Walker & Dunlop

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Bose George: Good morning, let's get the next session started. Next up was have Walker & Dunlop, a commercial multifamily mortgage originator and servicer. The Company has been in business for 73 years and completed its IPO in December of 2010. Presenting from Walker & Dunlop we have Willy Walker, the President and CEO, Debbie Wilson, the CFO, and Claire Harvey, the Head of Investor Relations. And with that, I will hand it over to Willy.

Willy Walker: Good morning. Thank you, Bose. When we went down the IPO path, we met with lots and lots of analysts and some of them took a little bit longer to get up to speed on what we did at Walker & Dunlop and others got it overnight. Bose was clearly one of the analysts who got what we do overnight and I think his research on Walker & Dunlop has been excellent since going public. And I don't say that just because he's got a -- what do you have out on us, Bose? It's either a buy or whatever your equivalent of a buy is. But as you all know, there are analysts who understand business model and those that take awhile to get up to speed and Bose has clearly been one of the ones who's gotten up to speed quickly on us. So thank you, and it's a pleasure to be here to present today.

I've got, I don't know, 20 slides to run through. I will jump into it and I've got to pause here for a second and do your forward-looking statements disclaimer at the front. So as Bose said, we've been in business for a long time, 74 years. We went public in December of 2010. We are a leading provider of capital to the commercial real estate industry. We originate, sell and service loans and we've grown the firm quite dramatically in the past couple of years. We were the 45th largest commercial real estate lender in 2007 and moved up to being the 11th largest commercial real estate lender in 2010. That has as much to do with what we're doing at Walker & Dunlop as it does with the broader market and the dislocation in the market.

If you went back to the 2007 lead tables, there would be firms on there called Lehman Brothers and Washington Mutual and a couple of other firms that no longer exist. So that dislocation provide a huge opportunity for us to step in and we have done just that.

Highly profitable business model. We have for the last four years had operating margins of between 29% and 33%. In the first quarter of 2011, we did 37% operating margins and 23% net margins. And I will talk a little bit about why our business model is so profitable and there is a massive market opportunity for us.

The commercial real estate finance industry is a $3.2 trillion industry. If (inaudible) ten-year paper, that means that on an annual basis there's probably about $320 billion that gets financed. And Walker & Dunlop did $3.2 billion of originations in 2010. So we did a one share last year.

I spent the majority of my career prior to joining Walker & Dunlop outside of the United States in Latin America and in Europe and I'm often asked, when does Walker & Dunlop go abroad? And I always am quick to say with the market potential that exists and market opportunity in the United States, there's absolutely no reason for Walker & Dunlop to look beyond the shores of the United States for now as it relates to growth and opportunity.

So this is our platform and this slide is a little -- it's clearly with the light and everything else probably a little difficult to see, so let me jut quickly run it through. Our clients are essentially commercial real estate owner operators, developers across the country. Our company is broken up into really five operating groups. We have our multifamily finance group that goes out and meets with multifamily owner operators across the country.

We have our FHA finance group that primarily talks to apartment owners and developers although also hospitals and senior living owner operators We have our healthcare finance group that is specifically focused in the healthcare world. And then we have two groups that focus more broadly in all of commercial real estate, all commercial real estate asset classes. That's our capital markets group which is basically our brokerage operation. And then you've got our investment services group which is really in the fund and fund management business.

So where do we get our capital? Our capital comes from Fannie Mae and Freddie Mac on our multifamily finance group. It comes from HUD on our FHA HUD origination business. On the healthcare finance and seniors, it comes from both the agencies Fannie and Freddie as well as from HUD as well as from third party capital. CMBS is coming back a little bit there, banks are coming back a little bit there. On capital markets we work with conduits and life insurance companies to broker loans to them. And as it relates to investment services, it's large, institutional investors who have either equity investments or mezzanine investments in commercial real estate.

Below those sources of capital is what we do at Walker & Dunlop from a back office standpoint. So the real platform that allows us to originate, to underwrite, to warehouse, to sell, to asset-manage, and to service. And those are all the underlying functions that we do at Walker & Dunlop. So that's essentially who we're selling to, that's essentially how we go to market as it relates to our product groups and where we get our capital from.

If you take a look at how we actually go and sell what we do, on the left-hand side is our lending platform. We have eight offices across the United States. Those are the red dots. The blue dots are our correspondent lenders. So those are local mortgage banks that originate loans for us. We underwrite the loans and then we lend on the property. We then warehouse the loan and we sell it off to Fannie, Freddie or HUD.

And so we have really a much bigger presence if you will of feet on the street through our correspondent channel than the actual number of employees and originators at Walker & Dunlop would lead you to believe. We did sign up an agreement with Cushman & Wakefield in the second quarter which we announced during our first quarter earnings to partner with them on investment sales. We're an investment sales broker at Cushman & Wakefield. We'll bring Walker & Dunlop in for agency financing on investment sales opportunities.

I've been asked time and time again, what do we think we're going to get as far as incremental deal flow from that partnership. To be very honest with you, I do not know. Cushman expects to do $3 billion of multifamily investment sales in 2011. Whether we get 10% of that deal flow or 50% of that deal flow is to be determined. And so I really don't have a number for people to sit there and put into their models what we think we're going to get, but we are very excited by that partnership with Cushman & Wakefield.

On the right-hand side is the direct versus correspondent channel. So as you can see, green is correspondent, blue is direct. And back in 2000, this graph starts in 2000 on the left, back -- I joined the firm in 2003 and one thing that was happening was that the correspondent channel, because there was so much capital from Wall Street and from life insurance companies and commercial banks, the correspondent channel was not as loyal as we would have liked. And so we started to build up a direct origination sales force to be able to make sure that we controlled the channel.

And so as you can see here, we built up a direct sales force that got to a height in 2007 where there was almost no loyalty in the channel, if you will, where we were doing over 80% of our deal flow direct. But then all of a sudden all other sources of capital went away, and lo and behold, our correspondents said, hey, Walker & Dunlop and access to the agencies is the only game in town. And you can see they started feeding us a ton of deal flow and the percentage between correspondent and direct came back down to about a 50/50 balance.

Where we are very focused right now is maintaining those correspondent relationships, but building up our direct origination sales force. So the majority of our recruiting efforts today are on bringing in new direct originators who understand how to originate loans in our space.

Our loan origination volumes by quarter, as you can see, they have grown quite dramatically over the past couple of years. The breakdown here, the dark blue -- do I have a legend on here? I'm sorry that I -- the dark blue is Fannie Mae, the green is capital markets, so that's going to CMBS and life insurance companies. What's that? This one is by quarter. Thank you, Claire. I'm sorry. It's not broken down by execution, this is by quarter. So first quarter, second quarter, third quarter, fourth quarter. I bet you actually, if you laid over Fannie Mae, Freddie Mac, capital markets would be almost similar, but thank you for correcting me on that.

So you can see here, from a quarterly basis, our origination volumes varied quite a bit. There was a lot of question as it relates to Q1 2011 doing $507 million of originations. I think a number of analysts had expected us to do great originations in the first quarter. And if you look back to '07, '08, and '09 and the light blue at the bottom there, 2011 was a perfectly normal first quarter for us. 2010 Q1 was an abnormally strong quarter for us. The guidance we gave in our last call was on Q2 to do $750 million to $1.25 billion of originations in Q2. And on the year we've given guidance to do $3.5 billion to $4.25 billion of aggregate originations.

And so on the right-hand side there, you can see if we're at the low end of that range, we'll get to about $3.5 billion on the year aggregate. And if we're at the high end of the range, we'll be at about $4.25 billion. But one thing investors need to understand abut our company is that origination volumes vary quarter to quarter. And you can see the green there, that Q2 is historically a strong quarter and Q4 is historically a strong quarter with one and three being less strong if you will. But it varies. Interest rates moving the way that interest rates have moved right now, lots of people who may have a Q3 or a Q4 refinancing, might accelerate the process to try and grab rates where they are today. So where rates move will have some bearing on what we do on volumes on a quarter to quarter basis.

So who do we compete with I've been asked? In the Fannie Mae and Freddie Mac world as well as with HUD, you need a license to originate loans for them. It is really no different than if you were an outsource contracting partner to DOD or the Department of State and they have a vendor list that they go to. You need to be a firm of a certain size and of certain quality to be able to get a contract to do outsourcing of call center operations for the US Department of State. And you probably need to partner with someone like SAIC if you're not big enough to be on that preferred vendor list. Fannie and Freddie have roughly 25 third parties who they have licenses with to originate loans for them in the commercial space. And we are one of those 25.

As you can see here on the left-hand side, as I mentioned previously, we're the 11th largest commercial real estate lender in the country If I gave you the top 20 commercial real estate lenders and you took the list home and showed it to someone at your home, I'm pretty sure they'd recognize 19 of the 20 brands. There are all big commercial banks and all big life insurance companies and then you have Walker & Dunlop that's very focused in this space and has done an extremely good job of niching it.

If you look on the bottom left on Freddie, that's HUD, excuse me, we're the number eight HUD FHA originator. On Fannie we're the second largest Fannie Mae DUS lender. Just one side note, Fannie publishes numbers on an annual basis. These rankings are by the Mortgage Bankers Association where we were number two. On Fannie's list, we're number three, because Fannie does it on deliveries to them. This is on rate locks. A little nuance, but I don't want anyone being confused if they see that we're number three on a Fannie Mae list. And on Freddie Mac, we're number ten.

But inside of those lists, you can see we compete every single day with Wells Fargo and Deutsche Bank and PNC, CBRE, some of the world's largest financial services and real estate services firms, and we've been very, very successful at not only competing with them, but picking up market share.

On the left, historic revenue mix. Difficult slide for anyone to see, even Bose up front. But it's broken down between our origination related fees which is the dark blue at the bottom, gain attributable to MSRs, so our servicing fees that we book, is the green part. The gray is servicing fees. The yellow is interest income and the light blue or the fuchsia at the top is other income that we earn.

A couple things of note here. First of all, you can see origination fees changing quite dramatically quarter by quarter You can see Q1 2010 which is right here where we had a huge amount of originations in Q1 2010 and booked a lot of origination fee income.

You can see the green part of MSRs being booked, growing consistently. And I'll go a little bit deeper into our MSRs and what that means in a moment. The servicing fees that come off of our servicing portfolio as we've grown our surviving portfolio to almost $15 billion, that cash flow that's coming off the servicing portfolio continues to grow. And the other piece is interest income. If you look on the right here, interest income in 2010 was 5% of our income. We have a lot of escrow deposits, we make money in our warehouse lines. The issue there is in this low rate environment, where we're basically earning nothing on our short term deposits, that number is nothing today. If we go into a higher interest rate environment, expect to see that number go up quite a bit. It's only 5% of our revenues today, but we do have deposits and warehouse income that we earn that will go up if rates start to move.

You will get to some flexion point, and I don't know what the actual number is, where Walker & Dunlop is earning the most on its deposits before it loses an incremental unit of business. And by that, at some point as rates start to move up, that deal that we would refinance in this low interest rate environment won't be able to be done given current underwriting parameters and that deal goes away. And as you move into a higher and higher interest rate environment, the origination volume should come down a little bit, but all the other income, if you will, will continue to grow, if that makes sense.

On the right-hand side I break down for you on gains from mortgage banking activities, this is how we report in our financial statements, you can see that 70% of our income comes from those two. The origination related fees of 35% is all cash. That's when we originate the loan, we make an origination fee on originating that loan. The green down there on gain attributable to MSR is all non cash. We, at the time of origination when we lock the rate, we take the present value of the future servicing streams and we book it as an MSR. Any of you who have invested in single family mortgage originators and seller servicers, if you will, this is a very different business.

That is all non cancelable servicing. This is not a single family model where you've got to run your regression analysis to figure out what your prepayments are going to be and sit there and put an MSR value of two years or three years or five years That is all prepayment protected.

So I will show you in a second the value of that to us over the long term. But lots of people have had questions about cash earnings and non cash earnings. We love that green piece of the pie because it is future revenue streams that are prepayment protected. You can see servicing fees of 22%, income of 5% and then other of 3% to give you a sense of the breakdown and how we've seen fees grow over the past couple of years.

So you can see here loan origination volumes in millions and this is where we break down Fannie, Freddie, and HUD. So you can see on the far left Fannie back in 2007 was the dark blue. Capital markets was the green and that was really our business. Just Fannie Mae and just capital markets which was the CMBS and life insurance companies.

In 2009 you can see the Freddie Mac which is the gray and HUD which is the light blue, were introduced. We acquired a company from Credit Suisse in 2009 in the depths of the financial crisis and that added Freddie Mac and HUD to our origination, if you will, suite. And as you can see in 2010, we grew our Freddie Mac and HUD businesses tremendously at the same time as growing our Fannie Mae business and our capital markets business started to come back. Our capital markets business today is very vibrant given the amount of capital that's coming from life insurance companies as well as CMBS lenders.

Down below is a breakout on a basis point standpoint of how much we're making in origination fees and how much we're making in MSRs. So you can see back in 2007 our average origination related fee was 62 basis points. Originate a loan, we were making 62 basis points on the aggregate value of the loan we originated.

You can see that grow to in 2010, I would caution going all the way over to Q1 2011. Our business is really hard to look at on a quarterly basis, so I would very much say, don't get to caught up in 145, the 187 or the 37. We manage the business on an annual basis and that's what I think investors need to see. Just as I've said, don't get too upset about a 507 first quarter I would highly caution people that if we have a very strong second quarter don't all of a sudden say that it's going to go linear from second quarter.

So we've given guidance of $750 million to $1.25 billion on the second quarter and depending on where we go there, we're really managing the business no an annual basis. So let me get to 2010. You can see our average origination fee increased 133 basis points. If you go down to our MSR bookings, those have grown from 44 basis points in 2007 to 136 basis points in 2010.

Are those margins sustainable? No. (Inaudible) model out Walker & Dunlop going forward for the next ten years at 133 basis points average origination fee and 136 basis points average MSR booking. The market will change. I would put forth that if you modeled it somewhere in between the 62 and the 133 or the 44 and the 136, you're going to get to something that over the next ten years is where we will average out.

One thing I have said and said repeatedly, we have not seen any margin compression so far We've seen no pricing pressure so far, we've seen no margin pressure on our servicing fees. Will that change? I expect it to. When? I'm not exactly sure.

And all of that goes back to -- sorry -- all that goes down into, as I said previously, operating margins that have gone from 32% to 29% to 32% and they were at 37% in Q1 2011. I wouldn't get too wrapped up in 37% Q1 2011. Q1 is always a high margin quarter for us because our employee base is on a variable cost structure which is actually a good segue to the next one, which is that our personnel expense is all based on our producers originating loans and they are all on variable pay. So as you can see here, quarter by quarter, the amount that is fixed which is in blue and the amount that is variable which is in green, varies significantly. So you can look at Q1 2009, fixed expenses were 70% of our personnel expenses and only 30% of our personnel expenses in Q1 were originators. The reason there is because all of our originators haven't gotten into their splits. They haven't moved up in their commission schedules to be able to be bringing home, if you will, the lion's share of the money.

If you look in Q4 2010, which is this here, you can see that it's switched there where 70% of our personnel expenses were variable to our producers and only 30% were in our fixed overhead costs in the company. People want salaries like myself.

And you can see the components of personnel expense by year, it averages out to about 50%. 50% fixed, 50% variable. One thing you can see in 2010 is because we did so much origination volume with essentially the same number of people we had on the street in 2009, we got real leverage out of the platform.

So to that point, on this slide you can see our production and the productivity of our platform. So you can see origination volumes between '09 and '10 going up 42%. You can see the number of transactions going up 17% and the average deal size going up 22% year on year. Total revenues growing at 37% year on year. As you can see, headcount didn't grow that much. We only added 6% on a headcount basis. The revenue per employee, this number I love, which is in 2010 we were at $776,000 of revenue per employee. The number of producers at the end of the year was 27. I think our last filing showed that we have 32 producers, so we've added a number of producers. And revenues per producer, $4.5 million. It's a neat business model.

If you think about some of our competitors that have thousands and thousands of people out on the street every single day, and what they have to manage and the complexity and the amount of the overhead that they carry, our variable cost pay structure and the size of our organization I don't want to say makes my job easy, but it makes it a lot easier than it would be with a lot more complexity and a lot more fixed costs.

Servicing portfolio. I love this slide. As you can see, our servicing portfolio has grown a great deal. In 2008 at the end of the year we had a servicing portfolio of just under $7 billion. At the end of Q1, our servicing portfolio was just under $15 billion, so we have doubled -- over doubled -- well we have over doubled our servicing portfolio over that period of time.

The top line here is the average servicing fee in the overall portfolio. So as we have grown the portfolio, we've also grown the average servicing fee from 17 basis points to 21 basis points. The line at the bottom which is green shows you the average duration on the portfolio. Remember, all of this is prepayment protected and the average duration, 95% of it, excuse me, 95% of this portfolio is prepayment protected. The average duration on the portfolio has gone from 7.19 years to 8.01 years. So as we've grown the portfolio, we've not only added hugely more profitable servicing, but we've extended the life of the portfolio.

If you translated that into servicing fees on a quarterly basis, we've grown quarterly servicing income from just under $3 million to just under $8 million over that same period of time. So go to the end here, we're at almost $8 million a quarter. Let's back it up and say it's $7 million a quarter. $7 million a quarter provides us with $28 million a year in cash flow off of the servicing portfolio. I've just told you the average life is eight years and it's all prepayment protected. So let's take that $30 million over an eight year period, and then discount that back at you pick the discount rate, but do that math and get back to an overall value of the servicing portfolio as far as guaranteed cash flows. And you'll see that the value of the servicing portfolio if you look at it just on a standalone basis should be somewhere around $200 million and $210 million. Add to that the cash on our business which is $70 million, we've got about $30 million of payables, that's $40 million of free cash sitting on our balance sheet. That's about $250 million in our servicing portfolio and our cash. Our market cap this morning is about $285 million, $290 million.

So if you look at the servicing portfolio and you say value that alone and then put the cash in the company, our actual operating platform is being valued -- let's take my numbers and discount them heavily. It's $200 million in the cash on the servicing portfolio. Still, our entire operating platform which is producing 32% operating margin and is growing at over 20% a year, is being valued at somewhere less than $100 million.

If you take a look at our at risk portfolio, it has grown quite a bit. This is where we're making all of our money, on our Fannie Mae at rick portfolio. As you can see, it has grown up to $6.7 billion of at risk loans that we have with Fannie Mae. We take the first loss position on those loans. If we were bad at credit and underwriting, the profitability of our model in 2008, 2009, and 2010 would have been nothing close to what it was. As you may recall, we maintained greater than 30% pretax operating margins during (inaudible).

Credit has been a huge strength of ours. You can see that our 60 days delinquencies peaked in Q2 of 2010 right here at about (inaudible) basis points and have been coming down significantly. That is (inaudible) portfolio as it relates to overall credit risk in their portfolios. And we believe that we are beyond the worst of this downturn. Multifamily is an asset class that's performed exceedingly well and we continue to see improvement in our overall portfolio. And I will tell you as we were out on the road and the road show, many (inaudible) looked at our loss statistics, you can see down below our net write offs is that yellow line (inaudible) across the bottom at almost zero. Then you can see our net (inaudible), that green line that started to come up in the last couple of quarters as we were taking some reserves against future losses. And they said, we haven't seen anything like this in commercial real estate. Your track record is quite something. And this slide I think goes to that.

Upper left is banks and thrifts. Commercial multifamily mortgage delinquencies. You can see banks and thrifts upper left, life insurance companies and Fannie and Freddie down here on the bottom right. All of them lost a lot of money in '90, '91, '92 in the last commercial real estate crisis. What ended up happening though is, as you can see, the life insurance companies and Fannie Mae and Freddie Mac learned something in '91 and '92. Commercial banks seemed to have repeated the same mistake.

Now you have to also remember though, the majority of those defaults in commercial banks were on construction loans. And they got caught with the timing of the downturn and people just not having cash to be able to fund their short term obligations. Conduits, up here in the upper right, they weren't around in '91, -- '90, '91, and so they didn't have the experience back then and so therefore maybe we give them a pass for getting to those default rates.

What's ended up happening from a competitive standpoint is that because life insurance companies in the lower left did so well during the downturn, they are back. They're back lending and they're competing for loans today and they are winning low leverage, Class A multifamily deals. They're competing well and they're coming in and they are wining a deal here and there. Are they wining a lot of deals? No. But they're clearly competing.

We don't see conduits compete at all on multifamily so far. Will they? Probably. But I think there are two reasons why they haven't competed so far. First of all, multifamily has been so rate sensitive up until now that if they're going to price a deal at a five coupon and put it on a warehouse line and then go securitize it, if they get any significant movement to rates, they're getting caught upside down on that trade So they'd rather price a deal in retail, hospitality or office at a 6%, 6. 25% and have less rate sensitivity to it for their pooling and securitization than going into multifamily.

The second thing is this. B-piece buyers if they look into the pools that were done in 2005, '06, and '07, multifamily is the worst performing asset class in all CMBS pools. Worst. So B-piece buyers are sitting there saying, I'm not so sure that the conduits knew how to actually underwrite these loans and do good loans in the last time around, I'm not sure I really want to buy into a pool that has a significant multifamily presence or percentage. So, so far we haven't seen conduits back in our space. They will come back when those two things change.

Growth. Where are we going? As I said at the beginning, it's a $3.2 trillion market. As you can see to the right, on the $3.2 trillion, multifamily alone is about $850 billion of aggregate outstanding. On the right-hand side you can see the refinancings that are coming up in multifamily. Non bank -- so this has no bank refinancing volumes in it, this is just CMBS, life insurance and agencies. But you can see in those three, if you will, food groups, there is a $25 billion refinancing opportunity in 2011 growing to $37 billion, $34 billion. We did $2.6 billion, $2.7 billion last year at Walker & Dunlop in multifamily. So on a $25 billion refi market without including banks, there's a huge market opportunity just in our core multifamily market as well as broadening out into other asset classes.

So the opportunities from a refi standpoint between now and 2017 are tremendous. As you can see, it's amazing. All you have to do is take a look at the volumes that went on between 2004, '05, '06, '07 and it's all ten year paper and you can see then it hits the wall, the exact same wall that we hit with financings in '08, '09 and '10 comes back to show you what the refinancing opportunity is in the out years of the decade.

IPO proceeds. So why did we go public and what are we doing with the money we raised? We went public because we were capital constrained. We were a privately held company and if I wanted to go do something like hire a new originator that I had to pay a nice signing bonus to or go acquire a company, it was basically sitting around with my family and saying, let's either put capital back into this or I'll raise debt and that will cut the dividends and that makes Thanksgiving dinner table conversations a little difficult.

So we went public to raise capital and we raised capital and we are in the process of putting that capital out. As I mentioned previously we are doing a tremendous amount of recruiting right now. In our last quarterly conference call I mentioned that we should have some announcements as it relates to recruits and new hires on our direct origination sales force. But we are growing our feet on the street and putting people into our existing platform.

We are also out looking to acquire businesses that are mortgage origination shops. So brokerage firms as well as originators directly in our space. If we go out and acquire a brokerage firm, that gives us additional access to deal flow. If all of it continues to go brokered to Wall Street or to life insurance companies, the numbers stay the same. But if we convert any percentage of that origination volume into what I call our proprietary products, that being Fannie, Freddie and HUD, we immediately get margin lift.

So if we went out and acquired a company that had $600 million of origination in a pure brokerage business, and we were able to convert $100 million of that into multifamily originations for Fannie, Freddie and HUD, we immediately get pick up in the overall profitability of that business line.

Our fund management business, we're in the process of expanding that both from being able to provide funds to our clients -- so we have lots of clients who come to us and say, Walker & Dunlop, you're great at a first trust mortgage, but do you have joint venture equity that can go into one of my deals? As well as acquiring new funds to manage and just have the asset management cash flows kick off of those operations.

Finally, on the right-hand side, expand our product offerings. We've talked in previous calls about our interim financing fund. I think that in the second quarter we will have an announcement as it relates to an interim financing facility to allow us to go and lend on assets that are not stabilized yet. So this is an asset that's a multifamily property, someone just bought it, it's 70% leased. You can't finance it with Fannie or Freddie until it's 90% leased. So we'll lend on it, hold it for a 9, 12-month period and then take out our interim financing with permanent financing from one of the agencies.

And then broadening our lending focus. Looking at retail, looking at hospitality, looking at office, and broadening out what we do from a lending standpoint beyond just our core multifamily markets.

So let me quickly, as we look through here on our growth and expansion strategy, I'm going to go back to the slide I showed at the beginning of our platform and tell you a littler bit about where we're focused. As I said, we're trying to add originators. Most of the originators that we're adding are in our multifamily finance group. As it relates to clients and broadening our client base, as I just said, broadening out into office, retail, hospitality, and then in our core multifamily market. As it relates to capital, there's no doubt that there's questions about Fannie and Freddie. What's the future of Fannie and Freddie look like? This slow recovery plays very well for a company like Walker & Dunlop on two ends. One, private capital is not just pouring back into commercial real estate. Is it a much better market today than it was a year ago? Yes. Is it a dramatically improved market over three years ago? Yes. But you don't have everyone and their brother and all the big, private sources of capital lining up to make commercial real estate loans today. That's good from a competitive standpoint.

The second piece is this slow recovery makes any kind of change to what Fannie and Freddie do today that much further off from my personal point of view. There is no legislation that talks about a dramatic change to what Fannie and Freddie do. There are 15 pieces of legislation that have been drafted by the House Financial Services Subcommittee. Not one of them has any kind of transformative impact on Fannie and Freddie. The only one you could possible think about having a transformative change is if they were forced to change everyone inside of Fannie and Freddie from their existing pay scale over to a government pay scale. But I'm not so sure that Congress is stupid enough to say we've got $5 trillion of liability sitting in Fannie and Freddie and we want the B-team taking care of those $5 trillion. But they might. They might. But I'm not so sure they're going to do that.

But I think that we are re in the recovery and the fact that it hasn't accelerated and hasn't picked up means that Fannie and Freddie being in the housing market is that much more important which means that you probably don't get any transformative legislative discussion until 2013. Even the most conservative think tanks out there think that a five to seven year wind down is the fastest that you could wind Fannie and Freddie down. So if you've got '13 for the legislation to get worked on -- and remember, we almost closed the federal government over a $38 billion issue in the 2011 budget and we're talking about a $5 trillion decision here.

So let's just say that, think it through, 2013 is the year they get the legislation done. It gets passed. '14 is the first year where you start on a wind down strategy, five to seven years. You're in 2019 to 2021 before you have anything that's really impacted these markets. Maybe the change begins in year three or year four. Great. If Walker & Dunlop can't diversify its business, continue to grow and pick up market share in other asset classes and other lending platforms beyond our core Fannie and Freddie business, shame on us. We're very focused on it and we will execute on that.

And then our services will stay the same. So finally, let me just click all these up. So as I said at the beginning, we've been in business for a long period of time, we've got an extremely strong track record from a credit standpoint, we've grown the firm dramatically over the past couple of years, and I think we've got a huge market opportunity to grow into. Our growth, we've shown over the past couple of years to be able to grow in a highly competitive marketplace.

One of the things I think people miss is the fact that in 2008, 2009, and 2010, if you were an originator at Wells Fargo, if you were an originator at PNC, and you originated products for their conduit, for their balance sheet, and for anybody else on a brokerage basis, the only product you could sell, the on last year product you could sell was Fannie or Freddie.

So lots of people say, oh, Walker & Dunlop got kind of a pass in 2008, 2009 and 2010 because there was no capital out there. There were 25 other firms every day beating us up to win every deal we won. And during that hyper competitive time in our space, we not only competed, but we grew and we gained market share. So now that we are back where the originator from Wells Fargo has other executions, where the originator from CBRE has all these other executions, as we stay focused on our core business, the opportunity for us to continue to grow and grow our firm profitability I think are tremendous.

And then finally, the business model is highly profitable and don't forget about those MSRs and the value of our servicing portfolio. Lots of our competitors are in an originate/sell, originate/sell and they don't have that stable cash flow, that stable income stream that provides them with the ability to have volumes fall off and maintain their profitability. Walker & Dunlop does.

And so on that, I think I'm out of time. Do I go to Q&A? Do I have any time?

Bose George: We have time for a couple questions.

Willy Walker: Any questions?

Unidentified Audience Member: Can you just talk about profitability on the correspondent channel versus your direct channel? Is there any meaningful difference? And also, a lot of the correspondents have the distinction that they don't have to touch licenses or -- is that the real distinction between them and the direct channel?

Willy Walker: The correspondents are correspondents to us because they cannot take loans directly to the agencies on their own and they have a correspondent relationship with us where we split origination fees. And then they get a small strip of the servicing fees that their loans make for Walker & Dunlop. So they get 10% of the servicing fees that we get off of the loans that they originate for Walker & Dunlop.

So if you look at it from an origination fee standpoint, our direct origination sales force, $0.55 on every dollar stays with the house and $0.45 of every dollar goes to our direct origination force. It varies producer by producer but that's on average and we split fees with the correspondents.

So direct is about 5 percentage points accretive or more profitable to us. But at the same time, having the variable cost structure of the correspondent channel and when volumes go down it's not on our back, it's on their back, is a very valuable channel to us and we want to make sure that we maintain that as we grow our direct origination sales force.

Bose George: Let me do one more. Have you guys provided the size of your escrow balances? Is that public?

Willy Walker: Debbie, have we? (Inaudible). And it is what? It's disclosed in our 10-K and it's $275 million. So that's back to that interest income piece that that $275 million is earning what everyone else is earning at banks today which is basically nothing. But if you got into a higher short term interest rate environment, that would start to kick off a significant amount of income. And those escrow balances, as we grow our HUD business, if you want to watch how those escrow balances will grow, the HUD business is very escrow rich, if you will. So many of the HUD deals come with significant escrow balances. So if you watch us grow our HUD business, that comes with significant escrows and that's where you'll see the growth in the escrow balances.

Bose George: Okay. Thank you very much.

Willy Walker: Thank you.