PMA FINANCIAL NETWORK

CREDIT QUARTERLY

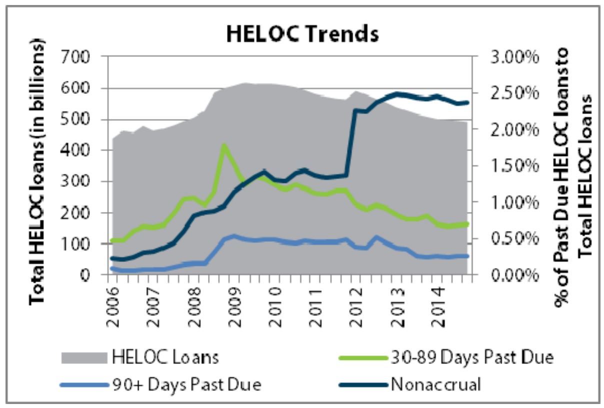
MARCH 2015

INSIDE THIS ISSUE

RECENT NEWS

Homeowners, Economists Concerned about Home Equity Loans

In the years leading up to the financial crisis, homeowners were eagerly borrowing money against the equity in their homes, through a Home Equity Line of Credit (HELOC). For the subsequent ten years, borrowers could draw on this money to access extra cash for home improvements, tuition expenses or to aid with their cash flow, and only pay interest on the balance of the line of credit. Ten years later, borrowers are experiencing payment shock, as their HELOC loans are about to require either a balloon payment of the entire principal balance, or a greatly increased monthly payment including both principal and interest. Also known as the "HELOC reset," payments become fully amortized with no additional draw capability. The Wall Street Journal reported that about $50 billion in HELOC loans will reset each year from 2015 to 2017.



Source: SNL Financial

Economists' main concerns with the reset include the potential increase in nonperforming loans and a decline in consumer spending. For example, a homeowner who owes $100,000 on a HELOC with a 3% interest rate would see payments rise to $965 from $250 after the interest-only period ends and the loan converts to a 10 year amortizing mortgage. This homeowner will likely be forced to change discretionary spending habits in order to afford the extra $715 required monthly. For homeowners who cannot afford the payment, TransUnion is predicting "as much as 20% of all HELOCs are at increased risk of default."

Positively, banks are reacting proactively, by contacting potential troublesome borrowers and staying ahead of any problems. Because of this, the Office of the Comptroller of the Currency recently revised its reset risk predictions downward by 20% through 2017.

Sources: American Banker, Bloomberg, Office of the Comptroller of the Currency, Standard & Poor's, Wall Street Journal, TransUnion

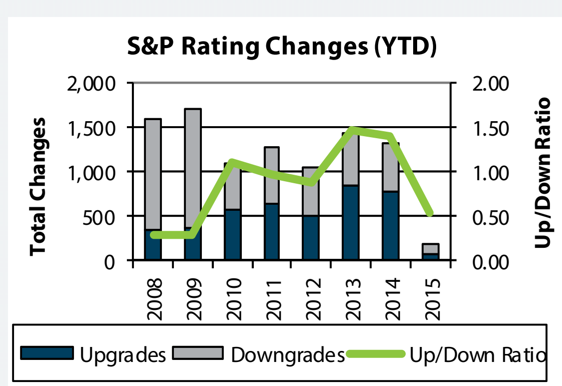
CREDIT TRENDS

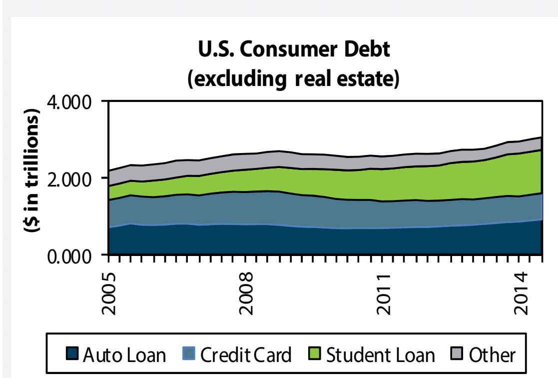
S&P RATING CHANGES:

The number of Standard & Poor's U.S. rating changes and the ratio of upgrades to downgrades.

U.S. CONSUMER DEBT:

Total outstanding debt by loan type in trillions of dollars, excluding debt secured by real estate.





Source: Bloomberg, Federal Reserve Bank of New York

BANK FAILURES

2015	**3**
Florida	1
Georgia	1
Illinois	1
2014	**18**
Illinois	5
Oklahoma	2
Maryland	2
Georgia	1
Florida	1
California	1

Source: Federal Deposit Insurance Corporation (FDIC)

BANKING TRENDS

4th Quarter 2014 Highlights

While 61% of banks reported improved 4th quarter earnings, the industry return on average assets fell to 0.96% from 1.09% the year before. Higher litigation expenses at a few large banks and lower noninterest income from sales, securitization and servicing of residential mortgage loans were to blame for the slight decline. Positively, the noncurrent loan rate declined for the 16th consecutive quarter and fell below 2% for the first time since 2008. Net chargeoffs in the fourth quarter were 18.3% lower than in the fourth quarter 2013, marking an eight year low in the category, with the largest improvements going to retail loan categories.

Total assets increased 1.3% for the fourth quarter, while loan and lease balances rose by 1.8%. The introduction of the Liquidity Coverage Ratio aided in the large increase in the holdings of U.S. Treasury securities (by 17.3%) and balances at the Federal Reserve (by 4.4%). Nearly three fourths of the increase occurred at banks with assets greater than $250 billion, as these banks are subject to the ratio for the first time effective January 1, 2015.

2014 year end marked the second time in the last three years that no new banks were charted. Mergers and failures caused the total number of banks to fall from 6,812 at December 31, 2013, to 6,509 at December 31, 2014. The FDIC's "Problem List" declined from 329 to 291 during the fourth quarter. The "Problem List" is at its lowest level since 2008.

Source: FDIC: Quarterly Banking Profile

PRUDENT MAN PROCESS

The Prudent Man Analysis

The Prudent Man Process includes the initial analysis of a bank's credit quality and the ongoing risk management throughout the life of a deposit. The process helps public funds investors avoid repayment, reinvestment and reputation risk that may be associated with a bank failure.

1 | **BANK CREDIT ANALYSIS**
- Gather Data
- Analyze Data

2 | **RISK MANAGEMENT**
- Assign PMA Rating and Deposit Limits
- Ongoing Risk Management

The process begins with gathering bank, industry and economic data from an extensive list of sources. Bank financial data is received from a variety of regulatory filings. Industry tools like Bloomberg and SNL Financial are utilized in obtaining data and other relevant information. Additionally, a number of publications focusing on the banking industry and local and national economy are monitored daily.

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