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WD - Q4 2013 Walker & Dunlop Inc Earnings Conference Call

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PRESENTATION

Operator

Welcome to Walker & Dunlop's fourth quarter and full year 2013 earnings conference call and webcast. Hosing the call today from Walker & Dunlop is Willy Walker, Chief Executive Officer. He is joined by Steve Theobald, Chief Financial Officer, and Claire Harvey, Vice President of Investor Relations. Today's call is being recorded and will be available for replay beginning at 10.00 AM Eastern. The dial-in number for the replay is 800-283-4216. At this time all participants have been placed in a listen-only mode, and the floor will be open for your questions following the presentation. (Operator Instructions).

It is now my pleasure to turn the floor over to Claire Harvey, please go ahead.

Claire Harvey - *Walker & Dunlop, Inc. - VP, IR*

Thanks Zach. Good morning everyone, thank you for joining the Walker & Dunlop fourth quarter and full year 2013 conference call. I have with me this morning our Chairman and CEO, Willy Walker, and our CFO, Steve Theobald. This call is being webcast live on our website, and a recording will be available later this morning. Both our earnings press release and website provide details on accessing the archived call.

This morning we posted our earnings release and presentation to the Investor Relations section of our website, www.walkerdunlop.com. These slides serve as a reference point for some of what Willy and Steve will touch on this morning. Participants who are interested in following along should pull those up and have them available.

Please also note that we may reference certain non-GAAP financial metrics, such as adjusted net income, adjusted earnings per diluted share, adjusted operating margin, adjusted income from operations, adjusted EBITDA, and adjusted total expenses during the course of this call. Please refer to the earnings release and the presentation posted on our website for a reconciliation of the GAAP and non-GAAP and related explanations.

Investors are urged to carefully read the forward-looking statements language in our earnings release. Statements made on this call which are not historical facts may be deemed forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements including statements regarding future financial operating results involve risks, uncertainties and contingencies, many of which are beyond the control of Walker & Dunlop, and which may cause actual results to differ materially from the anticipated results. Walker & Dunlop is under no obligation to update or alter our forward-looking statements, whether as a result of new information, future events, or otherwise. We expressly disclaim any obligation to do so. More detailed information about risks factors can be found in our reports on file at the SEC.

With that, I will turn the call over to Willy.

Willy Walker - *Walker & Dunlop, Inc. - Chairman, CEO*

Thank you Claire. Thank you everyone for joining us on this snowy morning in Washington, DC. 2013 will go down as a transformative year for Walker & Dunlop, and I am extremely proud of all we accomplished. Although our loan origination volumes did not hit the guidance we established at the beginning of the year, we were able to work through the surprise GSE Loan origination caps and rising interest rates to increase origination volumes 18% year-on-year, while growing revenues 24%. 18% growth in origination volumes outpaced the industry by 3 percentage points, and was thanks to the investments in origination talent we made in 2012.

Two years ago we outlined a strategic plan that contained four major goals. First, we told investors that we would continue to do as much business with the agencies as we possibly could. Although FHFAs arbitrary caps on Fannie and Freddie, along with HUD running out of commitment authority twice, had significant impacts on our business in 2013. Our origination volumes of $2.8 billion, $1.7 billion, and $1.1 billion respectively allowed us to finish the year as Fannie Mae's largest [dust] lender for the second straight jeer. Move up from being the fourth largest Freddie Mac program plus seller to number three, and to move from the sixth largest HUD originator to number five.

With a new permanent director at FHFA and an approved 2014 federal budget, we begin 2014 with the assumption that the exogenous regulatory and governmental shocks that these three lines of business suffered in 2013 will not be repeated. Our jump up the league tables in 2012 was due to the combination of Walker & Dunlop and CWCapital. But the numbers we put up in 2013 came from a fully integrated, highly cohesive Walker & Dunlop. These origination numbers and rankings speak volumes about the team, culture and origination talent we have today.

The second piece of the strategy outlined in 2012 was to grow our capital markets business to increase our access to deal flow. As demonstrated on slide seven, we made great hires in 2012, and those hires paid off in 2013, with brokered originations reaching $2.6 billion, and growing 117% year-on-year. The growth in this business line has done many things. First, it is expanded our physical footprint by adding new offices and employees in Florida, Wisconsin, Texas, Arizona, and California. Second, it has expanded our access to capital by bringing new lending relationships with life insurance companies and CMBS lenders. Third, it has expanded our client bass. And finally, it has expanded dramatically our access to deal flow on non-multifamily assets, such as office buildings, retail malls, and hotels. This line of business is not as profitable as our agency lending businesses, where we booked significant Mortgage Servicing Rights, but it is a solid business on its own, and it adds a tremendous amount to Walker & Dunlop from an origination and diversification standpoint.

The third piece of the strategy we outlined in 2012 was to raise proprietary capital to feed into this expanding origination platform. We started the year originating loans for our balance sheet, and in Q3 we partnered with two large institutional investors to begin a large loan bridge program, that allows us to compete head to head with large banks and mortgage REITs on interim and bridge financing. In Q4, we announced the formation of a CMBS platform with our largest shareholder, Fortress Investment Group. Almost $90 billion in commercial property financing was done in 2013 with CMBS lenders, and it is estimated the number could be over $100 billion in 2014. We have our partnership with Fortress completed. We have hired our team. And we expect to be accepting our first loan applications during the first quarter .

The fourth and final component of the strategy outlined in 2012 was to have over 50% of our revenues derived from servicing and asset management fees by 2017. As shown on slide nine, we have seen tremendous growth in our loan servicing portfolio, increasing at 11% in 2013 over 2012, and 166% since going public in 2010. Servicing fees in 2013 were $90.2 million, representing 28% of revenue, up from $52.2 million, or 20% of revenue in 2012. As we continue to grow our servicing portfolio, and raise proprietary capital to fund our lending operations, we will transform Walker & Dunlop more and more into an asset management firm.

Our 2013 numbers reflect a fantastic job by our origination team of staying focused on our existing businesses to remain one of the largest providers of capital for Fannie, Freddie, and HUD in an extremely challenging environment, while at the same time they showed the investments we made in 2012 to grow our origination platform and expand our product offering having a material impact on our results. W&D is a vastly different company today than it was a year ago, and I am both thankful for all of the hard work that got us here, as well as excited about what this Company can do going forward.

I will now turn the call over to Steve, and come back to talk about what we see happening in 2014. Steve.

Steve Theobald - *Walker & Dunlop, Inc. - CFO*

Thank you Willy, and good morning everyone. I am going to spend the majority of my time this morning on our full year results, while providing highlights to some important transactions and trends in the fourth quarter. Net income for 2013 was $41.5 million, or $1.21 per diluted share, compared to $33.8 million, or $1.31 per diluted share in 2012. Adjusted net income which excludes certain non-operating items was $44 million, or $1.28 per diluted share, compared to $48.4 million, or $1.87 per diluted share in 2012. Adjusted EBITDA for 2013 was $56.8 million, a significant increase from $29.4 million in 2012.

Operating margin for 2013 was 21%, and adjusted operating margin was 22%, compared to 22% and 31% respectively in 2012. As Willy mentioned, we made tremendous progress during 2013 in the execution of our diversification strategy, with brokered and interim loans accounting for 33% of our $8.4 billion of origination volume, compared to only 17% in the prior year. As we have discussed in our previous conference calls, many of our financial metrics were affected by the shift in mix during 2013, and I will spend additional time on this morning's call explaining those effects. We expect to see our non-agency originations continue to be a significant and growing portion of our overall volumes, as we strategically grow these areas of our business, so it is important for our investors to understand the impacts of this growth on our financial results going forward.

Let's start with revenue. Total revenue for the year was $319 million, a 24% increase over 2012, driven by increased mortgage banking gains and servicing fees. Mortgage banking gains increased by 9% in 2013 on 18% volume greet. Here we see the impact of the shift in mix., lower mortgage banking margins.

Looking at slide eight our mortgage banking margins in 2013 were 243 basis points compared to 262 basis points in 2012, with all of the decline coming from Mortgage Servicing Rights. However, if you look at the dotted green line on the graph which shows the gains attributable to MSR as a percentage of only GSE and HUD originations, you can see that excluding the impact of our brokered originations, our margin actually rose from 158 basis points in 2012 to 164 basis points in 2013. The point here is that the decline in our mortgage banking margin is a function of the change in our mix of originations, as our origination fee and servicing margins by product remained at very healthy levels during 2013.

As Willy mentioned servicing revenues were $90.2 million for the year, an increase of 73% over 2012. Our servicing portfolio is now at $38.9 billion and continues to grow, adding net loans of $3.8 billion during the year, and our weighted average servicing fee remains at 24 basis points. During the fourth quarter, Fannie Mae sold $515 million of its small loan portfolio that we serviced on their behalf. As a result, we transferred those loans out of our servicing portfolio and received a termination fee from Fannie Mae of $1.8 million, which is included in other income.

We do not expect this transfer to materially impact our servicing revenues going forward, given the relatively small size of the pool, and the fully amortizing nature of the underlying loans. We have integrated and operated the combined servicing portfolio for a little more than a year, and now have the eighth largest commercial servicing portfolio in the country. This size and experience should allow us to achieve improving economies of scale and cash flows, as we continue adding new volume to the platform with little incremental cost.

Turning now to expenses. Our total expenses for the year were $252.3 million, up 25% over last year. The increase in total expenses was largely due to the $24.6 million increase in personnel expense, and a $22 million increase in amortization and depreciation. Most of the increase in expenses is due to the fact that 2013 is our first full year as a combined enterprise following the CWCapital acquisition. As a result, looking at certain expense relationships, is more useful than talking about the absolute dollar amounts of the changes.

For example, slide 10 provides some analysis related to our adjusted expenses as a percentage of revenue. Total compensation expense as a percentage of revenue was flat at 42%. While amortization and depreciation expense increased to 24% of revenue compared to 21% of revenue in 2012. On compensation expense, the fixed portion of our compensation as a percentage of revenue increased over 2012 as we added head count during the first half of 2013 in anticipation of higher volumes. Going forward, I would expect that percentage to decline with the actions we took in October to reduce head count. Variable compensation expense actually declined as a percentage of revenue, due largely to the fact that more of our revenues came from non-origination sources like servicing and interest income, and our discretionary bonus payments were less in 2013 than they were in 2012.

Our amortization and depreciation expenses have increased due to the significant increase in our Mortgage Servicing Rights. We expect that overall amortization expense will continue to increase given the growth in our MSRs, but it will be a lower percentage of our revenues over time. As I just mentioned and as we discussed during our last earnings call, we took several actions related to our cost structure in the fourth quarter. First, we significantly downsized one of our offices upon the departure of the only loan originator in that office. Second, we shut down our small loan lending group, and finally, we eliminated a number of positions across the organization where we felt we had excess capacity. All told, we reduced our head count by a little more than 50 employees, and we took a charge for severance and lease costs of approximately $700,000.

Also during the quarter we closed on our $175 million debt facility. Approximately $75 million of the proceeds were used to pay off our previous term loan, which resulted in the write-off of $1.2 million in deferred issuance costs that were being amortized over the life of the debt. The remaining proceeds of the new term loan will be used to fund our proprietary capital initiatives, opportunistically repurchase Company shares, and for general corporate purposes.

Turning now to credit, we continue to see favorable trends in our portfolio, with very low delinquencies and losses. At the end of December we had only one loan in our at-risk portfolio that was over 60 days delinquent. With the increase in our on balance sheet interim lending portfolio, we took the step in the fourth quarter to provide an allowance for loan losses in the amount of $441,000 against this portfolio. This allowance represents a general reserve, as every loan in the portfolio continues to pay and perform as expected.

I want to now touch briefly on operating margin, as this is another metric that is heavily influenced by the breadth of our originations. Our adjusted operating margin declined in 2013 to 22% from 31%, as the combination of the higher percentage of brokered originations, investments in proprietary capital, and an elevated expense base contributed to the decline. We believe we have taken the appropriate actions to address operating expenses during the fourth quarter. However, we will continue to invest in future growth, and do not plan for the GSEs to get back to 70% of our business. As a result, over the near-term we expect operating margins to remain in the low to mid 20% range, but where we ultimately end up will be a function of mix.

Shortly after the IPO, when the Company was smaller and mostly a Fannie Mae lender, it made sense to provide volume guidance which the Company routinely met or exceeded. In addition, the dominance of the Fannie Mae business made it easier to predict a range of earnings generated by that volume. As we have grown and become more diverse in our capabilities, it has become more challenging to provide a meaningful range of future annual and quarterly origination volumes, particularly when significant differences in the mix from quarter-to-quarter can create significant differences in the bottom line.

Perhaps no quarter illustrates this better than the second quarter of 2013,where we delivered volumes right in the middle of the guidance range but missed consensus earnings per share estimates. Since we were given guidance on a metric that was not adding the desired clarity to estimates of our future financial performance, we considered either giving additional guidance or giving none at all. Since loan originations can fluctuate dramatically, and we have no way to predict precisely whether we will finance a loan with the agencies on our balance sheet, or brokered through a third party, each of which has a distinct profit profile, we have decided to no longer provide loan origination guidance.

It is our hope that more focus is placed on our revenue and EPS growth, as well as a number of other metrics we are focused on. For example, this quarter we are providing adjusted EBITDA information for the first time. We believe this is an important measure for us, as it provides a proxy for cash flow before interest and taxes, and really focuses on the cash generation of our underlying businesses, as well as providing a guidepost for our ability to effectively and prudently use leverage.

Slide 11 shows the trend in adjusted EBITDA over the last five years, with a dramatic increase in 2013, driven by the surge in servicing fees and our increased origination activity. Looking ahead we expect our servicing portfolio to continue to grow, and with future growth in our proprietary capital initiatives, adjusted EBITDA to grow as well. Slide 11 also shows the trend in our return on equity since the IPO. The decline from the high in 2011 is a function of the additional capital used to acquire CW in 2012, and the outsized returns generated in 2011 by a business with a significant concentration in the GSEs.

Going forward, we are targeting a return on equity in the low to mid-teens, which we think offers a sustainable attractive return for a diversified lending business. Improvements in our returns will come from increasing our servicing and asset management revenues, as those activities require less capital than our lending businesses. Of course, we will also improve our ROE by simply growing our earnings. Before I turn the call back to Willy, I want to take a few moments to discuss how our proprietary capital initiatives will impact our future results, as the effects on our financial measures will be different than our core origination businesses.

Let me start with our on balance sheet interim loans. These loans are included in our interim loan originations, and are carried at historical costs, with all origination fees and costs deferred and recognized over the life of the loan. As a result, there is no immediate revenue recognition when we originate these loans. Rather, we recognize the net interest income associated with this portfolio over time, and report that income as a component of our net warehouse interest income.

For our large loan bridge venture, those loans also are included in our interim loan originations, with any origination fees and expenses running through our financial statements in a manner similar to a brokered origination. We do not record a mortgage servicing right for those loans, instead we will receive an asset management fee based on the total amount outstanding in the venture, which we will include in other revenue. In addition, as the owner of 5% of the entity, we will record 5% of the net earnings of the venture each quarter, also through other revenue.

The impacts of our conduit business will be slightly different based upon the source of the origination. For example, any loan sourced to our conduit by a Walker & Dunlop originator will be reported as a Walker & Dunlop origination, and will appear in our income statement similar to a brokered origination. We will record origination fees and commission expenses on these loans but no Mortgage Servicing Rights. Conduit loans that are sourced by the originator specifically dedicated to the conduit venture will not be reported as Walker & Dunlop originations, so there will be no immediate P&L impact from those loans. We will act as the primary servicer for all of the loans in the conduit irrespective of where they originated, and the benefit of that will through servicing fees each quarter. Finally, each quarter we will be recording our 20% share of the conduit ventures' net earnings as of the revenue.

To summarize, we expect the growth in our proprietary capital initiatives will result in the following impacts to our key metrics. Margin on mortgage banking gains will decline, because we are not recording mortgage servicing rights on any of the proprietary capital originations. Our servicing portfolio will continue to grow, but proprietary capital servicing will put downward pressure on our average servicing fees, as those loans generally offer lower servicing fees than our existing core business. However, this effect may not be visible for several years, given the size and dynamics of our existing portfolio.

Finally, our proprietary capital initiatives should result in increases to operating margins, adjusted EBITDA, and returns on equity, as we are picking up additional revenues from the ventures, without adding significant expenses, and with less capital required. We made great progress in 2013 towards our goals of product and revenue diversification. The business is financially sound, and with $170 million in cash we are poised for a successful 2014 as well.

With that, let me turn it back to Willy.

Willy Walker - *Walker & Dunlop, Inc. - Chairman, CEO*

Thanks, Steve. I would reiterate Steve's comment about the dramatic growth in adjusted EBITDA. We have grown our cash flow in adjusted EBITDA dramatically, as we have increased the size of our servicing portfolio. The average life of our servicing portfolio is approximately ten years, and over 90% of the loans in the servicing portfolio are pre-payment protected, making our servicing asset both reliable and very valuable. At the end of 2013, the servicing portfolio was valued by a third-party firm at $415 million, comprising 80% of Walker & Dunlop's current market capitalization.

As I mentioned previously, it is our assumption that the exogenous regulatory and governmental shocks that GSEs and HUD experienced in 2013 don't repeat themselves in 2014. We have no ability to predict what FHFA under Director Mel Watt will do with its 2014 scorecard for Fannie and Freddie. From conversations with regulators, government officials, and industry association executives however, it is our assumption Fannie and Freddie's multifamily lending and caps are unchanged from 2013 at $30 billion and $26 billion respectively. With $56 billion to lend between the two of them, Fannie and Freddie will still be the dominant sources of capital for the multifamily industry in 2014. Walker and Dunlop has every intention of being the largest Fannie Mae dust lender again, and we will work tirelessly to try and move up to number two with Freddie Mac.

It should be noted that we dropped the percentage of originations with Fannie and Freddie from 70% in 2012 to 52% in 2013, it is our strategy to do as much with the agencies as we possibly can, yet continue growing our other lines of business to broaden our lending platform. What we do see developing more generally is a very robust, highly competitive real estate finance industry. After growing 15% in 2013, commercial mortgage originations are expected to increase 7%, to $300 billion in 2014, per the Mortgage Bankers Association forecast. With only $92 billion of that $300 billion being loan maturities, the name of the game in 2014 will be winning new financings on properties that are being sold, properties coming out of construction financing, or on properties where the owner decides to refinance the existing mortgage before its maturity date for tax or interest rate reasons. Scale will matter in this financing environment, and W&D's stature as one of the largest commercial real estate finance companies in the United States makes a big difference when capital is abundant.

Walker & Dunlop has grown originations at a compound annual growth rate of 26% since 2007, and 38% since going public. Our sales force has never been bigger. Our client relationships have never been deeper, and the breadth of our financing solutions we are offering has never been more diverse.

Our entry into the CMBS market is highly anticipated. We have a fantastic partner in Fortress, we have assembled a first rate management team, and we have a tremendous distribution network to feed loans into our CMBS execution. I previously mentioned that over $90 billion of CMBS originations were done in 2013, which includes both single issuer and pooled CMBS. The Mortgage Banker's Association tracks pooled CMBS originations, which reached $49 billion in 2013, and is forecasted to increase by almost 25% to $61 billion in 2014, by far the largest year-over-year jump of any source of capital. We expect to start issuing loan applications during the first quarter, and do our first securitization in early Q2 .

Life insurance companies are projected to grow their originations moderately in 2014, from $63 billion last year to $65 billion this year. $65 billion will be a new record lending level for insurance companies. Walker & Dunlop expanded our life insurance company correspondent relationship significantly over the past year, and as shown on slide seven, life insurance originations by our capital markets team grew from 55% of brokered originations in 2012 to 62% in 2013.

The execution of our strategy to build the premier commercial real estate financial company in the United States now provides our sales force a broad array of financing solutions for its customers. We can connect our borrowers with traditional third-party capital providers, such as our Best-in-Class agency executions, a network of life insurance companies, CMBS, and banks, or through any of our proprietary capital solutions, such as our on balance sheet interim loan program, the large loan bridge program, or our newly formed CMBS conduit. This access to a variety of capital provides a compelling platform for talented loan originators to meet their client's financing needs.

With that as a backdrop, we will continue to expand our sales force in 2014, adding origination talent across the country. With all of the supply of capital, 2014 will be a challenging year for lenders. There is robust competition for origination talent, as well as access to clients. But this is where Walker & Dunlop differentiates itself. We have been named one of the Great Places to Work by the Great Places to Work Institute and Fortune Magazine for two consecutive years. We have effectively and efficiently integrated Walker & Dunlop and CWCapital, making Walker & Dunlop one of the most recognized brands in our industry. We have worked with many clients for decades, and have in those relationships a deep sense of trust and flawless execution.

And in the Multifamily arena we are clearly viewed as the lender who has done more to advance the cause of Fannie Mae and Freddie Mac's Multifamily businesses on Capitol Hill than any other lender in the country. We live in a highly competitive industry, where the only difference between our money and someone else's are the people at Walker & Dunlop, and the terms and conditions under which we will lend our money. But Walker & Dunlop's culture, people and track record do make a difference. And we demonstrate that every day of every year. We have a great team. We have great clients. We have a dramatically diversified business from just a year ago, and we very much look forward to continuing to grow, and providing our shareholders with fantastic returns over the coming years.

With that, I would like to thank everyone for joining us this morning, and ask the operator to open the line for questions.

QUESTIONS AND ANSWERS

Operator

The floor is now open for questions. (Operator Instructions). I will pause for a moment to allow questions to queue. We will take our first question with Steve DeLaney with JMP Securities. Please go ahead.

Steve DeLaney - *JMP Securities - Analyst*

Thank you. Good morning everyone. Pretty impressive that you all made it in, with the snow down there. So I guess Willy I would like to pick up on your comments about the CMBS conduit joint venture. You may have noticed last week there was a new IPO in the market for a company called Ladder Capital, whose primary business is CMBS conduit originations and sales. I guess what I wanted to ask you about, I know it is early on, but it appears in that business, and it will all depend on I guess where spreads are on AAAs and levels of competition, but it would seem that gain on sale margins, in recent years have been anywhere from 5% to 7% of the principal balance of the loans, and ROE opportunities in excess of 30%. As you look at that business, do you see that new addition to potentially being the highest ROE business that Walker & Dunlop may be entering?

Willy Walker - *Walker & Dunlop, Inc. - Chairman, CEO*

Steve we clearly saw Ladder go public, and I congratulate them for getting out, and getting out what I think is a very healthy valuation. And as you rightly describe, gain on sale margins have been quite high in the CMBS lending space over the past couple of years. It is not our expectation that they remain that high going forward.

Steve DeLaney - *JMP Securities - Analyst*

Right.

Willy Walker - *Walker & Dunlop, Inc. - Chairman, CEO*

I believe that there were at the Mortgage Banker's Association conference last week in Orlando the count was I believe 38 conduits up and going today, and so it is a very competitive and very robust environment, and so I think the pricing actually that people are looking at right now is 4% on the high side, 3% as your average, and many people modeling out closer to 2%. But it is still a very healthy business, and with the current interest rate environment, which is for lack of a better term somewhat benign in that rates aren't spiking up and down, there is obviously rate movement on a daily basis but not to the degree that makes securitization difficult. If we stay in a relatively moderate volatility interest rate environment, doesn't really matter whether they continue to go up slowly or come down slowly, you will be able to see I think a very robust securitization market. If we get big fluctuations in interest rates, as we saw in sort of May and June of last year, clearly the CMBS market has a very difficult time pricing and selling in that type of an environment, and that would slow down the originations we see at the conduit.

Steve DeLaney - *JMP Securities - Analyst*

Sure. And Steve touched on this but I think it is important from a capital efficiency standpoint, I understand you won't be, while you will be servicing loans you won't be booking MSR, and the gain on sale that you do book will be a cash gain?

Steve Theobald - *Walker & Dunlop, Inc. - CFO*

That is correct, Steve.

Steve DeLaney - *JMP Securities - Analyst*

Okay, thanks. And one final thing Willy I noticed there was a 8-K filed yesterday, indicating that Mr. Taylor, who represented Credit Suisse would not stand for re-election. Recently we have seen some 144 A filings, and we don't let these numbers are precise, this is what we had, that they owned about $2.9 million, or 8.4% as of September 30, but it appears that they may have sold as much as one-third of that position based on the 13 Ds we have seen. Do you have any view or insight as to what their plans are with the balance of their position, and would it be conceivable that Walker & Dunlop may be able to negotiate some kind of a block trade using the senior facility? Thank you.

Willy Walker - *Walker & Dunlop, Inc. - Chairman, CEO*

Sure, Steve. First of all, Mr. Taylor is stepping off the Board as CS no longer has a right to a seat on the Walker & Dunlop Board. Mr. Taylor has been appointed to a new position inside of Credit Suisse, and it may sense for him to step off the Board at this time. So nothing other than normal course of business ought to be read into that.

And then as it relates to CS and their position, they have as you accurately stated had a 10-B-51 filed since I believe either late 2013, or just at the beginning of 2014. I think the numbers that I have is that they sold about 0.5 million shares over the last month-plus, and whether they keep that 10-B-51 in, pull it, look for a block trade, I honestly don't know. With their current share holding level, CS has gone from being a very significant shareholder in Walker & Dunlop to not that material a shareholder in Walker & Dunlop. We have enjoyed having them as a partner. We made them a lot of money on the acquisition of Column, and the stock that they took in Walker & Dunlop, and as you probably know, we do quite a bit of business on the trading side of sales of securities with Credit Suisse, and it would be great to see the partnership between our two companies continue to expand, but I don't think anything ought to be read into Mr. Taylor stepping off the Board, either from a growth of the partnership, and I can't tell you anything as it relates to their plans for their shares.

Steve DeLaney - *JMP Securities - Analyst*

Okay. Appreciate all of the comments, and best of luck in 2014. Thank you.

Willy Walker - *Walker & Dunlop, Inc. - Chairman, CEO*

Thanks, Steve.

Operator

We will go next to Jason Stewart with Compass Point. Please go ahead.

Jason Stewart - *Compass Point - Analyst*

Good morning, thanks. Willy, I appreciate your comments on your expectations for FHA lending caps in 2014. But I am also curious to know what your thoughts are on how you think the market, and particularly Fannies, have been operating year-to-date, whether they are operating under that assumption or whether they are a little bit more conservative.

Willy Walker - *Walker & Dunlop, Inc. - Chairman, CEO*

Jason, both Fannie and Freddie are operating under that assumption. So it is business as usual, and I believe both of them from plenty of discussions with them are operating under the assumption that Fannie has got 30, and Freddie has got 26, but clearly until Director Watt comes out with a scorecard nobody will know for sure what it looks like, but that is the way that they are operating, and if you will for all practical purposes it is business as usual.

Jason Stewart - *Compass Point - Analyst*

And so when we look at Fannie's Multifamily in January at $1.4 billion it is clearly low, how much of that do you think was pulled forward into last year, and is refilling of the pipeline, et cetera, just due to seasonality? And secondly do you think Watt actually does come out with a scorecard this year, or is it going to be business as usual to operate under 2013's? And my question really centers around there was so much uncertainty created by the scorecard in March or April of last year, and we will see uncertainty rather than the level created more of a problem in the market.

Willy Walker - *Walker & Dunlop, Inc. - Chairman, CEO*

Yes, so Jason, your first point as it relates to Fannie's January volumes, as you know both Fannie and Freddie worked very hard to hit their lending caps in 2013, and Freddie, if you will, landed the airplane right on the aircraft carrier, right at their cap of $26 billion. And Fannie came in at $28.8 billion, so 1 billion two below the $30 billion cap. But they pushed very hard to get as much done in 2013 as they could before the end of the year. And as such there is very little carry over business between 2013 and 2014.

I believe last January Fannie did over $4 billion in the month of January, and so what you are seeing is a lot of carry over last year, which quite honestly caused them even a heightened problem when FHFA came out with their cap last year, because Fannie had such a robust January and February, that they were well ahead of what that cap would have done, which caused them to put on the brakes even further. So I think what you are seeing set up in 2014 is really business as usual in the sense of getting to that $30 billion, and not having a lot of fall over from 2013 into 2014 to have them have to put on the brakes at any time.

More specifically, on the scorecard, clearly Director Watt can do whatever he sees fit. I would say that most people expect him to come out with a scorecard, because the last scorecard did cause the questions that you accurately mentioned, and the one thing that we have been talking to both the regulator as well as the agencies about, is making sure that the scorecard is not a one-year scorecard like last year's but a multi-year scorecard, so that we and other industry players, as well as our investors have some visibility as it relates to where FHFA would like to see Fannie and Freddie's Multifamily businesses go over several years as the legislative debate on Capitol Hill moves forward.

Jason Stewart - *Compass Point - Analyst*

Okay. Thank you. That is great color. Thank you for that. One final and I will jump out, when I heard Steve, and if I missed this let me know, I don't want to read too much into this, I heard Steve mention uses of proceeds from the debt, number one lending, number two share buybacks and I didn't hear anything about an acquisition, and I know that was something listed previously as potential use of proceeds, am I reading too much into it to say you think you can do this organically and are not looking at acquisitions, or is that still on the table?

Willy Walker - *Walker & Dunlop, Inc. - Chairman, CEO*

Very much still on the table. Sorry, Jason, you are correct, in the data offering it is in there and we were quite honestly trying to be as consistent as possible, and we left it out. We are as you can imagine out looking at a number of different opportunities, nothing to talk about at this point, but the continued diversification of our platform, and the growth in our asset management business is really the focus.

Jason Stewart - *Compass Point - Analyst*

Okay. Thank you.

Operator

We will go next to Brandon Dobell with William Blair, please go ahead.

Brandon Dobell - *William Blair & Company - Analyst*

Thanks, good morning. Couple of quick ones following on the agency question, I know that it sounds like the expectation is for no change in total volume. How do you think about the change perhaps in mix, i.e. more focus on affordable, less focus on kind of Class A brass and glass Multifamily, any comments there about what that may or may not do for you guys?

Willy Walker - *Walker & Dunlop, Inc. - Chairman, CEO*

Brandon, good morning.

Brandon Dobell - *William Blair & Company - Analyst*

Good morning.

Willy Walker - *Walker & Dunlop, Inc. - Chairman, CEO*

For once we have worse weather in Washington than you have there.

Brandon Dobell - *William Blair & Company - Analyst*

I think the only time this year though.

Willy Walker - *Walker & Dunlop, Inc. - Chairman, CEO*

Exactly, although I think it is probably colder there than it is here because of the rain, which is pretty terrible.

Brandon Dobell - *William Blair & Company - Analyst*

Probably.

Willy Walker - *Walker & Dunlop, Inc. - Chairman, CEO*

So your question is a very good one. As you well know, FHFA under de Marco was very focused on, if you will, Fannie and Freddie lending in the high end of the market, and trying to get them to move, if you will, further down towards moderate and affordable lending. That theme in the general discussion has died down somewhat, but it is still very much on the table and something that people are talking about. The most recent discussion is keep their caps where they are, and then allow them to do as much affordable as they can possibly do. So if Fannie and Freddie want to grow beyond their caps of 30 and 26, do it in the affordable space. And if you did that, you would allow them to continue to do all they want in the high end, but you would also get what many people have talked about, which is increased capital going to affordable housing. That may be accepted by FHFA.

I spoke to them about it last week on specifically that point, and they may come out with something that talks about trying to get more of their capital going to more affordable housing. I have also pointed out to both FHFA and HUD that in the 2014 federal budget, HUD has $30 billion of capital for Multifamily and health care lending. That $30 billion is almost 3X what they had just three years ago. And so one of my comments to people across the board is if you really want affordable housing to get additional capital, there is plenty of it in the HUD budget, just make HUD that much more efficient to be able to meet the market opportunity.

To be honest with you, not many people have really liked that statement, because I think it would force HUD to get a little bit more competitive, and it would also allow Fannie and Freddie to go do whatever they wanted. But the bottom line is affordability is still very much a theme. I would not be surprised if Director Watt is focused on affordability. But at the same time, the general discussions are the FHFA scorecard last year was the 10% arbitrary cut was 100% arbitrary, it had no long-term goal behind it, and it was not the right thing to do. So what we are hearing now is you need to back off of that, but where they go on the longer term strategy quite honestly Brandon, we will see when the scorecard comes out.

Brandon Dobell - *William Blair & Company - Analyst*

Okay. Fair enough. You mentioned during the call about the slice of loans sold in the servicing portfolio, where you got the termination fee. How do you gauge I guess the risk of more of those types of transactions happening where the servicing balance declines either marginally and materially as one of the agencies sells a portfolio to somebody else, would you expect a pick up in that activity, no change? Just trying to gauge I guess the risk to that servicing portfolio from those types of secondary market transactions?

Steve Theobald - *Walker & Dunlop, Inc. - CFO*

Brandon, this is Steve. I'll take that one.

Brandon Dobell - *William Blair & Company - Analyst*

Thanks.

Steve Theobald - *Walker & Dunlop, Inc. - CFO*

Yes, from my perspective, this was really an isolated, unique situation having to do with a cash balance portfolio.

Brandon Dobell - *William Blair & Company - Analyst*

Okay.

Steve Theobald - *Walker & Dunlop, Inc. - CFO*

That Fannie held. That they wanted to get off their balance sheet. There is really not much if anything like that left in our servicing portfolio, so I don't really see this as a trend per se as much as just a one-off transaction.

Brandon Dobell - *William Blair & Company - Analyst*

Okay. Any color on what the mix of property types from an origination volume point of view look like in 2013 versus 2012? I.e. Multifamily, health care, office, and is there any color on where you think looking out over the three to five-year time frame, what the mix of originations may look like from a property perspective?

Willy Walker - *Walker & Dunlop, Inc. - Chairman, CEO*

We haven't given guidance on the long-term trend, if you will, or the break out in the mix. Steve just turned to a slide, what slide is it?

Steve Theobald - *Walker & Dunlop, Inc. - CFO*

Seven.

Willy Walker - *Walker & Dunlop, Inc. - Chairman, CEO*

Slide seven that gives you a sense, Brandon, of the various asset classes that we lent on in 2012 and 2013. I would point out that one of the somewhat surprising data points is that 48% of our capital markets or brokerage activity in 2013, was on Multifamily. And I think that is important in the sense that had we not made the investments to grow that business line, the pull back by the agencies in 2013 would have been even greater on Walker & Dunlop's overall activity, because I think that shows very clearly that the deal flow came to Walker & Dunlop, but the agencies weren't competitive for it in 2013 because of the regulatory landscape, and we were fortunate enough to have people who took that deal flow and took it somewhere else, and were able to source it with a life insurance company or a CMBS lender.

And so I look back on 2013 and say first of all, that does show how uncompetitive the agencies became in 2013. I think we will see that change in 2014. And then second of all, thank goodness we have expanded our capital markets group to be able to take that deal flow and place it with another a source of capital. The other side to it is that as the economy continues to heal, I think that we will continue to see improvements in the office sector, in the retail sector, as well as in the hospitality sector, and so lending opportunities in those sectors I think will continue to be robust, particularly as we come into the refinancing wave of 2015, 2016, and 2017, when so much of those asset classes were financed by CMBS back in 2005, 2006, and 2007.

Brandon Dobell - *William Blair & Company - Analyst*

Got it. Okay. And final, Steve, you talked about low to mid 20s operating margins I believe as opposed to EBITDA margins, operating margins for now, if you guys are successful in driving those revenue targets you talked about with servicing and asset management, maybe it would seem like that the pressure on margins would be up as opposed to down, although I guess it depends on how big the agencies remain. Maybe just a little color on how that longer term revenue mix target or goal may impact what looks like low to mid 20s margins now? Thanks.

Steve Theobald - *Walker & Dunlop, Inc. - CFO*

And I agree, Brandon, with your premise. I think all things being equal, as we increase our revenues from our proprietary capital initiatives that should put upward pressure on operating margin.

Brandon Dobell - *William Blair & Company - Analyst*

Okay.

Steve Theobald - *Walker & Dunlop, Inc. - CFO*

Because essentially through equity pick ups on the various ventures that we are invested in, those come through as revenue with no expenses.

Brandon Dobell - *William Blair & Company - Analyst*

Got it.

Steve Theobald - *Walker & Dunlop, Inc. - CFO*

So the calculus is such that if you held everything else flat and that was the dynamic, it would increase operating margins, but obviously the rest of the business isn't static.

Brandon Dobell - *William Blair & Company - Analyst*

Right. Right.

Steve Theobald - *Walker & Dunlop, Inc. - CFO*

So it all depends on what flows through the mix master at the end of the day.

Brandon Dobell - *William Blair & Company - Analyst*

Got it. Alright. Thanks. Good luck with the snow today.

Steve Theobald - *Walker & Dunlop, Inc. - CFO*

Yes. Thanks.

Operator

We will take our last question from Charles [Navin] with Wells Fargo, please go ahead.

Charles Navin - *Wells Fargo - Analyst*

Good morning, and thank you for taking my call. In the past you have given an origination target for the CMBS business of $1 billion for the first year. My first question is does that still stand? And secondly, how should we think about the ramp up of that business over time?

Willy Walker - *Walker & Dunlop, Inc. - Chairman, CEO*

So the expectation is still that we will do $1 billion in the conduit in 2014, as I said previously to Steve Delaney's question, Charles, a lot of it obviously depends on the interest rate environment and volatility in interest rates. As it relates to the ramp, I would just go back to the Mortgage Banker's Association that CMBS pool originations grow by 25% year-on-year. Behind all of that I also pointed out that in 2013, there is going to be, their projection is $300 billion of total commercial real estate financing in 2014, and of that only $92 billion is coming off of refinancings, where loans are maturing in 2015 and needing to be refinanced. So you got $208 billion that is, if you will, new originations.

What ends up happening in 2015, 2016, and 2017 is the mix of refinancings versus new financings changes dramatically, and the refinancing volumes grow between 2014 and 2015 grow I think over 70% year-over-year, and so there is a big, big opportunity, because most of that refinancing volume is coming out of CMBS pools. And so one of the issues there is that if we are successful at getting the conduit launched, which we are in the process of doing right now, and we get out there and we start to gain some real traction, we think that there is fantastic growth opportunity in 2015, 2016 and 2017 for the conduit, given this big wave of refinancings that will be coming about, if you back up to 2007 in 2007 $230 billion of commercial real estate was financed by CMBS. Now all of that isn't sitting out there to be refinanced in 2017, but a lot of it was ten-year paper that does need to be redone in 2017. So there is a great opportunity for the conduit to grow quite dramatically, but we have not given any guidance on what we think that growth will be, but the market drivers looks very promising.

Charles Navin - *Wells Fargo - Analyst*

And understanding that it is going to fluctuate from quarter-to-quarter, how should we think about the mix within the originations of what Walker & Dunlop is going to originate in-house versus what it will source through its partner?

Willy Walker - *Walker & Dunlop, Inc. - Chairman, CEO*

I have got to ask my General Counsel, am I allowed to give what our assumption is on that?

Richard Lucas - *Walker & Dunlop, Inc. - General Counsel*

In-house versus outside?

Willy Walker - *Walker & Dunlop, Inc. - Chairman, CEO*

Yes.

Richard Lucas - *Walker & Dunlop, Inc. - General Counsel*

From a timing perspective I think, Charles, we really don't know.

Willy Walker - *Walker & Dunlop, Inc. - Chairman, CEO*

Can I give my assumption?

Richard Lucas - *Walker & Dunlop, Inc. - General Counsel*

We can give an assumption.

Willy Walker - *Walker & Dunlop, Inc. - Chairman, CEO*

Charles our assumption is that 60% would come from outside and 40% will come internally, but that is nothing other than a guess as it relates to how effective we are going to be at selling the conduit, and how much activity that we are going to get from brokers and third parties.

Charles Navin - *Wells Fargo - Analyst*

Okay.

Willy Walker - *Walker & Dunlop, Inc. - Chairman, CEO*

But right now we're breaking it down that 60% will come from external forces and 40% will come internally.

Charles Navin - *Wells Fargo - Analyst*

Okay. One final follow up, we have seen some other non bank financials attain FHLB membership as a source of chief long-term funding. To the extent you could comment, is that an avenue that you have looked into or could potentially explore in the future?

Willy Walker - *Walker & Dunlop, Inc. - Chairman, CEO*

I know it has been done. I also know that there is plenty of talk about whether it should be allowed. And we are currently not looking at that.

Charles Navin - *Wells Fargo - Analyst*

Okay. Thank you. Thank you for taking my question. Good quarter, guys.

Willy Walker - *Walker & Dunlop, Inc. - Chairman, CEO*

Thank you very much. Appreciate it.

Operator

And there are no further questions. I would like to turn the conference back over to our speakers for any closing remarks.

Willy Walker - *Walker & Dunlop, Inc. - Chairman, CEO*

Great. I would say thank you everyone for joining us this morning from wherever you are. If you are on the East Coast and dealing with this storm, stay warm and stay safe. And we look forward to talking to all of you again next quarter. Thank you very much.

Operator

Thank you. This does conclude today's conference call. Please disconnect your lines at this time, and have a wonderful day.
