

04-Nov-2015

Walker & Dunlop, Inc. (WD)

Q3 2015 Earnings Call

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Chairman and Chief Executive Officer

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MANAGEMENT DISCUSSION SECTION

Operator: Welcome to the Walker & Dunlop's Third 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 AM Eastern Standard Time. The dial in number for the replay is 800-839-2488. The archived call is also available via webcast on the company's website.

At this time, all participants have been placed in a listen-only mode and the floor will be open for 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, Steve and good morning, everyone. Thank you for joining us on the Walker & Dunlop third quarter 2015 earnings conference call.

For the first time ever we have taken our show on the road, Willy, Steve and I are reporting this morning from beautiful Southern California. We acquired Johnson Capital almost exactly one year ago, so it's fitting that we are reporting this quarter from Johnson Capital's old offices that have added so much to our platform.

The acquisition doubled our capital markets group and added significant brokered presence across the country. This quarter our brokered originations hit an all time high of \$1.3 billion. And in the last 12 months, we have originated \$2.9 billion of loans in the State of California; making it our largest state by origination volume. And as some of you who listen to the whole music on the conference bridge noticed the Beach Boys songs reinforce the theme of catching the commercial real estate financing wave and the good vibration of our financial performance is sending out.

And now on to the necessary legal disclosures. 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 slide presentation to Investor Relations section of our website, www.walkeranddunlop.com. These slides serve as a reference point for some of what Willy and Steve will touch on this morning.

Please also note that we will reference the non-GAAP financial metric adjusted EBITDA during the course of this call. Please refer to the earnings release and presentation posted to our website for a reconciliation of adjusted EBITDA to net income.

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 risk factors can be found in our most recent Form 10-K and subsequent Form 10-Q reports on file with SEC.

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

Willy Walker

Chairman and Chief Executive Officer

Thank you, Claire and good morning, everyone. The commercial real estate finance market continued its substantial year-over-year growth again this quarter. 2015 is looking like it may close as the most active year in a decade in terms of debt financing volumes and investment sales activity. We have positioned Walker & Dunlop to have the scale and market position to capitalize on this cycle, and for the fifth consecutive quarter we're reporting year-over-year growth across our financial results.

In three of the last four quarters, we have closed over \$4 billion of transaction volume on the strength of our GSE originations, the dramatic growth of our capital markets business and the broadened Walker & Dunlop presence across the commercial real estate industry. This quarter, we originated \$4.1 billion of loans, and closed \$825 million of investment sales volume for total transaction volume of \$4.9 billion.

Entering the third quarter, we were anticipating a slowdown in GSE lending given Q2 market disruptions and a relatively weak deal pipeline. However, in the middle of the quarter, due to market volatility and Fannie Mae re-

entering the market activity picked up significantly, and we ended the quarter outperforming our initial expectations, particularly with Fannie Mae.

As you can see on slide three, another strong quarter puts our market share of Fannie Mae's total multifamily originations year-to-date at 11.3% and at 13.7% with Freddie Mac. We have now originated over \$1 billion per quarter with each of the GSEs for five consecutive quarters and the combined \$2 billion of GSE originations per quarter has directly benefited our financial performance over that time.

Year-to-date, Fannie Mae has delivered \$32 billion of loans, while Freddie Mac has delivered \$34 billion. Our thinking continues to be that Fannie and Freddie will each finish the year between \$40 billion and \$45 billion of capped and uncapped business, leaving them with significant capacity entering the fourth quarter. The market is very active today, and we'll continue to use our position as one of the GSEs largest partners to gain market share and grow.

As an aside, Q4 is typically the most active quarter of the year from a total loan volume standpoint. Given the exceedingly strong and consistent loan volume we have produced all year, we do not see Q4 being materially different than previous quarters this year. In November of last year, we doubled the size of our capital markets team with the acquisition of Johnson Capital. The continued integration of that team coupled with the strong commercial real estate financing market has generated outstanding returns thus far in 2015.

In the third quarter, we originated a record \$1.3 billion of brokered loans. For context, that is more brokered business originated in a quarter than we originated in all of 2012. With a solid pipeline of business, we are expecting to finish the year originating around \$4 billion in loans, which means we'll have scaled our capital markets origination volume 3x in three years. That is quite an accomplishment.

In April of this year, we entered the investment sales business with the acquisition of Engler Financial Group. In its first full quarter on our platform, our investment sales team closed \$825 million in sales activity. Bringing their total to \$1.1 billion in just five and half months at Walker & Dunlop. Our investment sales team has a terrific reputation across the country, and we expect the momentum in this business to continue into 2016.

Our year-to-date transaction volume is \$13.1 billion, which is \$1.7 billion or 15% more than all of 2014. Loan origination growth combined with investment sales activity and significant increases in servicing fees and interest income have generated year-to-date diluted EPS of \$1.99, which is 26% greater than the \$1.58 in diluted EPS we generated for all of last year.

Beyond the significant top line and bottom line growth, we've generated 19% return on equity, 29% operating margin and adjusted EBITDA of \$95.3 million, or \$10.5 million greater than all of last year. These numbers and performance metrics widely exceed our expectations and are due to the brand we have built, the ability to deliver best-in-class execution for our clients, and the leverage we have achieved in our operating platform at significantly higher origination volumes.

It should be noted that Walker & Dunlop strong run of five consecutive quarters with over \$2 billion of GSE originations began shortly after FHFA issued the 2014 GSE scorecard. We believe, as we have for many years, that the GSEs will maintain their role as the bedrock of America's mortgage finance system.

The financial results we have achieved in the first three quarters of the year are phenomenal, but what is more exciting is that our market leadership position, and the investments we have made, position us even more competitively to achieve our goal of building the premier commercial real estate finance company in the United States.

With that, I'll turn the call over to Steve to discuss our financial results in more detail. And then, I'll come back with some thoughts about the regulatory environment and what we see ahead in 2016. Steve?

Stephen P. Theobald

Chief Financial Officer & Executive VP

Thanks, Willy, and good morning, everyone. As Willy mentioned, Q3 is the latest in the string of quarters in which we have shown significant year-over-year growth in transaction volumes. This level of production has resulted in significant increases in profitability and outperformance in our key financial metrics, with diluted earnings per share this quarter of \$0.66, up 40% from the \$0.47 we reported last year.

Return on equity annualized for the quarter at 18% increased dramatically yet again up from 15% in last year's third quarter predominantly due to a 34% increase in net income. Operating margin for the third quarter was 28%, up from 25% in Q3 2014. The improvement in operating margin was driven by the benefits of scale that come when volumes are above \$3 billion and from growth in revenue sources not directly tied to variable compensation. We continue to grow revenue at a rate faster than expenses, with 40% year-to-date growth in total revenue compared to a 29% increase in expenses.

During the quarter, Fannie and Freddie accounted for 63% of loan originations, with brokered volume at 32% resulting in a gain on sale margin of 172 basis points as shown on slide seven. 37% of our GSE volumes in the quarter were adjustable rate loans, remaining at level higher than our historical range of 15% to 20%. We continue to be pleased with gain on sale margin in the 160 basis point to 180 basis point range. As they are a reflection of the mix that comes with the diversification of our lending activity, specifically the dramatic increases we have seen in our Freddie Mac and brokered production. We also view the elevated levels of adjustable rate financing as creating opportunities over the next few years to capture additional volumes as these loans are either refinanced or the underlying properties are sold.

Slide eight, shows some details of the on balance sheet interim loan portfolio, which ended the quarter at \$347 million, \$30 million higher than at the end of the previous quarter. The economics of this portfolio remain strong, and we continue to see opportunities to prudently grow beyond our original target of \$250 million to \$300 million. With that said, we have a significant number of loan maturities ahead and we'll likely see the portfolio decline somewhat in the fourth quarter, before resuming its growth in 2016. Servicing fees continue to grow and were up 17% over Q3 2014. At \$29.3 million they were nearly 25% of total revenues.

On slide nine, you'll see the servicing portfolio ended the quarter at \$47.8 billion, up over \$6.5 billion from a year ago. During the quarter, our growth rate was dampened by maturities, pay-offs and transfers of life company servicing, which was replaced by longer term, more profitable GSE servicing. The fair value of our mortgage servicing rights as at September 30, 2015 was \$501 million, a milestone, as the value crossed over \$0.5 billion for the first time. This compares to our net book value of \$404 million indicating a substantial amount of inherent value in the assets. With no delinquencies in the portfolio, and the weighted average servicing fee increasing from 24 basis points to 25 basis points for the first time ever, the fundamentals of the portfolio have never been stronger.

Slide 10 shows that 17% of our total revenues came from interest income and other revenue sources. Interest income continues to benefit from growth in the interim loan portfolio, which generated \$2.5 million of net interest income during the quarter. In addition, the year-over-year increase in GSE production volumes resulted in \$4.3 million of net warehouse interest income, a 33% increase over the prior year.

On this slide, we show the most significant contributors of other revenues. Investment sales, which contributed \$4.7 million to the total, and prepayment fees, which were up significantly year-over-year and contributed \$4.3 million. Finally, other revenues included \$2 million fee we earned on a very large HUD transaction that was assumed during the quarter for which we participated in an advisory role.

Total expenses were \$87.3 million in the third quarter, a 19% increase over Q3 2014, with most of that increase coming from personnel costs, which remain our largest expense. However, as a percentage of total revenues Q3 2015 personnel expense decreased to 41% from 43% in the prior year quarter, exemplifying the impact of our improved scale.

The combination of all other expense categories declined to 31% of total revenues compared to 32% of revenues in the prior year. Looking ahead, we expect the traditional pattern of higher expenses in the fourth quarter due to our seasonally higher commission costs, which will then reset to lower rates in the first quarter of next year. Adjusted EBITDA was \$31 million for the quarter, up from \$20.7 million in Q3 2014.

Slide 12 provides more detail around the drivers of adjusted EBITDA. As you can see some from the slide, the growth in our servicing portfolio along with the investments we have made are returning significant cash back to the business, which in turn allows us to continue to invest in additional growth opportunities creating a virtuous cycle. Our cash generation continues to increase and we averaged close to \$10 million of adjusted EBITDA per month over the past year.

Our financial performance this year has been spectacular, benefiting from the business environment within which we find ourselves, as well as from the investments we have made over the last few years. We continue to see strong opportunities for growth and have the financial stability and resources to capitalize on those opportunities as they materialize.

With that, let me turn the call back over to Willy.

Willy Walker

Chairman and Chief Executive Officer

Thanks, Steve. Since going public in 2010 we have acquired companies to grow and diversify our lending operations. The year we went public, we originated \$457 million of brokered loans in our capital markets group. Since then due to the exceptional organic growth, strategic hiring and one acquisition, we have built a team that has originated \$4.1 billion of loans over the past year, representing nearly 10x growth over five years. With non-bank commercial loan maturities expected to increase significantly in 2016, we are very optimistic about our capital markets business.

We have expanded our lending operations as well by investing over \$92 million of capital in interim loans on our balance sheet with a total portfolio balance of \$347 million at the end of Q3. This lending program has been broadly welcomed by our borrowers and provided strong bottom line returns to our business.

In addition to the dramatic growth in our capital markets and balance sheet lending businesses, we launched our conduit with Fortress Investment Group last year. Although, our conduit has not scaled as we had hoped to-date our CMBS partnership has established a strong brand in the marketplace for originating and securitizing excellent deals. We see tremendous opportunity for our conduit in 2016 as CMBS maturities are forecast by the Mortgage Bankers Association to grow 82% to \$133 billion.

We remain committed to our core and multifamily lending business. There is a significant amount of multifamily debt maturing between 2016 and 2020, and maturing loans will continue to operate as a catalyst for investment sales and refinancing decisions by our customers. Not surprisingly, as you can see on slide 13, there is a strong correlation between investment sales activity and loan origination volumes. Our entry into the multifamily investment sales business has gone exceptionally well, and year-to-date that business has generated \$6.7 million of revenue on \$1.1 billion of sales volume. We love this business and see it as being hugely complementary to our multifamily lending going forward.

As you can see on slide 14, multifamily mortgage debt outstanding in the United States exceeded \$1 trillion for the first time ever in 2015. And is now by far the largest commercial asset class by total debt outstanding. It is fantastic to be one of the largest multifamily lenders in the country in the largest commercial asset class.

Slide 15 shows the growth in multifamily originations from the MBA's forecast. The original forecast published a year ago anticipated that multifamily debt originations would be \$186 billion in 2015. Last week, the MBA updated its forecast and now expects the multifamily market will finish the year at \$224 billion. The MBA, Fannie and Freddie all expect 2016 to be a larger multifamily financing year than 2015 with estimates ranging from \$225 billion to \$250 billion.

The growth in multifamily lending makes the speech given two weeks ago by Director, Mel Watt of the Federal Housing Finance Agency very significant. In that speech, Director, Watt told the market that the 2016 GSE scorecard would be similar to the 2015 scorecard. And that each GSE would have \$30 billion of capital for market rate business and unlimited capital for affordable, small, manufactured and seniors housing loans.

Additionally, Director, Watt described a quarterly review to the GSE scorecard, allowing FHFA to proactively adjust the GSE's lending limits upward should the market be larger than expected. This year, the multifamily financing market grew significantly faster than projected causing a market disruption in Q2. It was clear from Director, Watt's statement that FHFA wants to be proactive to ensure that the liquidity that GSEs provide to the multifamily market is adequate and consistent to the meet the markets' needs. Director, Watt also outlined a few new targeted multifamily property types that will be excluded from the market rate capped business, and we look forward to seeing the details behind those exclusions when the scorecard is released later this year.

As we have grown towards our goal of becoming the premier commercial real estate finance company in the United States, we have obtained significant scale through acquisitions and increased our brand recognition through the tireless efforts of our exceptional sales teams. All while maintaining the culture and customer service of a small company. Our size has become a differentiator for us, because we have the scale and expertise of large financial services institutions, but we can act in a rapid and entrepreneurial manner.

In a customer-driven business, we have developed a reputation as of high touch lender with speed and certainty of execution not easily matched in the marketplace. Our decades of experience in the multifamily industry and our reputation as one of the very best commercial real estate lenders and brokers in the country has led to greater access to clients and opportunities to finance complex and large transactions. We have seen the benefits of our increased brand and scale in our financial results as this cycle of increased financing activity has gotten underway.

We remain very optimistic about the fundamentals of our business. We do not have a single loan in our at-risk portfolio that is 60 days delinquent at the end of Q3.

Nearly 25% of our Q3 revenues came from long-term largely prepayment protected servicing fees that have an average life of 10 years. We have taken our quarterly EBITDA from \$10 million in Q3 2013 to \$20 million in Q3

2014, to \$30 million in Q3 2015. We have an incredible highly profitable business model that is providing our investors with fantastic risk adjusted returns.

I am truly thankful to all the individuals of this company that have made this year such a success. Two weeks ago, Walker & Dunlop was once again named one of the great small and medium size places to work by the Great Places to Work Institute. Of all the accolades Walker & Dunlop receives, this award is by far the most important and meaningful. It has always been our belief that if Walker & Dunlop is a great place to work filled with great people that the financial results and success would follow, and follow they have.

With that, I would like to ask the operator to open the lines of questions and thank all of you for joining us this morning.

QUESTION AND ANSWER SECTION

Operator: The floor is now open for questions. [Operator Instructions] Thank you. Our first question is from Jade Rahmani from KBW.

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

Q

Good morning, and thanks for taking the questions. I just wanted to get your thoughts on recent volatility in rates in the CMBS market. Are you seeing any changes in how sponsors are looking at deals, or is there any reason to be more cautious as you look to make additional loans?

Willy Walker
Chairman and Chief Executive Officer

A

Good morning, Jade and thanks for joining us. There is no doubt that the choppiness in the market that really began in earnest in mid-August has made pricing deals and structuring deals quite challenging. I think the markets were, for lack of a better term, quite consistent for the first eight and a half months of the year, but come mid-August when the market – when particularly equity markets started to dislocate somewhat, it created a lot of gapping out on spreads, even as you had a tightening on treasuries.

All that has done is made our role as an advisor to our clients far more important, and it is a true testament to the strength of our team that our Q3 results are what they are, and that as we started Q4 and that choppiness has remained in the markets that our team has been working very closely with clients to get deals done.

The final thing, specifically your point about CMBS, clearly the CMBS market has been volatile and you've seen that in all the tracking on the macro-numbers. I would only say that our conduit is gaining momentum given we've been in the market now for over a year, and we have a great brand and we have a great team. So as I said in my prepared remarks, we see a huge opportunity for our conduit in 2016 given the amount of CMBS financing that needs to be refinanced next year.

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

Q

Thanks for that. In terms of the originations outlook, what kind of impact do you think large transactions that you may not win, such as Lone Star or Stuy Town could have on the market, and specifically the GSEs capacity?

Willy Walker

Chairman and Chief Executive Officer

A

So I think the trend of large deals will continue into 2016. There has been a pretty significant disparity between the value that private buyers will pay for assets and the value that the public markets are putting on the REIT assets today. And as a result of that, I think that we will see more private transactions, and there is a tremendous amount of equity capital still trying to find its way into the commercial real estate space and multifamily as probably the strongest asset class during this cycle, I believe will continue to attract the interest of both the private equity firms as well as foreign investors.

The nice thing is that with our scale, with both Fannie and Freddie, Walker & Dunlop is very much in the mix on almost every large transaction, as you just said in your comments, we do not work on the Lone Star transaction, nor are we working on the Stuy Town transaction today, but I would put forth to you that on all of the big transactions going on, we are in the mix and it's our expectation that we will win our fair share of large deals as we move forward.

Jade J. Rahmani

Keefe, Bruyette & Woods, Inc.

Q

And then just on M&A, the current environment and your views on the cycle, is M&A attractive? And if so, what areas of expansion do you think would complement WD's existing platform?

Willy Walker

Chairman and Chief Executive Officer

A

So as you know Jade we've been very successful at acquiring companies, holding on to the talented human capital that we acquire through those acquisitions, and successfully integrating those companies into Walker & Dunlop. And so I would be shocked if we don't continue to focus on growth through acquisition. It's a real core competency of our company and of our management team. And I think our results speak for themselves as it relates to the success we've had with the acquisitions we've done.

With that said, we are not interested in making dilutive acquisitions. We've been very good at making accretive acquisitions and in doing so you need to find the proper opportunity where the combination of what the acquiree does today, and the scale that Walker & Dunlop could provide to their operations is accretive for both partners. So we must have something that they don't have and they must have something that we don't have, or at least the combination provides something that either of us has today. And so we'll continue to look, and as I said previously, I think we've had a fantastic run on that front, and it's become a real core competency of our company.

Jade J. Rahmani

Keefe, Bruyette & Woods, Inc.

Q

Thanks. I'll get back in the queue.

Operator: Our next question is from Steve DeLaney from JMP Securities. Your line is open.

Steven C. DeLaney

JMP Securities LLC

Q

Thanks. Good morning, everyone. And Claire, I just wanted to mention we're having difficulty finding the slide deck on the website. So no problem, we can look for it. But I just wanted to mention that at least my team hasn't been able to locate it. Willy, thanks for addressing Mel Watt's speech. I wanted to follow-up on that. So this new

quarterly review concept, what do you believe the practical impact of that quarterly review will be in terms of GSE behavior? Will they simply perceive that they can lend as much as they want, and if the numbers get big that Mel Watt will simply adjust the cap?

Willy Walker

Chairman and Chief Executive Officer

A

So good morning Steve. And for the first time when I say good morning to you on a conference call I know exactly how good that morning is as far as waking up at the crack of dawn to be on this call.

Steven C. DeLaney

JMP Securities LLC

Q

Yeah, thanks.

Willy Walker

Chairman and Chief Executive Officer

A

So thanks for being on, on California time.

Steven C. DeLaney

JMP Securities LLC

Q

Yeah.

Willy Walker

Chairman and Chief Executive Officer

A

I think that that is a potential expectation, and I think it's probably a false expectation. In the sense that from listening to Director, Watt's speech as well as participating in a lunch right after that speech, it is very clear that the FHFA does not want to have the same type of market dislocation or market seize up that we saw in Q2 of this year when the agencies had a very strong Q1 and it looked like they were going to hit their caps and therefore had to go back into FHFA for review. So this will be a formal process that will make it so that that does not have to happen again.

With that said, I think both GSEs understand that the FHFA is very focused on market share and Fannie and Freddie's market share. So let's just take a look and think that in Q1, 2016, Fannie and Freddie said, let's just get back at it go hog wild. And all of a sudden you got to the end of Q1 and FHFA did their review, and although Fannie and Freddie did a ton of production the market wasn't as big as FHFA thought it was going to be. I do not expect FHFA at that time to, if you will, allow Fannie and Freddie to go beyond the existing caps if their market share has surged beyond 50% of the market for instance.

So I think at the end of the day, this review should they go and have a very strong first quarter and all of a sudden the aggregate market size has grown dramatically to make it so if they are less than 50% of the market, then I think there is clearly the opportunity that FHFA would broaden out the caps. But I think that if they are north of 50% and just sort of said, we're going to go and gobble up the market that they would have absolutely no reaction other than potentially a real – a negative reaction from FHFA as far their volumes.

Steven C. DeLaney

JMP Securities LLC

Q

So that's helpful. And it sounds like you're suggesting that 50% is the magic level at which the GSEs may be required to put on the brake, 50% market share, that would be a level that Mel Watt would not want to breach?

Willy Walker

Chairman and Chief Executive Officer

A

I would put forth to you that that's probably a level they would now want to breach. FHFA is very focused on 40%.

Steven C. DeLaney

JMP Securities LLC

Q

Okay, got it.

Willy Walker

Chairman and Chief Executive Officer

A

So they are talking 40%. I am giving you, if you will, some color thinking that where they to go over 50% I think it's a pretty quick, we're not giving you any relief. If they're under 50%, I think that there is clearly discussion, but where FHFA is targeting them to be is closer to 40%.

Steven C. DeLaney

JMP Securities LLC

Q

Got it. That's very helpful. Thanks for that clarity. And switching over to the CMBS conduit activity, nice to see that you did report \$56 million of origination sales in the quarter. We were curious, Willy, we did not see those loan sales reported by commercial mortgage alert in their weekly report, so contributors enter new issues. Is there something – but your first quarter and second quarter activity were picked up; was there anything different about the second quarter sales that – can you comment on which deal you sold into, or just curious why we didn't see until your press release?

Stephen P. Theobald

Chief Financial Officer & Executive VP

A

Hey Steve, this is Steve.

Steven C. DeLaney

JMP Securities LLC

Q

Thank you.

Stephen P. Theobald

Chief Financial Officer & Executive VP

A

To clarify on that Steve, the \$56 million represents what we originated through the Walker & Dunlop platform for the CMBS conduit during the quarter. The conduit actually did not participate in the securitization in Q3.

Steven C. DeLaney

JMP Securities LLC

Q

Got it.

Stephen P. Theobald

Chief Financial Officer & Executive VP

A

So we have one that we're in the throes of wrapping up right now that will be in the fourth quarter result.

Steven C. DeLaney

JMP Securities LLC

Q

So those loans were on the conduits, that loan or loans were on the conduit warehouse at 9/30?

Stephen P. Theobald

Chief Financial Officer & Executive VP

A

Exactly right.

Steven C. DeLaney

JMP Securities LLC

Q

That helps us understand. And your revenue recognition, does it occur when you deliver it to the conduit or when the new issue is actually executed?

Stephen P. Theobald

Chief Financial Officer & Executive VP

A

Yeah. So within the joint venture itself, we're marking things to market so there is some reflection of the economics at the end of the quarter, but most of the securitization related revenue obviously will be recognized when the deal occurs.

Steven C. DeLaney

JMP Securities LLC

Q

Got it. Okay, that's helpful. Thank you, Steve.

Stephen P. Theobald

Chief Financial Officer & Executive VP

A

Yeah.

Steven C. DeLaney

JMP Securities LLC

Q

And Willy, one last thing, obviously Engler a good first full quarter, over \$800 million. If we look at – I don't know whether that's a run rate type of quarter, but it would certainly project out to \$3 billion to \$3.5 billion a year in IS volume. You had stated earlier that you expected to start stepping up recruiting early 2016 once year-end compensation hurdles are kind of – compensation is reset for everyone. When we look out over the next couple of years, can you give us some sense of what your expectation would be for a growth rate in IS volume year-over-year? I mean, are we looking at something that is a 10% grower, or does it have the potential to be much greater than that? Thank you.

Willy Walker

Chairman and Chief Executive Officer

A

So Steve, first of all \$825 million in their first quarter Walker & Dunlop I would say is a little better than good. And we view it as being quite honestly spectacular. The second thing is, as it relates to recruiting, we have spent a lot of time focusing on expanding that team and that platform across the country. The success of that team in a very, very short period of time at Walker & Dunlop I think is reflective of the strength of our platform, and that has, if you will, emboldened into our recruiting efforts and helped us a tremendous amount.

I think the third thing on the recruiting side of things is that if somebody comes to Walker & Dunlop on the investment sales side, we basically are giving them a blank sheet of paper to go build their business, whether in the Western United States or in the Southwest or in the Northwest, and the Northeast, for that matter, which is a real advantage to us versus some of the competition, which have fully built out investment sales platforms where elbows might be a little sharp, if you will, and where territories are very, very specifically defined.

The final thing is, as it relates to the growth rate, we have not given projections on how fast we're going to grow that business. But I think it's – I do believe it's fair to look at the growth rate that we have built our capital markets business at. We set our mind to growing our capital markets businesses in 2012, put it out there as a stated objective and as you can see from the numbers we put up today on the growth of that business, we've been very successful at executing on that growth. Today, we don't see anything out there that says that our investment sales business can't grow in a similar fashion to our capital markets business, given our brand, given the deal flow that we see coming up in 2016, 2017 and 2018, and quite honestly the platform we acquired to be the cornerstone of our investment sales platform.

Steven C. DeLaney

JMP Securities LLC

Q

That's helpful. I appreciate your point about having a lot of open territory, which gives you, if you will, to use the word franchises that you can grant to this talent does put you in the driver seat, I think. So congratulations on another great quarter. Thanks for the color.

Willy Walker

Chairman and Chief Executive Officer

A

Thank you, Steve.

Claire Harvey

Vice President-Investor Relations

A

Steve on the slides I apologize for the confusion, they were posted under the Quarterly Results section of the website; they're now under both Quarterly Results and Webcasts & Presentations, so you can find them in both places.

Steven C. DeLaney

JMP Securities LLC

Q

Great. Thanks so much. Thanks very much.

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

Charles J. Nabhan

Wells Fargo Securities LLC

Q

Thanks and good morning. Staying with the investment sales business, could you comment, can you provide us with the operating margin for that business from this quarter, and comment on whether you see that as a normalized run rate in light of the growth initiatives in place for the business?

Stephen P. Theobald

Chief Financial Officer & Executive VP

A

Yeah, Chuck this is Steve, I think you can kind of back into it; we've given the revenue number, you can see in the income statement the amount of income that was attributable to non-controlling interest, which is 25%, which is based on the amount that EFG team retained. So you can figure out what the operating margin is. It's pretty strong right now, I think as we build out the platform and incur recruiting expenses and cost to get folks signed on to the platform, you should see that operating margin drift lower, but should remain at pretty good level.

Charles J. Nabhan
Wells Fargo Securities LLC

Q

Okay. And as a follow-up, it looks like about 37% of loans were floating rate this quarter. Could you comment on what you're seeing from a borrower behavior standpoint thus far in the fourth quarter, and your expectations going into 2016?

Willy Walker
Chairman and Chief Executive Officer

A

Sure Chuck. So Q1 and Q3 of 2015 were, if you will, floating rate quarters where the percentage of our originations that were floaters got close up close to 50% of our loan origination volume, up from sort of a historic average of around 25%. Q2 is back down at sort of the historic average of 25% floating and 75% fixed. I think the market has a rate increase of 25 basis points already built into it from an acquisition standpoint, and so I don't think that there are any buyers out there today who are not expecting a rate hike of 25 basis points either later this year or early in 2016. And as such, I think that people are doing their math and saying, we think the Fed might raise, and if the Fed raises, they're not going to continue to raise. So we like the additional spread we can pick up by going floating versus fixed.

And then the other major driver is that on a floating rate deal you're locked out for the first year and then you got a 1% prepayment penalty for the rest of the loan versus on a fixed rate loan you've got yield maintenance for 9.5 years of a 10 year loan. That prepayment flexibility has driven many buyers who don't plan to hold the assets for a longer than five-year or seven-year period to go and opt for variable rate financing. So it has been a very robust variable rate market. Fortunately, for us and for the agencies, Fannie and Freddie's variable rate products on the multifamily side are as good as or better than anybody else's. And so it is a very competitive product, and we've been selling a lot of it.

You're asking about 2016, I would put forth to you, as I said previously, most people have the 25 basis point rate increase already built into their numbers. And I would think that we continue to see a lot of variable rate into 2016 should there be a second or third rate increase by the Fed, my tummy would tell me that people start to think that rates actually might materially move and start to look more towards fixed than float. But as long as we're in this sort of potential rate increase might do it, than do it, but then sort of pause. I think borrowers will continue to look for variable rate financing.

Charles J. Nabhan
Wells Fargo Securities LLC

Q

Great. Thank you guys.

Willy Walker
Chairman and Chief Executive Officer

A

Yeah.

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

Jeffrey D. Adelson
Morgan Stanley & Co. LLC

Q

Hey guys. This is Jeff Adelson calling for Cheryl.

Willy Walker
Chairman and Chief Executive Officer

A

Good morning, Jeff.

Jeffrey D. Adelson
Morgan Stanley & Co. LLC

Q

Good morning. I was just wondering if you could elaborate a little bit more on the mix of variable versus fixed on the expense line. I know you mentioned that the acquisitions added to the fixed comp a little bit. But just wondering if you could just give some more color on that.

Willy Walker
Chairman and Chief Executive Officer

A

So you want to focus Jeff on variable versus fixed expenses?

Jeffrey D. Adelson
Morgan Stanley & Co. LLC

Q

Yeah. Just, I mean, it looks like you guys had some pretty good operating leverage on the comp side. So wondering if you could maybe elaborate whether there was some shift in the mix there, some seasonality we should be thinking of?

Stephen P. Theobald
Chief Financial Officer & Executive VP

A

No, Jeff I think really this is a reflection of the fact that we did \$4.9 billion of transaction volume. I mean at that level obviously our overall compensation expense is going to increase based on the commission payouts. But at that level of origination volume our fixed expenses are going to become a much smaller percentage of our overall revenue base and that's what we saw this year -- this quarter. We did see an increase in amortization expense on the mortgage servicing rights, which is a reflection of the fact that we've grown the servicing portfolio pretty significantly. So all things being equal, that level of amortization is going to continue to increase, but we also saw a slight pickup in prepayment activity which generated on the expense side some additional write-offs of mortgage servicing rights, but as you saw on the revenue slide, it also resulted in a pretty sizable increase in our prepayment fee income. So those kind of go hand-in-hand at this point.

Jeffrey D. Adelson
Morgan Stanley & Co. LLC

Q

Okay. That's helpful. And then just in thinking about the servicing portfolio, is 25 bps something we should be expecting on a run rate basis now, or does that maybe tick back down to the 24 bps over time?

Stephen P. Theobald
Chief Financial Officer & Executive VP

A

Yeah, look I think it's going to hover in the 24 basis point to 25 basis point range. It depends on the mix of business that we're putting into the portfolio going forward. As I mentioned in my remarks we had some transfers out on the life company servicing side, which is at much lower rates than our portfolio average, and that really

helps push the average fee up to 25 basis points. If we book a lot more life company servicing in Q4, it could pull that number back down on to 24 basis points, but it's going to be in that range for some time.

Jeffrey D. Adelson

Morgan Stanley & Co. LLC

Q

Got it. That's helpful. That's all I had. Thank you.

Stephen P. Theobald

Chief Financial Officer & Executive VP

A

Yeah.

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

Jade J. Rahmani

Keefe, Bruyette & Woods, Inc.

Q

Yes, hi. Thanks for taking my follow-up. Can you give a sense on the brokered loan size about product mix, maybe by property type or however you'd like to describe it?

Willy Walker

Chairman and Chief Executive Officer

A

Jade, we haven't broken that out. But I would put forward to you that there are couple of themes in there. First of all, it is across all property types, so retail office, hospitality, retail being our second largest asset class followed by office and hospitality being, if you will, the fourth. The other thing I'd put forth is that in our brokered business we are seeing a lot of multifamily going off to life insurance companies and CMBS lenders.

And I think that that is emblematic of the fact that W&D has such a strong reputation in the multifamily space that our brokers are having the opportunity with the strength of the GSEs as W&D's reputation and size with them to be able to go to potential clients and say, if you want the best agency execution, give me the deal. But I'll also take it out to the rest of the market and see what else is out there.

And on a low leverage deal that likely might go to a life insurance company, on a higher leverage deal it might go to a CMBS lender, and if it's sort in the 75% loan Tier 2, it's going to go to an agency and whether it's Fannie or Freddie, they are going to get best in class execution from W&D. So multi is by far the largest asset class of our brokered operations year-to-date. And as I said, with retail in number two, office in number three and hospitality in number four.

Jade J. Rahmani

Keefe, Bruyette & Woods, Inc.

Q

In terms of the – just looking at the balance sheet, the mortgage loans held for sale line item increased sequentially, significantly. Is that a timing factor, and did you see the GSEs extend sort of the time in which they would take to buy the loans from you?

Stephen P. Theobald

Chief Financial Officer & Executive VP

A

Yeah Jade, most of that impact is just a function of the increase in volume as it's sitting on our warehouse waiting to be delivered to the investor. There is some portion of our loans available for sale with Freddie Mac for which we

will be holding those loans beyond our typical period likely into 2016. As of the end of the third quarter that number was still relatively small. And you saw earlier in the quarter we put out a press release on a portfolio of loans that we had done that we arranged a separate warehouse line for that we're holding until probably sometime in early 2016 as well, that was about \$240 million portfolio. So there is some of that, but most of the surge in volume is just a function of the increase in origination activity.

Jade J. Rahmani

Keefe, Bruyette & Woods, Inc.

Q

So given that those loans are holding for longer, can you just give an update on current investment capacity and liquidity?

Stephen P. Theobald

Chief Financial Officer & Executive VP

A

Sure. So we've right now got about \$2 billion of overall warehouse capacity. We still have room within that number based on where you saw the loans available for sale balance. We've also had discussions with our banks as they've done historically in the fourth quarter when we've had volume increases, they've been very receptive to increasing that capacity and I know of no reason why that wouldn't continue to be the case.

Jade J. Rahmani

Keefe, Bruyette & Woods, Inc.

Q

Okay. Just on the conduit margin side, was the decline due to brokered loan mix? And can you just give us some color on the brokered loan margins?

Willy Walker

Chairman and Chief Executive Officer

A

So on the conduit side, I am not exactly sure what margin number you're pointing to on the brokered side, the brokerage business as you know Jade, we don't break out by execution of the various margins. But I would just put forth to you, if you look at the volume we've done in the broker business and the overall operating margin we have put up for several quarters now, that is playing very nicely into our overall operating margin from a scale and from a return standpoint.

And then as Steve mentioned in his comments, the 172 basis points gain on sale margin, that we had in the quarter, I think is emblematic of the diversification that we put into the business. Many investors have sat there and said, well, we love your gain on sale margin, but it's all Fannie Mae business, and if anything ever happened to Fannie Mae, your gain on sale margin would drop dramatically. And so as we have gone and built up our relationship with Freddie Mac to be in one of their very larger seller servicers, as we've scaled our brokerage business and as we've added our investment sales business as well as our balance sheet lending and the conduit.

Having the gain on sale margin be in that range that Steve put out there of 160 basis points to 180 basis points is exactly where we like to see it, because it is emblematic of the diversification we put into our business. With all that said, the gain on the sale margin that we're getting from our Fannie origination has been fantastic, and remains very strong. And so it's a very positive outlook from both of those standpoints from my perspective.

Jade J. Rahmani

Keefe, Bruyette & Woods, Inc.

Q

Great. Thanks for taking my follow-ups.

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

Brandon B. Dobell
William Blair & Co. LLC

Q

Thanks. Steve, just first a quick one, just want to confirm how you guys are thinking about the personnel expenses to finish out the year, and how we should think about the impact of Engler as we try and model the first part of next year too?

Stephen P. Theobald
Chief Financial Officer & Executive VP

A

Yeah, so Brandon, on the commission side, it's typically as you can see from our historical numbers, our commission expenses increased over the course of a fiscal year as folks get to the top-end of their splits. We're expecting that same dynamic here with respect to the fourth quarter. So I wouldn't be surprised if personnel expenses are a little bit higher in Q4 than they have been in the previous quarters.

Brandon B. Dobell
William Blair & Co. LLC

Q

Okay.

Stephen P. Theobald
Chief Financial Officer & Executive VP

A

I think what we have seen is on a year-over-year comparison, our personnel expenses have been running at a lower percentage of total revenue, but they have increased each quarter as we've gone through the year.

Brandon B. Dobell
William Blair & Co. LLC

Q

Okay [indiscernible] (52:28).

Stephen P. Theobald
Chief Financial Officer & Executive VP

A

And then when we roll the calendar to Q1 things start over, commission schedules reset and we'll start at the lower levels again come January 1. On the investment sales, obviously with us acquiring EFG in the second quarter, in April, there won't be any first quarter comp revenue from investment sales. So as you build in your model there, it's zero in 2015, and it will be whatever you model in 2016, and we'll get half a month of that benefit in the second quarter, and then at that point, it's fully comparable.

Brandon B. Dobell
William Blair & Co. LLC

Q

Got it, okay. And then Willy, a couple of one's for you. First, maybe some perspective on – I think you said \$225 billion to \$250 billion is kind of the expectation for next year's volumes. Some perspective on the likelihood of that \$250 billion being too low, given the momentum the market has, or do you think there were some special things this year, given just the talk about rate increases and that kind of stuff that makes that \$225 billion number the right place to start.

Willy Walker
Chairman and Chief Executive Officer

A

Brandon I'd put forth that \$225 billion is the right place to start. If you think there is \$1 trillion of multifamily debt outstanding the majority of that is 10-year paper that should give you \$100 billion a year turnover, as you know very well, there has been a tremendous amount of floating rate debt that's been put out there over the past several years, and that if you will, we'll expand that \$100 billion recurring out from refinancing standpoint and then the amount of investment sales activity that's been going on is also been a big driver of it.

I think one of the interesting data points is if you look at the Mortgage Bankers Association maturities graph that we have looked at many times as it relates to refinancing opportunity in the commercial real estate space. The market opportunity for multifamily in 2015 from a refinancing space was \$25 billion at the beginning of the year, and as we now see it's going to be more like a \$225 billion to \$230 billion a year. So if you're just focused on the refinancing opportunity from a maturity standpoint, you have the very great potential to miss a very significant opportunity.

Brandon B. Dobell
William Blair & Co. LLC

Q

Right.

Willy Walker
Chairman and Chief Executive Officer

A

With that said, the slide that we put in the presentation today showing the correlation between investment sales activity and financing activity, I think is really the one to keep our eye on. So if you have a robust macro environment where investors are still seeking commercial real estate and particularly seeking multifamily you're going to have the most important driver of financing volumes in that activity. And it's one of the reasons why we're so excited about our investment sales business, because we continue to pick up on both of those trends.

If for whatever reason investment sales activity falls off, we do have that bedrock, if you will, of the refinancing volumes, and as you know from having looked at the slide, the one asset class that continues to have refinancing, they grow in 2018-2019 and 2020 is multifamily because the agencies we're lending in 2008, 2009 and 2010. So we feel very well-positioned for both the upside of an expanding economy with increased investment dollars, as well as very well-positioned should the market start to falter somewhat, or investment sales activity falls off, and we have that un-recurring business activity of the refinancings.

Brandon B. Dobell
William Blair & Co. LLC

Q

Okay. Got it. That's helpful. And then last one, good return on equity thus far this year. It appears that would be sustainable, given the mix of business you guys have. But maybe some thoughts on what could change that ROE up or down by more than just kind of a point or two points, since that's kind of tough to model on a near-term basis. But as we think about risk or opportunity for, let's call it a 5-point move in the ROE. How should we bracket those different opportunities, I guess?

Willy Walker
Chairman and Chief Executive Officer

A

Yeah Brandon, I think a material alteration of our growth rates obviously would have an impact on that ROE number, to your point, I think we're pretty comfortable where the business is currently right now that we can continue to sustain higher than our target ROEs. We got to continue to invest in the platform to grow it. Clearly, the other way you materially impact that as you return capital to shareholders in some form or another and that would be another way to materially impact it.

Brandon B. Dobell

William Blair & Co. LLC

Q

Okay. Got it. All right. Thanks guys. Appreciate it.

Willy Walker

Chairman and Chief Executive Officer

A

Yeah.

Operator: [Operator Instructions] . Our next question is from Jordan Hymowitz from Philadelphia Financial. Your line is open.

Willy Walker

Chairman and Chief Executive Officer

A

Jordan, are you there?

Operator: Once again, Jordan Hymowitz your line is open. And it appears, we have no additional questions at this time. I would like to turn the floor back over to Mr. Willy Walker for any additional and closing remarks.

Willy Walker

Chairman and Chief Executive Officer

Great. Thank you, Steve. Thank you, Steve here, thank you, Claire. And thank you everyone for participating in the call today. And mostly thanks to W&D team for an absolutely fantastic Q3 as well as year-to-date results. And we look forward to talking to many of you during Q4 as well as at our Q4 earning call in February of next year. So thanks very much for joining us today. Have a nice day.

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

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