



**Date:** March 16, 2010  
**To:** Certified Development Companies  
**From:** Steve Van Order, DCFC Fiscal Agent  
**Subject:** Mar. 2010 SBA 504 Debenture Offering (2010-20C, 10B)

On March 17, 2010, 488 twenty-year debentures totaling \$270,930,000 and 47 debentures totaling \$19,881,000 will be funded through the sale of certificates guaranteed by SBA. Below are debenture pricing details:

Sale/Sale Comparison	Treasury	Swap Spread	Spread	Rate	T plus
<b>2010-20C (03/09/10)</b>	3.696%	4.25 BP	45.15 BP	4.19%	49.4 BP
<b>2010-20B (02/09/10)</b>	3.591%	9.75 BP	45.15 BP	4.14%	54.9 BP
<b>Change</b>	+10.5 BP	-5.50 BP	0 BP	+5 BP	-5.5 BP

Sale/Sale Comparison	Treasury	Swap Spread	Spread	Rate	T plus
<b>2010-10B (03/09/10)</b>	2.337%	27.50 BP	24.80 BP	2.86%	52.3 BP
<b>2010-10A (01/05/10)</b>	2.583%	28.25 BP	30.45 BP	3.17%	58.7 BP
<b>Change</b>	-24.6 BP	-0.75 BP	-5.65 BP	-31 BP	-6.4 BP

- The April offering will consist of *20-year debentures*.
- The *cutoff date* to submit loans to Colson for this offering is Tuesday **March 23**.
- A *request to remove a submitted loan* from a pool must be made through Colson Services by close of business Thursday, **April 1**.
- *Pricing date* is Tuesday **April 6**, on which the debenture interest rates will be set.
- The debentures will be funded on Wednesday, April 14.

In the March offering the spread to treasury on the 20-year debentures was inside of +50 BP for only the fourth time since program inception in 1986. The interest rate on the 10-year debentures set a new all time low. Times like these tend not to last for a protracted period. Much will depend on how soon the Fed takes before the first hike of the Interest On Reserves (IOR) rate. In this time of \$1 trillion excess reserves, the IOR rate, not the Fed funds rate, will be the main interest rate tool the Fed uses in a tightening policy.

The Fed has been steadily unwinding its unprecedented monetary and credit policy easing. By the end of this quarter the Fed will have closed all emergency liquidity facilities, completed the last of \$1.7 trillion in Fed portfolio purchases of government securities and closed the TALF to all but new issue CMBS (that will end in June).

The next phase of the Fed's policy unwind will be large scale operations to fence-in some of the \$1 trillion in excess bank reserves by using reverse repurchases (RRPs) with primary dealers and large money market funds and term deposits with banks. Although there is no evidence that the huge cache of excess reserves is flowing into the money supply, fencing-in excess reserves will help calm any nascent inflation worriers out there.

Assuming these steps go smoothly the next stage will be hikes in the IOR rate. In the prior monetary policy cycle last decade, before the FOMC started hiking the target Fed funds rate off the then-rock bottom low of 1%, it first sent two clear signals via language changes in its post-

meeting statements to set the markets up for the first hike. It makes sense that we will see something like this in this cycle. The first signal would be substitution of new language for the current promise to keep the target rate very low for an “extended period.”<sup>1</sup> The next signal, at a later meeting, would be language communicating the intent to raise the IOR rate in coming months. That signal probably will cause a sharp rise in treasury yields in advance of the first hike.

When might this all happen? In the prior policy cycle the FOMC sent the first signal in January 2004. It then was patient and continued to hold the target Fed funds rate at 1% until there was clear evidence of strong gains in non-farm payrolls. In 2004 the monthly pace of payrolls growth jumped from 100,000 in the winter to 300,000 in the spring and interest rates rose in expectation of a Fed hike. In May the FOMC communicated a hike was coming and in June it made the hike. The FOMC cited improved labor market conditions in the statement announcing that first hike.

This cycle there has been only one month of job gains since January 2008. We’d all love to see just the 100,000 monthly job creation pace that was slow enough to keep the FOMC on the sidelines in winter of 2004. In 2010, barring the rise of the bond vigilantes from the dead, if the labor market does not start showing regular signs of improvement, most on the FOMC will continue to vote in favor of leaving the IOR rate at 0.25% and the Fed funds target range at 0% to 0.25%. That scenario should produce continued low interest rates for 504 borrowers.

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<sup>1</sup> That conceivably could happen at today’s FOMC meeting although I do not expect it.