

Breakout Session VII

Understanding 504 Interest Rates & the Funding Process

CDC Board/Executive/Management Track



Germantown Room 1
Thursday, October 17
11:00 am – 12:00 pm

Thank you to our Alliance Partners



Speakers

Frank Keane, President

Eagle Compliance, LLC

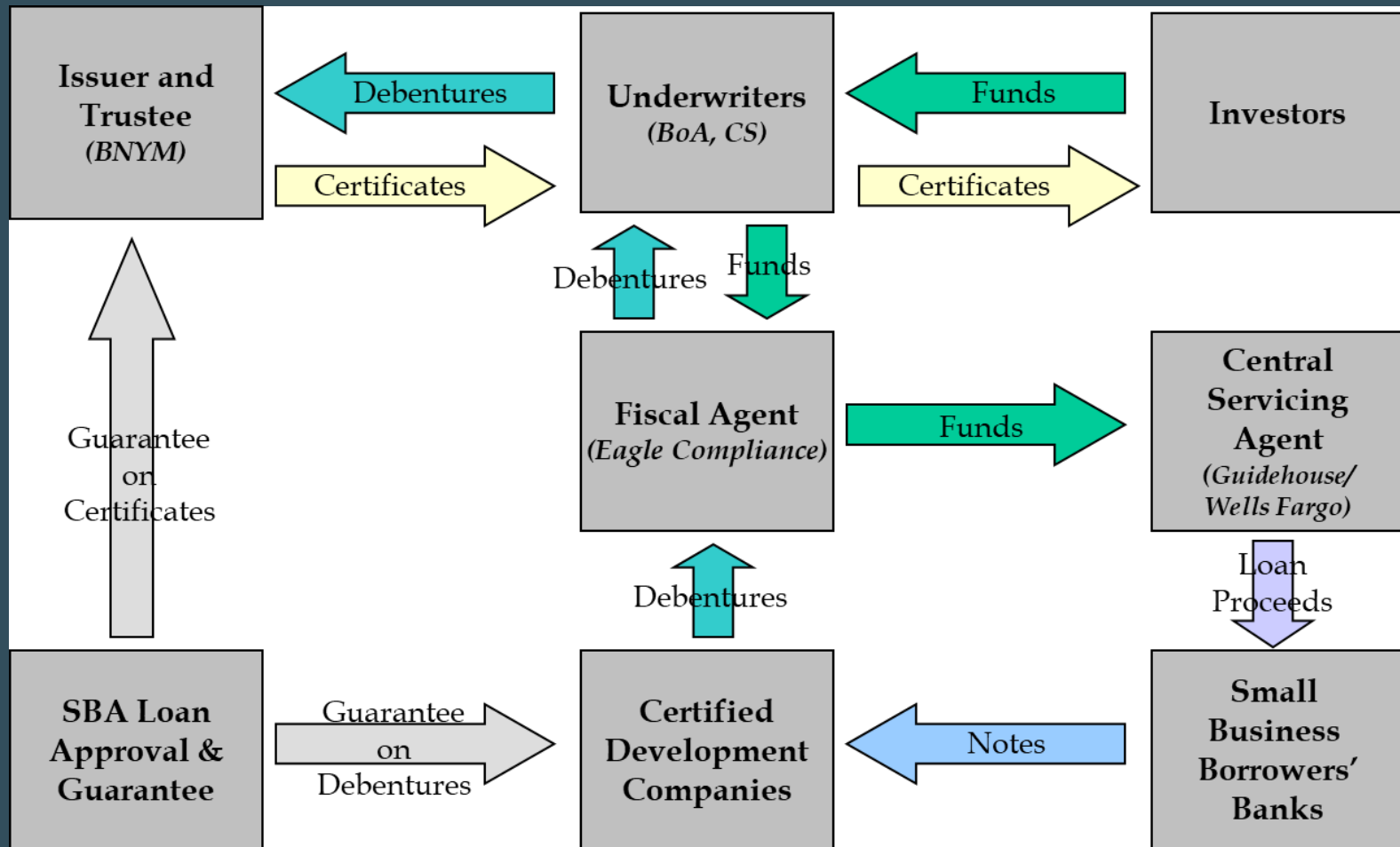
Steve Van Order, Selling Agent

Eagle Compliance, LLC

SBA 504 Capital Markets Team

- **Fiscal Agent/Selling Agent** – *Eagle Compliance LLC*. Manage the funding process to obtain the best monthly debenture rate available for borrowers
- **Underwriters** – *Credit Suisse and Bank of America*. Market, sell and trade DCPCs, take capital risk, pool debentures, product research
- **Issuing Agent and Trustee** – *The Bank of New York Mellon*. Hold debentures issued by CDCs, issue DCPCs as SBA's agent, distribute P&I to DCPC holders, report outstanding pool statistics
- **Central Servicing Agent** – *Guidehouse/WF*. Process loans, report new pool statistics to Eagle Compliance, collect loan payments, pay out proceeds
- **Legal Counsel** – *Morgan, Lewis & Bockius LLP*. Program and transaction legal advisors to underwriters and Eagle Compliance LLC

From Borrowers to Investors and Back



Typical Deadlines: e.g. October 2019 Sale

- **August 20 – September 6:** CDCs to submit forms to Sacramento for No Adverse Change
- **August 20 – September 6:** Upon approval of No Adverse Change by Sacramento request file will be placed in legal folder for District Counsel review
- **Tuesday September 24:** Upon District Counsel approval, send documents to CSA – due to CSA no later than September 26
- **Friday October 4:** CSA will provide preliminary numbers to FA
- **Monday October 7:** Pulled Loan Deadline
- **Tuesday October 8:** Selling Agent and Underwriters will announce/market sale
- **Thursday October 10:** DCPC 2019-20J and 25J debenture rates will be set
- **Wednesday October 16:** Funding Date. Legal Counsel will conduct conference call with SA, Underwriters, Trustee, CSA and SBA to close the sale and release funds to borrowers

Resources: Eagle Compliance Website

EAGLE COMPLIANCE, LLC

BUSINESS CONSULTING



[Click here to visit more historic debenture pricing](#)

SEPTEMBER 2019 DEBENTURE PRICING

The September 2019 504 debenture pricing is as follows:
25-year Debenture:
Debenture rate: 2.14%
Comparable Treasury Market Rate: 1.58%
Spread Over Treasury: + 0.56%
Debenture Pool: 251 loans (\$203,390,000)

20-year Debenture:
Debenture rate: 1.98%
Comparable Treasury Market Rate: 1.58%
Spread Over Treasury: + 0.40%
Debenture Pool: 194 loans (\$166,223,000)

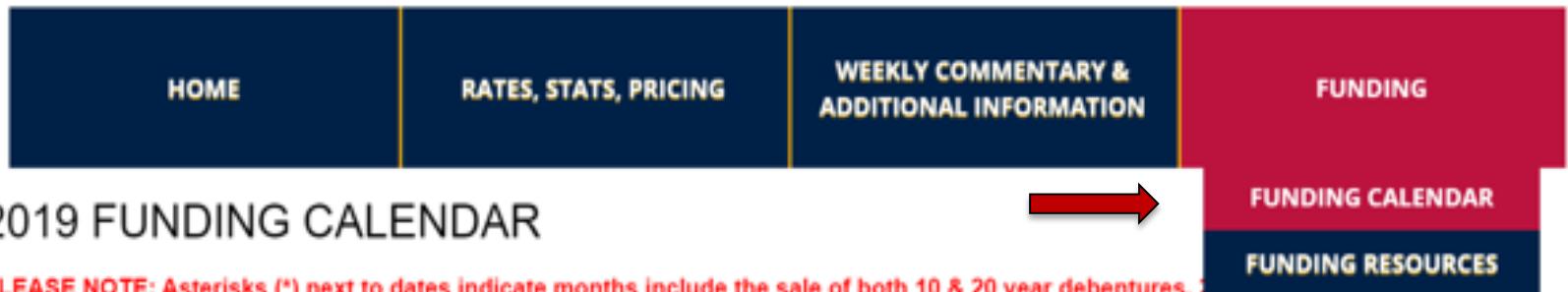
September 5, 2019.



Resources: Eagle Compliance Website

EAGLE COMPLIANCE, LLC

BUSINESS CONSULTING



PLEASE NOTE: Asterisks (*) next to dates indicate months include the sale of both 10 & 20 year debentures. debentures will be offered monthly. Once the 25 year debenture option is rolled out by the SBA, then 20/25 year debentures will be offered monthly, and months with asterisks will include both 10, 20/25 year debenture sales.

CSA Cut-Off Date	Pulled Loan Deadline	Announcement Date	Debenture Pricing Date	Funding Date
12/27/2018*	01/07/2019	01/08/2019	01/10/2019	01/16/2019
01/24/2019	02/04/2019	02/05/2019	02/07/2019	02/13/2019
02/21/2019*	03/04/2019	03/05/2019	03/07/2019	03/13/2019

The Three Interest Rates in 504

- **Debenture Rate:** The rate that determines interest paid semi-annually to investors in DCPCs
- **Note Rate:** The monthly-pay equivalent of the debenture rate. Borrower P&I portion of monthly payments and principal amortization schedule are calculated using the note rate
- **Effective Rates:** Rates calculated inclusive of P&I, CDC, borrower and CSA fees. Effective rates are provided to CDCs on a full-term basis and in five-year segments

How is the Debenture Rate Determined?

- **Debenture Rate** = swap rate + spread to swap.
- **Swap Rate** = treasury yield + swap spread.
 - 25- and 20-year maturities use 10-year swap rate
 - 10-year maturity uses 5-year swap rate
- **Pricing** – Selling Agent and Underwriters agree on the swap rate plus the spread to swap. The Selling Agent accepts the debenture rate and obtains approvals from Treasury and SBA.

Debenture and Note Features Differ

Feature	Debenture	Note
Interest rate	Debenture rate	Note rate
Payment date	Semi-annual	Monthly
Amortization	Semi-annual	Monthly
Prepayment	Semi-annual	Semi-annual
Prepay penalty	Scheduled	Scheduled

Why Do the Features Differ?

- *Debenture semi-annual payment* was originally chosen to appeal to government and corporate bond investors who expect semi-annual payments. Borrowers make monthly payments
- *Semi-annual prepayment restriction and prepayment penalties result in a lower interest rate for small business borrowers.* An option to prepay at anytime with no penalty would require a relatively higher debenture rate
- Historically, one-third of borrowers voluntarily prepaid. *All borrowers should not pay a higher rate so some can prepay*
- *Rich historical data appeal to investors.* 504 program boasts data since late 1986. This is a key selling point to investors

How is the Note Rate Calculated?

- **Note rate:** The annualized monthly-pay equivalent interest rate derived from the debenture rate. It has been ± 6 bps over debenture rate the long run but recently ± 4 bps given 2019's low debenture rates
- **Calculation:** The semiannual debenture P&I payment is divided by 6 to obtain a monthly payment. This must be further broken down into (a) interest due and (b) paid-down principal (so that principal due=0 after the last scheduled payment)

Calculating the Note Rate

(e.g., using HP12c calculator)

- **Assume** 3.60% debenture rate, \$350,000 OPB, 20-year final
- **Inputs** $n = 40$, $i = 1.8$ (rate / 2), $PV = 350,000$
- **Solve** for PMT which = (12,350.01)
- **Clear** registers using $\{f\}$ $\{FIN\}$ and $\{f\}$ $\{REG\}$
- **Inputs** $n = 240$, $PV = 350000$, $PMT = [-12,350.01 / 6]$
converts semi-annual payment to monthly
- **Solve** for i which = 0.30481. Annualized rate = $0.30481\% \times 12$
= 3.658%, within 0.001 point of CSA's reported rate for 6/2018

How Are Effective Rates Determined?

- Monthly annualized effective rates are derived by including the value of ongoing fees (i.e. CDC, borrower, CSA). Fees adjust every five years, but principal amortizes monthly. CSA calculates these rates, not Eagle Compliance or NADCO
- Effective rates do not include the impact of upfront fees and therefore are not APRs
- **Effective rate for any given month =**
(interest+CDC+SBA+CSA)/base UPB x 1200.
Where “base UPB” = opening UPB for each new monthly calculation (e.g. UPB at months 1, 61, 121, 181)
- Monthly annualized effective rates are then averaged (weighted by each month’s opening principal balance), reported by CSA and posted on the [Eagle Compliance Website](#)

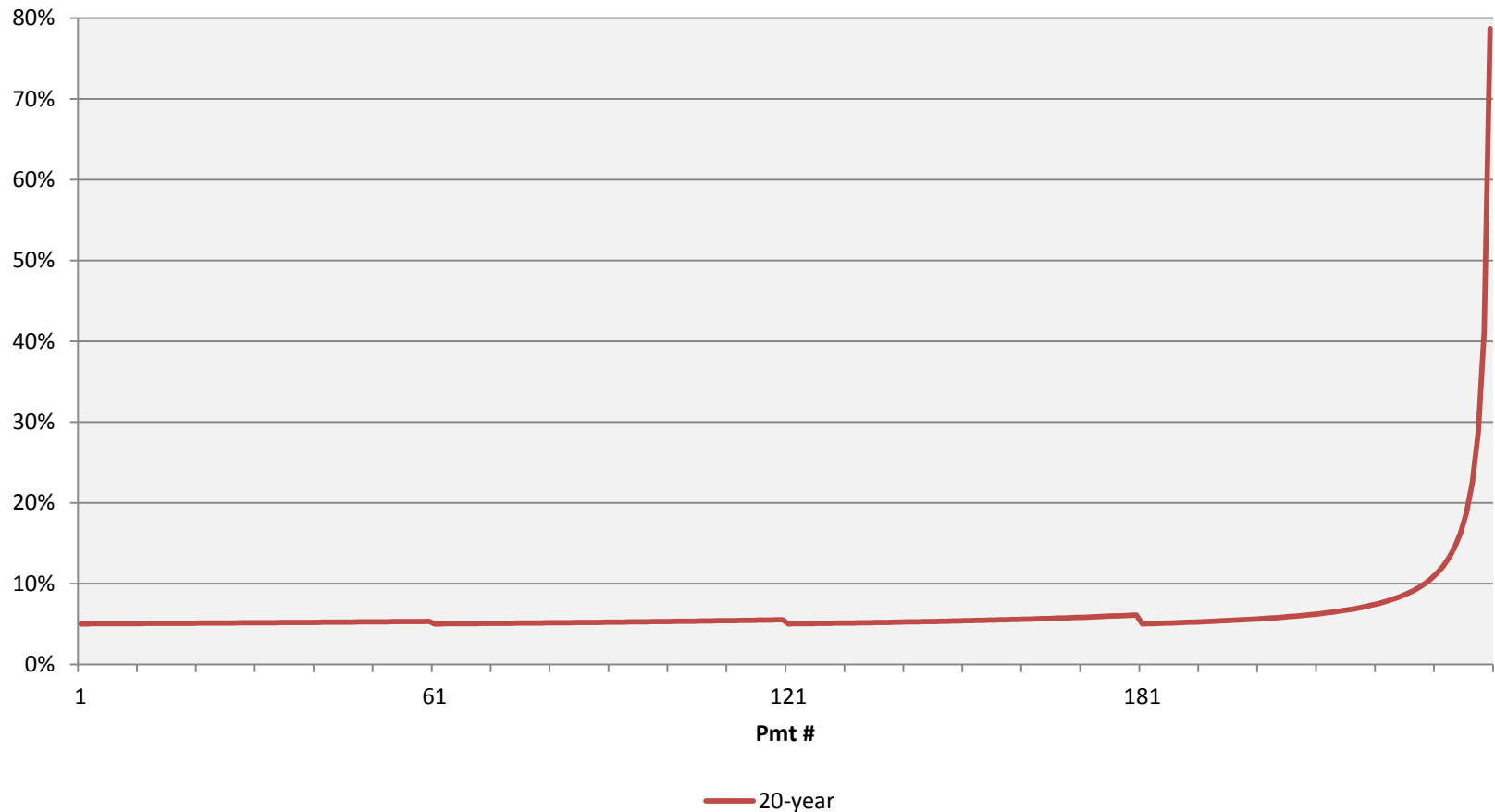
Periodic Effective Rates: Example

(3.60% rate, 3.658% note, 0.625% CDC, 0.642% SBA, 0.10% CSA)

Pmt#	UPB	Interest	All Fees	Eff. Rate
1	350,000	1,067	399	5.02%
60	286,017	872	399	5.33%
61	284,831	868	324	5.02%
120	208,030	634	324	5.53%
121	206,606	630	235	5.02%
180	114,418	349	235	6.13%
181	112,709	344	128	5.02%
240	2,052	6	128	78.74%

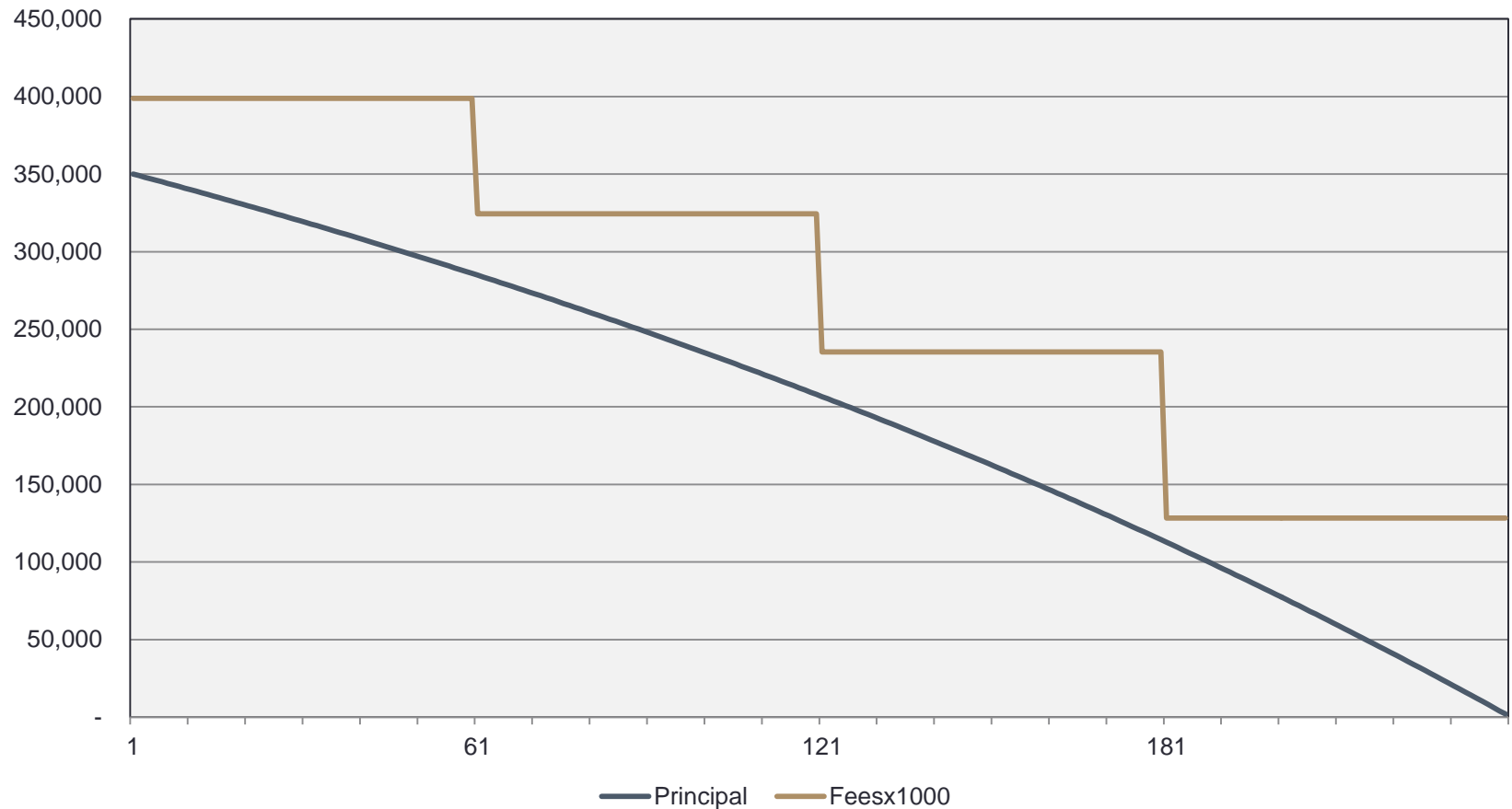
Effective Rates Rise Over Time

20-Year Loan Annualized Effective Rate Per Payment



Why Do Effective Rates Rise Over Time?

Principal Amortizes But Fees Step Down



How Can You Estimate Effective Rates?

- The Eagle Compliance website has an estimated effective rate calculator. The calculator is on the [504 Loan \(Effective\) Rate Calculators](#) page, that can be found under the Weekly Commentary & Additional Information tab
- The calculator is a downloadable Excel spreadsheet that includes separate tabs for 25-year, 20-year and 10-year rates
- *As a reminder:* The official effective rates are provided only by the Central Servicing Agent prior to each funding date. These calculators provide only estimates of the Effective Loan Rate and are not guaranteed for accuracy because Excel does not properly compute the initial, abbreviated, payment period

What's Up Next?

12:50 PM – 1:20 PM

Keynote Speaker and Diamond Awards and Hall of Fame Awards Presentation

Broadway Ballroom

Lance Brock, Owner

Climb Nashville

1:30 PM – 2:30 PM

Roles, Responsibilities & Expectations of CDC Board Members

****CDC Board Members Only****

Germantown Room 1

Expansion Refi Structures & Successes (Repeated)

****BDO/Loan Officer/Marketing/Third Party Lender Track****

Germantown Room 2

Creating Policy Manuals

****Servicing/Processing/Support Track****

Germantown Room 3