

RISK RATING DEFINITIONS

Risk Rating	Category	Description	Remarks
1	Exceptional	Top long-term debt.	Superior quality. Unquestioned primary source of loan repayment; no apparent risk
2	Very Good	Strong financial position.. May also include unrated lease loans to strong earnings, well capitalized and publicly traded companies which do not have long or short term debt ratings.	Above average quality. Primary source of repayment very likely to be sufficient, with secondary sources readily available: strong financial position; minimal risk; profitability, liquidity and capitalization are better than industry norms.
3	Standard	Reasonable credit requiring normal attention.	Average quality. Primary source of loan repayment is satisfactory, with secondary sources very likely to be realized if necessary; loan within normal credit standards; requires average amount of Loan Officer attention; company is of average size within its industry and may have difficulty accessing or does not have access to public markets for short term or capital needs.

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4	Acceptable	Close monitoring, strong guarantor/weak borrower; increased risk profile in the financial condition of the borrower and/or credit structure.	Generally acceptable asset quality. Primary source of loan repayment is acceptable and secondary sources are likely to be realized, if needed; Acceptable business credit, but borrower's operations, cash flow, or financial condition evidence more than average risk; requires above average levels of supervision and attention from Loan Officer. The source of Increased risk has been identified, can be effectively managed/corrected, and the increased risk is not significant to warrant a more severe rating.
5	Transitory Risk	Strained liquidity and leverage capacity or earnings; covenant violations occasional losses; slow pay; poor reporting.	Transitory Risk. Loan coverage is somewhat erratic, future coverage is uncertain, liquidity is strained and leverage capacity is considered minimal. Indicators of potential deterioration of repayment sources have resulted in uncertainty or unknown factors concerning the status of the credit. Risk Rating 5 is considered transitory in nature. When the factors causing the uncertainty have been clearly defined, a risk rating should be assigned commensurate with the risk characteristics and circumstances that exist. Quarterly memorandums to the Board of Directors regarding action plans for managing the risk of the credit must be developed for credits in this category.
6	Special Mention	Deterioration of repayment is in its earliest stages. Potentially weak primary repayment source. Past due 60 days; constant supervision.	Considerable Risk. A Special Mention asset has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in the deterioration of the repayment prospects for the asset or in the institution's credit position at some future date. Special Mention assets are not adversely classified and do not expose an institution to sufficient risk to warrant adverse classification.

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7	Substandard	<p>Past due over 90 days; non accrual; unacceptable business credit; repayment in the normal course in jeopardy due to the existence of one or more well defined weaknesses affecting the primary source of repayment. Loss of principal not likely if weakness corrected.</p>	<p>Very high risk. FDIC Definition - A substandard asset is inadequately protected by the current sound worth and paying capacity of the obligor or of the collateral pledged, if any. Assets so classified must have a well-defined weakness or weakness that jeopardize the liquidation of the debt. They are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.</p> <p>Substandard Real Estate Loan. FDIC Definition - Any such troubled real estate loan or portion thereof should be classified Substandard when well-defined weaknesses are present which jeopardize the orderly liquidation of the debt. Well-defined weaknesses include a project's lack of marketability, inadequate cash flow or collateral support, failure to complete construction on time or the project's failure to fulfill economic expectations. They are characterized by the distinct possibility that the bank will sustain some loss if the deficiencies are not corrected.</p>

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8	Doubtful	All substandard characteristics plus the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable.	<p>Doubtful. FDIC Definition - An asset classified doubtful has all the weaknesses inherent in one classified substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.</p> <p>Doubtful Real Estate FDIC Definition - Doubtful classifications have all the weaknesses inherent in those classified Substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently known facts, conditions and values, highly questionable and improbable. A Doubtful classification may be appropriate in cases where significant risk exposures are perceived, but loss cannot be determined because of specific reasonable pending factors which may strengthen the credit in the near term. Examiners (Loan Officers) should attempt to identify loss in the credit where possible thereby limiting the excessive use of the Doubtful classification.</p>
9	Loss	Loss Category	<p>Loss. FDIC Definition - An asset classified loss is considered uncollectable and of such little value that continuance as bankable assets is not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off this basically worthless asset even though partial recovery may be effected in the future.</p> <p>Loss Real Estate Loan. FDIC Definition - Advances in excess of calculated current fair value which are considered uncollectable and do not warrant continuance as bankable assets. There is little or no prospect for near term improvement and no realistic strengthening action of significance pending.</p>

COMMERCIAL REAL ESTATE RISK RATING CHARACTERISTICS

Risk Rating	Lifecycle	General Definition	Construction Risk	Project Cash Flow & Contingency Reserves or Collateral	Market Environment	Economic Value	Financial Strength of Developer / Guarantor
3	Market/ Stable	No actual or potential weaknesses	Project Construction has been completed	Project cash flows fully support debt service requirements without the benefit of subsidies or outside support.	Located in a stable market supported by a current market survey	Project NOI and LTV should support refinancing at maturity	If there is reliance on the developer, guarantor, sound financial capacity supported by current financial information.
4	Market/ Interim	No actual or potential weaknesses prevail	Project construction has been completed.	Project cash flows may not meet minimum debt service requirements, however, defined cash reserves, collateral or guarantors will support lease-up to a break-even level.	Located in a stable market supported by a current market survey.	Project NOI and LTV should support refinancing at maturity.	If there is reliance on the developer, guarantor, sound financial capacity supported by current financial information.
4	Construction	No actual or potential weaknesses prevail.	Construction is on schedule and the loan is in balance.	Defined cash reserves will support lease-up to a break-even level. Loan is in balance.	Located in a stable market supported by a current market survey.	Underwriting assumptions remain valid and projected NOI will support financing at maturity.	If there is reliance on the developer, guarantor, sound financial capacity supported by current financial information
5	Market/ Construction	Refer to ACommercial Real Estate Early Warning Indicators Exhibit 5. The purpose of this category is to identify temporary issues, which may require criticism of the loan when fully analyzed.					
6	Construction / Interim	Adverse conditions in any one of the following areas may result in a 6 (OAEM) rating. The degree or duration of an adverse condition which may impact the successful completion or refinancing of the project may differentiate the risk rating from 5 to 7.	Project is not on schedule or the loan is out of balance. Project is dependent on unprogrammed support to reach break-even cash flow.	Cash reserves will not carry to break-even; however, a strong guarantor has demonstrated the willingness and ability to carry the project to break-even.	Market conditions have deteriorated since the original underwriting. Cash flows or economic value may be jeopardized if the market does not stabilize although the loan is currently protected.	Refinancing at maturity is in question. Collateral coverage protects the loan and there is sufficient time before maturity to correct.	Developer or guarantor has financial problems which could adversely impact the success of this project. All other conditions remain stable.

COMMERCIAL REAL ESTATE RISK RATING CHARACTERISTICS

Risk Rating	Lifecycle	General Definition	Construction Risk	Project Cash Flow & Contingency Reserves or Collateral	Market Environment	Economic Value	Financial Strength of Developer / Guarantor
6	Market/ Stable		Project construction has been completed.	Unanticipated tenant vacancy or rate movements impact debt service with no cash reserves to carry.	Market conditions have deteriorated. Debt service or economic value may be in jeopardy because future leases may be affected by reduced demand or excess market supply.	Refinancing at maturity is in question. Collateral coverage protects the loan and there is sufficient time before maturity to correct.	Developer or guarantor has financial problems which could adversely impact the success of this project. All other conditions remain stable.
7	Construction	Repayment sources are in jeopardy. Any one of the conditions detailed for a 6, if advances, or any two conditions may result in a 7. A strong guarantor may offset value impairment and deficit cash flows.					
7	Market	Project has been completed.	Same as above	Same as above	Same as above	Same as above	Same as above
8			Potential loss; however, amount cannot be determined. Collateral coverage or the support of a strong guarantor is lacking.				

RATINGS 5 - 7

COMMERCIAL REAL ESTATE EARLY WARNING INDICATORS

These early warning indicators have been developed as a guide and have been left general in nature. Lending Officers must still use their discretion in assessing these indicators, for definitions such as these will never address every risk characteristic nor special circumstances.

Any one or combination of these characteristics may or may not be sufficient to move the credit rating to 5, 6, or 7. There will be varying degrees of severity or duration which will determine which rating is appropriate.

Any real estate loan believed to be a potential problem or evidencing any of the following “Red Flag” characteristics should be reported immediately to the Senior Lending Officer for review.

1. General Loan Characteristics

- Interest or other contingency reserves have been depleted
- Delinquent payments (i.e., interest, taxes, insurance, etc.) and/or change in payment pattern (for any loan which is subsidized or supported by a third party because contingency reserves have been depleted)
- Requests for extensions, waivers, or similar changes in conditions or terms of the loan - especially if these were not provided for in the original documents
- Lapse or inadequate insurance coverage
- A new subordinated lender or partner involved in the project
- Deferred maintenance has been noted and has not been corrected in a timely manner
- Environmental issues are raised which may lower the market value of the property, hinder completion or occupancy of the project, or result in a need for cash outlays to correct a condition

2. Construction Risk Characteristics

- Loan is “out of balance” and borrower is unable or refuses to contribute required equity
- Cost overruns which change the scope or nature of the project (i.e., improvements of a special purpose nature or over-improvements which may limit the refinancing/sale prospects for the project)
- Detrimental comments or concerns voiced by the inspecting architect, including hard costs exceeding physical completion
- Construction slower than typical or projected
- Major and/or numerous changes in plans and specifications
- Excessive change orders and/or substitution of lower quality materials
- Poorly documented draws, the filing of liens, or numerous or unusual inquiries from subcontractors, title insurance, or others involved with the project
- Threatened action or delays in approval by any governmental agency or public utility
- Change in project management, or other significant staff turnover
- Project not tracking to takeout commitment requirements

3. Project Cash Flow Characteristics

- Projected or actual depletion of interest reserve and/or operating deficit reserve funds and the project does not cover debt service of at least 1.0:1

A 6 rating is generally appropriate in cases where operating income and/or cash reserves may not be sufficient to carry the project to break-even. A pass rating may be appropriate where current financial information and performance demonstrate the developer/guarantor has the capacity and commitment to carry the project.

A 7 rating would be appropriate if it is felt the developer/guarantor is either unable or unwilling to support deficits, and there is insufficient operating income and/or cash reserves.

RATINGS 5 - 7

COMMERCIAL REAL ESTATE EARLY WARNING INDICATORS

In both cases, the ability and timing for NOI to support refinancing must be considered. If value is impaired, a more severe rating or additional reserve allocations must be considered.

- Aggregate lease expirations exceed 30% in the next 12 months
- Preleasing contracts voided
- Increasing vacancy, decreasing effective lease rates, increasing expenses, or the offering of concessions

4. Market Characteristics

- Leasing is 5% or more behind pro forma for three consecutive months
- Unanticipated concessions are being granted in the marketplace to attract tenants
- Deteriorating economic climate such as increase in competition, increase in supply, decrease in demand, or increase in interest rates
- Major variances from original underwriting assumptions, (e.g., market rates, vacancies, tenant finish, or concessions, etc.)

5. Borrower / developer / guarantor characteristics

- Changes in key personnel/management or responsibilities of key personnel have changed
- Borrower is unresponsive or uncooperative to requests to furnish information on the project or overall financial condition
- Delays in closing on permanent financing
- Occupancy, cash flow, or financing problems in other real estate owned/developed by the borrower
- Problems or renegotiations by borrower on other debt
- Legal actions, including significant mechanics liens, against borrower, developer, guarantor, partner, contractor or other concerned party
- Adverse publicity about borrower, project or related entity
- Change in the borrower's auditor or the opinion expressed in the audit
- A failure by the borrower to provide current financial statements and/or a deterioration in the borrower's financial condition
- Relationship problems among partners, owners, or investors
- Change in communication pattern from borrower
- Borrower or guarantor going into bankruptcy

