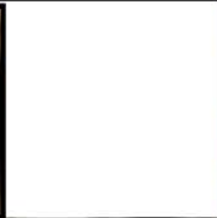
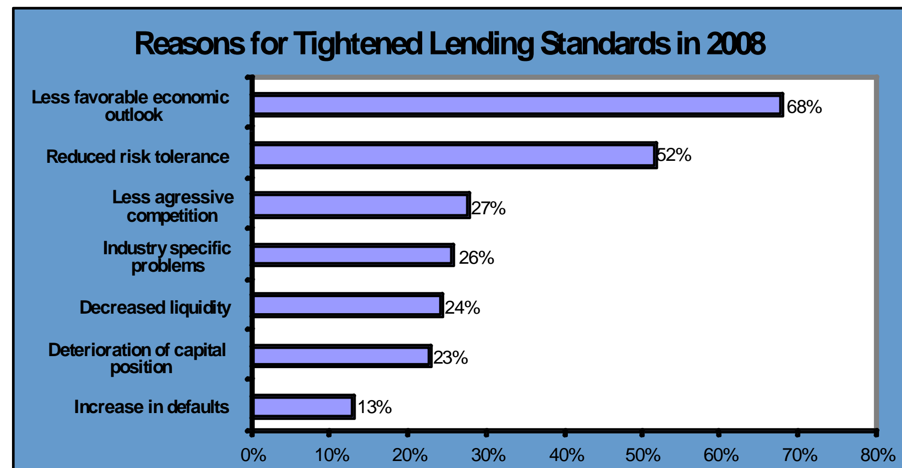
Phoenix "Lending Climate in America" Survey



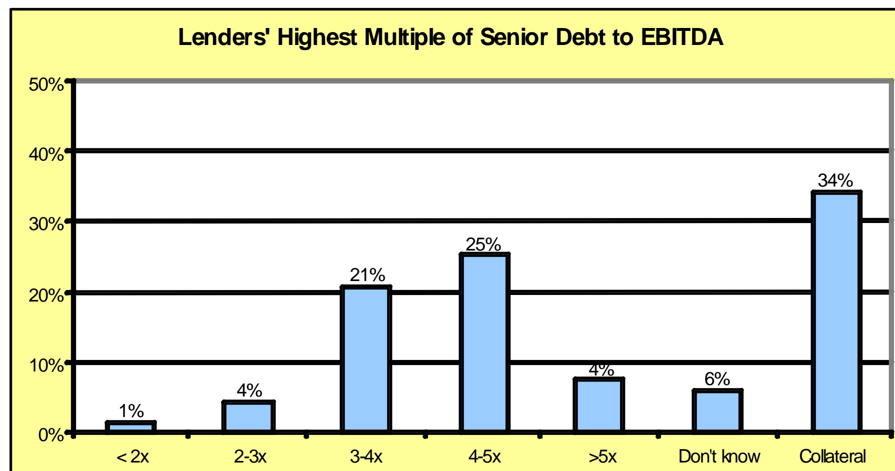
2nd Quarter 2008

Summary, Trends and Implications

1. **An overwhelming majority – 82 percent - of lenders indicated their financial institution has tightened its lending standards during 2008.** Of those lenders that did tighten lending standards this year, sixty-six percent sited a less favorable economic outlook as the primary impetus for doing so. Fifty-two percent designated their institution's reduced risk tolerance, while twenty-seven percent of respondents indicated less aggressive competition resulted in tightened lending standards. Industry-specific problems were selected by twenty-six percent of respondents. Approximately an equal percentage of lenders (23-24 percent) designated decreased liquidity and deterioration of capital position as the internal reason for tightened lending standards. Finally, thirteen percent of lenders chose an increase in defaults as the principal reason for the recently tightened lending standards.

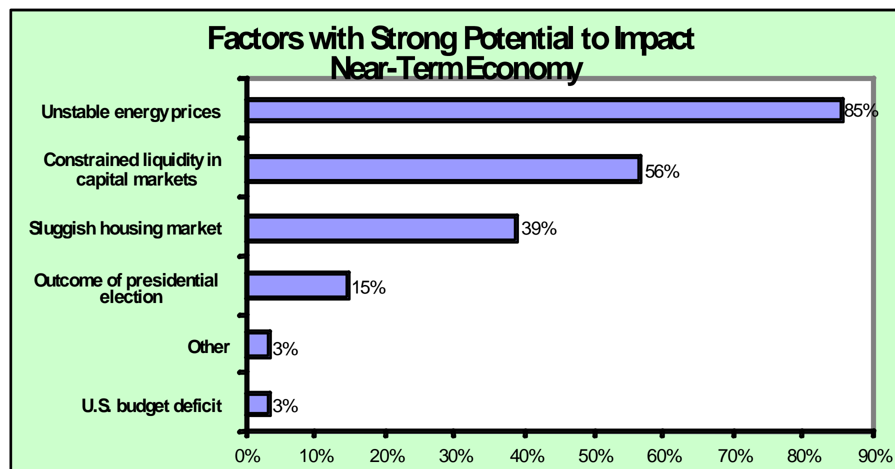


2. **Twenty-five percent of lenders indicated their financial institution would consider a loan request with a Senior Debt to EBITDA multiple as high as 4-5x, a 17 percentage point increase from the previous quarter.** Five percent of respondents indicated their institution would only consider a loan request with a multiple of less than 3x, while another twenty-one percent of lenders opined they would consider a loan request with a multiple as high as 3-4x. Four percent of respondents indicated they would consider a loan request with a Senior Debt to EBITDA multiple greater than 5x. Thirty-four percent of respondents indicated they are collateral lenders and do not utilize cash flow multiples as the primary factor in credit decisions.

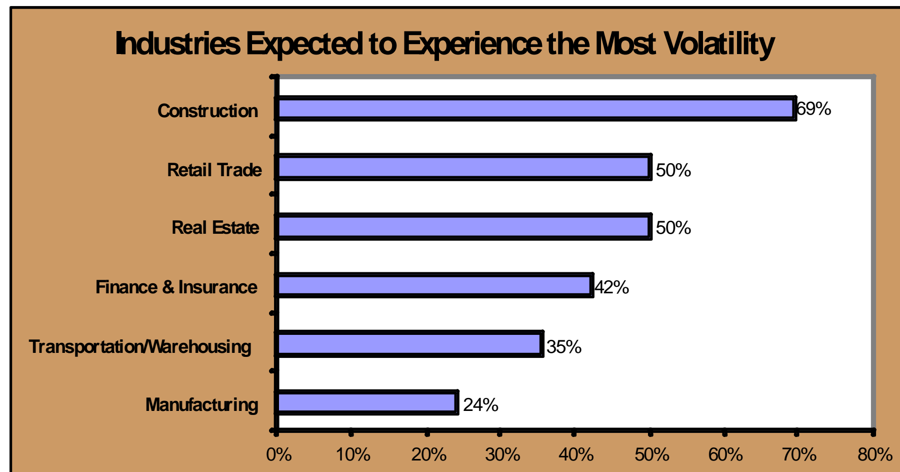


3. **Thirty-four percent of lenders believe their institution will have no change in the highest Senior Debt to EBITDA multiple it will consider in regards to a new loan request.** Fifteen percent of respondents believe internally that multiple will decrease less than 1x, while another six percent believe that multiple will decrease by more than 1x. Six percent of lenders opined that the multiple would increase 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.

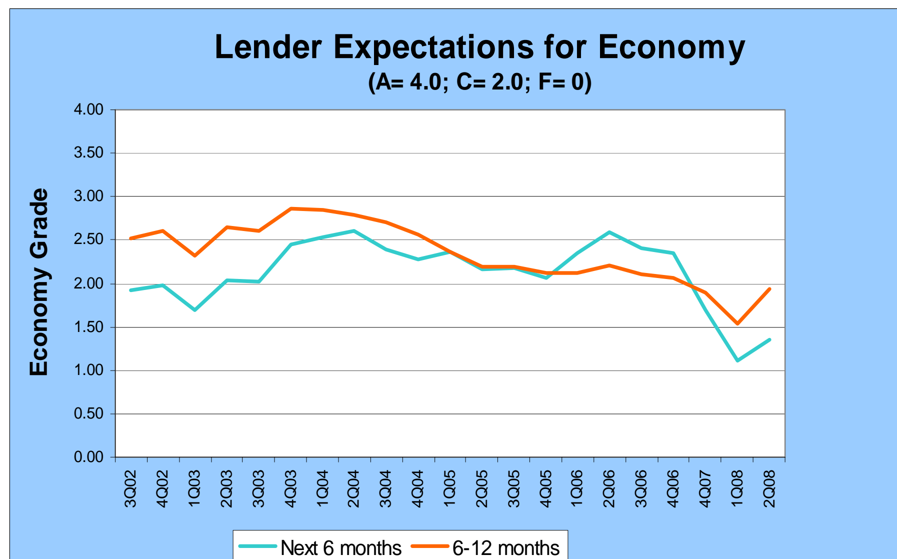
4. **Eighty-five percent of lenders designated unstable energy prices as a factor with a strong potential to impact the near–term economy.** The current constrained liquidity in the capital markets was chosen by 56 percent of respondents as having significant potential to have near-term economic impact. Thirty-nine percent of lenders chose the sluggish housing market, while fifteen percent designated the outcome of the upcoming presidential election. Finally, three percent each chose the U.S. budget deficit and "other" factors as having strong potential to impact the near-term economy.



5. **Sixty-nine percent 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, while 69 percent of lenders designated the construction industry, fifty percent each choose the Real Estate and Rental/Leasing and Retail Trade industries as the most likely to experience volatility. Forty-two percent of lenders believe the Finance and Insurance industries will experience the most volatility. Thirty-five percent of lenders believe the Transportation and Warehousing industry will experience the most volatility. The last industry to register a meaningful percentage – Manufacturing – was selected by twenty-four percent of respondents.

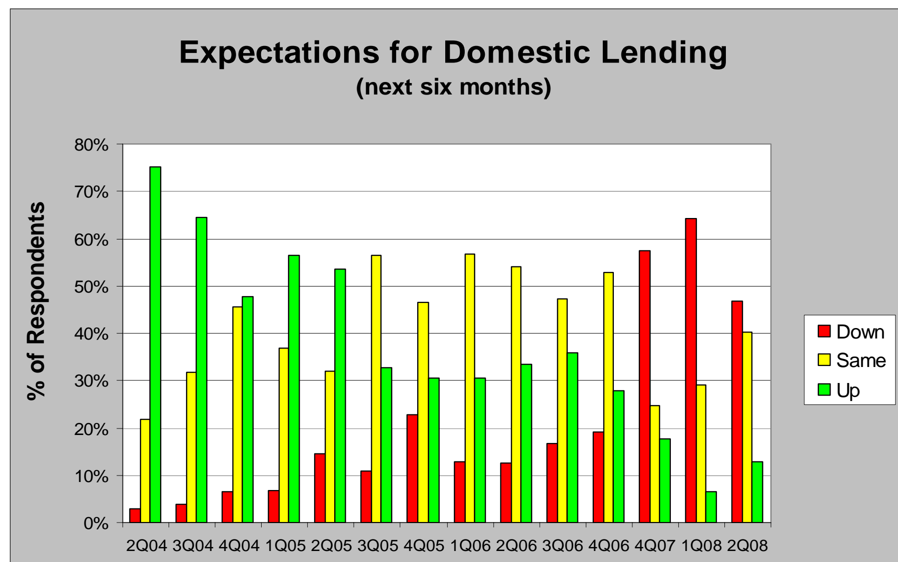


6. **In contrast to the recent declining outlook, lenders expectations for the economy improved from the previous quarter.** Lenders expect the economy to perform at a high "D" level during the next six months. The respondents' expectations for longer-term improvement remained better than the near-term outlook with a "C" expectation level.

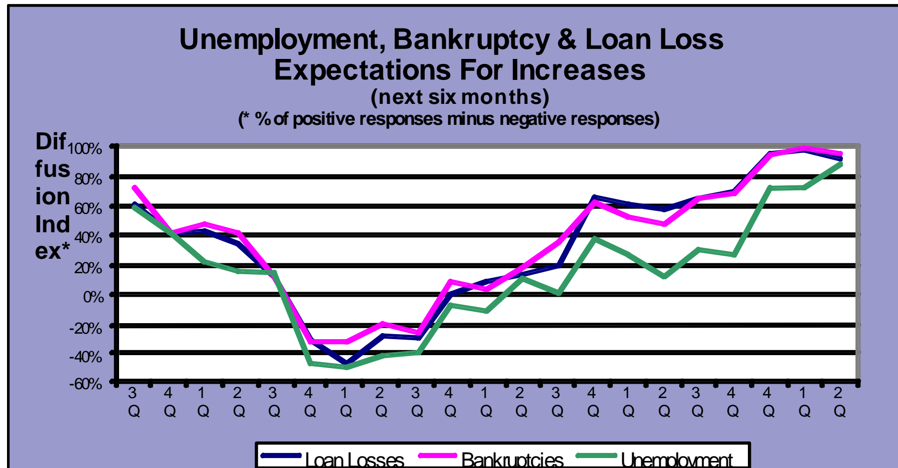


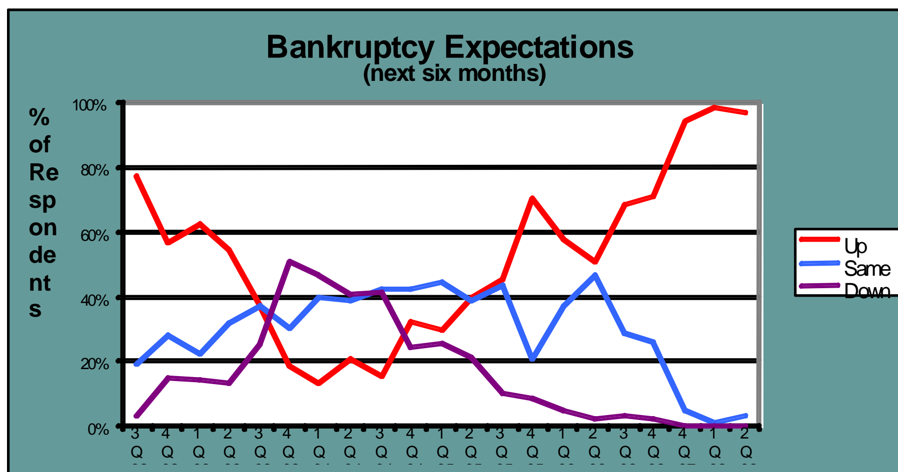
7. **The percentage of respondents with their customer having no growth expectations over the next 6 - 12 months was consistent with the previous quarter at thirty-two percent**. Sixty-six percent of lenders opined their customers had moderate growth expectations, in line with the previous quarter.

8. **While the loan demand diffusion index (the percentage of respondents forecasting a higher percentage less those anticipating a lower percentage) continued to be negative across all lending segments, respondents were relatively more optimistic across all lending segments in this survey.** The overall diffusion index for all lending segments improved to negative 28 percentage points (from negative forty-six percentage points in the previous survey). Respondents indicated that, on average for all domestic lending categories, thirteen percent have expectations for increased loan demand (versus 6 percent in the prior quarter).



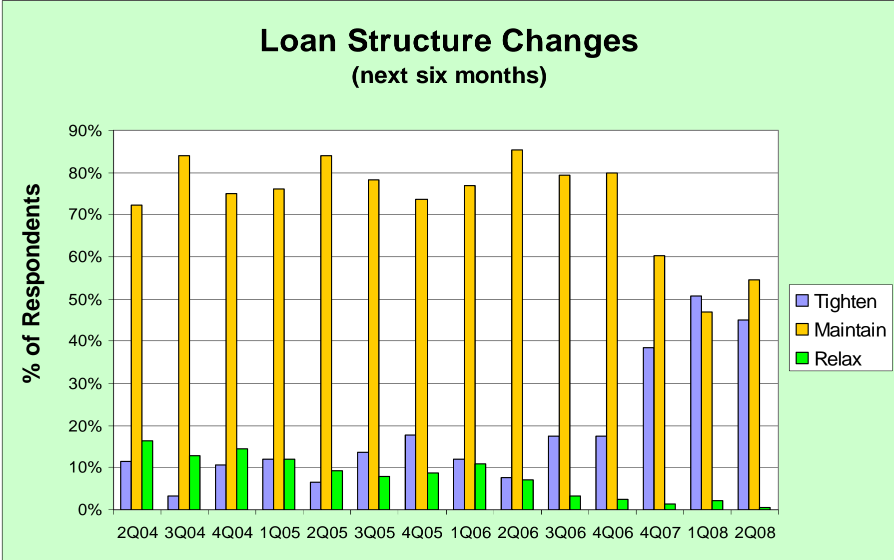
9. **The gross majority of lenders with expectations of deteriorating credit quality were consistent with recent surveys.** The loan loss diffusion index was at 92 percent, slightly down from the previous quarter, while ninety-seven percent of lenders anticipate higher bankruptcies. The percentage of respondents anticipating higher unemployment grew to 89 percent – up from 78 percent in the previous quarter.



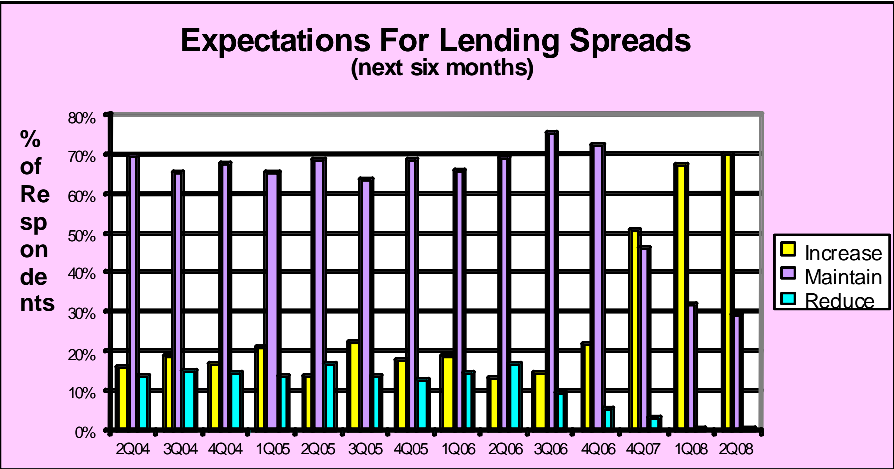


10. **In a significant shift from recent surveys, sixty percent of lenders anticipate interest rates will increase over the next six months (versus three percent in the previous survey).** Thirty-five percent of lenders are expecting interest rates to increase 50 bps in the second half of 2008, while another 25 percent of respondents are expecting a 25 bps increase over the next six months. Twenty-eight percent of lenders believe rates will remain unchanged, while the remaining eleven percent of respondents believes that interest rates will decrease over the next six months.

11. **The percentage of lenders expecting to tighten their existing loan structures decreased to forty-five percent (versus fifty-one percent in the previous survey).** As a result, the percentage of respondents planning to maintain their loan structure increased to 54 percent (versus 47 percent last quarter).



12. **More lenders anticipate increasing their current lending spreads in this interest rate environment.** Seventy percent of respondents (versus 67 percent in the previous quarter) expect to increase lending spreads from their current levels.



Phoenix Management
"Lending Climate in America"
2nd Quarter 2008

Survey Results

1. Tightening of Lending Standards in 2008

Respondents were asked whether their financial institution has tightened its lending standards during 2008.

- Eighty-two percent of respondents indicated that their institution had tightened its lending standards in 2008.
- The remaining eighteen percent of lenders responded that they have not tightened their lending standards this year.

2. Reasons for Tightened Lending Standards

Of the respondents that answered "Yes" to question #1, those respondents were asked what was the reason(s) for the tightening of lending standards in 2008. Respondents were asked to identify as many reasons as were applicable.

- Sixty-eight percent indicated the less favorable/uncertain economic outlook as a reason for the recent tightening of lending standards.
- Fifty-two percent of respondents replied that reduced risk tolerance resulted in the tightened lending standards.
- Twenty-seven percent of lenders indicated that less aggressive competition was the impetus for tightened lending standards.
- Twenty-six percent opined that industry specific problems were the reason for the revised lending standards.
- Twenty-four percent of respondents replied that decreased liquidity provided the impetus for the tightened lending standards.
- Twenty-three percent of lenders designated the deterioration of their institution's capital position as the reason for the tightened lending standards.

- Thirteen percent of respondents replied that the increase in defaults as a reason for the recent tightening of lending standards.

3. Highest Multiple of Senior Debt to EBITDA an Institution Would Consider

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

- Thirty-four percent of respondents replied they are collateral lenders and, therefore, do not make credit decisions based on cash flow/leverage multiples.

- Twenty-five percent indicated their institution would consider a loan request with a Senior Debt to EBITDA ratio as high as 4-5x.

- Twenty-one percent opined their institution would consider a loan request with a Senior Debt to EBITDA ratio as high as 3-4x.

- Seven percent responded their institution would consider a loan request with a Senior Debt to EBITDA ratio greater than 5x.

- The remaining thirteen percent of lenders were split between willing to consider a loan request with a multiple less than 2x, a loan request with a multiple of 2-3x, and not knowing what the highest leverage multiple their institution would consider.

4. 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.

- Thirty-four percent indicated that the Senior Debt to EBITDA multiple will not change at their financial institution over the next six months.

- Thirty percent of respondents replied they are collateral lenders and, therefore, do not make credit decisions based on cash flow/leverage multiples.

- Fifteen percent believed the leverage multiple will decrease less than 1.0x during the next six months.

- Nine percent of lenders stated they did not know if the leverage multiple would change at their institution over the next six months.

- Six percent believed the Senior Debt to EBITDA multiple will decrease more than 1.0x during the next six months.

- Six percent opined the Senior Debt to EBITDA multiple will increase during the next six months.

5. 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.

- Eighty-five percent designated unstable energy prices as the factor with the strongest potential to affect the near-term economy (an increase of twenty percentage points from the previous survey).

- Fifty-six percent designated constrained liquidity in the capital markets as the factor with the strongest potential to affect the near-term economy.

- Thirty-nine percent of respondents replied the sluggish housing market has the strongest potential to affect the economy over the next six months (a thirty-three percentage point decrease from the prior survey).

- Fifteen percent opined that the outcome of the upcoming presidential election had the strongest potential to affect the economy during the next six months.

- Three percent chose the U.S. budget deficit as the factor with the strongest potential to affect the economy in the next six months.

- Three percent believed that other factors (than the five factors specifically mentioned) have the greatest potential to affect the economy in the next six months.

6. 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-nine percent of respondents believed the construction industry will experience the greatest volatility over the next six months.

- Fifty percent each designated the real estate and rental/leasing industry and the retail trade industry as the industry expected to weather the greatest volatility in the near term.

- Forty-two percent believed the finance and insurance industry would experience the most volatility.

- Thirty-five percent responded that the transportation and warehousing industry would experience the most volatility during the next six months.

- Twenty-four percent opined the manufacturing industry would experience the most volatility.

- Fifteen percent designated the accommodation and food service industry as the anticipated most volatile industry over the next six months.

- The balance of the industry choices did not register designations greater than five percent from the respondents.

7. 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.

- Forty-eight percent responded their customers intend to raise additional capital in the next 6-12 months.

- Thirty-nine percent indicated their customers are planning on making an acquisition in the next six to twelve months.

- Thirty-seven percent indicated their customers are planning on introducing new products or services.

- Twenty-nine percent responded their customers' plan on making new capital investments in the next 6-12 months.

- Twenty-six percent of respondents indicated their customer's plan on entering new markets in the next 6-12 months.

- Twenty-one percent indicated their customers are planning on hiring new employees.

- Fifteen percent responded their customers' plan on engaging in "other" business actions in the next 6-12 months.

8. 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.

- While still at historically low levels, the percentage of lenders anticipating "Up" economic indicators increased across all lending segments versus the previous survey. As a result, the diffusion index for all lending segments improved to negative 28 percentage points - an 18 percentage point improvement from the previous quarter.

- Lenders maintained their negative credit quality outlook, as a near unanimous number of respondents believe that loan losses and bankruptcies will increase. The percentage of respondents forecasting an increase in interest rates (up 62 percentage points) significantly increased this period.

	1Q/2008			2Q/2008		
	Up	Down	Same	Up	Down	Same
Corporate Lending	5%	69%	26%	8%	50%	42%
Middle Market Lending	8%	61%	31%	18%	44%	38%
Small Business Lending	6%	63%	31%	13%	47%	40%
International Lending	18%	28%	54%	21%	31%	48%
	Up	Down	Same	Up	Down	Same
Loan Losses	97%	0%	3%	92%	0%	8%
Bankruptcies	99%	0%	1%	97%	0%	3%
Interest Rates	3%	61%	37%	65%	3%	32%
Unemployment	78%	4%	18%	89%	0%	11%
Bank Failures	75%	0%	25%	77%	0%	23%

9. U.S. Economy Grade – Second Half of 2008

Respondents were asked how they expected the U.S. economy to perform during the second half of 2008 (next six months) on a grading scale of A through F.

- Respondents' outlook for the economy's near-term performance improved slightly to a high "D" grade level for the second half of 2008. The percentage of lenders who believe that the economy will perform at a "C" level increased to 40 percent from 15 percent in the prior quarter.

	1Q/2008	2Q/2008
A	0%	0%
B	0%	0%
C	15%	40%
D	81%	55%
F	4%	5%
Weighted Avg.	1.11	1.35

10. U.S. Economy Grade – First Half of 2009

Respondents were asked how they expected the U.S. economy to perform during the first half of 2009 ("out" six months) on a grading scale of A through F.

- Lenders' expectations for the "out six-month" period were higher than expectations for the next six months for the third consecutive quarter – in contrast to the previous four surveys where the longer-term outlook was more negative that the near-term outlook. Respondents anticipating the economy to perform at a "C" level or higher during the first half of 2009 increased to 82 percent (increasing from 50 percent in the previous survey).

	1Q/2008	2Q/2008
A	0%	0%
B	6%	13%
C	44%	69%
D	49%	16%
F	1%	2%
Weighted Avg.	1.54	1.94

11. Customers' Future Growth Expectations

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

- In contrast to the lenders' expectations for an improved near-term and long-term economic outlook, respondents maintained similar expectations of forecasted customer growth percentages as compared to the prior survey.

	1Q/2008	2Q/2008
Very Strong	0%	0%
Strong	1%	2%
Moderate	65%	66%
No Growth	34%	32%

12. 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.

- In contrast to the three previous quarters, respondents indicating their financial institutions would tighten their loan structures declined. The overall average of financial institutions planning to tighten their loan structures fell to 45% from 51% of respondents in the prior quarter survey.

	1Q/2008			2Q/2008		
	Tighten	Maintain	Relax	Tighten	Maintain	Relax
Loans> $25 million	55%	45%	0%	52%	48%	0%
$15 – 25 million	53%	45%	2%	48%	52%	0%
$5-15 million	49%	48%	3%	40%	60%	0%
Under $5 million	46%	50%	4%	41%	58%	1%
Overall Average	51%	47%	2%	45%	54%	1%

13. 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.

- Seventy percent of respondents plan to increase their current interest rate spreads and fee structures on all sizes of loans – the highest percentage of respondents in the last seven years and an increase from 67 percent in the prior survey.

	1Q/2008			2Q/2008		
	Reduce	Maintain	Increase	Reduce	Maintain	Increase
Loans> $25 million	0%	36%	64%	0%	38%	62%
$15 – 25 million	0%	30%	70%	0%	30%	70%
$5-15 million	1%	30%	69%	0%	22%	78%
Under $5 million	0%	33%	67%	2%	25%	75%
Overall Average	0%	33%	67%	1%	29%	70%

14. 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.

- In a dramatic shift from the previous two surveys, respondents forecast an increasing interest rate environment. The percentage of lenders anticipating a 25 bps or more increase in interest rates rose to sixty percent (versus three percent in the prior quarter survey).

	1Q/2008	2Q/2008
-More than 1.0	17%	0%
-1.0	17%	0%
-.75	13%	2%
-.50	32%	7%
-.25	13%	3%
0	6%	28%
+.25	1%	25%
+.50	0%	30%
+.75	1%	3%
+1.0	1%	2%
More than 1.0	0%	0%
Weighted Avg.	- 63 basis points	+ 20 basis points

15. Current Competition

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

- The percentage of lenders identifying regional banks as the primary source of competition increased to forty percent this survey as compared to twenty-one percent last quarter. Similarly, respondents designating commercial finance organizations as the primary source of competition increased to 20 percent versus four percent in the previous survey.

	1Q/2008	2Q/2008
Money Center Banks	6%	10%
Local Commercial/Community Banks	53%	13%
Factors	8%	8%
Regional Banks	21%	40%
Commercial Finance Organizations	4%	20%
Other	8%	8%