

# Phoenix Management Services “Lending Climate in America” Survey



**4<sup>th</sup> Quarter 2017  
Summary, Trends and Implications**

PHOENIX  
"LENDING CLIMATE IN AMERICA"

4<sup>th</sup> Quarter 2017

SUMMARY, TRENDS AND IMPLICATIONS

- 1. As the Trump Administration nears its first anniversary, which of the following financial metrics do you expect the Administration to focus most heavily on over the next year(s)?**

50% of lenders expect that GDP growth will be the financial metric the Trump Administration will focus heavily on over the next year. Garnering the second highest amount of responses, 27%, were lenders that expect the Administration to focus on jobs growth over the next year. 11% of lenders believe that the Trump Administration will focus heavily on personal income growth, while 8% expect the Administration to focus heavily on stock and/or bond market appreciation. Of the lenders surveyed, 4% expect the Federal deficit to be the financial metric the Trump Administration will focus heavily on over the next year.

- 2. In your opinion, which of the following stands to benefit the most from the Trump Administration's newly proposed fiscal tax plan?**

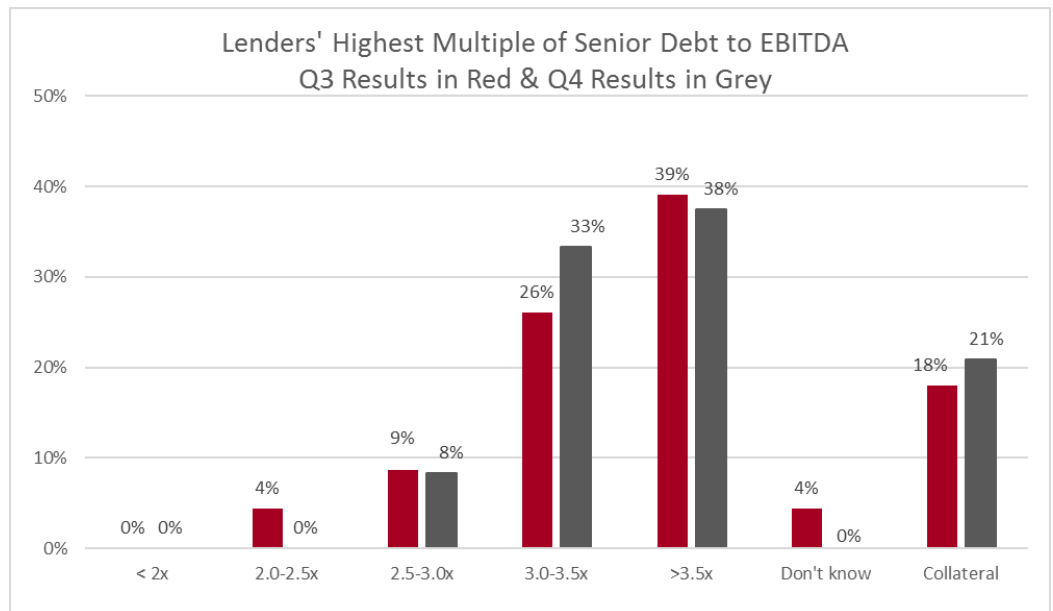
The answer that received the highest percentage response, 38%, were the lenders that believe GDP growth will benefit the most from the Trump Administration's newly proposed fiscal tax plan. Lenders that believe personal income growth will benefit the most from the Trump Administration's newly fiscal tax plan, garnered 26% of the responses. Of the lenders surveyed, 12% believe that a) jobs growth, b) stock and/or bond market appreciation, and c) federal deficit will benefit the most from the Trump Administration's newly proposed fiscal tax plan.

- 3. The U.S. has seen a spike in the volume of second lien lending in 2017 according to Thomson Reuters LPC data. Volume in the first half of 2017 was \$15.5B, nearly three times higher than the first half 2016 volume of \$5.3B. What will be the main driver of continued growth in second lien lending volume in 2018?**

Lenders garnering 42% of responses think that M&A financing will be the main driver of continued growth in second lien lending volume in 2018. Garnering the second highest amount of responses of 35%, were the lenders that believe refinancing of higher yield debt will be the main driver of continued growth, while 15% of lenders believe that growth and expansion will be the main driver of continued growth in second lien lending volume in 2018. 8% of lenders expect the second lien lending to cool down in 2018.

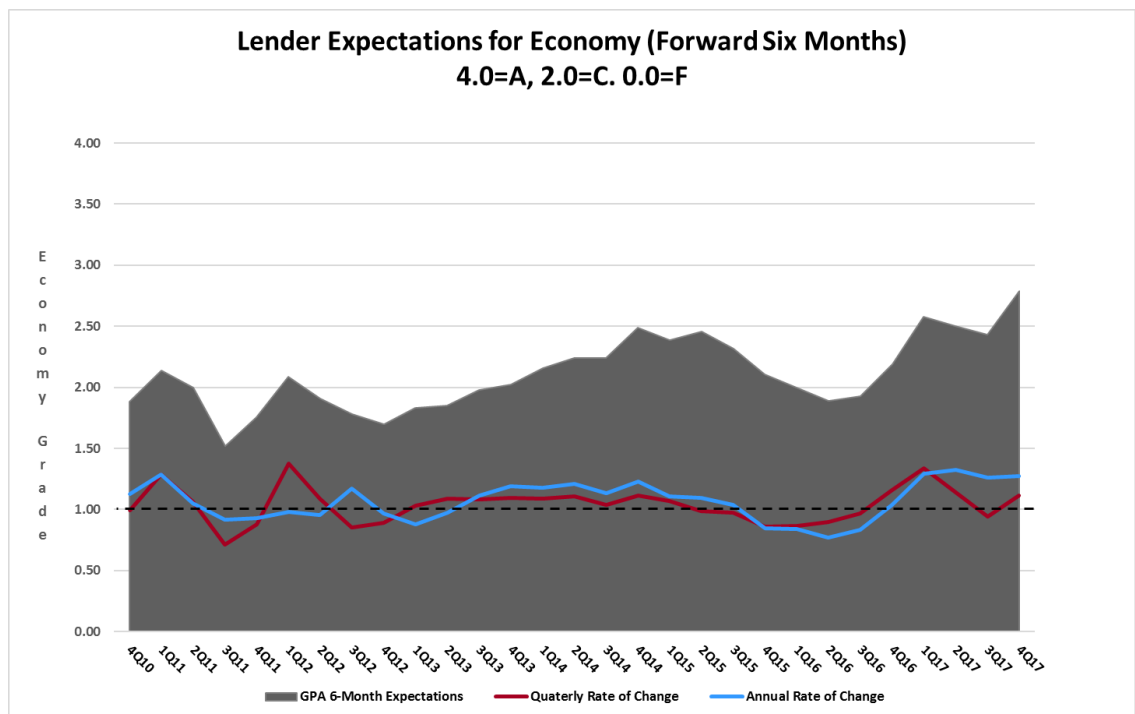
- 4. Leverage multiples remained relatively unchanged this quarter.**

Multiples remained relatively unchanged in 4Q 2017. 38% of lenders indicated that the >3.5x range would be the highest EBITDA ratio they would consider. The percentage of respondents who would consider a debt to EBITDA ratio of 3.0-3.5x increased 7 percentage points to 33%. The percentage of lenders who indicated the highest ratio they would consider is between 2.5-3.0x decreased 1 percentage point to 8%. None of the lenders surveyed stated their institutions highest multiple is less than 2.5x. In addition, 21% of lenders responded that they were collateral lenders and therefore do not make decisions based on cash flow/leverage multiples.



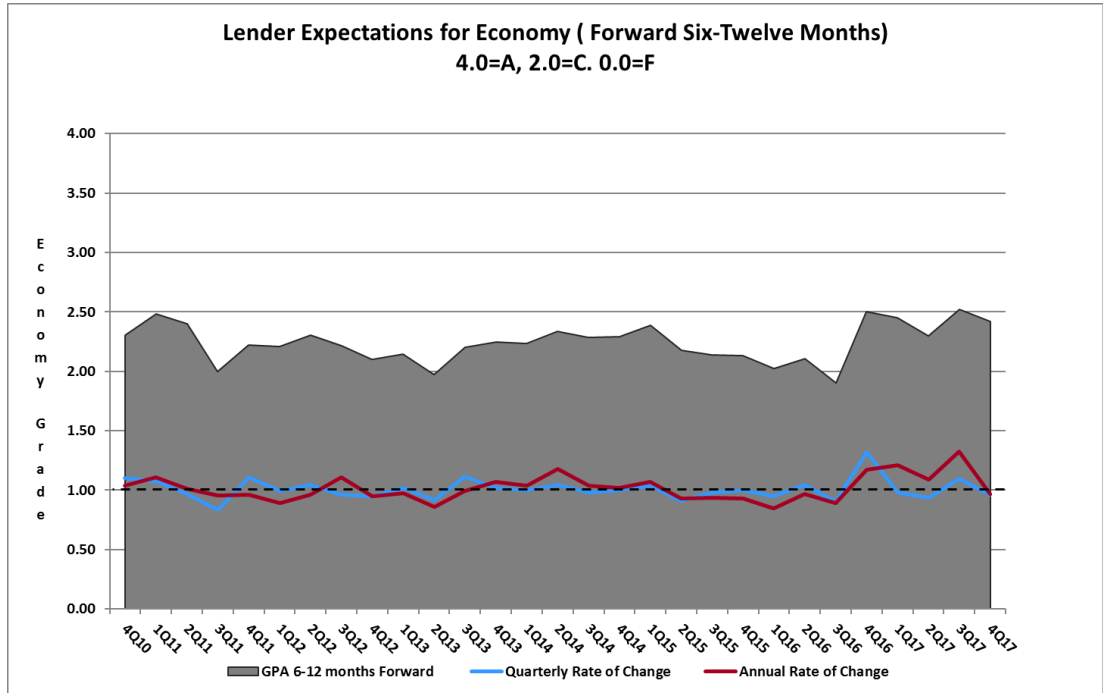
**5. Economic performance expectations increase for the near term in this quarter's survey.**

Lenders optimism in the U.S. economy for the short term increased significantly this quarter and remains at an overall “B” grade; the index GPA increased to 2.79 from the 3Q 2017 results of 2.43. 71% of the lenders believe the economy will perform at a “B” level over the next six months, compared to 48% in the previous survey. Furthermore, 25% of lenders surveyed believe the economy will perform at a “C” grade, compared to 48% in the previous survey. 4% of Lenders believe that the economy will perform at an “A” level.



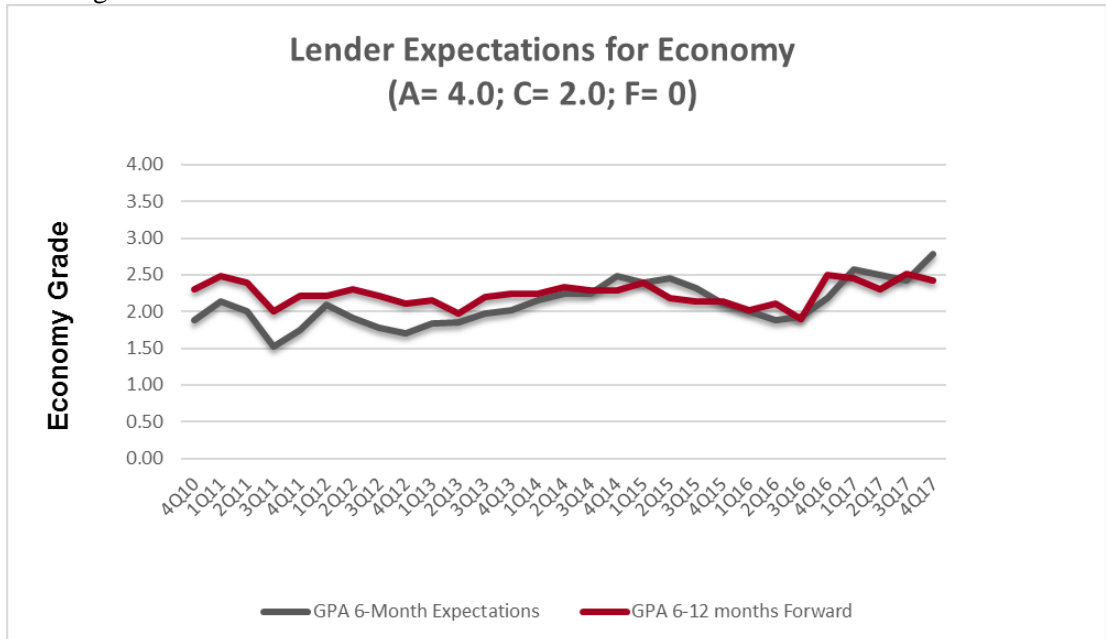
Lenders growth expectations for the U.S. economy beyond six months remained at an overall “B” grade this quarter. The weighted average decreased 10 points to a 2.42 GPA from 2.52 in the previous quarter. 46% of lenders believe the economy will perform at a “B” level in the next six to

twelve months, which is 2 percentage points higher than the previous quarter. The percent of lenders (38%) that believe the economy will perform at a “C” level decreased 14 percentage points from the previous quarter. The percentage of respondents who believe the economy will perform at a “D” level beyond the next six months increased 0% to 12%. The percentage of lenders that believe that economy will perform at an “A” level remained unchanged at 4%.



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

The 4Q 2017 survey reverses the recent trend of a higher long term GPA than near term GPA. The long term grade of “B” reflects lender’s positive expectations for the economy in both the near and long term.



**Phoenix Management Services**  
**“Lending Climate in America”**  
**4<sup>th</sup> Quarter 2017**

**Survey Results**

- 1. The majority of Lenders think GDP growth will be the financial metric the Trump Administration will focus most heavily on over the next year(s).**

Lenders were asked: As the Trump Administration nears its first anniversary, which of the following financial metrics do you expect the Administration to focus most heavily on over the next year(s)?

GDP Expansion	50%
Jobs Growth	27%
Personal Income Growth	11%
Stock and/or Bond Market Appreciation	8%
Federal Deficit	4%

- 2. Lenders believe that GDP expansion will benefit the most from the Trump Administration’s newly proposed fiscal tax plan.**

Lenders were asked: In your opinion, which of the following stands to benefit the most from the Trump Administration's newly proposed fiscal tax plan?

GDP Expansion	38%
Personal Income Growth	26%
Jobs Growth	12%
Stock and/or Bond Market Appreciation	12%
Federal Deficit	12%

- 3. Lenders believe M&A financing will be the main driver of continued growth in second lien lending volume in 2018.**

Lenders were asked: The U.S. has seen a spike in the volume of second lien lending in 2017 according to Thomson Reuters LPC data. Volume in the first half of 2017 was \$15.5B, nearly three times higher than the first half 2016 volume of \$5.3B. What will be the main driver of continued growth in second lien lending volume in 2018?

M&A Financing	42%
Refinancing of Higher Yield Debt	35%
Growth and Expansion	15%
Second Lien Lending Will Cool Down	8%

#### 4. Highest Senior Debt to EBITDA Leverage Institutions Would Consider

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

<u>EBITDA Level</u>	<u>3Q 2017</u>	<u>4Q 2017</u>
Greater than 3.5x	39%	38%
Between 3.01x and 3.50x	26%	33%
Between 2.51x and 3.00x	9%	8%
Between 2.01x and 2.50x	4%	0%
Less than 2.0x	0%	0%
Collateral lenders	18%	21%
N/A	4%	0%

#### 5. Anticipated Change in Senior Debt to EBITDA Multiple

Respondents were asked, over the next six months, how the Senior Debt to EBITDA multiple would change at their financial institution.

<u>Change in Senior Debt to EBITDA Level</u>	<u>3Q 2017</u>	<u>4Q 2017</u>
Increase greater than 0.5x	5%	4%
Increase less than 0.5x	18%	4%
Decrease less than 0.5x	0%	0%
Decrease greater than 0.5x	4%	0%
No change	55%	68%
Collateral lenders	14%	16%
N/A	4%	8%

#### 6. Factors with Strongest Potential to Affect Near-Term Economy

Respondents were asked, over the next six months, which two factors had the strongest potential to affect the economy.

<u>Factors Affecting Near-Term Economy</u>	<u>3Q 2017</u>	<u>4Q 2017</u>
U.S. Budget Deficit	32%	50%
Stability of Stock Market	45%	38%
Sluggish Housing Market	18%	29%
Unstable Energy Prices	55%	25%
Other	14%	25%
Constrained Liquidity in Capital Markets	9%	13%

## 7. Industries Expected to Experience Greatest Volatility

Respondents were asked, over the next six months, which industries will experience the most volatility (i.e. Chapter 11 filings, mergers and acquisitions, declining profits, etc.). Respondents were asked to select the top three industries.

<u>Industries Experiencing Most Volatility</u>	<u>3Q 2017</u>	<u>4Q 2017</u>
Retail Trade	91%	83%
Healthcare and Social Assistance	22%	33%
Mining	22%	25%
Finance and Insurance	9%	25%
Wholesale Trade	13%	21%
Real Estate and Rental/Leasing	17%	17%

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

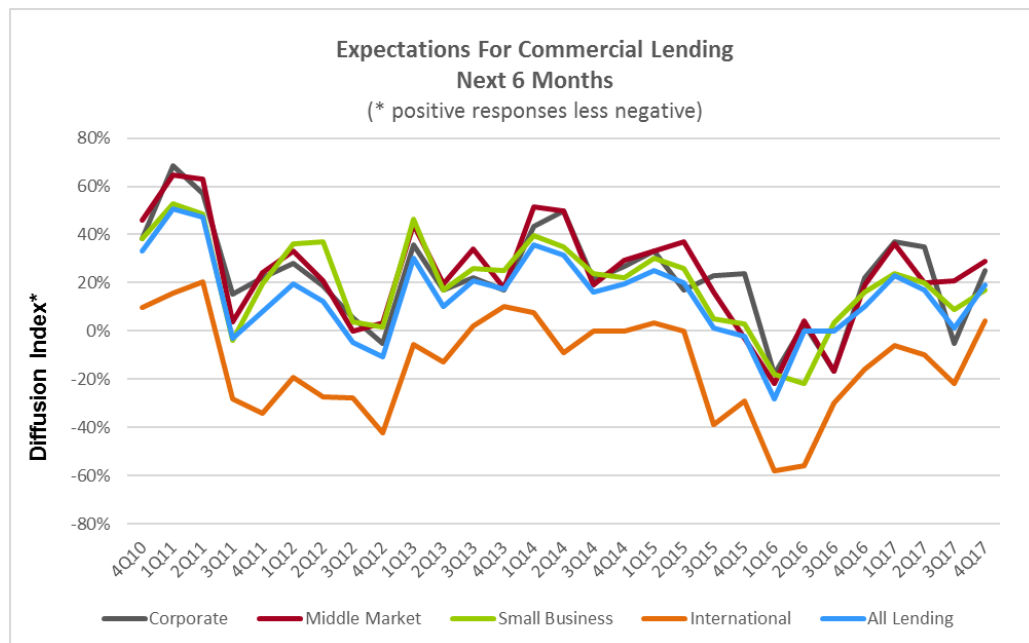
Respondents were asked which of the following actions their customers planned in the next six to twelve months. Lenders were asked to designate all potential customer actions that applied.

<u>Customers' Plans</u>	<u>3Q 2017</u>	<u>4Q 2017</u>
Capital Improvements	70%	75%
Making an Acquisition	52%	67%
Hiring New Employees	65%	54%
Introducing New Products or Services	30%	42%
Entering New Markets	48%	38%
Raising Additional Capital	39%	25%
"Other" Initiatives	0%	4%

## 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 4Q 2017, lenders optimism increased significantly in large corporate (25%) and small businesses (17%). In addition, expectations increased slightly for middle market in 4Q 2017 with a diffusion index of 29%, an 8 percentage point difference from the previous quarter of 21%. The diffusion index for international lending increased significantly from a -22% in 3Q 2017 to a 4% in 4Q 2017. The diffusion index for the average for all domestic lending increased from 9% in 3Q 2017 to 23% in 4Q 2017, and the diffusion index for all lending increased to 19% from 1% in Q3 2017.



	<u>3Q/2017</u>					<u>4Q/2017</u>			
	<u>Up</u>	<u>Down</u>	<u>Same</u>	<u>Diffusion Index</u>		<u>Up</u>	<u>Down</u>	<u>Same</u>	<u>Diffusion Index</u>
Corporate Lending	4%	9%	87%	-5%	Corporate Lending	29%	4%	67%	25%
Middle Market Lending	30%	9%	61%	21%	Middle Market Lending	33%	4%	63%	29%
Small Business Lending	22%	13%	65%	9%	Small Business Lending	26%	9%	65%	17%
International Lending	5%	27%	68%	-22%	International Lending	21%	17%	62%	4%

- The interest rate diffusion index increased to 91% compared to 78% the previous quarter. Loan losses diffusion index also increased 12 percentage points to 21% in Q4 2017 compared to 9% in Q3 2017. The bankruptcies diffusion index also increased this quarter to 38% from 22% in the previous quarter.

	<u>3Q/2017</u>					<u>4Q/2017</u>			
	<u>Up</u>	<u>Down</u>	<u>Same</u>	<u>Diffusion Index</u>		<u>Up</u>	<u>Down</u>	<u>Same</u>	<u>Diffusion Index</u>
Loan Losses	26%	17%	57%	9%	Loan Losses	25%	4%	71%	21%
Bankruptcies	26%	17%	57%	22%	Bankruptcies	42%	4%	54%	38%
Interest Rates	78%	0%	22%	78%	Interest Rates	91%	0%	9%	91%
Unemployment	13%	22%	65%	1%	Unemployment	4%	29%	67%	-16%
Bank Failures	9%	17%	74%	-8%	Bank Failures	4%	8%	88%	-4%



## 10. U.S. Economy Grade – Next Six Months

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

- Lenders optimism on the U.S. economy significantly increased this quarter from 2.43 in 3Q 2017 to 2.79 in 4Q 2017, which remains at an overall “B” grade. In the current quarter, 71% of respondents believe the economy will perform at a “B” level, which represents an increase of 23 points from the previous quarter. There was an increase of lenders (4%) that believe the economy will perform at an “A” level, while 25% of lenders believe that the economy will perform at a “C” level in the near term.

<u>Grade</u>	<u>3Q/2017</u>	<u>4Q/2017</u>
A	0%	4%
B	48%	71%
C	48%	25%
D	4%	0%
F	0%	0%
Weighted Average Grade	2.43	2.79

## 11. U.S. Economy Grade – Beyond the Next Six Months

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

- Lenders expectations for the U.S. economy’s performance in the longer term decreased from the prior quarter. The weighted average GPA decreased 10 points from a 2.52 in the previous quarter to 2.42, which is a “B” grade. 46% of lenders feel as though the economy will perform at a “B” level beyond the next six months (compared to 44% last quarter). Lenders who believe the economy will perform at a “C” over the next twelve months decreased 14 percentage points to a 38%. 4% of lenders continue to believe the economy will perform at an “A” grade over the next six to twelve months while the percentage of lenders that believe the economy will perform at a “D” grade increased 12 percentage points to 12%.

<u>Grade</u>	<u>3Q/2017</u>	<u>4Q/2017</u>
A	4%	4%
B	44%	46%
C	52%	38%
D	0%	12%
F	0%	0%
Weighted Average	2.52	2.42

## 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 decreased 5 percentage points from 83% in Q3 2017 to 78% in Q4 2017. 4% of lenders ascribe “very strong growth”, and 18% of lenders ascribe “strong growth” for their borrower’s growth in the next six months. Furthermore, 0% of lenders favor “no growth”. This continued belief of “moderate growth” is a positive signal from lenders on the U.S. economy.

<u>Indication</u>	<u>3Q/2017</u>	<u>4Q/2017</u>
Very Strong	0%	4%
Strong	17%	18%
Moderate	83%	78%
No Growth	0%	0%

### 13. Loan Structure

Respondents were asked whether their financial institutions planned to tighten, relax, or maintain their loan structures (collateral requirements, guarantees, advance rates, loan covenants, etc.) in each of four different-sized loan categories.

Many lenders are content right now and plan to maintain their current loan structure. However, in 4Q 2017 we did see a slight increase, 6 percentage points, of lenders that plan to relax their loan structure.

	<u>3Q/2017</u>			<u>4Q/2017</u>		
	<u>Tighten</u>	<u>Maintain</u>	<u>Relax</u>	<u>Tighten</u>	<u>Maintain</u>	<u>Relax</u>
Loans > \$25 million	14%	81%	5%	9%	77%	14%
\$15 – 25 million	5%	91%	4%	9%	77%	14%
\$5-15 million	0%	96%	4%	4%	87%	9%
Under \$5 million	13%	78%	9%	8%	79%	13%
Overall Average	8%	86%	6%	8%	80%	12%

### 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, fewer lenders (2 percentage points less) expect to increase their interest rates spreads in Q4 2017 versus Q3 2017.

	<u>3Q/2017</u>			<u>4Q/2017</u>		
	<u>Reduce</u>	<u>Maintain</u>	<u>Increase</u>	<u>Reduce</u>	<u>Maintain</u>	<u>Increase</u>
Loans > \$25 million	10%	81%	9%	18%	73%	9%
\$15 – 25 million	5%	91%	4%	13%	73%	14%
\$5-15 million	9%	73%	18%	0%	87%	13%
Under \$5 million	9%	73%	18%	0%	88%	12%
Overall Average	7%	79%	14%	8%	80%	12%

## 15. The Fed and Interest Rates

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

4Q 2017 displayed a more even dispersion between +1/4 point and +1/2 point increases, with 50% of respondents favoring an increase of +1/2 point or more and 46% of respondents favoring +1/4 point increase.

<u>Bps Change</u>	<u>3Q/2017</u>	<u>4Q/2017</u>
+ 1/2 point or more	41%	50%
+ 1/4 point	50%	46%
Unchanged	9%	0%
- 1/4 point	0%	4%
- 1/2 point or more	0%	0%
Weighted Average	0.33 bps	0.38 bps

## 16. Current Competition

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

- Regional Banks continue to place at the top of the survey, garnering 45% of responses. Local Community/Commercial Bank, at 21% of respondents, saw an increase of 8 percentage points. Commercial Financial saw a slight decrease with 17% of respondents, and Money Center Banks remained unchanged in the number of respondents (17%).

	<u>3Q/2017</u>	<u>4Q/2017</u>
Regional Bank	44%	45%
Local Community/Commercial Bank	13%	21%
Commercial Finance Co.	22%	17%
Money Center Banks	17%	17%
Factors	0%	0%
Other	4%	0%