# Phoenix Management Services
# "Lending Climate in America" Survey

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## 3rd Quarter 2016
## Summary, Trends and Implications

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# "LENDING CLIMATE IN AMERICA"

## 3rd Quarter 2016

## SUMMARY, TRENDS AND IMPLICATIONS

1. **Under whose leadership would the economy perform better under?**

   The majority of lenders (63%) believe that the economy would perform better under the leadership of Trump and Pence while, 37% of lenders believe that the economy would perform better under the leadership of Clinton and Kaine.

2. **What will be the most influential aspect on U.S. oil & gas prices in the coming year?**

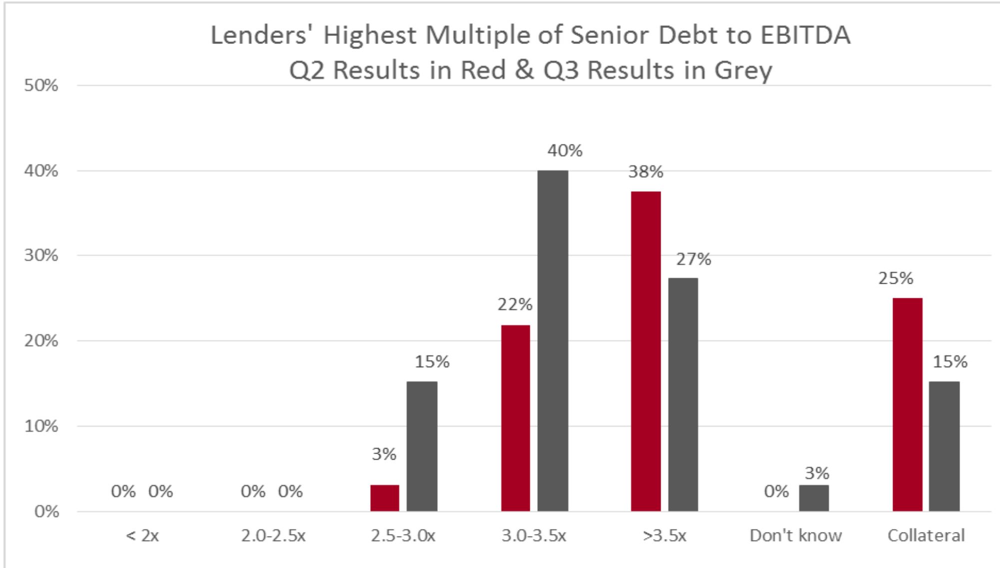
   The answer that received the highest percentage response, 51%, were lenders that believe a lessened reliance on foreign sources will be the most influential aspect on U.S. oil & gas prices in 2017. Garnering the second highest amount of responses, at 20%, were lenders that believe a) exploitation of new technology, and b) increased environmental regulation have the most influence on U.S. oil & gas prices in the coming year. Of the lenders surveyed, only 9% of lenders believe increased U.S. rig count will be the most influential aspect on U.S. oil & gas prices in the next year.

3. **The FOMC delayed a potential rate hike this summer as it waited for capital markets to stabilize after the United Kingdom's vote to leave the European Union (known as "Brexit"). With positive sentiments expressed in the FOMC's July meeting, making future rate hikes more likely, which economic factor/metric will have the greatest impact on the FOMC's decision whether or not to raise short-term interest rates during its September meeting?**

   The majority of lenders, garnering 37% of responses, believe that the unemployment rate will have the greatest impact on whether or not the FOMC decides to raise short-term interest rates at its September meeting. Not far behind, with 29% of responses, were the lenders that believe inflation/CPI will have the greatest impact on the decision to increase short-term interest rates at the September FOMC meeting. 17% of lenders believe GDP growth will have the greatest impact, while 11% of respondents believe the strength of the U.S. dollar versus foreign currencies will be the greatest impact on the FOMC's decision on whether to increase short-term interest rates. Of the lenders surveyed, only 6% believe that the stock market volatility will have the greatest impact on the FOMC's decision on whether or not to increase short-term interest rates at its September meeting. At the conclusion of the FOMC's September meeting, the committee decided to leave interest rates unchanged for the time being.

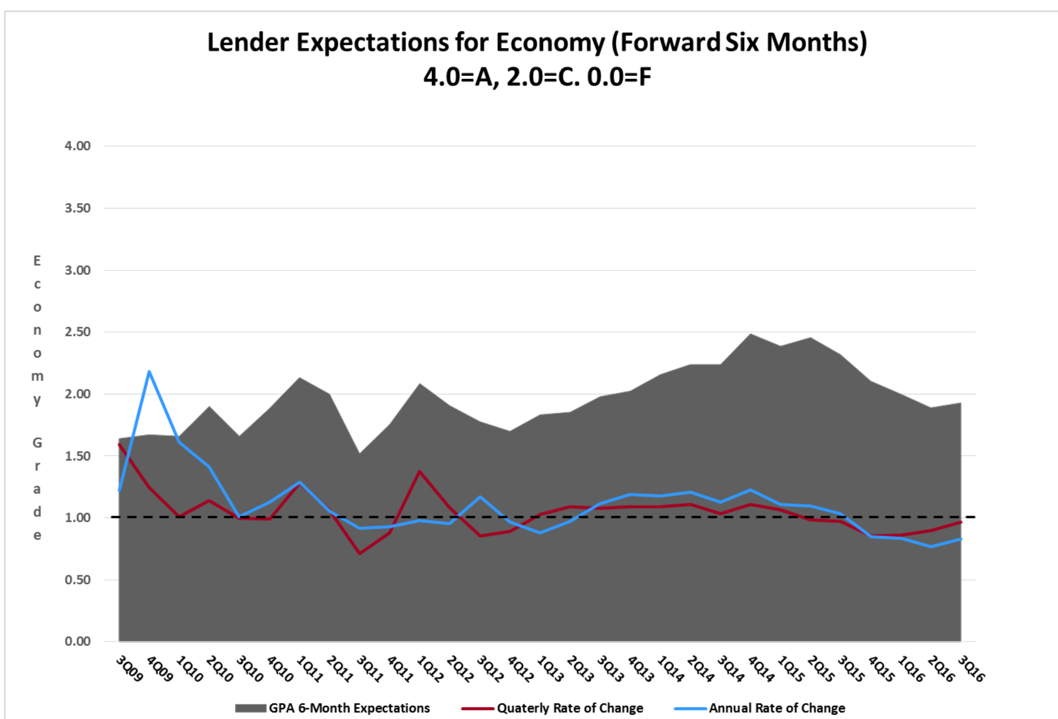
4. **Leverage multiples are expected to increase versus the prior quarter.**

   Multiples have shifted slightly in 3Q 2016. 27% of lenders indicated the >3.5x range would be the highest EBITDA ratio they would consider, a 9 percentage point decrease from the prior quarter. The percentage of respondents who would consider a debt to EBITDA ratio of 3.0-3.5x increased 18 percentage points to 40%. The percentage of lenders who indicated the highest ratio they would consider is between 2.5-3.0x saw an increase of 12 points to 15%. Zero percent of respondents stated their institutions highest multiple is in the 1) 2.0-2.5x range, or 2) less than 2.0x. In addition, 15% of lenders responded that they were collateral lenders and therefore do not make decisions based on cash flow/leverage multiples.



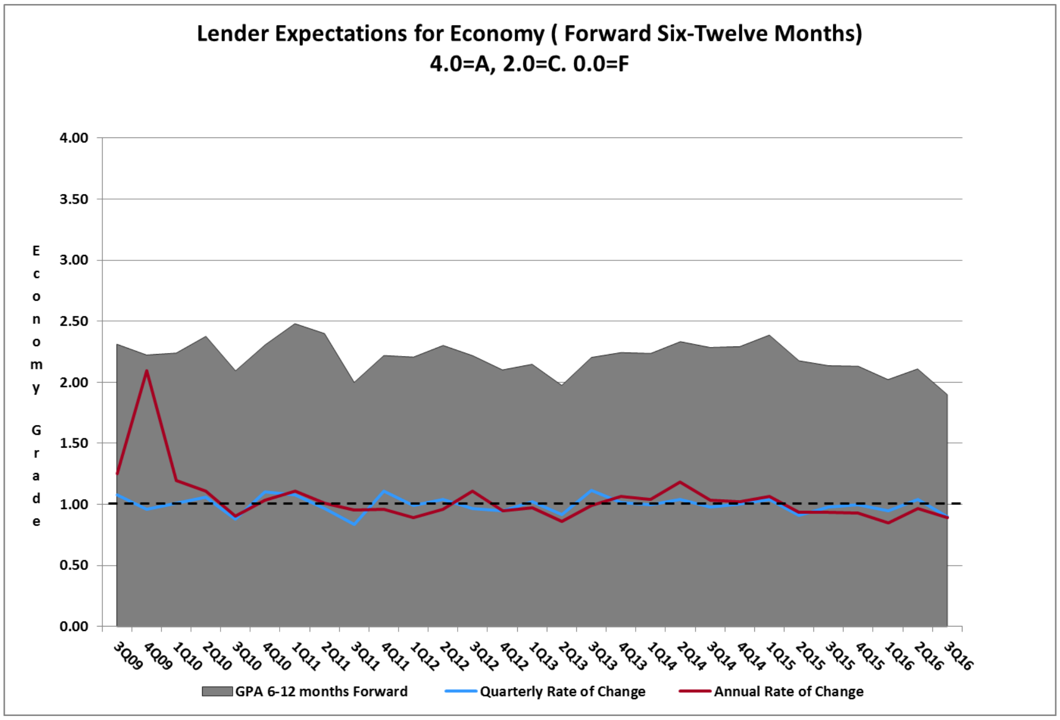

## 5. Economic performance expectations continue to weaken in this quarter's survey.

Lenders optimism on the U.S. economy for the short term increased this quarter but remains at an overall "C" grade this quarter; the index GPA increased to 1.93 from the 2Q 2016 results of 1.89. The majority of lenders (57%) believe the economy will perform at a "C" level over the next six months, compared to 82% in the previous survey. However, 20% of lenders surveyed believe the economy will perform at a "B" grade, compared to 4% in the previous survey. Lenders that believe that the economy will perform at a "D" level increased 6 points from the previous quarter to 20% in 3Q 2016. 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.



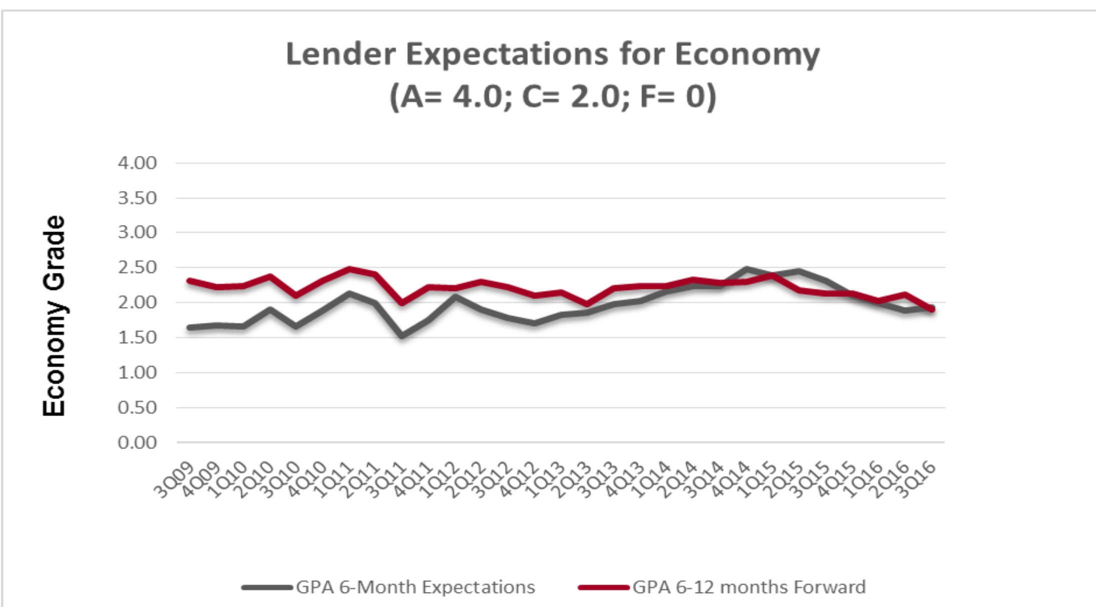

** Rate of Change of 1.0 is at equilibrium and signifies "no change" from the corresponding prior period of comparison.*

Lenders growth expectations for the U.S. economy beyond six months decreased 21 points to a 1.90 GPA from 2.11 in the previous quarter, but still maintains a "C" grade. 23% of lenders believe the economy will perform at a "B" level in the next six to twelve months, which is 5 percentage points lower than the previous quarter. The percent of lenders (44%) that believe the economy will perform at a "C" level increased 1 percentage point from the previous quarter. The percentage of respondents who believe the economy will perform at a "D" level beyond the next six months increased 8 percentage points to 33%, when compared to the previous quarter.




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

The 3Q 2016 survey reversed the previous quarter's results of a higher long term GPA than near term GPA. The 0.21 point drop in long term GPA implies a continuing dampening of lender's long term expectations of the economy, and the 1.90 GPA represents the lowest since Q1 2009.



**Phoenix Management Services**
**"Lending Climate in America"**
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## Survey Results

### 1. Lenders believe that the economy will perform better under the leadership of Trump and Pence.

Lenders were asked: Under whose leadership would the economy perform better under?

- 63% of lenders believe that the U.S. economy will perform better under the leadership of Trump and Pence.

- 37% of respondents believe that the economy will perform better under the leadership of Clinton and Kaine.

### 2. Leaders believe that lessened reliance on foreign sources will be the most influential aspect on U.S. oil and gas prices in 2017.

Lenders were asked: What will be the most influential aspect on U.S. oil & gas prices in the coming year?

- 51% of lenders believe a lessened reliance on foreign sources will be the most influential aspect on U.S. oil & gas prices in 2017.

- 20% of lenders believe a) exploitation of new technology, and b) increased environmental regulation will be the most influential aspect on U.S. oil & gas prices in the coming year.

- 9% of the lenders surveyed believe increased U.S. rig count will be the most influential aspect on U.S. oil & gas prices in the next year.

### 3. Lenders believe that unemployment rate will have the greatest impact on whether or not the FOMC decides to raise short-term interest rates at its September meeting.

Lenders were asked: The FOMC delayed a potential rate hike this summer as it waited for capital markets to stabilize after the United Kingdom's vote to leave the European Union (known as "Brexit"). With positive sentiments expressed in the FOMC's July meeting, making future rate hikes more likely, which economic factor/metric will have the greatest impact on the FOMC's decision whether or not to raise short-term interest rates during its September meeting?

- 37% of lenders believe that unemployment rate will have the greatest impact on whether or not the FOMC decides to raise short-term interest rates at its September meeting.

- 29% of lenders surveyed believe inflation/CPI will have the greatest impact on the decision to increase short-term interest rates at the September FOMC meeting.

- 17% of lenders believe GDP growth will have the greatest impact on the FOMC's decision in regards to increasing short-term interest rates.

- 11% of respondents believe the strength of the U.S. dollar versus foreign currencies will be the greatest impact on whether the FOMC decides to increase short-term interest rates.

- 6% believe that the stock market volatility will have the greatest impact on the FOMC's decision on whether or not to increase short-term interest rates at its September meeting.

## 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.

| EBITDA Level | 2Q 2016 | 3Q 2016 |
|---|---:|---:|
| Greater than 3.5x | 38% | 27% |
| Between 3.01x and 3.50x | 22% | 40% |
| Between 2.51x and 3.00x | 3% | 15% |
| Between 2.01x and 2.50x | 0% | 0% |
| Less than 2.0x | 0% | 0% |
| Collateral lenders | 25% | 15% |
| N/A | 12% | 3% |

## 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.

| Change in Senior Debt to EBITDA Level | 2Q 2016 | 3Q 2016 |
|---|---:|---:|
| Increase greater than 0.5x | 0% | 6% |
| Increase less than 0.5x | 0% | 9% |
| Decrease less than 0.5x | 9% | 9% |
| Decrease greater than 0.5x | 0% | 0% |
| No change | 53% | 58% |
| Collateral lenders | 25% | 15% |
| N/A | 13% | 3% |

## 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.

| Factors Affecting Near-Term Economy | 2Q 2016 | 3Q 2016 |
|---|---:|---:|
| Stability of Stock Market | 43% | 43% |
| Sluggish Housing Market | 18% | 39% |
| U.S. Budget Deficit | 7% | 39% |
| Other | 11% | 36% |
| Unstable Energy Prices | 64% | 29% |
| Constrained Liquidity in Capital Markets | 39% | 25% |

## 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.

| Industries Experiencing Most Volatility | 2Q 2016 | 3Q 2016 |
|---|---:|---:|
| Retail Trade | 71% | 58% |
| Mining | 71% | 52% |
| Education Services | 7% | 24% |
| Real Estate and Rental/Leasing | 8% | 24% |
| Manufacturing | 36% | 18% |
| Construction | 14% | 18% |
| Utilities | 18% | 15% |

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

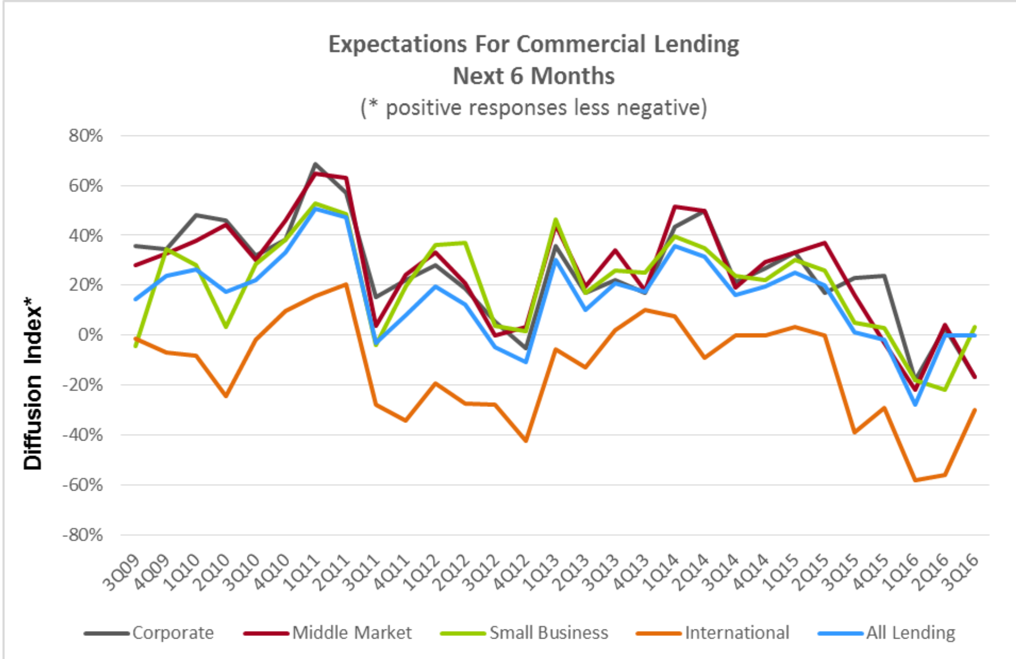
Respondents were asked which of the following actions their customers planned in the next six months. Lenders were asked to designate all potential customer actions that applied.

| Customers' Plans | 2Q 2016 | 3Q 2016 |
|---|---:|---:|
| Making an Acquisition | 50% | 53% |
| Raising Additional Capital | 36% | 53% |
| Capital Improvements | 46% | 40% |
| Introducing New Products or Services | 50% | 37% |
| Hiring New Employees | 32% | 23% |
| Entering New Markets | 25% | 27% |
| "Other" Initiatives | 7% | 13% |

## 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 2016, lenders optimism decreased significantly in large corporate and middle market to a negative 17%. Conversely, expectations increased for small business in 3Q 2016 with a diffusion index of 3%, a 25 percentage point difference from the previous quarter of negative 22%. The diffusion index for international lending also continued to stay in the negatives, however increasing to a negative 30% from negative 56% in the previous quarter. The overall lending diffusion index and domestic lending diffusion index continues to remain unchanged at 0%.




| | 2Q/2016 | | | 3Q/2016 | | |
|---|---|---|---|---|---|---|
| | Up | Down | Same | Up | Down | Same |
| Corporate Lending | 14% | 11% | 75% | 7% | 23% | 70% |
| Middle Market Lending | 18% | 14% | 68% | 10% | 27% | 63% |
| Small Business Lending | 4% | 26% | 70% | 27% | 23% | 50% |
| International Lending | 0% | 56% | 44% | 10% | 40% | 50% |

- The interest rate diffusion significantly increased to a 76% compared to a 53% the previous quarter. Loan losses diffusion index decreased significantly to 37% in Q3 2016 compared to 67% in Q2 2016. The bankruptcies diffusion index also decreased significantly to 40% from 81% in the previous quarter.

| | 2Q/2016 | | | 3Q/2016 | | |
|---|---|---|---|---|---|---|
| | Up | Down | Same | Up | Down | Same |
| Loan Losses | 71% | 4% | 25% | 43% | 7% | 50% |
| Bankruptcies | 81% | 0% | 19% | 47% | 7% | 47% |
| Interest Rates | 57% | 4% | 39% | 76% | 0% | 24% |
| Unemployment | 14% | 4% | 82% | 20% | 10% | 70% |
| Bank Failures | 11% | 7% | 82% | 3% | 23% | 73% |

## 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 increased this quarter, buts its GPA remains at a "C" level, with a 1.89 in 2Q 2016 to 1.93 in 3Q 2016. In the current quarter, 57% of respondents believe the economy will perform at a "C" level, which represents a decrease of 25 points from the previous quarter. The grade-point average remains at the "C" level as there has been concentration of opinions. There was a significant increase of lenders (20%) that believe the economy will perform at a "B" level, a 16 point increase from the 2Q 2016 results, while 20% believe the economy will perform at a "D" level, a 6 point increase. 3% of lenders believe the economy will perform at an "F" level, a 3 point increase from 2Q 2016.

| Grade | 2Q/2016 | 3Q/2016 |
|---|---|---|
| A | 0% | 0% |
| B | 4% | 20% |
| C | 82% | 57% |
| D | 14% | 20% |
| F | 0% | 3% |
| Weighted Average Grade | 1.89 | 1.93 |

## 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 21 points from a 2.11 in the previous quarter to 1.90, which is still a "C' grade. 23% 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 increased 1 percentage point to a 44%. There was an increase of lenders (33%) that believe the economy will perform at a "D" grade over the next six to twelve months while the percentage of lenders that believe the economy will perform at an "F" grade remains unchanged at 0%.

| Grade | 2Q/2016 | 3Q/2016 |
|---|---|---|
| A | 4% | 0% |
| B | 28% | 23% |
| C | 43% | 44% |
| D | 25% | 33% |
| F | 0% | 0% |
| Weighted Average | 2.11 | 1.90 |

## 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 9 points compared to 2Q 2016. With a concentration remaining towards moderation, 0% of lenders ascribe "very strong growth", and 3% of lenders ascribe "strong growth" for their borrower's growth in the next six months, a 1 percentage point decrease from 2Q 2016. There was an 8 point decrease in lenders favoring "no growth" to 13%. The continued belief of "moderate growth" is a positive signal from lenders on the U.S. economy.

| Indication | 2Q/2016 | 3Q/2016 |
|---|---|---|
| Very Strong | 0% | 0% |
| Strong | 4% | 3% |
| Moderate | 75% | 84% |
| No Growth | 21% | 13% |

## 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 2016 we did see a slight increase, 7 percentage points, with lenders that plan to tighten their loan structure.

| | 2Q/2016 | | | 3Q/2016 | | |
|---|---|---|---|---|---|---|
| | Tighten | Maintain | Relax | Tighten | Maintain | Relax |
| Loans> $25 million | 9% | 87% | 4% | 11% | 81% | 8% |
| $15 – 25 million | 9% | 87% | 4% | 7% | 85% | 8% |
| $5-15 million | 8% | 88% | 4% | 27% | 69% | 4% |
| Under $5 million | 19% | 81% | 0% | 29% | 64% | 7% |
| Overall Average | 11% | 85% | 3% | 18% | 75% | 7% |

## 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 did indicate a decrease to continue to maintain their interest rates spreads and an upturn to increase their interest rate spreads.

| | 2Q/2016 | | | 3Q/2016 | | |
|---|---|---|---|---|---|---|
| | Reduce | Maintain | Increase | Reduce | Maintain | Increase |
| Loans> $25 million | 4% | 87% | 9% | 12% | 76% | 12% |
| $15 – 25 million | 4% | 88% | 8% | 7% | 68% | 25% |
| $5-15 million | 4% | 88% | 8% | 8% | 64% | 28% |
| Under $5 million | 4% | 78% | 18% | 4% | 64% | 32% |
| Overall Average | 4% | 85% | 11% | 8% | 68% | 24% |

## 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.

3Q 2016 continues to display a less proportionate dispersal between +1/4 point and +1/2 point with 67% of respondents continuing to favor +1/4 point. However, we did see an increase of 13 percentage points of lenders favoring +1/2 point. There was a significant decrease, 27 percentage points, with lenders expecting interest rates to remain unchanged.

| Bps Change | 2Q/2016 | 3Q/2016 |
|---|---|---|
| + 1/2 point or more | 11% | 24% |
| + 1/4 point | 59% | 67% |
| Unchanged | 30% | 3% |
| - 1/4 point | 0% | 3% |
| - 1/2 point or more | 0% | 3% |
| Weighted Average | 0.20 bps | 0.26 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 in regards to respondents (33%) for the survey. Commercial Finance, at 27% of respondents, saw a slight increase while Money Center Banks saw a slight decrease with 17% of respondents. There was also a decrease in the number of respondents (13%) for Local Community/Commercial Banks from the previous quarter's survey.

| | 2Q/2016 | 3Q/2016 |
|---|---|---|
| Regional Bank | 33% | 33% |
| Commercial Finance Co. | 19% | 27% |
| Money Center Banks | 19% | 17% |
| Local Community/Commercial Bank | 22% | 13% |
| Factors | 0% | 0% |
| Other | 7% | 10% |