Walker & Dunlop Presentation
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Thanks to all of you for attending. I'm Brandon Dobell, the analyst at Blair that covers real estate services companies, and it's my pleasure to have Debbie Wilson, CFO from Walker & Dunlop here. I thought we'd start off with maybe five minutes or so of overview comments and then go into Q&A. If any of you in the audience have a question please just raise your hand. Don't want to monopolize the time, but we'll spend the whole time doing Q&A versus anything else. So with that I'll turn it over to Debbie for some overview comments, and we'll go from there.

Deborah Wilson

Good afternoon. Let me take a couple of minutes to talk about who we are. We are Walker & Dunlop. We are the 11th largest commercial real estate company in the nation. If you have a presentation and can take a minute to turn to page 4 for just a second. We are 11th as I mentioned. We came from 45th in 2007. So we took quite a bit of market share.

If you take a couple of minutes and look at this, most of the people we compete against are very large banks and insurance companies. But what I think you'll also find is all this time we were growing--I'm going to flip you to another page which is page seven--you will see that our income from operations grew 31% in the nine months ended 9/30/11, to the comparative period in '10. And in addition to that, we have a proven track record of growing. If you flip to the slide just before that--sorry as I run you through the stack quickly--you'll see that our revenue and income from operations have grown at a compounded average rate of 25% over the last four years.

While we are growing we are diversifying. If you think about it, we do most of our originations with the multi-family and commercial space. But multi-family primarily with the GSE's and HUD. If you're familiar with the commercial real estate market, that's been the primary capital source since about '08. But if you'll look on page five for just a second and look on the right hand side, in '07, you'll see that about 60% of our originations came from multi-family and about 40% from commercial, which is that other category. And in '11, 22% is commercial, and that's really based on the capital sources. We are always actively looking for new capital sources in the market as they come back to commercial real estate. The thing that's really important to be in this business is you've got to be relevant, and relevant is having volumes.

We are not a balance sheet lender. We're not a bank. We originate and sell almost everything we do. And if you look on page 14 for just a minute, I do want to say that the volumes that we do with Fannie Mae, we take credit risk on. We take about, we're capped at 20% of the UP on risk, but effectively think of it as we own the B pieces for the Fannie Mae originations.

What's important on this is our credit portfolio and statistics over years. If you'll look at the bottom of the page you'll see that our 60 day delinquencies have been under 1% and they're nothing at September 30 of '11. We have no loans greater than 60 days delinquent at 9/30/11. Our delinquencies peaked in 2/2/10 at 164 basis points but very very small compared to the industry. If you think about it our losses have averaged 1 basis point of our portfolio over the last 10 years. One basis point. If you look on page

11 for just a second, this is our servicing portfolio. You can see that we get paid an average of 22 basis points [per] year of service and we've lost an average of one over the last ten years.

While we've done all this growth and diversification, what's really important to us are margins. So I want to take you to page 15 for just a second. As I've run you through the stack, thank you for your patience. If you look at the last line on this page you'll see the operating margin since '08 through Q3 of '11. 29% in '08, 32% in '09, 33% in '10 and 37% year to date. We've indicated that we expect to finish the year in the mid 30's. So margins have remained strong in spite of all of our growth.

Why is that? There are two reasons. One is we talked a minute ago about the servicing portfolio. Servicing portfolio is prepayment protected. So it's 10 year loans, 30 year amortizations with yield maintenance for about nine and a half years. So for most of the loans in our portfolio greater than 90%, if the loans prepay I get a check for the rest of the servicing fees for yield maintenance, which is present valued at the risk free treasury rate. So effectively I created an annuity in my servicing fees that are going to be there for a long period of time.

In addition--so I've got a stable revenue source, but I also have a big variable expensive structure. If you look on page 13 for just a second, you'll see that my expense base is primarily personnel, of which about half is variable. It varies over time but effectively I don't have a big fixed cost structure base. I have a variable structure base.

What are we going to do going forward? Let's go to page 16 for just a second. Clearly we do business with the GSE's and I'm sure Brandon will ask me the question, because he always does and we love that.

Brandon Dobell

No, no, not going to do that, no.

[laughter]

Deborah Wilson

If you step away from Fannie and Freddie and look at the multi-family sections of their business, they're wildly profitable. Fannie Mae has made $105 million through nine months and Freddie Mac has made $750 million through nine months in their multi-family divisions. Delinquencies are low, they're well. Fannie Mae's is at 57 basis points at June 30 and I think Freddie Mac's is 33 basis points. So I think you'll see that the lending that has gone on in that arena, which is the lending that we do, has performed very well and it's done very thoughtfully. There are people that wonder if we take enough risk or not. But it has performed very well.

When we think about going forward it's always important to diversify capital sources. So we're looking at increasing what we call the capital markets group which is our Other or Commercial. Commercial comes in and out of the market. It's not been in favor since '08. Life insurance companies, banks and CNBS are the primary sources. But life insurance companies have been in, but they're small compared to the rest of the market. Banks tried to figure out what they were doing in '08 and '09 and '10. They're yield-starved so they need some help. But they do short-term variable rate lending. We do long-term fixed rate lending that gets put in securities. So there's a big advantage in the market because most borrowers want fixed rate.

So, what's important for us is to diversify. We'll end up diversifying away from the GSE's as needed over time. But it continues to be a very strong and stable and profitable platform for us. But what's important for us is deal flow. So we expect to expand our capital markets platform over time. That will give us access to deals for both multi-family, but primarily non-multi-family. because if you look on the last section of that on page 16, we're really talking about proprietary capital. We do some fund management for both Fannie Mae and some pension funds right now. Those funds are equity and debt for the commercial real estate market. We would like to continue to expand that business.

When we're expanding that business we'd also like to co-invest as part of that. So we believe it's important that we do two things. One, be able to fund management because it's a fee-based business, which we really are if you think about it. And then second of all we want to expand our ability to take risk, because we've taken on multi-family right now. We have a long track record of commercial, so we'd like to do some commercial as well. We're very thoughtful about the risks we take, but we also want to get paid appropriately for the risk.

So in summary, we're the 11th largest. We've grown, we're diversified. We've done it not on our balance sheet. We've been profitable for most of the period of time and maintained strong margins. And we're looking about continuing to grow and diversify going forward.

Brandon Dobell

Perfect. So let's start with GSE questions. I guess from a capital allocation perspective, you mentioned a number of ways you want to diversify the revenue base, diversify the business. How can we think about how you prioritize allocating capital to acquisitions, hiring producers, starting a fund management business? Have you got a certain pool of capital? Or do you want to go raise more capital in some respect to put that capital to work and how we think about how you do that?

Deborah Wilson

Sure. So the first thing I want to do is put the capital that I have to work. There's a timeline about hiring producers versus making acquisitions versus starting up and managing fund business.

Producers become available in our business generally for one of two reasons. One is the company that they're working with is being sold and there's some sort of uncertainty in the market, or it's time in their career to make a change. Frequently there have been a number of our lenders, about four of the lenders in the Fannie/Freddie space in the multi-family side get sold every year. So there's a fair amount of noise in the market and there's a fair amount of movement among producers. So bringing them back and forth in companies happens. But they generally have the tendency to stay five to seven to ten years where they go. So the movement of the sale creates an opportunity to bring people on board. So we're actually looking at attracting and hiring producers and we've done that.

We've brought a number of people over from Deutsche Bank, because Deutsche Bank has been up for sale for a while. And then in addition to that I think you'll notice we made an announcement on December 1st that we put together a HUD team in Nashville, which will significantly increase our HUD [??]. So we're doing some acquisitions of people, as well as we're looking at a number of acquisitions on the mortgage banking side.

Who do we look at for targets? The first ones that make sense to us are our correspondents. We talked a little bit about my variable cost base. About half of my volume comes through correspondence. Correspondence in my world means a deal, not a loan. So they'll bring it, we'll underwrite it, we'll close it and we'll do asset management. But that flow brings us. We see a certain part of their volume, but we don't see all their volume. So they're small and when put together appropriately with the right infrastructure, that allows us to grow. We could make a large acquisition, but first of all it's hiring producers, second of all there's a longer tail on buying companies.

The third thing is the this fund management. We like the fund management business. It is a fee-based business without a lot of capital. We have good experience in that. We've made a number of offers and have had a number of conversations in that space and we continue to have those.

We continue to have a number of conversations on the capital market side, on acquiring companies. If you think about our world prior to August, the CMBS market had ramped up and so these people thought they were very valuable. When the CMBS market imploded in July and August they realized that they're not quite as valuable as they thought. So it has allowed us to regenerate some conversations without having to pay too much money.

So first, producers; second, companies; and then fund management takes a long time. If you're in the fund management business you know that because it takes a long time to raise capital and put it to work. So we're trying to team with the people that do that, so that just takes longer.

Brandon Dobell

Fair enough. You mentioned the importance of margins as well as diversification. How much flexibility do you think you have on the margins if you found the right opportunity to diversify away from a) multi-family, and b) the agencies? Are you willing to sacrifice margin to be much broader or do you think you can become much broader without giving away too much on the margin line?

Deborah Wilson

I do think diversification can happen. It depends on where the diversification is, but the reality of it is is if we're doing diversification and we take risk in that business, the margins we think will be okay, because you get paid to take the risk. Underwritten appropriately, it gives us the margins that we have. If we diversify like we talked about in the capital market space, that is a lower margin business. We don't really underwrite it. We send the deals to life insurance companies or CMBS and we service them. They're all non-risk and it's a low fee business, so that would cause some margin compression.

Am I comfortable with where we are? Yes. If I did a lot of capital markets, would it have a margin implication? Sure, sure. To be honest to get to the right deal flow, to set it up for the next part of the [securitization] role that happens, that could occur.

Brandon Dobell

OK. Fair enough. Obviously multifamily is a big part of the business, not only the housing market trends are in your favor, but probably demographics are in your favor. How long do you think you've got, in this kind of good part of the cycle for multifamily, before either it gets too expensive, higher producers, or before sources of capital starts to look elsewhere because the cap rates are too low?

Deborah Wilson

So for those in the market, the multifamily business is having a good run. They have for a number of years. Capital has been readily available. In '08 or '09 there was some spreads between bid/ask for values of properties, so people weren't refinancing if they didn't have to and transactions weren't occurring. What's happening now is, as vacancies have declined and rents are starting to increase, the bid/ask spread in properties has come in substantially and transactions are starting to happen. So to the question about--ask your question one more time.

Brandon Dobell

How long do you think this . . .

Deborah Wilson

Run happens?

Brandon Dobell

How long does it run and does talent get more and more expensive to go after or does something else besides that--as cap rates get too low, so capital sources look elsewhere--is that what caused it to fall off?

Deborah Wilson

Two things--one is producers, there is a point that the cheapest way to bring someone in is to hire a producer. Because you will have some sort of small signing bonus, but you're effectively not paying for a company, and company generally includes a servicing portfolio. So the least expensive is to bring in a person; the second is to bring in a company. We prefer to bring in people. Are there signing bonuses going on right now? Absolutely. Are they too expensive? The answer is no. You look for a payback within a year and as long as that works you can continue.

My sense of it is, is the producers will continue to be in high demand for the next two or three years. What we found though, to be perfectly honest, is many people are looking for a cultural fit as much as they are looking for a financial fit. So [Arcadia's] throwing money at people, there are a couple of other people that are throwing big money at people, but if you don't like the company and you don't like the infrastructure and you don't think they have the process to run your business, you're not going to go there. What we're finding is that money doesn't always get them.

As it relates to multifamily and cap rates--because it's been a favorite asset class--cap rates have come back down, and cap rates are effectively the bell weather of the value of multifamily. Cap rates determine how much you can leverage your property and the returns you're going to get. Those rates have come down back again to almost pre-boom levels. So they're kind of 5%-6%, 4% depending on the market. There are other parts of the market that are higher.

How long will people continue to find this attractive? I think it depends, to your point, there are a number of yield-starved investors in this space; insurance companies need it for a long period of time and they need long-term money. They are actually willing to do debt at fairly low leverage and low rates right now and it continues to be attractive.

For buyers of multifamily properties, it's interesting. We have a conference every year and last year in Sun Valley when we had our conference, there were two groups of people on the stage; one that had said, 'properties are too expensive, cap rates are too low, therefore, I'm not going to go after them.' There was another group of people that said, 'you know, I'd really like 6%, but I bought them at a 5.5 cap. I'm 50 basis points off of my yield, but I'm loving life because cap rates have now come down a little more.'

The message that I took away from that is if you're in the multifamily property business and the acquisitions, assuming that the cap rates are in the geographic range, you're not going to get hung up about 50 basis points coming or going. I think that combined with the fact that commercial still continues to struggle, so office, retail, hotel, still continues to struggle from the cap rate basis. As long as there is a very wide spread, some people are going to come to the commercial as opposed to the multifamily, but the reality of it is there are a lot of people that still consider this very, very risky, because there's not a stable debt source available for these kinds of properties. So many people continue to stay in the multifamily.

Brandon Dobell

OK. As a bit of a segue there, two or three quarters ago you signed a partnership with Cushman & Wakefield.

Deborah Wilson

We did.

Brandon Dobell

On the investment sales part of the business, to jump start that effort for diversification. Maybe a little bit of an overview on what's important for you guys and what's been going on since you signed it. And are there other opportunities out there? Other brokerage firms, that look like that one, to accelerate the diversification into investment sales and, probably not leasing, but maybe you could comment on that as well.

Deborah Wilson

We sit in the real-estate finance world and real-estate finance gets fed by a number of places. First of all by refinances in the market. Second of all by buildings and new units. And third by acquisitions and sales, and acquisitions are generally driven by investment sales groups. So you will see people like CBRE, JOL, HFF, that have an investment sales division as well as a debt division.

We live in the debt world with some equity through the funds. We do not have investment sales, so as Brandon mentioned, we went out and signed a partnership agreement or a strategic alliance with Cushman & Wakefield. Cushman & Wakefield plays fairly large in the multifamily investment sales, so they are representing the sellers or the buyers of multifamily properties.

Frequently in that space, that can have an impact and drive debt to a particular location. So instead of building an investment sales division and hoping the debt would come, we effectively did a correspondent arrangement with them so I don't have the fixed costs with them, but I can hopefully get some of the revenues from them.

So far, we continue to look at a number of deals. There are several large offices within Cushman & Wakefield across the country. We've had no volume from that at this point in time. How long did we think it would take to ramp up? It's a little slower than we thought it would be, but we continue to see good volume and good flow from that. We always believe it takes about a year to 18 months to get really strong relationships with a new correspondent or a new strategic relationship because they're learning you and you're learning them. So we really haven't seen any volume yet. We haven't closed any loans [??], but we continue to see a fair amount of flow through.

Brandon Dobell

Are there opportunities, or would you look at opportunities to do similar things with other firms in different property types?

Deborah Wilson

We could. Would we want to do that with like non-multi-family? The answer would be yes. But we need to do it as we build up the capital market space, because our capital markets group is, right now, in the mid-Atlantic area. So if we had the ability to do debt in other parts of the country with life insurance and CMBS. Sure, It would make sense.

Why I like it as a CFO is I don't have a fixed base to expense for.

Brandon Dobell

The servicing portfolio, the past several years has seen a pretty nice increase in the average servicing fee. Maybe talk a little bit about the drivers behind the increase in the servicing fee. How sustainable that trajectory is, or alternatively, what could change those average basis points you get on that portfolio.

Deborah Wilson

So for those of you--let me turn to a page for a second. Page 24, the last page in the book. This is our portfolio, and then I have one other--I think it's page 11. Yes, page 11 is what Brandon's talking about. Our portfolio has effectively gone from $7 billion to almost $16 billion since 2008. And the average servicing fee has gone from 17 basis point to 22 basis points. And also, the average life has gone from 7.2 years to 8.4 years.

In our space we effectively get paid every year to service a loan. It's built in the coupon to the borrow. The average on that is 22 basis points. If you think about it there's really two types of loans that we service. We either don't take risk on them, or we take risk on them. As you can imagine, there's one servicing fee for the loans you take risk on and there's a different servicing fee for the loans that you don't take risk on. So when you look at the 22 basis points, it's a blend of those where you have risk and those you don't have risk.

On page 24, you will see that at 9/30/11 it's $15.9 billion, of which $10 billion is with Fannie Mae, of which we have risk on about $7 billion of that. So we have risk on about half of the portfolio, so that gives you a sense of that.

How sustainable is it? The servicing fees for all the loans, with the exception of Fannie Mae, have not changed as long as I've been in this business, and I've been in this business for 20 years. The servicing fees are set by the investor or set as part of the pool, and they've honestly not changed in 20 years.

The things that do change are Fannie Mae, and the reason Fannie Mae changes is there's a piece for the non-risk servicing and there's a piece for taking a credit risk, and this one expands and contracts depending on the pricing of credit. So right now, credit spreads are pretty wide, so we're getting a nice healthy servicing fee on that. That servicing fee is set when you rate lock the loan and it stays out there for the entire life of the loan.

How sustainable is that? What we expect to see is the things that are maturing in our portfolio over the next few years have a lower servicing fee than the weighted average servicing fee. So we expect the servicing fee will continue to rise as long as Fannie Mae remains a good piece of our volumes, combined with the things that we expect to mature, will mature, over a number of years.

Brandon Dobell

If the market shifts, the sources of capital replace the agencies as a source of capital. My understanding is that those type of people either don't split off the deal in servicing--so it will be tougher for you guys to have the same kind of market share or flow on the servicing side--or if they do, they hammer you on price more than the agencies do. Maybe a little bit of color on those two, I call them risks, but it seems now they're so far off into the future, because there's no source of capital out there, it's a little bit tough to build that into the overall risk.

Deborah Wilson

What I think Brandon is talking about is that in the CMBS world, every time a pool is done, the servicing fee is bid up. In addition to the, someone buys the B pieces in the CMBS that has a price associated. So if you think about our Fannie Mae space, because we share risk of up to 20%, we effectively hold the B piece on the Fannie Mae portfolio, because we take the first 5% of risk and some shared risk [down] to 20%. So that pricing of servicing fee has an inherent return in that. Every time you do a CMBS deal, the servicing fee is bid out and the B pieces are bid out and they always go to the highest bidder.

So the reality of it is, Brandon's right, those margins can contract depending on how voracious people's appetites are for the B piece part of the risk as opposed to the servicing. What we generally see is that the servicing fee gets compressed quite a bit in that space, because they're three really big players on that market, and they beat those spreads down. But what we find is the B piece risk is much more, I was going to use the word stable, but it still moves.

So, if we're going to deal as capital diversifies, [and we end the] CMBS, do I absolutely have to service it? I'm not going to service it unless I can make good money on it, but I will happily take the B piece on the stuff that we originated, assuming it's got the right returns.

Brandon Dobell

The pie ratio, between multi-family deal debt origination and servicing obviously is quite high with the agencies. Would you expect it to be that high with the insurance companies, or has the source of capital changed due to the [??] maintain, and then related to that, is there anything that you can do to either increase or protect that pie ratio as the capital sources change?

Deborah Wilson

So if you originate for Fannie and Freddie, they expect you to keep the servicing because it's a long-term relationship, and with Fannie I have the risk. On the FHA space, you can monetize that every day of the week if you like and sell it into the markets. We have chosen to keep it and maintain it because we like the yields [of Fred] and our cost of servicing. We like the long-term relationship with our buyer, so it makes economic sense.

As we go into other spaces and other capital spaces--Brandon is talking about origination and servicing tie and how do you keep that together--we actually think it's important to do both, unless someone is paying me an egregious amount of money for the servicing then I'll move on. We have not chosen to do that in the past, unless it was compelling, because of the borrower relationship. With life insurance companies, it's a little harder to do. We think that as long as we have a big presence with them we will continue to get their business, but it's about being on their radar screen.

They make sure that their top 10-20 lenders have good servicing portfolios, because of other strategic relationships, so it's really important on us that we're tied with them from that perspective, that we've got to be able to keep that and keep those relationships. We like it. We think it's a long-term relationship that's valuable to us.

Brandon Dobell

Have you guys talked at all about what kind of a 3-5 year margin--target's the wrong word, but a margin range that you feel comfortable with in the business? With there being a lot of variables that are changing, getting sources of revenues and things like that, but if we're building out of some kind of discounted [??] model, where should we think about margins being, looking out 3-5 years?

Deborah Wilson

We haven't talked about that. We've clearly said that we'll end this year at 35%. We haven't given guidance for next year either, for volumes; we've given guidance for this year. We have not, and we've not been prepared to talk about it. I do think what's important is we are committed to growing. Could there be some margin compression? It depends on if we grow out a lot of capital markets. Are we gonna grow for the [safeguard]? The answer is no. It has to make economic sense to us, but we really haven't given any guidance.

Brandon Dobell

There's a lot of potential outcomes with Fannie and Freddie, the multi-family side. Rather than going through what the outcomes could be, what do you think about the time-frame for visibility on those outcomes, regardless of what the outcome could end up being, because who knows what the [??] could come up with.

Deborah Wilson

We were talking at lunch, that there's an over and under of whether it happens before or after I retire. But, it honestly varies. We went down and talked to treasury a year ago and spent a lot of time with the working group about what they were thinking about and what it meant. It was interesting to watch them think through, and the answer is, I think it's a longer time [??]. Is it going to be longer than they would like? I think the answer is yes because one, it's $5 trillion and how do you take $5 trillion and do something with it?

Multi-family on the other side, combined Fannie and Freddie is about $400 billion. You can actually do something with that if you want. We talked a little bit earlier, if you talk Fannie Mae multi-family and spin it off by itself, it's the 15th largest bank in the nation. So these are not small entities, so my sense of it is it's a long term horizon. Everyone has said they're not going to do anything at all until after the elections. My sense of it is, is until the housing market stabilizes for a considerable period of time such that whatever they do doesn't disrupt the housing market, they'll start to do something.

But I have to tell you, one week it's on, next week it's off. The next week it's on, the next week it's off. It's a big problem but my guess is it's a 5-7 year horizon. But you know, that's what they said in the white paper. They said once we decide what we're going to do, it's going to be 5-7 years after that.

Brandon Dobell

Okay, any last questions from the audience?

Deborah Wilson

Who aren't asleep?

Brandon Dobell

Debbie, appreciate the time. Thank you very much for coming down. Enjoyed it.