

Phoenix Management Services “Lending Climate in America” Survey



**1st Quarter 2016
Summary, Trends and Implications**

PHOENIX
"LENDING CLIMATE IN AMERICA"

1st Quarter 2016

SUMMARY, TRENDS AND IMPLICATIONS

1. Which economic factor will have the greatest impact on the Federal Reserve's upcoming decisions on the direction of short-term interest rates in 2016?

35% of lenders believe the greatest impact on the Federal Reserve's decision on the direction of short-term interest rates in 2016 will be from the limited evidence of inflationary pressures. The next highest contingent, garnering 30% of responses, were the lenders who believe that the trend of U.S. industrial production will have the greatest impact on the Fed's decision. Not far behind, with 26% of responses, were lenders that believe the strength of the U.S. dollar will have the greatest impact. 9% believe the pace of domestic growth will have the greatest impact, while 0% of the lenders surveyed believe that the corresponding rate decisions by European Central Bank will have an impact on the Federal Reserve's decision regarding short-term interest rates.

2. Oil prices have fallen more than 70% over the past twenty-four months. Which of the following factors will have the greatest impact on oil prices in 2016?

The answer that received the highest percentage response, 35%, were lenders that believe the OPEC's consolidated efforts to limit supply in an effort to boost prices will have the greatest impact on oil prices in 2016. Garnering the second highest amount of responses, at 17%, were lenders that believe a) declining demand from China, and b) Iran's increasing production in an effort to regain market share post-international sanctions will have the greatest impact on oil prices. 15% believe that a) declining global demand (other than China), and b) reduced domestic production from U.S. companies deciding to cap production and enact expense cuts until oil prices return to recent, higher levels will have the greatest impact on oil prices in 2016.

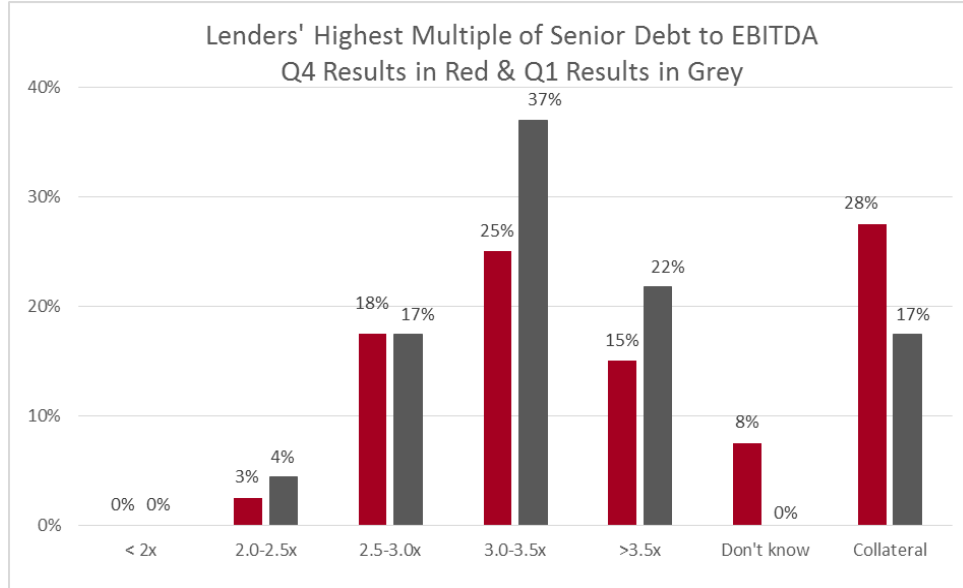
3. The average equity index- seeking to reflect the performance of publically traded financial companies – is down 12-15% for the recent 52-week timeframe. What is the most significant financial challenge currently facing banks/lending institutions?

The majority of lenders, garnering 43% of responses, believe that the increased regulations and the cost of compliance is the most significant financial challenge currently facing banks/lending institutions. Not far behind, with 28% of responses, were lenders that believe the most significant financial challenge currently facing banks/lending institutions is weak loan demand. 22% of lenders believe that troubled industry sectors placing increased pressure on credit quality metrics is the most significant financial challenge, while 4% of respondents believe that the most significant financial challenge currently facing banks/lending institutions is the prospect of negative interest rates charged by the Fed. Of the lenders surveyed, 0% believe that reduced lending as institutions hoard cash to preserve capital requirements is the most significant financial challenge currently facing banks/lending institutions.

4. Leverage multiples are expected to increase versus the prior quarter.

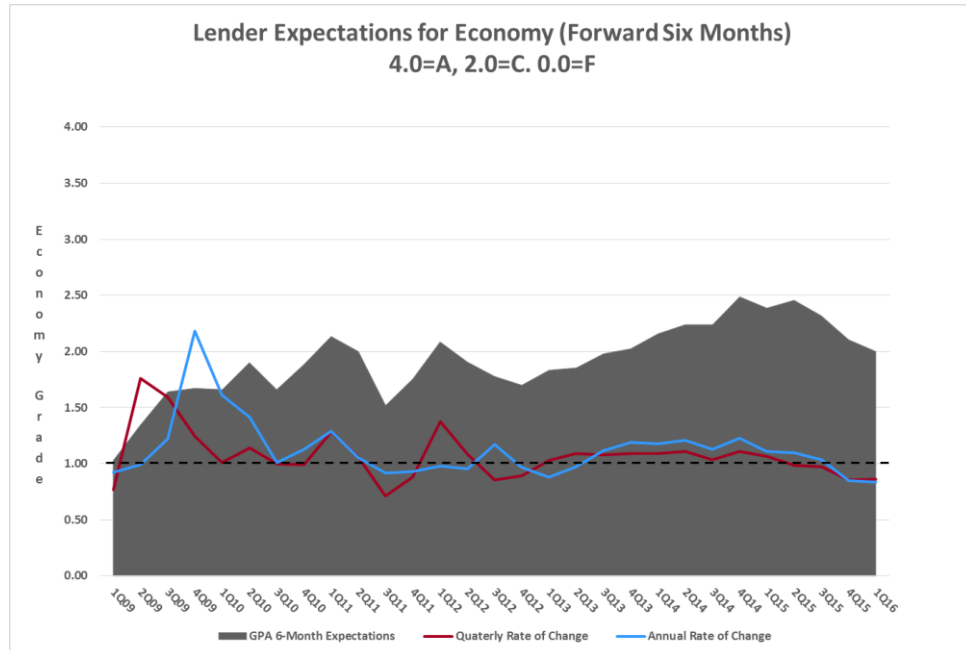
Multiples have shifted in 1Q 2016. 22% of lenders indicated the >3.5x range would be the highest EBITDA ratio they would consider, a 7 percentage point increase from the prior quarter. The percentage of respondents who would consider a debt to EBITDA ratio of 3.0-3.5x increased 12 percentage points to 37%. The percentage of lenders who indicated the highest ratio they would consider is between 2.5-3.0x saw a decrease of 1 point to 17%. 4% of respondents stated their

institutions highest multiple is in the 2.0-2.5x range and zero percent indicated their institutions highest multiple is less than 2.0x, remaining the same from the previous quarter. In addition, 17% of lenders responded that they were collateral lenders and therefore do not make decisions based on cash flow/leverage multiples.



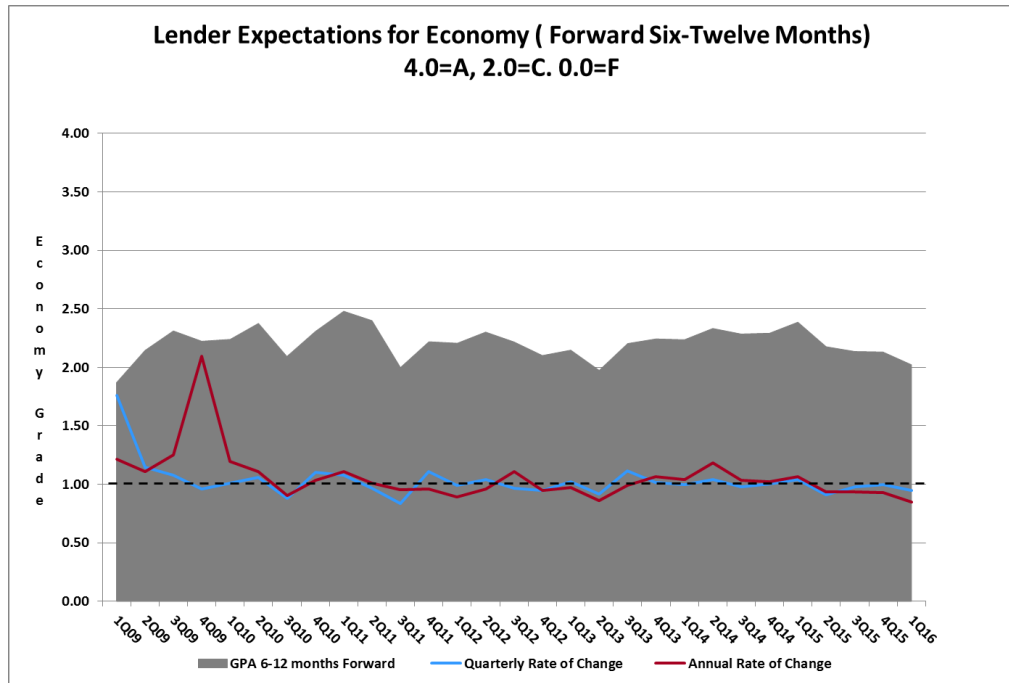
5. Economic performance expectations continue to weaken in this quarter's survey.

The near term economic growth sentiment remained at an overall “C” grade this quarter; the index GPA decreased to 2.00 from the 4Q 2015 results of 2.11. The majority of lenders (77%) believe the economy will perform at a “C” level over the next six months, compared to 68% in the previous survey. Conversely, 11% of lenders surveyed believe the economy will perform at a “B” grade, compared to 21% in the previous survey. Lenders that believe that the economy will perform at a “D” level remain unchanged in 1Q 2016 at 11%. This survey continues the recent trend in which a higher percentage of lenders believe the economy will perform in the “C” grade level versus a “B” level over the next six months.



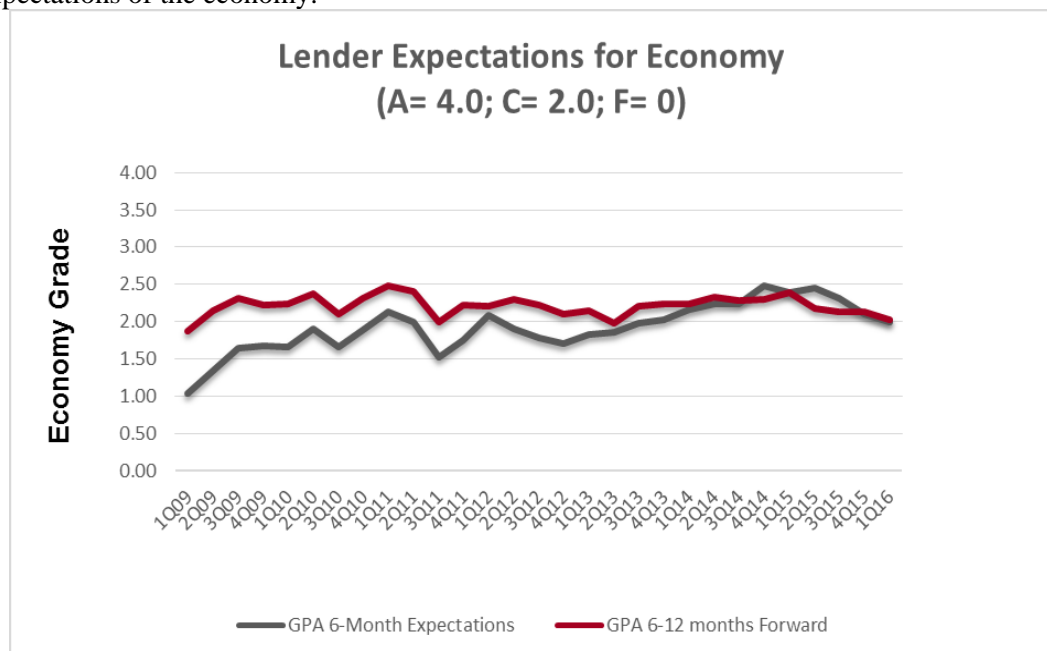
* Rate of Change of 1.0 is at equilibrium and signifies “no change” from the corresponding prior period of comparison.

Lenders growth expectations for the U.S. economy beyond six months dropped 11 points to a 2.02 GPA from 2.13 in the previous quarter, but maintains a “C” grade. 30% of lenders believe the economy will perform at a “B” level in the next six to twelve months, which is 2 percentage points higher than the previous quarter. There was a decrease (43%) of lenders believe the economy will perform at a “C” level in the next six to twelve month period, compared to 58% in the previous quarter. The percentage of respondents who believe the economy will perform at a “D” level beyond the next six months increased 16 percentage points to 27%, when compared to the previous quarter. The 1Q 2016 survey continues the trend in lenders appearing to be more pessimistic about the future.



* Rate of Change of 1.0 is at equilibrium and signifies “no change” from the corresponding prior period of comparison.

The 1Q 2016 survey reversed the recent trend of higher near term GPA than long term GPA. The 0.11 point drop in nearer term GPA implies a continuing dampening of lender’s short term expectations of the economy.



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Survey Results

1. Lenders believe the limited evidence of inflationary pressures will have the greatest impact in regards to the Federal Reserve’s upcoming decisions on the direction of short-term interest rates.

Lenders were asked: Which economic factor will have the greatest impact on the Federal Reserve’s upcoming decisions on the direction of short-term interest rates in 2016?

- 35% believe the limited evidence of inflationary pressures will be the greatest impact in regards to the Federal Reserve’s upcoming decision regarding the direction of short-term interest rates.
- 30% of lenders believe the greatest impact will be the trend of U.S. industrial production.
- 26% believe that the greatest impact will be strength of the U.S. dollar.
- 9% believe that the pace of domestic wage growth will be the greatest impact on the Federal Reserve’s decision regarding short-term interest rates.
- 0% of lenders believe that corresponding rate decisions by European Central Bank will have the greatest impact on the Federal Reserve’s decision.

2. Lenders believe that the OPEC’s consolidated efforts to limit supply in an effort to boost prices will have the greatest impact on oil prices in 2016.

Lenders were asked: Oil prices have fallen more than 70% over the past twenty-four months. Which of the following will have the greatest impact on oil prices in 2016?

- 35% of lenders believe that the OPEC’s consolidated efforts to limit supply in an effort to boost prices will have the greatest impact on oil prices in 2016.
- 17% believe that the a) declining demand from China, and b) Iran’s increasing production in an effort to regain market share post-international sanctions will have the greatest impact on oil prices.
- 15% believe that a) declining global demand (other than China), and b) the reduced domestic production from U.S. companies deciding to cap production and enact expense cuts until oil prices return to recent, higher levels will have the greatest impact on oil prices in 2016.

3. Lenders believe that increased regulations and the cost of compliance is the most significant financial challenge currently facing banks/lending institutions.

Lenders were asked: The average equity index – seeking to reflect the performance of publically traded financial companies – is down 12-15% for the most recent 52-week timeframe. What is the most significant financial challenge currently facing banks/lending institutions?

- 43% of lenders believe that increased regulations and the cost of compliance is the most significant financial challenge currently facing banks/lending institutions.
- 28% believe the most significant financial challenge currently facing banks/lending institutions is weak loan demand.
- 22% believe that troubled industry sectors placing increased pressure on credit quality metrics is the most significant financial challenge currently facing banks/lending institutions.
- 4% of lenders believe the prospect of negative interest rates charged by the Fed is currently the most significant financial challenge facing banks/lending institutions.
- 0% of the lenders surveyed believe reduced lending as institutions hoard cash to preserve capital requirements is the most significant financial challenge facing banks/lending institutions.

4. Highest Senior Debt to EBITDA Leverage Institutions Would Consider

Respondents were asked the highest multiple of Senior Debt to EBITDA their financial institution would consider with regard to a loan request.

<u>EBITDA Level</u>	<u>4Q 2015</u>	<u>1Q 2016</u>
Greater than 3.5x	15%	22%
Between 3.01x and 3.50x	25%	37%
Between 2.51x and 3.00x	18%	17%
Between 2.01x and 2.50x	3%	4%
Less than 2.0x	0%	0%
Collateral lenders	28%	17%
N/A	8%	0%

5. Anticipated Change in Senior Debt to EBITDA Multiple

Respondents were asked, over the next six months, how the Senior Debt to EBITDA multiple would change at their financial institution.

<u>Change in Senior Debt to EBITDA Level</u>	<u>4Q 2015</u>	<u>1Q 2016</u>
Increase greater than 0.5x	3%	0%
Increase less than 0.5x	3%	2%
Decrease less than 0.5x	10%	20%
Decrease greater than 0.5x	0%	5%
No change	55%	52%
Collateral lenders	20%	17%
N/A	5%	2%

6. Factors with Strongest Potential to Affect Near-Term Economy

Respondents were asked, over the next six months, which two factors had the strongest potential to affect the economy.

<u>Factors Affecting Near-Term Economy</u>	<u>4Q 2015</u>	<u>1Q 2016</u>
Unstable Energy Prices	50%	67%
Stability of Stock Market	50%	49%
Constrained Liquidity in Capital Markets	29%	27%
Sluggish Housing Market	26%	18%
U.S. Budget Deficit	11%	9%
Other	32%	9%

7. Industries Expected to Experience Greatest Volatility

Respondents were asked, over the next six months, which industries will experience the most volatility (i.e. Chapter 11 filings, mergers and acquisitions, declining profits, etc.). Respondents were asked to select the top three industries.

<u>Industries Experiencing Most Volatility</u>	<u>4Q 2015</u>	<u>1Q 2016</u>
Mining	68%	70%
Retail Trade	57%	47%
Manufacturing	11%	29%
Construction	24%	27%
Finance and Insurance	14%	27%
Healthcare and Social Assistance	32%	20%
Utilities	8%	16%

8. Customers' Plans in the Next Six to Twelve Months

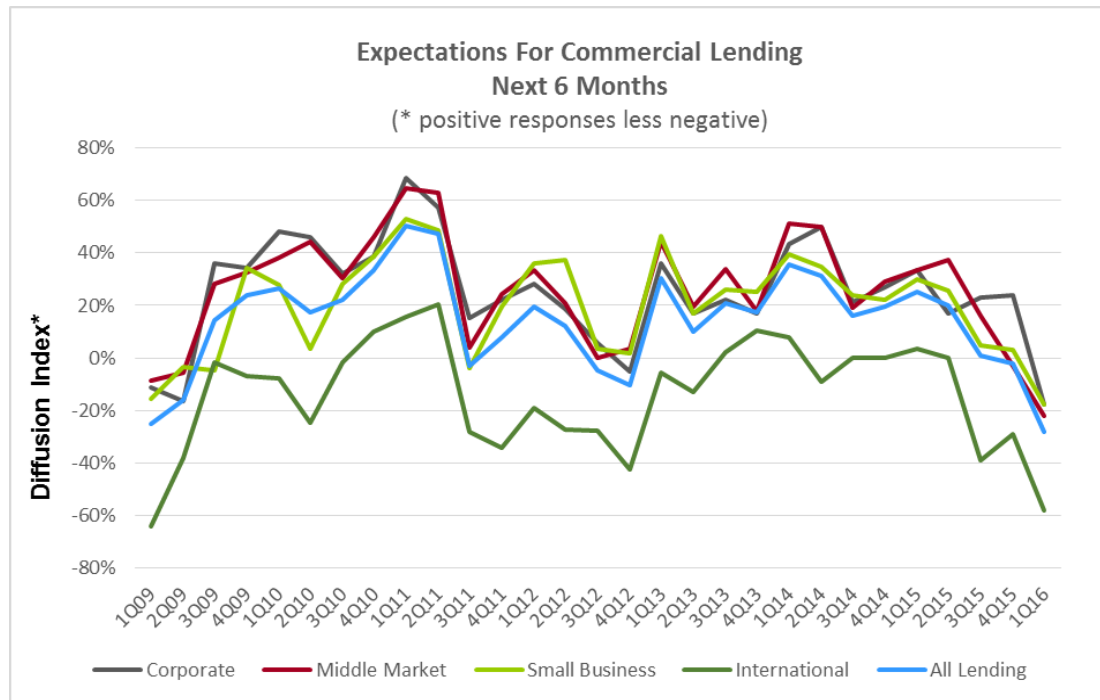
Respondents were asked which of the following actions their customers planned in the next six months. Lenders were asked to designate all potential customer actions that applied.

<u>Customers' Plans</u>	<u>4Q 2015</u>	<u>1Q 2016</u>
Making an Acquisition	62%	65%
Introducing New Products or Services	41%	51%
Capital Improvements	60%	44%
Entering New Markets	49%	42%
Raising Additional Capital	27%	35%
Hiring New Employees	46%	23%
"Other" Initiatives	11%	5%

9. Economic Indicators

Respondents were asked whether they expected the following economic indicators to be up, down, or remain the same over the next six months.

- In 1Q 2016, lenders optimism decreased significantly in middle market from a negative 3% in 4Q 2015 to a negative 22%. Additionally, expectations decreased for small business in 1Q 2016 with a diffusion index of negative 18%, a 21 percentage point difference from the previous quarter of 3%. The overall lending diffusion index decreased to negative 28% from a negative 2% in the prior quarter's survey. The domestic lending diffusion index decreased as well this quarter, decreasing 10 points to negative 18%. The diffusion index for international lending also continued to stay in the negatives, however decreasing significantly to a negative 58% from negative 29% in the previous quarter.



	<u>4Q/2015</u>			<u>1Q/2016</u>		
	<u>Up</u>	<u>Down</u>	<u>Same</u>	<u>Up</u>	<u>Down</u>	<u>Same</u>
Corporate Lending	29%	5%	66%	5%	23%	73%
Middle Market Lending	21%	24%	55%	7%	25%	68%
Small Business Lending	21%	18%	60%	9%	27%	64%
International Lending	14%	43%	43%	5%	63%	33%

- The interest rate diffusion significantly decreased to a 40% compared to a high 87% the previous quarter. Loan losses diffusion index increased dramatically to 61% in Q1 2016 compared to 35% in Q4 2015. The bankruptcies diffusion index increased to 51% from 29% in the previous quarter, which is the highest it has been since Q4 2009.

	<u>4Q/2015</u>			<u>1Q/2016</u>		
	<u>Up</u>	<u>Down</u>	<u>Same</u>	<u>Up</u>	<u>Down</u>	<u>Same</u>
Loan Losses	40%	5%	55%	61%	0%	39%
Bankruptcies	34%	5%	61%	57%	0%	43%
Interest Rates	87%	0%	13%	40%	0%	61%
Unemployment	5%	5%	90%	7%	9%	84%
Bank Failures	0%	14%	86%	11%	5%	84%

10. U.S. Economy Grade – Next Six Months

Respondents were asked how they expected the U.S. economy to perform during the next six months on a grading scale of A through F.

- Lenders optimism on the U.S. economy showed a slight decline this quarter, but its GPA remains at the “C” level, with a 2.11 in 4Q 2015 to 2.00 in 1Q 2016. In the current quarter, 77% of respondents believe the economy will perform at a “C” level, which represents an increase of 9 points from the previous quarter. The grade-point average remains at the “C” level as there has been concentration of opinions. 11% of lenders believe the economy will perform at a “B” level, a 10 point decrease, and 11% believe the economy will perform at a “D” level, remaining unchanged from the previous quarter.

<u>Grade</u>	<u>4Q/2015</u>	<u>1Q/2016</u>
A	0%	0%
B	21%	11%
C	68%	77%
D	11%	11%
F	0%	0%
Weighted Average Grade	2.11	2.00

11. US Economy Grade – Beyond the Next Six Months

Respondents were asked how they expected the U.S. economy to perform beyond the next six months on a grading scale of A through F.

- Lenders expectations for the U.S. economy’s performance in the longer term has decreased from the prior quarter. The weighted average GPA decreased 11 points from a 2.13 in the previous quarter to 2.02, which is a “C” grade. 30% of lenders feel as though the economy will perform at a “B” level beyond the next six months (compared to 28% last quarter). Lenders who believe the economy will perform at a “C” over the next twelve months decreased 15 points from a 58% in Q4 2015 to 43% in Q1 2016. There was an increase of lenders (27%) that believe the economy will perform at a “D” grade over the next six to twelve months while 0% believe the economy will perform at an “F” grade.

<u>Grade</u>	<u>4Q/2015</u>	<u>1Q/2016</u>
A	0%	0%
B	28%	30%
C	58%	43%
D	11%	27%
F	3%	0%
Weighted Average	2.13	2.02

12. Customers’ Future Growth Expectations

Lenders assessed their customers’ growth expectations for the next six months to a year.

- The percentage of respondents indicating their customers have “moderate” growth expectations for the next six months to one year increased by 6 points compared to 4Q 2015. With a shift back towards moderation, 0% of lenders ascribe “very strong growth” as well as “strong growth” for their borrower’s growth in the next six months. There was a 14 point increase in lenders favoring “no growth” to 27%. The continued belief of “moderate growth” is a positive signal from lenders on the U.S. economy.

<u>Indication</u>	<u>4Q/2015</u>	<u>1Q/2016</u>
Very Strong	0%	0%
Strong	8%	0%
Moderate	79%	73%
No Growth	13%	27%

13. Loan Structure

Respondents were asked whether their financial institutions planned to tighten, relax, or maintain their loan structures (collateral requirements, guarantees, advance rates, loan covenants, etc.) in each of four different-sized loan categories.

- Many lenders are content right now and plan to maintain their current loan structure. However, in 1Q 2016 we did see a slight increase with lenders that plan to tighten their loan structure.

	<u>4Q/2016</u>			<u>1Q/2016</u>		
	<u>Tighten</u>	<u>Maintain</u>	<u>Relax</u>	<u>Tighten</u>	<u>Maintain</u>	<u>Relax</u>
Loans > \$25 million	14%	78%	8%	20%	78%	2%
\$15 – 25 million	11%	86%	3%	20%	78%	2%
\$5-15 million	14%	83%	3%	14%	83%	2%
Under \$5 million	11%	84%	5%	16%	82%	2%
Overall Average	12%	83%	5%	17%	80%	2%

14. Interest Rate Spread

Lenders were asked whether their financial institutions planned to reduce, maintain or increase their interest rate spreads and fee structures on similar credit quality loans.

- While a majority of lenders continue to maintain their interest rate spreads and fee structures, lenders indicated a slight across-the-board uptick in their plan to decrease interest rates.

	<u>4Q/2015</u>			<u>1Q/2016</u>		
	<u>Reduce</u>	<u>Maintain</u>	<u>Increase</u>	<u>Reduce</u>	<u>Maintain</u>	<u>Increase</u>
Loans > \$25 million	11%	75%	14%	17%	71%	12%
\$15 – 25 million	6%	77%	17%	15%	68%	17%
\$5-15 million	6%	69%	25%	9%	67%	24%
Under \$5 million	3%	59%	38%	7%	61%	33%
Overall Average	6%	71%	23%	12%	67%	21%

15. The Fed and Interest Rates

Respondents were asked in what direction the Fed would move interest rates and by how much in the coming six months.

1Q 2016 saw a less proportionate dispersal between +1/4 point and +1/2 point with 50% of respondents favoring +1/4 point. There was also a 34% increase in 1Q 2016 with lenders expecting interest rates to remain unchanged.

<u>Bps Change</u>	<u>4Q/2015</u>	<u>1Q/2016</u>
+ 1/2 point or more	58%	14%
+ 1/4 point	42%	50%
Unchanged	0%	34%
- 1/4 point	0%	2%
- 1/2 point or more	0%	0%
Weighted Average	0.39 bps	0.19 bps

16. Current Competition

Respondents were asked to identify the segment of the industry from which they were experiencing the most competition.

- Regional Banks and local commercial/community banks saw a slight decrease in the number of responses but continue to place at the top in regards to respondents for the survey. Money Center Banks saw a slight increase, while Commercial Finance saw a slight decrease in the number of respondents.

	<u>4Q/2015</u>	<u>1Q/2016</u>
Regional Bank	34%	30%
Local Community/Commercial Bank	26%	22%
Commercial Finance Co.	21%	17%
Money Center Banks	13%	15%
Factors	0%	0%
Other:	5%	11%