

7

How Borrower Payments are Applied

General principles used	146
Timing of monthly payments	149
Order in which payments are applied	150
Standard rules for applying payments	151
Details on each payment category	152
Unallocated funds	158
Payment examples	159
Five-year anniversary dates – current vs. non-current	167
A closer look at the last payment	169
Note Amortization vs Debenture Amortization Differences	181

Applying borrower payments

General principles used

It is the CDC's responsibility to see that a borrower is current on 504 Loan payments. Knowing how borrower payments are applied – especially if the borrower falls behind in 504 Loan monthly payments – helps you understand the financial impact to the borrower.

The process of applying a borrower's payment to fees, principal, interest, etc., is referred to as "**Application of Funds.**"

General Principles

1. Accrual accounting method used.

- a. 503 and 504 loan payments are based on an accrual accounting method.
- b. This means that a loan payment is applied to fees, interest and principal that accrued the preceding month.
- c. This also means that a borrower is "current" as of the last day of the previous month.
- d. For example, a borrower's payment made January 4, 2008 brought the loan current through December 31, 2007.
- e. This is important to remember in order to calculate accrued interest due. You will calculate interest that accrues on the actual principal balance.

2. 30-day months used.

- a. All monies are calculated using a standard 30-days, regardless of the actual number of calendar days in the month.
- b. Remember this if you are calculating accrued interest due.

3. The first month's principal and interest payment is different.

- a. The borrower's monthly payment is the same for each month for the first five (5) years.
- b. However, interest accrues for only a partial month – from the day the loan is funded through the 30th of the month – since the loan is funded in mid-month less than 30 days of interest are applied.

Applying borrower payments

General principles used

- c. Therefore, a smaller amount of the first payment is applied to interest and a larger amount is applied to principal in the first month's payment. The *Application of Funds Report* and *504 Note Amortization Schedule* will show this.
4. **Fees decrease every five (5) years.**
 - a. Servicing fees and guaranty fees, which are part of the monthly payment amount, are calculated on the loan's outstanding principal balance at the start of each five (5) year interval.
 - b. Thus, fees will remain the same for a five (5) year period, then decrease for the next five (5) year period as shown on the *504 Note Amortization Schedule*. If the borrower is current at that point the amounts on the 504 Note Amortization Schedule will apply. If the borrower is not current, a new monthly payment amount will be calculated using the actual 504 Note balance at the start of the period.
 5. **Monthly payments decrease every five (5) years.**
 - a. Because fees are based on the outstanding principal balance of the Note at each five (5) year anniversary date, monthly payments decrease every five (5) years.
 - b. Here are two key points to keep in mind:
 - (1) The decrease affects fees accrued **after** the five (5) year anniversary dates only.
 - (2) If a borrower is not current on the 504 Loan or on a catch-up deferment plan at the five (5)-year anniversary date, the servicing fees and monthly payment must be recalculated by COLSON based on the **actual** principal balance at the 504 Loan's five (5)- year anniversary date. This means the borrower will pay higher fees for the entire next five (5) year period compared to the original *504 Note Amortization Schedule*.

Timing of monthly payments

Table 7-1: Monthly Debit Timetable

Monthly Debit Timetable	Debit Action
1st business day of the month	Borrower payment is due.
2nd business day through the 15th calendar day of the month	Borrower can wire payment to remain current if ACH rejects
16th calendar day of the month	Late fee is added if: <ul style="list-style-type: none"> • Monthly payment is not received, or • Partial payment is not enough to bring the loan current.
30th calendar day of the month or last business day if the 30th is not a business day	If the correct monthly payment is received: <ul style="list-style-type: none"> • Borrower is current • Late fee is still owed if the payment was received after the 15th or the amount received did not bring the 504 Loan current

The order in which payments are applied

Here is the order in which funds are applied when the borrower is current on 504 Loan payments and also when the borrower is **not current** on 504 Loan payments:

Table 7-2: Order in Which Payments Are Applied	
When the borrower is current	When the borrower is not current
1st SBA Guarantee Fee	1st Due from [Name of the Borrower] Receivable for the SBA Guarantee Fee applied in one-month increments until satisfied.
2nd CSA Servicing Fee	2nd Due from [Name of the Borrower] Receivable for the CSA Servicing Fee applied in one-month increments until satisfied.
3rd CDC Servicing Fee	3rd Due from [Name of the Borrower] Receivable for the CDC Servicing Fee applied in one-month increments until satisfied.
4th Interest	2nd SBA Guarantee Fees paid in one (1) month increments until current.
5th Principal	4th CSA Servicing Fees paid in one (1) month increments until current.
	5th CDC Servicing Fee paid in one (1) month increments until current.
	3rd Interest paid in one (1) day increments until current.
	4th Principal paid until the <i>504 Note</i> balance matches the <i>504 Note Amortization Schedule</i>
	5th Late Fee paid in one (1) month increments until current.
	6th Unallocated funds (reserve).

Note: The SBA Guarantee Fee applies only to loans approved after October 13, 1995.

Standard rules for applying payments

Table 7-3: Standard Rules for Applying Payments	
Sequence	How Payment is Applied
(1)	<p>Borrower Receivable</p> <ul style="list-style-type: none"> • Applied in one (1) month increments until satisfied • Order in which monies are applied → If not enough to satisfy, the balance is applied to the next fee. <ul style="list-style-type: none"> • SBA Guarantee Fee • CSA Servicing Fee • CDC Servicing Fee
(2)	<p>Current Month's Fees</p> <ul style="list-style-type: none"> • Applied in one (1) month increments until satisfied • Order in which monies are applied: → If not enough to satisfy, the balance is applied to the next fee. <ul style="list-style-type: none"> • SBA Guarantee Fee • CSA Servicing Fee • CDC Servicing Fee
(3)	<p>Interest</p> <ul style="list-style-type: none"> • Determine interest required • If amount available satisfies interest required, balance is applied to the principal. • If amount available does NOT satisfy interest required; then: <ul style="list-style-type: none"> • Calculate the daily interest • Calculate the number of full days that interest can be paid • Apply balance available for interest to the number of full days that interest that can be paid; then - • If balance is left, the balance is applied to the principal.
(4)	<p>Principal</p> <ul style="list-style-type: none"> • Balance fully applied to reduce the principal balance. • Balance applied until it matches the <i>504 Note Amortization Schedule</i>. At this point the loan is current; then - • If a balance is left after the loan is brought "current," the balance is applied to late fees.
(5)	<p>Late Fee</p> <ul style="list-style-type: none"> • Assessed if no payment is received by the 15th or if insufficient payment is received. • Applied in one (1) month increments; then - • If there is not enough to satisfy the late fee, the balance goes to the Unallocated Funds (reserve)
(6)	<p>Unallocated Funds (reserve)</p> <ul style="list-style-type: none"> • Monies available if there is a balance after all other payment categories are satisfied; or • If the balance was insufficient to satisfy the late fee, those monies will be held here.

Details on each payment category

Due from [Name of Borrower] Receivables

Due from [Name of Borrower] Receivables

Fees are advanced by COLSON on the second business day of the month. If the ACH rejects or if a borrower's check is not good, COLSON sets up a "Due from [Name of Borrower] Receivable account for the fees that were advanced on the monthly payment.

- The next monies received from the borrower will be applied **first** to these receivables.
- Monies are applied in one (1) month increments until all receivables are fully paid before any payment is available to be applied to fees for the current month, interest, principal and late fees.
- If the payment is sufficient to fully satisfy this receivable, any balance is applied to the next category.

Is a CDC ever obligated to pay back a servicing fee advanced by COLSON but never paid by the borrower?

Yes. If a loan is transferred to SBA for servicing or is accelerated, and a Due from [Name of Borrower] Receivable is outstanding for CDC servicing fees, the outstanding CDC servicing fee is deducted from the CDC servicing fee payments in the next check COLSON sends to the CDC after the loan has been transferred or the CDC can remit a check for the amount due.

Will COLSON advance servicing fees for two or more consecutive months?

If the borrower is still on ACH, COLSON will advance servicing fees the second month when the ACH debit rejected the previous month. If the debit rejects the second month, the borrower is automatically removed from ACH and must wire his/her payment.

The CDC can notify COLSON of special circumstances that might warrant not removing the borrower from ACH payments. In this case, a third payment could be advanced.

Details on each payment category

Interest applied when a borrower is not current

Interest applied when a borrower is not current

After a payment is applied to current month's fees and the payment satisfies these fees, the balance is applied next to interest.

- Interest required to become current is based on the actual note balance and is applied in one (1) day increments.
- It is applied until interest is current.
- Use the following steps to calculate the interest.
 1. Determine the interest required. Multiply the actual principal balance times the Note interest rate divided by 360 times equals the daily interest rate [the number of days interest is due.]

Remember: Accrual accounting uses 30-day months. Unless a previous payment satisfied only part of the interest due, the number of days of interest due will typically be in increments of 30 days.

2. If the balance available to be applied to interest is greater than the interest required in step 1 above, the interest is brought current and you can move on to the next application of funds – applying the balance to the principal.
3. If the balance available to be applied to interest is less than the interest required in step 1 above, you must then determine how much of the balance available can be applied to interest since interest can be applied in full days only. You begin by calculating how many full days of interest can be paid.
4. Once you calculate the number of full days of interest that can be paid, multiply the number of full days of interest that can be paid times the daily interest rate. This will give you the amount of the payment that will be applied to the interest.
5. Subtract the amount of the payment that will be applied to the interest from the monies available to be applied to the interest. If there is a balance after this calculation, the balance is applied to the principal.

Details on each payment category

Calculation for interest applied when a borrower is not current

Calculation for interest applied when a borrower is not current

Example:

Actual Principal Balance:	\$345,110.56
504 Note Rate:	7.045%
Number of days of interest due:	60
Balance available for interest:	\$3,264.50

- **Interest Required** = Actual Principal Balance x 504 Note rate ÷ 360 x number of days

$$\$345,110.56 \times .07045 \div 360 \times 60 = \$4,052.17$$

Is the balance available for interest sufficient to fully pay the interest required?

- If yes, the interest is brought current and you can move on to the next application – reduction of the principal.
- If no, then determine the amount that can be applied to the interest. This requires the next three calculations.
- **Daily Interest** = Interest Required ÷ number of days of interest due

$$\$4,052.17 \div 60 = \$67.54$$

- **Number of Days of Interest that can be Paid** = Balance available to be applied to interest ÷ Daily Interest (round DOWN to a full day)

$$\$3,264.50 \div \$67.54 = 48.33 \text{ Round DOWN to } 48$$

- **Amount Applied to Interest** = Number of Days of Interest that can be Paid x Daily Interest

$$48 \times \$67.54 = \$3,241.92$$

Amount Available for Interest	\$3,264.50
Amount Applied to Interest	<u>\$3,241.92</u>
Balance Available to be Applied to the Principal	\$ 22.58
Interest Required	\$4,052.17
Interest Applied	<u>\$3,241.92</u>
Accrued Interest Outstanding	\$ 810.25 (12 days of interest)

Details on each payment category

Calculation for interest applied when a borrower is not current

Should our CDC calculate accrued interest due and give this information to the borrower?

To avoid the risk of giving your borrower the wrong information, it may be wise to check the loan detail feature on the COLSON web site or ask COLSON to prepare a “work-up” on a loan when the borrower owes accrued interest.

If a Borrower plans to wire a payment on a certain date, the Colson Customer Service Representative can tell you what information is needed to accurately calculate the amount due.

A CDC can generate the work-up using the COLSON website. If you are unfamiliar with the COLSON website and need technical assistance you may talk to your COLSON Customer Service Representative

Details on each payment category

Calculation for principal applied when a borrower is not current

Remember: Principal is applied until the actual *504 Note* balance matches the *504 Note Amortization Schedule*.

Calculation for the amount applied to the principal when a borrower is not current

- **Principal required to become current** =

Principal balance from the *504 Note Amortization Schedule* - Actual Principal Balance

- **Balance available for principal to bring the loan current** =

Balance available for principal - Principal required to become current

- If this is a **positive** number, the principal is brought current and you can move on to the next application – the reduction of the late fees in one (1) month increments.
- If this is a **negative** number, the payment was insufficient to bring the loan current.

Details on each payment category

Calculation for late fees

Calculation for late fees

The amount of the late fee is the **greater of \$100 or 5% of the monthly payment** on any note edition dated August 1985 or after. You may note that in some states, the state law sets a lower rate, however the 504 loan fee is set by Federal law.

Example:

<u>Monthly Payment</u>	<u>Late Fee at 5%</u>	<u>Late Fee at \$100</u>
\$3,785.00	\$189.25	\$100
\$ 378.50	\$ 18.93	\$100

How do late fees affect the borrower’s application of funds?

Late fees are always applied last. First, all amounts owed must be brought current. This is true even if a late fee was assessed prior to the accruals or assessed in a prior month.

What if late fees are paid between the 16th and the end of the month? Also, what if late fees are not paid in the month in which they are assessed?

Late fees may be paid at any time. Late fees are applied last and only if the borrower is current.

Can a late fee owed be partially paid?

No. A partial payment on a late fee cannot be made unless the CDC waives the remaining amount.

For example, if the borrower owes \$189.25 in a late fee and the amount available from the borrower’s payment that can be applied to late fees is \$125.00, then no late fee is applied.

- The *Application of Funds Report* will show \$125.00 in “Difference to Escrow Account.”
- The *Status of Portfolio Report* will show \$189.25 in late fees due.

Note: For more information on late fees refer to Chapter 5.

Details on each payment category

Calculation for unallocated funds – 504 loans

Calculation for unallocated funds – 504 loans

The unallocated funds account is used for any balance received that has not been applied. You will see various titles that refer to this account. With 504 loans, **Escrow** or **Escrow/Reserve** or **Difference to Escrow Account** or **Unallocated Funds** are all the same account and mean the same thing.

- If a balance is left after a borrower makes a payment and all amounts the borrower owes are satisfied, the balance is placed in this account.
- Monies are placed in this account only **after** the principal is brought current.
- If a payment made satisfies everything but the late fees, remember that late fees can only be paid in one (1) month increments. If the balance available for late fees is not enough to satisfy a monthly late fees, the balance available will be placed in the “Unallocated Funds” account and the late fee will remain outstanding.

What action should the CDC take if there are monies in Unallocated Funds?

The most common reasons monies are in this account are that the borrower:

- Is not on ACH and did not reduce the payment to match the five (5) year reduction on the anniversary date. Colson automatically adjusts the amount for loans on ACH.
- Did not send a payment large enough to close out a late fee.
- Is in arrears and sent in more than was needed to satisfy all payments due.

The CDC should look into and understand why there are monies in this account. Talk to a COLSON Customer Service Representative if you need assistance.

If there is a balance in this account because the borrower did not send a payment large enough to close out the late fee, either waive the remaining difference or notify the borrower. Instruct the borrower to send in the balance of the late fee due. A late fee payment may be sent by check as it does **not** have to be wired. See Chapter 5.

If there is a balance in this account for any other reason and the borrower is current, the CDC may instruct COLSON to return the balance to the borrower. This request must be in writing.

Payment examples

Background information for payment examples

Note Amortization Schedule for Payment Examples

COLSON SERVICES CORP

AMORTIZATION SCHEDULE (FFLD220C)

MONTHLY/5 YRS

BWR:	ACE REAL ESTATE, LLC	AMT:	374,000.00	1-5	3,407.49
OC:		RATE:	8.091%	6-10	3,374.21
ISS:	May 13, 2007	ESC:	3142.57	11-15	3,325.30
ID #:	01001 9876544000 CDC NAME	TERM:	20 YEARS	161-20	3,252.09

MONTH	YR	NO	INTEREST	PRINCIPAL	BALANCE	SBA	CDC	CSA	PAYMENTS
JUN	07	1	1,681.13	1,461.44	372,538.56	38.96	194.79	31.17	3,368.53
JUL	07	2	2,511.84	630.73	371,907.83	38.96	194.79	31.17	3,368.53
AUG	07	3	2,507.59	634.98	371,272.85	38.96	194.79	31.17	3,368.53
SEP	07	4	2,503.31	639.26	370,633.59	38.96	194.79	31.17	3,368.53
OCT	07	5	2,499.00	643.57	369,990.02	38.96	194.79	31.17	3,368.53
NOV	07	6	2,494.66	647.91	369,342.11	38.96	194.79	31.17	3,368.53
DEC	07	7	2,490.29	652.28	368,689.83	38.96	194.79	31.17	3,368.53
JAN	08	8	2,485.89	656.68	368,033.15	38.96	194.79	31.17	3,368.53
FEB	08	9	2,481.46	661.11	367,372.04	38.96	194.79	31.17	3,368.53
MAR	08	10	2,477.01	665.56	366,706.48	38.96	194.79	31.17	3,368.53
APR	08	11	2,472.52	670.05	366,036.43	38.96	194.79	31.17	3,368.53

↑	↑	↑	↑	↑	↑	↑	↑	↑	↑
Month/Yr Payment is due	Pmt #	Payment applied to interest & principal	Principal balance after application of monthly principal payment	SBA Fee	CDC Fee	CSA Fee	Total monthly payment		

Note: After the **December** payment, the loan is **current through November 30**

The **goal is to bring the loan current through August**. The Payment Examples on the next pages use **three different amounts** to illustrate what happens when the payments are applied.

Loan Data for Payment Examples

DECEMBER:	ACH Payment OK	Current through	November 30
JANUARY:	ACH Reject	Current through	November 30
FEBRUARY:	ACH Reject	Current through	November 30
March 1:	Wires Payment		
Actual Principal Balance last current	November 30		\$368,689.83
Amortization Schedule Principal Balance after	March 08 payment		\$366,706.48

504 Note Rate	8.091%
Monthly P & I	\$3,142.57
CSA Fee	\$ 31.17
CDC Fee	\$ 194.79
SBA Fee	\$ 38.96
Total Monthly Payment	\$3,407.49
Late Fee @ 5% of monthly payment	\$ 170.37

Monies Wired in Payment Examples

Example # 1:	Wired one (1) monthly payment	\$ 3,407.49
Example # 2:	Wires three (3) monthly payments	\$10,222.47
Example # 3:	Wires three (3) monthly payments & two (2) late fees due	\$10,563.21

Payment examples

Overview of payment examples

Here is a summary of the payment examples. Details for each payment amount are found on the next pages.

Table 7-4: OVERVIEW OF PAYMENT EXAMPLES

Sequence	Order in which payment is applied	Due	Payment Wired		
			#1	#2	#3
1	Balance Available for Borrower Receivable (Dec. and Jan)		3,407.49	10,222.47	10,563.21
	Borrower Receivable				
	CSA Fee	62.34			
	CDC Fee	389.58			
	SBA Fee	<u>77.92</u>			
	Total Receivables	529.84	529.84	529.84	529.84
2	Balance Available for Current Month's Fees (Feb.)		2,877.65	9,653.67	10,033.37
	CSA Fee	31.17			
	CDC Fee	194.79			
	SBA Fee	<u>38.96</u>			
		Total current month's fees	264.92	264.92	264.92
3	Balance Available for Interest		2,612.73	9,692.63	9,768.45
	Interest required	7,457.67	7,457.67	7,457.67	7,457.67
	Total interest paid		2,568.66	7,457.67	7,457.67
	Balance available to be applied to principal		44.07	1,970.04	2,310.78
			44.07	1,970.07	2,310.78
4	4 Balance Available for Principal				
	Actual Principal Balance November 30	368,689.83			
	Amort Principal after March Payment	366,706.48			
	Principal due to become current	1,983.35	1,983.35	1,983.35	1,983.35
	Payment applied to principal		44.07	1,970.04	1,983.35
	Principal Balance after March payment		368,645.76	366,719.79	366,706.48
5	5 Balance Available for Late Fees		0.00	0.00	327.43
	Late Fees Due	340.68			
	Late Fees Paid/Applied		0.00	0.00	170.37
	Difference to Escrow Account				157.06
April 1 Application of Funds Report will show:					
	CSA Fee		31.17	31.17	31.17
	CDC Fee		194.79	194.79	194.79
	SBA Fee		38.96	38.96	38.96
	Interest Applied		2,568.66	7,457.67	7,457.67
	Principal Applied		44.07	1,970.04	1,983.35
	Difference to Escrow Account		0.00	0.00	157.06
April 1 Status of Portfolio Report will show:					
	Monthly Payment		3,407.49	3,407.49	3,407.49
	Fees		264.92	264.92	264.92
	Int/Rsv		7,373.93	2,472.52	2,472.52
	Principal		2,609.33	683.36	670.05
	Late		340.68	340.68	170.37
	Remit total by April 15 to be current		10,588.86	3,761.48	3,577.86
	Actual Bal at Mar 31		368,645.76	366,719.79	366,706.48

Payment examples

Details on payment #1 – not enough to pay all interest due

Table 7-4: OVERVIEW OF PAYMENT EXAMPLES (continued)				
Sequence	Order in Which Payment is Applied	Due	Payment #4	How Payment is Applied
1	Balance Available for Borrower Receivable Borrower Receivable SBA Fee CSA Fee CDC Fee Total Receivables	 77.92 62.34 <u>389.58</u> 529.84	3,407.49 529.84	Payment applied to: (see bold under Payment #1) 1 Total receivables 2 Total current month's fees 3 Partial interest 4 Partial principal 5 No late fees
2	Balance Available for Current Month's Fees SBA Fee CSA Fee CDC Fee Total current month's fees	 38.96 31.17 <u>194.79</u> 264.92	2,916.61 264.92	
3	Balance Available for Interest Interest required Total interest paid Balance available to be applied to principal	 7,457.67 	2,612.73 7,457.67 2,568.66 44.07	If the balance available for interest cannot fully pay the interest required, you must determine the days interest that can be applied.
4	Balance Available for Principal Actual P Balance November 30 Amort Principal after March Payment Principal due to become current Payment applied to principal Principal Balance after March payment	 368,689.83 366,706.48 1,983.35 	 1,983.35 44.07 368,645.76	After applying 32 days interest, there is a small balance that is available to be applied to reduce the principal. Although the balance is reduced, the payment is not sufficient to bring the loan current
5	Balance Available for Late Fees Late Fees Due Late Fees Paid/Applied Difference to Escrow Account	 336.85 	0.00 0.00	
April 1 Application of Funds Report will show:				Excludes the Borrower Receivable.
CSA Fee			31.17	
CDC Fee			155.83	
SBA Fee			38.96	
Interest Applied			2,651.62	
Principal Applied			39.03	
Difference to Escrow Account			0.00	
			How totals are calculated for each payment:	
April 1 Status of Portfolio Report will show:			Past Due	Apr Pymt Due
Monthly Payment			3,407.49	
Fees			264.92	225.96
Int/Rsv			7,373.93	2,472.52
Principal			2609.33	670.05
Late			340.68	0.00
Remit total by April 15 to be current			10,588.86	3,368.53
Actual Bal at Mar 31			368,645.76	

Payment examples

Payment #1 – calculations and comments

Calculations for application of funds for example of Payment #1

- **Calculation of Daily Interest** = Interest Required: \$7,457.67 ÷ Number of days of interest due: 90
$$\$7,457.67 \div 90 = \$82.86$$

Balance available for interest: **\$2612.73**
- **Calculation of the Number of Days of Interest that can be Paid** = Balance available to be applied to interest: \$2,690.65 ÷ Daily Interest: \$82.86 (then round DOWN to a full day):
$$\$2,612.73 \div \$82.86 = 31.53 \text{ Round DOWN to } 31$$
- **Calculation of the Interest that can be Applied** = Number of Days of Interest that can be Paid: 32 x Daily Interest: \$82.86
$$31 \times \$82.86 = \$2,568.66$$

Number of days of interest due (Dec., Jan. & Feb. @ 30 days each): **90**
Number of days interest applied: **31**
Number of days interest outstanding (# days due minus # days applied) **59**

Comments

As the Application of Funds Report will show, the monies wired by this borrower paid:

- Outstanding borrower receivables from ACH rejects in January and February
- Current month's fees for March
- 31 days of accrued interest
- Principal payment of \$44.07
- No late fees

If no other payment is made in March

- 59 days of accrued interest is owed
- \$1,939.28 is owed in principal to bring the loan current through February
- An additional late fee is assessed March 16
- Three (3) late fees are outstanding
- Status of Portfolio Report will show these amounts due as well as the April payment due

- This loan is **not current**

Payment examples

Details on payment #2 – not enough to bring principal current

Table 7-4: OVERVIEW OF PAYMENT EXAMPLES (continued)				
Sequence	Order in Which Payment is Applied	Due	Payment #2	How Payment is Applied
1	Balance Available for Borrower Receivable Borrower Receivable SBA Fee CSA Fee CDC Fee Total Receivables	 77.92 62.34 <u>389.58</u> 529.84	10,222.47 529.84	Payment applied to: (see bold under Payment #2) 1 Total receivables 2 Total current month's fees 3 Partial interest 4 Partial principal 5 No late fees
2	Balance Available for Current Month's Fees SBA Fee CSA Fee CDC Fee Total current month's fees	 38.96 31.17 <u>194.79</u> 264.92	9,653.67 264.92	
3	Balance Available for Interest Interest required Total interest paid Balance available to be applied to principal	 7,457.67 	9,692.63 7,457.67 7,457.67 1,970.04	
4	Balance Available for Principal Actual P Balance November 30 Amort Principal after March Payment Principal due to become current Payment applied to principal Principal Balance after March payment	 368,689.83 366,706.48 1,983.35 	1,970.04 1,983.35 1,970.04 366,719.79	The payment is \$13.31 short of the total principal needed to bring the principal balance current. If the borrower does not bring the principal current by March 15, another late fee will be assessed.
5	Balance Available for Late Fees Late Fees Due Late Fees Paid/Applied Difference to Escrow Account	 340.68 	0.00 0.00	
April 1 Application of Funds Report will show: CSA Fee CDC Fee SBA Fee Interest Applied Principal Applied Difference to Escrow Account			 31.17 194.79 38.96 7,457.67 1,970.04 0.00	Excludes the Borrower Receivable.
			How totals are calculated for each payment:	
April 1 Status of Portfolio Report will show: Monthly Payment Fees Int/Rsv Principal Late Remit total by April 15 to be current Actual Bal at Mar 31			 3,407.49 264.92 2,472.52 683.36 340.68 3,761.48 366,719.79	 Past Due 0.00 0.00 13.31 340.68 353.99 Apr Pymt Due 264.92 2,472.52 670.05 0.00 3,407.49

Payment examples

Payment #2 – calculations and comments

Calculations for application of funds for example of Payment #2

- **Calculation of Interest Required =**
Actual Principal Balance x 504 Note rate ÷ 360 x number of days

$$\$368,689.83 \times .08091 \div 360 \times 90 = \$7,457.67$$

Balance available for interest: **\$9,427.71**

- **Calculation of Daily Interest and the Calculation of the Number of Days of Interest that can be Paid:** Not needed since balance available for interest is greater than interest required.

- **Calculation of the Principal that can be Paid**

Balance available for principal:	\$1,970.04
Actual principal balance of Nov 30:	\$368,689.83
Note Amortization Schedule principal balance after March payment:	\$366,706.48
Total principal required to bring the loan current:	\$1,983.35
Balance available minus principal required to bring loan current:	(\$13.31)
Actual principal balance after application of monies to the principal:	\$366,719.79

Comments

As the Application of Funds Report will show, the monies wired by this borrower paid:

- Outstanding borrower receivables from ACH rejects in January and February
- Current month's fees for March
- 90 days of accrued interest
- Principal payment of \$1,970.04 leaves an amount of \$13.31 to become current
- No late fees

If no other payment is made in March

- An additional late fee will be assessed since the borrower's principal balance is \$13.31 short of being current after the March payment
- Three (3) late fees were assessed and are outstanding
- Status of Portfolio Report will show these amounts due as well as the April payment due
- This loan is **not current**

Payment examples

Details on payment #3 – difference to unallocated funds

Table 7-4: OVERVIEW OF PAYMENT EXAMPLES (continued)				
Sequence	Order in Which Payment is Applied	Due	Payment #3	How Payment is Applied
1	Balance Available for Borrower Receivable Borrower Receivable SBA Fee CSA Fee CDC Fee Total Receivables	 77.92 62.34 <u>389.58</u> 529.84	10,563.21 529.84	Payment applied to: (see bold under Payment #3) 1 Total receivables 2 Total current month's fees 3 Partial interest 4 Partial principal 5 No late fees Difference to Escrow
2	Balance Available for Current Month's Fees CSA Fee CDC Fee SBA Fee Total current month's fees	 38.96 31.17 <u>194.79</u> 264.92	10,033.37 264.92	
3	Balance Available for Interest Interest required Total interest paid Balance available to be applied to principal	 7,457.67 	9,768.45 7,457.67 7,457.67 2,310.78	Balance available is sufficient to pay all interest due. Balance available is sufficient to bring principal current.
4	Balance Available for Principal Actual P Balance November 30 Amort Principal after March Payment Principal due to become current Payment applied to principal Principal Balance after March payment	368,689.83 366,706.48 1,983.35 	2,310.78 1,983.35 366,706.48	
5	Balance Available for Late Fees Late Fees Due Late Fees Paid/Applied Difference to Escrow Account (The balance after payment is placed in "Difference to Escrow Account" as unallocated funds.)	 340.68 	327.43 170.37 157.06	Balance available is sufficient to pay only one month's late fee due. <ul style="list-style-type: none"> Late fees are paid in one (1) month increments.
April 1 Application of Funds Report will show:				Excludes the Borrower Receivable.
	CSA Fee CDC Fee SBA Fee Interest Applied Principal Applied Difference to Escrow Account	 31.17 155.83 38.96 7,457.67 1,983.35 155.12		
April 1 Status of Portfolio Report will show:				Except for one (1) month's late fee, there are no outstanding amounts past due. The loan is current .
	Monthly Payment Fees Int/Rsv Principal Late Remit total by April 15 to be current Actual Bal at Mar 31	 3,407.49 264.92 2,472.52 670.05 170.37 3,577.86 366,706.48		

Payment examples

Payment #3 – calculations and comments

Calculations for application of funds for example of Payment #3

<ul style="list-style-type: none"> Calculation of Interest Required = Actual Principal Balance x 504 Note rate ÷ 360 x number of days $\\$368,689.83 \times .08091 \div 360 \times 90 = \\$7,457.67$ Balance available for interest: \$9,427.71
<ul style="list-style-type: none"> Calculation of Daily Interest and the Calculation of the Number of Days of Interest that can be Paid: Not needed since balance available for interest is greater than interest required.
<ul style="list-style-type: none"> Calculation of the Principal that can be Paid Balance available for principal: \$2,310.78 Actual principal balance of Nov 30: \$368,689.83 Note Amortization Schedule principal balance after March payment: \$366,706.48 Total principal required to bring the loan current: \$1,983.35 Balance available minus principal required to bring loan current: \$327.43 Actual principal balance after application of monies to the principal: \$366,706.48
<ul style="list-style-type: none"> Calculation of the Late Fees that can be Paid Balance available for late fees: \$327.43 Late fees due: \$340.68 Payment of one (1) late fee: \$170.37 Balance to unallocated funds: \$157.06

Comments

The borrower wired three monthly payments and two late fees for a total of \$10,563.21. This payment was sufficient to satisfy all outstanding payments due **EXCEPT** payment of the late fees. Here's what you need to remember:

- Since late fees are applied in one (1) month increments, only one (1) late fee is paid.
- \$155.12 is placed in the Difference to Escrow account.
- In this example, the borrower needs to pay \$13.31 to satisfy the second late fee.
- When the borrower pays the remaining \$13.31, the second late fee will be satisfied, and the Difference to Escrow account will be cleared.

If no other payment is made in March

- The borrower is current.
- There is an outstanding late fee.

5-year anniversary dates – current vs. non-current

If the loan is **NOT CURRENT** at its 5-year anniversary date, COLSON must recalculate the fees based upon the **ACTUAL PRINCIPAL BALANCE** at the 5-year anniversary date.

This means the fees paid by the borrower to the CSA, CDC and SBA will be higher for the next five (5) years. Principal and interest payments will continue to follow the original *504 Note Amortization Schedule*.

The CDC is responsible for correcting the problem and letting the borrower know

It is the CDC's responsibility to make certain the loan payments are current.

If the CDC has a loan that is not current and the loan is approaching the 5-year anniversary date, talk to the borrower. Explain that the fees will be higher than what is specified on the amortization schedule and that the payment will increase compared to what the original amortization schedule calls for.

If the borrower does not become current and the fees/monthly payment is recalculated, is a new ACH debit or any other paperwork required?

No.

A closer look at the last payment

A loan reaches maturity when the borrower has made all scheduled loan payments for the full payment period of the loan

How much will the borrower owe on the loan's last payment? There are two things to keep in mind:

1. The *504 Note* and the *504 Authorization* obligates the borrower to repay the 504 loan in equal installments for the life of the loan. The last line of the *504 Note Authorization Schedule* changed in mid-1999 to reflect equal payments for the life of the loan.

Through the June 1999 funding

MONTH	NO	PRINCIPAL	BALANCE	SBA FEE	CDC FEE	CSA FEE	MONTHLY PAYMENT	TOTAL INTEREST	TOTAL PRINCIPAL
Nov 18	235	1,511.45	7,761.48	57.40	41.00	6.56	1,656.10	157,677.93	206,839.97
Dec 18	236	1,519.27	6,160.03	57.40	41.00	6.56	1,656.10	157,709.80	208,359.24
Jan 19	237	1,527.13	4,640.76	57.40	41.00	6.56	1,656.10	157,733.81	209,886.37
Feb 19	238	1,535.01	3,113.63	57.40	41.00	6.56	1,656.10	157,749.92	211,421.40
Mar 19	239	1,542.97	1,578.60	57.40	41.00	6.56	1,656.10	157,758.09	212,964.37
Apr 19	240	.18	35.63	57.40	41.00	6.56	1,656.10	157,758.27	213,000.00
							Last Payment:	140.77	

Note: The unallocated portion of the last payment is used to pay off the debenture. Since the debenture is the CDC's obligation, the CDC is responsible for any shortage. If the entire amount of the last payment is not remitted, the CDC is responsible for remitting any shortage or the shortage will be withheld from future CDC payments (fees and/or float).

As of the July 1999 funding

MONTH	NO	PRINCIPAL	BALANCE	SBA FEE	CDC FEE	CSA FEE	MONTHLY PAYMENT	TOTAL INTEREST	TOTAL PRINCIPAL
Nov 18	235	1,511.45	7,761.48	57.40	41.00	6.56	1,656.10	157,677.93	206,839.97
Dec 18	236	1,519.27	6,160.03	57.40	41.00	6.56	1,656.10	157,709.80	208,359.24
Jan 19	237	1,527.13	4,640.76	57.40	41.00	6.56	1,656.10	157,733.81	209,886.37
Feb 19	238	1,535.01	3,113.63	57.40	41.00	6.56	1,656.10	157,749.92	211,421.40
Mar 19	239	1,542.97	1,578.60	57.40	41.00	6.56	1,656.10	157,758.09	212,964.37
Apr 19	240	.18	35.63	57.40	41.00	6.56	1,656.10	157,758.27	213,000.00
							Last Payment:	1,656.10	

2. If the loan is not current at the time the loan approaches maturity, the borrower will need to make additional payments to retire the note on its maturity date. Otherwise, the borrower has not satisfied the terms of his/her note obligation.

A closer look at the last payment

504 Note Amortization vs. Debenture Amortization Table Differences

504 Note Amortization versus Debenture Amortization Table Differences

The following discussion is from a Development Company Funding Corporation memorandum. The purpose of this discussion is to bring an awareness and understanding of the differences that exist between the pre-July 1999 504 note and underlying debenture amortization tables so that CDCs may better appreciate the implications, quantify potential P&L impact and respond to their Board of Directors, accountants and borrowers who raise questions regarding these loans.

With the first series of 504 loans reaching maturity, some borrowers are questioning why, for the last 504 payment, the full monthly payment amount has been debited against their designated bank account when their 504 loan amortization table shows the outstanding principal balance and accrued interest going into the last payment as only a fraction of the normal monthly payment. This situation pertains to outstanding ten and twenty year 504 loans that funded prior to July 1999. In July 1999 the 504 note amortization table programming was modified to correct this problem going forward.

Description Of Problem

When 504 loans were introduced in November of 1986, the Central Servicing Agent (CSA) at the time developed a computer program to generate monthly amortization tables for both ten and twenty year 504 notes which would result in principal and interest being collected from 504 borrowers over six monthly payments sufficient to satisfy the semiannual P&I payment due the holder of the underlying debenture.

The software that generated the amortization table was programmed to leave the smallest possible principal amount to be repaid in the last payment resulting in the 504 amortization table and note interest rate being understated. Because of this, the 504 loan amortization table allocated slightly more of each monthly payment to principal reduction and slightly less to interest expense than should have been the case. Therefore the pre-July 1999 amortization tables show only a small amount of principal and interest due the last payment, only a fraction of the normal monthly payment, which would be needed to retire the underlying debenture. (See Exhibits 1. & 1.a.)

The other result of the methodology employed in generating the 504 monthly note amortization table from the semiannual debenture amortization table is that in the case of ten year loans, the note amortization table, at any point in time during the life of the loan, shows a lower outstanding balance than the debenture amortization table. In the case of twenty year loans, the note amortization table, at any point during the first twelve years, shows a greater outstanding balance than the debenture amortization table but reverses in

A closer look at the last payment

504 Note Amortization vs. Debenture Amortization Table Differences

year thirteen when the debenture balance begins to show a greater amount than the outstanding note balance. (See Exhibits 2. & 2.a.)

The difference, in the case of both ten and twenty year loans, builds over time but is transparent to the borrower until the last payment when the borrower's designated checking account is debited for the normal monthly P&I amount which is greater than the final outstanding balance of principal and interest showing on the borrower's note amortization table. Under no circumstances will the difference ever be greater than one monthly payment although in loans reaching maturity the difference can be pretty close.

Relationship To Float

If 504 loans were repaid on a semiannual basis the way the underlying debentures are, this problem would never have occurred. The payment of P&I received semiannually from our borrower would be identical to that forwarded on to the debenture holder and the note and debenture amortization schedules would, therefore, be identical. However, because of credit monitoring concerns and normal market practices, 504 commercial mortgages are repaid monthly while the public bond markets expect debentures with a semiannual repayment. As such, 504 payments made by our borrowers are held by the CSA for six months at which point the accumulated total is remitted to the debenture holder to cover the semiannual payment of P&I.

All active CDCs with outstanding 504 portfolios receive a semiannual float check every May and November. The first and largest component of this check is the interest earned on the monthly payments mentioned above and held by the CSA until remitted to the debenture holder at the next semiannual debenture date. The second component of this check is interest earned on loan prepayments held by the CSA until the semiannual anniversary when the debenture is paid off. The last component of the float check is the difference between the outstanding note balance and the outstanding debenture balance at the time of prepayment. (See Exhibit 3.)

Some CDCs have argued that CDC risk, relative to the amortization table, differences should have nothing to do with the benefit the CDC receives from the semiannual float check and that the industry should look to recoup the potential 504 amortization table differences from the SBA or the CSA. The fact of the matter is that both the amortization table difference and the float arose because of the mismatch of the 504 monthly note repayment schedule versus the 504 semiannual debenture schedule and NADCO views the CDC's risk relative to the amortization table difference as consideration for the float.

A closer look at the last payment

504 Note Amortization vs. Debenture Amortization Table Differences

Quantifying The Potential Financial Impact

The amortization table differences have a potential financial impact on CDCs. In the case of those loans that reach maturity, borrowers, based on their amortization tables, may argue that they do not owe the total final payment. Depending on the resolution of this between the borrower and the CDC, the CDC may end up absorbing some or all of the last payment shortfall. In the case of those loans which prepay, the prepayment amount as calculated by the CSA is based on the note amortization table, so if a borrower prepays during a period when the note balance is less than the debenture balance per the respective amortization tables the CDC will suffer the shortfall as a debit against its float check. With respect to ten year notes this would be at any point during the life of the loan and in the case of twenty year notes, this would be anytime after year twelve. Conversely, if a borrower prepays a twenty year note at any point during the first twelve years when the note balance is greater than the debenture balance the calculated prepayment amount will be greater than the amount necessary to satisfy the underlying debenture and the excess will be credited to the CDC.

The process to quantify a CDC's potential maximum exposure is a relatively simple one albeit possibly labor intensive depending on the size of the portfolio. To do this, only the note amortization schedule is needed. The maximum CDC exposure for each pre July 1999 504 loan is calculated by taking the total of accrued interest and principal balance outstanding on the last line of the amortization schedule (line 120 in the case of ten year notes and line 240 in the case of twenty year notes) and deducting this from the constant P&I component of the monthly 504 payment. The CDC's maximum exposure is just a compilation (which should be prepared by maturity date order) of this difference for all outstanding pre July 1999 504 loans.

The above process will disclose the CDC's maximum exposure as of the report date but may not be the best management tool. The reason for this is that a CDC's potential maximum exposure is in all likelihood considerably greater than the actual loss it will incur. This is because prepayments will result in a smaller note/debenture amortization table actual difference than the difference that would exist at the time of the final 504 monthly payment. As of April 2004 only 444 of the 1,918 ten year 504 loans issued between November 1986 and June 1999 remain outstanding. Of the 28,585 twenty year loans funded during the same period, only 13,660 currently remain outstanding. The other factor that will reduce a CDC's actual exposure is that not all borrowers will question the last payment on their 504 loan.

If a CDC is looking for a more useful gauge of its exposure, a table that captures the changing amortization difference over the life of a loan may provide a better management tool. By estimating the potential exposure each year during the life of the portfolio, a

A closer look at the last payment

504 Note Amortization vs. Debenture Amortization Table Differences

CDC will be better able to gauge what effect the amortization table differences will have on its operating results.

To do this the CDC would set up a spreadsheet with the vertical axis denoting year of maturity and the horizontal axis denoting year of impact or in other words the potential maximum incremental loss in a given year. The spreadsheet would be recalculated each year eliminating those loans which have either matured or were prepaid. At the beginning of each year the CDC could get a fairly accurate assessment of its maximum potential exposure for that year.

To Reserve Or Not To Reserve?

Various CDC executives have stated that either their Board of Directors or CPAs have raised the issue of reserving for the amortization table differences. This is a matter that has to be resolved by the individual CDC with its professional advisors.

What Is DCFC's Position

Based on research and discussions with individuals who were in the SBA or the CDC industry at the time of the introduction of the 504 Program, there is no evidence to suggest that the amortization table differences were anything other than an unintentional result of the original programming of the 504 note amortization table. It was always the intention of the program that the 504 borrower was to make 120 or 240 constant P&I payments sufficient to pay the interest and retire the underlying debenture.

While some CDCs have raised the possibility of suing either or both the CSA and the SBA to absorb the risk of the amortization table difference, it is DCFC's view that this would not be positive for the industry.

Other CDCs have questioned the possibility of reissuing the 504 note and amortization table with the appropriate corrections. DCFC does not believe this to be an appropriate solution for the following two reasons. DCFC is of the opinion that not all borrowers will question the last payment when their notes mature, but if new notes and amortization tables were issued this would raise questions from the vast majority of borrowers with loans outstanding. Also, with the rate of prepayment, this action would raise questions with borrowers who may ultimately prepay their notes, thereby never reaching maturity. Lastly it is questionable whether the lender can unilaterally change the interest rate on the note and amortization tables.

A closer look at the last payment

504 Note Amortization vs. Debenture Amortization Table Differences

Some CDCs have suggested that unless this matter is brought to an ultimate resolution, the CDC industry risks having a class action lawsuit brought upon it by disgruntled borrowers. This is simply not the case. As the situation currently stands no borrower has been wronged and, therefore, has suffered no damages for which to sue.

As can be seen from the foregoing this is not a simple issue. DCFC's position on the matter is to educate and provide support to CDCs regarding this issue. DCFC is of the opinion that it was always the intent of the 504 program that the borrower makes 120 or 240 constant P&I payments sufficient to pay the interest and retire the underlying debenture. As such NADCO believes it is appropriate for 504 borrowers to make the last 504 payment in the full normal monthly amount but that CDCs use best practices when negotiating this with their borrowers to ensure the continued good name of the individual CDC and the 504 industry.

How To Work With Your Borrower

Some CDCs have stated that it is their policy to pay the last payment difference to any borrower who makes the request. Other CDCs wish to be able to explain the issue to their borrowers in order for their borrowers to understand that they are responsible for the same P&I payment as they have made every month since their notes were issued. In the case of those CDCs for whom this has already been an issue, their borrowers agreed to the total final payment only after the situation was explained and the borrower was made to understand that they were not being cheated.

The following talking points may be of help in explaining the issue to and negotiating with a borrower. Also, a letter that has been helpful in resolving the issue with borrowers is included as Exhibit 4.

- The borrower receives a loan from the CDC that is funded by a debenture of like amount held by an investor. The investor is repaid via semiannual P+I payments over the term of the debenture that matches the term of the 504 loan.
- The 504 monthly loan payments are calculated by dividing the semi-annual debenture payment amount by six and rounding up to the nearest penny. Therefore the total of principal and interest paid by our 504 borrower over six months is exactly the total of principal and interest that must be remitted to the investor for each semiannual payment. The monthly 504 P&I payment is fixed for the life of the loan and documented on the top of the note amortization schedule and the borrower was told at the time of the Note that they will be making either 120 or 240 payments of this amount plus fees over the life of the 504 loan.

A closer look at the last payment

504 Note Amortization vs. Debenture Amortization Table Differences

- However, in the calculation of the 504 note and amortization table interest rate, there was a programming glitch which understated the rate and therefore the 504 note amortization table applied slightly more of the monthly P&I payment to principal than should have been applied, with interest being understated by a like amount. As a result the 504 note amortization table shows only a fraction of the total P&I that needs to be remitted in the last 504 payment in order to satisfy fully the outstanding principal and interest on the underlying debenture.
- By refusing to make the entire last payment, the borrower is exploiting a clerical error to avoid making the total payments the borrower fully expected to make upon obtaining the 504 loan. The shortfall then has to be made up by the Not For Profit CDC that helped them in the first place.

Not all borrowers will be willing to agree with this. In these cases it is important to maintain the good name of the CDC and the industry and perhaps a partial settlement might be feasible.

To Reserve Or Not To Reserve?

Accounting for loss contingencies is governed by the Financial Accounting Standards Board's Financial Accounting Statement 5 (FAS 5), *Accounting for Contingencies*. FAS 5 defines a loss contingency as:

“...an existing condition, situation, or set of circumstances involving uncertainty as to possible...loss to an enterprise that will ultimately be resolved when one or more future events occur or fail to occur. Resolution of the uncertainty may confirm the...loss or impairment of an asset or the incurrence of a liability.”

FAS 5 states that “...an estimated loss from a loss contingency...shall be accrued by a charge to income if *both* of the following conditions are met:

- Information available prior to issuance of the financial statements indicates that it is probable that an asset had been impaired or a liability had been incurred at the date of the financial statements. It is implicit in this condition that it must be probable that one or more future events will occur confirming the fact of the loss.
- The amount of loss can be reasonably estimated.”

A closer look at the last payment

504 Note Amortization vs. Debenture Amortization Table Differences

FAS 5 goes on to state that “...if no accrual is made for a loss contingency because one or both of the conditions above are not met, the disclosure of the contingency shall be made when there is at least a reasonable possibility that a loss... may have been incurred. The disclosure shall indicate the nature of the contingency and shall give an estimate of the possible loss or range of loss or state that such an estimate cannot be made. Disclosure is not required of a loss contingency involving an unasserted claim or assessment when there has been no manifestation by a potential claimant of an awareness of a possible claim or assessment unless it is considered probable that a claim will be asserted and there is a reasonable possibility that the outcome will be unfavorable.”

There are several issues that have to be analyzed and ultimately interpreted to determine the applicability of FAS 5 to the amortization table situation. The question hinges on whether an incurrence of a liability has occurred as defined by FAS 5. There are several issues that make answering this question difficult. One issue is that a loss, in the case of the last payment difference, will only arise if a borrower asserts a specific claim. One can debate whether this meets the criteria that it must be *probable* that one or more future events will occur confirming the fact of the loss. Additionally, there is the question as to whether this liability even “belongs” to the CDC. If the CDC does not consider the last payment difference its liability, then accruing for it or disclosing it would not be necessary. It should also be taken into consideration that reflecting an accrual or disclosure in the CDC’s financial statements is, in essence, an acknowledgement of liability.

Another factor to consider is that the treatment can differ depending on whether a CDC budgets and/or accrues for the float. For those CDCs that do, then a proper matching of revenue and expense may indicate that the estimated expense related to this amortization table difference also be accrued, since the float is, in fact, used to offset the resulting liability to the borrower. This is specifically the case of prepayments of pre-1999 loans, where the float is actually impacted by the difference. At a minimum, if an accrual is not deemed necessary, then disclosure may be needed.

There are other CDCs who do not accrue for or count on the float income in their annual budgeting process and look at the two semiannual float checks as extra income above what is budgeted to run their operation for the year. The handling of this potential loss contingency may differ among those CDCs. CDCs in this category may not need to accrue for this expense, as they are not accruing the income, which would be reduced by this expense.

A closer look at the last payment

504 Note Amortization vs. Debenture Amortization Table Differences

To help quantify the financial impact, the CDC can use a spreadsheet as previously described to make a reasonable determination as to how much its float check may be impacted by the amortization table differences. As long as the CDC is reasonably comfortable that its float check will not be wiped out in its entirety, there should be no reason to accrue for potential amortization table differences. It is not likely that a semiannual float check would be totally offset by amortization table differences, but even if it were to occur Colson will not look to collect the amount of the deficit from the CDC. Instead Colson would carry the deficit forward and offset it against the next semiannual float check.

CDCs are advised to with their professional advisors on amortization tables. Materiality will also factor into the discussion as this will differ for each CDC.

- Exhibit 1: Note Amortization Schedule Example
- Exhibit 1a: Debenture Amortization Schedule
- Exhibit 2: 10-Year 504 Sample Loans – Difference between Note and Debenture
- Exhibit 2a: 20-Year 504 Sample Loans – Difference between Note and Debenture
- Exhibit 3: Colson Services Corp. Sample Float Check Letter to CDC
- Exhibit 4: CDC Sample Letter to Borrower Explaining the Difference Issue

(Exhibits are contained on the following pages.)

A closer look at the last payment

504 Note Amortization vs. Debenture Amortization Table Differences

Exhibit 1a

US Government Guaranteed 5.9500% Development Company Participation Certificates, Series 1999-20B

DEBENTURE AMORTIZATION SCHEDULE

Small Business Concern: Madison Cutting Die Inc

Issuer: CDC Name

Debenture Number: 1999-20B/00-000-27152

SBA Loan Number: 243999-4005

Debenture Principal: 1,000,000.00

<u>Payment Date</u>	<u>Amount Paid</u>	<u>Interest Paid</u>	<u>Semi-annual Payment</u>	<u>Remaining Principal Amt</u>	<u>Payment Date</u>	<u>Amount Paid</u>	<u>Interest Paid</u>	<u>Semi-annual Payment</u>	<u>Remaining Principal Amt</u>
08-01-99	15871.30	27105.36	42977.06	984128.30	08-01-09	23911.16	19065.90	42977.06	616959.51
02-01-00	13699.24	29277.82	42977.06	970429.26	02-01-10	24622.51	18354.55	42977.06	592337.00
08-01-00	14106.79	28870.27	42977.06	956322.47	08-01-10	25355.03	17622.03	42977.06	566981.97
02-01-01	14526.47	28450.59	42977.06	941796.00	02-01-11	26109.35	16867.71	42977.06	540872.62
08-01-01	14958.63	28018.43	42977.06	926837.37	08-01-11	26886.01	16090.96	42977.06	513986.52
02-01-02	15403.65	27573.41	42977.06	911433.72	02-01-12	27685.96	15291.10	42977.06	486300.56
08-01-02	15861.91	27115.15	42977.06	895571.81	08-01-12	28309.62	14467.44	42977.06	457790.94
02-01-03	16333.80	26643.26	42977.06	879238.01	02-01-13	29357.78	13619.28	42977.06	428433.16
08-01-03	16819.73	26157.33	42977.06	862418.28	08-01-13	30231.17	12745.89	42977.06	398201.99
02-01-04	17320.12	25656.94	42977.06	845098.16	02-01-14	31130.55	11846.51	42977.06	367071.44
08-01-04	17835.39	25141.67	42977.06	827262.77	08-01-14	32056.68	10920.38	42977.06	335014.76
02-01-05	19365.99	24611.07	42977.06	808896.78	02-01-15	33010.37	9966.69	42977.06	302004.39
08-01-05	18912.38	24064.68	42977.06	789984.40	08-01-15	33992.43	8984.63	42977.06	268011.96
02-01-06	19475.02	23502.04	42977.06	770509.38	02-01-16	35003.70	7973.36	42977.06	233008.26
08-01-06	20054.41	22922.65	42977.06	750454.97	08-01-16	36045.06	6932.00	42977.06	196963.20
02-01-07	20651.02	22326.04	42977.06	729803.95	02-01-17	37117.40	5859.66	42977.06	159845.80
08-01-07	21265.39	21711.67	42977.06	708538.56	08-01-17	38221.65	4733.41	42977.06	121624.15
02-01-08	21898.04	21079.02	42977.06	686640.52	02-01-18	39358.74	3618.32	42977.06	82265.41
08-01-08	22549.50	20427.56	42977.06	664091.02	08-01-18	40529.66	2447.40	42977.06	41735.75
02-01-09	23220.35	19736.71	42977.06	640870.67	02-01-19	41735.75	1241.64	42977.06	0.00

Total Debenture Interest = 719,082.40 (to Exhibit 1)

A closer look at the last payment*504 Note Amortization vs. Debenture Amortization Table Differences***Exhibit 2**

10-YEAR 504 SAMPLE LOANS - DIFFERENCE BETWEEN NOTE AND DEBENTURE

Original Principal Balance	\$ 285,000				Original Principal Balance	\$ 330,000			
Debenture Rate	6.050%				Debenture Rate	6.950%			
Note Rate	6.122%				Note Rate	7.050%			
Issue Date	3/11/98				Issue Date	5/14/97			
Spread Between Note & Debenture Rates	0.072%				Spread Between Note & Debenture Rates	0.100%			
	Note Bal	Deb Bal	Difference	Yr		Note Bal	Deb Bal	Difference	Yr
Sep-98	273,873.39	273,972.82	(99.43)	1	Nov-97	317,420.46	317,528.81	(108.35)	1
Mar-99	262,948.66	263,091.03	(142.35)		May-98	305,322.56	305,452.46	(129.90)	
Sep-99	251,685.27	251,880.06	(194.79)	2	Nov-98	292,791.89	292,956.45	(184.56)	2
Mar-00	240,072.67	240,329.96	(257.29)		May-99	279,812.96	280,026.21	(213.23)	
Sep-00	228,100.94	228,430.47	(330.43)	3	Nov-99	266,369.79	266,646.64	(276.85)	3
Mar-01	215,756.22	216,171.02	(414.80)		May-00	252,445.71	252,802.13	(356.42)	
Sep-01	203,029.70	203,540.72	(511.02)	4	Nov-00	238,023.55	238,476.52	(452.97)	4
Mar-02	189,908.62	190,528.36	(619.74)		May-01	223,085.47	223,563.10	(477.63)	
Sep-02	176,380.76	177,122.37	(741.61)	5	Nov-01	207,613.04	208,314.57	(701.53)	5
Mar-03	162,433.49	163,310.85	(877.36)		May-02	191,567.13	192,443.02	(855.89)	
Sep-03	148,053.80	149,061.53	(1,027.73)	6	Nov-02	174,967.94	176,019.93	(1,031.99)	6
Mar-04	133,228.31	134,421.78	(1,193.47)		May-03	157,794.96	158,026.14	(1,231.18)	
Sep-04	117,942.17	119,318.57	(1,375.40)	7	Nov-03	139,966.97	141,441.82	(1,454.85)	7
Mar-05	102,184.15	103,758.49	(1,574.34)		May-04	121,541.95	123,246.44	(1,704.49)	
Sep-05	85,936.55	87,727.71	(1,791.16)	8	Nov-04	102,437.12	104,418.77	(1,981.65)	8
Mar-06	69,185.24	71,212.00	(2,028.76)		May-05	82,648.87	84,938.84	(2,287.97)	
Sep-06	51,914.57	54,196.69	(2,262.12)	9	Nov-05	62,152.76	64,777.92	(2,625.16)	9
Mar-07	34,108.46	36,666.67	(2,558.21)		May-06	40,923.47	43,918.47	(2,995.00)	
Sep-07	15,750.31	18,606.37	(2,856.06)	10	Nov-06	18,934.78	22,334.16	(3,399.38)	10
Mar-08	17.90	17.90	17.90		May-07	11.26	11.26	11.26	
Original Principal Balance	\$ 708,000				Original Principal Balance	\$ 439,000			
Debenture Rate	5.800%				Debenture Rate	8.350%			
Note Rate	5.858%				Note Rate	8.491%			
Issue Date	9/1/98				Issue Date	4/1/91			
Spread Between Note & Debenture Rates	0.058%				Spread Between Note & Debenture Rates	0.141%			
	Note Bal	Deb Bal	Difference	Yr		Note Bal	Deb Bal	Difference	Yr
Mar-99	679,284.21	679,664.91	(280.70)	1	Oct-91	422,875.39	423,011.00	(135.61)	1
Sep-99	651,569.17	651,985.84	(416.47)		Apr-92	407,877.39	407,983.64	(106.25)	
Mar-00	623,080.76	623,634.15	(573.39)	2	Oct-92	392,231.26	392,328.89	(97.63)	2
Sep-00	593,736.29	594,488.82	(752.53)		Apr-93	375,909.02	376,020.55	(111.53)	
Mar-01	563,572.39	564,527.42	(955.03)	3	Oct-93	358,881.43	359,031.34	(149.91)	3
Sep-01	532,545.02	533,727.10	(1,182.08)		Apr-94	341,118.08	341,332.83	(214.80)	
Mar-02	500,629.47	502,064.37	(1,434.90)	4	Oct-94	322,587.02	322,895.41	(308.39)	4
Sep-02	467,800.33	469,515.08	(1,714.75)		Apr-95	303,255.23	303,688.22	(432.99)	
Mar-03	434,031.43	438,054.41	(2,022.98)	5	Oct-95	283,086.06	283,879.13	(591.07)	5
Sep-03	399,295.89	401,856.84	(2,360.95)		Apr-96	262,049.40	262,834.68	(785.26)	
Mar-04	363,586.01	366,296.14	(2,730.13)	6	Oct-96	240,101.60	241,119.94	(1,018.34)	6
Sep-04	328,813.34	329,945.34	(3,132.00)		Apr-97	217,295.37	218,498.63	(1,293.28)	
Mar-05	289,008.60	292,576.72	(3,568.12)	7	Oct-97	193,319.71	194,932.88	(1,613.17)	7
Sep-05	250,121.70	254,161.78	(4,040.08)		Apr-98	168,401.88	170,383.26	(1,961.38)	
Mar-06	210,121.63	214,671.22	(4,549.59)	8	Oct-98	142,407.28	144,806.69	(2,401.41)	8
Sep-06	168,976.53	174,074.92	(5,098.39)		Apr-99	115,289.35	118,166.38	(2,877.03)	
Mar-07	126,653.63	132,341.93	(5,688.30)	9	Oct-99	86,999.58	90,411.76	(3,412.18)	9
Sep-07	83,118.20	89,440.41	(6,321.21)		Apr-00	57,487.32	61,496.38	(4,011.06)	
Mar-08	38,383.59	45,337.65	(6,999.06)	10	Oct-00	26,699.75	31,377.87	(4,678.12)	10
Sep-08	53.96	53.96	53.96		Apr-01	29.75	29.75	29.75	

Source: Debenture Amortization Schedule and Note Amortization Schedule

A closer look at the last payment

504 Note Amortization vs. Debenture Amortization Table Differences

Exhibit 2a

20-YEAR 504 SAMPLE LOANS - DIFFERENCE BETWEEN NOTE AND DEBENTURE

20-YEAR 504 SAMPLE LOANS - DIFFERENCE BETWEEN NOTE AND DEBENTURE					20-YEAR 504 SAMPLE LOANS - DIFFERENCE BETWEEN NOTE AND DEBENTURE				
Original Principal Balance			\$ 95,000		Original Principal Balance			\$1,000,000	
Debtenture Rate			6.800%		Debtenture Rate			6.800%	
Note Rate			6.864%		Note Rate			6.864%	
Issue Date			6/16/99		Issue Date			6/16/99	
Spread Between Note & Debtenture Rates			0.064%		Spread Between Note & Debtenture Rates			0.064%	
	Note Bal	Deb Bal	Difference	Yr		Note Bal	Deb Bal	Difference	Yr
Dec-99	93,578.43	93,592.99	(14.56)	1	Dec-99	985,035.88	985,189.45	(153.57)	1
Jun-00	92,405.56	92,407.31	(1.75)		Jun-00	972,689.71	972,708.67	(18.96)	
Dec-00	91,191.86	91,181.32	10.54	2	Dec-00	969,913.72	959,803.54	110.18	2
Jun-01	89,935.92	89,915.64	20.28		Jun-01	946,692.95	946,459.64	233.31	
Dec-01	88,636.24	88,602.86	33.38	3	Dec-01	933,011.90	932,662.05	349.85	3
Jun-02	87,291.32	87,247.52	43.80		Jun-02	918,854.54	918,395.34	459.20	
Dec-02	85,899.57	85,846.10	53.47	4	Dec-02	904,204.31	903,643.56	560.75	4
Jun-03	84,459.36	84,397.03	62.33		Jun-03	889,044.03	888,390.22	653.81	
Dec-03	82,969.02	82,896.69	70.33	5	Dec-03	873,355.96	872,618.27	737.69	5
Jun-04	81,426.79	81,349.41	77.38		Jun-04	857,121.71	856,310.07	811.64	
Dec-04	79,830.87	79,747.45	83.42	6	Dec-04	840,322.28	839,447.39	874.89	6
Jun-05	78,179.38	78,091.02	88.36		Jun-05	822,937.98	822,011.38	926.60	
Dec-05	76,470.40	76,378.27	92.13	7	Dec-05	804,948.47	803,982.55	965.92	7
Jun-06	74,701.94	74,607.29	94.65		Jun-06	786,332.65	785,340.74	991.91	
Dec-06	72,871.92	72,776.10	95.82	8	Dec-06	767,068.72	766,065.11	1,003.61	8
Jun-07	70,978.18	70,882.65	95.53		Jun-07	747,134.13	746,134.10	1,000.03	
Dec-07	69,018.49	68,924.82	93.67	9	Dec-07	726,505.52	725,525.44	980.08	9
Jun-08	66,990.59	66,900.42	90.17		Jun-08	705,158.73	704,216.06	942.65	
Dec-08	64,892.08	64,807.19	84.89	10	Dec-08	683,068.77	682,182.21	886.56	10
Jun-09	62,720.51	62,642.79	77.72		Jun-09	660,209.76	659,399.19	810.57	
Dec-09	60,473.34	60,404.80	68.54	11	Dec-09	636,554.91	635,841.54	713.37	11
Jun-10	58,147.92	58,090.72	57.20		Jun-10	612,076.55	611,482.93	593.62	
Dec-10	55,741.55	55,697.96	43.59	12	Dec-10	586,745.98	586,252.98	449.85	12
Jun-11	53,251.41	53,223.85	27.56		Jun-11	560,533.54	560,252.98	280.56	
Dec-11	50,674.58	50,665.62	8.96	13	Dec-11	533,408.53	533,324.36	84.17	13
Jun-12	48,008.03	48,020.41	(12.38)		Jun-12	505,339.18	505,480.10	(140.92)	
Dec-12	45,248.64	45,285.26	(36.62)	14	Dec-12	476,292.60	476,689.28	(396.68)	14
Jun-13	42,393.20	42,457.12	(63.92)		Jun-13	446,234.78	446,919.50	(684.72)	
Dec-13	39,438.34	39,532.82	(94.48)	15	Dec-13	415,130.50	416,137.54	(1,007.04)	15
Jun-14	36,380.50	36,509.10	(128.50)		Jun-14	382,943.36	384,309.00	(1,365.64)	
Dec-14	33,216.41	33,382.57	(166.16)	16	Dec-14	349,635.62	351,398.29	(1,762.67)	16
Jun-15	29,942.06	30,149.74	(207.68)		Jun-15	315,168.29	317,368.61	(2,200.32)	
Dec-15	26,553.71	26,806.99	(253.28)	17	Dec-15	279,501.00	282,181.92	(2,680.92)	17
Jun-16	23,047.41	23,350.59	(303.18)		Jun-16	242,591.97	245,798.89	(3,206.92)	
Dec-16	19,419.03	19,776.67	(357.64)	18	Dec-16	204,397.97	208,178.83	(3,780.86)	18
Jun-17	15,664.34	16,081.24	(416.90)		Jun-17	164,874.27	169,279.69	(4,405.42)	
Dec-17	11,778.93	12,260.16	(481.23)	19	Dec-17	123,974.56	129,057.98	(5,083.42)	19
Jun-18	7,758.26	8,309.17	(550.91)		Jun-18	81,650.94	87,468.73	(5,817.79)	
Dec-18	3,597.60	4,223.84	(626.24)	20	Dec-18	37,853.34	44,465.45	(6,611.61)	20
Jun-19	0.00	0.00	0.00		Jun-19	0.00	0.00	0.00	

Source: Debtenture Amortization Schedule and Note Amortization Schedule

A closer look at the last payment

504 Note Amortization vs. Debenture Amortization Table Differences

Exhibit 3

COLSON SERVICES CORP.
101 Barclay Street
8th Floor
New York, NY 10286

NOVEMBER 7, 2001

CDC NAME
CDC ADDRESS

DEAR CDC: CDC NUMBER

THE CURRENT REPORT PERIOD DATE RANGE COVERS FROM APRIL 1,
2007 THRU SEPTEMBER 30, 2007.

YOUR PRO RATA SHARE OF THE INTEREST EARNED ON THE 504
ESCROW ACCOUNT PORTION REPRESENTING YOUR BORROWERS MONTHLY
PAYMENTS FOR THE REPORT PERIOD IS: \$_____

THE BALANCE DUE THE CDC (IF POSITIVE) OR DUE FROM THE CDC (IF
NEGATIVE) FROM SETTLING THE LOANS THAT HAD PREPAID DURING THE
REPORT PERIOD IS: \$_____

TOTAL: \$_____

A CHECK FOR THIS AMOUNT IS ENCLOSED.

THE PRO RATA CALCULATIONS ARE BASED ON THOSE AVERAGE DAILY
BALANCES MAINTAINED BY THE BORROWERS IN THE 504 ESCROW ACCOUNT
FOR THE APPLICABLE REPORTING PERIOD.

THE INTEREST ACCRUAL CALCULATION WILL BE PERFORMED SEMI-
ANNUALLY WITH DISBURSEMENTS IN MAY AND NOVEMBER.

IF COLSON CAN BE OF FURTHER ASSISTANCE TO YOU CALL CUSTOMER
SERVICE AT 1-800-225-4285.

VERY TRULY YOURS,

COLSON SERVICES CORP.

A closer look at the last payment

504 Note Amortization vs. Debenture Amortization Table Differences

Exhibit 4

CDC LETTERHEAD
CDC NAME
CDC ADDRESS

DATE

BORROWER NAME
BORROWER ADDRESS

Re: Final Payment Amount on SBA 504 Loan

Dear Mr. / Ms. _____:

It has come to my attention that your amortization schedule was miscalculated with regards to the final payment on your SBA 504 loan. I would like to clarify the discrepancy regarding final payments, explain how they were calculated and why the final amount noted in your amortization schedule is incorrect.

SBA 504 Loans are funded through the monthly sale of a pool of debentures to investors. The debenture interest rate is set based on what the investors are willing to accept as sufficient return on their investment, and is used to calculate the semi-annual Debenture Payment to the investors. SBA, however, as a convenience to the small business borrower, collects loan payments on a monthly basis. To calculate the Monthly Payment, the Debenture Payment is divided by six. It is clear from that calculation that 120 equal monthly payments will be needed to pay the Debenture in full. A "Note Rate" is then calculated to express the interest rate for the loan as amortized monthly, rather than the semi-annual based Debenture Rate. However, the monthly amortization schedule that was printed for your reference was calculated incorrectly and from this amortization schedule, the system "backed into" an incorrect Note Rate (through iteration). The Note Rate is only an expression of your loan payments on a monthly basis. The Debenture Rate and Debenture Payment are still correct. Therefore, the correct calculation of your Amortization Schedule would show that 120 equal monthly payments are needed to pay off your Debenture in full. A full final payment is still needed to completely pay off the underlying outstanding principal balance of the debenture.

Due to the fact that most loans are paid off before maturity, it was decided that corrected Amortization Schedules would not be issued. However, if you refer to your closing documents for this loan, both the 504 Note and the Loan Agreement refer to paying off the Debenture through equal monthly loan payments until *MATURITY DATE*. The Central Servicing Agent Agreement also further describes the Note Rate and payment calculation as being derived from the debenture. Essentially, the underlying Debenture must be paid in full by making 120 equal payments of principal and interest, notwithstanding the amortization schedule that was printed for reference. A refund of the final payment would mean that *CDC NAME*, as a private, non-profit economic development entity, would be paying approximately 1/6 of your final semi-annual debt obligation.

I hope this helps to clarify the mistake made and the actual amount owed for your last payment. I apologize for any inconvenience this may have caused you. Should you have any further questions regarding this matter, please feel free to contact me.

Sincerely,