SBA Procedural Notice

TO:	All Employees	**LIMIT NO.:**	5000-1081
SUBJECT:	One Month LIBOR Plus 3 Percent Allowed as SBA Base Rate	**EFFECTIVE:**	11/14/2008

Introduction

Due to the recent, unprecedented disruption in American and International capital markets, in October 2008 the President's Working Group on Financial Markets announced that the U.S. government would initiate a broad range of actions and initiatives designed to stabilize and restore confidence in our financial markets and reestablish a key tenet of continuing American economic growth. As a result, and in consultation and collaboration with the President's Working Group, the U.S. Small Business Administration is initiating several actions designed to support and reenergize the Nation's small business capital markets.

Background

Under SBA's loan guaranty program, greater numbers of small businesses can obtain loans from banks, small business lending companies, credit unions, and other participating financial institutions, because the Agency provides various incentives and risk mitigators to make these loans profitable for lenders. However, the recent turmoil and uncertainty in the financial markets have seriously affected SBA lenders' cost of funds, their ability to sell SBA loans in the Secondary Market, and their liquidity. This has led to severely reduced small business access to capital (including SBA lending) at a critical juncture for the U.S. economy. As a result, the volume of lending under SBA's primary small business lending program (the 7(a) loan program) during October 2008 has dropped almost 50 percent from the same period last year. (SBA approved 7,239 7(a) loans for $1 billion during October 2007 compared to 3,340 loans for $673 million during October 2008.) In addition, the secondary market for SBA-guaranteed loans has been substantially reduced.

Due to the globalization of the financial markets, many SBA lenders' source and cost of funds (and/or internal yield model) is partially or completely based on the London Interbank Offered Rate (LIBOR) rather than the Prime Rate, which traditionally has been SBA's base interest rate for establishing the maximum interest rate lenders can charge for SBA-guaranteed loans. As a result, increasing numbers of lenders use LIBOR as the base rate for their internal business models and for pricing their loans. SBA's requirement for lenders to use the Prime Rate (or SBA's Optional Peg Rate) to price 7(a) loans unnecessarily complicates their business practices and expands their risk, which increases their costs for making such loans.

Historically, LIBOR rates, which are shorter term interbank lending rates, have consistently been about 3 percentage points less than the Prime Rate, which has historically been the lending rate charged by U.S. banks to their best customers. This 3 percentage point differential between many of SBA's lenders' cost of funds and the Prime Rate, which is the basis for SBA's interest rate maximums, has helped SBA lenders to profitably make small business loans. However, due to the recent volatility and uncertainty of the international financial markets, the 3 percent spread between LIBOR and Prime has been greatly reduced, and on some days LIBOR has actually exceeded the Prime Rate. As LIBOR rates more closely approximate the Prime Rate, SBA's lenders cannot profitably make SBA loans based on the Prime Rate. As a result, they have substantially reduced or eliminated their SBA lending in recent months.

Additionally, over 40 percent of SBA loan guaranty dollars are sold into the Secondary Market, which provides a critical and major source of liquidity for leading SBA lenders, particularly non-depository SBA lenders. With the uncertainty in the financial markets, the convergence of Prime and LIBOR rates, and the allowable interest rate charged on SBA loans being based on the Prime Rate, SBA lenders are encountering significant problems with selling their SBA loans on the secondary market. Also, with LIBOR based funds being the source of funds for many secondary market investors, the convergence of LIBOR and Prime Rates has reduced the demand for SBA backed securities. As a result, many lenders are experiencing major liquidity problems and have greatly limited or discontinued their secondary market activities, which has limited their capacity to make SBA loans.

Changes in SBA Regulation and SOP

As a result of these issues, and following discussions with the lending industry, SBA has concluded that allowing lenders to use an adjusted thirty day (one month) LIBOR rate as a base rate for pricing SBA loans will ameliorate several of the factors that are impeding small businesses' access to capital through SBA's guaranteed loan programs. SBA is allowing an adjustment of 3 percentage points to the thirty day (one month) LIBOR rate to reflect the historical 3 percentage point spread between the LIBOR and the Prime Rate and to help reduce the uncertainty and the financial risk to lenders and to secondary market participants.

The Agency has therefore revised its regulation at 13 CFR 120.214(c) and, henceforth, the allowable base rate establishing the maximum interest rate lenders may charge for SBA 7(a) loans will be the following: 1) Prime Rate; 2) Thirty day (1 Month) London Interbank Offered Rate plus 3 percentage points; or 3) Optional Peg Rate. The Prime or LIBOR rate will be that rate which is in effect on the first business day of the month, as identified in a national financial newspaper or newspaper website each business day. SBA publishes the Optional Peg Rate quarterly in the Federal Register. Base Rates will be rounded to two decimal places with .004 being rounded down and .005 being rounded up. These changes are applicable to 7(a) loan applications that lenders may currently have in process, but they are not applicable to loan applications that have already been received by SBA.

Lenders should note that SBA's maximum 7(a) interest rates continue to apply to SBA base rates: Lenders may charge up to 2.25 percent above the base rate for maturities under seven years and up to 2.75 percent above the base rate for maturities of seven years or more, with rates 2 percent higher for loans of $25,000 or less and 1 percent higher for loans between $25,000 and $50,000. (Allowable interest rates are slightly higher for SBAExpress loans.)

Attachment 1 provides the specific revisions to SOP 50 10(5), Subpart B, Chapter 3, Paragraph 4, which are effective with this notice.

Changes in SBA's Management Information Systems and Secondary Market Process

SBA's management information systems have been modified to accommodate this change. Lenders will thus be required to indicate on their completed Form 4-I, Form 1920 SX, Form 2276, and/or Form 2301, and in any E-Tran 7(a) loan applications whether the applicable interest rate is based on Prime, LIBOR or the Optional Peg Rate. In using E-Tran, lenders should be aware that SBA's online E-Tran process will be immediately available to accommodate the addition of LIBOR. However, lenders using the E-Tran file transfer facility will be unable to shift to the LIBOR base rate until their file transfer software vendors complete required programming changes. SBA has been in touch with these vendors and, while these changes will be forthcoming, lenders will need to coordinate with their respective vendors to determine a firm delivery date.

In reporting interest rate information to SBA on the above referenced forms or through E-Tran, if the interest rate is based on Prime, the lender must specify the applicable Prime Rate as of the first of the month, the applicable spread above Prime, and the applicable loan interest rate to the borrower.

If the interest rate is based on LIBOR, the lender must specify the applicable LIBOR rate as of the first of the month plus three percentage points, which will represent the base rate. The lender must then specify the applicable spread above the adjusted LIBOR base rate and the applicable loan interest rate to the borrower.

If the interest rate is based on SBA's Optional Peg Rate, the lender must specify SBA's latest applicable quarterly Peg Rate, the applicable spread above the Peg Rate, and the applicable loan interest rate to the borrower.

SBA is working with Colson Services, SBA's Fiscal and Transfer Agent, to facilitate the purchase and/or sale of LIBOR based SBA backed loans on the secondary market. We are in the process of revising SBA Form 1086 to accommodate a LIBOR base rate. We are also revising the 2009 version of SBA's Loan Authorization to accommodate a LIBOR base rate. It will be available November 17, 2008 at:
http://www.sba.gov/aboutsba/sbaprograms/elending/authorizations/index.html. Lenders are urged to download and reinstall this latest version of the 2009 Authorization.

For questions concerning this notice, please contact Charles Thomas at (202) 205-6656 or charles.thomas@sba.gov or Gail Hepler at (202)205-7530 or gail.hepler@sba.gov.

Grady B. Hedgespeth
Director
Office of Financial Assistance

Attachment 1
Modifications to SOP 50-10(5), Subpart B, Chapter 3, Paragraph 4 (Pages 145-151)

4. INTEREST RATES

a. General Policy on Interest Rates (13 CFR 120.213; 120.214; 120.215)

(1) …

…

(4) A loan may have a fixed or variable interest rate. For loans with a variable interest rate, the following terms must be defined:

(i) Base Rate:

(a)_For standard 7(a), CLP and PLP loans, there are three acceptable base rates:

1. the Prime Rate;
2. the Thirty day (1 Month) London Interbank Offered Rate (LIBOR) plus 3 percentage points; or
3. the SBA Optional Peg Rate.

The Prime or LIBOR rate will be that rate which is in effect on the first business day of the month, as identified in a national financial newspaper or newspaper website each business day. SBA publishes the Optional Peg Rate quarterly in the Federal Register. Base Rates will be rounded to two digits with .004 being rounded down and .005 being rounded up.

(b) …

(5) Reference Chart on Interest Rates

[*The reference chart remains unchanged.*]

NOTE 1: Variable rate loans may be pegged to one of the following: (i) Prime Rate; (ii) Thirty day (1 month) LIBOR plus 3 percentage points; or (iii) SBA Optional Peg Rate.

NOTE 2: …

NOTE 3: SBA Express Loan Program and Pilot Loan Programs (except Patriot Express). For these programs, lenders are authorized to establish their own base rate for variable rate loans, so long as their overall effective rate for these loans does not exceed the Wall Street Journal Prime Rate by 6.5 percentage points for loans of $50,000 or less and by 4.5 percentage points for loans over $50,000 up to $350,000, regardless of the maturity of the loan. (However, the amount of interest SBA will pay to a lender following default is capped at the maximum interest rate for the standard 7(a) loan program.) Lenders may also adjust their interest rates on variable rate loans at their discretion, which could be more frequently than monthly, but the adjustment must be consistent with the frequency of their adjustments for similar non-SBA guaranteed loans. Loans with interest rate adjustments more frequently than monthly or with base rates other than the base rates allowed by 13 CFR 120.214(c) cannot be sold on the Secondary Market.

b. Base Rate, Allowable Spread, and Allowable Variance for Small Loans (13 CFR 120.214)

(1) A loan may have a variable interest rate. The base rate may be one of the following:

(i) Prime Rate:

(ii) Thirty day (1 month) LIBOR plus 3 percentage points; or

(iii) SBA Optional Peg Rate.

…

g. SBA Express Interest Rate Policy

(1) …

(2) For variable rate loans, an SBA Express lender is not required to use the base rate identified in 13 CFR 120.214(c). It may use the same base rate of interest it uses on its similarly-sized non-SBA guaranteed commercial loans, as well as its established change intervals, payment accruals, etc. However, the interest rate throughout the term of the loan may not exceed the maximum allowable SBA Express interest rate and the loan may be sold on the Secondary Market only if the base rate is one of the base rates allowed in 13 CFR 120.214(c).

…

h. Pilot Loan Programs Interest Rate Policy

(1) Patriot Express Loans

(i) …

(iii) For variable rate loans, a Patriot Express lender is not required to use the base rate identified in 13 CFR 120.214(c). It may use the same base rate of interest it uses on its similarly-sized non-SBA guaranteed commercial loans, as well as its established change intervals (including intervals more frequently than monthly), payment accruals, etc. However, the interest rate throughout the term of the loan may not exceed the maximum allowable Patriot Express interest rate and the loan may be sold on the Secondary Market only if the base rate is one of the base rates allowed in 13 CFR 120.214(c).

(2) Export Express Loans

(i) …

(ii) For variable rate loans, an Export Express lender is not required to use the base rate identified in 13 CFR 120.214(c). It may use the same base rate of interest it uses on its similarly-sized non-SBA guaranteed commercial loans, as well as its established change intervals, payment accruals, etc. However, the interest rate throughout the term of the loan may not exceed the maximum allowable Export Express interest rate and the loan may be sold on the Secondary Market only if the base rate is one of the base rates allowed in 13 CFR 120.214(c).

The subparagraphs not specifically revised above remain unchanged.