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What a rollercoaster ride, but watch out for the next hill.

Small Business Lender Sentiment Survey
On Lending and Employment
Second Quarter 2010

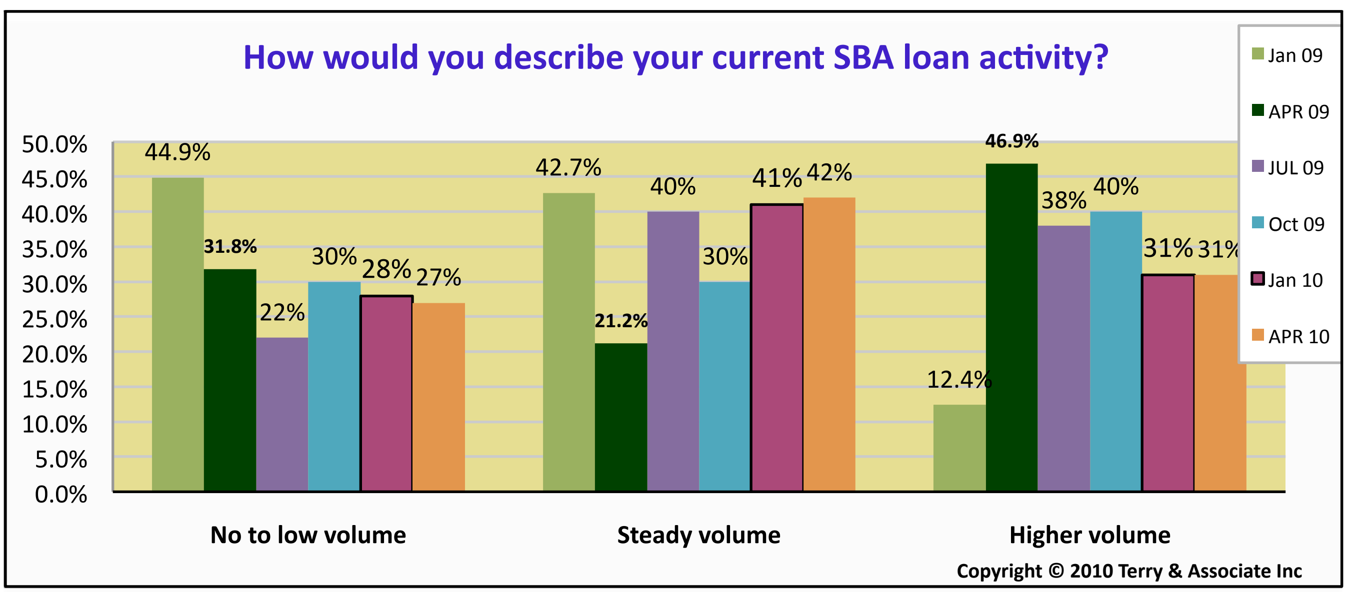
In this issue:

Signs of stabilization: Is it a tick or a trend?
How could credit get any tighter?
SBA lender employment: New hires tempered by more layoffs to come.

There are many reasons to be encouraged about our industry. Industry giants, CIT and Main Street Lenders are finding the capital backing they need for the future. CIT, back from bankruptcy, just secured a Billion Dollar warehouse package and Main Street was just acquired by Capital Source giving these companies the support needed to gain more market share and lending momentum into the future. Far too many other lenders continue to operate on the brink.

Over 1200 lenders have made 16,558 loans this calendar year compared to 8,205 loans the same period last year. Sounds great until you acknowledge 2007, when during the same period over 28,000 loans were made. The secondary market concerns were just about to be forgotten. Then FAS 166 raised its ugly head. Will the SBA make a stand to support lenders and solve this pending change that will set back lending again?

We have come so far, yet so far to go. The rollercoaster has topped the hill and we are enjoying a little reprieve before the next hill. How high and tough will the next hill be and what is it going to take to make it over? Keep reading!



Cautious optimism continues to be the resounding theme in SBA lending circles. With 6 quarters of data collected from these surveys, it would appear that a trend in loan activity is settling in. But, the chart above continues to show ***that the road to recovery is far from over***. When almost a third of survey respondents report "no to low lending volume" it is hard to get too excited about where we are in the journey back to "normal."

There continues to be three main issues affecting the outcome of lending this year. First, will the economy continue a modest amount of improvement or will we have another set back? Even with the amazing recovery in the stock market, which has spawned national optimism, most money managers are declaring that this is the year "to protect principal". There are many huge money funds that have been raised to buy toxic CRE. However, few deals are being done, because the general concensus is that there is more devaluation to come. As discussed below, commercial and SBA credit is actually tighter than it was the same period last year. Credit policy is directly tied to credit quality in existing loan portfolios. And deteriorating credit quality has credit policy tighter than anytime that can be remembered.

The statement has been made that the SBA Stimulus Plan has been more successful in creating and retaining jobs than any other stimulus program of the past year. If this is true and Washington knows it is, why isn't there more Congressional action? If President Obama can get a health care bill past, is it so hard to get new SBA lending initiatives done? Survey respondents declare a larger SBA loan size is a mandate. And if the 90% guaranty is not approved for the calendar year, there are many respondents who say credit will disappear again.

The third issue continues to be troubled lending institutions. In January of this year there were 522 banks on the watch list. Now there are over 850. Many former lenders are working for or are under contract with the FDIC. Most of these are two year contracts. With new capital extremely hard to come by and growing toxic CRE, the words "protracted recovery" gain greater definition.

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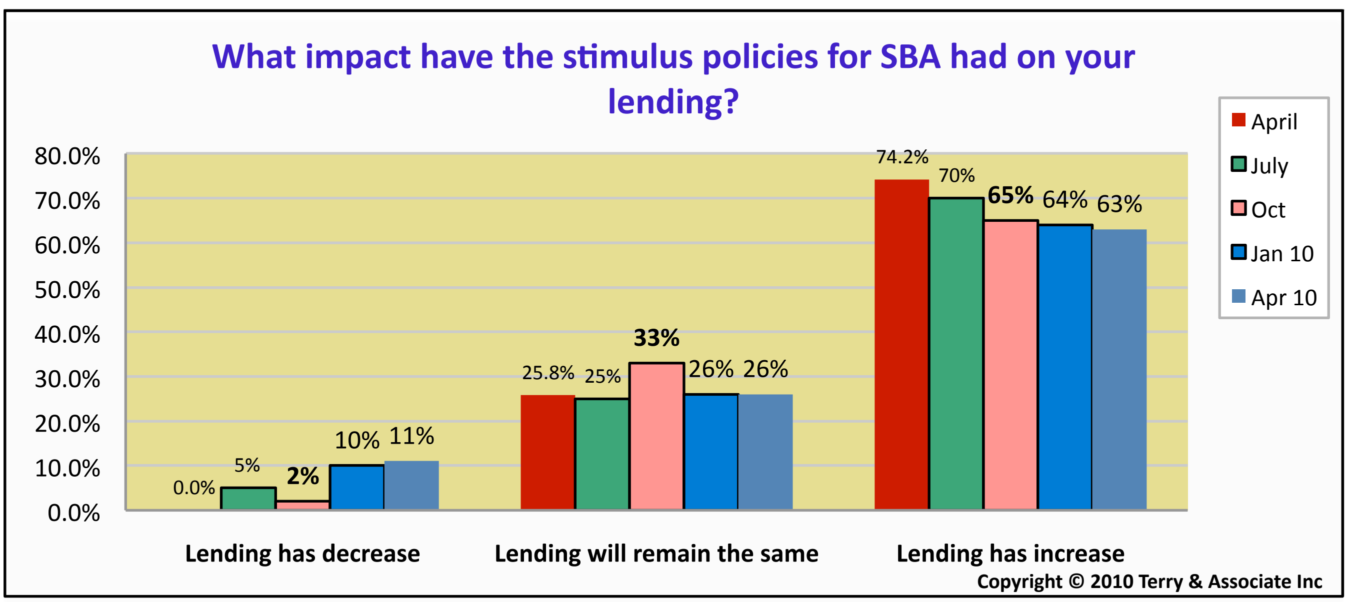

Looking at the past 5 quarters and expectations for a sixth quarter, a definitive statement has been made about the impact of the SBA stimulus programs. No one should mistake the 11% of respondents who report a decrease in lending. It has nothing to do with the SBA stimulus, but rather, the challenges of lack of capital and/or regulatory pressures being faced by these lending institutions.

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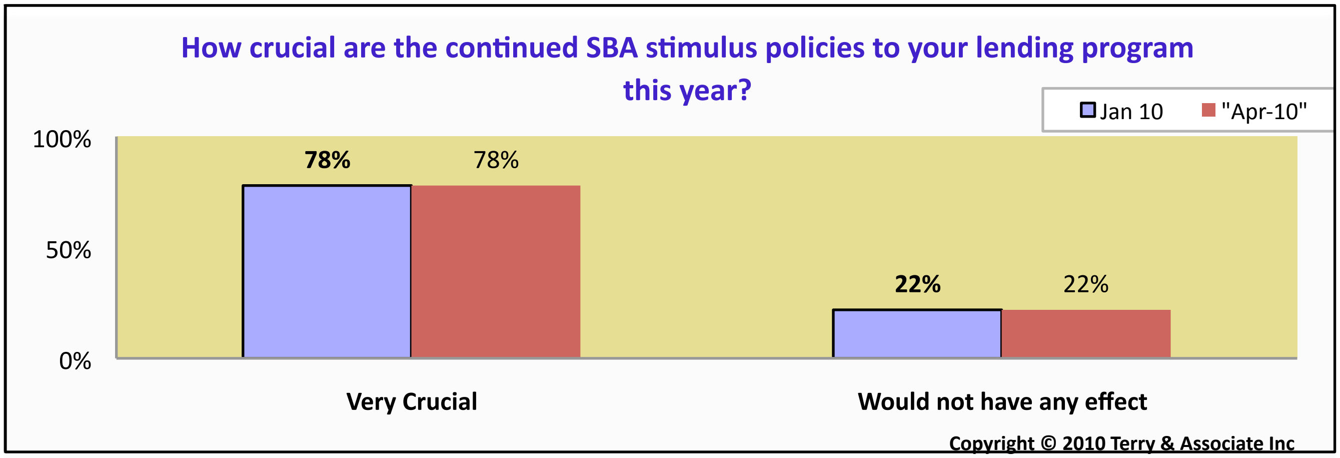
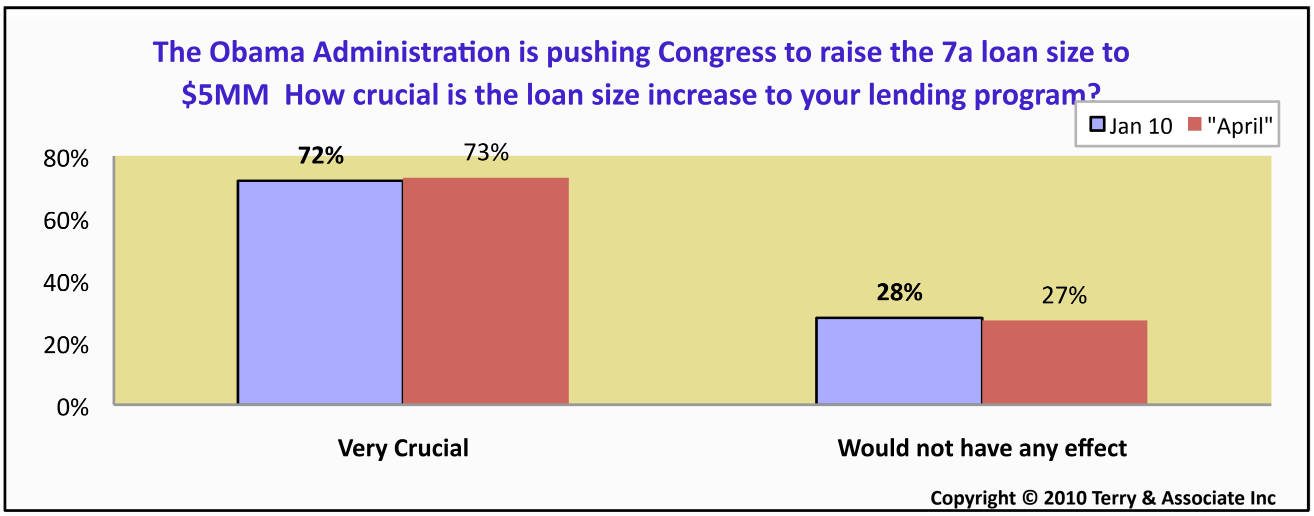


As reported at the beginning of the year, and now going into the second quarter, survey respondents are adamant about the need for continued SBA stimulus policies. Thankfully they have been extended through MAY (if the money doesn't run out). **The answer is to wear the phone out calling your Washington decision makers!**



There is growing doubt that a larger 7a loan will ever materialize. Survey respondents were again strongly in favor. But at this point, continued stimulus policies are the major focus of the many comments received. And, in fact, if the loan size was to be increased, but the 90% guaranty wasn't included, survey responses show a larger loan size would not help.

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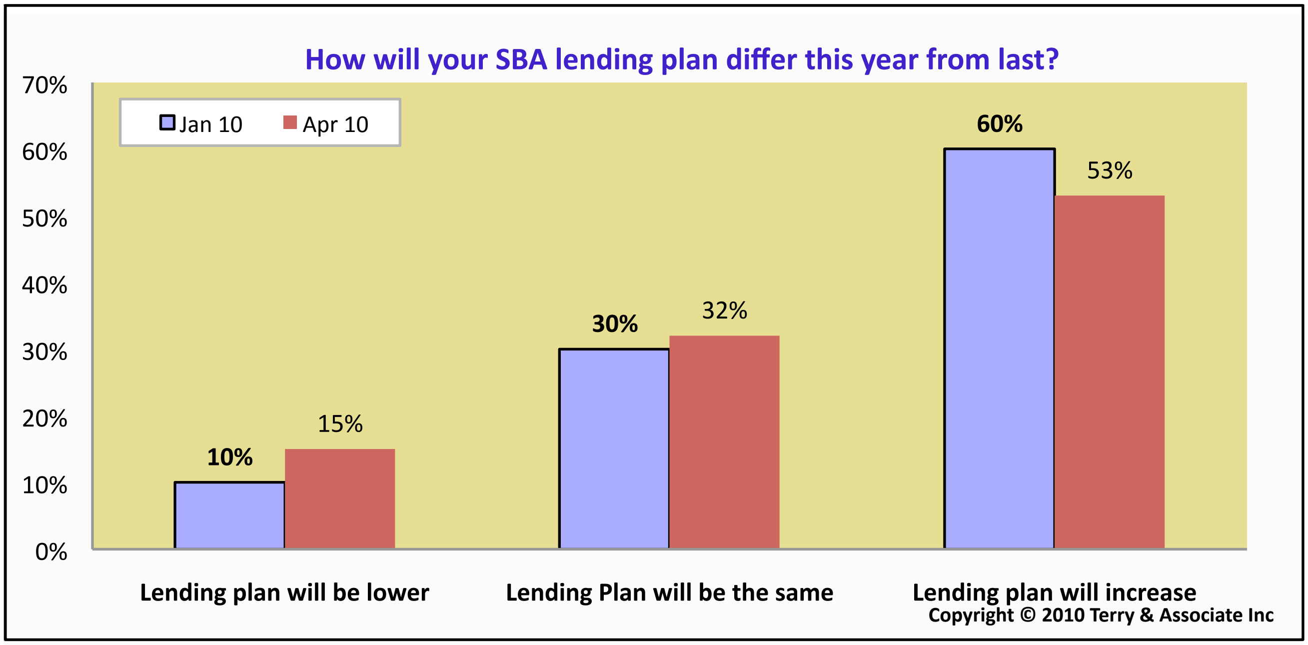
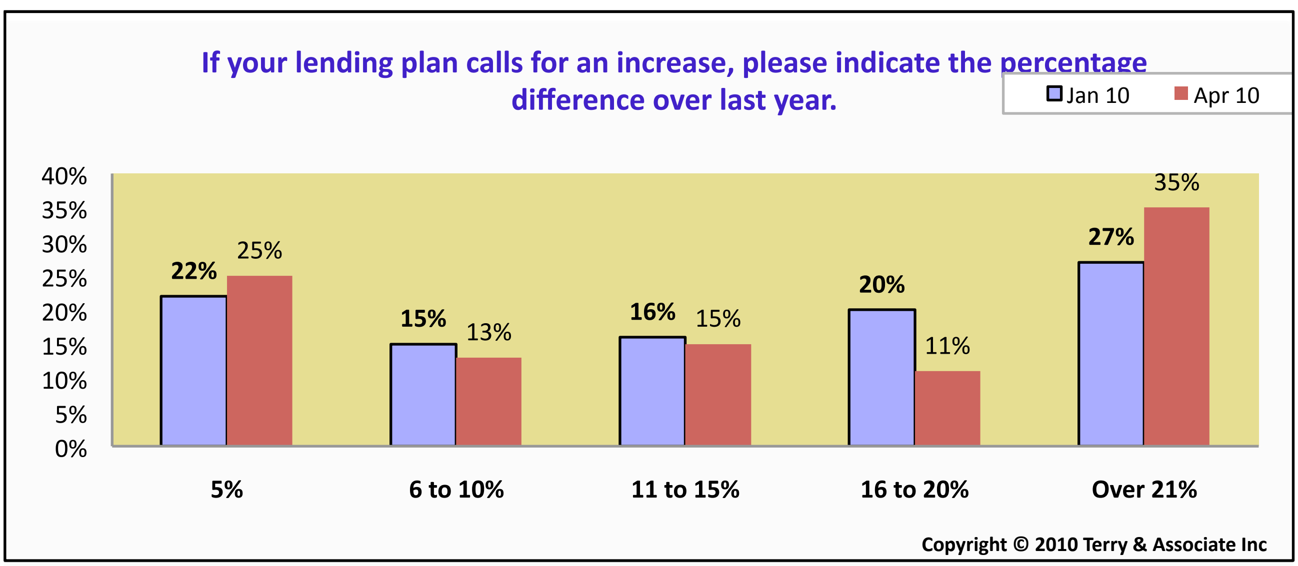
The chart below shows that in the first quarter survey respondents were reporting plans for strong increases in SBA lending over the same period last year. However, that is not saying very much. As mentioned above, the number of SBA loans made by this time last year was only 8205. The same period in 2007, it was over 28000. So, the SBA reports this year the number is an exciting 16558. The only encouragement that can be gained from this is the knowledge that without the SBA stimulus policies, there is little doubt that any loan growth would have occurred.



Wait a minute! Why has lower lending gone up 50%? And, why has there been a 7% decline in those expecting an increase in lending? Comments on this question reveal a number of on-going issues that management had thought would be overcome by now. More on this below under challenges going forward.

And before you get too excited about the 53% of respondents showing an increase, that is still just HALF of all respondents reporting an increase.

Read the chart below. Only 35% of those reporting see better than 20% gains over the previous year. The strong indication here is that the overall growth in SBA lending is coming from the very top producing lenders. The remaining is spread out over 65% of those reporting loan growth, many of which are relatively new to SBA lending.



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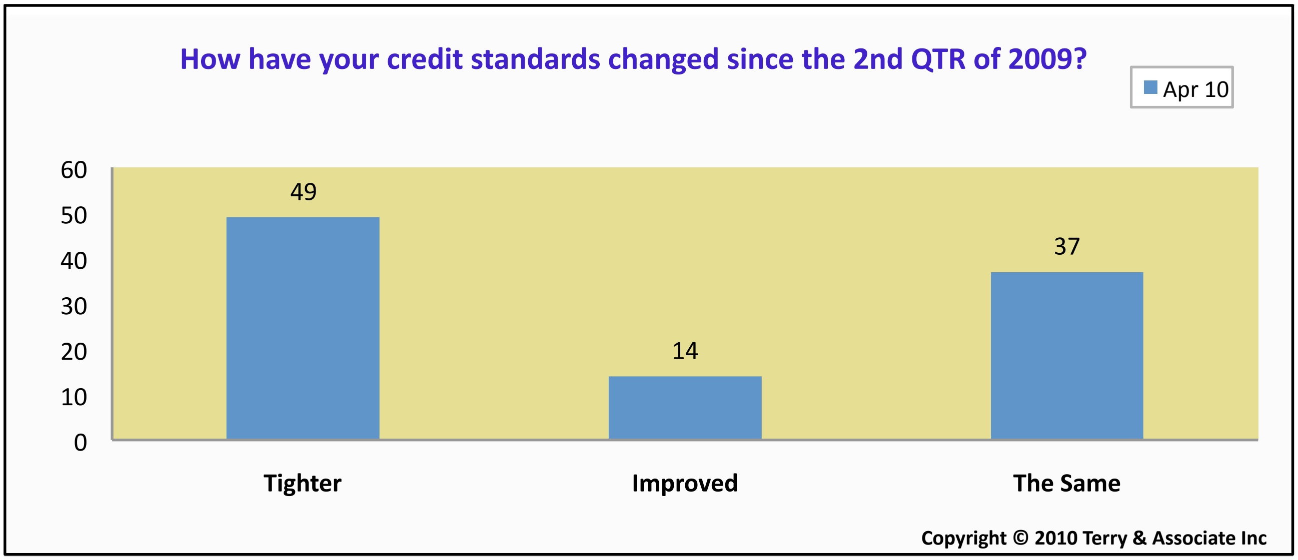

Quite frankly, the response to this question was expected to be **substantially improved**. WOW, what a zinger! Credit this time last year was reported to be as tough as anyone could ever remember. With almost half reporting that credit is even tighter, isn't it amazing that there has been any loan growth.

Comments to this question show the need to stretch every available dollar of capital. And, there is little to no room for under performing loans. Other comments reflect the recognition of a protracted economic recovery and the very real chance of significant inflation sometime during the next few years. Can you spell "stress test." All loan requests going forward will factor in as much as a 2% increase in the interest rate to make sure that these loan applicants can handle the anticipated rate hike.

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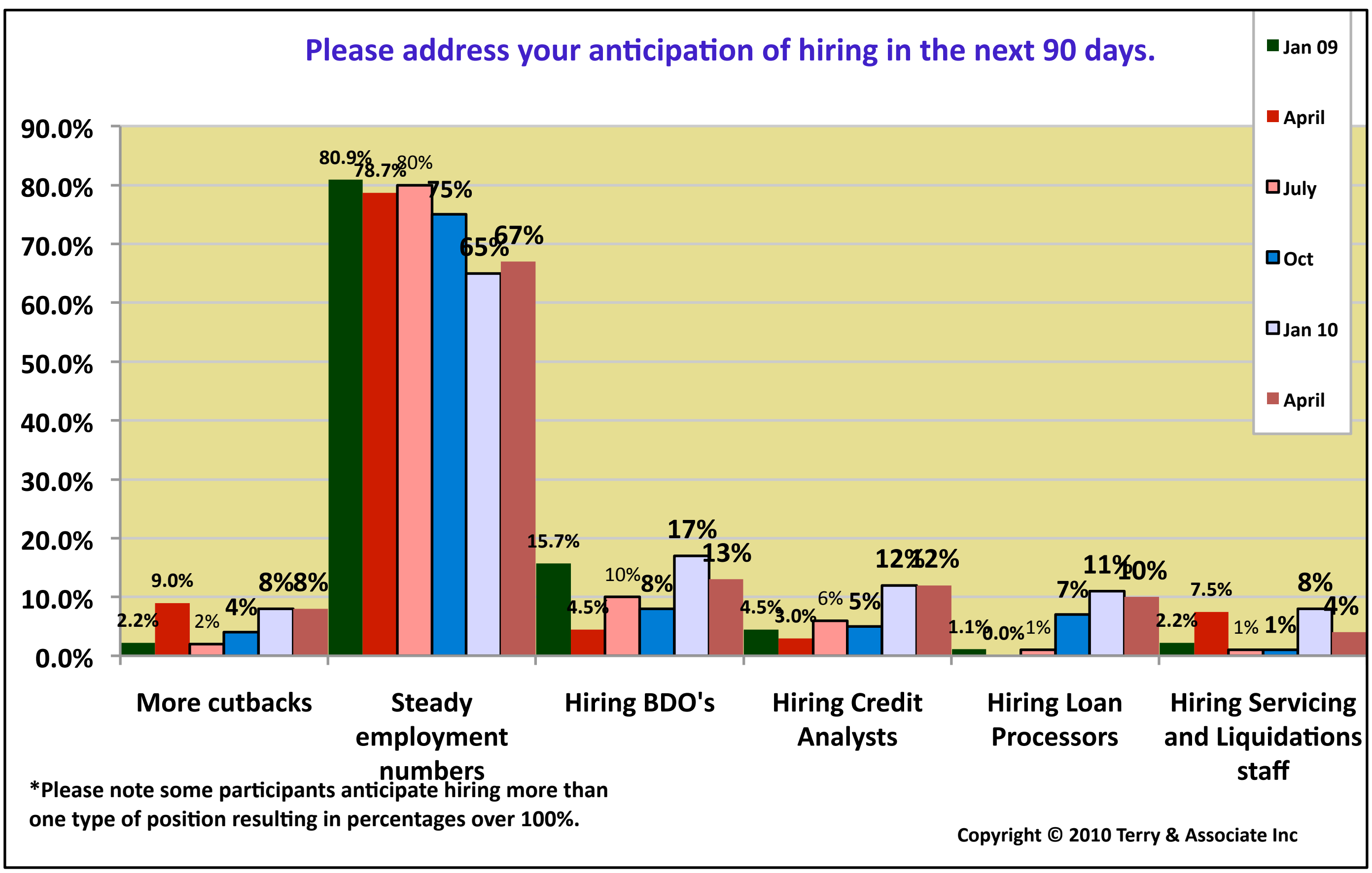

One of the most encouraging signs of recovery is the reported anticipation of new hires. In the past new hires were isolated to hiring some BDO's or servicing staff. Now new hires are anticipated in each of the identified positions above. A decline in "steady employment" is greatly accepted when it means more hiring is forthcoming. However, this has to be tempered with the reality that anticipated cutbacks are about as high as any quarter reported during the 6 quarters that the survey has been taken.

For the past year, those who have been hired have accepted wages at the 1995 level. With a shrinking available talent pool, this practice will not continue much longer. While few expect to see 2007 wage offers, most candidates are expecting realistic and reasonable compensation. This is especially true for BDO's who have been accepting base salaries in the $40's and $50's. Expect to see higher bases yet nothing like was paid in 2006 and 07.

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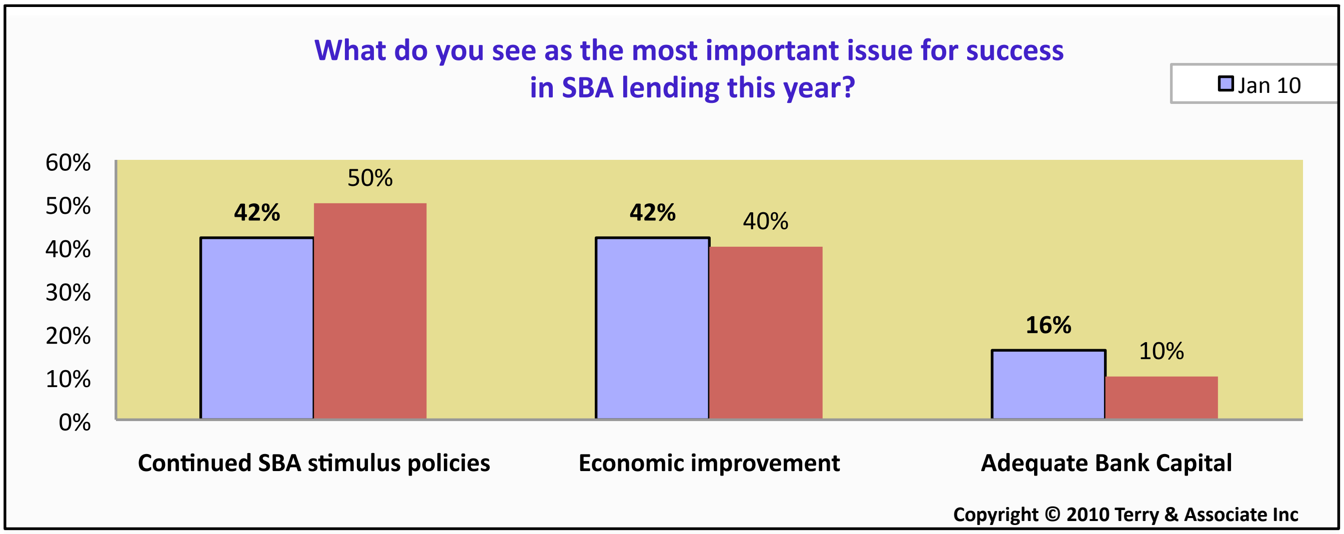
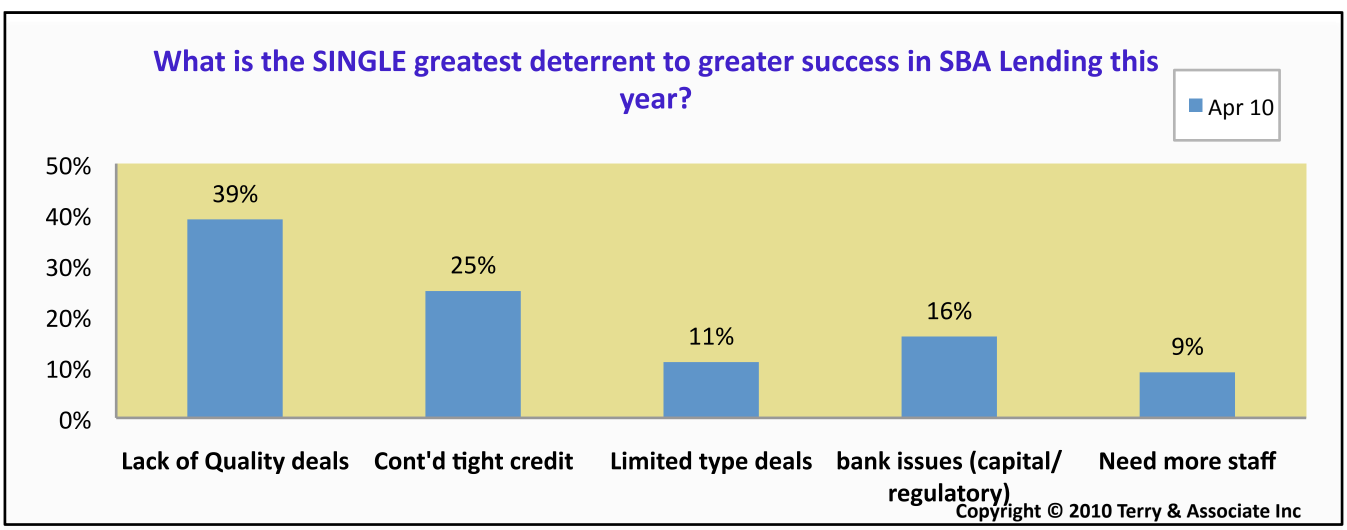


The above chart shows the importance of both a continued improvement in the economy and the continued need for the SBA stimulus policies. In fact, most of the comments received on this question emphatically declared these two factors to be decidedly "most important". Sadly, maintaining adequate capital will plague many lenders this year.



Many respondents wanted to list more than one issue, However, the survey was programmed to allow just one answer to the above choices. Combining the top 2 issues of lack of quality deals and continued tight credit represents 64% of all responses. Bank issues continue to hamper loan growth. The need for more staff is a welcomed sign of recovery even if it represents only 9% of respondents. Thanks goes out to all operations managers who chose this option.

Summary

- The continued SBA stimulus policy is a mandate by lenders. Even though the stimulus has been extended through May, a Congressional decision is needed to extend the policies through the calendar year.
- Even though news reports and the stock market would suggest that the great recession is over, bankers and the Comptroller of the Currency know better. Credit quality and under performing loans are the worse in 25 years. This continues to create a very tight credit policy for new loan requests.
- And with any type of recovery will come an increase in interest rates in the effort to prevent inflation. That will keep in place a very tight credit policy for the next year.
- SBA industry employment looks to make improvements over the next 90 days. However, there has been virtually no change in anticipated cutbacks. Gains from new employment will be offset by cutbacks yielding a possible net gain of zero.

Tim Terry
President
tim@sbasearch.com
940-381-6200

About Terry & Associates, Inc.

Since 1992 Terry & Associates, Inc. has been providing executive search and consulting services to banks and non-banks who provide Small Business Administration (SBA) government guaranteed loans. The company has also set up new SBA lending departments for banks interested in the many incentives and market advantages that SBA lending can provide. Tim is also a frequent speaker on the SBA industry and has testified before Congress on behalf of small business lending.

Terry & Associates, Inc. is publishing a quarterly survey report which offers a national perspective on the status of lending to the small business sector. For more information, contact Tim Terry at 940.381.6200 or tim@sbasearch.com.