

# What's Working

## USING SBA FLOATERS IN A BARBELL STRATEGY

**With the Fed now in a holding pattern as they await additional data to determine the very direction of their next move, a barbell approach may be warranted. The long end of the barbell will be vital if the economy continues to weaken and yields move even lower. The short end of the barbell, on the other hand, would protect against a more resilient continued recovery or an increase in inflation expectations. Also, given the flatness in the current curve and the likelihood that this flatness will unwind relatively slowly, bonds indexed to the short end may provide a strong yield play over the next 18 to 24 months.**

SBA 7(a) pools are an ideal candidate for the short end of the barbell due to the quarterly coupon adjustment and the absence of any periodic or lifetime cap on the quarterly coupon adjustment. For those unfamiliar with SBA 7(a) pools, here are some of their key characteristics:

- Quarterly coupon adjustment
- Indexed to Prime
- No periodic or lifetime caps
- Backed by US Government
- 0% risk weighting

It's noteworthy that Prime moves lockstep with the Federal Funds Target Rate (at a spread of 300 basis points), so a security indexed to Prime is effectively indexed to the Target Rate.

The two primary types of SBA 7(a) pools are those backed by equipment loans and those backed by real estate loans. Equipment pools generally have 8- to 11-year maturities at issue, while real estate pools generally have 21-year or longer maturities at issue. While some buyers prefer the shorter maturity of the equipment pools, term is not a focal point of most buyers given the quarterly adjust and uncapped nature of the coupon.

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SBA 7(a) pools trade within a very wide price range, from modest discounts to premiums as high as fifteen points, with pricing based primarily on the reset margin of the pool's coupon. Here are three current offerings showing the large degree of pricing diversity currently available.

Type	Pool	Cpn	BP Reset Spread to Prime	Maturity	Price	Yield for Given CPR:				
						10	12	14	16	18
RE	510396	4.00	(150.0)	1/2043	<b>103.56</b>	3.29	3.21	3.13	3.05	2.96
Equip	522486	5.32	(18.4)	6/2028	<b>105.87</b>	3.40	3.29	3.19	3.07	2.96
RE	510371	5.57	7.5	2/2044	<b>109.75</b>	3.77	3.58	3.39	3.18	2.98

Beyond the ability for SBA 7(a) pools to quickly adjust to changing market levels, the table highlights the high relative yields and very wide spreads to fixed-rate alternatives currently available in these pools. At a 14 CPR, the three pools shown above provide a yield of 3.13% to 3.39%, or a spread to the 10-year Treasury yield of between 61 and 87 basis points. All three also move only slightly below 3.00% if speeds where to come in faster at 18 CPR.

While the best yield value can often be found in higher premium pools, the increasing issuance of pools priced closer to par over the last 18 months has allowed buyers more flexibility in mitigating prepayment concerns. Where prepay risk has historically been addressed by diversifying into many different pools, this becomes less important at the lower premium exposures. While there are no par price offerings currently available, SBA 510378 is a recent offering that can be used as an example.

Type	Pool	Cpn	BP Reset Spread to Prime	Maturity	Price	Yield for Given CPR:				
						10	12	14	16	18
Par RE	510378	3.10	(240.0)	2/2044	100.375	2.97	2.96	2.94	2.92	2.90

The par handle pool comes in just below 3.00% at 14 CPR, but still provides a current spread to the 10-year Treasury yield of 42 basis points, with almost no erosion in yield at faster speeds.

Whether you are looking for an uncapped floating rate security or simply trying to maximize yield in a short duration security, SBA pools may be a very good fit for you. If you have any questions about this article or would like access our extensive library of educational materials on the SBA sector, please reach out to your account rep.

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