Development Company Finance LLC

Date: August 13, 2010

To: Certified Development Companies

From: Steve Van Order, DCFLLC Fiscal Agent

Subject: August 2010 SBA 504 Debenture Offering (2010-20H)

On August 11, 2010, 539 twenty-year debentures totaling $294,048,000 were funded through the sale of certificates guaranteed by SBA. Below are debenture pricing details:

Sale/Sale Comparison	Treasury	Swap Spread	Spread	Rate	T plus
2010-20H (08/03/10)	2.900%	-2.75 BP	64.75 BP	3.52%	62.0 BP
2010-20G (07/06/10)	2.981%	7.25 BP	74.65 BP	3.80%	81.9 BP
Change	-8.1 BP	-10.00 BP	-9.90 BP	-28 BP	-19.9 BP

- The September offering will consist of *20- and 10-year debentures.*
- The ***cutoff date*** to submit loans to Colson for this offering is Tuesday **August 24**
- A ***request to remove a submitted loan*** from a pool must be made through Colson Services by close of business Thursday, **September 2**.
- ***Pricing date*** is Tuesday **September 7**, on which the debenture interest rates will be set.
- The debentures will be funded on Wednesday, September 15.

The FOMC statement released on August 10 contained the following highlights:

1) Downgrade to its assessment of current and anticipated economic growth.
2) Recognition that disinflation has been in place for quarters versus months.
3) No change to the “extended period” commitment for near-zero target Fed funds rate.
4) Announced it will maintain current balance sheet size by reinvesting principal payments on holdings of housing agency debt and MBS in longer-term treasuries by buying in the open market. It will continue to roll over maturing treasury holdings by buying at Treasury auctions.
5) KC Fed President Hoening again dissented on policy disagreeing that the recovery was weaker and with the decision keep the balance sheet size stable.

Let’s talk about the change in portfolio policy, the big news in the statement. Based on the FOMC statement the Fed will use principal payments out of its agency holdings to buy more treasuries via open market operations to keep its holdings of government debt at about $2 trillion. Of interest, the FOMC excluded reinvestment of coupon payments from its agency holdings. A technical note from the NY Fed stated the maturities will be between two- and 30-years and include inflation-indexed and nominal coupons. The first operation will be August 17.

This was not an easing of monetary policy but simply a stalling of the passive withdrawal of monetary stimulus that was underway. The Fed will not create more excess bank reserves in the system from this activity. Shrinking the portfolio would have resulted in a passive withdrawal of monetary stimulus as excess bank reserves would have been drawn down too. So this decision simply maintains the current level of central bank monetary stimulus. It also will keep the average maturity of the Fed's portfolio longer than expected.
So how many term treasuries might the Fed buy? On March 8 NY Fed operations chief Brian Sack estimated that over $200 billion of agency holdings will mature by the end of 2011. Today's balance of all agencies held at the Fed compared to March is about the same at $1.2 trillion. Just in straight agency debt the Fed has about $12 billion maturing by the end of this year. Mr. Sack's projection results in an average of near $12 billion a month maturing in agencies through the end of 2011. On average each month Treasury is auctioning about $170 billion in nominal two-, three-, five-, seven-, ten- and 30-year maturities plus some TIPS. An average $12 billion against $170 billion issues means today in the treasury market emerged a new buyer (the Fed) equivalent to near 7% of nominal coupon treasury issuance. That's a pretty good-sized buyer. If this program lasts through 2011, the Fed might even eclipse China as the world's biggest holder of treasuries. How about that?

The Fed's August 11 decision will help treasury yields stay quite low but when might the markets start to agitate for a true policy easing? The economic data over the next months will be very important. If the data improves, this period will be viewed as a typical early recovery stumble before expansion and yields will rise quite a bit. If the data remains poor, pressure will be on the central bank to reach in the bag for another trick.