

INTRODUCTION TO THE LOSS REPORT

The FY 1998 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 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.

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 Rates are determined by the Headquarters program offices 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 less than 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; also, 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. The program is designed to promote small business formation and growth by guaranteeing long-term loans 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 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, which 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 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 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). Such 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, 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 assist 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 1997	\$5,521,172,814	\$69,957,435,800	\$75,478,608,614
FY 1998	\$50,000	\$5,704,733,640	\$5,704,783,640
Cumulative Disbursements	\$5,521,222,814	\$75,662,169,440	\$81,183,392,254
Charged Off Loans			

Balance as of 1997	\$1,097,466,206	\$5,036,409,987	\$6,133,876,193
1998 Loan Principal	\$7,468,420	\$248,558,978	\$256,027,398
1998 Judgment Principal	\$307,237	\$4,337,749	\$4,644,986
1998 Other Receivables	\$1,060,653	\$3,066,276	\$4,126,929
Cumulative Charged Off Loans	\$1,106,302,516	\$5,292,372,990	\$6,398,675,506
Recoveries			
Balance as of 1997	\$60,932,229	\$205,633,482	\$266,565,711
FY 1998	\$2,096,276	\$22,418,752	\$24,515,028
Cumulative Recoveries	\$63,028,505	\$228,052,234	\$291,080,739
Actual Net Losses			
Cumulative Charged Off Loans Net of Cumulative Recoveries	\$1,043,274,011	\$5,064,320,756	\$6,107,594,767
Actual Loss Rate	18.90%	6.69%	7.52%
(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.

An adjustment has been made to the opening disbursement balance to account for missing historical data and rounding differences.

Development Company Loans	Direct/IP	Guaranteed	Program Total
Disbursements			
Balance as of 1997	\$696,140,948	\$8,829,737,389	\$9,525,878,337
FY 1998	\$0	\$1,489,667,189	\$1,489,667,189
Cumulative Disbursements	\$696,140,948	\$10,319,404,578	\$11,015,545,526
Charged Off Loans			
Balance as of 1997	\$189,213,762	\$142,048,156	\$331,261,918
1998 Loan Principal	\$727,361	\$26,193,566	\$26,920,927
1998 Judgment Principal	\$0	\$202,165	\$202,165
1998 Other Receivables	\$466,806	\$62,200	\$529,006
Cumulative Charged Off Loans	\$190,407,929	\$168,506,087	\$358,914,016
Recoveries			
Balance as of 1997	\$6,873,336	\$5,544,815	\$12,418,151
FY 1998	\$904,672	\$1,016,752	\$1,921,424
Cumulative Recoveries	\$7,778,008	\$6,561,567	\$14,339,575
Actual Net Losses			
Cumulative Charged Off Loans Net of Cumulative Recoveries	\$182,629,921	\$161,944,520	\$344,574,441

Actual Loss Rate	26.23%	1.57%	3.13%
(Actual Losses/Disbursements)			

An adjustment has been made to the opening disbursement balance to account for missing historical data and rounding differences.

Small Business Investment Companies (SBIC)	Direct/IP	Guaranteed	Program Total
Disbursements			
Balance as of 1997	\$798,220,667	\$3,747,005,846	\$4,545,226,513
FY 1998	\$0	\$415,060,000	\$415,060,000
Cumulative Disbursements	\$798,220,667	\$4,162,065,846	\$4,960,286,513
Charged Off Loans			
Balance as of 1997	\$116,161,239	\$325,574,735	\$441,735,974
1998 Loan Principal	\$9,732,862	\$10,371,319	\$20,104,181
1998 Judgment Principal	\$4,649,219	\$1,198,178	\$5,847,397
1998 Other Receivables	\$10,419,946	\$0	\$10,419,946
Cumulative Charged Off Loans	\$140,963,266	\$337,144,232	\$478,107,498
Recoveries			
Balance as of 1997	\$5,120,535	\$42,549,059	\$47,669,594
FY 1998	\$2,742,112	\$109,379	\$2,851,491
Cumulative Recoveries	\$7,862,647	\$42,658,438	\$50,521,085
Actual Net Losses			
Cumulative Charged Off Loans Net of Cumulative Recoveries	\$133,100,619	\$294,485,794	\$427,586,413
Actual Loss Rate	16.67%	7.08%	8.62%
(Actual Losses/Disbursements)			

An adjustment has been made to the opening disbursement balance to account for missing historical data and rounding differences.

Microloan Loans	Direct/IP	Guaranteed	Program Total
Disbursements			
Balance as of 1997	\$55,691,363	\$0	\$55,691,363
FY 1998	\$7,019,132	\$3,350,584	\$10,369,716

Cumulative Disbursements	\$62,710,495	\$3,350,584	\$66,061,079
Charged Off Loans			
Balance as of 1997	\$0	\$0	\$0
1998 Loan Principal	\$0	\$0	\$0
1998 Judgment Principal	\$0	\$0	\$0
1998 Other Receivables	\$0	\$0	\$0
Cumulative Charged Off Loans	\$0	\$0	\$0
Recoveries			
Balance as of 1997	\$0	\$0	\$0
FY 1998	\$0	\$0	\$0
Cumulative Recoveries	\$0	\$0	\$0
Actual Net Losses			
Cumulative Charged Off Loans Net of Cumulative Recoveries	\$0	\$0	\$0
Actual Loss Rate	0.00%	0.00%	0.00%
(Actual Losses/Disbursements)			

All Business Loans	Direct/IP	Guaranteed	Program Total
Disbursements			
Balance as of 1997	\$7,071,225,792	\$82,534,179,035	\$89,605,404,827
FY 1998	\$7,069,132	\$7,612,811,413	\$7,619,880,545
Cumulative Disbursements	\$7,078,294,924	\$90,146,990,448	\$97,225,285,372
Charged Off Loans			
Balance as of 1997	\$1,402,841,207	\$5,504,032,878	\$6,906,874,085
1998 Loan Principal	\$17,928,643	\$285,123,863	\$303,052,506
1998 Judgment Principal	\$4,956,456	\$5,738,092	\$10,694,548
1998 Other Receivables	\$11,947,405	\$3,128,476	\$15,075,881
Cumulative Charged Off Loans	\$1,437,673,711	\$5,798,023,309	\$7,235,697,020
Recoveries			
Balance as of 1997	\$72,926,100	\$253,727,356	\$326,653,456
FY 1998	\$5,743,060	\$23,544,883	\$29,287,943
Cumulative Recoveries	\$78,669,160	\$277,272,239	\$355,941,399

Actual Net Losses			
Cumulative Charged Off Loans Net of Cumulative Recoveries	\$1,359,004,551	\$5,520,751,070	\$6,879,755,621
Actual Loss Rate	19.20%	6.12%	7.08%
(Actual Losses/Disbursements)			

An adjustment has been made to the opening disbursement balance to account for missing historical data and rounding differences.

Disaster Loans	Direct/IP	Guaranteed	Program Total
Disbursements			
Balance as of 1997	\$20,729,813,446	\$39,817,968	\$20,769,631,414
FY 1998	\$592,877,202	\$0	\$592,877,202
Cumulative Disbursements	\$21,322,690,648	\$39,817,968	\$21,362,508,616
Charged Off Loans			
Balance as of 1997	\$1,860,026,615	\$1,936,933	\$1,861,963,548
1998 Loan Principal	\$117,769,769	\$0	\$117,769,769
1998 Judgment Principal	\$1,052,961	\$0	\$1,052,961
1998 Other Receivables	\$898,898	\$0	\$898,898
Cumulative Charged Off Loans	\$1,979,748,243	\$1,936,933	\$1,981,685,176
Recoveries			
Balance as of 1997	\$145,070,264	\$8,805	\$145,079,069
FY 1998	\$9,780,593	\$0	\$9,780,593
Cumulative Recoveries	\$154,850,857	\$8,805	\$154,859,662
Actual Net Losses			
Cumulative Charged Off Loans Net of Cumulative Recoveries	\$1,824,897,386	\$1,928,128	\$1,826,825,514
Actual Loss Rate	8.56%	4.84%	8.55%
(Actual Losses/Disbursements)			

An adjustment has been made to the opening disbursement balance to account for missing historical data and rounding differences.

All Agency Programs	Direct/IP	Guaranteed	Program Total

Disbursements			
Balance as of 1997	\$27,801,039,238	\$82,573,997,003	\$110,375,036,241
FY 1998	\$599,946,334	\$7,612,811,413	\$8,212,757,747
Cumulative Disbursements	\$28,400,985,572	\$90,186,808,416	\$118,587,793,988
Charged Off Loans			
Balance as of 1997	\$3,262,867,822	\$5,505,969,811	\$8,768,837,633
1998 Loan Principal	\$135,698,412	\$285,123,863	\$420,822,275
1998 Judgment Principal	\$6,009,417	\$5,738,092	\$11,747,509
1998 Other Receivables	\$12,846,303	\$3,128,476	\$15,974,779
Cumulative Charged Off Loans	\$3,417,421,954	\$5,799,960,242	\$9,217,382,196
Recoveries			
Balance as of 1997	\$217,996,364	\$253,736,161	\$471,732,525
FY 1998	\$15,523,653	\$23,544,883	\$39,068,536
Cumulative Recoveries	\$233,520,017	\$277,281,044	\$510,801,061
Actual Net Losses			
Cumulative Charged Off Loans Net of Cumulative Recoveries	\$3,183,901,937	\$5,522,679,198	\$8,706,581,135
Actual Loss Rate	11.21%	6.12%	7.34%
(Actual Losses/Disbursements)			

An adjustment has been made to the opening disbursement balance to account for missing historical data and rounding differences.

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 on 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. 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. 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 held only until the Agency can sell it, 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 1998 on the following pages.

Other Program Costs: Total Non-Recoverable Expenses and Net Losses on ColPur in FY 1998
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	* Gen. Business	Local Dev	SBIC	Disaster	Total
Total Non-Recoverable Expenses	\$47,443	\$31,116	\$0	\$0	\$78,559
GAINS					
Gain on Sale of ColPur	\$4,241,458	\$1,073,898	\$67,990	\$918,061	\$6,301,407
Income Earned on Assets					

Acquired	\$0	\$0	\$0	\$0	\$0
Gross Gains on ColPur	\$4,241,458	\$1,073,898	\$67,990	\$918,061	\$6,301,407
LOSSES					
Loss on Sale of ColPur	\$18,547,136	\$2,933,110	\$2,406,961	\$1,701,766	\$25,588,973
Expenses Incurred on Assets Acquired	(\$16,176)	\$0	\$0	\$0	(\$16,176)
Gross Losses on ColPur	\$18,530,960	\$2,933,110	\$2,406,961	\$1,701,766	\$25,572,797
Net Gain (Loss) on ColPur	(\$14,289,502)	(\$1,859,212)	(\$2,338,971)	(\$783,705)	(\$19,271,390)
Total Additional Program Costs	\$14,336,945	\$1,890,328	\$2,338,971	\$783,705	\$19,349,949

*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.