

kcFED *Small Business Lending* SURVEY**Loans Secured by Small Business Administration Guarantees Drive Large Increases in New Small Business C&I Lending**

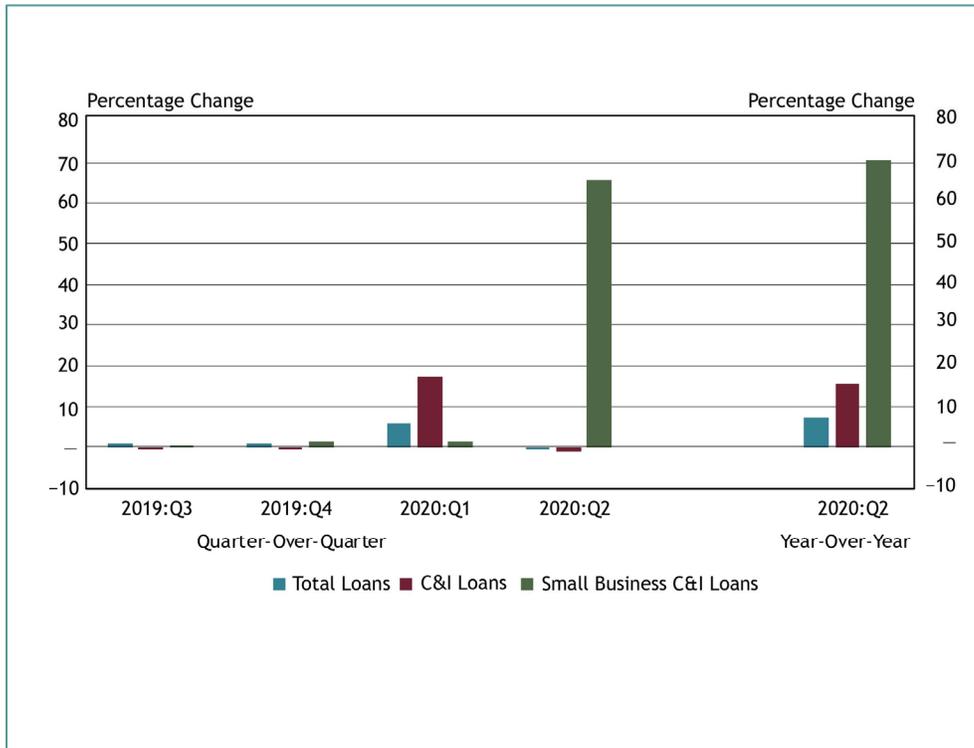
Outstanding balances on small business commercial and industrial (C&I) loans increased significantly in the second quarter of 2020, driven primarily by loans related to the Small Business Administration's (SBA) Paycheck Protection Program (PPP). Outstanding small business C&I loans increased 70.4 percent in the second quarter compared with the previous year, while the percent of these loans secured by SBA guarantees increased from 8 percent to 47 percent in the same period. Originations of new small business C&I loans increased more than 1,000 percent from the second quarter of 2019 and over 970 percent from the first quarter of 2020. Interest rates decreased across all loan types, but most significantly for fixed rate term loans, which fell to 1.20 percent, just above the PPP rate of 1.00 percent. On net, 43 percent of respondents reported declining credit quality with 44 percent reporting tightening credit standards. Of those who responded to the survey's special question on the impact of COVID-19 on small business lending, 99 percent reported taking steps to mitigate borrower problems, noting payment deferrals, PPP participation, and other actions. Respondents were split nearly equally on whether loan demand would increase or decrease in the second half of 2020.

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Chart 1: Small Business C&I Loan Balances Increase Quarter-over-Quarter and Year-Over-Year



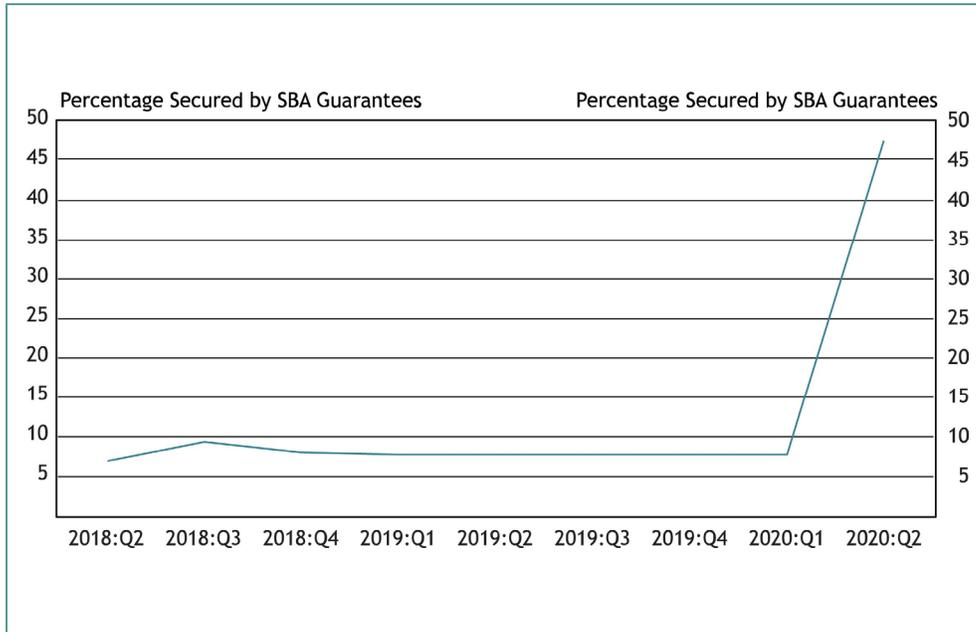
Note: Items are calculated using a subset of respondents that completed the FR 2028D for the last five quarters surveyed.

Sources: Call Report, schedule RC-C Part I, items 4 and 12; and FR 2028D, items 4.b and 5.c.

Balances on outstanding small business C&I loans increased in the second quarter compared with the prior quarter and the same period year-over-year. Compared with the prior quarter and the second quarter of 2019, small business C&I loans increased 65.5 and 70.4 percent, respectively, due primarily to a significant increase in fixed rate loans and loans guaranteed by the SBA, related primarily to the PPP. Total loans and total C&I loans remained relatively stable quarter-over-quarter with slight decreases of 0.5 and 1.1 percent, respectively. Compared with the second quarter of 2019, total loans and total C&I loans increased 6.9 and 15.3 percent, respectively, primarily driven by an increase in total loans and total C&I loans in the first quarter of 2020.

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Chart 2: Outstanding Loan Balances Secured by SBA Guarantees Increase

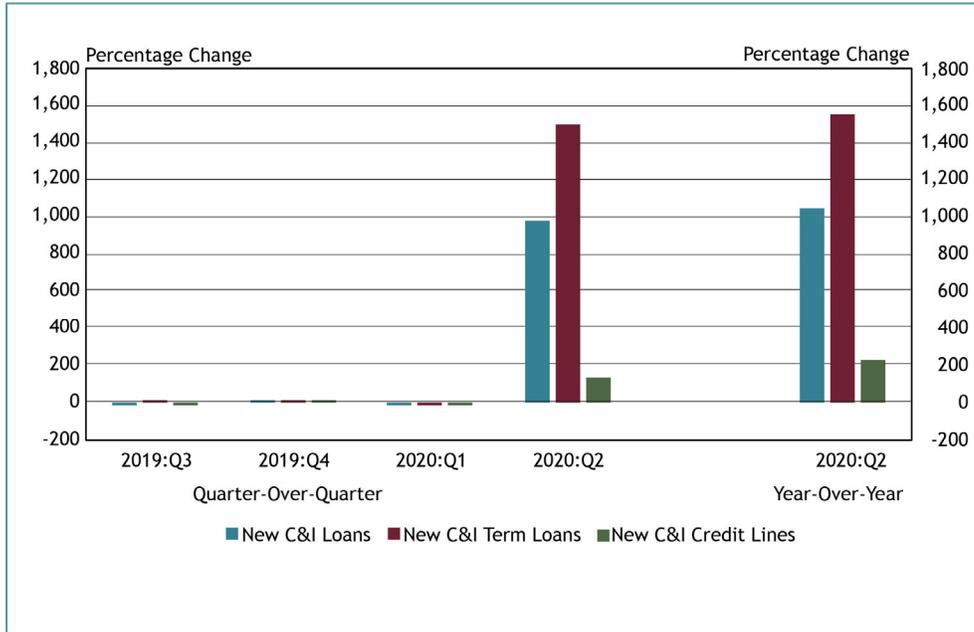


Source: FR 2028D, items 4.b, 4.j, 5.c., 5.i.

The percentage of outstanding small business C&I loan balances secured by the SBA increased sharply from 8 percent to 47 percent in the second quarter. The percent of balances secured by the SBA had ranged from 7 to 9 percent in previous data collections for the Small Business Lending Survey.

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Chart 3: New Small Business C&I Term Loans and Credit Lines Increase Quarter-Over-Quarter and Year-Over-Year



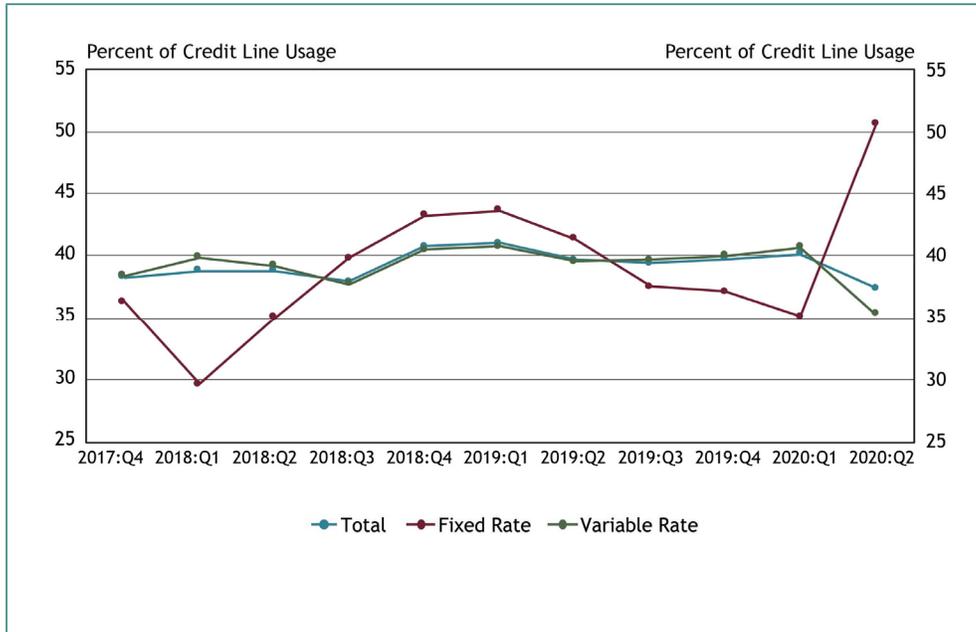
Note: Items are calculated using a subset of respondents that completed the FR 2028D for the last five quarters surveyed. All loan types referenced in Chart 3 refer to small business lending.

Source: FR 2028D, items 7.b and 10.c.

New small business C&I term loans and lines of credit increased quarter-over-quarter and year-over-year, with new C&I term loans reporting the largest increase. Compared with both the prior quarter and the second quarter of 2019, new small business C&I term loans increased over 1,500 percent.

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Chart 4: Fixed Rate Credit Line Usage Increases

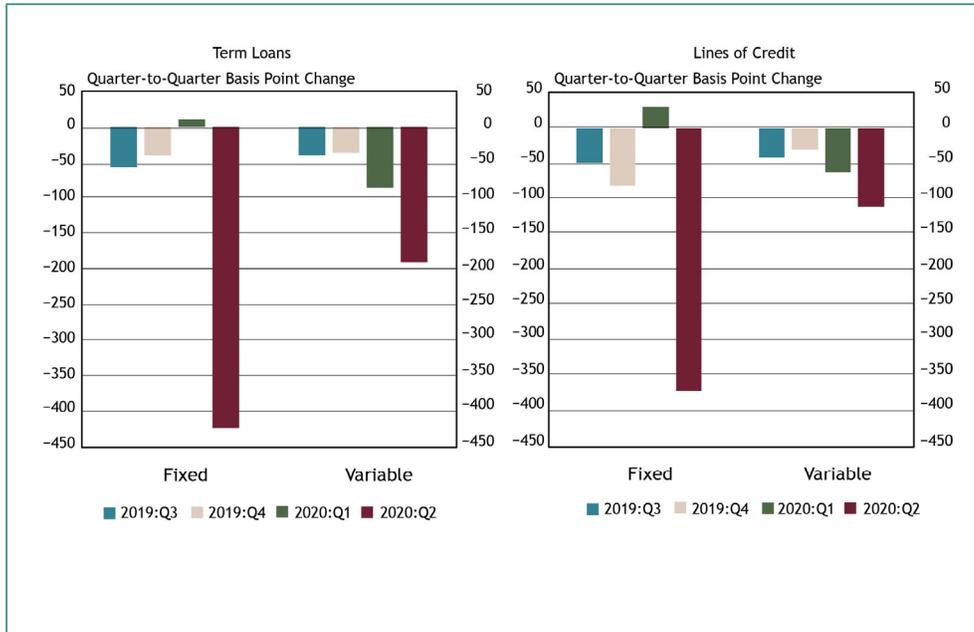


Source: FR 2028D, items 5.b and 5.c.

Use of fixed rate small business C&I lines of credit increased to its highest level since the inception of the survey to 51.0 percent, while use of variable rate small business C&I credit lines decreased to its lowest level since the inception of the survey to 35.0 percent. Compared with the prior quarter, the use of total small business C&I credit lines decreased from 40.0 to 37.0 percent.

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Chart 5: Interest Rates Decrease Across all Loan Categories



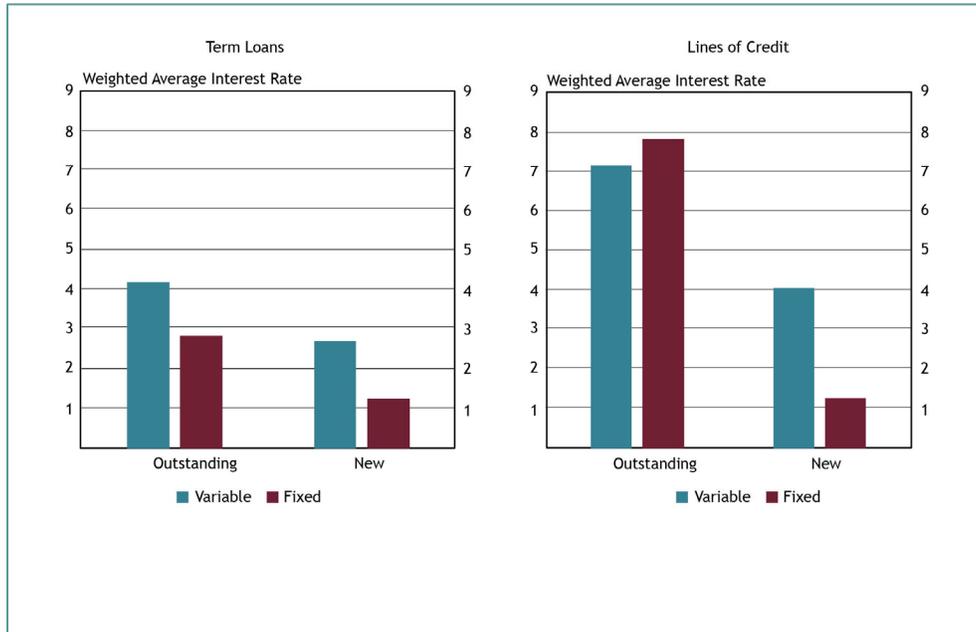
Note: Items are calculated using a subset of respondents that completed the FR 2028D for the last five quarters surveyed.

Source: FR 2028D, items 7.c and 10.d.

Weighted average rates on fixed and variable rate term loans and lines of credit decreased in the second quarter. Weighted average rates for all outstanding small business C&I loans declined by the largest margins since the survey’s inception, with the most significant drops reported in fixed rate term loans and lines of credit, which fell 425 and 375 basis points, respectively. This significant decrease in fixed rates for term loans and lines of credit primarily can be attributed to significant SBA lending to small businesses through the PPP at 1.00 percent in the second quarter.

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Chart 6: Rates on New and Outstanding Term Loans Lower than Rates for Lines of Credit



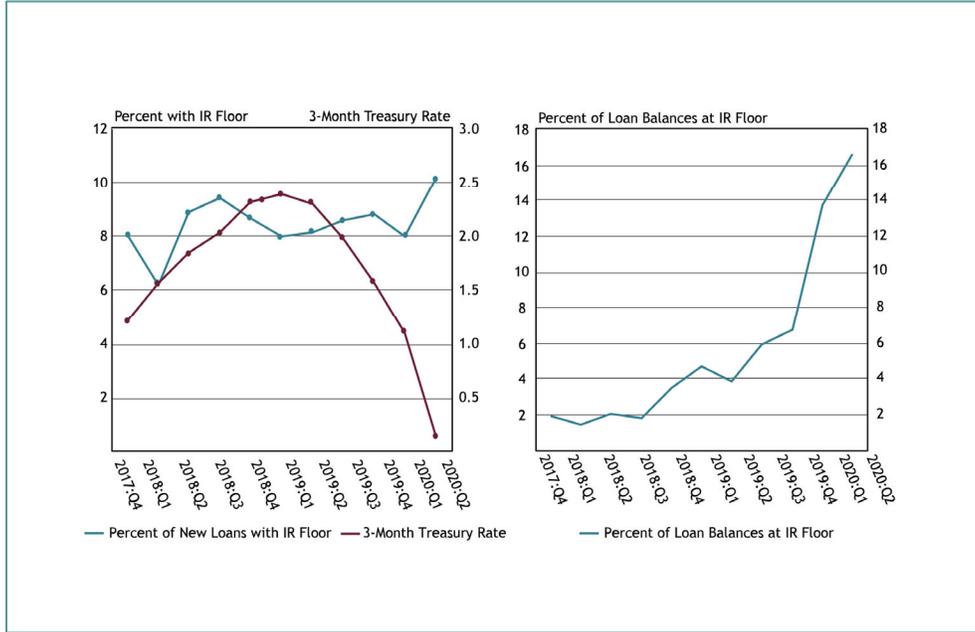
Note: Average interest rates are weighted by the dollar volume of new small business C&I loans.

Source: FR 2028D, items 4.c, 5.d, 7.c and 10.d.

Weighted average interest rates on variable and fixed rate new and outstanding small business C&I term loans and lines of credit ranged from 1.20 percent to 7.83 percent in the second quarter. The weighted average rates for new and outstanding small business C&I fixed and variable rate term loans were lower than the corresponding rates for new and outstanding small business C&I fixed and variable rate lines of credit. Weighted average variable and fixed rates on outstanding lines of credit were the highest, at 7.15 and 7.83 percent, respectively, while weighted average rates on new fixed rate term loans and lines of credit were the lowest at 1.20 and 1.24 percent, respectively.

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Chart 7: Percent of New Small Business C&I Loans with Interest Rate Floors and Total Small Business C&I Loan Balances at Interest Rate Floor Increase

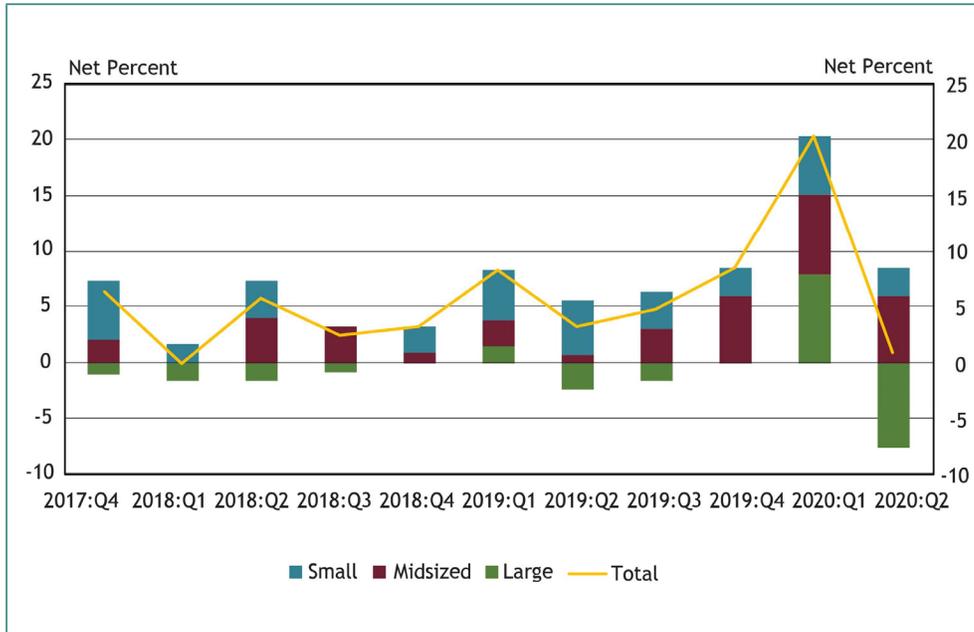


Source: FR 2028D, items 4.o, 5.n, 7.m, 7.o, 10.l, 10.n.

The percent of new small business C&I loans with interest rate floors and the percent of total small business C&I loan balances at interest rate floors increased in the second quarter to 10.2 percent and 16.6 percent, respectively, while the 3-Month U.S. Treasury Rate neared zero at 0.14 percent. The increase in the percent of loan balances at interest rate floor is attributed primarily to the falling rate environment.

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Chart 8: Respondents Report Mixed Credit Line Usage



Notes: Chart 8 shows diffusion indexes for credit line usage. The diffusion indexes show the difference between the percent of banks reporting decreased credit line usage and those reporting increased credit line usage. Net percent refers to the percent of banks that reported having decreased (“decreased somewhat” or “decreased substantially”) minus the percent of banks that reported having increased (“increased somewhat” or “increased substantially”).

Small banks have total assets of \$1 billion or less, midsized banks have total assets between \$1 billion and \$10 billion and large banks have total assets greater than \$10 billion.

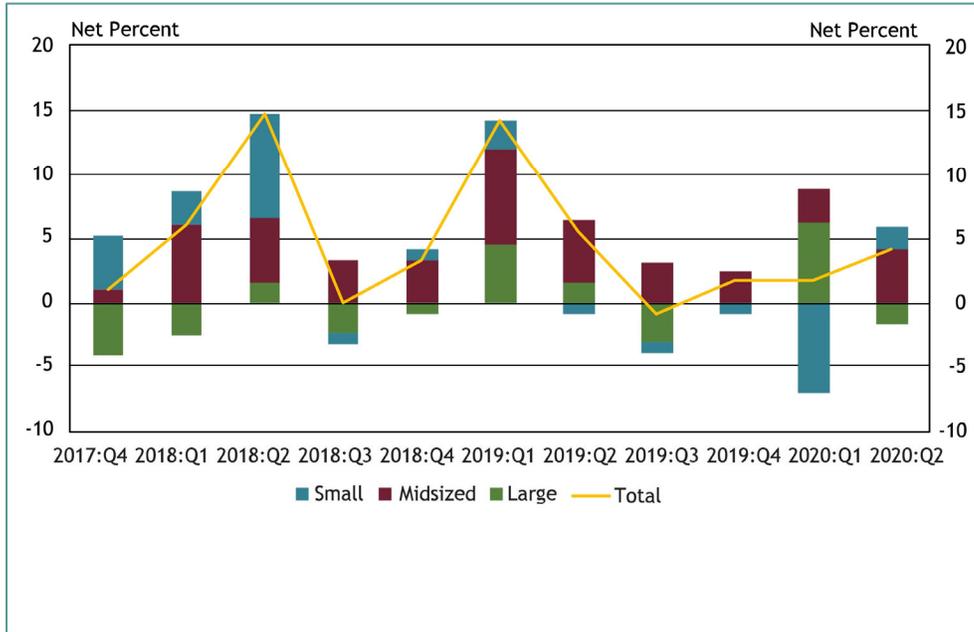
Source: FR 2028D, items 11 and 12.

The percentage of respondents indicating a change in credit line usage, whether an increase or decrease, increased from 38 percent in the first quarter to 58 percent in the second quarter, the first time since the inception of the survey in which more than half of the respondents reported a change in credit line usage.¹ While responses were nearly evenly split between increased or decreased credit line usage, on net, about 1 percent of respondents indicated an increase. Of the banks reporting a change, 84 percent cited changes in national or local economic conditions as a very important reason for a change and 69 percent cited change in borrower’s business revenue or other business specific conditions as a very important reason for a change.

¹ A detailed breakdown of responses can be found in the aggregate survey data on the Small Business Lending Survey page.

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Chart 9: More Small and Midsized Banks Report an Increase in Loan Demand



Notes: Chart 9 shows diffusion indexes for loan demand. The diffusion indexes show the difference between the percent of banks reporting weakened loan demand and those reporting stronger loan demand. Net percent refers to the percent of banks that reported having weakened (“moderately weaker” or “substantially weaker”) minus the percent of banks that reported having stronger (“moderately stronger” or “substantially stronger”).

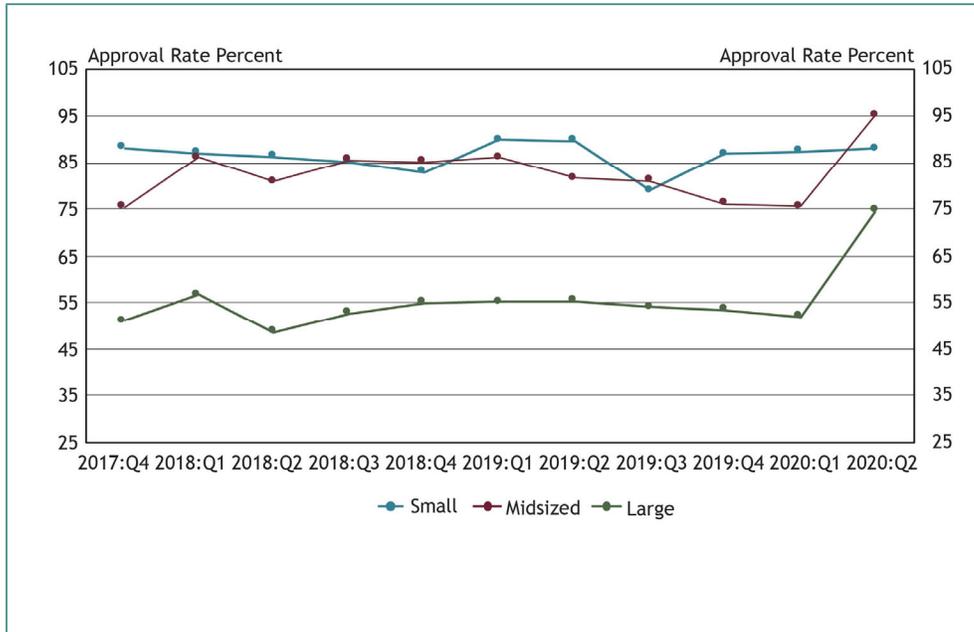
Small banks have total assets of \$1 billion or less, midsized banks have total assets between \$1 billion and \$10 billion and large banks have total assets greater than \$10 billion.

Source: FR 2028D, item 13.

In the second quarter, about 67 percent of banks, reported a change in loan demand.¹ On net, the number of midsized banks indicating stronger loan demand was about 4 percent, while the number of small banks reporting stronger loan demand was 2 percent. The number of large banks reporting weaker loan demand was 2 percent, on net.

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Chart 10: Application Approval Rates Increase for all Bank Sizes



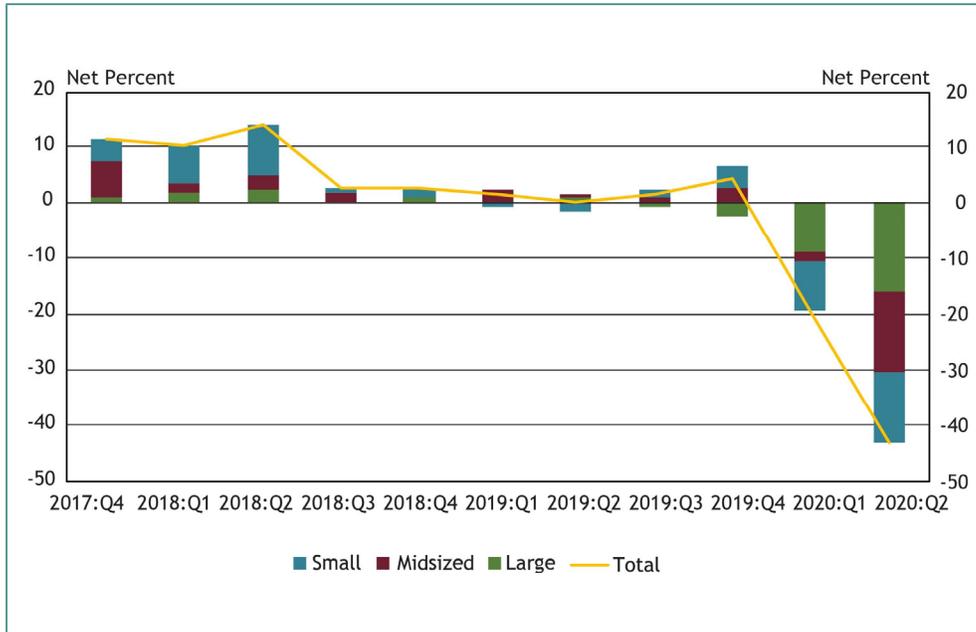
Note: Small banks have total assets of \$1 billion or less, midsized banks have total assets between \$1 billion and \$10 billion and large banks have total assets greater than \$10 billion.

Source: FR 2028D, items 14.a and 17.

Application approval rates for midsized and large banks reached their highest levels since the inception of the survey, increasing from 75 and 52 percent in the first quarter of 2020 to 95 and 75 percent in the second quarter, respectively. Application approval rates for small banks increased slightly from 87 percent in the first quarter of 2020 to 88 percent in the second quarter. The three most commonly cited reasons for denying a loan were borrower financials, credit history and collateral.

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Chart 11: Decreases Reported in Credit Quality across all Bank Sizes



Notes: Chart 11 shows diffusion indexes for credit quality of applicants. The diffusion indexes show the difference between the percent of banks reporting a decline in credit quality and those reporting improvement in credit quality. Net percent refers to the percent of banks that reported declining credit quality (“declined somewhat” or “declined substantially”) minus the percent of banks that reported improving credit quality (“improved somewhat” or “improved substantially”).

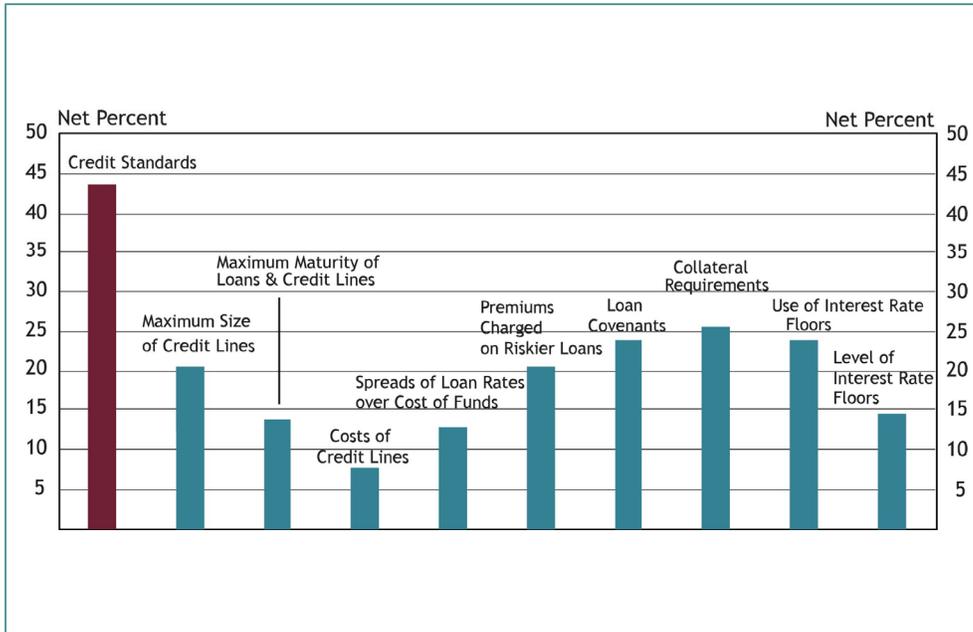
Small banks have total assets of \$1 billion or less, midsized banks have assets between \$1 billion and \$10 billion and large banks have assets greater than \$10 billion.

Source: FR 2028D, items 24 and 25.

In the second quarter, about 43 percent of banks, on net, reported a decrease in the credit quality of applicants, the largest decline since the inception of the survey, and only the second time in which respondents of all bank sizes, on net, reported a decrease. Of the respondents reporting a change in credit quality, whether an increase or decrease, 49 percent cited the liquidity position of business owners as a very important reason for a change. Other commonly cited reasons for a change include the debt-to-income level of business owners, prospects for business growth or enterprise values and recent business income growth.

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Chart 12: Banks Tighten Credit Standards and Loan Terms



Note: Chart 12 shows diffusion indexes for credit standards (red bar) and various loan terms. The diffusion indexes show the difference between the percent of banks reporting tightening terms and those reporting easing terms. Net percent refers to the percent of banks that reported having tightened (“tightened considerably” or “tightened somewhat”) minus the percent of banks that reported having eased (“eased considerably” or “eased somewhat”).

Source: FR 2028D, items 18, 19, 20 and 22.

About 48 percent of respondents reported a change in credit standards in the second quarter, up about 23 percent from the first quarter. Of banks indicating a change in credit standards, 44 percent on net reported tightening their credit standards, an increase of about 26 percent from the previous quarter.

On net, respondents indicated that all loan terms tightened with collateral requirements, use of interest rate floors and loan covenants tightening the most. Respondents reporting tightening credit standards or loan terms in the second quarter cited a less favorable or more uncertain economic outlook and worsening industry specific problems.

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Chart 13: COVID-19 Pandemic and its Impact on Small Business Lending

A special question in the second quarter 2020 collection of the Small Business Lending Survey asked:

- a. Have you been able to confidently assess the financial position/repayment capacity of your small business borrowers?**
- b. How do you expect small business loan demand to change in the second half of the year?**
- c. What arrangements has your bank made to assist your small business borrowers and, if so, when were they made and what were the terms? (For example, did you offer payment deferrals of principal and interest?)**

The data collection period for the survey took place in the month of August. Responses to this special question may be more reflective of a point in time rather than the impact faced by an institution on June 30, 2020. Eighty-seven percent of reporting institutions (102) provided an answer to the special question. Of those institutions that responded to the special question:

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99% INDICATED SOME TYPE OF LOAN MODIFICATION

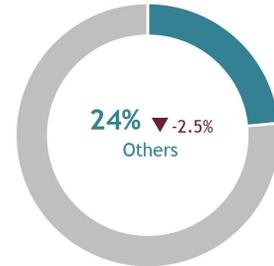
MITIGATION ACTIONS



90% of the respondents cited the use of loan payment deferrals of principal and/or interest as a mitigation tool. This is a 12% increase compared with the first quarter. The most common terms for deferrals range from 3-6 months



38% of the respondents cited participation in PPP as a mitigation tool. This is a 35% decrease compared with the first quarter.



Besides payment deferrals and PPP participation, other actions cited by 24% of the respondents to mitigate the impact of COVID-19 included the reduction of loan interest rates and close contact with customers. This is a 2.5% decrease compared with the first quarter.

FINANCIAL POSITION AND LOAN DEMAND

Have you been able to confidently assess the financial position/repayment capacity of your small business borrowers?		
Not Confident	Somewhat Confident	Confident
7%	55%	27%

How do you expect small business loan demand to change in the second half of the year?		
Increase	Decrease	No change
25%	34%	29%

Other contributors to this release included Rosine Boni, Dan Harbour, Alli Jakubek, Tony Walker, and Jim Wilkinson.