

Phoenix Management Services “Lending Climate in America” Survey



**3rd Quarter 2018
Summary, Trends and Implications**

PHOENIX
"LENDING CLIMATE IN AMERICA"

3rd Quarter 2018

SUMMARY, TRENDS AND IMPLICATIONS

- 1. The Trump Administration has reached a preliminary deal with Mexico that would make key changes to NAFTA. Do you feel the U.S. economy would benefit from re-negotiating NAFTA?**

Garnering the highest percentage of responses (60%), were lenders that felt positive about re-negotiating NAFTA and believe it has aging elements that should be re-visited by the U.S. Of the lenders surveyed, 25% were neutral in their decision and believe that the U.S. economy will continue to grow whether NAFTA is changed or not. Lenders whose opinions were negative, believing that re-negotiating NAFTA will have serious consequences on the U.S., garnered 16% of the responses.

- 2. President Trump's proposed tariffs are intended to address China's trade deficit and intellectual property theft. What do you think will be the long-term impact of the tariffs on U.S. companies?**

The answer that received the highest percentage response, 56%, were the lenders whose opinions were negative in regard to Trump's proposed tariffs and believe that it will cause U.S. companies' cost to increase resulting in higher prices for consumers, manufacturing to move offshore, and ultimately a slowdown in U.S. GDP growth. Lenders whose opinions were positive and believe that the tariffs will cause an increase in demand for American-made products, which will increase production in American factories, eliminate trade barriers, and help shrink the U.S.'s \$568 billion trade deficit, garnered 44% of the responses.

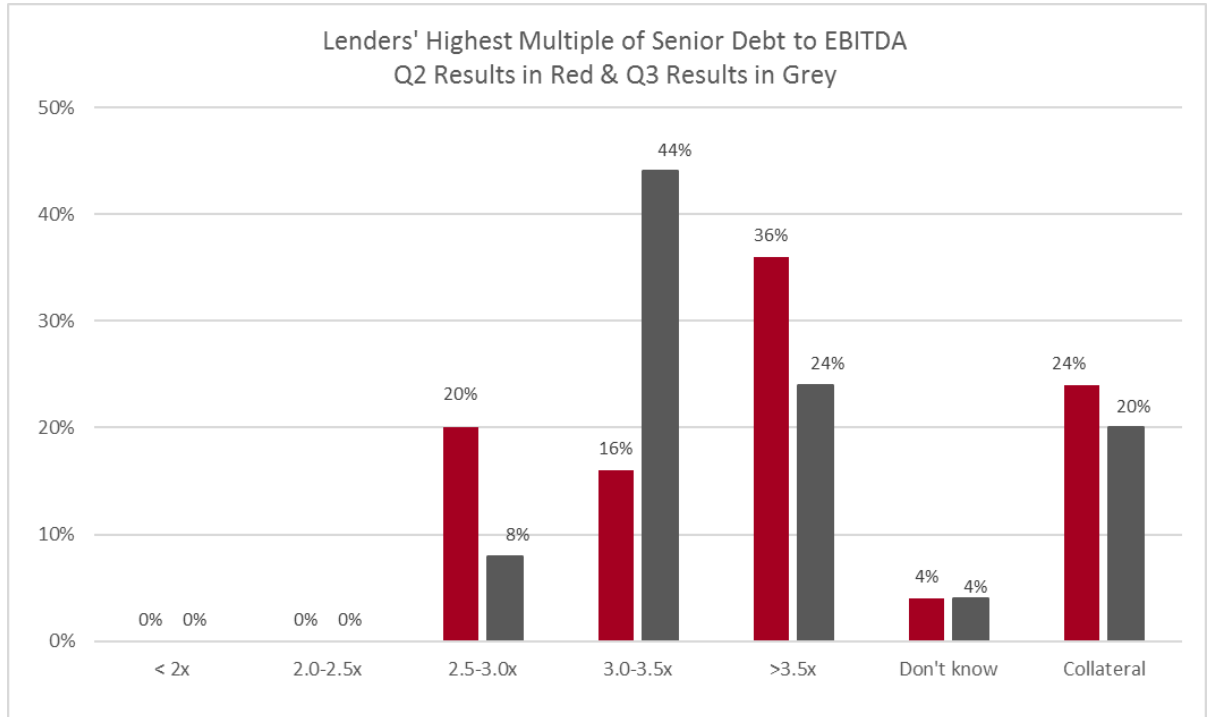
- 3. Currently, 80% of U.S. construction companies are experiencing a workforce shortage. This imbalance between supply and demand is impacting the cost of construction companies' projects. Risks to lenders to construction companies is increasing due to rising instances of delays in completing the project, failures to complete the projects, or the incurrences of costs in excess to the project's budget. In your opinion, what is the main driver for the construction worker shortage?**

Lenders were evenly split on two responses, which garnered 40% each: a) the new workforce doesn't view construction as a good paying career, and b) controlled immigration and an aging workforce as the two main drivers for the construction workers shortage. Lenders garnering 16% of responses think the main driver for the construction workers shortage is because after the recession hit, skilled workers left the industry and have never returned. 4% of lenders surveyed think the construction workers shortage is due to projects being too small and workers are looking for the security of long-term.

- 4. Leverage multiples shifted this quarter.**

Multiples shifted in 3Q 2018 with 24% of lenders indicating that the >3.5x range would be the highest EBITDA ratio they would consider versus 36% in 2Q 2018. The percentage of respondents who would consider a debt to EBITDA ratio of 3.0-3.5x increased to 44% from the previous quarter's results of 16%. The percentage of lenders who indicated the highest ratio they would

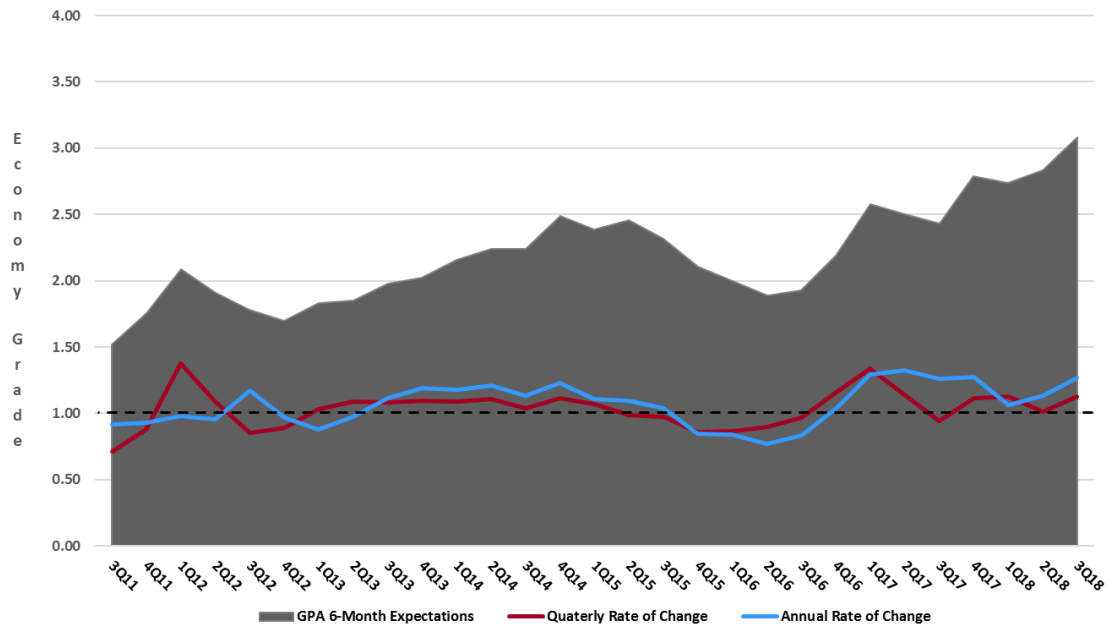
consider is between 2.5-3.0x decreased 12 percentage points to 8%, and 20% of lenders responded that they were collateral lenders and therefore do not make decisions based on cash flow/leverage multiples.



5. Economic performance expectations increase for the near term in this quarter's survey.

Lenders optimism in the U.S. economy for the short term increased this quarter and remains at an overall “B” grade; the index GPA increased to 3.08 from the 2Q 2018 results of 2.83. 83% of the lenders believe the economy will perform at a “B” level over the next six months, compared to 67% in the previous survey. Of the lenders surveyed, 13% expect the U.S. economy to perform at an “A” grade. Furthermore, 4% of lenders surveyed believe the economy will perform at a “C” grade, compared to 25% in the previous survey, and none of the lenders surveyed believe that the economy will perform at a “D” or “F” level.

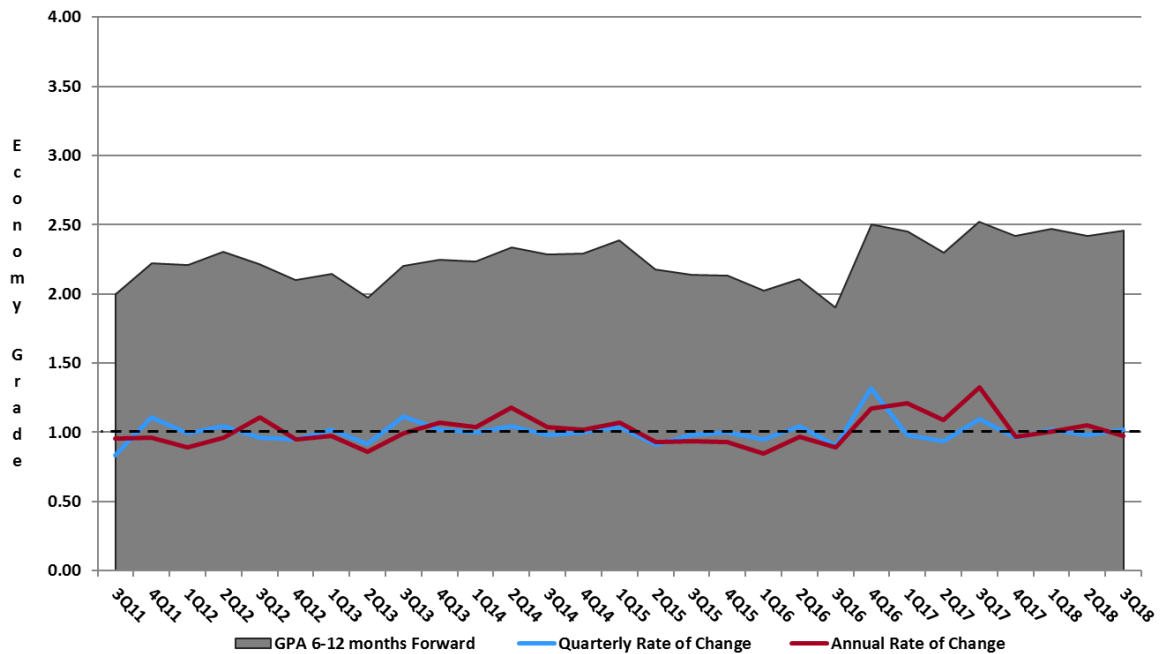
Lender Expectations for Economy (Forward Six Months) 4.0=A, 2.0=C. 0.0=F



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

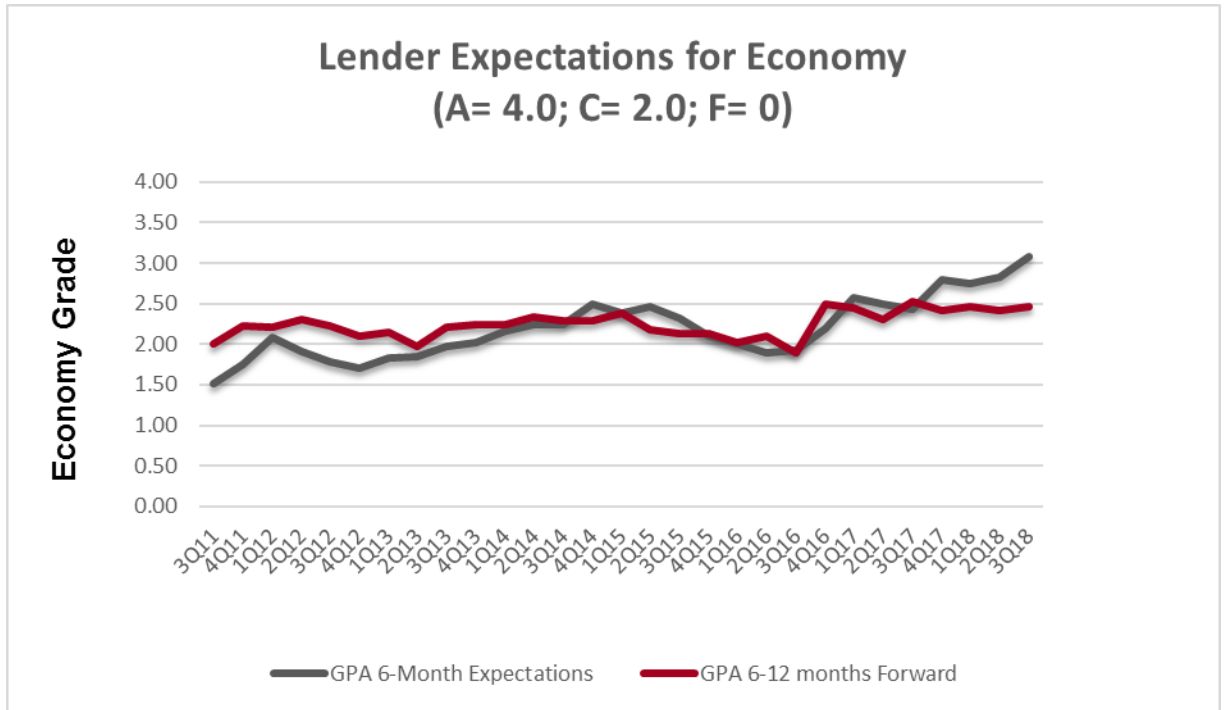
Lenders growth expectations for the U.S. economy beyond six months remained at an overall “B” grade this quarter. The weighted average increased 4 points to a 2.46 GPA from 2.42 in the previous quarter. 42% of lenders believe the economy will perform at a “B” level in the next six to twelve months, which is a 4 percentage point decrease from the previous quarter. The percent of lenders (50%) that believe the economy will perform at a “C” level increased 12 percentage points from the previous quarter. However, the percentage of respondents who believe the economy will perform at a “D” level beyond the next six months decreased from 12% to 4%.

Lender Expectations for Economy (Forward Six-Twelve Months) 4.0=A, 2.0=C. 0.0=F



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

The 3Q 2018 survey continues the recent trend of a higher near-term GPA than long term GPA. The grade of “B” reflects lender’s positive expectations for the economy in both the near and long term.



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Survey Results

- 1. The majority of Lenders believe the U.S. economy would benefit from re-negotiating NAFTA as it has aging elements that should be revisited by the U.S., Mexico, and Canada.**

Lenders were asked: The Trump Administration has reached a preliminary deal with Mexico that would make key changes to NAFTA. Do you feel the U.S. economy would benefit from re-negotiating NAFTA?

Yes: NAFTA has aging elements that should be re-visited by the U.S., Mexico, and Canada.	60%
Neutral: The U.S. economy will continue to grow whether NAFTA is changed or not.	24%
No: Re-negotiating NAFTA could have serious consequences for the U.S. economy.	16%

- 2. Lenders believe the long-term impact of President Trump’s proposed tariffs will be negative as U.S. companies’ cost will increase, causing higher prices for consumers, manufacturing to move offshore, and ultimately a slowdown in the U.S. GDP growth.**

Lenders were asked: President Trump's proposed tariffs are intended to address China's trade deficit and intellectual property theft. What do you think will be the long-term impact of the tariffs on U.S. companies?

Negative: U.S. companies' cost will increase, causing higher prices for consumers, manufacturing to move offshore, and ultimately a slowdown in U.S. GDP growth.	56%
Positive: The tariffs will cause an increase in demand for American-made products, which will increase production in American factories, eliminate trade barriers, and help shrink the U.S.'s \$568 billion trade deficit.	44%

3. Lenders believe the two main drivers for the construction workers shortage is due to the new workforce generation not viewing construction as a good paying career, and because of controlled immigration and an aging workforce.

Lenders were asked: Currently, 80% of U.S. construction companies are experiencing a workforce shortage. This imbalance between supply and demand is impacting the cost of construction companies' projects. Risks to lenders to construction companies is increasing due to rising instances of delays in completing the project, failures to complete the projects, or the incurrences of costs in excess to the project's budget. In your opinion, what is the main driver for the construction worker shortage?

The new workforce generation does not view construction as a good paying career.	40%
Controlled immigration and an aging workforce.	40%
After the recession hit, skilled workers left the industry and have never returned.	16%
The projects are too small, workers are looking for the security of long-term.	4%

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>2Q 2018</u>	<u>3Q 2018</u>
Greater than 3.5x	36%	24%
Between 3.01x and 3.50x	16%	44%
Between 2.51x and 3.00x	20%	8%
Between 2.01x and 2.50x	0%	0%
Less than 2.0x	0%	0%
Collateral lenders	24%	20%
N/A	4%	4%

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>2Q 2018</u>	<u>3Q 2018</u>
Increase greater than 0.5x	0%	4%
Increase less than 0.5x	12%	4%
Decrease less than 0.5x	4%	0%
Decrease greater than 0.5x	0%	4%
No change	56%	68%
Collateral lenders	24%	16%
N/A	4%	4%

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>2Q 2018</u>	<u>3Q 2018</u>
Other	33%	48%
Stability of Stock Market	46%	32%
Unstable Energy Prices	46%	32%
U.S. Budget Deficit	25%	32%
Constrained Liquidity in Capital Markets	8%	20%
Sluggish Housing Market	17%	16%

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>2Q 2018</u>	<u>3Q 2018</u>
Retail Trade	70%	88%
Real Estate and Rental/Leasing	25%	28%
Transportation and Warehousing	8%	20%
Agriculture, Forestry, Fishing & Hunting	8%	16%
Mining	25%	12%
Healthcare and Social Assistance	42%	12%
Wholesale Trade	0%	12%

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

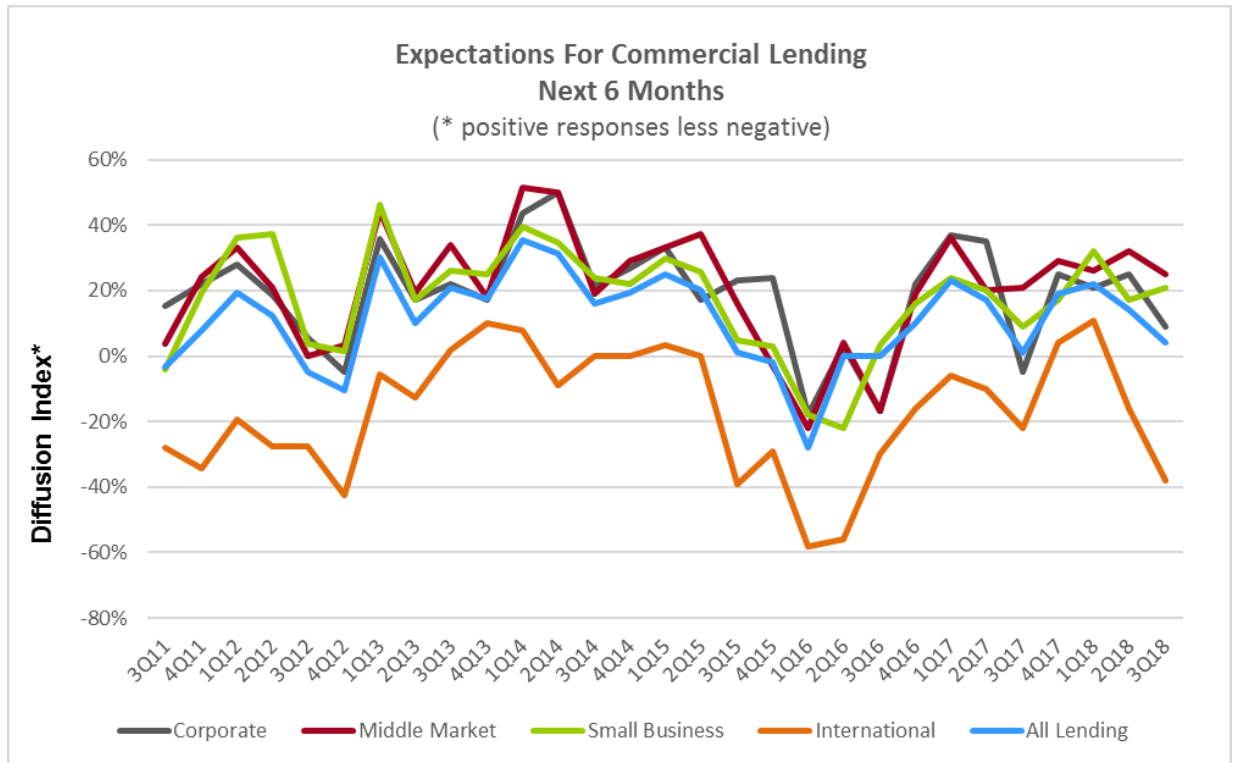
Respondents were asked which of the following actions their customers planned in the next six to twelve months. Lenders were asked to designate all potential customer actions that applied.

<u>Customers' Plans</u>	<u>2Q 2018</u>	<u>3Q 2018</u>
Capital Improvements	79%	84%
Hiring New Employees	63%	76%
Raising Additional Capital	38%	48%
Making an Acquisition	67%	44%
Introducing New Products or Services	46%	40%
Entering New Markets	42%	32%
"Other" Initiatives	4%	0%

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 3Q 2018, lenders optimism decreased in large corporate (9%) and middle market (25%). However, expectations increased slightly for small business in 3Q 2018 with a diffusion index of 21%, a 4-percentage point difference from the previous quarter of 17%. The diffusion index for international lending decreased significantly from -16% in 2Q 2018 to -38% in 3Q 2018. The diffusion index for the average for all domestic lending slightly decreased from 25% in 2Q 2018 to 18% in 3Q 2018, and the diffusion index for all lending decreased to 4% from 14% in Q2 2018.



	<u>2Q/2018</u>					<u>3Q/2018</u>			
	<u>Up</u>	<u>Down</u>	<u>Same</u>	<u>Diffusion Index</u>		<u>Up</u>	<u>Down</u>	<u>Same</u>	<u>Diffusion Index</u>
Corporate Lending	33%	8%	59%	25%	Corporate Lending	17%	8%	75%	9%
Middle Market Lending	45%	13%	42%	32%	Middle Market Lending	25%	0%	75%	25%
Small Business Lending	38%	21%	41%	17%	Small Business Lending	30%	9%	61%	21%
International Lending	13%	29%	58%	-16%	International Lending	24%	6%	70%	-38%

- The interest rate diffusion index in Q3 2018 continues to remain unchanged at 100%. Loan losses diffusion index increased 5 percentage points to 34% in Q3 2018 compared to 29% in Q2 2018, and the bankruptcies diffusion index also decreased from a 29% in Q2 2018 to 21%.

	<u>2Q/2017</u>					<u>3Q/2018</u>			
	<u>Up</u>	<u>Down</u>	<u>Same</u>	<u>Diffusion Index</u>		<u>Up</u>	<u>Down</u>	<u>Same</u>	<u>Diffusion Index</u>
Loan Losses	33%	4%	63%	29%	Loan Losses	38%	4%	58%	34%
Bankruptcies	42%	13%	45%	29%	Bankruptcies	25%	4%	71%	21%

Interest Rates	100%	0%	0%	100%	Interest Rates	100%	0%	0%	100%
Unemployment	8%	21%	71%	-13%	Unemployment	9%	13%	78%	-4%
Bank Failures	4%	17%	79%	-13%	Bank Failures	0%	4%	96%	-4%

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 significantly increased this quarter from 2.83 in 2Q 2018 to 3.08 in 3Q 2018, which continues to remain at an overall “B” grade. In the current quarter, 83% of respondents believe the economy will perform at a “B” level, which represents an increase of 16 points from the previous quarter. There was also an increase of lenders (13%) that believe the economy will perform at an “A” level, and a decrease of lenders (4%) that believe that economy will perform at a “C” level.

<u>Grade</u>	<u>2Q/2018</u>	<u>3Q/2018</u>
A	8%	13%
B	67%	83%
C	25%	4%
D	0%	0%
F	0%	0%
Weighted Average Grade	2.83	3.08

11. U.S. 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 increased from the prior quarter. The weighted average GPA increased 4 points from a 2.42 in the previous quarter to 2.46, which is a “B” grade. 42% of lenders feel as though the economy will perform at a “B” level beyond the next six months (compared to 46% last quarter). Lenders who believe the economy will perform at a “C” over the next twelve months increased 12 percentage points to a 50%. However, there was a decrease of lenders (4%) that believe the economy will perform at a “D” grade over the next six to twelve months, and 4% continue to believe the economy will perform at an “A” grade.

<u>Grade</u>	<u>2Q/2018</u>	<u>3Q/2018</u>
A	4%	4%
B	46%	42%
C	38%	50%
D	12%	4%
F	0%	0%
Weighted Average Grade	2.42	2.46

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 remains unchanged at 58%. 33% of lenders ascribe "strong" growth for their borrower's in the next six months, a 1-percentage point decrease from Q2 2018. Furthermore, 9% of lenders believe their customers have "very strong" growth prospects. This view of "moderate" and "strong" growth is a positive signal from lenders on the U.S. economy.

<u>Indication</u>	<u>2Q/2018</u>	<u>3Q/2018</u>
Very Strong	8%	9%
Strong	34%	33%
Moderate	58%	58%
No Growth	0%	0%

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 3Q 2018 we did see a slight decrease, 10 percentage points, of lenders that plan to relax their loan structure.

	<u>2Q/2018</u>			<u>3Q/2018</u>		
	<u>Tighten</u>	<u>Maintain</u>	<u>Relax</u>	<u>Tighten</u>	<u>Maintain</u>	<u>Relax</u>
Loans > \$25 million	5%	77%	18%	5%	90%	5%
\$15 – 25 million	5%	86%	9%	5%	95%	0%
\$5-15 million	17%	70%	13%	5%	95%	0%
Under \$5 million	16%	71%	13%	17%	75%	8%
Overall Average	11%	76%	13%	8%	89%	3%

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.

A majority of lenders continue to maintain their interest rate spreads and fee structures. In Q3 2018, the percentage of lenders that plan to reduce their interest rate spreads increased to 29%, and there was a 12-percentage point decrease (4%) that plan to increase their interest rate spreads.

	<u>2Q/2018</u>			<u>3Q/2018</u>		
	<u>Reduce</u>	<u>Maintain</u>	<u>Increase</u>	<u>Reduce</u>	<u>Maintain</u>	<u>Increase</u>
Loans > \$25 million	23%	73%	4%	27%	73%	0%
\$15 – 25 million	23%	73%	4%	32%	64%	4%
\$5-15 million	22%	52%	26%	39%	57%	4%

Under \$5 million	13%	57%	30%	17%	74%	9%
Overall Average	20%	64%	16%	29%	67%	4%

15. The Fed and Interest Rates

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

100% of respondents in 3Q 2018 believe the Fed will raise interest rates in the next six months, with 67% of respondents favoring an increase of +1/2 point or more and 33% of respondents favoring +1/4 point increase.

<u>Bps Change</u>	<u>2Q/2018</u>	<u>3Q/2018</u>
+ 1/2 point or more	96%	67%
+ 1/4 point	4%	33%
Unchanged	0%	0%
- 1/4 point	0%	0%
- 1/2 point or more	0%	0%
Weighted Average	0.58 bps	0.42 bps

16. Current Competition

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

- Regional Banks continue to place at the top of the survey, garnering 33% of responses. Commercial Finance, at 21% of respondents, saw an increase of 4 percentage points. Local Community/Commercial Bank saw an increase with 21% of respondents, and Money Center Banks also saw a slight increase in respondents (13%).

	<u>2Q/2018</u>	<u>3Q/2018</u>
Regional Bank	50%	33%
Commercial Finance Co.	17%	21%
Local Community/Commercial Bank	13%	21%
Money Center Banks	8%	13%
Factors	4%	0%
Other	8%	12%