

PCBB



Senior Credit Conference
- *Credit & Lending Hot Topics* -
March 4, 2016

Steve Brown, CEO

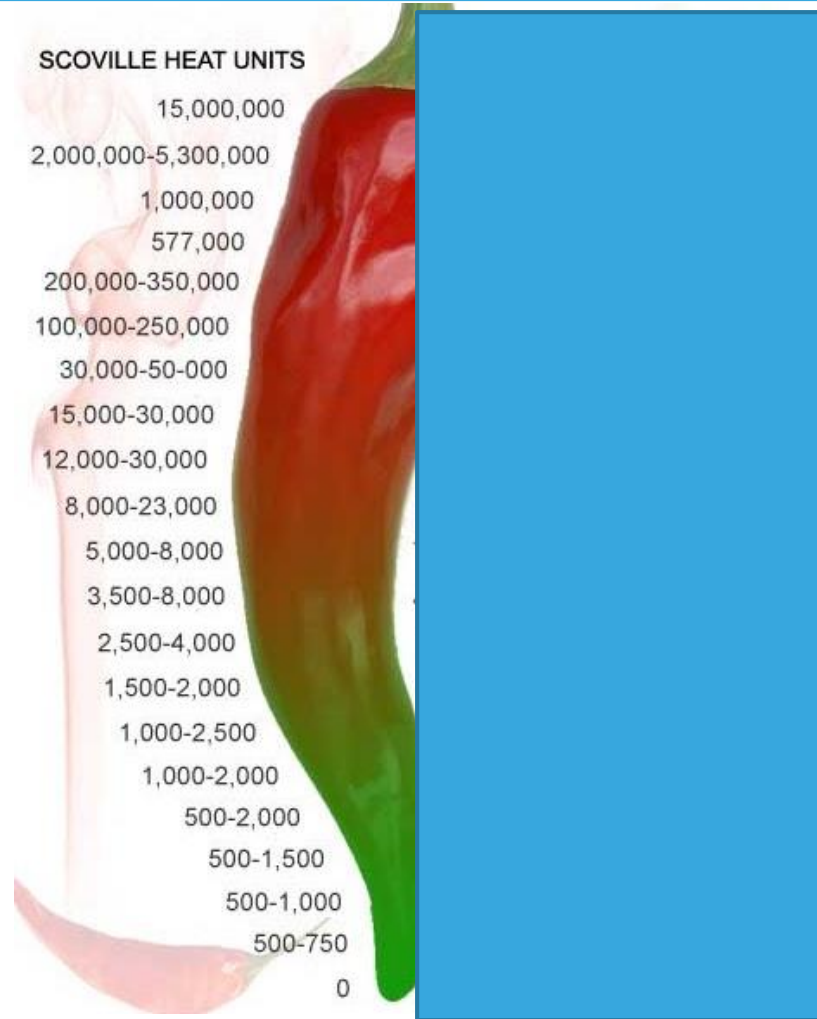
Subject Today = Hot Topics

First, Something Interesting:

- Heat measurement in peppers = Scoville Heat Units (SHU)
- Capsaicin = chemical that stimulates receptor nerve endings
- # of SHU = amount of capsaicin in a particular pepper



What Is The Hottest Pepper?



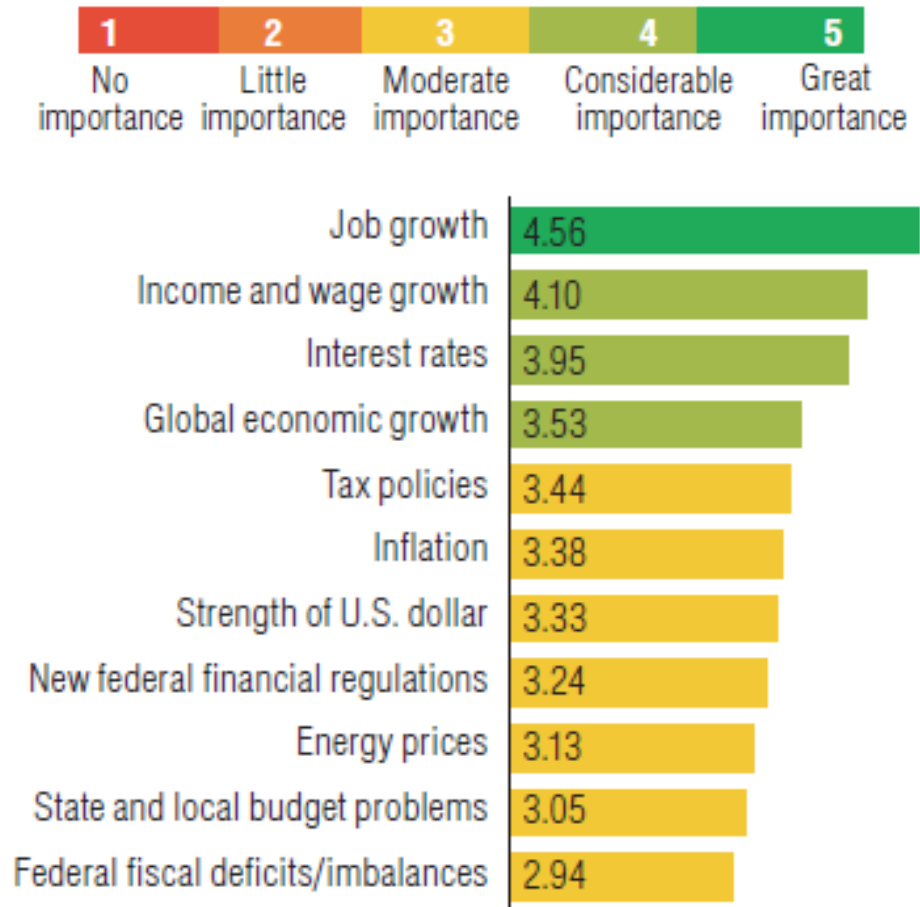
Source: Essential Oil

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Most Important Real Estate Issues This Year

**HOT
TOPIC!**

Economic & Financial Issues



Source: PWC, *ULI Trends in Real Estate 2016*

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Real Estate & Development Issues



Source: PWC, *ULI Trends in Real Estate 2016*

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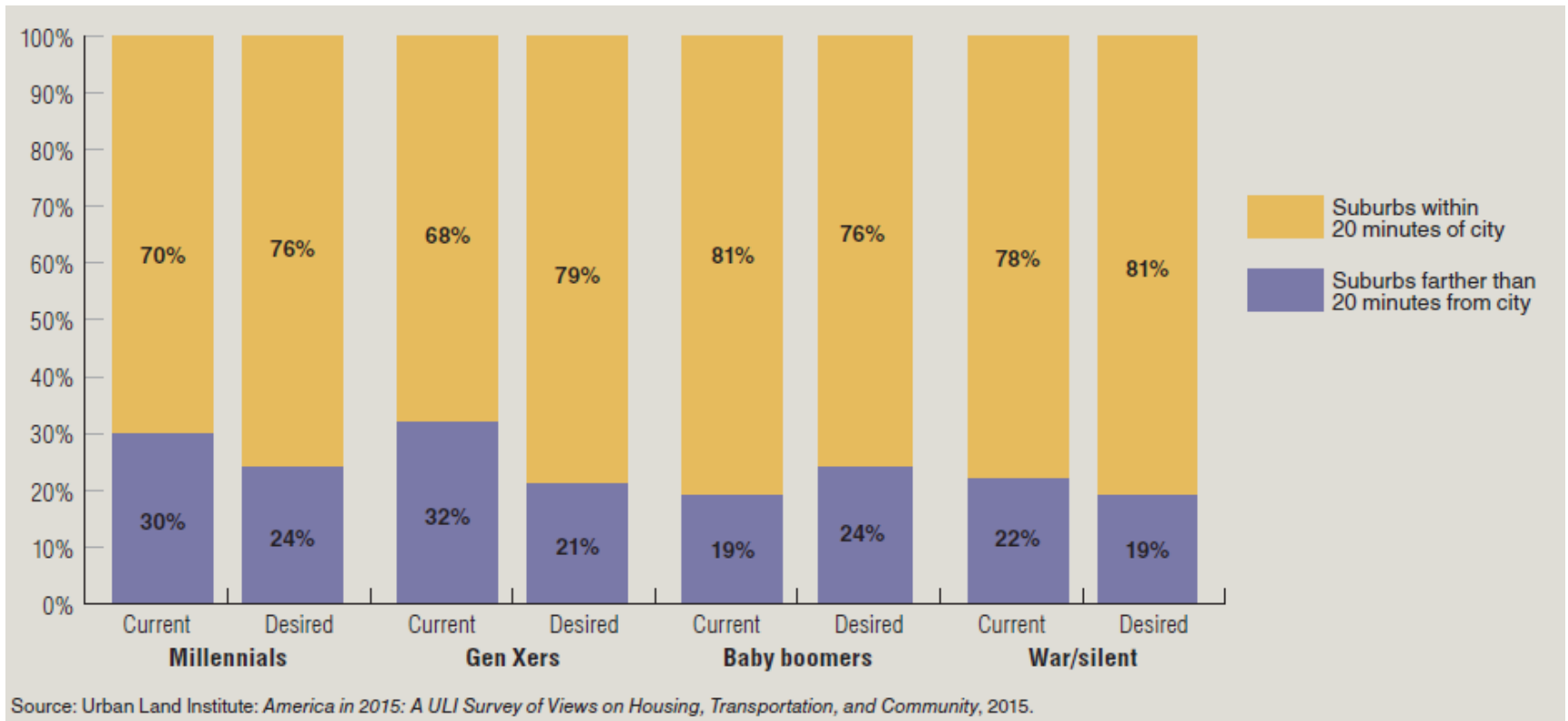
Let's Shift Now To Credit & Lending

**HOT
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Real Estate Markets

- Decent economic fundamentals helping with absorption and occupancy in most real estate markets
- Broader global interest in US markets, given weakness abroad, is also underlying investor support and expanding growth
- Since the recession, jobs growth has been higher in core cities vs. periphery locations, boosting demand in those locations – yet in the top 40 metro areas, 84% of all jobs are outside city centers
- Over the longer term, suburban markets close to cities may find footing, as millennials that put off getting married and having kids begin to do so – portion of this 80mm group relocates to suburbs

Millennial Living Next 5Ys – Near Cities



Source: PWC, *ULI Trends in Real Estate 2016*

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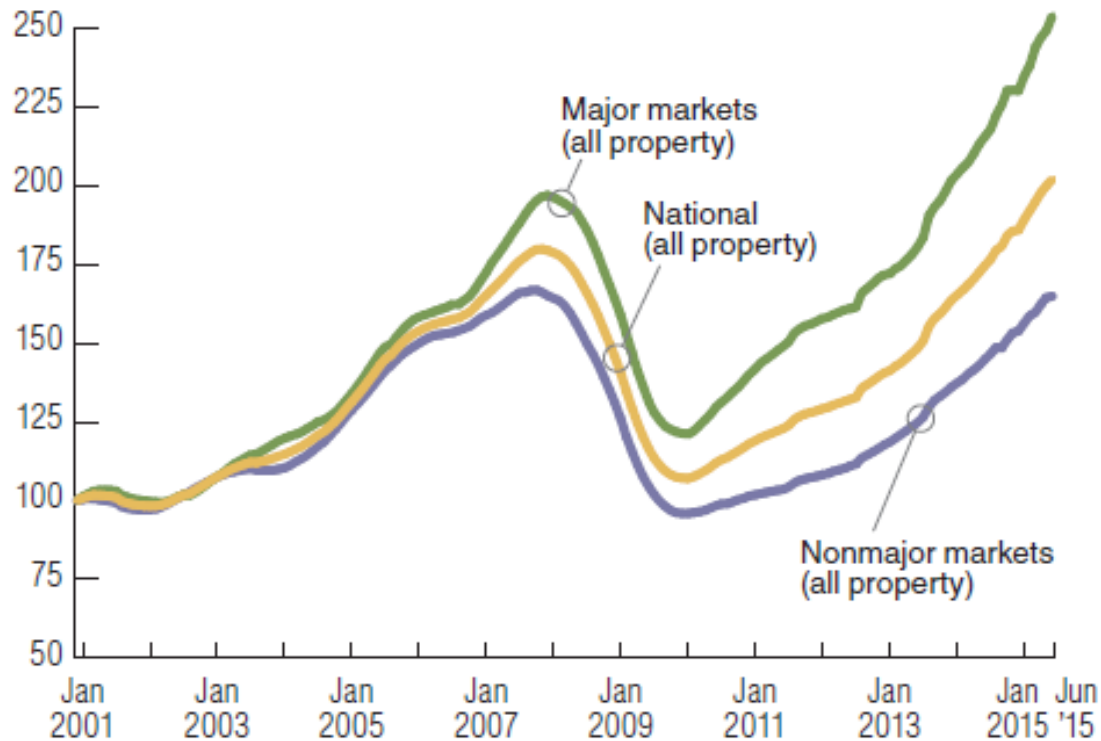
Commercial Property Investor Appetite



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Prices Rising Since 2009

Commercial Property Prices by Market

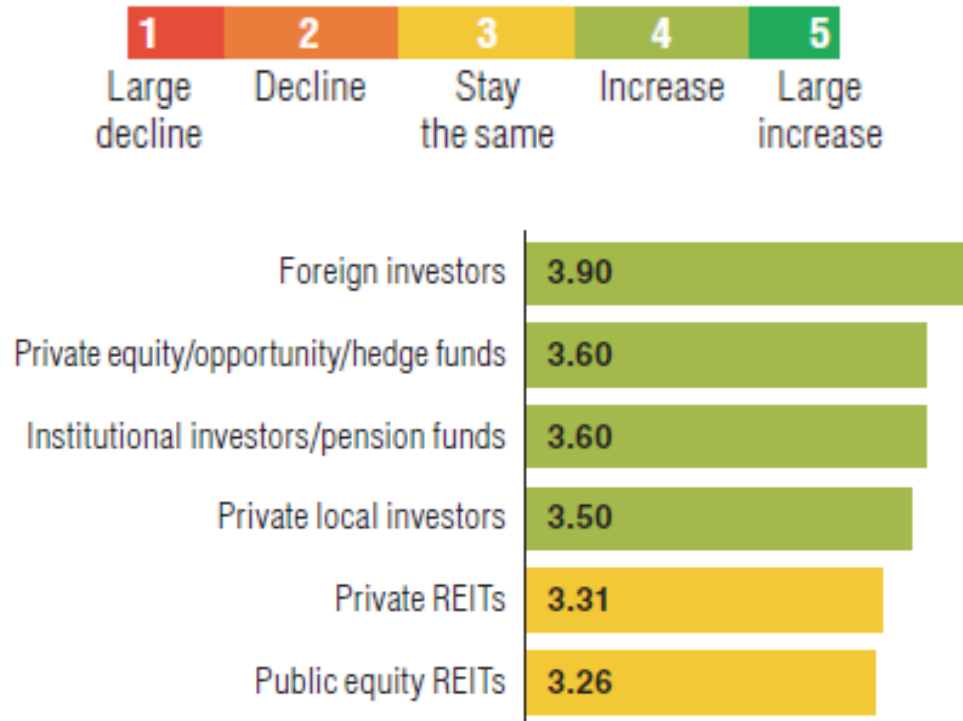


Source: Moody's and Real Capital Analytics

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Sources of Real Estate Capital Investment

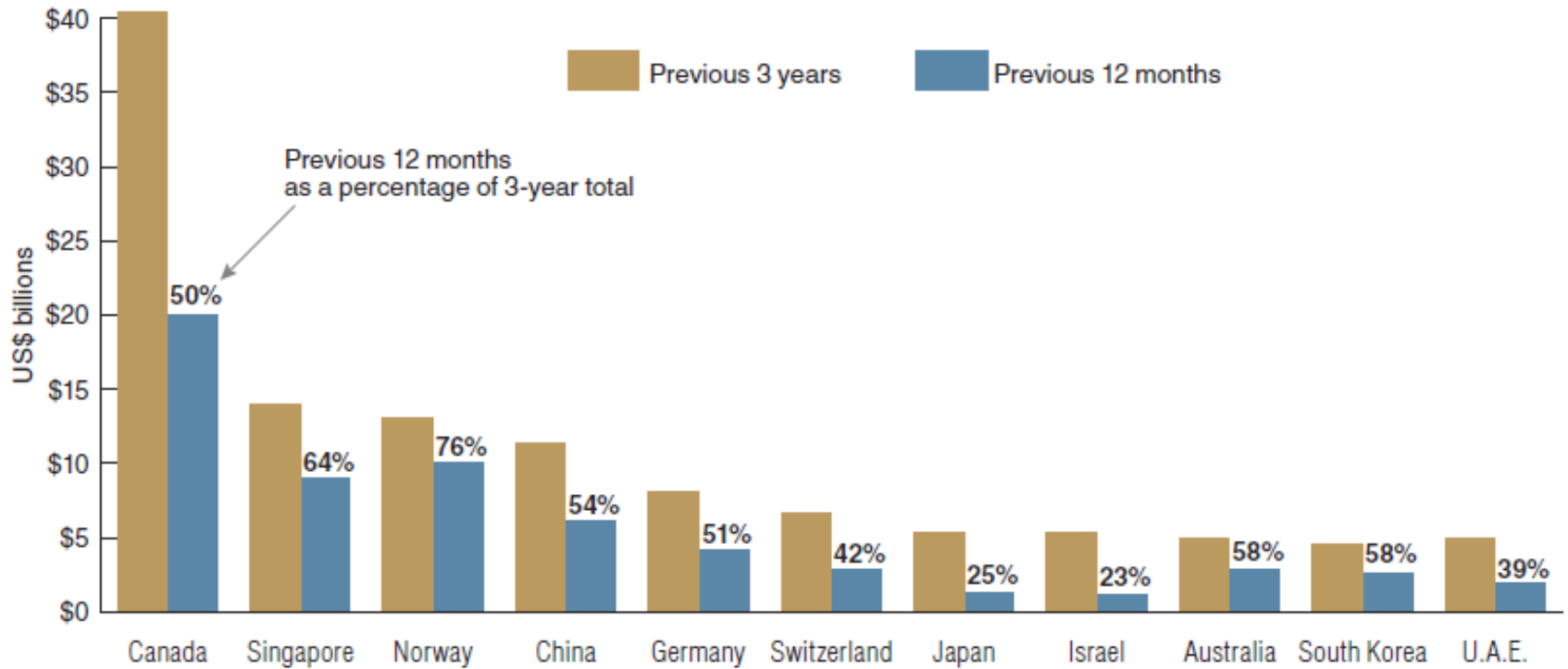
Equity Sources - 2016



Source: PWC, ULI Trends in Real Estate 2016

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Global Investment in US RE by Country



Source: Real Capital Analytics

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Bank Loan Opportunity by Property Type

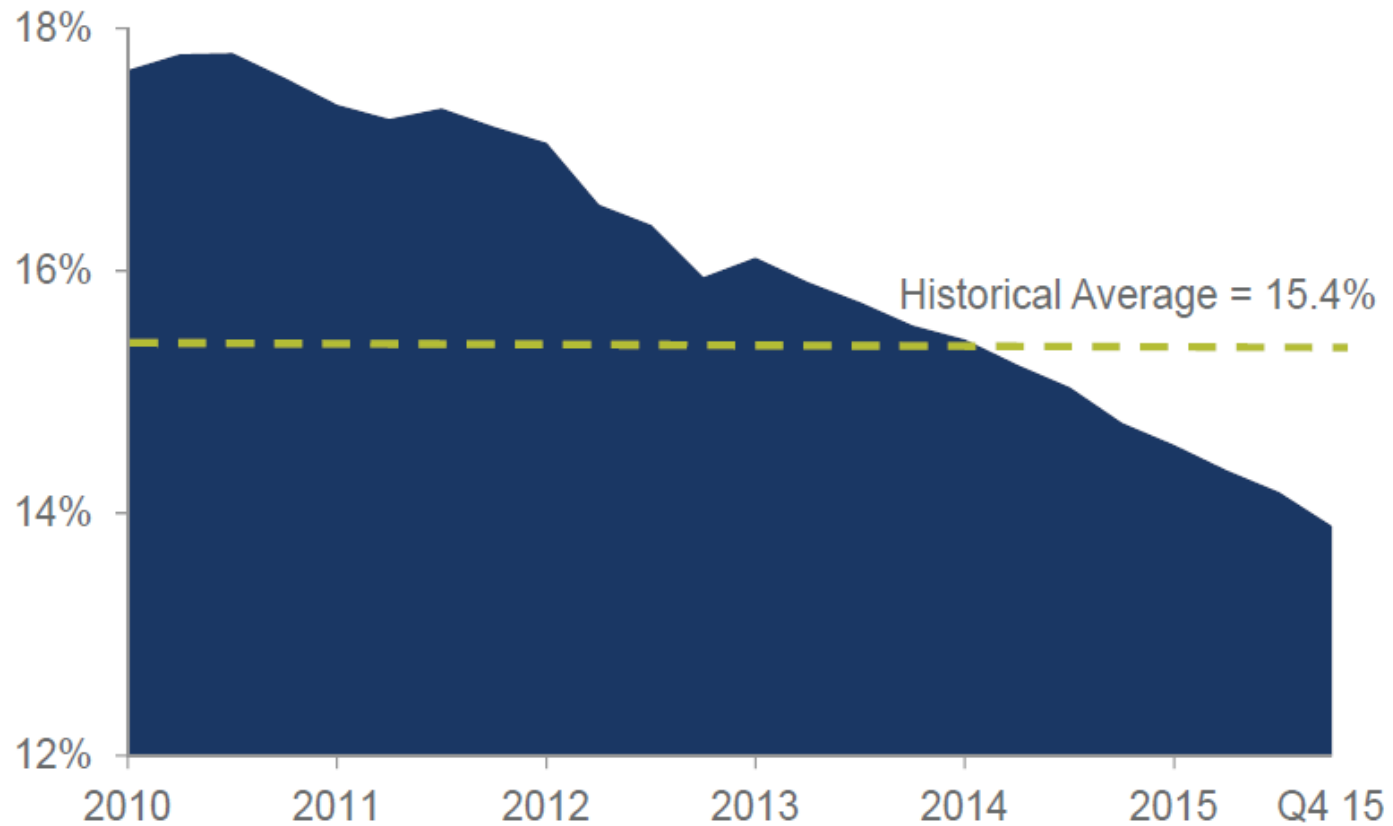
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Office

- Decent situation projected through 2017
- Jobs growth has spread throughout most major areas of the country, reducing office vacancies and increasing rents
- More work spaces redesigned to be open spaces and more are also being shared with others
- Work-life balance is also more important now, with the number of miles traveled by car for people 34Ys or younger down 23% since 2001
- Walk, take public transportation or use Uber – what is the impact of this on office space and in turn bank lending?

Office – Vacancy

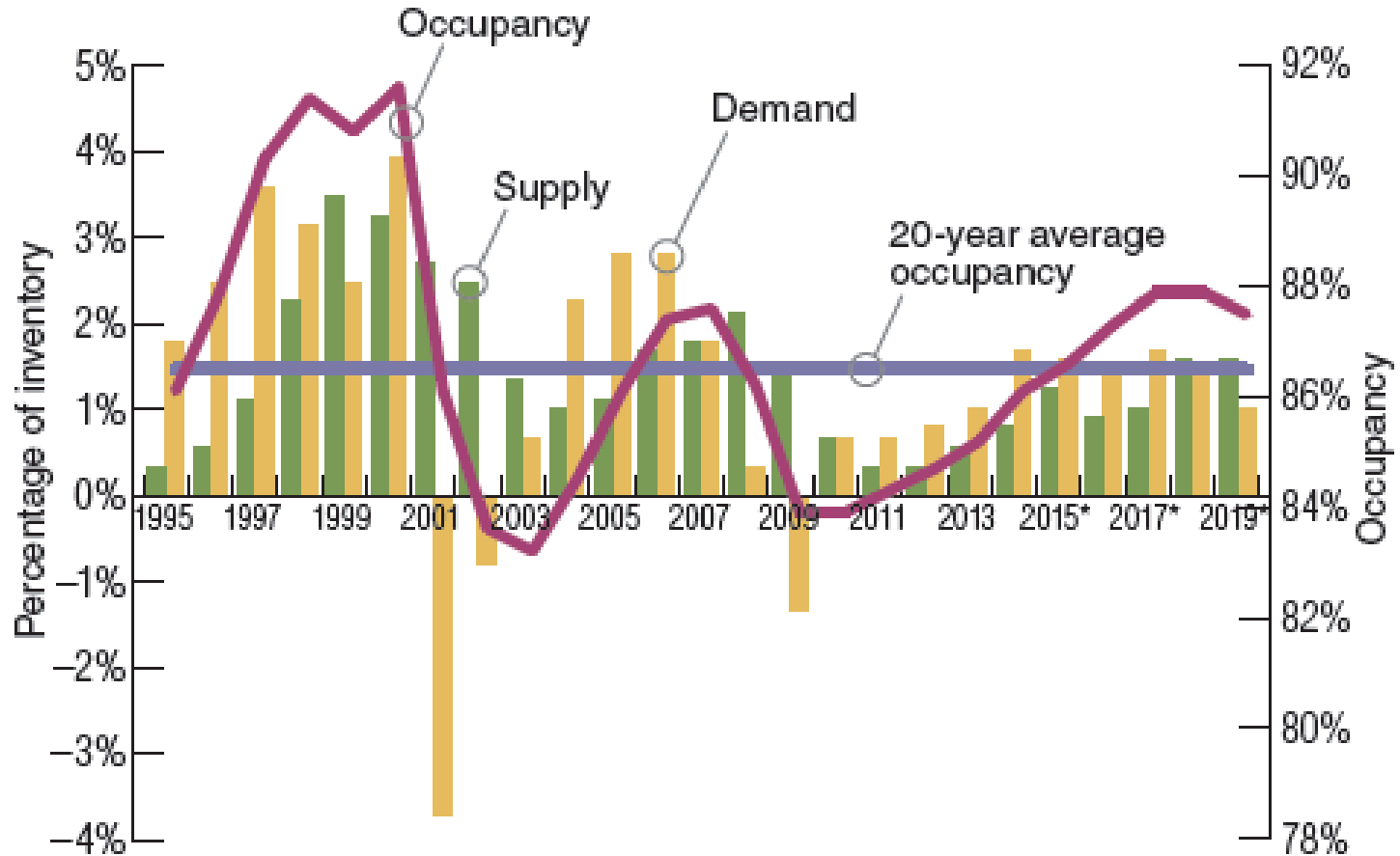
Overall Vacancy



Source: Cushman & Wakefield

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Office – Supply/Demand



Source: CBRE Econometric Advisors

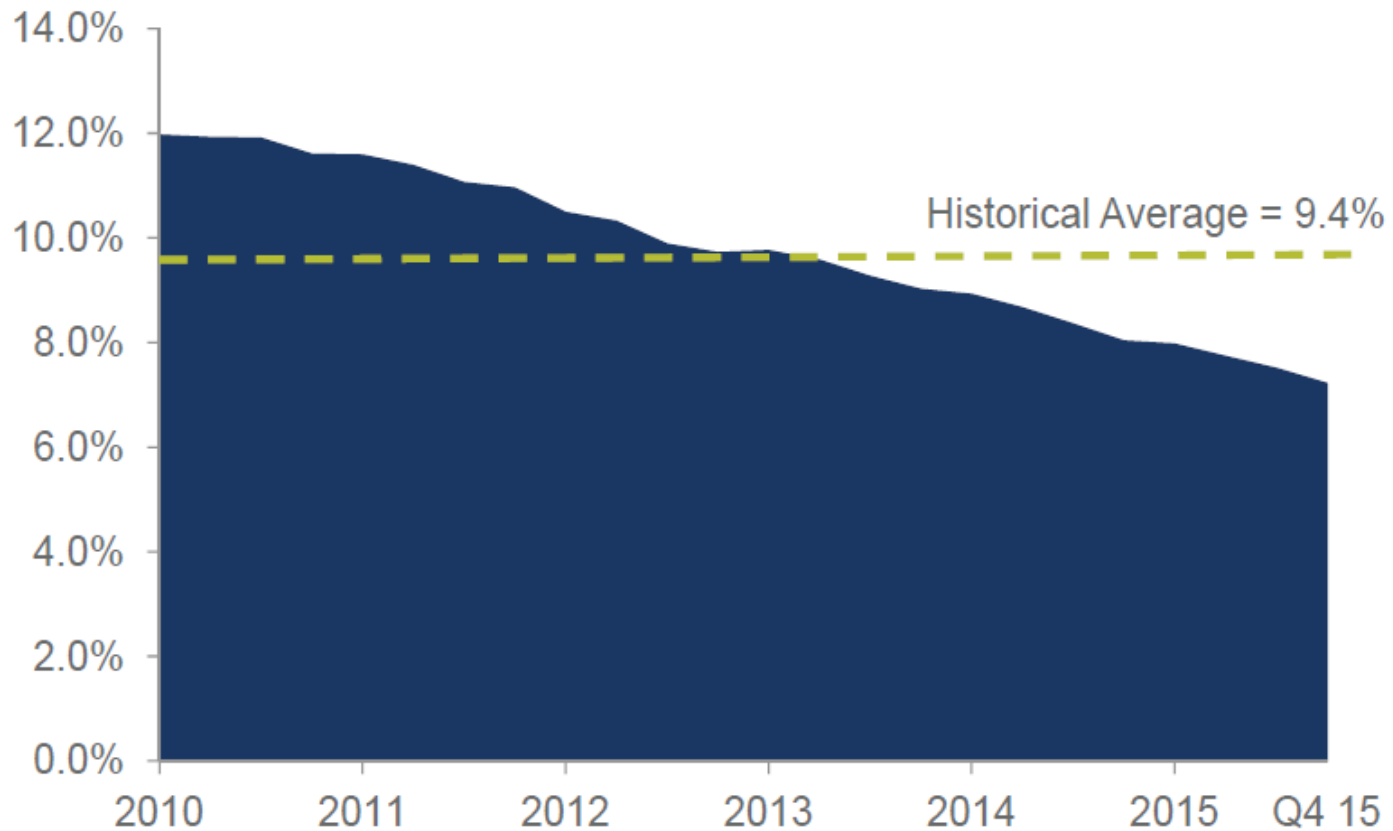
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Industrial

- Supply and demand fundamentals are sound
- Warehouse and distribution space supported by consumer spending
- Good jobs outlook should support this sector
- Supported by technology sector growth, as ecommerce drives need for fulfillment centers
- Manufacturing space is the exception with slowdown abroad for US goods and higher dollar

Industrial – Vacancy

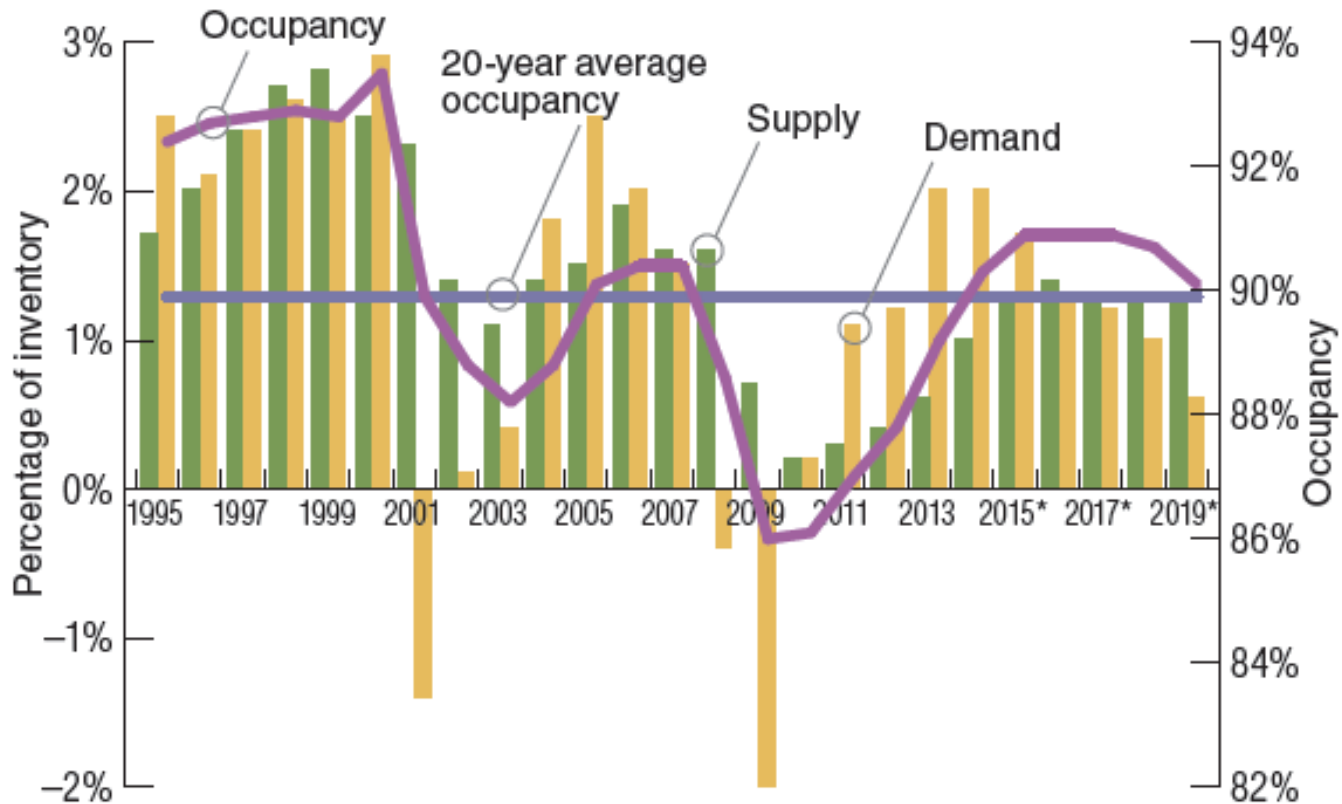
Overall Vacancy



Source: Cushman & Wakefield

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Industrial – Supply/Demand



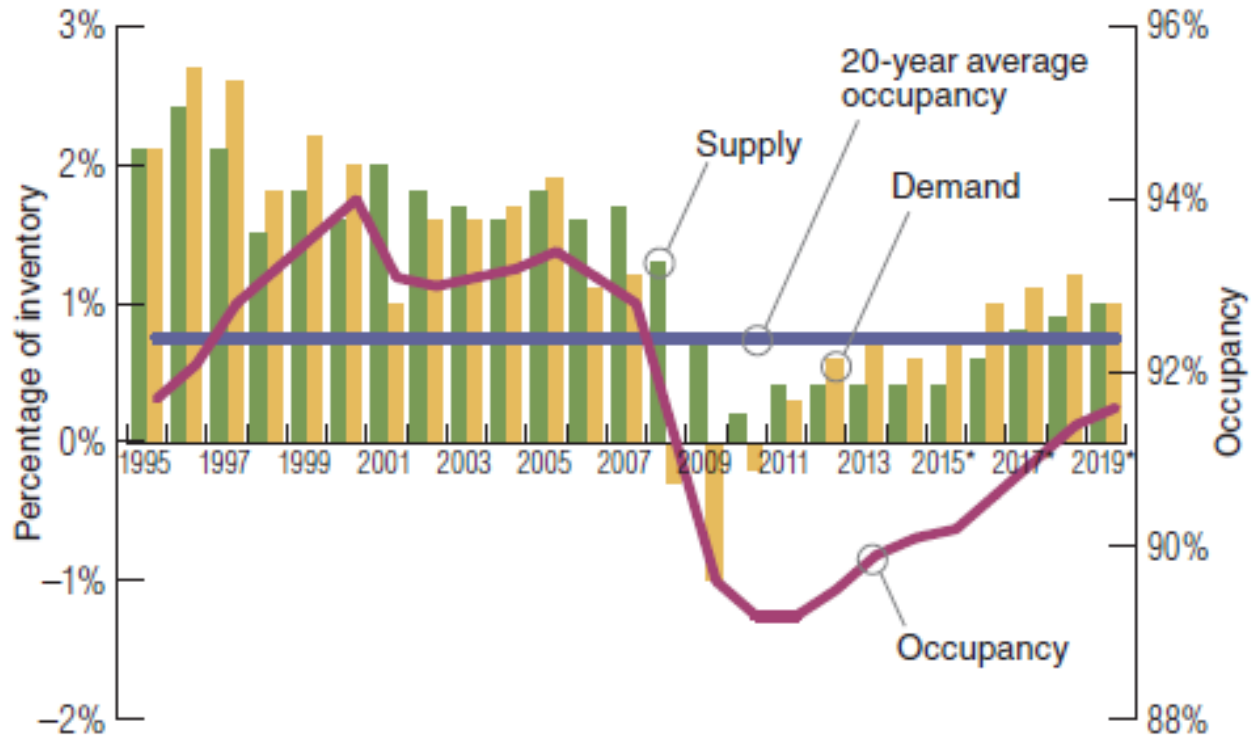
Source: CBRE Econometric Advisors

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Retail

- Ecommerce is strong as Amazon eats everyone's lunch
- Large retail players like Macy's and others are closing stores
- Apparel and department stores most at risk, so malls will be negatively impacted
- Could see a consumer spending boost from lower oil prices though as consumers have more spending money

Retail – Supply/Demand



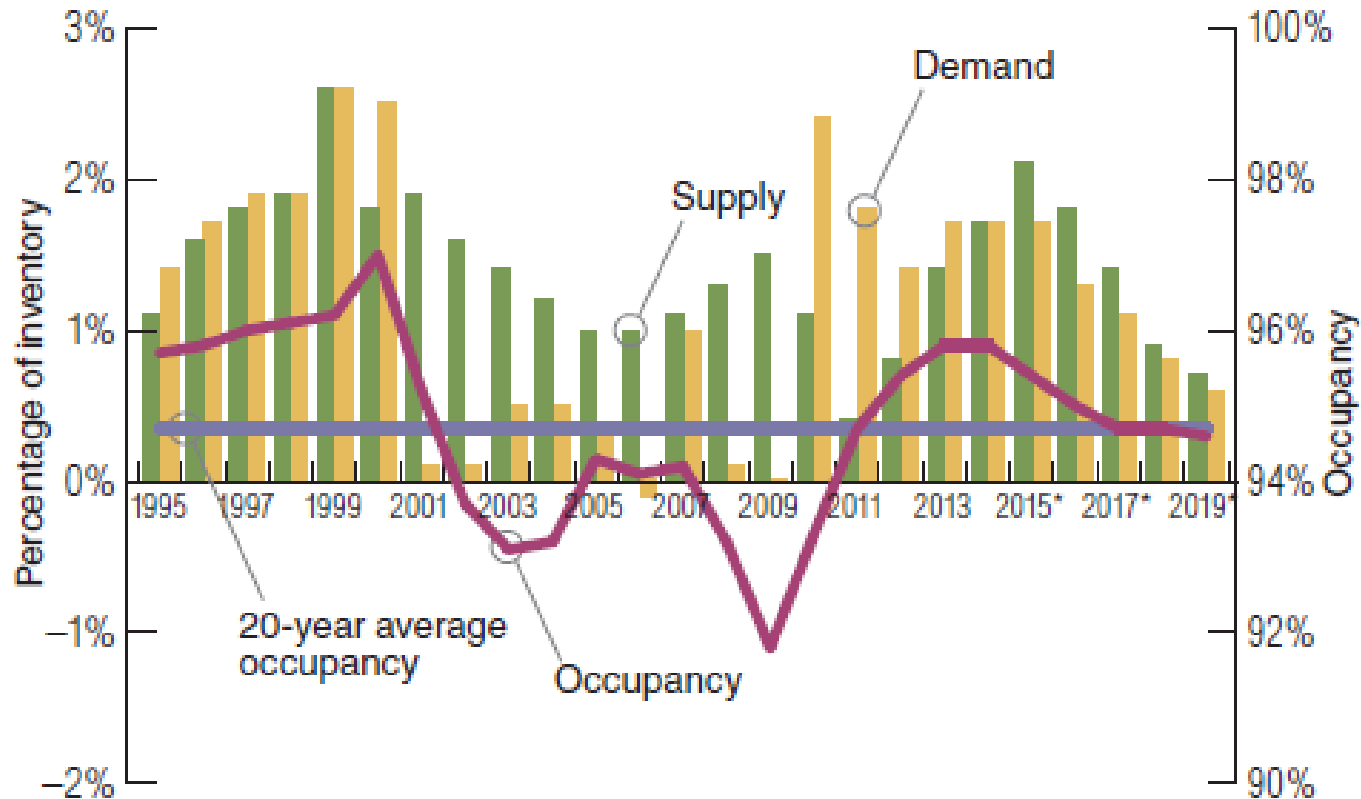
Source: REIS, Inc

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Multifamily

- High prices and low cap rates increasing fear
- Millennials living in apartments vs. owning homes right now, but could shift in coming years
- Rent increases continue to be high
- Building has increased to meet demand
- Support will be found where jobs are found – providing not already too saturated

Multifamily – Supply/Demand



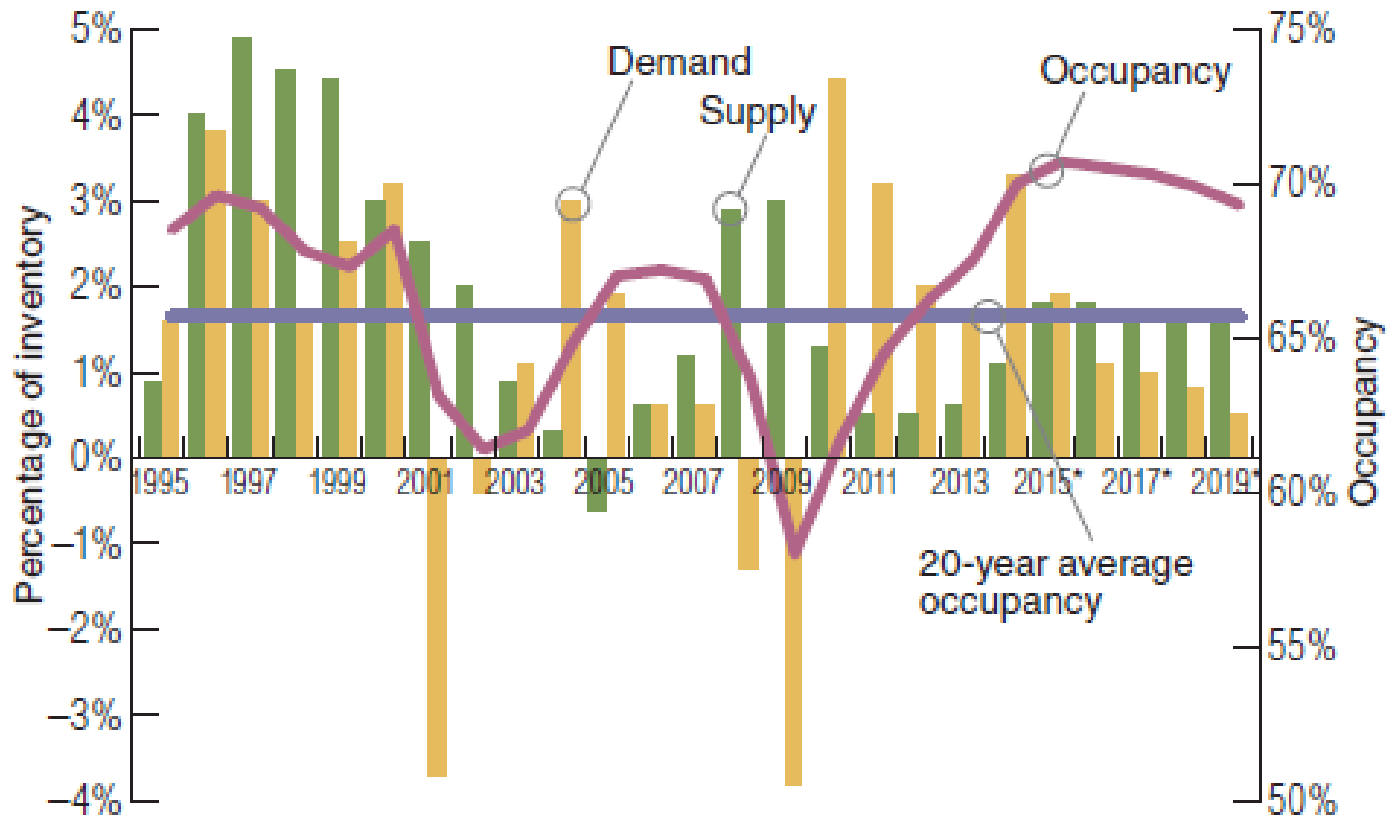
Source: REIS, Inc

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Hotel / Lodging

- High US dollar and weak global economies reducing demand
- Upstarts like Airbnb, HomeAway, etc. impacting some hotels
- More hotels being built adds to stress over time
- Overseas purchases of US hotels running pretty high though
- Very much a cyclical industry, so care should be taken

Hotel/Lodging – Supply/Demand



Source: CoStar Portfolio Strategy

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What Are Regulators Doing?

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Major Industry Issues

- Dodd Frank hitting big banks – required to hold more on balance sheet and keep “skin in the game”
- Basel III negatively impacting acquisition, development and construction lending activity due to new rules under HVCRE – more capital more cost

Regulatory Wave is Building

- Bank competition is high leading to loosening of terms and conditions – rising risk?
- History teaches us we are likely heading into a recession in coming years – are banks ready?
- Dec 2015 & Jan 2016 – regulators remind banks of existing regulatory guidance on prudent risk management practices for CRE lending through economic cycles

Remember These – 100% / 300%

- Total reported loans for construction, land development, and other land represent 100% or more of the institution's total risk-based capital **or**
- Total commercial real estate loans represent 300% or more of the institution's total risk-based capital, **and**
- The outstanding balance of the institution's CRE loan portfolio has increased by 50% or more during the prior 36 months

Plus, Still In Motion – Basel III + CECL

- Basel changes capital and reduces leverage; CECL changes loan loss reserves and profitability



Post Crisis Regulatory Approach

- Higher expectations
- More proactive / not waiting for an exam
- Actively applying lessons learned from crisis
- More proactive communication to set expectations

Regulatory Concern – Past Half Way?



What Are Bankers Doing?

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Industry Issues & Opportunity

- US CRE market is in pretty good shape overall
- Fundamentals are generally improving
- Investor demand remains strong - prices are rising
- Property owners have ready access to financing
- Wild card is oil impact, but expected to be highly localized as to impact

Lending Trends

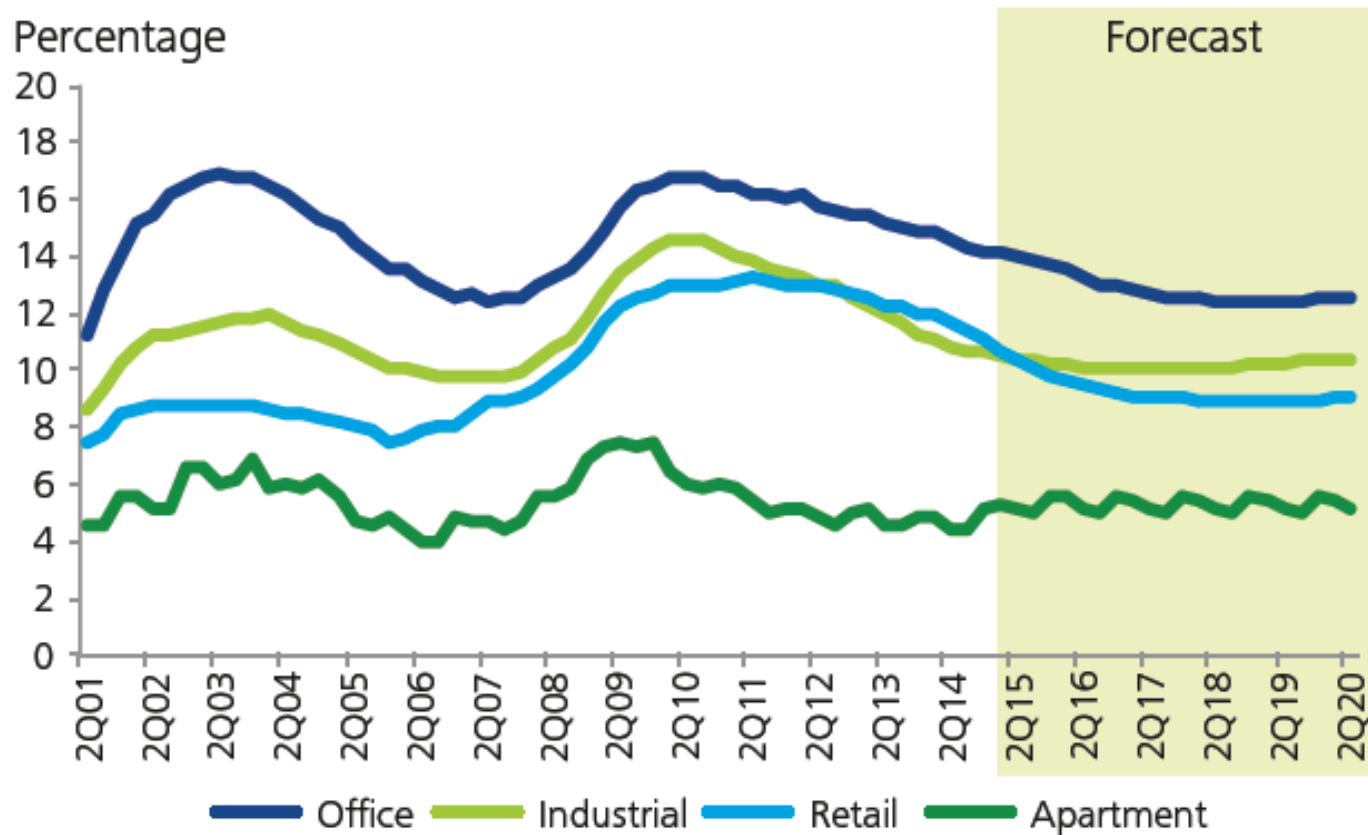
- CMBS rolling over with fewer institutional options for lending – opportunity for community banks?
- High competition for customers, more customer shopping around
- 75% LTV = partial guarantees
- 65% LTV = no guarantees

Lending Opportunities

- Demand for biz and consumer services = up
- Multifamily construction = strong
- Loan demand = growing at modest pace
- Ag softer due to low commodity prices
- Residential construction = expanding in multifamily and SFR
- Commercial construction = mostly in hot markets
- CRE activity = expanding
- Manufacturing = soft (strong dollar, weak overseas)

Sector by Sector Projections

National vacancy rate by property type

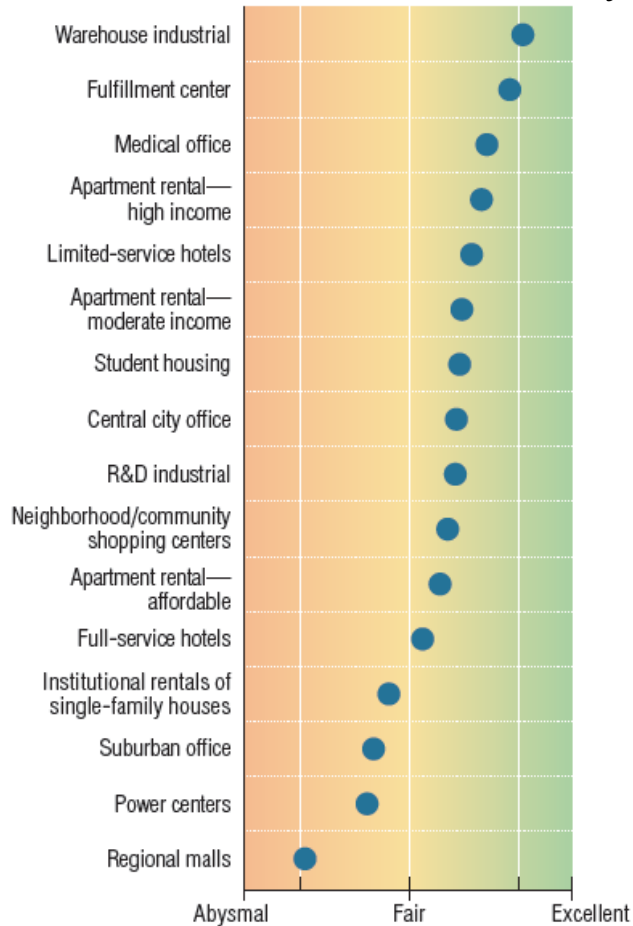


Source: Deloitte

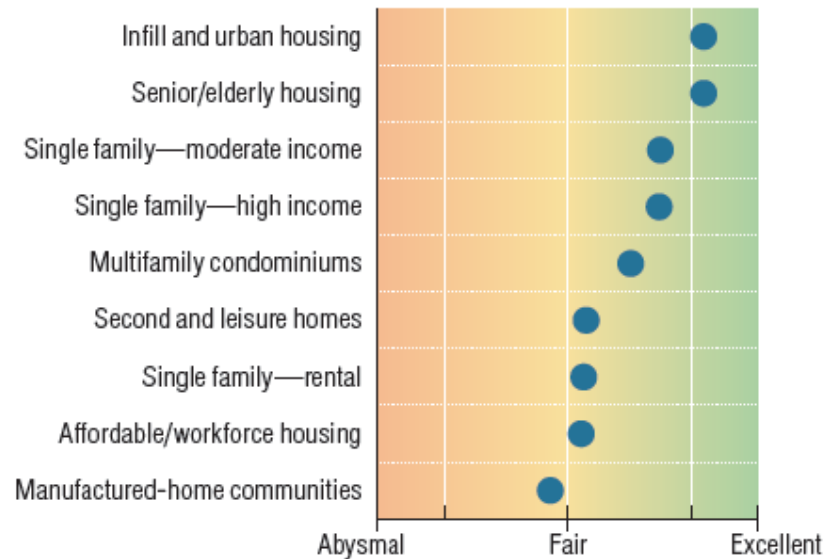
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Lending Prospects - 2016

Commercial / Multifamily



Residential



Source: PWC, ULI Trends in Real Estate 2016

Regional Strength

Overall rank		Investment prospect scores, by sector					Local outlook score*	
		Office	Retail	Industrial	Multifamily	Hotel		Housing
4	Seattle	3.92	3.80	3.86	3.80	3.61	4.16	4.31
6	Denver	3.62	3.59	3.98	3.75	3.27	4.08	4.23
8	San Francisco	3.71	3.90	3.45	3.86	4.25	4.10	4.31
9	Portland, OR	3.73	3.60	3.74	3.78	3.57	3.45	3.93
10	Los Angeles	3.74	3.82	4.02	3.91	3.74	3.59	3.94
12	San Jose	3.70	3.75	3.63	4.06	3.67	3.78	4.22
14	Orange County	3.62	3.60	3.56	3.93	3.47	3.75	4.02
16	San Diego	3.59	3.61	3.39	3.89	3.53	3.71	3.88
17	Phoenix	3.59	3.50	3.66	3.68	3.02	3.68	3.67
23	Honolulu	2.33	3.69	3.30	3.88	3.30	3.88	3.67
28	Oakland/East Bay	3.26	3.28	3.45	3.50	3.26	3.51	3.92
36	Inland Empire	2.61	3.03	3.94	3.54	2.91	3.64	3.39
42	Salt Lake City	3.17	3.06	3.76	3.10	3.06	3.06	4.21
49	Albuquerque	2.75	3.00	3.25	3.17	3.25	3.33	3.13
54	Boise	2.97	3.18	3.30	3.32	3.05	3.30	3.92
59	Tacoma	3.00	3.58	3.55	3.64	3.04	4.11	4.13
61	Sacramento	3.13	3.27	2.91	3.23	2.91	2.91	3.30
62	Las Vegas	2.66	2.38	3.56	3.38	3.42	3.04	3.60
70	Tucson	2.50	3.50	3.25	3.70	3.00	2.67	3.04
72	Spokane	3.32	3.32	3.32	2.81	2.81	2.81	2.94
33	West average	3.25	3.42	3.54	3.60	3.31	3.53	3.79

Source: *Emerging Trends in Real Estate 2016* survey.

* Average score of local market participants' opinion on strength of local economy, investor demand, capital availability, development and redevelopment opportunities, public/private investments, and local development community.

Other Things To Think About

A 3D graphic with the words "HOT" and "TOPIC!" in a bold, sans-serif font. "HOT" is rendered in red, and "TOPIC!" is rendered in white. The letters have a slight shadow and a metallic sheen, giving them a three-dimensional appearance as if they are floating or attached to a surface. The background is a plain, light gray.

What is the Impact of 3D Printing?

5 story apt bldg ¹	Camera Lens	Car	Purse
Houses	Flute	Knife	Hat
Toys	Cell Phone Case	Power tools	Necklace
Car Wheel	Light	Lawn mower	Nuts/Bolts
Binoculars	Clock	Concrete castle	Fan
Guitar	Coffee Cups	Bracelets	Clamps
Wheelchair	High Heels	Artificial limbs	Hinges
Bikini	Lights	Pizza	Skateboards
Dresses	Airplane parts	Drones	Car lug nuts
Violin	Cakes	Adult products	Rover
Skull	Chocolate	Door handles	Belt sander
Ear	Peanut Butter	Coat buttons	Gun

¹Takes 50% to 70% less time; saves 50% to 80% on labor; saves 30% to 60% of construction waste

Or Atlas?

<https://www.youtube.com/watch?v=rVlhMGQgDkY>

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