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Walker & Dunlop, Inc. (WD)

Q1 2015 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Welcome to Walker & Dunlop's First Quarter 2015 Earnings Conference Call and Webcast. Hosting the call today from Walker & Dunlop is Willy Walker, Chairman and CEO. 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 11:30 a.m. Eastern Time. The dial-in number for the replay is 800-839-2434. 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.

Claire Harvey
Vice President-Investor Relations

Thanks, Kevin. Good morning, everyone. Thank you for joining the Walker & Dunlop first quarter 2015 earnings 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 this 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.

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Please also note that we may reference certain non-GAAP financial metrics such as adjusted diluted earnings per share and adjusted EBITDA during the course of this call. Please refer to the earnings release and presentation posted on our website for reconciliations of the GAAP and non GAAP financial metrics and related explanation.

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 including statements regarding future and financial operating results involve risks, uncertainties, and contingencies, many of which are beyond the control of Walker and Dunlop, and which may cause actual results to differ materially from the anticipated results.

Walker and 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 risk factors can be found in our reports on file with SEC.

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

Willy Walker
Chairman, President and Chief Executive Officer

Thank you, Claire. Good morning and thank you all for joining us. Today, we have the pleasure of reporting record operating results for the first quarter 2015.

As Steve will run through in just a moment, our financial results are outstanding by all measures. The economic drivers we spoke about in our last earnings call proved to be incredibly strong tailwinds for our business, as we achieved the highest quarterly loan originations in our history. I want to begin by congratulating and thanking all of my colleagues at Walker & Dunlop for an outstanding quarter.

We spent the last five years acquiring companies and hiring commercial real state finance experts to create a national lending platform to capitalize on the 2015, 2016, and 2017 commercial loan maturity cycle. The first quarter of that 12-quarter cycle just ended and our Q1 results demonstrate the value of the investments we have made.

Our quarter-over-quarter loan originations grew by 175%, due to competitive pricing from the GSEs, significant new investment in U.S. commercial real estate and the continued low interest rate environment. Record loan originations, EBITDA and diluted earning per share come from having built a scaled lending platform, with some of the very best real estate finance professionals in the industry, who are meeting their clients' needs in an exceedingly active market.

This is a successful start to the year beyond our loan origination and financial results. We repurchased 3 million shares of our stock from Fortress Investment Group in March, deploying $47 million of capital, and what appears to be another very well-timed repurchase.

Fortress has been a great partner over the past two-and-a-half years. They are still the majority shareholder in our CMBS joint venture and we just did a huge financing on one of their many commercial real estate investments. We expect to keep partnering with Fortress in many ways in the coming years.

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We also just announced our entry in the investment sales arena with the acquisition of Engler Financial. Walker & Dunlop investment sales will provide us with the additional revenues and client touch points going forward. And we plan to scale the investment sales platform rapidly.

With that, I'll turn the call over to Steve to discuss our financial results.

Stephen P. Theobald
Chief Financial Officer & Executive VP

Thank you, Willy, and good morning, everyone. Let me spend a few minutes going through the numbers, starting with our key operating metrics, where we achieve record results across the board.

Diluted earnings per share were $0.66, up 214% over the first quarter of 2014, driven by the robust origination activity and overall revenue growth during the quarter. As extraordinary as EPS was this quarter, and it was, our focus is never on just one quarter's results, but on our performance over the long run. To illustrate, slide 4 shows our trailing four-quarter adjusted EPS trend, which for the past year has shown steady growth and was $2.03 per share for the trailing four quarters ended March 31, 2015, an all-time high.

Slide 4 also illustrates our trailing four-quarter return on equity, which showed the same positive trend. For Q1, return on equity of 19.6% far exceeded our target of low- to mid-teen due to the record income generated during the quarter.

The buyback of the Fortress shares did not have much impact in this number, but will have a positive effect going forward. And combined with the strong start to the year and a positive operating environment in front of us, we believe our return on equity for the year should be toward the upper end of target.

Operating margin at 32% came in well above our target of mid-20%, as we benefited from the fact that we originated over $4 billion in loans in the first quarter of the year, when our commission rates are at their lowest, and as we continued to manage growth in our fixed expenses.

Moving now to volumes, slide 5 provides information on our loans originated during the quarter. As Willy mentioned, the strong demand for commercial real estate financing drove the significant year-over-year increase in originations from $1.6 billion last year to $4.3 billion in this year's first quarter.

The strength in GSE deal flow that we saw in the second half of last year continued into the first quarter, as Fannie and Freddie were a combined 77% of our first quarter volumes. Originations with Fannie Mae increased 197% and originations with Freddie Mac increased 442%, making Freddie the largest component of our volume for the second quarter in a row. Our brokered originations increased 83% year-over-year, as we benefited from the strength of the market and our investments in growing our capital markets platform.

Average transaction size for the quarter, as shown on slide 6, increased 76% to $23.3 million and was impacted by the origination of two large portfolios totaling approximately $1.1 billion, with $670 million going to Freddie Mac and $402 million going to Fannie Mae. As we've said in the past, it is very difficult to predict when or if a large transaction will happen and we were fortunate enough to have two hit in the same quarter.

In addition, we continued to see strong demand from borrowers for floating rate loans based on the attractiveness of the spread and the prepayment flexibility offered by these products, as 45% of our Q1 GSE volumes were floating rate.

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We generated $112.1 million in total revenues in the quarter, as shown on slide 7. The 73% increase over Q1 2014 was largely driven by origination fees and MSRs, which grew 100% and 125% respectively. Gain on sale margin of 167 basis points was down from the prior year but flat to the fourth quarter 2014, as product margins held steady for the second straight quarter. It remains a highly competitive lending environment, but the benefits of scale enabled us to expand operating margin, even as gain on sale margins have declined.

Servicing fees continued to grow and during the first quarter increased 15% over Q1 last year, as we saw a $7.2 billion increase in the servicing portfolio over that same time period. Net warehouse interest income grew year-over-year due to the strong increase in loans held for sale and the growth of our interim loan portfolio.

Other revenues of $7.4 million increased to 106%, driven almost entirely by fee income earned from loan prepayments and an increase in earnings from our CMBS joint venture. Fees received on prepayments were $4.7 million in Q1 2015.

As you will see from slide 8, total expenses for the quarter were $76.7 million. Personnel costs, our largest driver of expenses, were up 63% given the strength of our originations and financial performance, which drove up commission expense and bonus compensation. This increased variable compensation 156% year-over-year. However, personnel expense as a percentage of revenue declined from 38% to 36%, given the strength of our revenue growth and management of fixed personnel costs.

Finally, adjusted EBITDA was $35.4 million for the first quarter compared to $19.8 million in the first quarter last year. On a trailing four-quarter basis, we've generated adjusted EBITDA just over $100 million. The dramatic increase from just $63 million a year ago is illustrated on slide 9.

With the repurchase of shares from Fortress, we've now fully deployed the net proceeds of our 2013 term loan. Our strong cash flow generation and the capital received from the term loan have allowed us to return $82 million to shareholders through share repurchases, while growing our interim loan program, acquiring Johnson Capital and Engler Financial, and supporting our CMBS platform.

All these investments are now benefiting our company and shareholders through higher returns and profitability. Our continued strong financial performance and adjusted EBITDA generation give us the ability to raise additional debt to support future acquisitions and growth opportunities as they arrive, greatly enhancing our financial flexibility.

With that, let me turn it back over to Willy.

Willy Walker

Chairman, President and Chief Executive Officer

Thanks, Steve. This is an outstanding first quarter for Walker & Dunlop and our shareholders. Over last several years, we scaled our GSE and HUD platforms through the acquisition of CWCapital, grew our capital markets group with strategic new hires and the acquisition of Johnson Capital, and established alternative products through our CMBS joint venture and balance sheet lending. We've built this platform to take advantage of the unique market opportunity presented by the refinancing wave and it's great to see those investments rewarded early n this refinancing cycle.

For 2015, GSE scorecard allocated $60 billion of capital to Fannie and Freddie for market rate multi-family lending. Having finished 2014 at 12% market share with Fannie and 10% market share with Freddie, holding

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market share constant would produce $6.6 billion of GSE lending in 2015 for Walker & Dunlop. Having originated $3.4 billion with the GSEs in the first three months of the year, we are well ahead of schedule.

If you turn to slide 10, it shows that in the first quarter, we captured 9.2% of Fannie's originations and 16.7% of Freddie's. Our combined market share of the $20.4 billion deployed by the GSEs was 12.9%, a fantastic accomplishment reflecting the value of being one of the GSEs' very largest partners. With at least $40 billion left to lend over the next nine months, we are focused on capturing our share of the GSEs' remaining capital and ending this year yet again as a top partner with them both.

After an 83% increase in our capital markets originations from Q1 2014, we feel very good about achieving our established goal of originating $3 billion to $5 billion of brokered loans this year.

Our CMBS conduit recently added two new originators to the platform and closed $96 million of business in the first quarter, generating almost $1 million of net income to Walker & Dunlop for our minority ownership stake. Although $96 million of volume is below expectations, we are seeing great growth in the conduit pipeline and are thrilled with the profitability of our first three securitizations.

Our balance sheet lending operation generated $1.9 million of interest income in Q1. And right now, we project to generate $8 million to $10 million of interest income on the year. We launched this program in 2011 and it's become both a hugely strategic and profitable line of business.

Given the GSEs' strong start to the year, there has been significant discussion about when they will hit their lending caps. This issue is being actively discussed by the GSEs and the industry with the Federal Housing Finance Agency, and it is our expectation that FHFA make some adjustments to the caps. But as the GSEs have raised pricing over the past several weeks to slow down originations, several things have happened.

First, GSE quotes that were outstanding have been accepted, making Q2 GSE volume strong. Second, Walker & Dunlop CMBS platform is now pricing on top of or inside the GSEs, adding significant volume to our CMBS pipeline. Very few of our GSE competitors have their own CMBS platform, and we plan to take advantage of this product offering at W&D.

Third, our balance sheet lending, which had a slow first quarter, is more active than ever, given the need for interim financing and the GSEs' reduced appetite for it.

Fourth, Walker & Dunlop's capital markets group has never been larger and never had access to more capital, providing our multi-family customers with access to third-party capital to finance their deals.

Fifth, our HUD group now has the opportunity to work on standard market rate multi-family refinancings.

And finally, Walker & Dunlop's warehouse lenders have approached us about expanding our warehouse lines in Q3 and Q4 to allow us to lock rate on deals that we would deliver to the GSEs or other sources of capital in 2016.

All of this is very positive for Walker & Dunlop and demonstrates the value of our investments in capital markets, CMBS and balance sheet lending operations over the past several years.

The profit profiles of all of these executions differ and, ultimately, we have limited control of where our deal flow goes. However, we started the year with the goal to gain market share with the GSEs, deliver a low- to mid-teens ROE, deliver a mid-20%s operating margin and grow earnings per share at double-digit rates.

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Those goals were established with an understanding that the GSEs would have $60 billion to lend outside of their affordable buckets and that the demand for commercial real estate financing would be strong. None of that has changed.

As a result, our fantastic start to the year makes us confident that we are on track to achieving those goals, whether the caps are raised or not. The rest of 2015, along with 2016 and beyond, provide W&D with huge opportunities to continue originating large volumes of business with the GSEs and other sources of capital to meet our clients' ever-growing financing needs.

GE recently announced that it's exiting its financing and commercial real estate lending businesses. One area that GE provided significant capital to was the seniors housing space, an area we've clearly defined as a market opportunity and one where we just originated a $670 million financing for New Senior Investment Group, the largest financing ever done by Walker & Dunlop.

We have the expertise in seniors housing to be a major player and GE's departure from this business represents a significant opportunity for us to recruit talented mortgage bankers. This also represents an opportunity for our HUD lending operations, as HUD continues to be one of the largest providers of capital to seniors housing.

We announced recently our entry into the investment sales business by acquiring a 75% interest in Engler Financial Group. Engler is based in the Southeast, has an exceptional reputation with multi-family owners and developers, and will create broader and more meaningful relationships with our collective clients.

We will be making meaningful capital investments in this new business line and believe that the combination of our market position and relationships in the multi-family industry and Engler's decades of investment sales experience provide a fantastic opportunity to build a nationally recognized investment sales platform, with the same commitment to best-in-class customer satisfaction that has made our company so successful over the last 77 years.

We've grown revenues at a compound annual growth rate of 19% over the past three years and grew revenues 73% in Q1 2015 over Q1 2014. We've grown adjusted EBITDA at a 70% compound annual growth rate over the last three years and grew at 79% in Q1 2015 over Q1 2014.

We have built the platform we aspired to build to take advantage of the refinancing wave that is upon us. We have the brand, national footprint, market leadership position, and real estate finance experts to fully take advantage of the next three years of increased transaction volume. And behind the platform and the people is a business model that is sound, highly profitable and enduring due to the $46 billion servicing portfolio that will generate over $100 million in revenues in 2015 and beyond.

It is clear we are off to a fantastic start. We've assembled an outstanding team of professional to capitalize on this financing cycle and our first quarter results reflect the success of our efforts. We still have much work to do in order to achieve our goals this year, but I would like to thank and congratulate my colleagues at Walker & Dunlop once again for their efforts this quarter and the strongest financial results we have ever produced.

With that, I would like to ask the operator to open the line for any questions.

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QUESTION AND ANSWER SECTION

Operator: The floor is now open for your questions. [Operator Instructions] Our first question is coming from Steve DeLaney with JMP Securities. Your line is now open.

Steve C. DeLaney
JMP Securities LLC

Q

Thanks. Good morning, everyone, and congratulation on a great quarter. Willy, I just want to start, the obvious thing is the volume, first quarter. I guess, we need to think out of the box because some of us are just ingrained in thinking that first quarter commercial real estate lending is always going to be the lightest of the year. There's obviously some different dynamics going on, especially multi-family.

I'm just wondering if you could talk a little bit about the borrower mentality early in the year in this surprisingly large level in 1Q, pretty much flat to 4Q. Are people concerned about GSE running out of capacity? They want to get their deals done. They're worried about rates rising. What is your sense of sort of the borrowers' mentality and why business was so strong in 1Q? Thanks.

Willy Walker
Chairman, President and Chief Executive Officer

A

Sure, Steve. Good morning and thanks for getting up early to join us. I would say a couple of things on what we saw in Q1. And I'd say a couple of things that we didn't see. The first thing is, specifically to your question of people thinking that the GSEs would run out of money being a driver, in Q1, not whatsoever.

Steve C. DeLaney
JMP Securities LLC

Q

Okay.

Willy Walker
Chairman, President and Chief Executive Officer

A

So, that is not at all a driver. I would say that in the first month of Q2, it has clearly been a driver of people saying, I'll take that financing, let's go. But in Q1, specifically to your question, it was a very, very active acquisitions market in Q1, and that's reflected in the numbers of HFF and CBRE and those firms that have scaled investment sales platforms.

The second thing is that surprisingly, as Steve pointed out, we did significantly more floating rate financing in Q1 2015 than we have done previously, which would say to you that borrowers are not concerned about a rate increase. And although they may be concerned about a rate increase, they clearly all opted to go with floating rate. And as Steve said, that's due to the spread between fixed rate and floating rate, and I would also say the prepayment flexibility that floating rate loans have today versus a fixed rate loan which has call protection on it.

The third thing I'd say is the most active buyers right now are the funds. And so funds being very active out there are A) looking for prepayment flexibility, B) are looking for the ultimate spread delta, if you will, between fixed rate and floating rate due to their promote structure and being really shorter-term holders of these assets than, if you will, longer-term holders who are going to buy and put it away with long-term debt.

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So those were the major drivers in Q1.

Steve C. DeLaney
JMP Securities LLC

Q

Yeah. And your comment about acquisitions is – strikes me. I'm thinking a lot of that might have been tax-driven, right? I mean, if the funds are the buyers and you had individuals, family offices, et cetera, selling, they may have been tax-motivated to sell in 1Q versus 4Q. Just a thought on that.

But I guess, combination of this acquisition market being very strong and the fact that you also had these two very large deals, a little over $1 billion or 25% of volume, I mean can you give us some thoughts about as we look forward to 2Q and 3Q? Is this a level roughly, $4 billion a quarter, just in a range is – how should we feel about the potential for the next couple of quarters relative to 1Q?

Willy Walker
Chairman, President and Chief Executive Officer

A

So, Steve, we as you know are not giving origination guidance anymore. So I'm not going to walk you through what our projections are on 2Q, 3Q and 4Q.

Steve C. DeLaney
JMP Securities LLC

Q

Okay.

Willy Walker
Chairman, President and Chief Executive Officer

A

We are very clear in saying that our strategy has been to build this platform and scale this platform to take advantage of the refinancing wave that everybody has seen coming for 2015, 2016 and 2017.

And as we said in our earnings announcement this morning, Q1 is clearly reflective of that refinancing wave having hit. And that's not just a comment about Walker & Dunlop's Q1. You look at all of our competitor firms, they all had good Q1s. And I think almost all of them beat analysts' expectations in Q1.

So we are not the only ones out there benefiting from this. We may have benefited more than others in Q1. But we see a fantastic opportunity in front of us. And we've built a fantastic platform to take advantage of it. But Q1, this was somewhat of anomaly as far as the volumes. I've already said in my prepared remarks that we see Q2 as being strong.

And as it relates to the rest of this year, into 2016 and 2017, we think there's a fantastic opportunity for W&D to continue to grow. And we reiterated the, if you will, financial drivers that we laid out at the beginning of the year as it relates to ROE, operating margin and double-digit EPS growth.

Steve C. DeLaney
JMP Securities LLC

Q

That is really helpful. Thank you, Willy. And just one quick thing finally, just shifting over to strategic and talking about loan brokerage and property sales, Engler acquisition. I mean, these obviously are high-ROE, capital-light businesses that warrant a much higher P/E than probably just the traditional real estate finance business.

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Looking out, as you try to scale these businesses going forward, are there any internal targets in terms of say a percentage of revenue over the next couple of years that we might look to see this business grow to in terms of how meaningful they can be to your blended revenue mix? Thanks.

Willy Walker
Chairman, President and Chief Executive Officer

A

Sure, Steve. I would say that we've clearly, when we announced the acquisition of Engler, put out that we want to build a national platform and we are very focused on doing just that. But it's also – we're two weeks into it.

I would say that investors in W&D can look back to when we said we wanted to get into the CMBS space and the launching of our conduit and we wanted to get into the balance sheet lending space and the launch of our balance sheet lending. That we have been very successful at starting up these new businesses, attracting great talent and manage those businesses putting capital to them. And both our balance sheet as well as CMBS platform are becoming meaningful percentages of both revenues as well as net income.

And so we do have targets what we want to do with Engler, and quite honestly, we are in a period of time right now when there is a huge amount of investment sales activity out there and we know that that will not last forever. But we're not giving any guidance right now and what percentage of revenues we would get out of investment sales.

Steve C. DeLaney
JMP Securities LLC

Q

Okay. Great. Thanks for your time and [ph] kind of just (26:28) morning, Willy.

Willy Walker
Chairman, President and Chief Executive Officer

A

Thank you, Steve.

Operator: Our next question comes from Jade Rahmani with KBW. Your line is now open.

Jade J. Rahmani
Keefe, Bruyette & Woods, Inc.

Q

Thanks for taking the questions. Regarding the GSE cap issue, if the GSEs emphasize affordable and manufactured housing to work around the caps, how is WD positioned in that respect?

Willy Walker
Chairman, President and Chief Executive Officer

A

So, Jade, on the manufactured housing side, we are a very significant originator of manufactured housing to both Fannie and to Freddie. We were actually Freddie's largest manufactured housing seller servicer in 2014. So we have access to a lot of deal flow there.

On the affordable side, we have a number – we have a lot of loan originators who focus on affordable. Most of that deal flow traditionally has gone to HUD. And the one thing I would say, as it relates to winning on affordable deals, because of the Community Reinvestment Act and because commercial banks are very focused on lending to meet their CRA requirements, winning affordable deals against commercial banks is very difficult. And just in Q1, we had a number of deals that we lost to commercial banks by a pretty wide margin.

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And so one of the things that both GSEs are somewhat challenged with is that to win deals against the commercial banks, given commercial bank's cost of funds and desire for affordable housing loans to meet CRA requirements is, if you will, a steep curve. So we will continue to focus on it. And I know that both Fannie and Freddie are very focused on it. But how much they can actually do as a percentage of their overall originations is to be determined.

Jade J. Rahmani Q
Keefe, Bruyette & Woods, Inc.

Thanks. That's very helpful. Regarding the competitive environment, do you have concerns about the level of competition and deteriorating underwriting standards? For example, is the floating rate mix evidence of aggressive pricing on the part of the funds you described? What's your view of the competitive environment?

Willy Walker A
Chairman, President and Chief Executive Officer

The actual underwriting on the deals we're doing today, Jade, is very good. If you look at our Q1 2015 versus Q1 2014 LTV and debt service cover, both of them – LTV went from 68% to 70%, debt service cover went from 1.47x down to 1.45x. So, quarter-on-quarter, the type of loans that we're doing, we'll do 70% loans at 1.45x debt service cover for the rest of our lives and be very good from a credit standpoint.

The question really comes in what kind of a rate environment are we in 10 years from now when these loans need to be taken out. And quite honestly, if you could tell me the answer to that, I'd love to know it. But we are, I believe, underwriting with very good and conservative estimates, as it relates to where interest rate will be and what type of spread we would have to apply to those interest rate projections to be able to refinance out all of the loans that we're originating today, and we feel good about those estimates. But that's, quite honestly, right now given we're in such a low interest environment, that's really the question. What's your exit rate and what's the financing market look like 10 years from now when we need to refinance [ph] all this paper (30:00).

Jade J. Rahmani Q
Keefe, Bruyette & Woods, Inc.

On the CMBS business, do you have goals you could talk about regarding quarterly volume or at least the steepness of ramp? Sounds like 2Q you would expect CMBS volumes to be up strongly? And also, are you seeing any pushback from banks' securitizes or even B-piece buyers regarding the contributions to securitizations from the non-securitizer?

Willy Walker A
Chairman, President and Chief Executive Officer

So, on that question, yes. As you well know, a number of the – of both securitizers, aggregators have gotten pressure from the B-piece buyers as well as the A buyers to, if you will, reduce the number of contributors that they have. We are very pleased to have two partners to contribute to and feel very good about the quality of our collateral. And given the profits we made off of our modest contributions in Q1, I think that's reflective of the fact that we have fantastic collateral that has gotten premium pricing.

On your question as it relates to volume, we have not given guidance as it relates to how much volume we are doing. But, per my comments previously, the overall CMBS market is extremely active as you know and I believe the projections are that through May there will have been over $45 billion originated to CMBS conduits. So there's a lot of deal flow going to conduits in 2015. And given our access to deal flow through our brokerage network as well as our multi-family origination network, we do think that our volumes will increase nicely in Q2.

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Jade J. Rahmani
Keefe, Bruyette & Woods, Inc.

Q

Thanks for taking my questions.

Willy Walker
Chairman, President and Chief Executive Officer

A

Sure.

Operator: Our next question comes from Charles Nabhan with Wells Fargo. Your line is now open.

Charles Nabhan
Wells Fargo Securities LLC

Q

Good morning and thank you for taking my questions. If we were to assume the status quo for the GSE lending caps through 2015, given some of the pricing adjustments that have been made in the past month or so, do you anticipate a smoother allocation in volumes over the course of the year? Maybe if you could just touch on your expectations for trajectory, assuming flat lending caps?

Willy Walker
Chairman, President and Chief Executive Officer

A

So, Charles, if you look at what was done in Q1 by the two of them, Fannie did $10.5 billion, Freddie did $10 billion, so that's $20.5 billion in the first quarter. As I mentioned, when they raised pricing, all of the outstanding deals, almost everybody jumped at the deals before pricing moved or as pricing moved. So, during the month of April, there was sort of a surge as it relates to people taking what was out there.

So what you had is sort of a compression of Q2, where the pipeline for Q2 really kind of came crashing in during the month of April and will probably out there in May and June as well. And so what you're going to – what they are going to be dealing with is, depending on what FHFA does and how much cap they still have for Q3 and Q4, they will do one of two things.

First of all, they will figure out how they're going to allocate capital, and that allocation of capital is going to be on who their biggest borrowers are, who their most loyal clients are, who their biggest seller services on the Freddie Mac side are, and who their biggest partners are on the Fannie Mae DUS program. So there will be I believe some, if you will, segmentation of the market as it relates where they're putting out capital. And they will continue to focus on affordable small loans and affordable housing.

And then the final piece to it, as I alluded to in our prepared remarks, they will sit there and also figure out how much deal flow they want to take and can take on the caps in 2015, and how much they want to work with us to rate-lock in 2015 and carry over for delivery in 2016. And I think a lot of that's going to be pretty dynamic to what does FHFA do for the rest of 2015 and then also what's the 2016 scorecard look like.

And so we will – right now we're sort of in a wait-and-see mode, but relative to our day-to-day operations around W&D and what's going on right here, it's very much business as usual right now.

Charles Nabhan
Wells Fargo Securities LLC

Q

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Okay. And if I could switch gears to expenses. I was wondering if could comment on the cost structure. As you continue to – as you scale the Engler business and you add personnel in key areas such as CMBS, could you comment on any rationalization efforts you might have going on within the core business that might offset some of those additional expenses?

Stephen P. Theobald
Chief Financial Officer & Executive VP

A

Yeah. Chuck, at this point, I think given the growth we've had in the platform, I think we feel like we're operating pretty efficiently at the moment. To the extent that there are investments to be made, and there will be investments that we make in the investment sales side to grow that platform, I think we'll be using the same disciplined approach there that we have in the investments we've made on our lending platform when we're looking at either acquiring groups of producers or hiring folks and recruiting them individually.

So I think we've been pretty successful historically at getting people on to the platform in a way that's economically good for them and good for us, and we'll continue to take that same approach as we build the investment sales platform.

Charles Nabhan
Wells Fargo Securities LLC

Q

Okay. Great. Thank you.

Operator: Our next question comes from Cheryl Pate with Morgan Stanley. Your line is now open.

Cheryl M. Pate
Morgan Stanley & Co. LLC

Q

Hi. Good morning. And congratulation on a great quarter. Just a couple maybe a little bit longer-term type questions. Just thinking through the ROE and the operating margin targets that you've had and as you sort of think about how the business has transitioned to some larger deal sizes and things like adding on the investment sales, is there sort of upside to those targets when you think about that sort of over more of a medium-term timeframe?

Willy Walker
Chairman, President and Chief Executive Officer

A

Good morning, Cheryl. That's a good question. I think, as Steve said in his remarks, the large deals are tough to predict on when we'll get them. I will say I'm very pleased that we were successful in winning the two large deals we did in Q2. And there are a lot of large deals out there right now. I mean, one of the big things that is very much in both the GSEs' volume as well as the CMBS volume, across the industry they're big portfolios that are trading hands, needing refinancing. And so there are a lot of big deals out there. And as you can see by our average deal size having grown as much as it did in the quarter, we are seeing more and more large opportunities.

To translate that right back into an adjustment on our operating margin, I will tell you, at least I am hesitant to do so. And that is just that what you really saw in Q1 is that we got to a volume of originations that basically pushed all the scale through the system and got you to the type of operating margins that we did. And so one big deal in a lower-volume quarter would not allow you to achieve that same kind of operating margin. So it was two big deals coupled with great, if you will, normal deal flow. And then, getting the leverage out of the platform is what really drove the operating margin up into the 30% range. You want to add anything to that?

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Steve C. DeLaney
JMP Securities LLC
A

I think, that and fact that first quarter our commission rates are at their lowest level for the year because our producers are starting over in their commission splits. And so, as we go through the year, that percentage will increase. So the variable costs side of equation will increase as we go through the year just naturally.

Cheryl M. Pate
Morgan Stanley & Co. LLC
Q

Great. That's helpful. And then, just secondly, you guys have obviously grown the servicing portfolio very successfully over the last few years. And I think we can see a dramatic increase when we look at the trailing 12-month adjusted EBITDA data that you've presented. Just wondering, when you sort of think about the opportunities for capital deployment, and obviously there have been several successful acquisitions in terms of growth opportunities, just wondering, given the stability of the servicing portfolio, about your thoughts to things like perhaps a dividend over time as well.

Willy Walker
Chairman, President and Chief Executive Officer
A

So, Cheryl, there are fantastic opportunities for us to continue to reinvest our capital in the business and continue to grow it, and whether that's continuing to scale our balance sheet lending, whether it's deploying more capital into the CMBS lending operation, continuing to grow the Engler platform across the country, or any number of other opportunities to continue to broaden and diversify the platform.

Right now, we feel that the capital that we are generating is much better served being invested into the business rather than being returned to shareholders. But you raised an issue that, as you can imagine, given the consistent cash flow that is kicking off of the servicing portfolio is one that we've obviously looked at. But, right now, it is the board and management's view that we have lots of opportunities to continue to invest capital.

And as you have seen just in the last year of our opportunistic share buybacks in March of 2014 and then again in March of 2015, we've been pretty good at figuring out when to buyback stock when we thought it was cheap and putting that capital to work to benefit our shareholders. And so I think that adds up to almost $85 million that we've deployed, if you will, in returning capital to our shareholders by doing those buybacks.

Cheryl M. Pate
Morgan Stanley & Co. LLC
Q

Okay. Great. Thanks very much, guys.

Operator: Our next question comes from Jason Stewart with Compass Point. Your line is now open.

Jason M. Stewart
Compass Point Research & Trading LLC
Q

Hey. Good morning. Thank you. Willy or Steve either, on the recent increase in rates on the GSEs, how should we think about that impacting margin going forward for that business?

Willy Walker
Chairman, President and Chief Executive Officer
A

The recent what rates?

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Stephen P. Theobald
Chief Financial Officer & Executive VP
A

Increase in pricing...

Willy Walker
Chairman, President and Chief Executive Officer
A

Increase in pricing?

Stephen P. Theobald
Chief Financial Officer & Executive VP
A

Yes.

Willy Walker
Chairman, President and Chief Executive Officer
A

It's – I mean, it doesn't hurt.

Jason M. Stewart
Compass Point Research & Trading LLC
Q

And just remind us how that'll flow through if early 2Q volumes are being hit at rates offered in late 1Q? Is that an impact that we should expect to see later in the year or 2Q?

Willy Walker
Chairman, President and Chief Executive Officer
A

No. I mean I'd say, Jason, that I mean you won't see the – I mean, given the volume of business we're doing right now, first of all on the Freddie side, as you know, servicing fees are fixed there. On the Fannie side, you will – as pricing widens, we will probably pick up at the margin, if you will, richer servicing fees as we and they widen out and if we continue to win deals, it will be richer servicing.

But you won't see that flow through our financials. That's not going to materially move the gain on sale margin on the quarter or move the servicing portfolio one way or the other. Just on a quarter's shift in doing a couple hundred million dollars increase servicing fees. So it'll be nice on that book of business, but it's not going to move our numbers. You concur with that, Steve?

Stephen P. Theobald
Chief Financial Officer & Executive VP
A

Yeah. I think the only place, as Willy mentioned, that you'd see us, Jason, is in the MSRs because I don't think from an origination fee perspective you're seeing any difference right now. So, to the extent that our Fannie servicing rates are a little bit higher with the increase in pricing, we'll get a little bit of benefit, all things being equal, in the MSRs that we book in the second quarter.

Willy Walker
Chairman, President and Chief Executive Officer
A

Right.

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Jason M. Stewart
Compass Point Research & Trading LLC

Okay. Fair enough. And then, just conceptually as we think about – I think the floating rate product is relatively more competitive today from the GSEs than it was, say, a year or two years ago. If we go back towards deeper yield curve, how that interplay works with banks and the GSEs, and whether you think that business is going to be more competitive through different curve shapes, the GSEs first as the bank – any kind of color as we think through that potential interplay would be helpful to me.

Willy Walker
Chairman, President and Chief Executive Officer

I'd only say there, Jason – and it's a really good question. We're not seeing the banks be nearly as competitive as they were in 2013. And I think that's twofold. One, I think that there was a sense after the recession/financial crisis where banks really did almost no commercial real estate lending right out of the crisis that in 2013 there was sort of a memo that went out to all of the commercial real estate lending groups and the commercial banks across the United States saying, back up the bus, let's load up on commercial real estate. You're not seeing that today.

The second thing is, back then, there was almost no construction activity in the country. Today, there's plenty of construction activity in the country to take bank capital and deploy it in shorter-term loans, which is a space that they have owned and dominated for most cycles.

And then, the third thing, as you rightfully say, the agencies have very, very competitive floating rate product today. So banks – right, I mean, there are clearly banks that want to take a deal now. And as I mentioned previously, on the affordable space, they get very, very competitive because they need that type of deal flow. But the competitive threat from banks right now to the GSEs, to conduits, to life insurance companies is not nearly as evident.

The final thing I would say is that Dodd-Frank, Basel III and the regulatory environment is making banks strongly reconsider whether they want to hold on to mortgage servicing rights for the long term. And that is making many of them stick with shorter-term loans that are floating rate loans rather than going longer-term fixed rate or even longer-term variable.

Jason M. Stewart
Compass Point Research & Trading LLC

Okay. That's helpful. Thank you.

Operator: Our next question comes from Brandon Dobell with William Blair. Your line is now open.

Brandon B. Dobell
William Blair & Co. LLC

Thanks. Good morning, guys. Willy, on top of your comments about how you guys are holding the line on credit underwriting standards, maybe a different way to ask that question, are you guys seeing an increasing number or proportion of deals that you're not comfortable with? Meaning, is the pie of deals getting bigger? You guys are obviously growing originations, but the proportion of deals which you're not willing to step into is starting to grow.

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Willy Walker
Chairman, President and Chief Executive Officer
A

I honestly – from my perspective, Brandon, and I sit on loan committee but I only see a small percentage of the loans that we actually do, I would say no to that question. We've got our Chief Credit Officer, Richard Warner, on the phone and we're obviously happy to do that if you want to have a follow-up call.

Brandon B. Dobell
William Blair & Co. LLC
Q

Yeah.

Willy Walker
Chairman, President and Chief Executive Officer
A

I think he probably would echo what I'm saying, but he also sees a whole lot more than I do. But, as I said previously, the real issue right now is not where the loans we're doing or great loans we'd be doing for 2015.

Brandon B. Dobell
William Blair & Co. LLC
Q

Right.

Willy Walker
Chairman, President and Chief Executive Officer
A

It's trying to project out and see where rates will be. And then the only other thing that I would say as any kind of concern in what we're seeing is there has been a tremendous amount of IO put out on deals. IO is – typically you'd get two years or three years of IO and then IO moved out to five years. And over the last year, across all capital sources, there's been a lot of IO out there.

And so everyone feels really good and this makes perfect sense, right? Everyone feels really good about the cash flow of the actual asset performing today on an IO basis. The question is, you've got an IO loan, you've got no amortization and then what's going to happen 7 years or 10 years from now when that loan turns. But, I'd reiterate, we feel very, very good about our risk portfolio. And as you know in many instances, we're also originating loans where we're not taking risk and we feel pretty good about all that too.

Brandon B. Dobell
William Blair & Co. LLC
Q

Okay. Got it. Thanks. Maybe a question for Steve is, given the volume in the first quarter relative to how the commission multipliers or hurdles work, should we expect that the producers are now at a much higher commission level, so Q2 through Q4 they're going to be picking up more than they normally would in kind of a regular year? Or am I missing how the commission structures work for the calendar year?

Stephen P. Theobald
Chief Financial Officer & Executive VP
A

Yeah. So, Brandon, I am not sure I would use the term much higher but certainly...

Brandon B. Dobell
William Blair & Co. LLC
Q

Okay.

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Stephen P. Theobald
Chief Financial Officer & Executive VP
A

...as we go through the year, they do get to higher levels. I think if you look at our historical personnel expense as a percentage of revenue, you'll see a fairly distinct pattern as we go through the year. And I think our expectation is we would have a similar pattern this year.

Brandon B. Dobell
William Blair & Co. LLC
Q

Okay. Got it. And then, finally on Engler. Willy, you mentioned the opportunity to really expand the platform there. How do we think about the investment necessary to do that? And when you say significantly expand the platform, how do we think about the – is it number of people or throughput capacity on investment sales deal, what I think about how big this make it for you guys?

Willy Walker
Chairman, President and Chief Executive Officer
A

So we have a – we would like to be in three big cities beyond their existing footprint by the end of the year. We'll see if we can get there. But we'd like to be in three MSAs, new MSAs for that platform by the end of the year.

I think as it relates to hiring of talent, given our platform, and this is multi-family-focused right now, right? So...

Brandon B. Dobell
William Blair & Co. LLC
Q

Right.

Willy Walker
Chairman, President and Chief Executive Officer
A

...given our brand in the multi-family space and just the amount of financing we do in the multi space, we feel that there is a great opportunity for investment sales professionals who are on platforms that do not have anything close to Walker & Dunlop's client relationships or brand recognition in the multi-family space to jump from those platforms to our platform.

The second thing is that, because we now have a platform to build off of with our brand and offices across the country, we don't necessarily need to go after the star brokers. There's a great opportunity for sort of the second or third tier people and teams of investment sales professionals to be able to come to W&D and leverage off of our access to deal flow, client relationships, financing platform, and I believe really take their career to a whole different level.

So the strategy here is not go out and throw huge signing bonuses out at the star brokers at some of our big competitors and try and bring those people across. Given the breadth of our platform, we think we can grow this in a very cost-effective manner with some really fantastic talent that may not be the headliners at other shops.

Brandon B. Dobell
William Blair & Co. LLC
Q

Okay. And final one, given the nearly $5 million in prepayment fees this quarter and your comments about the refinancing wave kind of starting here in earnest, should we expect that number to stay at this kind of level, go up and others up – other component of that number driven by kind of floating rate and how the funds exit out of

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properties? But just trying to get a better feel for how we look at that repayment fee income number going forward relative to first quarter.

Willy Walker
Chairman, President and Chief Executive Officer **A**

It's a really good question and an impossible one to answer.

Stephen P. Theobald
Chief Financial Officer & Executive VP **A**

I'll take that. Hey, Brandon. But if you look-I mean, the last kind of three quarters we had roughly the same amount of prepayment fee income...

Brandon B. Dobell
William Blair & Co. LLC **Q**

Yep.

Stephen P. Theobald
Chief Financial Officer & Executive VP **A**

...each quarter. Does that make a trend for the rest of the year? Don't know. Like I said, it's really hard to predict.

Brandon B. Dobell
William Blair & Co. LLC **Q**

Okay. Okay. Thanks a lot.

Willy Walker
Chairman, President and Chief Executive Officer **A**

Yep.

Stephen P. Theobald
Chief Financial Officer & Executive VP **A**

Thank you.

Operator: Our next question comes from Jon McCullough with WHV Investment Management. Your line is now open.

Jonathan Winfield McCullough
WHV Investment Management, Inc. **Q**

Thanks for taking my question. Just to ask the refi wave question a little bit differently. Is there any reason why we should expect maybe the refis to be pulled forward significantly, so the waves are just bigger but there are not many of them? I'm just trying to think of like what's – how long can the trend be and kind of what you guys are thinking?

Willy Walker
Chairman, President and Chief Executive Officer **A**

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So it builds, Jon, over the three years. So, if you look at the refinancing volumes, 2015 is a huge step-up from 2014, 2016 is bigger than 2015 and 2017 is bigger than 2016. So, and those are annual volumes, so we haven't broken it down on a quarter-by-quarter basis.

So the thought of things being pulled forward, you're not at a rate right now that would tell you that tons is being pulled forward, so the contracts – it's hit and it's being redone.

Jonathan Winfield McCullough
WHV Investment Management, Inc.

Q

Got it.

Willy Walker
Chairman, President and Chief Executive Officer

A

I think the amount of investment sales activity was probably the delta in Q1. So should you have a deterioration in investment sales activity, you get back to a little bit sort of sitting right on top of the refinancing wave.

And then I would also say that, as it relates to rates, back to Steve DeLaney's question at the very, very beginning, what we – if everyone was freaked out about rates going up, we wouldn't have had as much variable rate financing in the first quarter.

And so I think a lot of people are out there thinking that rates might move at some point. But on the long bond, the other piece to all of that is that with the huge amount of foreign capital pouring into 10-year and 7-year U.S. Treasuries, even if Yellen and the Fed raise short-term interest rate, I think most people believe that the 10-year is going to stay, but grudgingly low for quite some time because of the amount of foreign capital chasing any kind of return on sovereign debt.

And so, as a result of that, people don't feel quite now pressured to run and grab a loan that's going to be priced off of a [ph] two (53:53) 10-year treasury. That may change, and as rates start to move towards the end of the year and the 10-year may or may not move, you might see that. But, right now what we're seeing from our borrowers is no great rush. It's just that they want to buy assets and refinance their assets as they come up for refinancing.

Jonathan Winfield McCullough
WHV Investment Management, Inc.

Q

That's very helpful. And then sort of just thinking about with the cash for GSEs, does – so here I'm on the West Coast. And so there's been a couple of big projects that come up and so some of the units have been in the buildings have been affordable housing, some of them not have had a certain percentage of affordable housing, others have been just normal units.

Does that fit affordable housing and does FHFA know that it's not exactly kind of cookie cutter, that it's kind of – that it's not as easy to get the affordable housing that maybe they have to think about it a little differently?

Willy Walker
Chairman, President and Chief Executive Officer

A

So, first of all, the definition of affordable is one that has been discussed at length with FHFA. And when and if they come out with modifications, and we said previously we believe that they will, but when and if they come out with modifications to 2015 scorecard, from our understanding of the dialogue that has gone on, it's our thinking that they may make adjustments to what the definition of affordable is so that some of the projects that you just

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cited that may not have qualified under the affordable definition would then qualify under the affordable definition, given what is truly affordable housing, workforce housing and the FHFA's desire to have Fannie and Freddie really focus on both the affordable product and the workforce housing, and not necessarily the higher-end type product.

And so I think that that's – I think when we see some adjustments to the scorecard that there will be something there where there is a reclassification of what qualifies as affordable.

Jonathan Winfield McCullough
WHV Investment Management, Inc.
Q

Okay. Appreciate it. Thank you so much.

Willy Walker
Chairman, President and Chief Executive Officer
A

Yep.

Operator: A follow-up question comes from Jade Rahmani with KBW. Your line is now open.

Jade J. Rahmani
Keefe, Bruyette & Woods, Inc.
Q

Hi. Thanks. Just on the Engler transaction, wanted to see if you care to lay out any parameters around how you think about annual accretion. For example, I think volumes averaged historically about $1 billion per year. Commissions in that business are in the 1.5% to 2% range. So we can make our own operating margin assumptions, but just want to see if you care to spell anything up.

Stephen P. Theobald
Chief Financial Officer & Executive VP
A

Yeah. Jade, this is Steve. I think, for kind of 2015, I wouldn't expect a lot from it on the combination of, one, we acquired a pipeline and so part of the revenue from that pipeline will likely be offset by some amortization of pipeline intangible.

And secondly, as we've discussed, we're going to be making some investments in that business. So we think at the margin it's going to be accretive, slightly accretive for this year. But I wouldn't expect a lot from a financial perspective in 2015.

Jade J. Rahmani
Keefe, Bruyette & Woods, Inc.
Q

How about going forward, beyond 2015?

Stephen P. Theobald
Chief Financial Officer & Executive VP
A

We'll cross that bridge when we get to it. We have plans for the rest of the year and we'll see how that goes.

Jade J. Rahmani
Keefe, Bruyette & Woods, Inc.
Q

All right. Thank you.

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Stephen P. Theobald
Chief Financial Officer & Executive VP

A

It's ongoing as you point out. Greg has run a very successful business and we're excited to have him on the team.

Jade J. Rahmani
Keefe, Bruyette & Woods, Inc.

Q

Thanks for taking the follow-up.

Stephen P. Theobald
Chief Financial Officer & Executive VP

A

You bet.

Operator: And it appears we have no further questions at this time. I'll turn the floor back over to Willy Walker for any additional or closing remarks.

Willy Walker
Chairman, President and Chief Executive Officer

I just thank everybody for joining us this morning, thank the W&D team for a fantastic quarter once again. And I hope all of you have a great day. Thank you.

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

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