Phoenix Management Services
"Lending Climate in America" Survey

3rd Quarter 2014
Summary, Trends and Implications

PHOENIX
"LENDING CLIMATE IN AMERICA"

3rd Quarter 2014

SUMMARY, TRENDS AND IMPLICATIONS

1. **With the anticipated end of the Fed's Quantitative Easing program in October, which of the following do you think is the most likely economic impact from the Fed's move out of the market?**

   The lenders surveyed this quarter were split on the impact the Fed's move would have on markets. The highest percentage of lenders, at thirty-one percent, believe the Fed's impact will take hold in the housing market, causing slower U.S. housing growth due to higher mortgage rates. The next highest contingent, garnering twenty-nine percent of the responses, were the lenders who believe the end of the Quantitative Easing program will cause negative pressure on U.S. equities. The next highest response rate, at twenty-one percent, believe that the U.S. dollar will strengthen versus foreign currencies and exports. Fifteen percent of lenders believe that domestic banks will outperform the rest of the stock market, in part due to higher net interest margin. The remainder of lenders wrote in their responses and included some of the following thoughts:

   "There will be no significant effect from the end of the Fed's Quantitative Easing program."

   "Low interest rates will continue through 2015."

2. **The Federal Reserve has recently displayed its concern about the underutilization of labor resources. What is your outlook on the unemployment rate and condition of the U.S. labor market?**

   While there were four choices to choose from, there was a very clear divide in the lenders surveyed. The answer that received the highest percentage response, at sixty-three percent of the respondents, was that the unemployment rate will continue to overstate the strength of the current labor market. The next highest answer, garnering a quarter of responses, was that the utilization of labor will increase as unemployment continues to decrease. A few lenders, six percent, believe the unemployment rate is an accurate measurement of the labor market as fewer people are leaving the workforce. The remaining six percent of respondents wrote in their own responses, which include the following response:

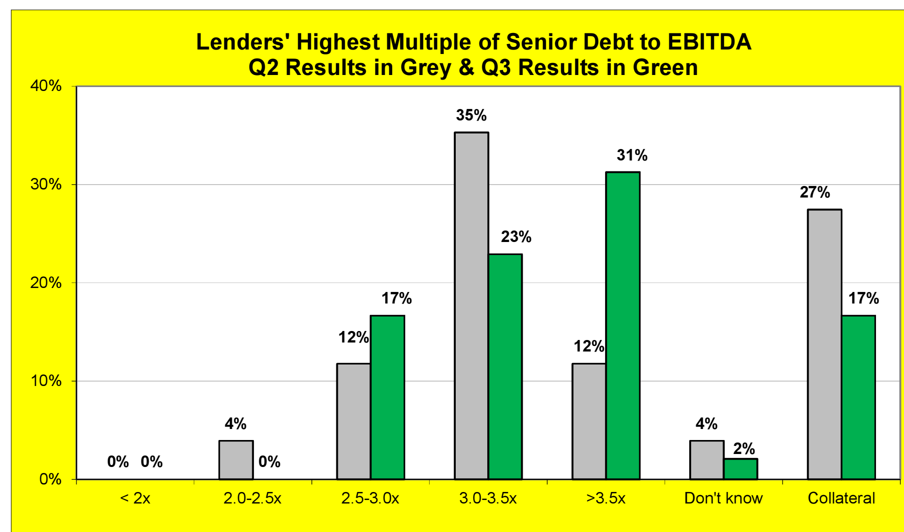
   "The true unemployment rate is higher than currently stated."

3. **While the U.S. has shown many signs of an improving economy, the global recovery has not kept pace. What do you believe will be the largest domestic impact of the divergence in economic recoveries?**

   Forty-four percent of respondents believe that the U.S. economic growth will be curtailed by a decline in the global economy. They believe the international economic conditions will outweigh the recent positive domestic economic measurements. The second highest contingent, at thirty-one percent, believes that the domestic growth is contingent upon the actions taken by the worlds most developed and industrialized countries. At fifteen percent of the responses, the next group of lenders are optimistic. They believe that the U.S. will be able to sustain domestic economic growth, independent of the international economies. Four percent of respondents believe that continued U.S. growth is dependent upon the proactive actions of foreign central banks.

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

Lenders' increased their appetite for leverage in 3Q 2014, with the highest percentage of lenders, at thirty-one percent, now indicating that the highest senior debt to EBITDA ratio their institution would consider is greater than 3.5x versus only twelve percent in 2Q 2014. Twenty-three percent of surveyed lenders indicated that the highest debt to EBITDA ratio they would consider is in the 3.0-3.5x range, which is twelve percentage points less than the prior quarter. Seventeen percent of lenders indicated that collateral supersedes senior debt to EBITDA ratio when considering a loan request, a decrease of ten percentage points from the last quarter. There was a slight increase in the number of the 2.5-3.0x range respondents, which was five percent increase from 2Q 2014 to seventeen percent. However, zero respondents stated their institutions highest multiple is in the 2.0-2.5x range, which garnered four percent the prior quarter.



5. **Senior debt to EBITDA leverage ratios are expected to remain stable over the next six months.**

The highest number, fifty-four percent of respondents, believe their institution will experience no change in leverage ratios over the next six months compared to forty-five percent that shared the same sentiment last quarter. Seventeen percent of respondents indicated they were collateral lenders and did not specifically focus on senior debt to EBITDA multiples (down nine percentage points from the previous survey). Thirteen percent of lenders believe there will be an increase of less than 0.5x the same as the prior quarter. Zero respondents believe they will increase leverage ratios greater than 0.5x compared to eight percent in the previous quarter. Lenders continue to expect minimal changes in their leverage ratios, as only seventeen percent of respondents believe that it will increase or decrease, down three percentage points from the prior quarter.

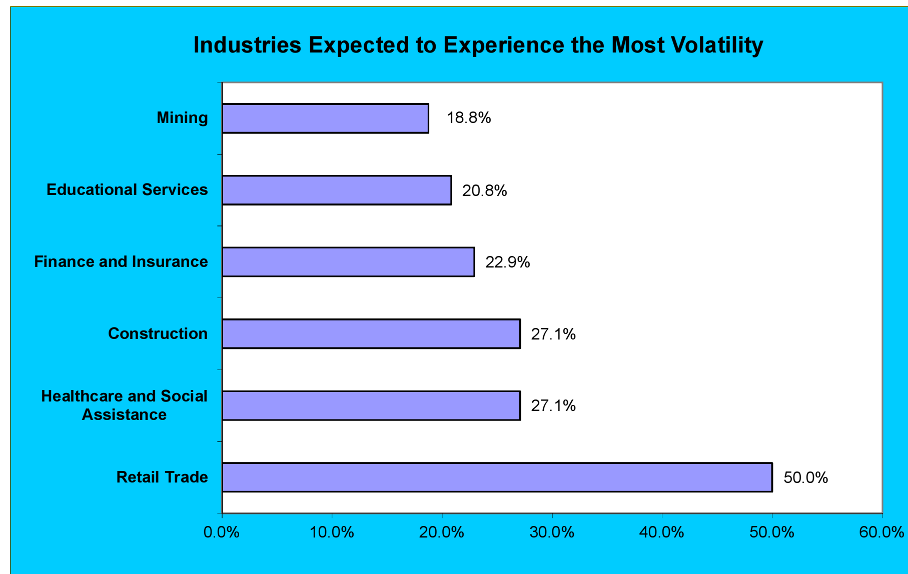
6. **Lenders are concerned with the U.S. housing market and the stability of the stock market.**

When asked to choose two factors that could have the strongest potential to negatively affect the economy in the next six months, fifty-five percent chose a sluggish housing market compared to fifty percent in the previous quarter. Forty-five percent of respondents believe that the stability of the stock market could have the strongest potential to affect the economy. This is a bump up from the previous quarter when the stability of the stock market was chosen by only thirty-one percent of respondents. The U.S. budget deficit remained in third place among respondents with thirty-one percent of responses, an eight percentage point increase over the previous quarter of twenty-three percent. Twenty-six percent of lenders cited unstable energy prices as a concern for possible headwinds, down slightly from the prior quarter's thirty-one percent reading. Constrained

liquidity in capital markets rounded out the remaining risk factors with ten percent of total responses.

7. **Lenders continue to believe volatility lies ahead for Retail, Real Estate and Healthcare Sectors.**

When asked to identify three industries that will experience the most volatility in the next six months, fifty percent of lenders agree that Retail Trade will experience the greatest volatility, an increase of one percentage point from the prior quarter's survey. Healthcare and Real Estate followed next garnering twenty-seven percent of those polled, a decrease of twenty-two percent and increase of thirteen percent from the prior quarter, respectively. The Mining industry garnered twenty-eight percent of votes, a significant increase from the thirteen percent reading in the prior quarter. Construction followed with twenty-five percent, a decline from the prior period of ten percentage points. Educational Services received eighteen percent. The Finance and Insurance industry received approximately twenty-three percent of the lenders response.



8. **Borrowers maintain plans for new capital investment and acquisitions for future growth.**

Making new capital investments ranked highest amongst responses, at fifty-eight percent of the lenders surveyed. Forty-four percent (up five percentage points from last quarter) of respondents expect borrowers to start making acquisitions. Hiring new employees was the third highest response, garnering forty percent of the responses. Additionally, thirty-one percent of lenders believe their borrowers will start entering new markets or introduce new products and services. Twenty-nine percent of lenders expect their borrowers to raise additional capital.

9. **Near term economic performance expectations improve in this quarter's survey.**

Economic growth sentiment remained at an overall "C" grade this quarter; the indexes GPA remained unchanged at 2.24 from the 2Q 2014 results. The majority of lenders (fifty-two percent) believe the economy will perform at a "C" level or lower over the next six months, compared to sixty-three percent in the previous survey. Conversely, thirty-six percent of lenders surveyed believe the economy will perform at a "B" grade or better, compared to thirty percent in the previous survey. The trend toward a better grade for the economy continued as more respondents switched this quarter in favor of a "B" grade or better. This survey continues the recent trend in which a higher percentage of lenders believed the economy would perform in the "A" or "B" grade level versus a "D" level over the next six months.

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

GPA 6-Month Expectations — Quarterly Rate of Change — Annual Rate of Change

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

10. Lenders long term prospects for the U.S. economy remain stable.

Lenders growth expectations for the U.S. economy beyond six months remained stable relative to the previous survey, yielding a "C" grade at 2.29. Forty-three percent of lenders believe the economy will perform at a "B" level in the next six to twelve months, which is four percentage points lower than the previous quarter. Forty-three percent of lenders believe the economy will perform at a "C" level in the next six to twelve month period, compared to forty percent in the previous quarter. Following a reading below 2.33 in 2Q 2014, lenders remain optimistic on the long term prospects for the U.S. economy.

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

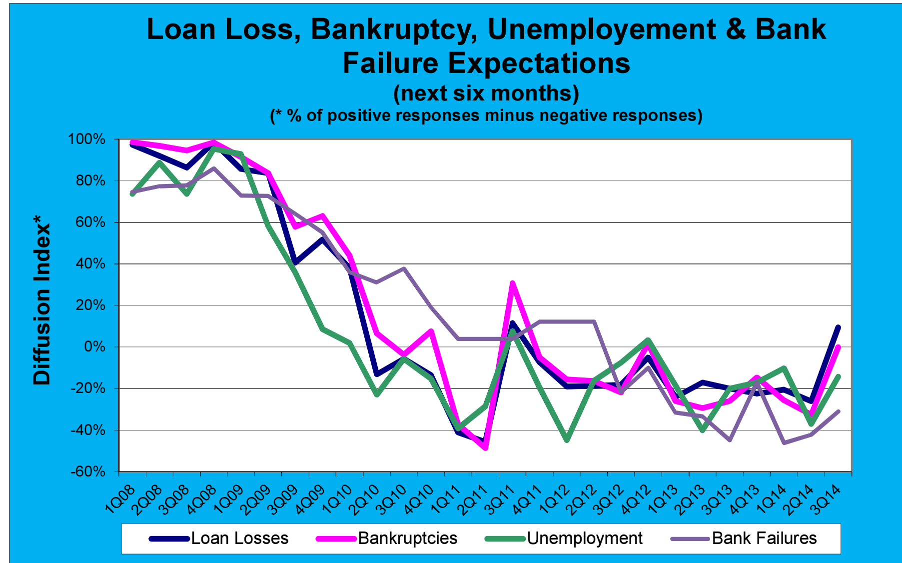
Forward Twelve Months — Quarterly Rate of Change — Annual Rate of Change

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

11. Lenders have rising expectations for increasing Loan Losses, Bankruptcies, Unemployment, and Bank Failures over the next six months.

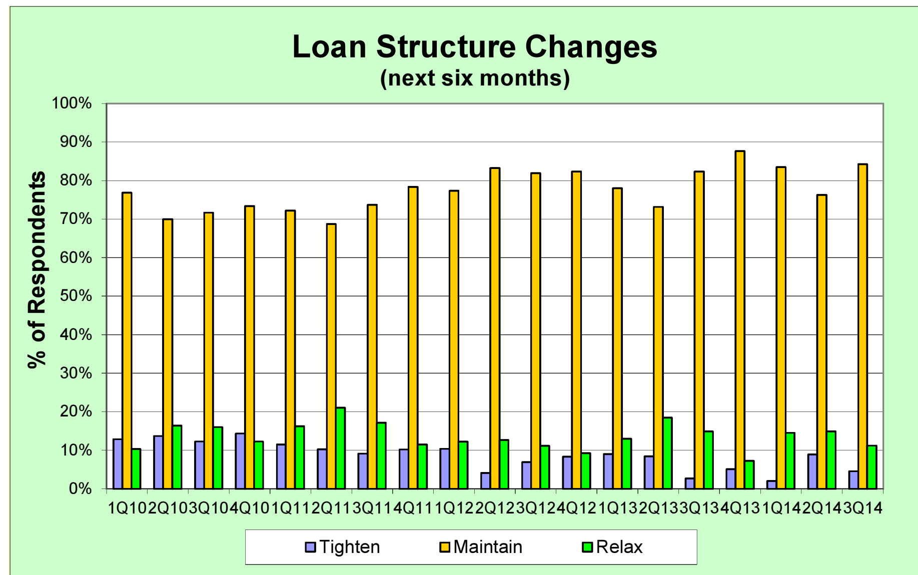
All four of these categories have seen an increase to their diffusion indexes when compared to the 2Q 2014. The loan losses category saw a thirty-six percentage point increase to positive ten percent. Bankruptcies saw the second largest change, increasing thirty-three percentage points to zero. Unemployment and Bank Failures maintain negative diffusion indexes of fourteen and thirty-one percentage points, respectively. The increase in diffusion indexes in these categories indicates

that lenders believe there will be more negative news in terms of these four categories, as all categories are increasing from near all-time lows for the survey.



12. Lenders continue to expect relaxed loan structures over the next six months.

The percentage of respondents planning to maintain their current loan structures increased by eight percentage points to eighty-four percent compared to 2Q 2014 of seventy-six percent. Lenders who expect to tighten their loan structures decreased by four percentage points compared with the prior quarter of nine percent of those surveyed. Eleven percent of lenders anticipate relaxing their client's loan structures a decrease of four percentage points versus the prior quarter. It would appear as though lenders continue to forgo structure in order to garner new business.



13. Lenders expect slight relief from compression in lending spreads.

Seventy-seven percent of respondents (versus seventy-one percent in the previous quarter) anticipate maintaining lending spreads at their current levels. Three percent of lenders anticipate increasing their credit spreads in the next six months, up one percentage points from the previous quarter but down notably from fourteen percentage points in 4Q 2014. The percentage of lenders expecting to reduce their current credit spreads decreased seven percentage points, representing twenty-one percent of total responses this quarter.

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Survey Results

1. Lenders were divided on the economic impact of the end of the Quantitative Easing program.

Lenders were asked: With the anticipated end of the Fed's Quantitative Easing ("QE") program in October, which of the following do you think is the most likely economic impact from the Fed's move out of the market?

- Thirty-one percent believe the end of the QE program will slow U.S. housing growth due to higher mortgage rates.

- Twenty-nine percent of respondents believe that the U.S. equities market will face negative pressures as the Fed stops pumping money into the markets.

- Twenty-one percent believe that the U.S. dollar will strengthen versus currencies and that exports will struggle.

- Fifteen percent of respondents believe that the end of the QE program will allow domestic banks to outperform the rest of the stock market, in part due to higher net interest margin.

2. Lenders believe that the condition of the current labor market is overstated by the U.S. unemployment rate.

Lenders were asked: The Federal Reserve has recently displayed its concern about the underutilization of labor resources. What is your outlook on the unemployment rate and condition of the U.S. labor market?

- Sixty-three percent believe the unemployment rate will continue to overstate the strength of the current labor market.

- Twenty-five percent of respondents believe that the utilization of labor will increase as unemployment continues to decrease

- Six percent of lenders view the unemployment rate as a more accurate measurement of the labor market as fewer people are leaving the workforce than recent years.

- Two percent of lenders wrote in their own response to the question.

3. Lenders believe that the global economic recovery will curtail the recent U.S. economic growth.

Lenders were asked: While the U.S. has shown many signs of an improving economy, the global recovery has not kept pace. What do you believe will be the largest domestic impact of the divergence in economic recoveries?

- Forty-four percent believe that the U.S. growth will be curtailed by a decline in the global economy.

- Thirty-one percent believe the domestic growth is contingent upon the actions taken by the worlds most developed/industrialized countries.

- Fifteen percent ore respondents believe that the U.S. will be able to sustain domestic economic growth independent of other economies.

- Four percent believe that the U.S. economic growth is dependent upon the proactive actions taken by foreign central banks.

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.

- Thirty-one percent of lenders opined their financial institution would consider a loan request with leverage multiples of greater than 3.5x (previous survey: 12 percent).

- Twenty-three percent believed their institution would consider a loan request with a Senior Debt to EBITDA multiple as high as the 3.01x – 3.50x range (previous survey: 35 percent).

- Seventeen percent of respondents replied they are collateral lenders and, therefore, do not make credit decisions based on cash flow/leverage multiples (previous survey: 27 percent).

- Seventeen percent indicated their institution would consider a loan request with leverage multiples as high as the 2.51x – 3.00x range (previous survey: 12 percent).

- Thirteen percent of lenders either "did not know" or did not respond with regard to how their institution's senior leverage ratio would change (previous survey: 10 percent).

- Zero percent of lenders believed their institution would consider a loan request with a Senior Debt to EBITDA multiple as high as 2.01x – 2.50x range (previous survey: 4 percent).

- Zero percent of lenders indicated that their financial institution would only consider a loan request with a Senior Debt to EBITDA ratio of less than 2.0x (previous survey: 0 percent).

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.

- Fifty-four percent indicated that the Senior Debt to EBITDA multiple will not change at their financial institution over the next six months (previous survey: 45 percent).

- Seventeen percent of respondents replied they are collateral lenders and, therefore, do not make credit decisions based on cash flow/leverage multiples (previous survey: 26 percent).

- Fifteen percent of lenders responded "Do Not Know" regarding how senior leverage ratios would change at their financial institution in the next six months (previous survey: 10 percent).

- Thirteen percent of lenders believe that the leverage multiple will increase less than 0.5x during the next six months (previous survey: 10 percent).

- Zero percent conclude that the leverage multiple will increase greater than 0.5x during the next six months (previous survey: 8 percent).

- Two percent conclude that the leverage multiple will decrease less than 0.5x during the next six months (previous survey: 2 percent).

- Two percent believe that the leverage multiple will decrease greater than 0.5x during the next six months (previous survey: 0 percent).

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.

- Forty-eight percent designated the sluggish housing market as the factor with the strongest potential to affect the near-term economy (previous survey: 47 percent).

- Forty percent opined that the stability of the stock market has the strongest potential to affect the economy during the next six months (previous survey: 29 percent).

- Twenty-seven percent of respondents selected the U.S. budget deficit as having the strongest potential to affect the economy over the next six months (previous survey: 22 percent).

- Twenty-three percent chose "other" factors as having the strongest potential to affect the economy during the next six months (previous survey: 27 percent).

- Twenty-three percent concluded that unstable energy prices have the strongest potential to affect the economy during the next six months (previous survey: 29 percent).

- Eight percent indicated constrained liquidity in the capital markets as the factor with the strongest potential to affect the near-term economy (previous survey: 8 percent).

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.

- Fifty percent believe the Retail Trade industry will experience the most volatility over the next six months (previous survey: 41 percent).

- Twenty-seven percent of respondents chose the Healthcare and Social Assistance industry to experience the greatest volatility (previous survey: 49 percent).

- Twenty-one percent designated the Construction industry as the industry expected to have the greatest volatility in the near term (previous survey: 31 percent).

- Nineteen percent of respondents believe the Finance and Insurance industry will experience the greatest volatility over the next six months (previous survey: 29 percent).

- Ten percent of survey takers are of the opinion Educational Services will experience significant volatility in the short term (previous survey: 12 percent).

- Twenty-three percent of respondents believe the Mining industry will experience significant volatility in the next six months (previous survey: 12 percent).

- Twenty-seven percent responded that the Real Estate and Rental/Leasing industry would experience the most volatility during the next six months (previous survey: 14 percent).

- Fifteen percent of lenders feel that the Manufacturing industry will face increasing volatility in the near term (previous survey: 14 percent).

- Eleven percent of lenders believe the Accommodation and Food Service industry to experience the greatest volatility (previous survey: 4 percent).

- The balance of the industry choices registered ten percent or less from the respondents.

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.

- Fifty-eight percent of lenders believe their customers will be making new capital investments (previous survey: 47 percent).

- Forty-four percent of lenders indicated their customers are planning on making an acquisition in the next six months (previous survey: 39 percent).

- Twenty-nine percent indicated their customers are planning on raising additional capital in the near term (previous survey: 29 percent).

- Forty percent of respondents indicated their customers plan on hiring new employees in the next six months (previous survey: 29 percent).

- Thirty-one percent responded their customers are planning on entering new markets in the near term (previous survey: 37 percent).

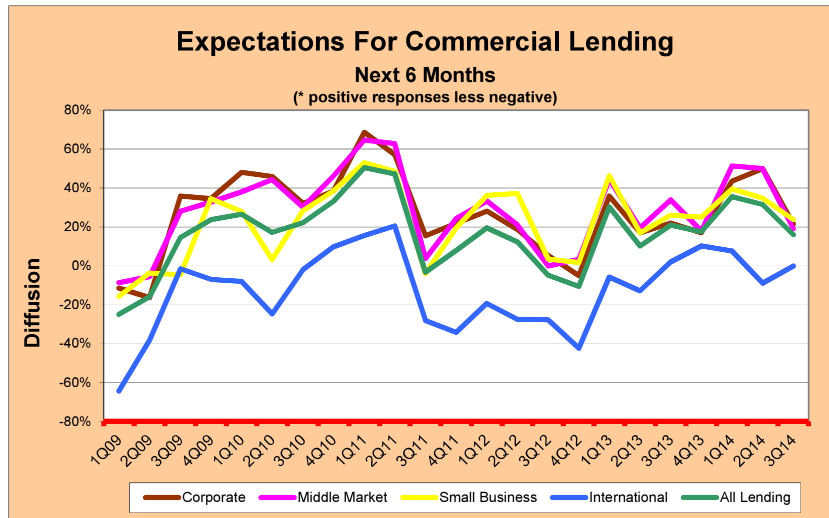
- Thirty-one percent of lenders believe their customers are planning on introducing new products or services (previous survey: 35 percent).

- Two percent of lenders believe their customers are planning "other" initiatives in the next six months (previous survey: 10 percent).

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.

- Expectations fell dramatically in 3Q 2014, as lenders expect decreased in every category of lending besides international; which includes corporate, middle market, and small business. Twenty-nine percent of respondents view the entire lending universe as improving compared to forty-one percent of respondents in the previous quarter. The overall lending diffusion index decreased to sixteen percent from thirty-one percent in the prior quarter's survey. The domestic lending diffusion index declined as well this quarter, decreasing twenty-four percentage points. The diffusion index for international lending saw an increase in its diffusion index to zero percent from last quarter's negative nine percent.



	2Q/2014			3Q/2014		
	Up	Down	Same	Up	Down	Same
Corporate Lending	52%	2%	46%	31%	10%	60%
Middle Market Lending	52%	2%	46%	26%	7%	67%
Small Business Lending	46%	11%	43%	38%	14%	48%
International Lending	16%	24%	60%	19%	19%	62%

- Lenders have shown a changing attitude as the loan losses diffusion index is in positive territory for the first time since 3Q 2011 and the bankruptcies diffusion index, at zero percent, is the highest it has been since 4Q 2012. It appears that lenders believe interest rates will go up at some point in the near future as our survey showed a diffusion index of sixty-two percent versus fifty percent in the prior quarter.

	2Q/2014			3Q/2014		
	Up	Down	Same	Up	Down	Same
Loan Losses	9%	35%	57%	29%	19%	52%
Bankruptcies	9%	41%	50%	19%	19%	62%
Interest Rates	52%	2%	46%	62%	0%	38%
Unemployment	9%	46%	46%	12%	26%	62%
Bank Failures	0%	42%	58%	2%	33%	64%

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 has stayed steady this quarter, as its GPA remains the same at 2.24. In the current quarter, fifty-two percent of respondents believe the economy will perform at a "C" level, which represents a decrease of eleven percentage points from the previous quarter. The grade-point average remained at the "C" level as lenders shifted away from a "C" and were split between the "B" and "D" level relative to last quarter.

Grade	2Q/2014	3Q/2014
A	0%	0%
B	30%	36%
C	63%	52%
D	7%	12%
F	0%	0%
Weighted Average Grade	2.24	2.24

11. US Economy Grade – Beyond the Next Six Months

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

- Lenders expectations for the US economy's performance in the longer term decreased slightly relative to the prior quarter. The weighted average GPA decreased by four basis points to 2.29, which is a "C' grade. Forty-three percent of lenders feel as though the economy will perform at a "B" level beyond the next six months (compared to forty-seven percent last quarter). Lenders who believe the economy will perform at a "C" over the next twelve months increased to forty-three percent from forty percent. The reaming fourteen percent of lenders believe over the next six to twelve months the economy will perform at a "D" grade.

Grade	2Q/2014	3Q/2014
A	0%	0%
B	47%	43%
C	40%	43%
D	13%	14%
F	0%	0%
Weighted Average	2.33	2.29

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 five percentage points compared to 2Q 2014. With a shift towards optimism, two percent of lenders now ascribe "very strong growth" for their borrower's growth in the next six months while ten percent ascribe to "strong growth" for their borrower's growth. Likewise, there was a decrease seen in lenders favoring "no growth" which decreased seven percentage points to two percent. This is a positive signal from lenders on the U.S. economy.

Indication	2Q/2014	3Q/2014
Very Strong	0%	2%
Strong	11%	10%
Moderate	80%	85%
No Growth	9%	2%

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, there was a slight decrease in the percentage of lenders indicating they are looking to relax loan structures for loans less than 15 million in the near future. This indicates it will remain a borrower's market, at least for the near future.

	2Q/2014			3Q/2014		
	Tighten	Maintain	Relax	Tighten	Maintain	Relax
Loans> $25 million	10%	78%	12%	5%	78%	16%
$15 – 25 million	5%	81%	14%	5%	81%	14%
$5-15 million	7%	74%	19%	5%	88%	8%
Under $5 million	14%	72%	14%	3%	90%	8%
Overall Average	9%	76%	15%	5%	84%	11%

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.

- It appears as though when analyzing loan spreads, almost no lenders expect to increase the interest rate spread on loans they are making. The two categories in which lenders expected some increase in pricing, was the $5-15 million and under $5 million categories, which only garnered five percent of responses. We anticipate borrowers will continue to benefit from competitive pricing based on the responses from the survey.

	2Q/2014			3Q/2014		
	Reduce	Maintain	Increase	Reduce	Maintain	Increase
Loans> $25 million	32%	68%	0%	32%	68%	0%
$15 – 25 million	29%	71%	0%	24%	76%	0%
$5-15 million	30%	70%	0%	15%	80%	5%
Under $5 million	22%	73%	4%	10%	85%	5%
Overall Average	28%	71%	1%	21%	77%	3%

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.

There is more certainty of the Feds monetary policy with the recent announcement of the end to the QE at the end of October, many lenders are now expecting rates to slowly increase over the next six months. As the bond buying program ends, it will be interesting to see if lenders expectations for interest rates change in future surveys.

Bps Change	2Q/2014	3Q/2014
-More than 1.0	0%	0%
-1.0	0%	0%
-.75	0%	0%
-.50	0%	0%
-.25	0%	0%
0	58%	51%
+.25	37%	37%
+.50	7%	12%
+.75	7%	0%
+1.0	2%	0%
More than 1.0	0%	0%
Weighted Average	0.11 basis points	0.11 basis points

16. Current Competition

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

- Money center banks and local commercial/community banks saw a decline in the number of responses. However it is still noteworthy that the top two (Regional banks and local commercial / community banks) still register roughly sixty-five percent of responses.

	2Q/2014	3Q/2014
Money Center Banks	18%	10%
Local Commercial/ Community Banks	27%	15%
Factors	2%	0%
Regional Banks	42%	51%
Commercial Finance Organizations	4%	20%
Other	7%	5%