

## **July 2011 Wisconsin Bankers**

### **A review of SBA's Portfolio**

Each year since 2000, the U.S. Small Business Administration (SBA) has released statistics on their loan portfolio performance as it relates to default and loss rates. This year's reports show the status as of September 30, 2010 for loans approved and disbursed between 10/1/2000 and 9/30/2010. Currently, the free reports can be accessed at the National Association of Government Guaranteed Lenders website, <http://www.naggl.org>.

The first report examines the combined SBA 7(a) and 504 loan portfolio performance by North American Industry Classification System (NAICS) code. The report looks at each SBA eligible NAICS code with statistically relevant results (10 or more disbursed loans) and provides failure and charge-off rates for each. 1,128 NAICS codes were represented in this year's report with a total of over 675,000 disbursements in the last 10 years. During that period, almost \$145 billion were disbursed for an average loan size of just over \$214,000. With the difficult economic times that small businesses have been experiencing over the last 3 years, default rates and charge-off rates have been on the increase. The default rate for the whole portfolio, which was 8.41% through FY2007, 11.95% through FY2008, and 17.09% through FY2009, has risen to 20.90% through FY2010. Like the default rate, the average charge-off has more than doubled, increasing from 1.19% through FY2007, 1.85% through FY2008 and 2.40% through FY2009 to 3.76% through FY2010.

The statistics also reveal the concentration that SBA has in various NAICS codes. To be expected SBA has a large concentration in the retail and service areas, including Limited and Full Service Restaurants. As a whole, restaurants continue to represent about 8.80% of SBA's total loans and 9.1% of total dollars disbursed. The default rate for the industry was 24.10% through 2010, compared to 11.5% through FY2007, 14.8% through FY2008 and 20.0% through FY2009. The average charge-off for restaurants was 5.28% through 2010 compared to 1.65%, 2.60% and 3.40% respectively in the prior three years.

Other concentrations exist with c-stores, hotels/motels, landscapers and professional service providers, such as dentists, doctors, and lawyers. It is very apparent that some of these industries present more risk than others and these reports can be a helpful tool for a lender working with an industry with which he or she is not familiar. For example, dentist practices are often highly leveraged due to the practice of distributing most of the retained earnings. The current RMA industry average Debt to Worth ratio for Dentists is -24.0 to 1. On the surface, it might appear that a loan to a dentist, so leveraged, might be too risky. However, we gain some additional insights into this industry by reviewing its default and charge-off percentages. Contrary to what might be expected, they currently have a low default rate of 5.55% compared to SBA's portfolio average of 20.90%. Their charge-off rate of 0.83% is also very low compared to the 3.76% average that SBA experiences. It should be noted that dentists have also been impacted by the economic hard times. Back in 2007, the default rates for dentists was 1.87% and the charge-off rate was 0.21%.

The second report narrows the focus somewhat and looks at the combined loan portfolio performance of those businesses that are part of franchise organizations. The 500 plus franchises that SBA lists in this report represents 5.2% of the overall SBA portfolio referenced in the first report and 10.5% of the portfolio dollars. The average default rate for a franchise over the last 10 years is 20.37% compared to 10.8% through FY2007, 13.41% through FY2008, and 17.14% through 2009. The average charge-off rate is currently 3.73 compared to 1.24% through FY2007, 2.01% through FY2008 and 2.69% through FY2009. In the past, both of these rates for franchises have been higher than the portfolio average as a whole. However, it is interesting to note in these most recent reports, that the average default and charge-off rates for franchises are now lower than the SBA's portfolio as a whole. This is significant, since franchises primarily serve retail and service businesses, which have traditionally had higher default and charge-off rates. It points to the beneficial side of franchises, which can offer the structure, guidance, and tools for the small business owner to succeed.

As with the analysis of the portfolio based on the NAICS codes, we are able to see SBA's concentration with various franchises. We can also see that some franchises consistently perform better than others. This information can help the lender identify which franchisors have a sound plan, adequately screen their franchisees and provide quality ongoing support.