

# INTRODUCTION TO THE LOSS REPORT

The FY 2005 Small Business Administration (SBA) Loss Report provides information to management on the Agency's loss experience for its various loan programs. The Loss Report focuses on the **actual losses as a percentage of disbursements** made to date on SBA loan programs. The report allows the user, at a glance, to review historical and current year data for each of the Agency's primary lending programs. The report combines the results of loans made since FY 1992 that are subject to the requirements of Federal Credit Reform accounting (credit reform loans) with the results of loans made prior to FY 1992 (pre-credit reform loans) that are not subject to this accounting requirement.

The concept of charge-off deserves some explanation. The SBA has extensive debt servicing and collection procedures using all reasonable efforts to assure maximum recovery of loans prior to charge-off. These procedures include the use of modern collection methods and the acquisition and sale of collateral through liquidation processes. Only after the Agency has exhausted these collection methods does SBA classify a loan as charged-off. For guaranty loans, the loan must first be purchased from the participating lender before this classification can be made. Also, charge-off does not preclude the Agency from further collection remedies if it is determined that these efforts would result in additional collections to the Agency. It should be noted that charged-off loan amounts are principal only, and do not include accrued interest.

This Loss Report includes additional data on the losses and gains from the sale of collateral (real estate and other property) acquired due to borrower loan defaults. This property is known as "ColPur." In addition, it includes other "costs of doing business" to service and liquidate defaulted loans that have been added to the loss of principal and interest since 1992 to give a complete picture of the component costs of SBA lending programs. We have not included, however, the losses on the financing of the sale of acquired collateral due to the lack of historical information.

The SBA uses loss data as part of its process to compute the subsidy rate for its loan programs. However, the loss rates developed in this Loss Report are not directly comparable with the SBA's subsidy rates. This is due to the other factors included in the subsidy rate computation such as loan fees, the present value of cashflows and interest rate considerations. As a result, the loss rates developed in this report are not easily compared to the subsidy rates on SBA's loan programs.

This report is prepared using the SBA's official records including general ledger and loan accounting system data.

# SBA LOAN PROGRAMS

## General Information

The following general information applies to business and disaster loan programs. All guidelines are of a general nature and subject to exceptions. Some of the loan programs discussed have been discontinued, although the SBA continues to maintain these loans in its portfolio.

Direct Loans were historically available only to certain special categories of borrowers unable to obtain SBA guaranteed loans made by participating lenders. Direct loans are disbursed directly by SBA. Currently, SBA only lends directly in the Microloan Business Program and the Disaster Loan Program.

Immediate Participation (IP) Loans historically were made jointly by SBA and private lenders when guaranty loans were unavailable to the borrower. This program has been inactive for years. For the purposes of this Loss Report, these loans are included in the Direct Loan category.

Guaranty Loans are made and disbursed by private lenders with the SBA providing a guaranty of 75 percent (85 percent for loans of \$150,000 or less). Upon borrower default, the SBA purchases the guaranty percentage of the unpaid balance of the loan. The maximum loan amount is \$2,000,000 but the maximum SBA guaranty is \$1,000,000.

Loan Proceeds may be used to establish a new business or to assist in the operation, acquisition, or expansion of an existing business. Loan proceeds may also be used for working capital, the purchase of inventory, machinery and equipment, and the construction, expansion and rehabilitation of business property.

Loan Maturity varies according to the prudent economic life of the assets being financed, subject to the following maximums:

- Working Capital - 7 to 10 years
- Machinery and Equipment - 10 to 25 years
- Building Construction or Purchase - 25 years

Interest Rates are determined by the SBA program office for Business direct loans. Guaranty loan rates may not exceed the New York prime rate by more than 2.25% for loans with a maturity of less than 7 years, or 2.75% for loans with a maturity of 7 years or more.

What follows is a more specific discussion of the various SBA loan programs.

## **GENERAL BUSINESS PROGRAM**

Defined under Section 7(a) of the Small Business Act, the 7(a) program is now more accurately called the General Business Program and is the largest of SBA's lending programs. The program promotes small business formation and growth by providing long-term loan guaranties to qualified firms.

General Business loans are always guaranty loans. The IP and direct loan programs for general business loans were discontinued in 1993. Direct loans included Economic Opportunity, Small Business Energy, Handicap Assistance, Veterans, Pollution Control, and Import Export Loan programs.

## **DEVELOPMENT COMPANY PROGRAM**

The Development Company program is actually a grouping of four separate and distinct lending programs defined under Section 7(a)(13) of the Small Business Act and Title V of the Small Business Investment Act. In general, all four programs consist of loans made through development companies for the purpose of fostering economic development in both urban and rural areas.

Section 501 (State) development companies are funded by a partnership arrangement between SBA and state governments. State development company loans are direct in nature. This program was discontinued in 1982.

Section 502 (Local) development companies were similar in nature to the Section 501 Loan program, only local, rather than state, governments are involved. The Section 502 program loan making activity was discontinued in 1995.

Section 503 and 504 (Certified) development companies provide fixed asset financing to small businesses for the construction or rehabilitation of owner-occupied or leased premises. These are guaranty loans only. The Section 503 program was discontinued in 1986, but was replaced by the Section 504 program that continues today.

The 504 Development Company Program is designed to assist businesses in the acquisition of long term fixed assets. The typical transaction has three components: First, a commercial lender provides 50 percent of the purchase price of real estate or equipment; Second, the borrower provides at least 10 percent of the amount; and Third, the SBA provides the balance through a Certified Development Corporation (CDC) funded through the issuance of debentures.

## **U.S. COMMUNITY ADJUSTMENT AND INVESTMENT PROGRAM (CAIP)**

The Department of Treasury entered into an agreement with the North American Development Bank (NADBank) to create and fund this program. CAIP is designed to help American communities that have suffered significant job losses as a result of changing trade patterns brought about by the North American Free Trade Agreement. CAIP provides economic support by increasing the availability and flow of credit, and encourages business development and expansion in impacted areas. Through CAIP, credit is available to businesses in eligible communities to create new, sustainable jobs or to preserve existing jobs.

CAIP is available with both the SBA 7(a) Loan Guaranty Program and the 504 Program to reduce borrower costs and increase the availability of these proven business assistance programs.

CAIP and the 7(a) Program: The SBA 7(a) Loan Guaranty Program provides lenders with a guaranty on loans and lines of credit to small businesses. For loans that meet the eligibility requirements of the CAIP, the NADBank pays the SBA loan guaranty fee that is typically paid by the lending institution or the borrower. This fee is based on the size of the loan guaranty and ranges from 2 to 3 percent of the amount of the guaranty.

CAIP and the 504 Program: The 504 Program has been added to the CAIP. The up front costs for this program are borne by the borrower and can amount to several thousand dollars, depending on the size of the transaction. As with the 7(a) Program, the CAIP may reimburse much of these costs for the borrower on eligible projects.

## **SMALL BUSINESS INVESTMENT COMPANIES**

SBA's Small Business Investment Company (SBIC) program provides long-term loans and/or venture capital to small firms. SBICs are privately owned and operated investment companies that are licensed and regulated by SBA. Venture capitalists participate in the SBIC program to supplement their own private capital through the issuance of SBA guaranteed debentures and preferred securities that are sold to private investors. SBA also licensed specialized SBICs (SSBICs) in the past (new licensing was discontinued in 1997) that specialize in meeting the needs of small firms owned by socially or economically disadvantaged persons. In addition, SSBICs leverage their own private capital by selling non-voting preferred stock to SBA. Since 1994, SBIC's can issue participating securities that are guaranteed by SBA and provide SBA potential revenue for its guaranty of timely payment of amounts due to the debenture holders. The following types of investments are commonly used by SBICs:

Loans with Warrants: SBICs may make loans in return for warrants that enable them to purchase common stock, usually at a favorable price, during a specific period of time.

Convertible Debentures: SBICs may make loans with a conversion feature whereby the debenture can be converted, at the SBIC's option, into an equivalent amount of common stock.

Stock: SBICs may purchase common or preferred stock from small firms.

Partnership Interests: SBICs may purchase a limited partnership interest in a partnership.

## **DISASTER LOAN PROGRAM**

Under the Disaster Loan Program, business owners, individuals, and nonprofit organizations are eligible for SBA financial assistance to repair the damage caused by natural disasters such as hurricanes, floods, and tornadoes. When the President or the SBA Administrator declares a specific area to be a disaster area, SBA offers two types of direct loans:

Physical Damage Disaster Loans are available to homeowners, renters, large and small businesses, and nonprofit organizations.

Economic Injury Disaster Loans are made to small businesses and small agricultural cooperatives that suffer substantial economic injury because of a physical disaster.

Interest rates on Disaster Loans are handled differently than other loans. For Business Loans, if a borrower is deemed able to obtain credit elsewhere, the interest rate may not exceed 8 percent. If these businesses cannot obtain alternative financing, the interest rate may not exceed 4 percent. For homeowners, the interest rate on Disaster Home Loans also follows the credit-elsewhere test. Treasury Department cost of funds, determine the interest rates for Business and Home loans, that are subject to these maximum interest rates. Loan maturity is also based on credit eligibility. Disaster Business Loan borrowers eligible for credit from other sources generally receive loans with a maturity not to exceed 3 years. Those borrowers that are unable to secure credit elsewhere can receive loans with a maturity of up to 30 years.

### **MICROLOAN PROGRAM**

The Microloan Demonstration Program, established in FY 1992, is to assist women, low income, and minority entrepreneurs possessing the capability to operate successful business concerns. The program also assists small business concerns in those areas suffering from a lack of credit due to economic downturn. The SBA makes direct loans to eligible and qualified intermediary lenders who then use the loan proceeds to make short-term, fixed interest rate microloans. These loans, usually made for less than the \$35,000 maximum, are for start-up, newly established and growing small business concerns. In conjunction with the loans made to intermediary lenders, SBA will make grants to such intermediary lenders to be used to provide intensive marketing, management, and technical assistance for microloan borrowers. SBA is authorized to make limited grants to eligible non-profit entities to provide marketing, management, and technical assistance to help low income individuals obtain private sector financing for their small businesses.



# **SBA LOAN LOSS REPORT**

## **SECTION I**

**Actual Losses  
On Pre Credit Reform and Credit Reform Loans  
(Consolidated)**

<b>* General Business Loans</b>	Direct/IP	Guaranteed	Program Total
<b>Disbursements</b>			
Balance as of 2004	\$5,521,257,814	\$116,533,820,209	\$122,055,078,023
FY 2005	\$0	\$9,578,780,830	\$9,578,780,830
Cumulative Disbursements	\$5,521,257,814	\$126,112,601,039	\$131,633,858,853
<b>** Charged Off Loans</b>			
Balance as of 2004	\$1,146,564,777	\$7,237,522,068	\$8,384,086,845
2005 Loan Principal	\$716,239	\$101,674,875	\$102,391,114
2005 Judgment Principal	\$0	\$556,571	\$556,571
2005 Other Receivables	\$82,342	\$895,674	\$978,016
Cumulative Charged Off Loans	\$1,147,363,358	\$7,340,649,188	\$8,488,012,546
<b>Recoveries</b>			
Balance as of 2004	\$68,724,012	\$306,385,958	\$375,109,970
FY 2005	\$1,067,375	\$11,025,928	\$12,093,303
Cumulative Recoveries	\$69,791,387	\$317,411,886	\$387,203,273
<b>Actual Net Losses</b>			
Cumulative Charged Off Loans Net of Cumulative Recoveries	\$1,077,571,971	\$7,023,237,302	\$8,100,809,273
<b>Actual Loss Rate</b>	19.52%	5.57%	6.15%
(Actual Losses/Disbursements)			

\* The following loan programs are included: 7(a), 8(A), FIS 8a, Economic Opportunity, Small Business Energy, Handicap Assistance, Veterans, Pollution Control, Import Export, Foreign Trade and RFC Business.

\*\* Loan balance write-downs associated with asset sales included.



Development Company Loans	Direct/IP	Guaranteed	Program Total
<b>Disbursements</b>			
Balance as of 2004	\$696,140,948	\$21,867,840,288	\$22,563,981,236
FY 2005	\$0	\$3,374,488,729	\$3,374,488,729
Cumulative Disbursements	\$696,140,948	\$25,242,329,017	\$25,938,469,965
<b>** Charged Off Loans</b>			
Balance as of 2004	\$195,255,329	\$417,593,201	\$612,848,530
2005 Loan Principal	\$55,386	\$43,498,365	\$43,553,751
2005 Judgment Principal	\$0	\$97,930	\$97,930
2005 Other Receivables	\$0	\$0	\$0
Cumulative Charged Off Loans	\$195,310,715	\$461,189,496	\$656,500,211
<b>Recoveries</b>			
Balance as of 2004	\$7,942,474	\$17,416,856	\$25,359,330
FY 2005	\$0	\$1,230,166	\$1,230,166
Cumulative Recoveries	\$7,942,474	\$18,647,022	\$26,589,496
<b>Actual Net Losses</b>			
Cumulative Charged Off Loans Net of Cumulative Recoveries	\$187,368,241	\$442,542,474	\$629,910,715
<b>Actual Loss Rate</b>			
(Actual Losses/Disbursements)	26.92%	1.75%	2.43%

\*\* Loan balance write-downs associated with asset sales included.

Small Business Investment Companies (SBIC)	Direct/IP	Guaranteed	Program Total
<b>Disbursements</b>			
Balance as of 2004	\$798,220,667	\$11,176,750,846	\$11,974,971,513
FY 2005	\$0	\$1,700,610,000	\$1,700,610,000
Cumulative Disbursements	\$798,220,667	\$12,877,360,846	\$13,675,581,513
<b>Charged Off Loans</b>			
Balance as of 2004	\$220,527,125	\$367,775,998	\$588,303,123
2005 Loan Principal	\$200	\$77,139,341	\$77,139,541
2005 Judgment Principal	\$264,060	\$45,833,477	\$46,097,537
2005 Other Receivables	\$0	\$0	\$0
Cumulative Charged Off Loans	\$220,791,385	\$490,748,816	\$711,540,201
<b>Recoveries</b>			
Balance as of 2004	\$9,904,861	\$44,072,968	\$53,977,829
FY 2005	\$1,175,189	(\$5,861,549)	(\$4,686,360)
Cumulative Recoveries	\$11,080,050	\$38,211,419	\$49,291,469
<b>Actual Net Losses</b>			
Cumulative Charged Off Loans Net of Cumulative Recoveries	\$209,711,335	\$452,537,397	\$662,248,732
<b>Actual Loss Rate</b>			
(Actual Losses/Disbursements)	26.27%	3.51%	4.84%

USCAIP Guaranty	Direct/IP	Guaranteed	Program Total
<b>Disbursements</b>			
Balance as of 2004	\$0	\$99,591,022	\$99,591,022
FY 2005	\$0	\$12,719,784	\$12,719,784
Cumulative Disbursements	\$0	\$112,310,806	\$112,310,806
<b>Charged Off Loans</b>			
Balance as of 2004	\$0	\$1,576,596	\$1,576,596
2005 Loan Principal	\$0	\$161,177	\$161,177
2005 Judgment Principal	\$0	\$0	\$0
2005 Other Receivables	\$0	\$0	\$0
Cumulative Charged Off Loans	\$0	\$1,737,773	\$1,737,773
<b>Recoveries</b>			
Balance as of 2004	\$0	(\$82,023)	(\$82,023)
FY 2005	\$0	\$0	\$0
Cumulative Recoveries	\$0	(\$82,023)	(\$82,023)
<b>Actual Net Losses</b>			
Cumulative Charged Off Loans Net of Cumulative Recoveries	\$0	\$1,819,796	\$1,819,796
Actual Loss Rate	0.00%	1.62%	1.62%
(Actual Losses/Disbursements)			

Microloan Loans	Direct/IP	Guaranteed	Program Total
<b>Disbursements</b>			
Balance as of 2004	\$182,823,612	\$12,843,106	\$195,666,718
FY 2005	\$18,514,388	\$0	\$18,514,388
Cumulative Disbursements	\$201,338,000	\$12,843,106	\$214,181,106
<b>Charged Off Loans</b>			
Balance as of 2004	\$97,297	\$0	\$97,297
2005 Loan Principal	\$0	\$0	\$0
2005 Judgment Principal	\$0	\$0	\$0
2005 Other Receivables	\$130,198	\$0	\$130,198
Cumulative Charged Off Loans	\$227,495	\$0	\$227,495
<b>Recoveries</b>			
Balance as of 2004	\$0	\$0	\$0
FY 2005	\$0	\$0	\$0
Cumulative Recoveries	\$0	\$0	\$0
<b>Actual Net Losses</b>			
Cumulative Charged Off Loans Net of Cumulative Recoveries	\$227,495	\$0	\$227,495
Actual Loss Rate	0.11%	0.00%	0.11%
(Actual Losses/Disbursements)			

All Business Loans	Direct/IP	Guaranteed	Program Total
<b>Disbursements</b>			
Balance as of 2004	\$7,198,443,041	\$149,690,845,471	\$156,889,288,512
FY 2005	\$18,514,388	\$14,666,599,343	\$14,685,113,731
Cumulative Disbursements	\$7,216,957,429	\$164,357,444,814	\$171,574,402,243
<b>** Charged Off Loans</b>			
Balance as of 2004	\$1,562,444,527	\$8,024,467,863	\$9,586,912,390
2005 Loan Principal	\$771,825	\$222,473,759	\$223,245,584
2005 Judgment Principal	\$264,060	\$46,487,979	\$46,752,039
2005 Other Receivables	\$212,540	\$895,674	\$1,108,214
Cumulative Charged Off Loans	\$1,563,692,952	\$8,294,325,275	\$9,858,018,227
<b>Recoveries</b>			
Balance as of 2004	\$86,571,347	\$367,793,758	\$454,365,105
FY 2005	\$2,242,565	\$6,394,545	\$8,637,110
Cumulative Recoveries	\$88,813,912	\$374,188,303	\$463,002,215
<b>Actual Net Losses</b>			
Cumulative Charged Off Loans Net of Cumulative Recove	\$1,474,879,040	\$7,920,136,972	\$9,395,016,012
Actual Loss Rate	20.44%	4.82%	5.48%
(Actual Losses/Disbursements)			

\*\* Loan balance write-downs associated with asset sales included.

Disaster Loans	Direct/IP	Guaranteed	Program Total
<b>Disbursements</b>			
Balance as of 2004	\$25,801,933,806	\$39,817,968	\$25,841,751,774
FY 2005	\$998,145,594	\$0	\$998,145,594
Cumulative Disbursements	\$26,800,079,400	\$39,817,968	\$26,839,897,368
<b>** Charged Off Loans</b>			
Balance as of 2004	\$2,875,019,815	\$2,089,483	\$2,877,109,298
2005 Loan Principal	\$61,256,386	\$0	\$61,256,386
2005 Judgment Principal	\$941,769	\$0	\$941,769
2005 Other Receivables	\$650,422	\$0	\$650,422
Cumulative Charged Off Loans	\$2,937,868,392	\$2,089,483	\$2,939,957,875
<b>Recoveries</b>			
Balance as of 2004	\$229,897,298	\$5,115	\$229,902,413
FY 2005	\$15,877,329	\$10,991	\$15,888,320
Cumulative Recoveries	\$245,774,627	\$16,106	\$245,790,733
<b>Actual Net Losses</b>			
Cumulative Charged Off Loans Net of Cumulative Recov	\$2,692,093,765	\$2,073,377	\$2,694,167,142
<b>Actual Loss Rate</b>			
(Actual Losses/Disbursements)	10.05%	5.21%	10.04%

\*\* Loan balance write-downs associated with asset sales included.

All Agency Programs	Direct/IP	Guaranteed	Program Total
<b>Disbursements</b>			
Balance as of 2004	\$33,000,376,847	\$149,730,663,439	\$182,731,040,286
FY 2005	\$1,016,659,982	\$14,666,599,343	\$15,683,259,325
Cumulative Disbursements	\$34,017,036,829	\$164,397,262,782	\$198,414,299,611
<b>** Charged Off Loans</b>			
Balance as of 2004	\$4,437,464,342	\$8,026,557,346	\$12,464,021,688
2005 Loan Principal	\$62,028,211	\$222,473,759	\$284,501,970
2005 Judgment Principal	\$1,205,829	\$46,487,979	\$47,693,808
2005 Other Receivables	\$862,962	\$895,674	\$1,758,636
Cumulative Charged Off Loans	\$4,501,561,344	\$8,296,414,758	\$12,797,976,102
<b>Recoveries</b>			
Balance as of 2004	\$316,468,645	\$367,798,873	\$684,267,518
FY 2005	\$18,119,894	\$6,405,536	\$24,525,430
Cumulative Recoveries	\$334,588,539	\$374,204,409	\$708,792,948
<b>Actual Net Losses</b>			
Cumulative Charged Off Loans Net of Cumulative Recoveries	\$4,166,972,805	\$7,922,210,349	\$12,089,183,154
Actual Loss Rate (Actual Losses/Disbursements)	12.25%	4.82%	6.09%

\*\* Loan balance write-downs associated with asset sales included.

# **SBA LOAN LOSS REPORT**

## **SECTION II**

### **OTHER PROGRAM COSTS**



## **OTHER PROGRAM COSTS**

The SBA term "ColPur" represents pledged collateral, the title to which is held by the SBA following the borrower's default on a loan. Title may be transferred to SBA in one of two ways.

First, a borrower may enter into a compromise agreement with SBA, offering the collateral in lieu of payment. A fair market value is assigned to the collateral and the borrower's indebtedness is reduced accordingly. The second method is through outright purchase of the property. Once obtained, the collateral is auctioned off at a sale. SBA issues a protective bid on the property that effectively results in SBA buying-out all prior lien-holders and assuming title to the property.

This collateral is held only until the SBA can sell it - recovering what it can from the sale. In cases where the amount recovered is less than what the SBA paid or compromised the property for, a loss on ColPur is recognized. In some cases, the sales proceeds for the collateral are greater than the ColPur value, and a gain is recognized on the sales transaction.

"In Kind Distribution" are distributions the SBA receives from Small Business Investment Corporations (SBIC). These distributions are generally in the form of securities. The SBIC may distribute securities to the SBA in lieu of payment of interest advances, distribution of profits, or a prepayment in the reduction of the underlying security. Normally the distributions are held only for a short period of time before they are sold. A gain or loss is recognized on the sale on each security. In 2005 there were no distributions.

The costs discussed above are summarized for FY 2005 on the following page.

<b>Other Program Costs: Net Losses on ColPur in FY 2005</b>					
	* Gen. Business	Local Dev	SBIC	Disaster	Total
<b>Net Gain (Loss)</b>	(\$455,987)	(\$937,111)	(\$216,214)	\$39,603	(\$1,569,709)

<b>Other Program Costs: SBIC In Kind Securities Activity in FY 2005</b>					
<b>Net Gain (Loss)</b>			\$6,803,627		\$6,803,627

\* The following loan programs are included: 7(a), 8(A), FIS 8a, Economic Opportunity, Small Business Energy, Handicap Assistance, Veterans, Pollution Control, Import Export, Foreign Trade and RFC Business.

# GLOSSARY OF TERMS

## Actual Loss Rate

Calculated as a percentage, this figure represents the ratio of net losses to total disbursements. Both net losses and disbursements are cumulative, inception to date for the program.

## ColPur

This term is an abbreviation for "Collateral Purchased" and refers to pledged collateral that the Agency holds title to following borrower default on a loan.

## Credit Reform

Accountability requirements pursuant to the Federal Credit Reform Act of 1990 in which credit program costs are recognized at the time obligations are incurred and reflect loan subsidies and Treasury borrowings as component cost elements.

## Disbursements

Cumulative total of the principal amount loaned under a particular program. Depending on the loan type (i.e. Direct, Guaranty, or Immediate Participation), the disbursement of monies is made by SBA, the participating lender, or both.

## In-Kind Distribution

The SBA receives stock dividends from Small Business Investment Corporations (SBIC) that are sold.

## Judgment

A judgment is obtained when SBA goes to court in order to collect on a defaulted loan.

## Loans Charged-Off

The cumulative total of principal balance still owed SBA that has been determined uncollectible.

## Recoveries

Borrower payments of principal and interest, judgements and other receivables applied to loans charged-off.