



WINDSOR
ADVANTAGE

**Mid-Year
Lending Report**
The state of SBA
lending with
industry expert
insights

Based on FY Q1 2022 - Q2 2022 Data

WHITE PAPER

2022



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EXECUTIVE SUMMARY

An Introduction from Windsor Advantage CEO, Will McClain

Welcome to the 2022 SBA 7(a) Loan Mid-Year Lending Report, an annual forecast of key market dynamics based on the best data available at the time of publication. Just as our strategic discussions with lenders and industry experts naturally focus on the SBA loan marketplace's current state and future trends, this report aims to capture the same forward-looking, proactive views as a foundational tool for its readers. We hope you find this tool educational, practical, and useful, and continue to reference this document as your own SBA market outlook may evolve throughout the next year

Government-guaranteed lending has experienced unprecedented growth in recent years. This along with the growth of American small businesses and the capital injected as a result of the Paycheck Protection Program (PPP) has dramatically altered how we think about the SBA market. There are 32 million¹ small businesses in the country with access to more government-guaranteed financing than ever before. In 2019, the SBA approved over \$23 billion in funding. That number grew by 36% in 2021, with a record \$36 billion+ approved for small businesses.²

With so much success in recent years, how will SBA lending change or stay the same in upcoming years? Will we maintain a similar trajectory, or will market factors impact SBA lending beyond? Through the first two quarters of the fiscal year (October 2021-April 2022) the SBA approved more than \$10 billion in financing through the 7(a) program.

Q1 and Q2 2022 data can help us understand the true outlook of the transformed SBA landscape. As we'll discuss later, one of the challenges SBA lenders face is understanding which data sets represent the true state of the SBA 7(a) program, and which data sets present unreliable trajectories. Market volatility created significant outliers between 2020-2021. Trend analysis that fails to properly recognize outliers fails to accurately portray the future outlook of SBA 7(a) potential for lenders. As we continue to capture data further removed from COVID, lenders will glean cleaner insights of the state of the market left in its wake.

In this report, we'll examine a few predominant themes shaping the current outlook for government guaranteed lenders, including:

- **Increased popularity of SBA programs throughout and after the pandemic**
- **Impacts of economic recovery efforts**
- **Recent Secondary Market responses**
- **Changes to compliance and regulatory oversight**

We hope this report provides SBA professionals with the data-driven insight needed to understand SBA lending today to better prepare for success in the years to come.

*1 FY 2023 Congressional Budget Justification FY 2021 Annual Performance Report – p. 2; Small Business Administration

*2 [SBA Atlas](#)

SBA NUMBERS AT A GLANCE

This data is powered by the [SBA Atlas](#), a free tool for SBA 7(a) lenders and their partners.

FY Q1- Q2 2022 – Overall State of the Industry

All Data

Total Number of Loans

20,302

Total Loan Volume

\$10,744,167,200

Average Loan Size

\$529,217

Franchise Specific Data

Total Number of Loans Franchise

2,888

Total Loan Volume Franchise

\$2,254,373,400

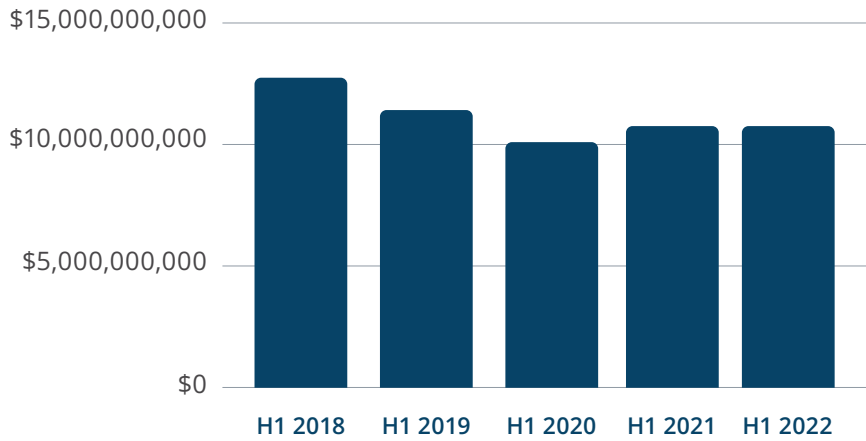
Average Loan Size Franchise

\$780,600

2022 Top Industries By SBA 7(a) Volume

Rank	Industry Description	NAICS Code	No. Of Loans	Loan Volume
1	Hotels (except Casino Hotels) and Motels	721110	347	\$ 880,668,800
2	Full-Service Restaurants	722511	850	\$ 459,365,200
3	Limited-Service Restaurants	722513	718	\$ 341,848,600
4	Child Day Care Services	624410	262	\$ 225,305,100
5	Gasoline Stations with Convenience Stores	447110	151	\$ 211,612,800
6	Car Washes	811192	125	\$ 177,756,500
7	All Other Specialty Trade Contractors	238990	349	\$ 172,222,400
8	Offices of Dentists	621210	216	\$ 169,283,500
9	Fitness and Recreational Sports Centers	713940	388	\$ 156,875,400
10	Offices of Physicians (except Mental Health Specialists)	621111	225	\$ 153,889,200

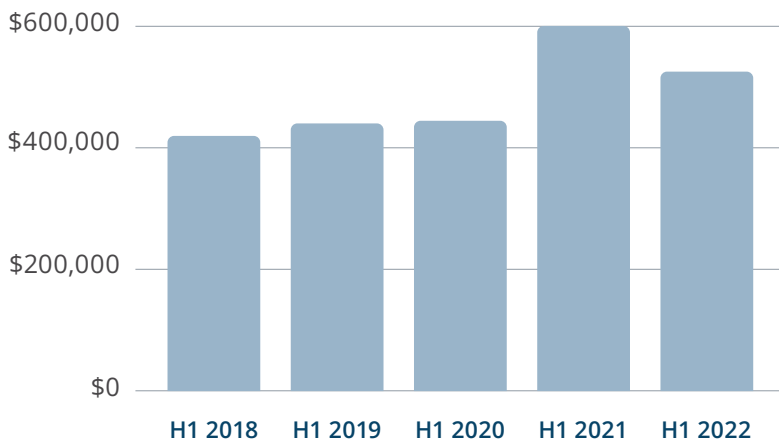
Yearly Loan Volume



7(a) loan volumes remained high throughout and after the initial impact of COVID-19.

	FY H1 2018	FY H1 2019	FY H1 2020	FY H1 2021	FY H1 2022
VOLUME	\$12,568,238,800	\$11,391,031,400	\$10,050,020,100	\$10,732,845,700	\$10,744,167,200

Average Loan Size

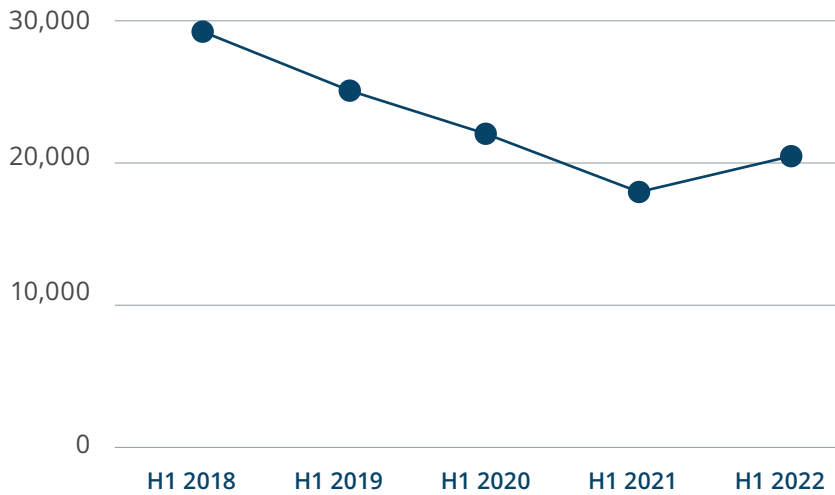


The **Average Loan Size in H1 2021 increased by 23%** compared to H1 2020. That number is starting to drop back down.

Average Loan Size in H1 of FY 2022 **decreased by 13%** compared to the same period last year.

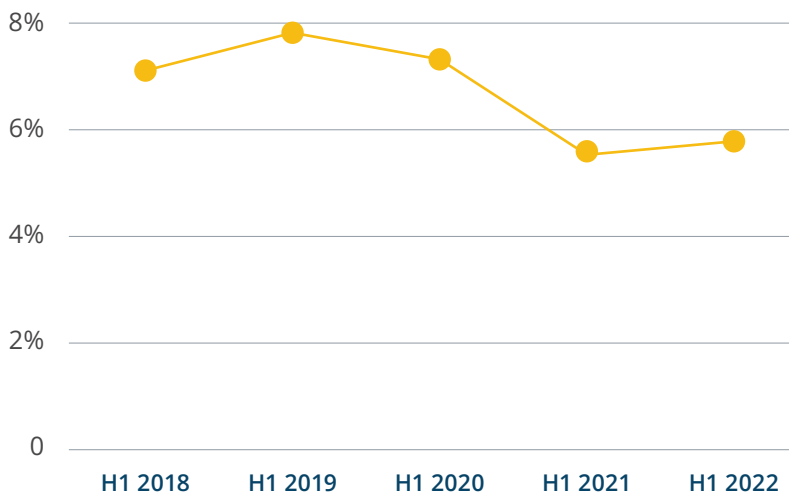
	FY H1 2018	FY H1 2019	FY H1 2020	FY H1 2021	FY H1 2022
AVG. LOAN SIZE	\$425,868.76	\$455,495.50	\$457,151.57	\$598,063.40	\$529,217.18

Number of Loans



The increase in Average Loan Size in H1 2021 correlated to fewer loans approved in that time period.

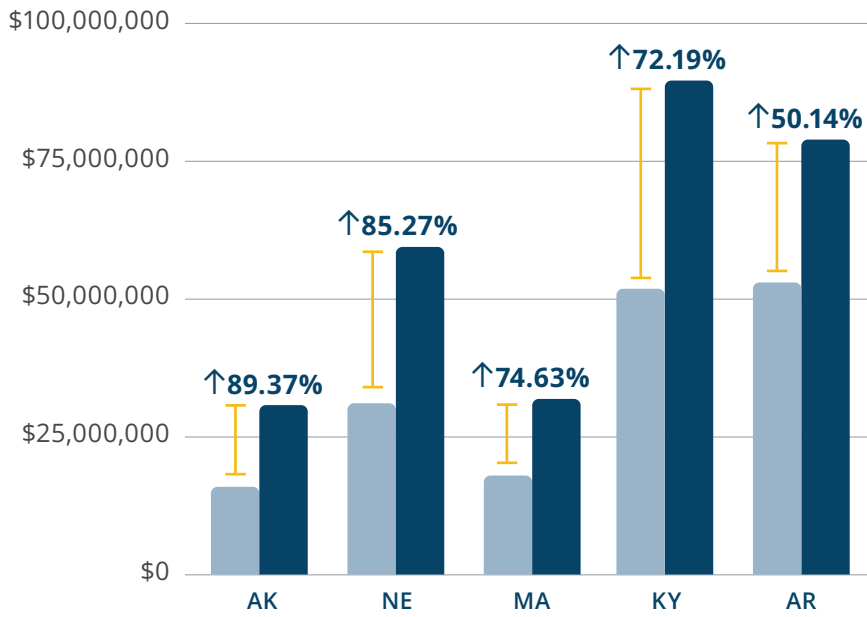
Average Interest Rate



Fewer and larger loans created higher concentrations of small business financing in 2021, a trend the SBA is actively seeking to correct. We expect the trajectory displayed in H1 2022 to continue.

Loan Volume by State

- H1 2020
- H1 2022



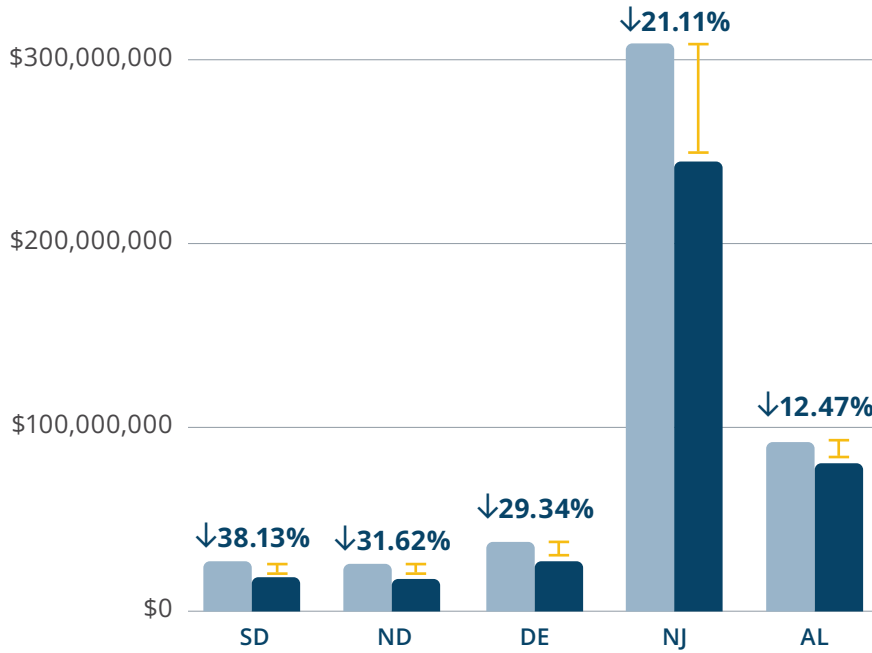
Alaska, Nebraska, Maine, Kentucky, and Arkansas are top states for 7(a) lending based on growth since 2020.

Kentucky's 72.19% growth over 2 years corresponds to significant lending activity in the state, with \$88 MM + approved in the first half of 2022.

	Alaska	Nebraska	Maine	Kentucky	Arkansas
H1 FY 2020	\$16,169,200	\$31,671,700	\$18,127,300	\$51,176,600	\$52,094,000
H1 FY 2022	\$30,620,000	\$58,679,300	\$31,655,700	\$88,119,300	\$78,212,100
% Growth	89.37%	85.27%	74.63%	72.19%	50.14%

Top 5 States with the Biggest Decrease in Volume

- H1 2020
- H1 2022



7(a) lending decreased most in South Dakota, North Dakota, Delaware, New Jersey, and Alabama.

Notably, **New Jersey experienced a 21.1% decrease** in approved 7(a) funds. The state remains a high loan volume state, however, this contraction is significant enough to alert local lenders of a potential downward trend in the region.

	S. Dakota	N. Dakota	Delaware	New Jersey	Alabama
H1 FY 2020	\$24,330,400	\$23,318,600	\$36,130,200	\$313,122,500	\$90,599,500
H1 FY 2022	\$15,053,000	\$15,945,000	\$25,531,000	\$247,032,500	\$79,305,000
% Decrease	38.13%	31.62%	29.343%	21.11%	12.47%

SBA UNDERWRITING IN 2022

Reviews & Compliance Changes in 2022

**With insight by Brent Ciurlino, Former Director,
Office of Credit Risk Management (OCRM)**

SBA oversight has tightened this year. Underwriting teams are seeing more screen outs, more frequent audits, and more strictly enforced criteria for borrower eligibility.

Public scrutiny of the Small Business Administration and its programs escalated in 2021 as news broke announcing the multiple convictions of business owners who mishandled or abused government-guaranteed loan programs. According to their May 2022 report, the Office of Inspector General identified \$4.6 billion in potentially fraudulent PPP loans which need to be addressed systematically according to new procedures implemented in February of this year.³

The ability to submit PPP applications closed over a year ago, and underwriting teams are no longer working on credit memos for the program. However, oversight agencies continue to grapple with how to address the outstanding fraud from those programs.

The SBA has already started implementing new procedures for other loan programs to prevent future fraud of this scale. Now that the changes have gone into effect, lenders who participate in the SBA 7(a) loan program may need to reassess their policies and procedures to keep their institutions efficient and compliant.

^{*3} SBA OIG Report 22-13, SBA'S HANDLING OF POTENTIALLY FRAUDULENT PAYCHECK PROTECTION PROGRAM LOANS, May 26, 2022.

OCRM's Shifting Focus

The SBA is attempting to hold more lenders accountable for verifying the credit worthiness of SBA borrowers. To do so, they've increased their focus on lenders' internal and external reviews and controls. Former OCRM Director, Brent Ciurlino, notes that certain lender activity and loan portfolio characteristics could also cause OCRM to flag a lender for review.

Ciurlino's widely adopted PARRiS Review Method lists seven (7) Risk Flags that draw OCRM's attention to audit a lender.

The Risk Flags Are:

- An Early Default Rate Greater Than 1%
- 5 Loans of Greater Than \$2 million are Serviced Over Last 12 Months
- Industry Concentration is Greater Than or Equal to 20%
- Franchise Lending is Greater Than or Equal to 10%
- The Lender Uses Loan Agents on Their Behalf (LSP and Brokers)
- 25% or More of a Lender's Loans Are Acquired

These flags reflect the SBA's attempt at holding lenders more accountable for upholding the 7(a) program's intended purpose as more players engage in government-guaranteed lending. There are more lenders than ever before in the SBA space, with 24.3% of FDIC chartered banks already closing an SBA loan in FY Q1 -Q2 2022.⁴ Compare that ratio to 19.9% of in the first half of 2019.⁵ Although this surge of activity has helped develop our industry, many more lenders will be responsible for audits this year compared to previous years. Including lenders that have been tempted to just 'dip their toe' into the market.

*4 Of the 4788 total active FDIC banks, 1165 conducted an SBA loan in H1 2022.

*5 Of the 5312 total active FDIC banks, 1055 conducted an SBA loan in H1 2019.

Credit Memo Line Items to Address in 2022

Successful compliance with these measures starts with efficient underwriting. In Q1 and Q2 of this year our underwriting teams noted the current areas of critique for OCRM Screen Outs:

Credit Elsewhere

The most notable change in underwriting this year is the increased attention to the credit elsewhere test. To combat the misuse of the programs, OCRM has emphasized the need for borrowers to prove funding is not available from any other source, including their personal assets.

Aside from accounting for personal equity, underwriting teams need to further expand on their borrower's inability to access funding than they have in previous years. This proactive approach reduces the risk of a delayed application process that would cause both lender and borrower frustration.

Details to include for justification of the credit elsewhere test, when applicable:

- The business is a startup (less than 2 years old).
- There is a justified need for a longer loan term.
- The borrower's current loan policy restricts cash flow basis evaluation.
- The borrower demonstrates a collateral shortfall.
- Any other limiting eligibility factors for conventional financing, like low credit scores.

Staffing

The credit memo should address plans for job creation and staffing. With labor challenges at the forefront of economists' minds, the SBA wants borrowers to come with a plan for creating and filling the jobs needed to keep their business running, mitigating chances for loan defaults.

Debt Schedule

The debt schedule should be complete with no empty boxes and must show that the business itself will support any existing debt on its own. Borrowers may sometimes submit debt schedules and balance sheets that do not match, triggering a screen out. Underwriting teams should verify that both tables match exactly before submitting them to the SBA.

Use of Proceeds – Working Capital

Working capital uses should now be detailed on the credit memo. Simply listing 'working capital' as the borrower's use was previously acceptable, but OCRM is now looking for specific uses. Verify that the credit memo outlines a project or initiative that the loan will be used for and its estimated financial impact, if possible, to create a stronger credit memo.

Management Experience & Key Employees

Creditworthiness is determined only in part by the borrower's financials. There must also be evidence that the borrower will be a successful leader in this venture. Borrower's management experience and/or the presence of key employees are now critiqued in greater detail. This is an added measure to assess that lenders are acting in alignment with the SBA's mission of preparing businesses to succeed.

What Lenders Need to Do

Lenders of all sizes need to be prepared for an audit this year, regardless of loan servicing or authorization volume. Your team should proactively plan for more frequent, smaller audits by keeping your processes well documented and streamlined. Prevent inefficiencies by focusing on the current areas of critique, accounting for the SBA's concerns before submitting the credit memo.

What Lenders Need to Tell Their Borrowers

Lenders need to clearly communicate expectations and documents needed from borrowers at the beginning of the underwriting process. The increased level of OCRM critique puts additional strain on both loan processors and their borrowers. Explain time sensitivity for document submissions. Communication and expectation management helps ensure your borrowers and underwriting teams work in tandem to efficiently produce a credit memo that the SBA will approve.

Business Valuations

Featured Insights from Neal Patel, CBA, CVA, Founder & Chief Appraiser, Reliant Business Valuation

Business valuations have changed in two notable ways this year. Valuation multiples are higher than those we've seen in recent history, particularly due to strong buyer demand and low cost of capital. However, inflation, current events, and investor sentiment could bring down valuations moving forward.

Additionally, business valuation procedures have been adjusted to account for outlier historical data. This must be done for businesses that experienced positive or negative volatility from COVID-19.

Lenders who are required to obtain an independent business valuation for their SBA 7(a) borrowers should be aware of the changes discussed in this article.

If the amount being financed (including any 7(a), 504, seller, or other financing) minus the appraised value of real estate and/or equipment being financed is \$250,000 or less, the Lender may perform its own valuation of the business being sold, unless the Lender's internal policies and procedures require an independent business valuation from a Qualified Source.

*Lender and Development Company Loan Programs,
SOP 50 10 6 – SBA p. 263*

How Valuations Are Changing This Year

Macro-level conditions are stabilizing the extraordinarily high business valuation multiples of recent years.

Now, inflation continues to drive up the producer price index. Business valuations are starting to respond, and values could begin to trend downward due to decreased margins and increased cost of capital.

Rising interest rates may help stem inflation, but **as the cost of borrowing goes up, valuations tend to go down**. More expensive capital tends to result in lower Price to Earnings multiples.

Meanwhile, supply chains struggle to fulfill the rising demand for goods. The energy, food, and manufacturing sectors are particularly impacted by the ongoing supply chain weaknesses. Inventory issues for these companies enable dollars to go in, but not out. Revenue, and consequently value, falls.

The war in Eastern Europe will continue to exacerbate the supply chain issues impacting business valuations. Rising prices of commodities including gas and wheat will inevitably continue affecting most businesses. Market sentiment will also drive down valuations, as uncertainty motivates more investors to follow risk-averse strategies.

Understanding these climate factors will help lenders better prepare for the impact on business valuations this year.

Adjusting Your Evaluation Process to Account for Outlier Events

If appraisers calculate business valuations today the same way they did prior to the pandemic, they could be grossly under or overvaluing the business. Instead, appraisers should discount outlier data and base projections on more reliable historical data segments.

Our recommendation for lenders is twofold. First, determine if your customer was dramatically impacted by COVID-19, and to what extent. Second, segment financial data by month to ensure COVID-19 impact is immaterial and that the buyer's projections accurately reflect normalized operations.

Appraisers rely on historical data to justify management's projections. Previously, financials from 2-3 years prior could accurately show an appraiser a company's growth and trajectory. Those models are no longer reliable in many cases. Data from late 2019-mid 2021 could be heavily skewed for industries that experienced volatility from the pandemic. On paper, it will look like some businesses crushed the competition. Others will appear crushed beyond saving. Neither scenario depicts sustainable trajectories once macro-level disruptions are taken into account.

Generally, the entire year of 2020 is an outlier. Business was disrupted across the map for most industries from March to December of that year. 2021 is a partial outlier. Operations were still lagging for most in Q1, but once vaccines rolled out to the public in early Q2, most industries started to recover. Individual months may also need to be discounted for COVID variant spikes, depending on the region.

This procedural change should only apply to businesses that experienced significant volatility from COVID-19. We observed negligible impacts on businesses that maintained a steady income stream without extended interruptions to normal business. In this case, lenders should rely on historical and recent data and proceed as usual here.

What Lenders Should Do

Lenders should implement the following changes immediately:

- **Request borrower's historical financial data broken down by month for the 12 most recent months.** Discount months that should be adjusted for outliers, and annualize months with more stable market conditions.
- **Obtain the most recent financials from borrowers.** Request June 2022 or more recent interim financials if available. The more recent financial data you have to reflect post COVID-19 conditions, the more accurate your projections will be in the business valuation.
- **Exercise greater levels of caution in extraordinarily high or low appraisals.** It's worth digging deeper into month-by-month data, if you can get it, to understand how clients arrived at their projections. Compare supplied projections with those calculated by an appraiser that does account for volatility to verify the valuation.

As lenders build their long-term strategies for SBA financing, they should build in safeguards to strengthen their portfolio:

- **Ask borrowers how they expect current events like supply chain disruptions will impact their business.** Take note of how the borrowers are responding. If they can't address how the problem would impact them, they may not be prepared to weather the upcoming economic challenges their industry will face.
- **Stress test all of your deals to ensure they will still cash flow, even if interest rates continue to rise.**
- **Run projections assuming at least a 200 basis point increase in rates.** Do the same for 20-30% increase in energy prices and 10% in labor costs.

If the deal still cash flows after multiple stress tests, or if you have a particularly strategic borrower that can anticipate solutions for upcoming challenges, your deal may be less risky. If either component is missing, be particularly cautious with valuations.

THE FUTURE OF SBA 7(A) LENDING

Secondary Market Sales Outlook

Secondary market conditions are unlike anything we've seen in the last 20 years, excluding the 2008 financial crisis. Premium prices for available inventory right now hover just under 110. At this same time last year, premiums were averaging closer to 120. Increased SBA activity, rising prepayment speeds, and an influx of guarantees on the secondary market have driven down demand and, consequently, prices. Lenders should prepare to exercise patience and potentially reevaluate their Sell/ Hold strategies to cope with the current cycle.

Despite its current downturn, we expect the secondary market will continue to be a strong fee income driver for financial institutions that adjust their strategy accordingly.

Current Conditions

Premium prices have dropped below where they typically run in a normal market for the first time in eight straight years. The ultimate question the secondary market faces: can demand keep up with supply this year?

Supply

Record volumes of loans are on the secondary market right now. In 2008, the market size for guarantees reached \$3-4 billion. It's more than doubled since then. A historic \$1.7 billion in guarantees were available at the end of May 2022. This trajectory puts us on track to reach \$2 billion in available pulls just over halfway through the calendar year, 20% of last year's entire SBA issuance.

Lenders should expect to see some collapse in pricing once the market value surpasses \$1B. It comes as no surprise that premiums have dropped dramatically this year.

Despite lower premiums, lenders continue to report healthy pipelines to the secondary market and inventories continue to grow. This volume was fueled by economic conditions during the pandemic, low-interest rates for borrowers, and increasingly widespread access to government-guaranteed financing. Coupled with additional lenders entering the space, conditions were primed for extraordinary growth. Even deteriorating premium prices have not deterred the rising volumes of supply on the secondary market which will continue to suppress premiums.

Demand

Demand has struggled to keep pace. All asset classes experienced significant changes in the first and second quarter of the fiscal year, SBA premiums included. Mortgage rates went from sub 3% to 6% in a little over 6 months. Investors have seen portfolios drop in value by approximately 10%, levels that usually take a couple of years to achieve.

SBA guarantees on the secondary market are not immune. If anything, the industry's tie to the Prime rate rather than a market rate causes it to lag the curve without the same hope for quick recovery. Where other asset classes can act more responsively, the SBA industry is dependent on a Prime rate that only adjusts quarterly. Pricing cannot recover as quickly, but it can certainly disintegrate because of other market behaviors, namely, prepayment speeds.

Constant Prepayment Rate (CPR) is the measure of loan prepayments as a percentage of the current outstanding loan balance and is the key indicator for tracking the performance of SBA 7(a) pools. As of the end of Q2 2022, pre-payment rates are up at least 50% year over year. In 2021, the CPR was 8% and borrowers were still receiving payments from the CARES Act. The CPR is now 12%, and it doesn't seem to be slowing down. If we maintain the trajectory established in the first half of 2022, there is a very good chance we could end this year with a 14% CPR base case. For context, this would be a 75% increase in prepays compared to 2021.

SBA 7(a) Premium Data

SBA 7(a) loan premium data is not widely published. This often makes it difficult for many lenders to ensure they are getting the highest secondary market premium, even in normal markets much less in those marked by uncertainty.

To be more competitive in the current market, lenders should prepare bid sheets and submit the opportunity to no less than eight 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.

The need for quality, guaranteed, variable-rate assets will continue to bolster the 7(a) and USDA secondary markets, regardless of pre-payment speeds. Based on a sample of more than \$250 million in government guarantees sold through Windsor's platform last calendar year in 2021, the table below shows bids on 25-year loans were as high as 121.99 and bids on 10-year loans were as high as 116.46.

2021

10Yr	P275	
Highest Monthly Average:	Apr-21	116.903
Highest Bid:	6/17/2021	116.460
Lowest Monthly Average:	Jan-21	112.667
Lowest Bid:	9/14/2021	110.429

25Yr	P275	
Highest Monthly Average:	May-21	121.989
Highest Bid:	4/13/2021	122.495
Lowest Monthly Average:	Dec-21	117.790
Lowest Bid:	12/28/2021	115.950

Compare those numbers to Q1 and Q2 of calendar year 2022.

Q1

10Yr	P275	
Highest Bid:	Jan 22	114.50
Lowest Bid:	Feb 22	111.045

25Yr	P275	
Highest Bid:	March 8, 22	119.014
Lowest Bid:	March 1, 22	118.777

Q2

10Yr	P275	
Highest Bid:	April 22	112.750
Lowest Bid:	June 22	107.994

25Yr	P275	
Highest Bid:	April 22	119.285
Lowest Bid:	June 22	111.500

Economic Corrections Impacting the Secondary Market

Lenders must remember that we're examining outlier trends as we analyze the recent secondary market data. Keep in mind our Q1 and Q2 2022 data compares the beginning of a bear market against the peak of last year's historic bull run. Trends in this industry are cyclical just as the rest of the economy.

The secondary market performed exceptionally well throughout 2020-2021. Those who joined the SBA space in recent years only experienced an unusually strong market until premiums started dropping in September 2021. Comparatively, this year's changes in premiums seem further pronounced.

The continuous downward trend in premiums we've experienced since is uncharacteristic of even a normal market. Compared to recent success, this turn has fueled market pessimism that continues to widen the gap between supply and demand, however, change may be on the horizon as economic conditions adjust to the impending bear market and base rates continue to rise.

Much of the pessimism clouding the secondary market outlook stems from overarching economic uncertainty. Demand is reliant on many external factors that are out of lenders' control, however, some relief may be in sight. Rates increased again at the end of July 2022 by another 75bps.⁶ Additional increases to the Prime rate should begin to temper some of the excess supply on the secondary market and stabilize demand.

Conversely, as rates rise the cost of borrowing grows more expensive. As a result, prepayment speeds could continue increasing to keep demand from rising back to more stable prices.

The key takeaway here is to stay patient. Like other markets, the secondary market for guarantees will not correct itself overnight. Apply short-term strategies to cope with current challenges but keep a long-term mindset as you build your strategy for the secondary market.

*6 [Fed Raises Interest Rate by 0.75 Percentage Point - WSJ](#)

Lender-controlled Factors to Consider

While lenders cannot fix the overarching problems weakening demand in the secondary market, they can adjust their strategy to accommodate expected market corrections. Patience will be crucial. You may also want to reconsider current Sell/Hold Strategies as a short-term solution to tide over your institution for the long run.

If you choose to hold, make sure you discuss with someone who can anticipate how the market will react to those maturities compared to shorter ones. It may influence your strategy on maximizing the cost-benefit of SBA lending as a fee income driver at your institution.

The following lender-controlled factors should be considered when structuring loans and estimating potential premiums:

- **Time** – 10-year loans should be bid to the secondary market immediately upon full disbursement and at a maximum, within thirty (30) days of funding in order to garner the highest secondary market premium. 25-Year loans should be bid within the first ninety (90) days.
- **Term** – Longer terms receive higher premiums. 25-year terms result in a higher premium than 10-year terms.
- **Spread** – Maximum spread over prime is 2.75% on loans over \$50,000. Maximum spreads receive the highest premium.
- **Adjust** – Quarterly and monthly adjusts receive the highest premiums, versus annual adjust and fixed rate loans.
- **Size** – Lenders should expect that every \$500,000 of a guaranteed portion above \$1,000,000, premium will drop by roughly a quarter point (0.25%).

The SBA's Renewed Focus on Small Loans

A key initiative for the SBA in 2022 is increasing the number of small loans. Prompted by both criticism of the organization and current data, the Administration will continue to incentivize lenders to process more small loans. Lenders that can adapt to processing higher quantities of smaller loans will be poised to succeed in the future landscape for SBA lending.

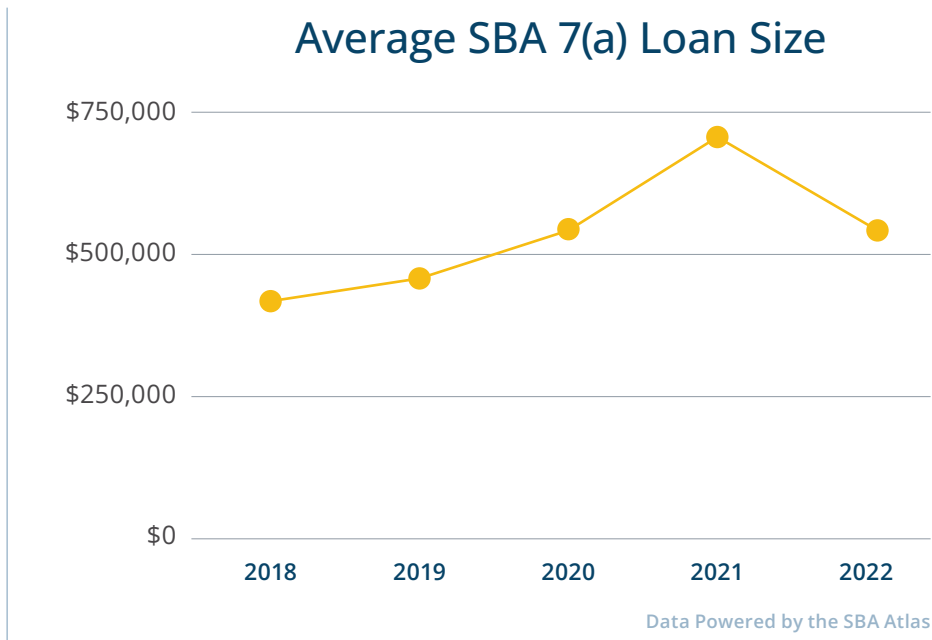
SBA Loan Volume this Year

Last year was a record year for government-guaranteed lending, with more than \$36 billion approved through the 7(a) program. However, the number of "small loans", defined as a loan of \$350,000 or less, authorized has decreased by 40.9% since 2015 (47,758 loans in FY2015 v. 28,219 loans in FY2021), a trend that runs counter to the mission of the SBA.

With fewer small loans approved, **average loan size by dollar volume increased by 40.3%** from 2018 to 2021, reaching \$704,581 in 2021.⁷ Historically, 10-12 lenders dominated the larger loan market. It now appears that small volume lenders are processing larger deals, creating higher concentrations of approved 7(a) funds. The largest loans approved for the 2021 fiscal year capped out at the program's maximum limit of \$5MM.

Already, the SBA's renewed focus on small loans has impacted SBA lending trends this year. The average loan size in H1 FY 2022 decreased to \$529,217, averaging roughly the same as 2020's yearly average. We expect the industry to maintain this trend for Q3 and Q4, largely due to market uncertainty, inflation's impact on the costs of borrowing, and the SBA's promotion of initiatives like the Community Advantage Pilot Program.

*7 [SBA Atlas Data](#)



Lender Incentives for Small Loans

Small loans have always been an SBA initiative, but the Administration now motivates lenders more directly to participate in small loan programs.

In 2020 the Administration directly incentivized lenders to process more small loans by waiving the guaranty fees on 7(a) loans under \$350,000. The fee removal makes the loan more attractive for both parties: driving borrower demand while increasing potential yields for lenders trading on the secondary market.

The SBA also vocalized its support of a wider-spread dispersal of funding in response to criticism faced for recent lending practices. After falling under [public scrutiny](#) for the misappropriation of EIDL and PPP funds, the Administration expressed a commitment to re-examine how existing 7(a) funds should be utilized to better support small businesses.

The Community Advantage Program is one such program. Originally set to expire this year, the SBA extended the program to 2024 and made changes to drive both lender and borrower demand for the funds, namely, the following:

- Increased maximum loan amount from \$250,000 to \$350,000.
- Opened eligibility to individuals with criminal backgrounds.
- Simplified and streamlined the application process for borrowers.
- Enabled lenders to make loan modifications including revolvers and lines of credit, as well as interest-only periods.

Only Community Advantage-approved lenders (CA lenders) are eligible to offer these loans. To qualify, 60% of the loans must go to underserved markets.⁸

Based on SBA action, lenders should assume Small Loans will continue to be a focus for the next few years.

The Lender's Role

Borrower behavior will always be motivated to some degree by economic factors outside of lenders' control. However, lenders will need to respond to the government-incentivized push for smaller loans with a strategy and execution plan that serves borrowers without compromising profit.

Lenders that have previously focused on large loans to maximize efficiency and returns should be prepared to pivot. Lenders that process small loans should be prepared to scale current operations. The key for both scenarios is a loan processing system that allows for increased packaging, closing, and underwriting capacity to balance smaller loan volumes.

Streamline Your Borrower Onboarding Process

Scaling loan production starts with scaling intake. Examine your current borrower onboarding process and reduce friction at these priority points in the process:

- 1. Prior to the loan application.** Set early expectations about application and funding timelines to avoid frustration from either party.
- 2. After the application is approved.** Communicate time-sensitive requests for document collection before deadlines begin to keep the process efficient.
- 3. Prior to Underwriting.** Provide your borrower with a checklist of documents needed for underwriting and answer any questions before the process begins.

*8 SBA Information Notice 5000-818641 – p. 2-3; Small Business Administration

Increase Internal Bandwidth

Processing higher volumes of SBA loans can strain departments without the resources or capacity to adapt to new loan strategies. Smaller internal teams that need to act quickly may consider working with a third-party partner to help springboard their loan processing department's growth. This could be a temporary solution to help you test the market before you commit to growth, or an outsource partner could become your permanent processing arm. Your institution may benefit from outsourced teams specialized in small loans, like Windsor Advantage's [Accel Team](#), created specifically for processing sub \$350,000 loans.

Organize for Scale

As you build a more robust lending department, prepare for efficient future growth by creating a documentation process that helps scale internal onboarding and training. Prepare your team for sustainable growth by streamlining and standardizing what you can to help operations continue at maximum capacity even while new roles develop at your institution.

Powering The Future of SBA Lending with Technology

By Chuck Evans, Executive VP for Lender Development and Training at Windsor Advantage

Digital transformations are revolutionizing financial services for the modern consumer. Bankers are pushing to adopt technology to meet our world's new standards for quality, convenient, and secure services.

Driving the digital transformations at financial institutions are improvements that primarily enhance the customer experience: improved customer data collection, the introduction of blockchain technologies, new digital banking products, and the implementation of automated processes, all have the potential to make life easier and better for bank customers.

PPP also changed how banks look at 3rd party vendors. Lenders needed a fintech solution to keep up with the demand generated by PPP. Now, many lenders are considering using these same solutions for smaller loans.

It's ideal for technology to enhance current and future customers' trust and engagement with your bank. It is crucial lenders leverage technology to keep SBA operations profitable in the current climate. SBA lenders must be motivated to adopt emerging technology by both the goal to improve current systems and the need for technology to solve critical functions.

The 2022 Catalysts for Change

This report outlines a series of environmental factors that have impacted SBA lending trends this year. These are the very same factors that motivate this increasingly pressing need for tech-enabled lending solutions:

Higher Levels of Fraud. As the SBA tightens its grip on regulatory compliance, lenders will need more advanced fraud detection technology. From screening borrowers at scale to keeping credit memos compliant with the most up-to-date policies, compliance professionals face a new level of scrutiny in the emerging SBA environment. Additional safeguards in the form of technology could reduce the human margin of error.

Higher Levels of SBA Small Loans. The increased focus on small loans will benefit lenders that can reduce per-loan processing costs. Staffing continues to be a challenge for SBA departments, however, lenders are still pressured to somehow scale underwriting and closing processes without driving up costs.

Increased Active SBA Lenders. More competition drives demand for better solutions that can help lenders stand out from the crowd. Tech-enabled processes that are more effective and efficient are viable solutions for lenders to get ahead of their competition.

Increased Competition for Borrower Interest. Borrowers who would traditionally choose SBA products may consider other financing options because of rising interest rates and market uncertainty. In recent years, interest rates and terms for SBA loans have been so favorable the benefits outweighed the negatives associated with the lengthy and often complicated application and funding process.

Now, the future of our economy is marked with uncertainty. Borrowers may not see the same appeal in SBA products as they did just a couple of years prior. Improvements to the customer experience through tech could help retain a vital interest in the programs so that SBA trends stay positive despite the volatility of the overall market.

Technology's Big Opportunity in SBA Loan Programs

There is ample opportunity for technology to disrupt the SBA space. The SBA world is largely untapped by fintech, unlike other financial services and banking products. While technologies exist to improve front-end and back-end functions of the SBA loan process, there is no technology that we know of that can service a loan from start to finish.

SBA lending presents a daunting challenge for developers. Software solutions must be incredibly secure, compliant, and robust enough to capture and process high volumes of data required for SBA loans for several different parties involved throughout the loan timeline. Additionally, the technology must solve the current disconnect between efficient underwriting processes and a user-friendly borrower experience. It is no small feat to accomplish one or the other, let alone both.

Cross-industry collaboration will be necessary to launch a software or tech stack that can be adopted throughout the industry. Tech companies, entrepreneurs, SBA lenders, and our partners must work together to create solutions that address the industry's key problems:

Increase Processing Capacity without Overhead

The highest priority for lenders should be preparing for scale. It's also the greatest challenge.

Securing a specialized workforce for SBA departments is a barrier that financial institutions still struggle to overcome. Internal teams may already be limited in bandwidth, let alone ready to quickly onboard waves of new hires who require extensive SBA training. If technology could maximize a single employee's efficiency while standardizing processes for more seamless onboarding and training, it could become indispensable to the SBA industry's next phase of growth.

Refine Compliance Monitoring

Undetected fraud and compliance missteps are expensive and time-consuming mistakes. The inevitable margin of human error in the SBA process can be greatly reduced when human intelligence is supplemented with reliable technology. Tech could help lenders move confidently forward with borrowers without invoking additional headcounts.

Improve Customer Experience

From what we've seen, there is a massive gap in functionality between the two sides of the loan application. There are both front and back-end solutions to improve the borrower experience and the loan processing power at an institution, but those processes could be more efficiently connected with the right tech. Approximately 75% of SBA lenders approve less than 6 loans per year. Eligibility determination is lacking, document collection is inefficient and both result in a poor borrower experience.

Specifically, pre-screening technology that could deliver a quick denial and an efficient approval would help more borrowers make it to the close-funded stage of the pipeline.

Inform Lender Strategy

Uncertainty clouds decision-making. The market volatility defining the current landscape leaves many lenders with questions: what is the best move next year? How do we pivot targeted efforts based on what is working, or is not? Where are the critical points in our borrower's journey from application to funding? Secondary to its primary function, SBA loan processing technology could help lenders reveal and understand the data powering their operation and the overall trends in their region. The invaluable insights gleaned from secure data captured throughout your lending process could help your organization prepare based on your own performance compared to the performance of the market at large.

What Can Lenders Do Now?

While we push for the development of technologies to simplify our industry's most critical challenges in a more comprehensive way, there are solutions lenders may leverage now to improve your processes. Lenders should begin by tracking the timelines in loan processing to better understand gaps in the customer experience. This can be accomplished through a simple tool such as an excel spreadsheet, or a more comprehensive loan operating or CRM system.

Identifying gaps on the process enables your organization to improve service delivery.

Measure the timing in each state of the loan process:

- Eligibility Determination and Loan Structure
- Credit Memo Preparation
- Document Collection from Borrower
- Timing of Third-Party Reports
- SBA Approval
- Closing

From leveraging third-party partners to building a customized tech stack, we encourage lenders to promote cross-industry collaboration that makes the need and the potential for newer technology known to those who could spur development.

Additionally, we encourage lenders to utilize current tools on the market to help them access and process public lending data more efficiently. We hope the recently launched [SBA Atlas](#) is a step in the right direction for making SBA loan data more accessible and relevant to lenders of all sizes throughout the country.

As we all navigate the new world of government-guaranteed lending, we hope to continue to provide lenders with the support and the tools necessary to thrive in an evolving and growing industry. There are at least 3500 new lenders introduced to the SBA as a result of PPP. Many of these are now looking at the SBA 7(a) and SBA 504 programs. In order to compete with the 25% of the lenders who approve 75% of the allocated volume, a consistent delivery system must be in place to provide the borrower with a quick no or conditional yes and subsequently an efficient process.

This can only be accomplished by investing in the necessary resources or partners to achieve some level of scale. The cost is not as great as one would envision.

Refine Your Lending Strategy



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