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

## 3rd Quarter 2010
## Summary, Trends and Implications

**PHOENIX**
**"LENDING CLIMATE IN AMERICA"**
**QUARTERLY SURVEY**

## SUMMARY, TRENDS AND IMPLICATIONS

1. **President Obama officially marked the end of the War in Iraq, which cost more than $700 billion, according the Congressional Budget Office. What level of benefit do you believe the end of the War provides to the Economy?**

   Forty percent of lenders believe that the official end of the War will have a "Slightly" beneficial impact on the Economy. Twenty-six percent opined that the impact will be "Moderately" beneficial to the Economy and another twenty-six percent of respondents think the ending of the War will generate no impact on the Economy. The remaining eight percent were the most optimistic of the group as they believe the end of the War in Iraq will be "Highly" beneficial to the U.S. Economy.

2. **Respondents were asked "What do you believe is the most effective way for the U.S. Economy to improve the unemployment rate, which stands at 9.6%?**

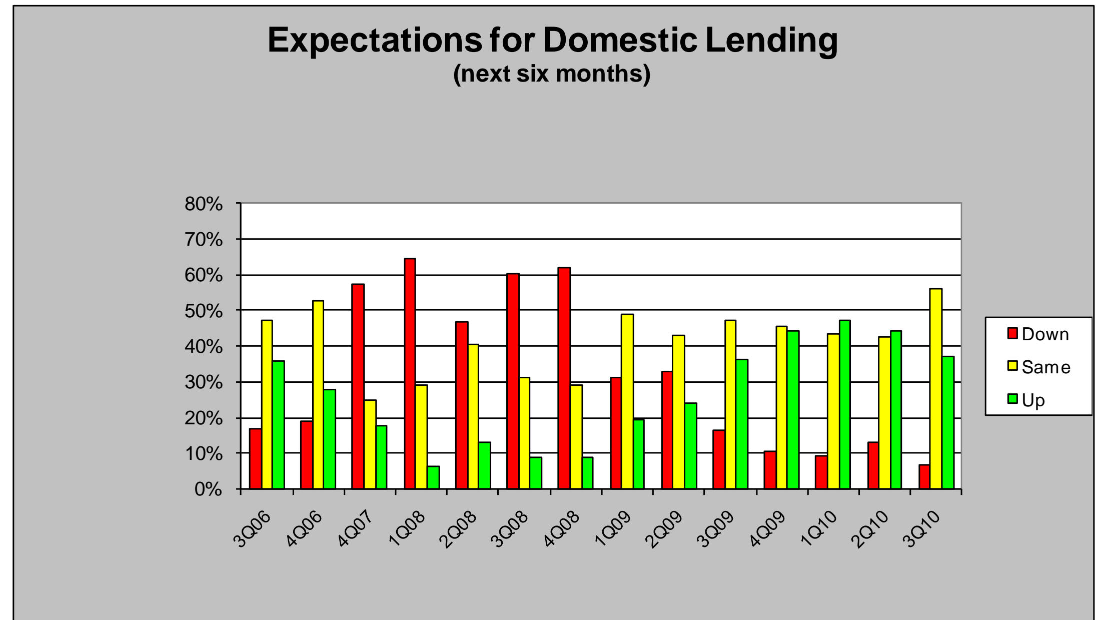
   Forty five percent of the participants believe that regardless of what initiatives are implemented in the short term, it will take several years from now to restore confidence in the U.S. economy and yield significant improvements in the labor markets. Twenty-three percent opined that the best way to job creation is by extending additional tax cuts to individuals. This would create more disposable income for Americans, which will lead to economic expansion and job creation, as consumer spending accounts for nearly two-thirds of the U.S. economy. Twenty-one percent chose the option of allowing the government to provide small businesses tax credits and incentives for hiring additional workers. Five percent of respondents suggested enacting the newly proposed Obama plan to increase the economic stimulus package by an additional $50 billion, targeted at improving our nation's infrastructure, which would serve as a catalyst for job creation. The final six percent chose "Other" for their response to the question.

3. **Participants were asked to answer based on the following issue: China's monthly trade surplus with the U.S. in July 2010 of $30 billion reached its highest level since January 2009. China's trade surplus with the U.S. accounts for nearly two-thirds of its total global surplus. What is your opinion on the growing economic trade imbalance between the U.S. and China?**

   Forty-two percent of respondents believe that China needs to take proactive steps to restore balance between the two countries by providing greater flexibility in its exchange rate and further open up its domestic markets for imports and foreign direct investment, as this would accelerate the world. Nearly one-third (32%) suggested that although it does call for some level of concern, the U.S. has become a service-based economy and manufacturing operations have gradually headed overseas because of cheaper labor costs, which make products cheaper for U.S. consumers. Thirteen percent opined that China has no responsibility to adhere to U.S. demands in order to improve the trade imbalance as China has been solely responsible for purchasing hundreds of billions in U.S. issued debt in order to help America finance the Iraq War and provide funding. Nine percent believe our trade relations with China has become an unsustainable issue, as the widening in the trade deficit gap with China is hindering U.S. economic growth and causing significant tension in bilateral trade relations between the two nations. The final four percent chose "Other" as their response.

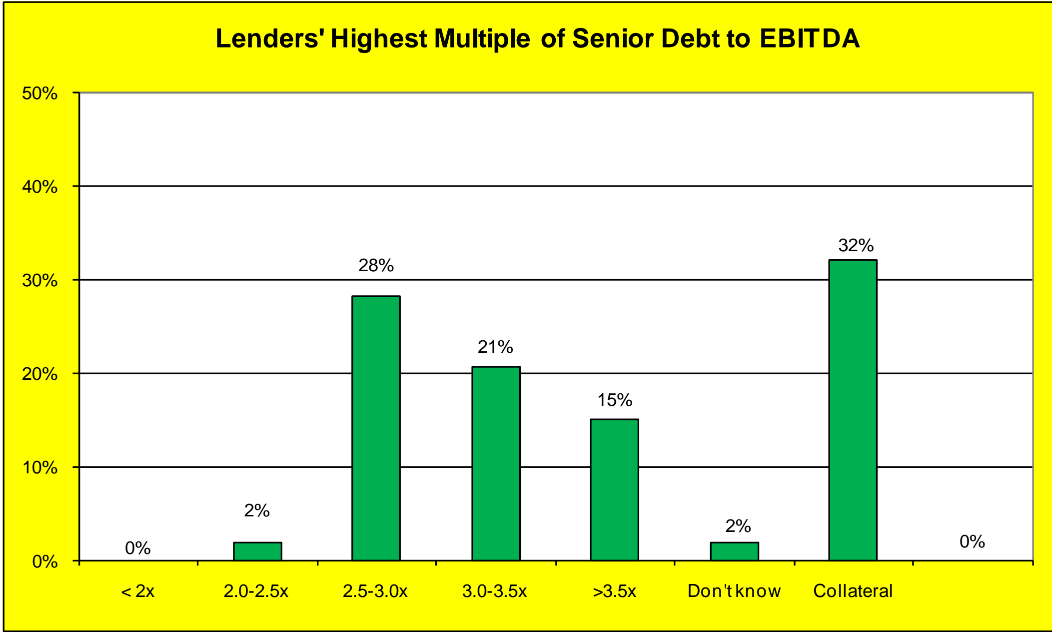
4. **Expectations for domestic lending remained in-line with expectations from the previous quarter.**

   The overall diffusion index for all domestic lending segments declined only one percentage points from last quarter's survey. Respondents indicated that, on average for all domestic lending categories; thirty-seven percent have expectations for increased loan demand (versus 44 percent in the prior quarter). However, the percentage of those lenders who believed loan demand would decline was reduced by nearly half versus the previous quarter (7 percent in Q3 2010 versus 13 percent in Q2 2010). Both Corporate and Middle Market commercial lending experienced double digit retreats in regard to expectations for increased loan demand (10 percent and 13 percent declines, respectively). International lending experienced a large increase in loan demand expectations jumping eleven percentage points from the previous survey.




5. **Senior Debt to EBITDA ratios maintained consistency regarding senior loan multiples compared to the previous survey.**

   Twenty-one percent of lenders indicated their financial institution would consider a loan request with a Senior Debt to EBITDA multiple as high as 3.0-3.5x, unchanged from the previous survey. Twenty-eight percent opined that their institution would only consider a loan request with a leverage ratio of 2.5-3.0x, two percentage points higher than Q1 2010. The percentage of lenders which indicated their institution would consider a loan request with a multiple greater than 3.5x was at fifteen percent, a decrease of only one percent from the previous survey. The percentage of lenders which indicated they are collateral lenders and do not utilize cash flow totaled thirty-two percent; five percentage points higher than the previous survey. Two percent responded they would consider a loan request only in the 2.0x-2.5x bandwidth (previous survey: 5 percent). The final two percent of lenders indicated they "Did Not Know".

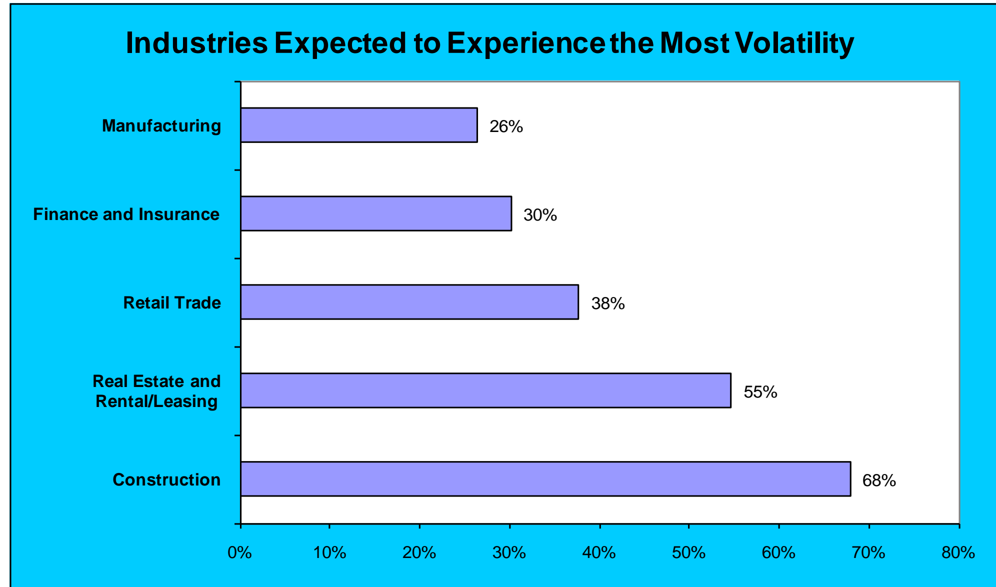



6. **Fifty-three percent of lenders believe their institution will have no change in the highest Senior Debt to EBITDA multiple it will consider in regards to a new loan request (fourteen percent higher than the previous quarter).**

   Eleven percent of respondents believe that the highest multiple will increase less than 0.5x (down from 21 percent in the previous quarter), while only four percent anticipate the multiple will increase greater than 0.5x over the next six months (seven percent in the previous quarter). No respondents suggested that the multiple would decline at their financial institution over the next six months. Thirty percent of respondents indicated they were collateral lenders and did not specifically focus on that multiple. Two percent of lenders responded that they did not know which direction their financial institution was headed in the near term.

7. **Two-thirds of respondents anticipate the Construction industry will experience the most volatility in the next six months**.

   When asked to identify three industries that will experience the most volatility in the next six months, sixty-eight percent chose the Construction industry as likely to experience the most volatility and fifty-five percent of lenders chose the Real Estate and Rental/Leasing industry. These two industries were the top two responses in the previous survey. Thirty-eight percent of lenders believe the Retail Trade industry will experience the most volatility, up fifteen percentage points from the previous survey. Thirty percent believe the Finance and Insurance industry will experience the most volatility in the near term and twenty-six percent credited the Manufacturing industry with the distinction.

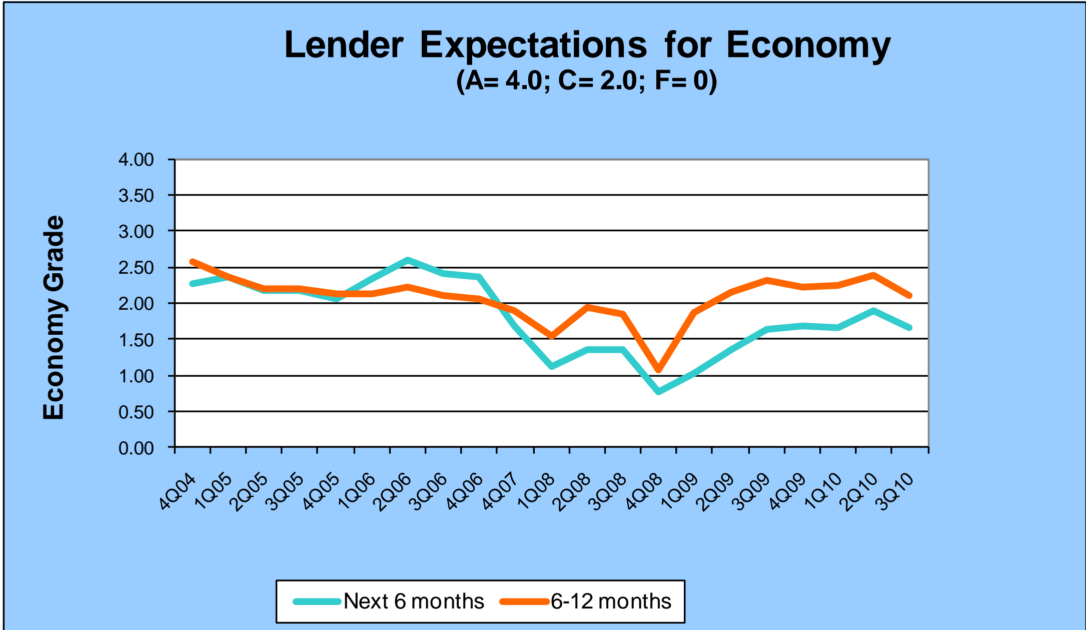



8. **Thirty-eight percent of respondents' customers anticipate raising additional capital in the next six months (up ten percentage points from the previous survey).**

   Twenty-eight percent responded their customers are planning on entering new markets; higher by five percentage points from the previous quarter. Twenty-six percent anticipate their customers to make new capital investments and introduce new products and services. One-quarter of respondents believe their customers will attempt to make an acquisition over the next six months. Twenty-three percent anticipate "hiring new employees" as a direct initiative of their clients' in the next six months.

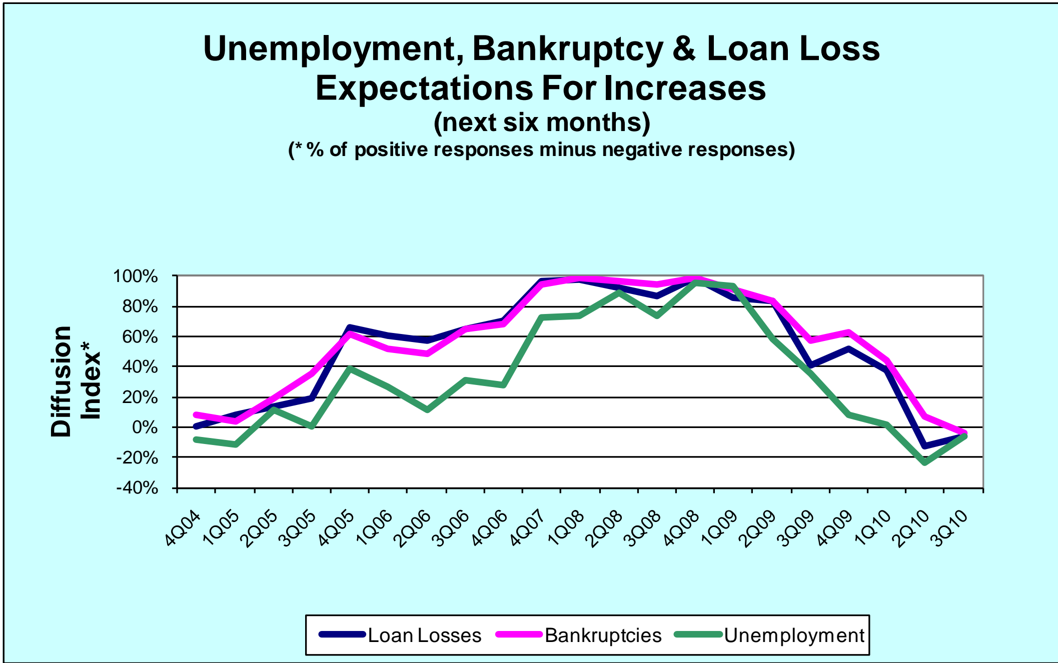
9. **Lenders expectations for the economy show a decline in growth expectations for the next six to twelve months compared to the previous survey.**

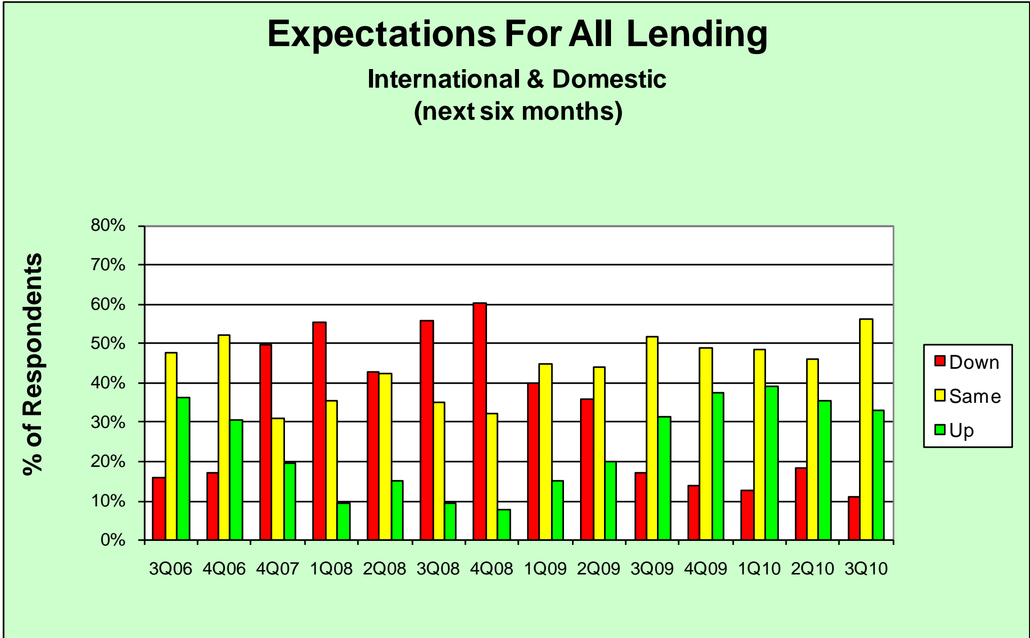
   Lenders expect the economy to perform at a "D" level for the next six months, which is a decline from the near "C" level demonstrated in the previous survey. While respondents anticipate the economy to show signs of improvement looking past the next six month period, growth expectations in comparison to the previous quarter are lower.




10. **Lenders expectations of macroeconomic indicators continued to show modest signs of improvement in all categories, except unemployment.**

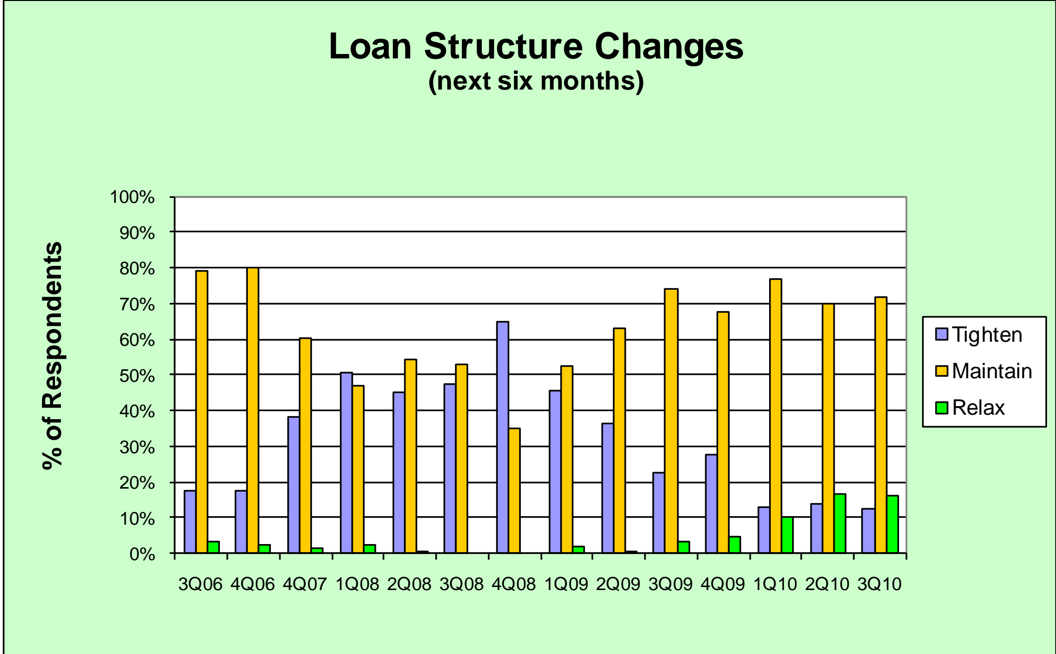
    Lenders expectations towards an increase in loan losses decreased by seven percentage points from the previous survey. Expectations relating to increases in bankruptcy filings also showed signs of improvement as it yielded a decline of eight percentage points from the previous survey. General concern regarding current unemployment rates resonated as lenders expectations for increased levels of unemployment jumped thirteen percentage points versus the previous survey.





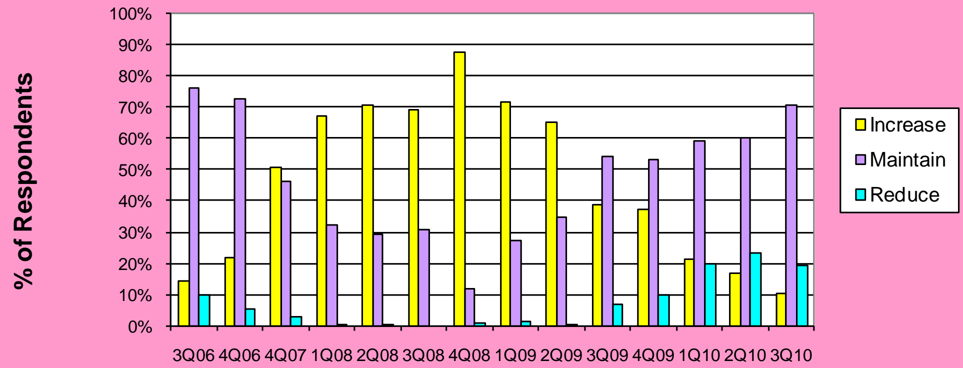

11. **The percentage of lenders expecting to tighten their existing loan structures declined to twelve percent (versus only 14 percent in the previous survey).**

    The percentage of respondents planning to relax their loan structure remained unchanged at only sixteen percent. Lenders who anticipate maintaining their loan structures increased by two percent to seventy two percent in Q3 2010.




12. **Expectations for lending spreads improved in comparison to the previous quarter as only ten percent anticipate increasing their lending rates in comparison to over seventeen percent in the previous survey.**

    Seventy-one percent of respondents (versus 59 percent in the previous quarter) expect to maintain lending spreads from their current levels and nineteen percent anticipate reducing their rates in comparison to twenty-three percent in Q2 2010.


Expectations For Lending Spreads
(next six months)
% of Respondents
100%
90%
80%
70%
60%
50%
40%
30%
20%
10%
0%
3Q06
4Q06
4Q07
1Q08
2Q08
3Q08
4Q08
1Q09
2Q09
3Q09
4Q09
1Q10
2Q10
3Q10
Increase
Maintain
Reduce

# 13.Phoenix Management
# "Lending Climate in America"
# 3rd Quarter 2010

## Survey Results

### 1. Economic Impact of the Official End of the War in Iraq

Lenders were asked: President Obama officially marked the end of the War in Iraq, which cost more than $700 billion, according the Congressional Budget Office. What level of benefit do you believe the end of the War provides to the Economy?

- Forty percent of lenders believe that the end of the War will prove to be "Slightly" beneficial to the Economy.
- Twenty-six percent chose the end of the War will have a "Moderately" beneficial impact on the Economy.
- Twenty-six percent of respondents agreed that the end of the War will have no beneficial impact on the Economy.
- The remaining eight percent of lenders are optimistic that the end of the War will have a "Highly" beneficial impact on the state of the Economy.

### 2. Initiatives to Improve the U.S. Unemployment Rate

Respondents were asked "What do you believe is the most effective way for the U.S. economy to improve the unemployment rate, which stands at 9.6%?

- Forty-five percent of the participants agreed that Regardless of what initiatives are implemented in the short term, it will take several years from now to restore confidence in the U.S. economy and yield significant improvements in the labor markets.
- Twenty-two percent of respondents believe the best way to improve unemployment is to extend additional tax cuts to individuals. This would create more disposable income for Americans, which will lead to economic expansion and job creation, as consumer spending accounts for nearly two-thirds of the U.S. economy.
- Twenty-one percent opined the best way to achieve lower unemployment is to allow the government to provide small businesses tax credits and incentives for hiring additional workers.
- Six percent of lenders believe that it would be most beneficial to enact the newly proposed Obama plan to increase the economic stimulus package by an additional $50 billion, targeted at improving our nation's infrastructure, which would serve as a catalyst for job creation.
- The final six percent of the participants chose "Other" as their response to the question.

## 3. The U.S.’ Increasing Trade Deficit with China

Lenders were asked to opine on the growing economic trade imbalance between the U.S. and China. China’s monthly trade surplus with the U.S. in July 2010 reached $30 billion, the highest level since January 2009.

- Forty-one percent believe that China needs to take proactive steps to restore balance between the two countries by providing greater flexibility in its exchange rate and further open up its domestic markets for imports and foreign direct investment, as this would accelerate the global economy.
- Thirty-two percent opined that although the trade imbalance calls for some level of concern, the U.S. has become a service-based economy and manufacturing operations have gradually headed overseas because of cheaper labor costs, which make products cheaper for U.S. consumers.
- Thirteen percent commented that China has no responsibility to adhere to U.S. demands in order to improve the trade imbalance as China has been solely responsible for purchasing hundreds of billions in U.S. issued debt in order to help America finance the Iraq War and provide additional funding.
- Ten percent of respondents believe this has become an unsustainable issue, as the widening in the trade deficit gap with China is hindering U.S. economic growth and causing significant tension in bilateral trade relations between the two nations.
- The remaining four percent chose “Other” factors in regards to the discussion question.

## 4. Highest Senior Debt to EBITDA Multiple 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-two 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).
- Twenty-eight percent believed their institution would consider a loan request with a Senior Debt to EBITDA multiple as high as the 2.5x – 3.0x range (previous survey: 26 percent).
- Twenty-one percent indicated their institution would consider a loan request with a leverage multiple as high as the 3.0x – 3.5x range (previous survey: 21 percent).
- Fifteen percent of lenders opined their financial institution would consider a loan request with a leverage multiple of greater than 3.5x (previous survey: 17 percent).
- Two percent believed their institution would consider a loan request with a Senior Debt to EBITDA multiple as high as the 2.0x – 2.5x range (previous survey: 5 percent).
- The final two percent answered “Do Not Know” to the question.

## 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-three percent indicated that the Senior Debt to EBITDA multiple will not change at their financial institution over the next six months (previous survey: 39 percent).
- Thirty percent of respondents replied they are collateral lenders and, therefore, do not make credit decisions based on cash flow/leverage multiples (previous survey: 30 percent).
- Eleven percent of lenders believe that the leverage multiple will increase less than 0.5x during the next six months (previous survey: 21 percent).
- Four percent conclude that the leverage multiple will increase greater than 0.5x during the next six months (previous survey: 7 percent).
- The remaining two percent of respondents did not know the degree to which the Senior Debt to EBITDA multiple would change at their financial institution.

## 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.

- Seventy-nine percent designated the sluggish housing market as the factor with the strongest potential to affect the near-term economy (previous survey: 56 percent).
- Thirty-eight percent indicated constrained liquidity in the capital markets as the factor with the strongest potential to affect the near-term economy (previous survey: 41 percent).
- Twenty-eight 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: 43 percent).
- Twenty-six percent opined that the stability of the stock market has the strongest potential to affect the economy during the next six months (previous survey: 30 percent).
- Eleven percent concluded that unstable energy prices have the strongest potential to affect the economy during the next six months (previous survey: 8 percent).

## 8. 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.

- Sixty-eight percent designated the Construction industry as the industry expected to weather the greatest volatility in the near term (previous survey: 57 percent).
- Fifty-five percent responded that the Real Estate and Rental/Leasing industry would experience the most volatility during the next six months (previous survey: 67 percent)

- Thirty-eight percent believe the Retail Trade industry would experience the most volatility over the next six months (previous survey: 23 percent).
- Thirty percent of respondents believe the Finance and Insurance industry will experience the greatest volatility over the next six months (previous survey: 39 percent).
- Twenty-six percent opined the Manufacturing industry would experience the most volatility (previous survey: 18 percent).
- Fifteen percent of respondents chose the Healthcare and Social Assistance industry to experience the greatest volatility (previous survey: 20 percent).
- Eleven percent agreed the Arts, Entertainment and Recreation industry will experience the greatest volatility in the next six months (previous survey: 10 percent).
- The balance of the industry choices did not register designations greater than ten percent from the respondents.

## 9. 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.

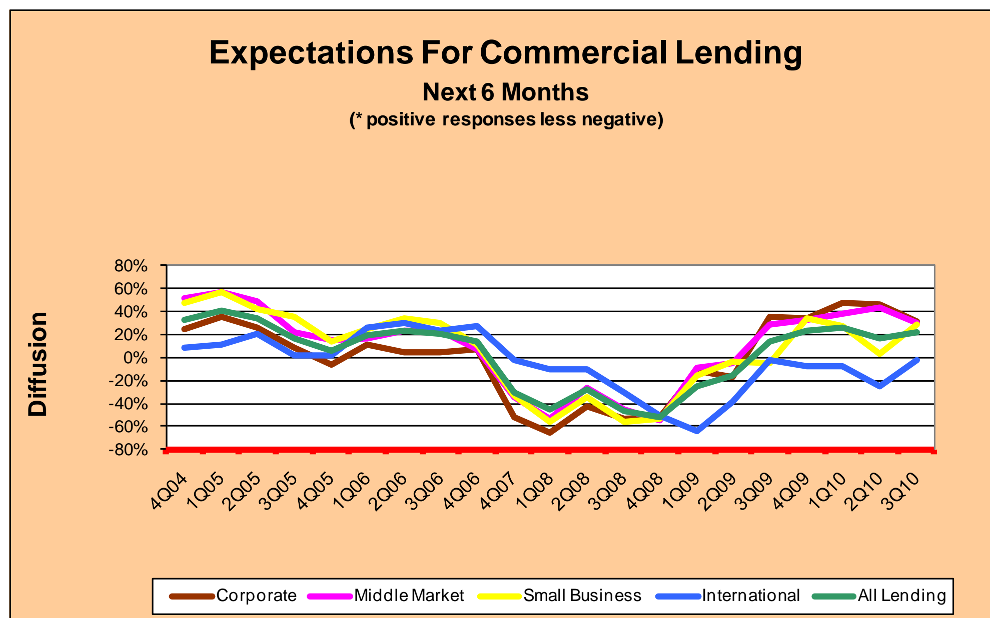
- Thirty-eight percent indicated their customers are planning on raising additional capital in the next months (previous survey: 28 percent).
- Twenty-eight percent responded their customers are planning on entering new markets (previous survey: 23 percent).
- Twenty-six percent of lenders believe their customers are planning on introducing new products or services (previous survey: 36 percent).
- Twenty-six percent of lenders believe their customers will be making new capital investments (previous survey: 34 percent).
- Twenty-five percent of lenders opined that their customers are planning on making an acquisition (previous survey: 21 percent).
- Twenty-three percent of respondents indicated their customers plan on hiring new employees in the next 6 months (previous survey: 31 percent).
- Eleven percent of lenders believe their customers are planning "other" initiatives in the next six months (previous survey: 15 percent).

## 10. 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.

- Respondents' sentiment regarding overall lending economic indicators experienced a slight increase from the previous survey. The diffusion index for all domestic lending segments equaled positive 30 percentage points - a decline of only one percentage point versus last quarter, however an improvement of ten percentage points from one year ago. Corporate and Middle Market corporate lending expectations both experienced declines from the previous survey; 14 percentage point decline for both groups. However, Small Business commercial lending expectations increased by twenty five percentage points in the diffusion index from the previous quarter.

Expectations for international lending also yielded a big rise from the previous quarter, increasing twenty-two percentage points in the diffusion index. The combination of the various lending segments yielded an overall five percentage point gain in Q3 2010 compared to the previous quarter's results.




| | 3Q/2010 | | | 2Q/2010 | | |
|---|---|---|---|---|---|---|
| | Up | Down | Same | Up | Down | Same |
| Corporate Lending | 38% | 6% | 56% | 48% | 2% | 50% |
| Middle Market Lending | 36% | 6% | 58% | 49% | 5% | 46% |
| Small Business Lending | 38% | 9% | 53% | 36% | 33% | 31% |
| International Lending | 21% | 22% | 57% | 10% | 34% | 56% |

- Macroeconomic indicators yielded mixed signals as loan losses and bankruptcies showed signs of improvement however, expectations of unemployment continuing to experience signs of weakness increased from the previous quarter. Expectations of unemployment increasing in the near-term jumped to twenty-one percent in Q3 from only eight percent in the previous quarter. Interest rate expectations also experienced a large change from the previous quarter. Only twenty-three percent of respondents believe interest rates will increase in the next six months compared to fifty nine percent in the previous survey.

| | Up | Down | Same | Up | Down | Same |
|---|---|---|---|---|---|---|
| Loan Losses | 23% | 28% | 49% | 29% | 43% | 28% |
| Bankruptcies | 28% | 32% | 40% | 34% | 28% | 38% |
| Interest Rates | 23% | 4% | 73% | 59% | 4% | 37% |
| Unemployment | 21% | 26% | 53% | 8% | 31% | 61% |
| Bank Failures | 42% | 4% | 54% | 38% | 7% | 56% |

## 11. 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.

- The outlook of the U.S. economy experienced a pullback from the previous quarter. The percentage of respondents who expect the economy to perform at a "C" level or better during the next six months declined from 88 percent in Q2 2010 to 64 percent in Q3 2010. The percentage of lenders who believe the economy will languish at a "D" level or worse increased by twenty-four percentage points from the previous survey (36 percent in Q3 2010 versus 12 percent in Q2 2010).

| Grade | 3Q/2010 | 2Q/2010 |
|---|---|---|
| A | 0% | 0% |
| B | 2% | 3% |
| C | 62% | 85% |
| D | 36% | 10% |
| F | 0% | 2% |
| Weighted Average Grade | 1.66 | 1.90 |

## 12. 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 ("out" six months) on a grading scale of A through F.

- Similar sentiment (compared to the previous survey) resonated as lenders expectations for the U.S. economy's performance in the "out six months" period yielded a decline compared to the previous survey, from a weighted average input of 2.38 in the previous survey to a grade of 2.09 in Q3 2010. Seventy-seven percent of lenders believe the economy will perform at a "C" level or worse compared to only 56 percent in the previous quarter.

| Grade | 2Q/2010 | 2Q/2010 |
|---|---|---|
| A | 0% | 2% |
| B | 23% | 42% |
| C | 64% | 48% |
| D | 13% | 8% |
| F | 0% | 0% |
| Weighted Average | 2.09 | 2.38 |

## 13. 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 was slightly lower from the previous survey at sixty-six percent (69 percent in Q2 2010). Nine percent of respondents opined that their customers have "strong" growth expectations for the next six months to a year compared to only six percent in the prior survey. Expectations of customers having "no growth" remained unchanged from the previous quarter's results at 25 percent.

| Indication | 3Q/2010 | 2Q/2010 |
|---|---|---|
| Very Strong | 0% | 0% |
| Strong | 9% | 6% |
| Moderate | 66% | 69% |
| No Growth | 25% | 25% |

## 14. 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.

- According to the survey results, there is an overall sentiment that loan structures will remain very similar to their positions last quarter. Lenders who believe that loan structures would tighten in the near term decreased by two percentage points from 14 percent in Q2 2010 down to 12 percent in the current quarter. The category of "Loans greater than $25 million" experienced the largest change versus the last quarter as only nine percent believe these larger size loan structures will tighten compared to seventeen percent in the previous quarter.

| | 3Q/2010 | | | 2Q/2010 | | |
|---|---|---|---|---|---|---|
| | Tighten | Maintain | Relax | Tighten | Maintain | Relax |
| Loans> $25 million | 9% | 76% | 15% | 17% | 63% | 20% |
| $15 – 25 million | 13% | 67% | 20% | 15% | 68% | 17% |
| $5-15 million | 14% | 72% | 14% | 11% | 76% | 13% |
| Under $5 million | 13% | 72% | 15% | 12% | 73% | 15% |
| Overall Average | 12% | 72% | 16% | 14% | 70% | 16% |

## 15. 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.

- Twenty percent of respondents plan to reduce their current interest rate spreads and fee structures on all sizes of loans – 3 percentage points lower than in the previous quarter. Only ten percent of lenders plan to increase their current interest rate spreads and fee structures on all size loans, an improvement of seven percentage points versus the previous survey and a dramatic decrease of twenty-nine percentage points compared to one year prior. The percentage of lenders who anticipate maintaining their interest rate spreads and fee structures increase to seventy percent, an increase of ten percent compared to the previous quarter.

| | 3Q/2010 | | | 2Q/2010 | | |
|---|---|---|---|---|---|---|
| | Reduce | Maintain | Increase | Reduce | Maintain | Increase |
| Loans> $25 million | 24% | 67% | 9% | 37% | 50% | 13% |
| $15 – 25 million | 24% | 67% | 9% | 26% | 60% | 13% |
| $5-15 million | 20% | 70% | 10% | 15% | 67% | 19% |
| Under $5 million | 10% | 77% | 13% | 15% | 63% | 22% |
| Overall Average | 20% | 70% | 10% | 23% | 60% | 17% |

## 16. 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.

- The percentage of lenders anticipating a 25 bps or more increase in interest rates decreased again versus the previous quarter as forty-six percent of respondents in the previous quarter believed the Fed would increase rates by at least 25 bps versus only twenty-nine percent in Q3 2010. Current expectations of an interest rate increase have declined significantly in the past six months as seventy-two percent of lenders anticipated a 25 bps or more increase in Q1 2010. An overwhelming majority (69 percent) believe the Fed will hold rates at their current level in the coming six months compared to fifty-four percent in the previous quarter.

| Bps Change | 3Q/2010 | 2Q/2010 |
|---|---|---|
| -More than 1.0 | 0% | 0% |
| -1.0 | 0% | 0% |
| -.75 | 0% | 0% |
| -.50 | 0% | 0% |
| -.25 | 2% | 0% |
| 0 | 69% | 54% |
| +.25 | 17% | 28% |
| +.50 | 12% | 16% |
| +.75 | 0% | 0% |
| +1.0 | 0% | 2% |
| More than 1.0 | 0% | 0% |
| Weighted Average | + 10 basis points | + 15 basis points |

## 17. Current Competition

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

- Similar to the previous several quarters, Local Commercial/Community banks served as the primary source of competition – 47 percent in Q3 2010 versus 54 percent in the previous quarter. Money Center banks have increased nearly double over the past two quarters as the primary source of competition (23 percent in Q3 2010 versus 12 percent in Q1 2010).

| | 3Q/2010 | 2Q/2010 |
|---|---|---|
| Money Center Banks | 23% | 15% |
| Local Commercial/ Community Banks | 47% | 54% |
| Factors | 9% | 13% |
| Regional Banks | 15% | 15% |
| Commercial Finance Organizations | 4% | 3% |
| Other | 2% | 0% |