

# INTRODUCTION TO THE LOSS REPORT

The FY 1997 Small Business Administration Loss Report serves as a management tool for the analysis of the Agency's loss experience for various loan programs. The Loss Report focuses on the **actual losses as a percentage of disbursements** made to date on SBA loan programs. Included in this year's report is a disclosure of the Agency's historical losses. The presentation allows the user, at a glance, to review historical and current data for each of the Agency's primary lending programs. The report combines the results of loans made since FY 1992, which are subject to the requirements of Federal Credit Reform accounting, with the results of loans made prior to FY 1992, which are not subject to this accounting requirement.

The concept of charge-off deserves some explanation. The SBA has an extensive debt servicing and collection plan to assure maximum recovery of loans made. Therefore, all reasonable efforts are made by the Agency to fully collect the debt prior to charge-off. This effort includes 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 is a reportable status assigned to a debt of the Agency. The assignment of this status 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 cumulative charged off loan amounts are principal only.

In addition, the "costs of doing business" related to SBA's lending programs have been addressed. Also considered are losses on the sale of "ColPur" (Collateral Purchased), e.g., real estate and other property that have been acquired by the Agency due to borrowers' loan defaults. These and other additional costs, when factored into the traditional actual – loss calculations for fiscal years since 1992, give a complete picture of the component costs associated with the overall 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.

Finally, it should be noted that data from SBA's official records and general ledger were utilized to complete this report.

## SBA LOAN PROGRAMS

## General Information

Direct Loans are available only to certain special categories of borrowers who are unable to obtain lender participation loans. Direct loans are disbursed directly from SBA funds. Direct loans have an administrative ceiling of \$150,000 in amount. Currently, SBA only lends directly in the Microloan Business Program and the Disaster Loan Program.

Immediate Participation (IP) Loans are those made jointly by SBA and private lenders. SBA's participation is administratively limited to 75% or \$150,000, whichever is less. IP loans are permissible only when a guaranty loan is unavailable to the borrower. This program is seldom used, and for the purposes of the loss study, these loans are included in the Direct Loan category.

Guaranteed Loans are made and disbursed by private lenders and guaranteed (generally up to 75%) by SBA. Upon default on the loan by the borrower, SBA will purchase an agreed-upon share of the unpaid balance of the loan. Maximum exposure allowable for SBA on a General Business guaranteed loan is \$750,000.

Loan Proceeds may be used to establish a new business or to assist in the operation, acquisition or expansion of an existing business. Uses may include 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 Rate is set quarterly by Central office for direct loans. Guaranty loan rates may not exceed the New York prime rate by more than 2.25% for loans with a maturity of under 7 years or 2.75% for loans with a maturity of 7 years or more.

The above information applies to Business loans. Disaster loans are covered in a separate section of this report.

Note: All guidelines are of a general nature and subject to exceptions.

## 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 by far the largest of SBA's lending programs, accounting for approximately 85% of all loan disbursements.

General Business loans are always guaranty loans. The IP and direct loan programs for general

business loans were discontinued in 1993. General Business loans in this report include 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 has not been in effect since 1982.

Section 502 (Local) development companies were similar in nature to the 501 Loan program, only local, rather than state, governments are involved. The 502 program 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 and was replaced by the Section 504 program.

## **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 with funds provided through SBA's guarantee of SBIC debentures and preferred securities that are sold to private investors. SBA also licenses specialized SBICs (SSBICs), which specialize in meeting the needs of small firms owned by socially or economically disadvantaged persons. In addition to debentures and participating securities, SSBICs may also leverage their own private capital by selling SBA non-voting preferred stock. SBICs also issue participating securities that are guaranteed by SBA and that provide SBA potential revenue for its guarantee 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 SBICs 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, two types of direct loans are offered by SBA:

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 Home loans are handled differently than other loans. If a borrower is deemed able to obtain credit elsewhere, the interest rate may not exceed 8%. For borrowers that cannot obtain alternative financing, the interest rate may not exceed 4%. 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**

On October 28, 1991 the President signed Public Law 102-140, the Commerce, Justice, State, The Judiciary, and Related Agencies Appropriations Act of 1992. Section 609 (h) of that law added a new subsection (m) to section 7 of the Small Business Act, 15 U.S.C. 636 (the Act). The new subsection authorized the Small Business Administration (SBA) to establish the Microloan Demonstration Program.

The purpose of this program is to assist women, low income and minority entrepreneurs, business owners, and other such individuals possessing the capability to operate successful business concerns and to assist small business concerns in those areas suffering from a lack of credit due to economic downturn.

SBA will make direct loans to eligible and qualified intermediary lenders who will use the loan proceeds to make short-term, fixed interest rate microloans, particularly loans in amounts less than \$25,000 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 to microloan borrowers under this program. In addition, SBA is authorized to make limited grants to eligible and qualified

non-profit entities to provide marketing, management and technical assistance to help low income individuals obtain, with or without loan guarantees, private sector financing for their small businesses.

**SBA LOAN LOSS REPORT**

**SECTION I**

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

*General Business Loans	Direct/IP	Guaranteed	Program Total
Disbursements			
Balance as of 1996	\$5,521,085,143	\$63,636,861,122	\$69,157,946,265
FY 1997	\$87,659	\$6,320,070,097	\$6,320,157,756
Cumulative Disbursements	\$5,521,172,802	\$69,956,931,219	\$75,478,104,021
Charged Off Loans			

Balance as of 1996	\$1,085,860,459	\$4,737,240,528	\$5,823,100,987
1997 Loan Principal	\$9,764,680	\$290,795,132	\$300,559,812
1997 Judgment Principal	\$66,091	\$4,575,434	\$4,641,525
1997 Other Receivables	\$1,774,976	\$3,798,893	\$5,573,869
Cumulative Charged Off Loans	\$1,097,466,206	\$5,036,409,987	\$6,133,876,193
<b>Recoveries</b>			
Balance as of 1996	\$58,693,808	\$185,168,247	\$243,862,055
FY 1997	\$2,238,421	\$20,465,235	\$22,703,656
Cumulative Recoveries	\$60,932,229	\$205,633,482	\$266,565,711
<b>Actual Net Losses</b>			
Cumulative Charged Off Loans Net of Cumulative Recoveries	\$1,036,533,977	\$4,830,776,505	\$5,867,310,482
Actual Loss Rate	18.77%	6.91%	7.77%
(Actual Losses/Disbursements)			

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

Development Company Loans	Direct/IP	Guaranteed	Program Total
<b>Disbursements</b>			
Balance as of 1996	\$696,140,948	\$7,134,013,531	\$7,830,154,479
FY 1997	\$0	\$1,695,716,858	\$1,695,716,858
Cumulative Disbursements	\$696,140,948	\$8,829,730,389	\$9,525,871,337
<b>Charged Off Loans</b>			
Balance as of 1996	\$184,336,262	\$116,383,110	\$300,719,372
1997 Loan Principal	\$3,308,133	\$25,132,085	\$28,440,218
1997 Judgment Principal	\$1,097,661	\$295,847	\$1,393,508
1997 Other Receivables	\$471,706	\$237,114	\$708,820
Cumulative Charged Off Loans	\$189,213,762	\$142,048,156	\$331,261,918
<b>Recoveries</b>			
Balance as of 1996	\$6,967,757	\$4,254,105	\$11,221,862
FY 1997	(\$94,421)	\$1,290,710	\$1,196,289
Cumulative Recoveries	\$6,873,336	\$5,544,815	\$12,418,151
<b>Actual Net Losses</b>			
Cumulative Charged Off Loans Net of Cumulative Recoveries	\$182,340,426	\$136,503,341	\$318,843,767
Actual Loss Rate	26.19%	1.55%	3.35%

(Actual Losses/Disbursements)			

Small Business Investment Companies (SBIC)	Direct/IP	Guaranteed	Program Total
<b>Disbursements</b>			
Balance as of 1996	\$798,220,667	\$3,404,770,846	\$4,202,991,513
FY 1997	\$0	\$339,735,000	\$339,735,000
Cumulative Disbursements	\$798,220,667	\$3,744,505,846	\$4,542,726,513
<b>Charged Off Loans</b>			
Balance as of 1996	\$68,106,586	\$236,797,040	\$304,903,626
1997 Loan Principal	\$17,252,348	\$57,732,594	\$74,984,942
1997 Judgment Principal	\$28,708,217	\$31,045,101	\$59,753,318
1997 Other Receivables	\$2,094,088	\$0	\$2,094,088
Cumulative Charged Off Loans	\$116,161,239	\$325,574,735	\$441,735,974
<b>Recoveries</b>			
Balance as of 1996	\$7,018,923	\$43,671,619	\$50,690,542
FY 1997	(\$1,898,388)	(\$1,122,560)	(\$3,020,948)
Cumulative Recoveries	\$5,120,535	\$42,549,059	\$47,669,594
<b>Actual Net Losses</b>			
Cumulative Charged Off Loans Net of Cumulative Recoveries	\$111,040,704	\$283,025,676	\$394,066,380
Actual Loss Rate	13.91%	7.56%	8.67%
(Actual Losses/Disbursements)			

Microloan Loans	Direct/IP	Guaranteed	Program Total
<b>Disbursements</b>			
Balance as of 1996	\$48,403,135	\$0	\$48,403,135
FY 1997	\$7,288,228	\$0	\$7,288,228
Cumulative Disbursements	\$55,691,363	\$0	\$55,691,363
<b>Charged Off Loans</b>			

Balance as of 1996	\$0	\$0	\$0
1997 Loan Principal	\$0	\$0	\$0
1997 Judgment Principal	\$0	\$0	\$0
1997 Other Receivables	\$0	\$0	\$0
Cumulative Charged Off Loans	\$0	\$0	\$0
<b>Recoveries</b>			
Balance as of 1996	\$0	\$0	\$0
FY 1997	\$0	\$0	\$0
Cumulative Recoveries	\$0	\$0	\$0
<b>Actual Net Losses</b>			
Cumulative Charged Off Loans Net of Cumulative Recoveries	\$0	\$0	\$0
Actual Loss Rate (Actual Losses/Disbursements)	0.00%	0.00%	0.00%

All Business Loans	Direct/IP	Guaranteed	Program Total
<b>Disbursements</b>			
Balance as of 1996	\$7,063,849,893	\$74,175,645,499	\$81,239,495,392
FY 1997	\$7,375,887	\$8,355,521,955	\$8,362,897,842
Cumulative Disbursements	\$7,071,225,780	\$82,531,167,454	\$89,602,393,234
<b>Charged Off Loans</b>			
Balance as of 1996	\$1,338,303,307	\$5,090,420,678	\$6,428,723,985
1997 Loan Principal	\$30,325,161	\$373,659,811	\$403,984,972
1997 Judgment Principal	\$29,871,969	\$35,916,382	\$65,788,351
1997 Other Receivables	\$4,340,770	\$4,036,007	\$8,376,777
Cumulative Charged Off Loans	\$1,402,841,207	\$5,504,032,878	\$6,906,874,085
<b>Recoveries</b>			
Balance as of 1996	\$72,680,488	\$233,093,971	\$305,774,459
FY 1997	\$245,612	\$20,633,385	\$20,878,997
Cumulative Recoveries	\$72,926,100	\$253,727,356	\$326,653,456
<b>Actual Net Losses</b>			
Cumulative Charged Off Loans Net of Cumulative Recoveries	\$1,329,915,107	\$5,250,305,522	\$6,580,220,629



Actual Loss Rate	18.81%	6.36%	7.34%
(Actual Losses/Disbursements)			

Disaster Loans	Direct/IP	Guaranteed	Program Total
Disbursements			
Balance as of 1996	\$19,823,794,610	\$39,682,968	\$19,863,477,578
FY 1997	\$906,018,826	\$0	\$906,018,826
Cumulative Disbursements	\$20,729,813,436	\$39,682,968	\$20,769,496,404
Charged Off Loans			
Balance as of 1996	\$1,753,590,958	\$1,936,933	\$1,755,527,891
1997 Loan Principal	\$104,637,157	\$0	\$104,637,157
1997 Judgment Principal	\$1,053,971	\$0	\$1,053,971
1997 Other Receivables	\$744,529	\$0	\$744,529
Cumulative Charged Off Loans	\$1,860,026,615	\$1,936,933	\$1,861,963,548
Recoveries			
Balance as of 1996	\$135,274,777	\$6,525	\$135,281,302
FY 1997	\$9,795,487	\$2,280	\$9,797,767
Cumulative Recoveries	\$145,070,264	\$8,805	\$145,079,069
Actual Net Losses			
Cumulative Charged Off Loans Net of Cumulative Recoveries	\$1,714,956,351	\$1,928,128	\$1,716,884,479
Actual Loss Rate	8.27%	4.86%	8.27%
(Actual Losses/Disbursements)			

All Agency Programs	Direct/IP	Guaranteed	Program Total
Disbursements			
Balance as of 1996	\$26,887,644,503	\$74,215,328,467	\$101,102,972,970
FY 1997	\$913,394,713	\$8,355,521,955	\$9,268,916,668
Cumulative Disbursements	\$27,801,039,216	\$82,570,850,422	\$110,371,889,638

<b>Charged Off Loans</b>			
Balance as of 1996	\$3,091,894,265	\$5,092,357,611	\$8,184,251,876
1997 Loan Principal	\$134,962,318	\$373,659,811	\$508,622,129
1997 Judgment Principal	\$30,925,940	\$35,916,382	\$66,842,322
1997 Other Receivables	\$5,085,299	\$4,036,007	\$9,121,306
Cumulative Charged Off Loans	\$3,262,867,822	\$5,505,969,811	\$8,768,837,633
<b>Recoveries</b>			
Balance as of 1996	\$207,955,265	\$233,100,496	\$441,055,761
FY 1997	\$10,041,099	\$20,635,665	\$30,676,764
Cumulative Recoveries	\$217,996,364	\$253,736,161	\$471,732,525
<b>Actual Net Losses</b>			
Cumulative Charged Off Loans Net of Cumulative Recoveries	\$3,044,871,458	\$5,252,233,650	\$8,297,105,108
Actual Loss Rate	10.95%	6.36%	7.52%
(Actual Losses/Disbursements)			

**SBA LOAN LOSS REPORT**

**SECTION II**

**Other Program Costs**

**OTHER PROGRAM COSTS**

Non-recoverable Program Expenses and ColPur Losses -- Definition

Other costs associated with SBA's loan programs include non-recoverable program expenses and losses on ColPur. These additional costs are an incremental factor in the total cost of SBA's credit programs.

Non-recoverable program expenses are those expenses absorbed by the Agency associated with its loan portfolio. These expenses are typically small in nature and classified as non-recoverable in that they are not added to the borrower's indebtedness. Examples include fees for title searches, UCC refile charges and other miscellaneous expenses.

The term "ColPur" represents pledged collateral, the title to which is held by the Agency following borrower 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. An agreed-upon value is assigned to the collateral and the borrower's indebtedness is reduced accordingly. The second method is through outright purchase of the property. Upon borrower default on a loan, the collateral is auctioned off at a sale. SBA issues a protective bid on the property that, if not outmatched, effectively results in SBA buying out all prior lien-holders and assuming title to the property.

This collateral is not held indefinitely. The Agency sells off the collateral, recovering what it can from the sale. In cases where the amount recovered is less than what the Agency paid or compromised the property for, a loss on ColPur is recognized.

These costs are summarized for FY 1997 on the following pages.

<p align="center"><b>Other Program Costs:</b>  <b>Total Non-Recoverable Expenses and Net Losses on ColPur in FY 1997</b></p>
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	* Gen. Business	Local Dev	SBIC	Disaster	Total
<b>Total Non-Recoverable Expenses</b>	(\$8,156)	\$44,956	\$2,624	\$224,599	\$264,023
<b>GAINS</b>					
Gain on Sale of ColPur	\$6,697,784	\$328,999	\$5,345	\$642,482	\$7,674,610
Income Earned on Assets Acquired	\$6,000	\$0	\$0	\$0	\$6,000
Gross Gains on ColPur	\$6,703,784	\$328,999	\$5,345	\$642,482	\$7,680,610
<b>LOSSES</b>					
Loss on Sale of ColPur	\$26,521,845	\$1,819,648	\$1,984,032	\$2,314,316	\$32,639,841
Expenses Incurred on Assets Acquired	\$38,002	\$0	(\$11,782)	(\$8,760)	\$17,460

Gross Losses on ColPur	\$26,559,847	\$1,819,648	\$1,972,250	\$2,305,556	\$32,657,301
Net Gain (Loss) on ColPur	(\$19,856,063)	(\$1,490,649)	(\$1,966,905)	(\$1,663,074)	(\$24,976,691)
Total Additional Program Costs	\$19,847,907	\$1,535,605	\$1,969,529	\$1,887,673	\$25,240,714

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

## 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, Guaranteed or Immediate Participation), the disbursement of monies is made by SBA, the participating lender or both.

### 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.

### Non-Recoverable Program Expenses

Expenses absorbed by the Agency associated with its loan portfolio, such as title search fees and UCC refile charges. These expenses are typically small in nature and classified as nonrecoverable in that they are not added to the borrower's outstanding indebtedness. Normally, loan expenses are added to the borrower's balance, as they are recoverable against the borrower's account.

### Other Receivables

This term refers to two different types of note receivable. The first is a note that is set up against ColPur, while the other is a note set up against the borrower. Defaults on the former are included

in the charge-off figure whereas the latter are not since they are considered a separate and distinct debt from the original loan.

### Recoveries

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