

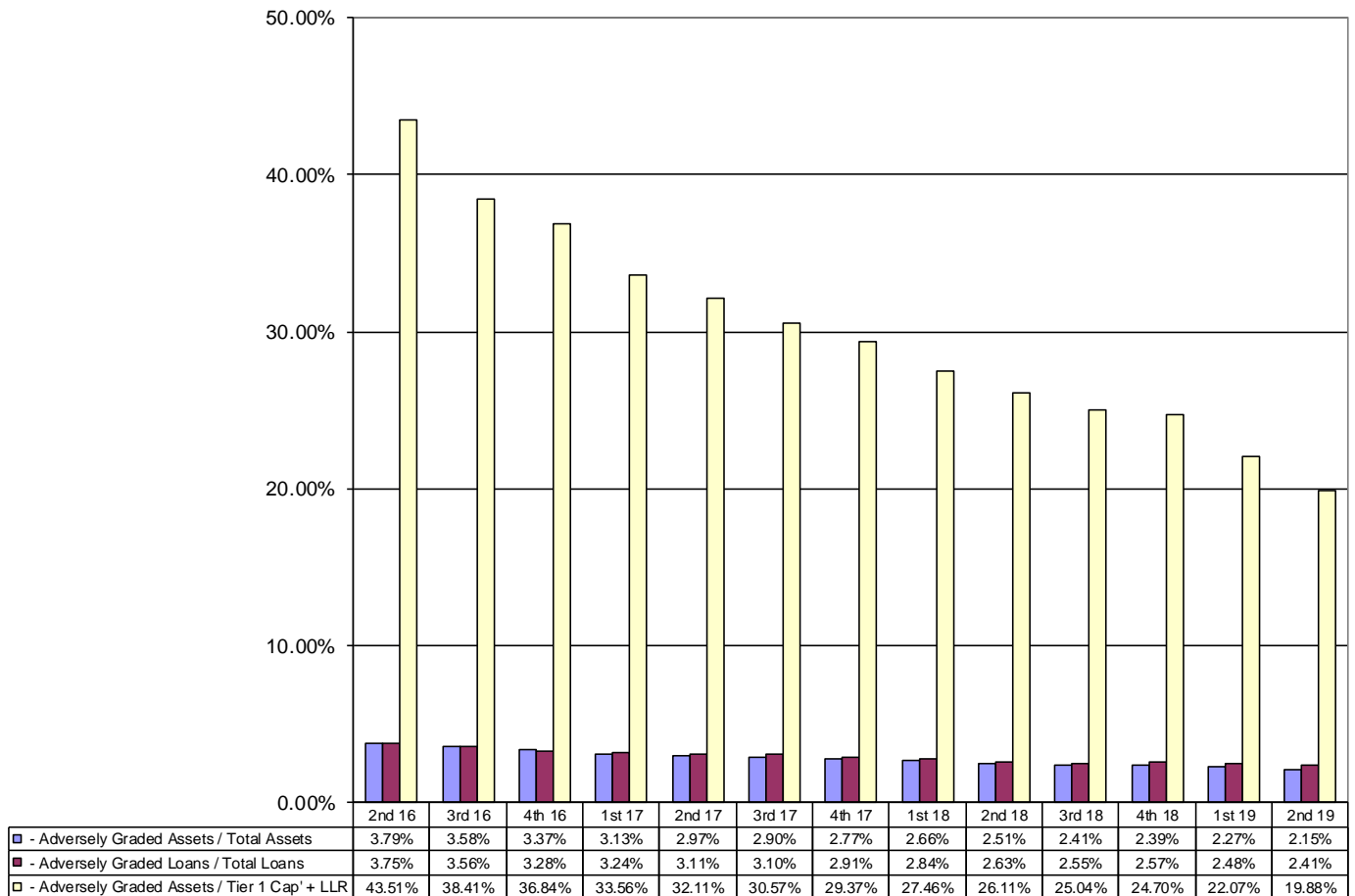


Asset Quality Update – Q2 2019 Edition

Trends in Asset Quality – Average Levels

Based on Steve H. Powell & Company client data, during the Second Quarter 2019, the average level of adversely graded assets decreased as a percentage of total assets and capital. The average level of adversely graded loans decreased as a percentage of total loans. Problem assets averaged 2.15% of total assets and 19.88% of tier-one capital plus loan loss reserve as compared to 2.27% of total assets and 22.07% of tier-one capital plus loan loss reserve while problem loans averaged 2.41% of total loans as compared to 2.48% of total loans during the First Quarter 2019.

**TRENDS IN ASSET QUALITY
 AVERAGE LEVEL OF ADVERSELY GRADED ASSETS**

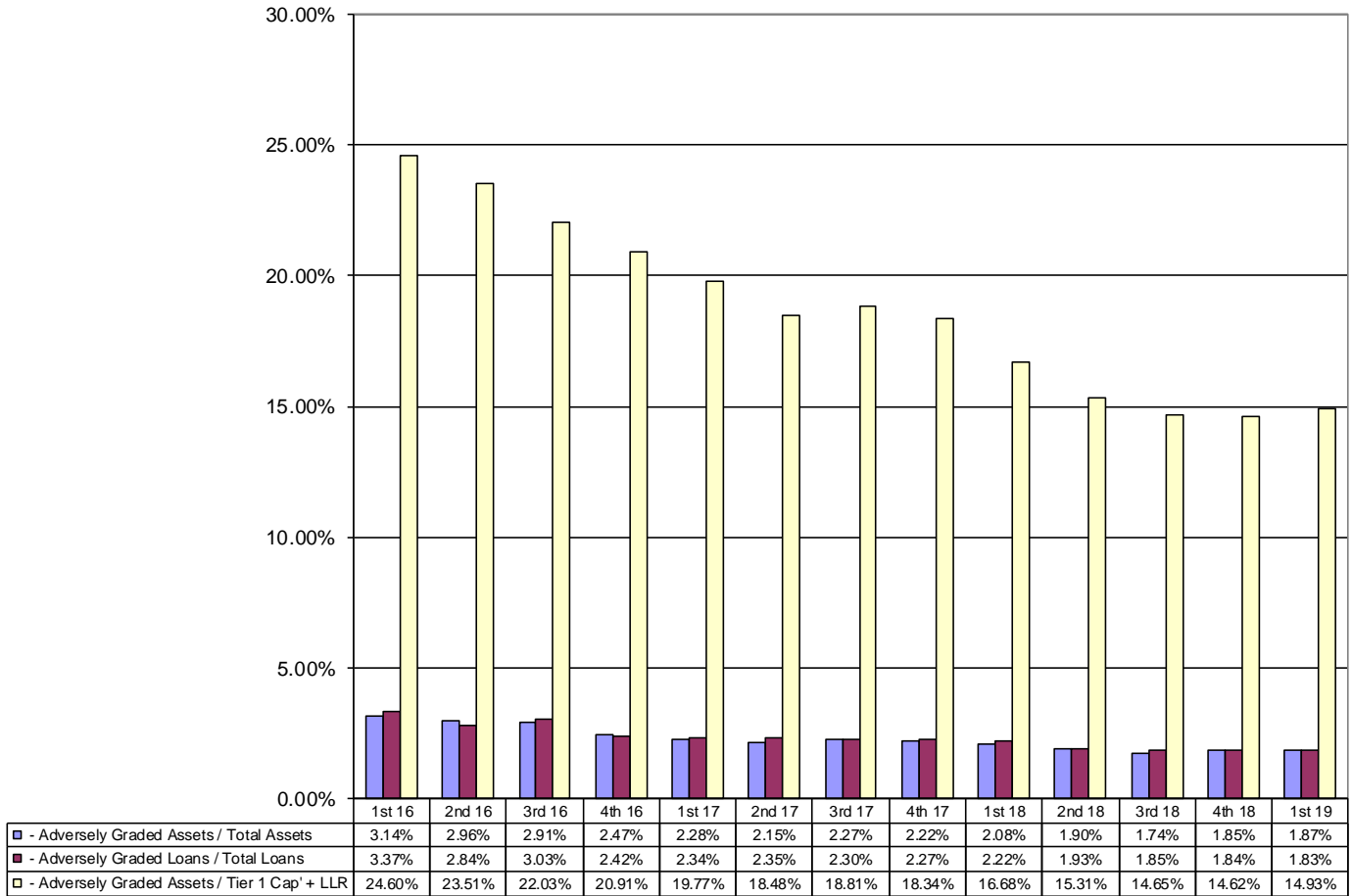


Steve H. Powell & Company was founded in August of 1993 by former banker and regulator, Steve H. Powell. With the goal of providing unparalleled asset quality monitoring and regulatory compliance services, the company's clientele base has grown and now exceeds 100 different financial institutions. We also provide our clients with bank charter consulting, due diligence support, regulatory applications, financial analysis, and strategic planning. The staff of Steve H. Powell & Company is comprised of former bankers & regulators who understand the complexities of today's regulatory environment. The unique skill sets possessed by our specialists are derived from extensive review experience in institutions of various sizes and charter types.

Trends in Asset Quality – Median Levels

The median level of problem assets as of Q2 2019 decreased to 13.3% of tier-one capital plus loan loss reserve as compared to 14.93% during Q1 2019. Note the downward trend as overall asset quality continues to improve.

**TRENDS IN ASSET QUALITY
MEDIAN LEVEL OF ADVERSELY GRADED ASSETS**



Historical Comparisons

During Q2 2019, increases in problem assets, as measured by adversely graded assets divided by tier-one capital plus loan loss reserve, were noted in approximately 17% of our clients. This quarter’s increase compares to:

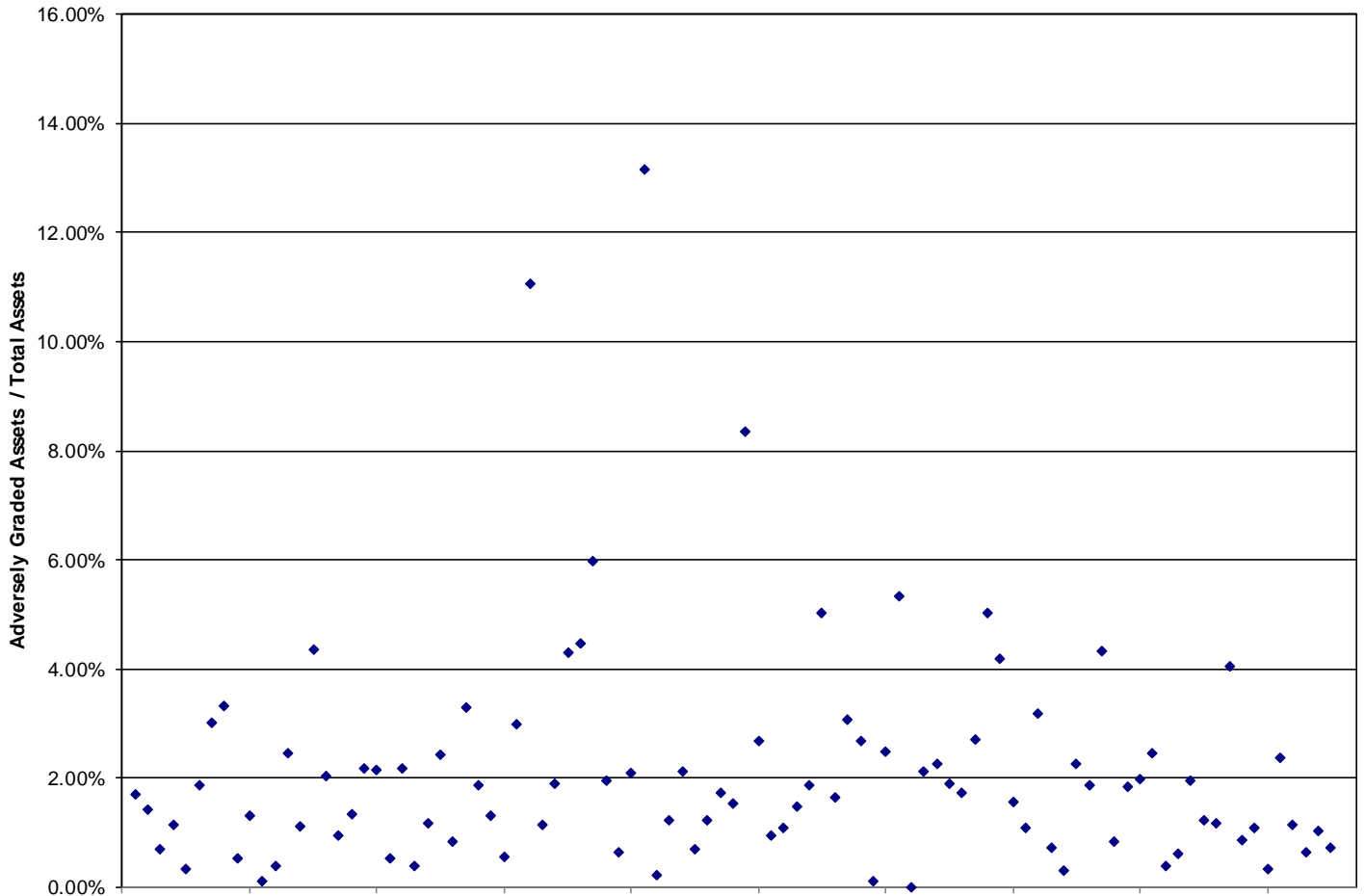
- 24% during the First Quarter 2019
- 10% during the Fourth Quarter 2018
- 16% during the Third Quarter 2018
- 20% during the Second Quarter 2018
- 15% during the First Quarter 2018
-

A higher level of volatility in the percentage of increases may be expected as overall asset quality stabilizes; however, increases may indicate a rise in portfolio risk.



Dispersion of Problem Assets – as a Percentage of Total Assets

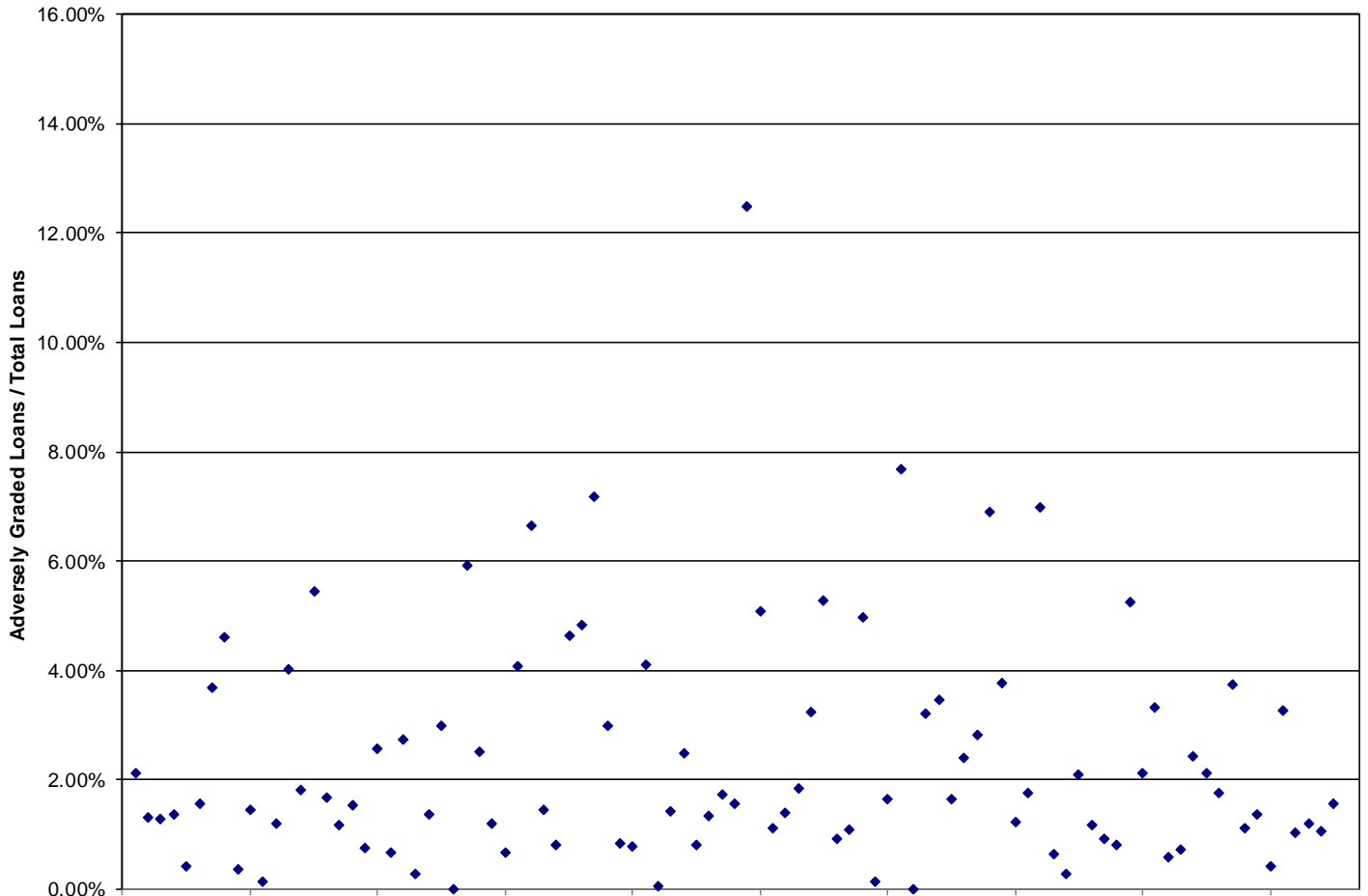
TRENDS IN ASSET QUALITY



The above graph shows the dispersion of problem assets as a percentage of total assets. A traditional benchmark for significant asset quality concern is adversely graded assets that exceed 10% of total assets.

Dispersion of Problem Loans – as a Percentage of Total Loans

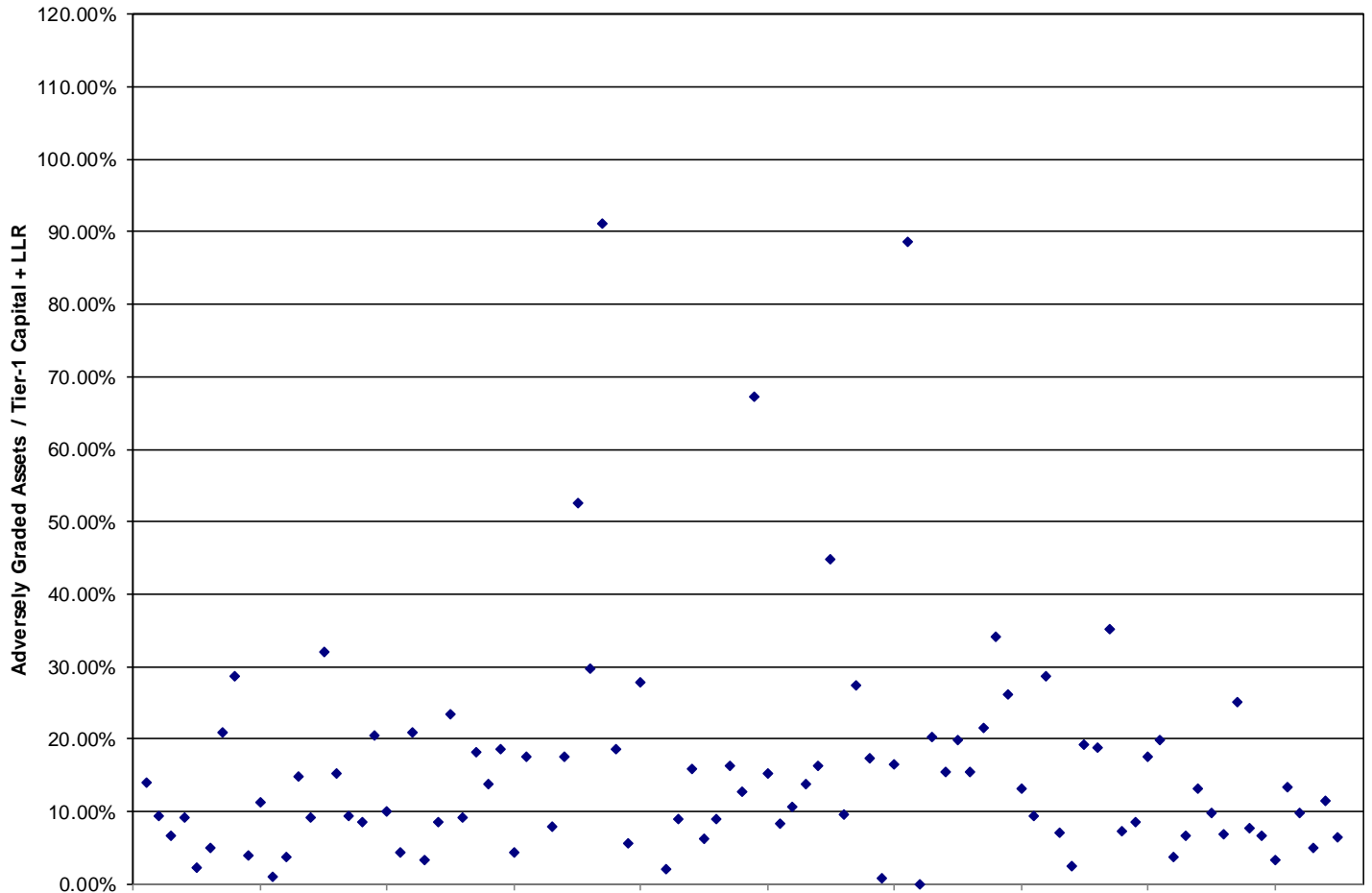
TRENDS IN ASSET QUALITY



A traditional benchmark for significant asset quality concern is adversely graded loans that exceed 10% of total loans.

Dispersion of Problem Assets – as a Percentage of Tier-One Capital & Reserves

TRENDS IN ASSET QUALITY



Note that two data points exceeding 120% are not included in the graph above for aesthetic reasons.

Historical Comparisons

Our sample group includes five (5) banks with problem assets exceeding 60% of tier-one capital plus loan loss reserve. This number compares to:

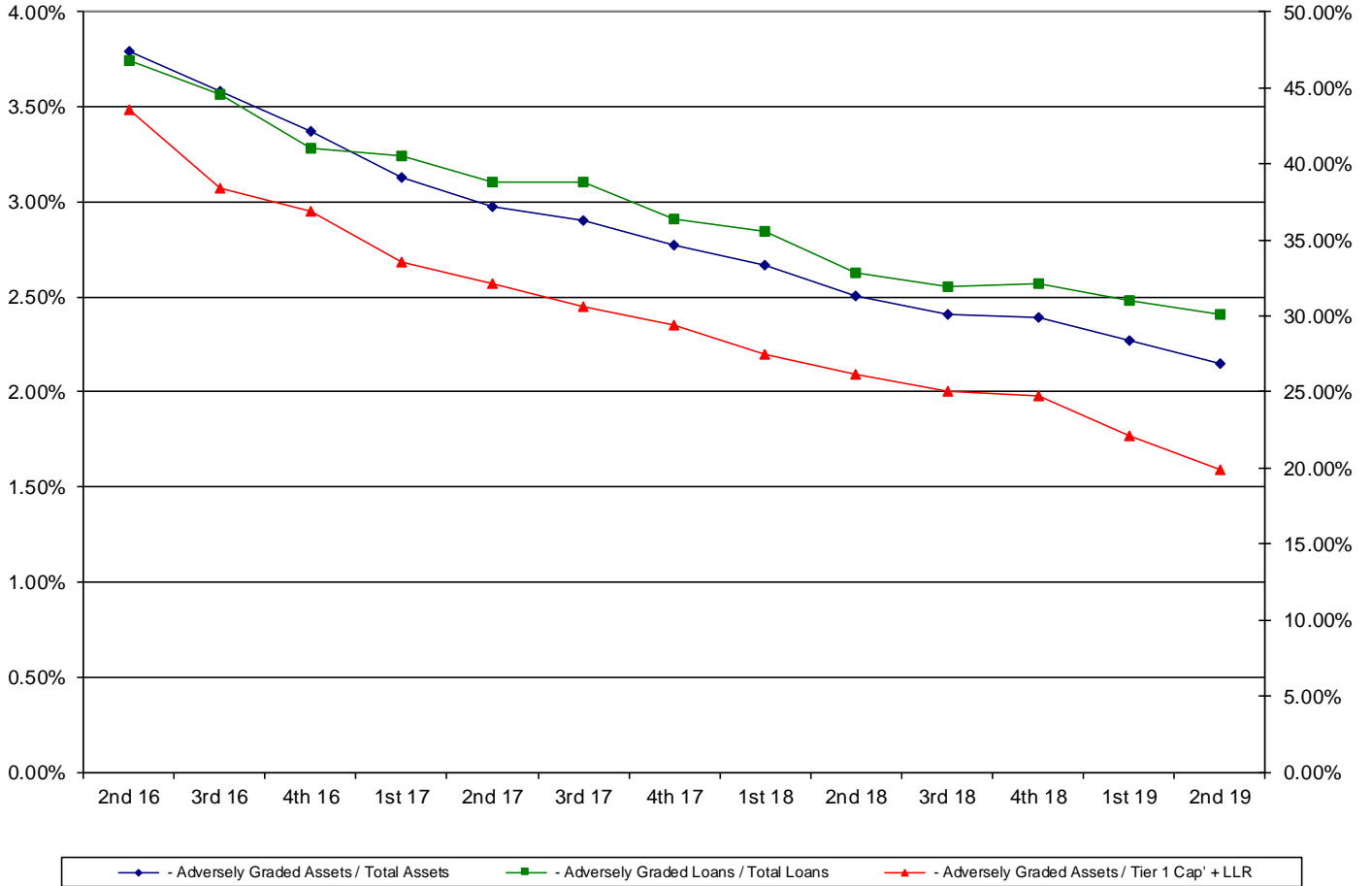
- Five (5) during the First Quarter 2019
- Six (6) during the Fourth Quarter 2018
- Six (6) during the Third Quarter 2018

Four (4) banks now exceed 80% of tier-one capital plus loan loss reserve – a level normally associated with some form of formal regulatory action – as compared to:

- Four (4) during the First Quarter 2019
- Six (6) during the Fourth Quarter 2018
- Five (5) during the Third Quarter 2018

Problem Asset Trend Analysis

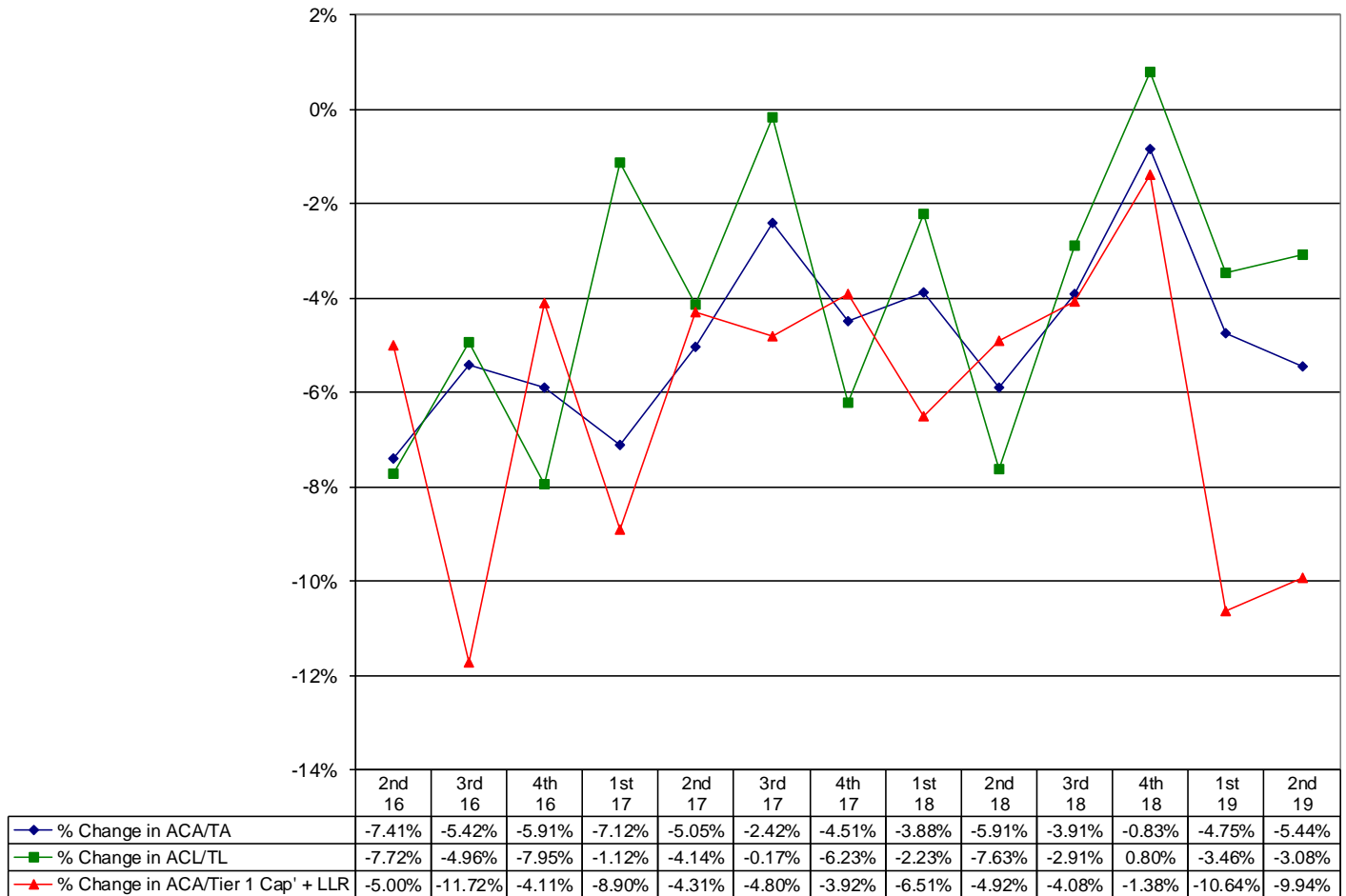
PROBLEM ASSET TREND ANALYSIS



The above graph again shows the trend in asset quality over the past three years as measured by adversely graded assets to total assets, adversely graded loans to total loans, and adversely graded assets to tier-one capital plus LLR.

Problem Asset Comparative Change Analysis

COMPARATIVE % CHANGE IN ADVERSELY CLASSIFIED ASSETS
Comparative to Assets, Loans and Tier One Capital + LLR



The above graph shows the pace of asset quality deterioration or improvement. The calculation is based on the percent change of problem asset levels from one quarter to the next. The graph indicates a favorable trend in asset quality ratios. Please note any data points below 0% indicate improvement in asset quality.

Modified Peer Data Analysis

We again performed an analysis in which six data points were excluded – the three lowest and the three highest data points, as based on classifications as a percentage of tier-one capital plus loan loss reserve.

With the excluded data points, problem assets (or loans when compared to total loans) averaged 1.93% of total assets, 2.32% of total loans, and 15.91% of tier-one capital plus loan loss reserve. Second Quarter 2019 modified data compares to the following First Quarter 2019 modified average data set:

- 2.06% of total assets
- 2.45% of total loans, and
- 17.36 of tier-one capital plus loan loss reserve

Proposed Changes to HVCRE

On July 12, 2019, Regulatory agencies issued a proposed rulemaking change to the definition of High Volatility Commercial Real Estate (HVCRE). The proposed changes would include:

- For a loan to be eligible for the one- to four-family residential properties exclusion from the HVCRE exposure definition, the credit facility would be required to include financing for construction of one- to four-family residential structures.
- The one- to four-family residential properties exclusion would not include credit facilities that solely finance land development activities, such as the laying of sewers, water pipes, and similar improvements to land.
- A facility that solely finances land development would be categorized as an HVCRE exposure, unless the exposure meets another exclusion from the revised HVCRE exposure definition.

Current HVCRE, 12 CFR 3.2 (definitions: High volatility commercial real estate [HVCRE]), excludes loans that provide AD&C funding that finances:

- (1) One- to four-family residential properties;
- (2) Real property that:
 - (i) Would qualify as an investment in community development ...
 - (ii) Is not an ADC loan to any entity described in 12 CFR 25.12(g)(3) (national banks) and 12 CFR 195.12(g)(3) (Federal savings associations), unless it is otherwise described in paragraph (1), (2)(i), (3) or (4) of this definition;
- (3) The purchase or development of agricultural land, which includes all land known to be used or usable for agricultural purposes (such as crop and livestock production), provided that the valuation of the agricultural land is based on its value for agricultural purposes ...; or
- (4) Commercial real estate projects in which:
 - (i) The loan-to-value ratio is less than or equal to the applicable maximum supervisory loan-to-value ratio ... ;
 - (ii) The borrower has contributed capital to the project in the form of cash or unencumbered readily marketable assets (or has paid development expenses out-of-pocket) of at least 15 percent of the real estate's appraised "as completed" value; and
 - (iii) The borrower contributed the amount of capital required ... before the ... bank ... advances funds under the credit facility, and the capital contributed by the borrower, or internally generated by the project, is contractually required to remain in the project throughout the life of the project. The life of a project concludes only when the credit facility is converted to permanent financing or is sold or paid in full...

Under the proposed revisions, HVCRE, as defined in capital rules, would be amended with an exclusion for AD&C financing involving one to four family construction. To be exempt from the HVCRE definition, "the credit facility would be required to include financing for construction of one-to-four family residential structures". Or, stated differently, if the AD&C loan does not include residential construction financing, HVCRE standards would apply. The proposed definition changes, if enacted, would not require a reevaluation of existing HVCRE loans.

Source:

Proposal - <https://www.fdic.gov/news/board/2019/2019-06-07-notational-fr-a.pdf>

Definition - <https://www.govinfo.gov/content/pkg/CFR-2019-title12-vol1/xml/CFR-2019-title12-vol1-part3.xml>

For more information about Steve H. Powell & Company, please visit us on the web at www.shpco.net.

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