2016 Q4

Small Business Credit Outlook

Closing and Opening Doors

The current period of transition in Washington is a reminder that as one door closes, another invariably opens.

A big new door is certainly opening for small-business credit. While the mood among the nation's entrepreneurs has generally brightened since the November 8 election, many uncertainties remain about what lies behind the next door in the form of policies.

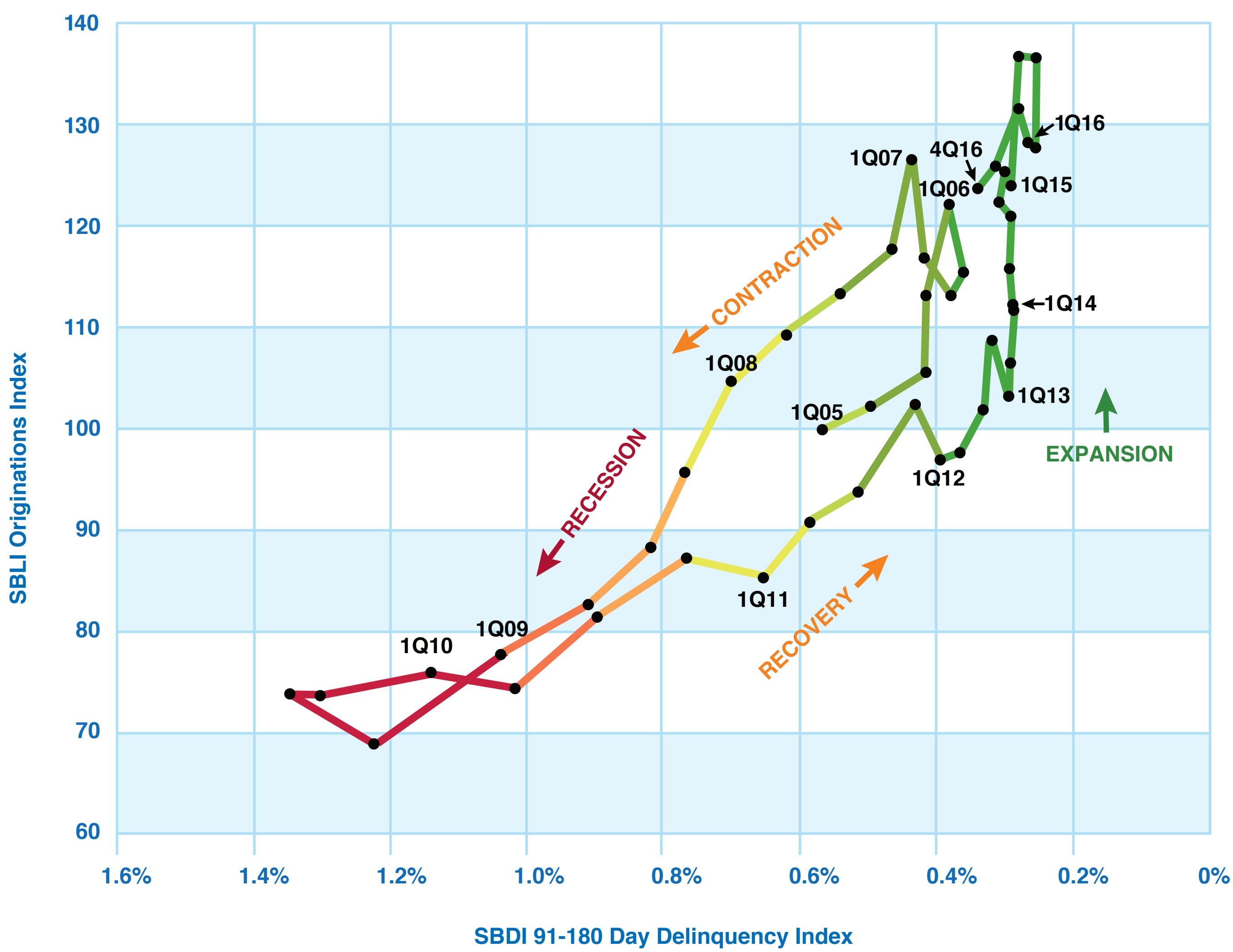
Our impression is that, before small businesses celebrate, they want to see the substance and the fine print on initiatives such as tax reform, infrastructure spending, foreign trade and government regulation.

Our latest data confirms this uncertainty. A combination of slightly rising delinquencies, developments in higher-risk sectors, and a more robust macro-economic climate suggest that small-business defaults are set to rise from the all-time lows posted in 2015-16. The good news is that we expect defaults to remain within the range associated with the expansionary phase of the business cycle.

Business Cycle

The business cycle headed south and towards higher credit risk for the better part of 2016. Three of four quarters in 2016 showed this trend. Compared to the end of 2015, credit risk rose with severe loan delinquencies up 8 basis points to 0.34%. Investments fell 6 points on the Thomson Reuters/PayNet Small Business Lending Index (SBLI) or -4% for the year. Higher credit risk and falling investment aren't the kinds of trends that bode well for the future of small business credit or the U.S. economy. While hard to say inflection point, the trend towards higher credit risk and lower investment by small businesses is worrisome.

PayNet Small Business Cycle

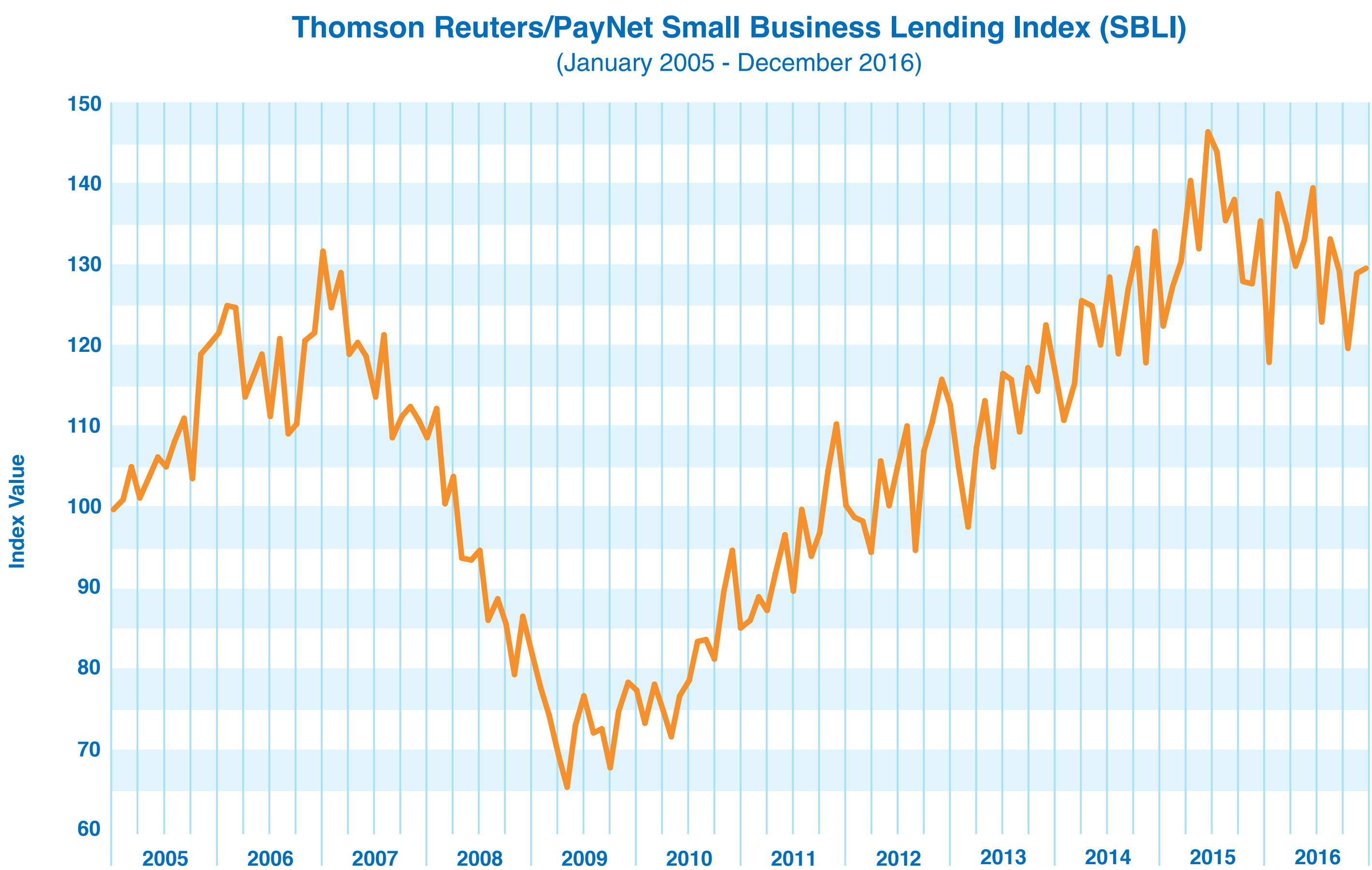


Recent Investment Activity

The Thomson Reuters/PayNet Small Business Lending Index (SBLI) was little changed in December. Small business borrowing and investment contracted by 4% from a year earlier, but rose by 0.5% from November.

This means that 2016 ended on the same hunkering-down note that marked the rest of the year. Borrowing and investment has shrunk on a year-over-year comparison in 8 of the past 12 months, and has basically been treading water for the past 2 years. The Index ended 2016 at 129.7, down from 134.1 in December 2014.

So while the mood may appear upbeat, it's clear that small businesses are not yet ready to put their money where their mouths are.



Credit Risk

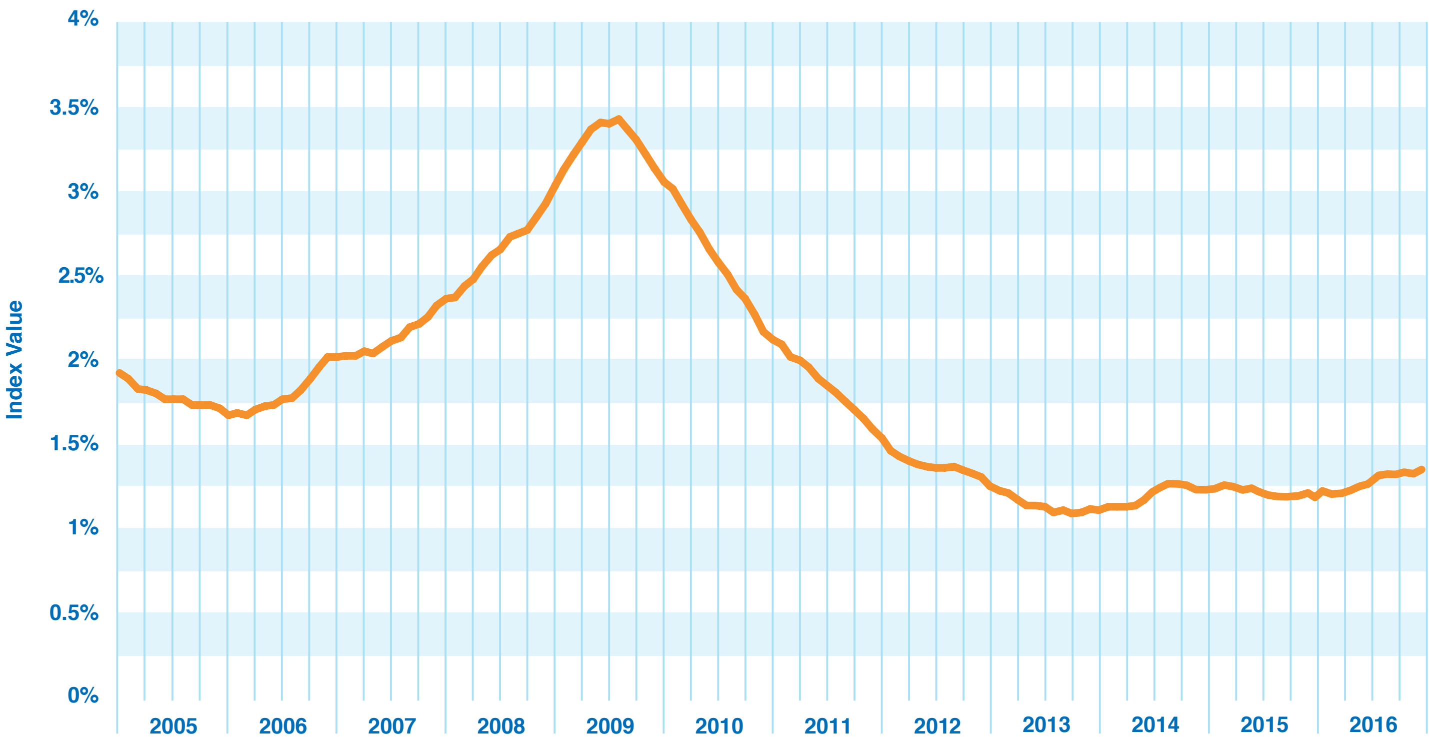
The Thomson Reuters/PayNet Small Business Delinquency Index (SBDI) rose slightly in December, and was up for the year as a whole. The 31-90 days past due rate stood at 1.35% in December, up 16 basis points (bps) from a year earlier.

Despite the rise in loans past due, the overall credit risk for small businesses remains quite low. The past-due rate of 1.19% at the end of 2015 was still one of the lowest ever. Even though delinquency rates are low, we have to recognize that the numbers are now starting to move up, pointing to higher small-business credit risk in 2017.

Thomson Reuters/PayNet Small Business Delinquency Index (SBDI)

(31 - 90 Days Past Due)

(January 2005 - December 2016)



Industry Analysis

The sectors currently driving small-business expansion are not the usual ones. Arts, Entertainment and Recreation has jumped 14.2% from December 2015, and Public Administration is up by 10.5%. The other two sectors driving growth are Administrative and Support and Waste Management and Remediation Services (up 6.8%) and Construction (up 4.3%). These sectors remain in expansion mode, but at a slower pace than in 2015.

The drop in the overall national index is largely due to the contraction in some key small-business sectors. Healthcare and Social Assistance was down 5.5%, undoubtedly due to uncertainty over the Trump administration's plans to repeal and replace the Affordable Care Act. An 8.8% drop in Accommodation and Food Services reflects weaker consumer spending.

Agriculture, Forestry, Fishing and Hunting was down 12.4% and Mining, Quarrying and Oil and Gas Extraction was down 14.1%, both slightly smaller drops than in 2015.

Transportation and Warehousing remains the most worrisome sector. It took a 14.1% hit last year, a sharp reversal from two years ago when it led small business growth.

A rise in sectoral loan delinquencies signals higher overall credit risk. But there is a silver lining, with improvements in some of the most volatile sectors. The Transportation delinquency rate fell 6 bps to 1.76% in December, its second straight monthly decline. Prior to November, the delinquency rate for this sector had not fallen for 21 months. Among Retailers, the delinquency rate rose 5 bps to its highest level since March 2013.

PayNet Small Business Lending Index
December 2016 vs. December 2015

Industry	YoY Change
Accommodation and Food	-8.8%
Administrative Services	6.8%
Agriculture	-12.4%
Entertainment	14.2%
Construction	4.3%
Education	1.8%
Finance	-1.4%
Health Care	-5.5%
Information	1.6%
Manufacturing	-0.2%
Mining	-14.1%
Other Services	0.8%
Professional Services	-4.3%
Public Administration	10.5%
Real Estate	-1.9%
Retail	-2.0%
Transportation	-14.1%
Wholesale	-2.7%
All Industries	**-3.8%**

Regional Analysis

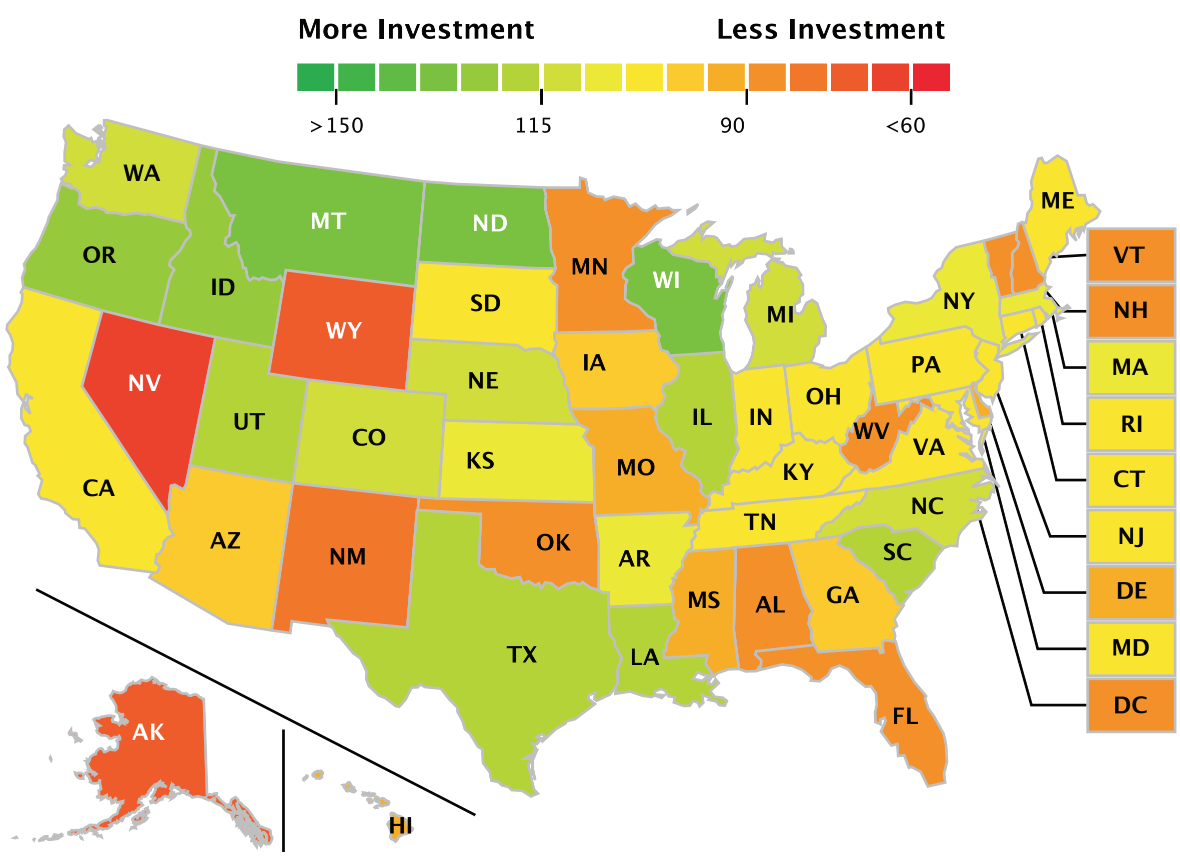
Small business borrowing and investment advanced in only 3 of the 10 largest states in December. Florida (up 3.6%) remains the fastest growing of the 10 largest states in the country. New York is the third fastest, at 1%. Even so, the rate of growth in these states has slowed from 2015.

The chief laggards in December were Ohio (down 7.4% from a year earlier), California (down 7%), Texas (down 8.2%) and Illinois (down 6.9%).

PayNet Small Business Lending Index

State	2015 YoY Change	2016 YoY Change
Florida	10.0%	3.6%
North Carolina	2.7%	3.3%
New York	3.1%	1.0%
Georgia	5.8%	-1.1%
Michigan	1.8%	-3.3%
Pennsylvania	5.4%	-3.8%
Illinois	-2.4%	-6.9%
California	6.3%	-7.0%
Ohio	5.2%	-7.4%
Texas	-0.7%	-8.2%
All States	**2.0%**	**-3.8%**

Small Business Lending Index as of Dec-2016



PAYNET®

Credit Risk Forecast

The macro-economic picture points to accelerating business activity within a more stimulative environment. We have witnessed a strong advance in the stock market, usually a reliable leading indicator. The Federal Reserve lifted its key Federal Funds Rate in December, and appears to be planning at least one or two more hikes this year.

We forecast that default rates will rise in 2017 due to:

- More recent and frequent loan delinquencies.
- Rising credit risk in major industry sectors.
- A brisk economy and rising interest rates, which tend to favor more risk taking.

We expect the small-business default rate to climb to 2.1% in 2017 from 1.8% last year. While this is not the direction we would prefer to see, the uptick is moderate and marks a return to traditional small-business credit conditions after the all-time lows of recent years. Even this year's expected 2.1% default rate remains well below the 2.5% that we typically consider normal.

Historical and AbsolutePD® Forecast Default Rates

Industry Segment	Actual Historical Default Rates (1)		Forecast Default Rates (2)	
	2015	2016	2017	2018
Mining	2.3%	4.6%	2.1%	1.9%
Transportation	2.6%	4.1%	4.5%	3.7%
Information	2.5%	2.1%	3.1%	2.8%
Construction	1.8%	2.1%	2.4%	2.1%
Agriculture	1.4%	2.1%	1.7%	1.6%
Professional Services	1.7%	2.0%	1.9%	1.8%
Accommodation and Food	1.6%	1.9%	2.7%	2.9%
Administrative Services	1.6%	1.8%	2.4%	2.1%
Health Care	1.7%	1.8%	2.3%	2.2%
Manufacturing	1.5%	1.8%	2.0%	1.9%
Retail	1.8%	1.8%	2.1%	2.2%
Other Services	1.2%	1.5%	1.9%	1.8%
Real Estate	1.0%	1.4%	1.9%	1.8%
Finance	1.2%	1.4%	1.8%	1.6%
Wholesale	1.3%	1.3%	1.7%	1.7%
Entertainment	0.9%	1.1%	1.5%	1.6%
Public Administration	0.6%	0.9%	1.9%	2.0%
Education	0.8%	0.9%	1.8%	1.7%
All Industries	**1.5%**	**1.8%**	**2.1%**	**2.0%**

Source:
(1) PayNet Small Business Default Index
(2) PayNet AbsolutePD®

$1.0mm or Less in Total Lease/Loan Exposure

About PayNet, Inc.

PayNet is the leading provider of credit ratings on small businesses enabling lenders to achieve optimal risk management, growth, and operational efficiencies. PayNet maintains the largest proprietary database of small business loans, leases, and lines of credit encompassing over 24 Million contracts worth more than $1.4 Trillion.

Using state-of-the-art analytics, PayNet converts raw data into real-time marketing intelligence and predictive information that subscribing lenders use to make informed small business financial decisions and improve their business strategy.

PayNet's small business capabilities range from historic credit-reporting and automated credit-scoring to detailed strategic business reviews that include portfolio risk measurement, default forecasting, peer benchmarking, and critical industry trend analysis.

PayNet Contact Information

PayNet, Inc.
5750 Old Orchard Rd., Suite 300
Skokie, IL 60077
866-825-3400

William Phelan
President
866-825-3400
bphelan@paynet.com

WEB
www.paynet.com

PAYNET RISK INSIGHT SUITE®
www.sbinsights.net

Taking the Risk Out of
Small Business Lending

For more information
please call (866) 825-3400
or visit sbinsights.net