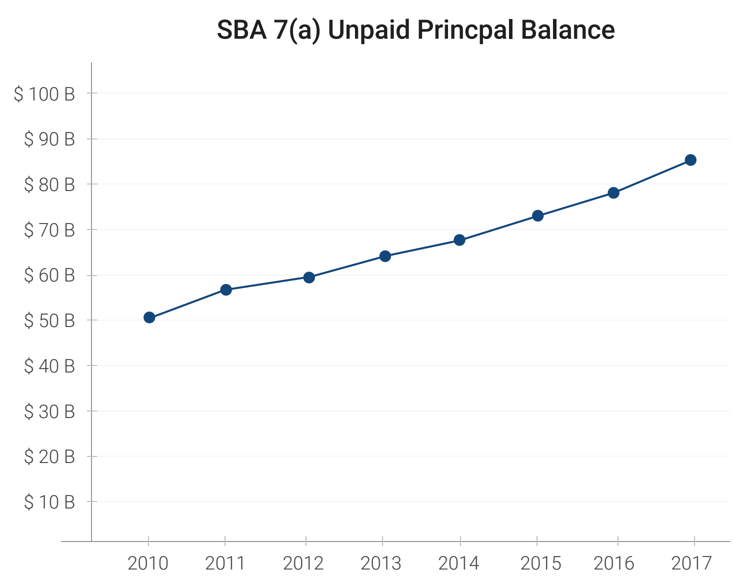
The SBA's 7(a) loan portfolio is continuing its steady growth trend along with the growth of the economy.

Servicing requirements are extensive and non-compliance with reporting can result in lengthy and complicated reconciling items with the SBA, as well as the potential for repairs and denials of guarantees. Lenders should ensure they are servicing loans well in accordance with the standards set forth by the SOP 50 57 2 and the lender's internal policies and procedures.

7(a) Portfolio Continues Steady Growth Trend

As of FY2017, the SBA oversees an $86 billion SBA 7(a) loan portfolio. While precise measurements of the total small business credit market are not available, [14] the SBA estimates that it is roughly $1.1 trillion, for outstanding bank loans of $1 million or less, plus credit extended by finance companies and other sources. The SBA 7(a) Program's unpaid principal balance was $86.1 billion, or about 6% of that amount, as of September 30, 2017.

The graph below shows the total amount of the 7(a) Program's unpaid principal balance by fiscal year:



SOURCE - Small Business Administration [15]

[14] *Small Business Administration – Office of Advocacy*

[15] *Small Business Administration – Unpaid Principal Balance by Program*

According to the SBA, three primary factors have contributed to the portfolio's recent outstanding balance growth:

- Continuous economic growth
- Increasing business financial stability
- Statutory changes to SBA loan programs

Status of the portfolio is classified by the Office of Credit Risk Management (as of June 30, 2017) as follows:

- **94.2%** Current
- **1.33%** Stressed (Past Due, Deferred and Delinquent)
- **4.46%** Active Default (Active Purchase, Liquidation)
- **2,219** Active Lenders with 7(a) Loan Portfolios

Regulatory Compliance

Jeff Nogle, Senior Vice President, Risk Management

All market participants must proactively analyze and control risk for their own success.

A focus on strategy and technology is key to competing in this market, but more than ever — compliance is critical to a successful and sustainable SBA lending strategy. As SBA loan volume has grown for the fifth consecutive year, OCRM has also made progress on lender oversight. While OCRM will help to identify inherent risk in the portfolio, it's critical for all market participants to proactively analyze and control risk for their own success.

Increased Capabilities of the Lender Portal and SBPS Monitoring

Effective risk management practices for lenders include utilizing the Lender Portal and SBPS Monitoring tools that OCRM offers for continuous lender self-evaluation.

The SBA's Lender Portal is a combined effort between Dun & Bradstreet and the SBA to increase transparency of OCRM's procedures and performance metrics for lenders to more accurately predict risk trends. Peer groups, portfolio benchmarks, forecasted purchase rates and loan level detail are all part of the quarterly reports the Lender Portal allows lenders to access.

PARRiS (P = Portfolio Performance; A = Asset Management; R = Regulatory Compliance; Ri = Risk Management; and S = Special Items) scores allow a lender to understand how OCRM views their portfolio as a whole. This score is a combined analysis of various risk factors and ultimately generates an aggregate score, allowing lenders to evaluate their portfolio on an overall basis. Loan level detail in comparison with lenders' internal risk rating allows for an analytical and proactive approach to effectively manage risk.

The Small Business Predictive Score (SBPS) is a credit score used by SBA to predict the likelihood of default purchases and ranks individual loans within a range between 0 – 300. The likelihood of delinquency, portfolio risk and lender performance across the lifecycle of each loan can be useful to lenders, especially when used in conjunction with internal risk rating and portfolio management. As the scores increase for a given set of loans, the probability of purchase for those loans decreases. Loans with scores in a higher range can be considered to have less risk of purchase than those with scores in a lower range. This scoring is used by the SBA as an indicative measure of the current credit quality of a lender's SBA loan portfolio.

Lenders must provide comprehensive and proactive support for all types of examinations, not just OCRM Risk-Based Reviews, but also FDIC Safety and Soundness examinations and internal audits and file reviews. Lenders are strongly recommended to participate in customized training, both internal and external, and to join trade associations. A lender should consider becoming an active member of the National Association of Government Guaranteed Lenders (NAGGL) and participating in its national and regional trainings. As SBA volume increases and lenders continue to scale their platforms, applying proper risk determinations and compliance checks within technology is critical to long-term success.

Summary

Record 7(a) volume in FY 2017 can likely be attributed to the increasing focus on technology by the top SBA lenders. The competitiveness of the marketplace, dominated by the top 50 lenders providing more than half the loans, requires that remaining participants increase their technological sophistication to compete more effectively.

In addition, simplified rules and processes should result in greater certainty and less confusion among lenders, creating an opportunity for increased participation in the Program while guidelines surrounding eligibility could perhaps have the most profound effect on increasing future volume.

Whether you use this framework or your own, we encourage all SBA lenders to consider the increased role of technology across all aspects of commercial lending.

About Windsor Advantage, LLC

Windsor Advantage provides banks and credit unions with a comprehensive outsourced SBA 7(a) and USDA lending platform.

Since 2010, Windsor has processed more than $1.7 billion in government guaranteed loans and currently services a portfolio in excess of $1.0 billion (as of January 31, 2018) for more than 75 lenders nationwide. With over 150 years of collective government guaranteed lending experience, cutting-edge technology and rigid controls, Windsor Advantage is uniquely qualified to assist clients with implementing a thoughtful and profitable lending initiative.

Windsor Advantage has a team of 30 professionals with offices in Chicago, Illinois; Indianapolis, Indiana; and Charleston, South Carolina.

For more information, contact Andrew Sheaffer at ***(312) 248-8530*** or visit www.WindsorAdvantage.com.