Walker & Dunlop

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Cheryl M Pate: Okay. We're going to go ahead and kick off our next presentation. Next up, we have Walker & Dunlop. And with us today we have both Willy Walker, CEO and Steve Theobald, CFO and Treasurer. So welcome, Willy and Steve; thanks for joining us today.

I thought maybe we'd kick it off on the multifamily side, which obviously we've seen very strong volumes from an industry perspective, over the last couple of quarters.

Can you maybe give us sort of an update on how volumes are trending, generally? I know there are some pricing changes that came in in the second quarter. Can you just sort of level that from where we are, from an industry perspective? Then we'll drill down from there.

Willy Walker: So, Q1 of -- and first of all, Cheryl, thank you for having us today. Great to be here.

Q1 of 2014 was a very slow quarter. Wasn't a whole lot of M&A activity in the commercial real estate space. And the refinancing volumes projected were at a 10-year low, coming down to 2014 troughing. And then start to build that '15/'16/'17. And so Q1 was slow, Q2 things started to pick up. And then the regulator came out with the scorecard for Fannie and Freddie. And in May of 2014 is when Fannie and Freddie really got back on their game, after the setbacks of 2013.

Since May of 2014, both agencies have been providing somewhere between $2 billion and $3 billion a month of liquidity to the market. That reached a peak of Fannie in April, providing $5.8 billion during the month of April, which is the last monthly numbers we have for both Fannie and Freddie.

As you know, in Q1 there was a very robust M&A market, as well as growth in refinancing volumes. What that then led to was Fannie and Freddie looking at their quarterly volumes and saying, "We're going to hit our caps if we keep going at this pace."

They started to gap out pricing to try and basically scare away deals. All that did was have investors -- borrowers -- jump at the deals that they had on the table. So April and May were quite strong months, as it relates to people having offers on the table, and taking advantage of where pricing was previously -- and where -- before it moved up too much.

I'd say right now we're in that sort of -- I'd say to some degree, there's a pause that's gone on, on two fronts. One is on the M&A front. A lot of people who had looked at deals saw agency spreads very, very tight, and also thought that a rate-increase by the Fed was a December event, were out buying assets and thinking they could make it all work.

I think that by the agencies widening and then also more clarity on the economy recovering and a potential rate increase -- potentially in September, but most people are sort of betting on December -- has a bunch of investors holding on the sidelines, right now, as it relates to moving forward on acquisitions.

Underneath all that is a refinancing market that is very, very healthy. And as you know over the next three years, is going to drive a huge amount of just general deal-flow in the refinancing market.

Cheryl M Pate: Right.

Steve Theobald: I also would just add to that treasury rates, as Willy mentioned, have increased quite a bit in the last month. "Quite a bit," being a relative term. Anytime we see that, there's generally been a pause in the market, as people digest that -- figure out whether that's going to stick -- where rates are heading, before they get back in. So I think we're seeing that, as well.

Cheryl M Pate: Good. Great.

And I guess just keeping on sort of the GSE's theme -- obviously there was no change to the cap for this year. But sort of expansion on the affordable bucket.

Can you help us think about really how we should be sizing the opportunity in the affordable bucket, and where we could really get to full-year for the GSE?

Willy Walker: So it really is a --

They both take in the book of business they've done year to date and run it through the models, and determined how much of what they've done year-to-date is capped-uncapped.

Then beyond that, they then have to look at what type of business they're going to do between now and the end of the year. We have a light sort of going on and off back there.

Unidentified Participant: Yes.

Willy Walker: Then they've got to look at what they're going to do between here and the end of the year. There's general talk, Cheryl, of both of them being able to lend somewhere around $40 billion this year. But nobody really knows, because it really does depend on how much of what they've done, year-to-date --

FHFA only came out last week with the definition of what high-income markets are and very-high-income markets. And then the other modification they made last week was that previously in the adjustments to the scorecard, they had said seniors' housing that was skilled nursing would not count against the cap at 80% of AMI.

They broadened that last week to include independent living. So just on that for-instance, you know that we did a large transaction in Q1 with new seniors. It was a $640 million deal. How much of that is now outside of the cap, because it's now in that non-cap bucket, can have a very significant play on how much they both have against the cap in Q1, and then also what they're going to do for the rest of the year.

But I think it's fair to say that the general talk is that if you look at $30 billion of capped business, both of them believe that there's the opportunity for them to do about another $5 billion to $10 billion on top of that in uncapped business.

Cheryl M Pate: Okay. Good.

And I think one of the things that we've seen is Walker & Dunlop is very well-positioned within the GSEs. You've done a great job of taking share. We can spend a few moments. What differentiates you? What has been sort of the key to success to winning share?

Is there more upside that we could see from here?

Willy Walker: We did 12% of Fannie’s volume last year, and we did 10% of Freddie’s volume last year. That made us Fannie's largest partner. That made us Freddie's third-largest partner.

In Q1, we did 9.2% of Fannie's business, and we did 16.7% of Freddie's business. So doing 16.7% of Freddie's business in Q1 made us their largest partner, and it was by-far the largest volume we've ever done with Freddie Mac.

We've been pretty focused on trying to be Number-1 with both of them. CB has been the largest seller servicer with Freddie Mac for quite some time. And it's hovered around 20% market share. Last year, they dropped down to 18% market share, as we and Berkadia both grew.

I just put forth that on the Fannie side, being Number 1 really does do a great deal to sell itself. It's a reasonably commoditized business. I've had plenty of borrowers say, "What's the difference between one DUS-lender and another DUS-lender?"

You can sit there and talk about your relationship with the agencies; the way you price deals; the way you structure deals. Your track record. But there's only one DUS-lender that can say, "We're Number 1."

Then people say, "Well, why are you Number 1? How come you do more than Wells Fargo and all these other big, big, big firms?" And you say, "Well, try us, and you can find out for yourself."

So that, on that side, sort of sells itself.

And then on the Freddie side, we've been growing so fast with Freddie. We only started working with Freddie in 2009. So we've gone from a 1% market share with Freddie in 2009 to a 10% market share in 2014.

And we just hire great people. We give them the support they need to be able to be effective. And we're very focused in this space.

I would also say, if you think about the firms that we compete with on a day-to-day basis, they are significantly larger than we are. What we do is a nought in the corner of their balance sheet or their income statement. Whereas for us, it's our full focus.

So if I go in to try to pitch someone for a piece of business and they say, "Well, you're up against Wells Fargo," for instance -- whom we go up against all the time, I get to sit there and say, "Well, if John Stumpf comes and sits down and says, "Your $22 million multifamily deal is really important to Wells Fargo," that's great. But it is really important to Walker & Dunlop.

Sometimes that works. Sometimes they say, "I don't care. I want to work with Wells Fargo.

But it's been that.

We've also grown a lot, Cheryl, as it relates to our national coverage. So as our brand has grown and as our stature with the agencies has grown, we have really developed a reputation as being one of the go-to places in the multifamily financing space.

So, that has built on itself as far as customers, to say if you're going to do a large transaction in the multifamily space and you want agency financing, you ought to give a call to Walker & Dunlop.

Cheryl M Pate: Great.

I think one of the trends that we've seen over the last couple of quarters has been this sort of a shift to more of a floating-rate loan structure. Can you maybe just give us a sense -- to the degree in which you think about it -- does that normalize, as rates have moved somewhat in the quarter? Or is it more endogenous factors that we should be considering?

Is it broader-based consumer or preference shift?

Willy Walker: If you look at our Q1 activity, 41% of our financing in Q1 was acquisition-financing. The majority of that was floating-rate debt. Why?

Because cap rates have compressed significantly. The people who have money burning a hole in their pockets are funds -- not the long-term investors. Long-term investors would love to have access to deal flow, but where funds and core foreign investors are buying properties at what cap rates, it's very difficult for just your typical long-term commercial real estate holder to be able to compete at these price points.

So you've got funds running to buy assets at low cap rates. And the only way to make the math work is to do floating-rate financing. Because if you're going to do fixed-rate, you're going to be in the high-3s; low-4s. And if you're going to do floater, you're in the high-2s, low-3s.

That spread differential between floating-rate and fixed-rate is going to give you the juice.

The second thing is, you'll get some IO in there, as well, which is going to boost your returns and get you potentially into promote.

And the final thing, which is the most important thing from the funds, is that floating-rate debt has a 1-year lockout, and then a 1% prepayment penalty for the rest of the loan.

If you do a 10-year fixed-rate loan, it's locked out for 9.5 years.

So if you're thinking that you got a fund life of 7 years and you're going to be trading that asset in 3 or 4 years, you'll want that prepayment flexibility on the financing that comes with a floater versus a fixed-rate deal.

Cheryl M Pate: Right.

Willy Walker: So the question really becomes with short-term rates potentially moving up, what's that going to do to LIBOR? And what's that going to do to spreads, and what it costs to finance on floaters?

If you have a flattening of the yield curve, how many people move toward fixed-rate?

All of that plays into where are we in the cycle. And what peoples' appetite is for new acquisitions.

But there, to use an example -- Carlyle just raised a $4 billion fund for real estate. The Carlyle guys and women aren't sitting around saying, "Okay. Well, let's try and figure out whether Yellen's going to raise rates or not." They're out deploying capital on a daily basis.

Cheryl M Pate: Right.

Willy Walker: So those types of investors are going to be there, sort of throughout the cycle. Then the long-term holders are trying to pick their opportunities. And if they do get their hands on an asset, they're going 12-, 15-, 20-year fixed-rate financing. Because they say, "If I can get an asset at a proper price and lock it away with a 405 or 410 coupon," for 15 or 12 years? "I'm going."

Cheryl M Pate: Yes. Absolutely.

Maybe if we could spend a couple of moments to compare the investment-sales versus the traditional retail or refi market. Sorry. Maybe we can tie that into the opportunity set from the Engler acquisition?

Willy Walker: We've had partnerships in the investment-sales space. We had a partnership with Cushman & Wakefield for a number of years. Didn't really produce a whole lot of deal-flow for them or for us.

Then when we acquired CW Capital, they had put together an investment sales partnership with ARA -- Apartment Realty Advisors. That partnership was a very good partnership. We did somewhere around $600 million to $800 million a year of joint transactions, where they were the sales broker and we were going to do the financing.

Then we decided when they were sort of up for purchase -- they ended up being bought by NuMark -- we decided to pass on the opportunity. So we sat there and said, "What are we going to from the investment-sales standpoint?"

The opportunity to buy Engler arose at the end of 2014. More than anything, the cultural fit between W&D and Engler was fantastic. So why investment sales at this time in the market cycle?

The first thing is, right now, there is not a borrower who doesn't want access to deal-flow. That's all it's about, right now.

You've got a refinancing coming up? Yes. It's fine. We'll use sort of whomever. And if Walker & Dunlop did it, great. But if you are buying an asset, it's such a competitive acquisitions market right now, that the ability for an HF or a CB to come in and say to somebody, "I'm the investment-sales broker. If I award this deal to you or tell the seller that they ought to pick you, we need to finance it on the back."

That tie-in between the two is extremely compelling, right now.

It's an important space to be in from a financial standpoint. But more importantly, it would sort of be like Morgan Stanley sitting there and having the best debt capital-markets desk in the country, but no investment-banking/M&A shop. Right?

So if we were going to go do a Term Loan B issuance and said, "Okay. Let's see if we're going to use Wells or Morgan Stanley," or whatever, you'd be working through that. But the differentiator to us -- to Steve and me, as we sit around -- is to have Seth Weintraub come into our office and say, "Hey. I've got an idea for you guys from an M&A standpoint."

"I've got someone you ought to go look at." What have you.

So for us, getting into the investment-sales space just broadens the relationship that we have with our clients, and makes us significantly more strategic to them. Because we're in the markets, looking at products and saying to them, "I've got an asset for you to buy."

Also, when they say, "I want to go refi my asset," we can also say to them, "Well, we'll also get you a BOV." We'll tell you what it's worth. So if you want to sell it today, go ahead. But if you want to refi it, this is what it looks like from a refi standpoint.

Up until now, we haven't had the ability to do that. Engler's a great platform in the Southeast, and we are very focused on scaling that across the country as quickly as we can.

Cheryl M Pate: Okay. Great.

Steve Theobald: I also think this is a procyclical business. It does really well when the market's hot. It's a capital-light business. So from a complement to our existing business model, it's a really great fit into that.

Cheryl M Pate: Got it.

Maybe we can sort of expand the opportunities. To think about commercial mortgage more broadly, and some of the opportunities.

You've been diversifying for some time, now. What are your targets and some of the better opportunities in the broader commercial real estate market today, as you continue to diversify?

Willy Walker: I think investors have struggled to try to put W&D into a comp bracket. If you think about the firms that I've just talked about that we compete with on a day-to-day basis, on the one hand, you've got Wells Fargo and on the other hand, you've got CBRE and HFF.

Three very different business models. One clearly being a depository, large commercial bank. The other being a globally-scaled real estate services company. And the other being a pure brokerage company.

People look at Wells on a valuation -- on a price-to-book. And some premium of a book. People look at CB and HF on a P/E basis. As you know better than I do, Cheryl, both of them trading in the high-teens/low-twenties.

Since we go head-to-head with them every day and have sort of pieces of both of them, I think people have a hard time looking at us. Because we're clearly not as capital-intensive as a bank. But we do have more capital needs than we have reserves on our balance sheet against our lending operation.

So the HFs of the world -- CB has that, as well -- but they're just scaled and they're global and they're in a lot of different other spaces than we are.

I think all of that comes around to, "What's the opportunity for growth for W&D?" We want to be the premiere commercial real estate finance firm in the United States.

As such, we really don't want to be a CBRE. I think today, with all great respect to Morgan Stanley, that Wells Fargo is the premiere commercial real estate finance company.

They've got balance sheet. They've got conduit. They've got agency. They've got bridge. They've got equity-placement. They've got investment-sales. They've got the full suite.

So, if you sit there and say, "Okay. Well what does Walker & Dunlop need to do to be able to kind of knock Wells Fargo off of that mantle?" You've got to scale out our investment-sales group like they have in Secured Eastdil.

You've got to continue to grow the brokerage operation like they have in Secured Eastdil. You need to expand our conduit, which we just started in 2014, and it's growing very nicely.

We're contributing to Wells today on our securitizations. So at some point, we're either doing our own securitizations or we're contributing to Wells and other people.

You need to expand our balance sheet lending, so that we're doing more on our balance sheet. Today we have about $300 million of collateral on our balance sheet, with about $90 million of equity tied up in that.

We told investors and you that we would do $250 million to $300 million, and then sort of revisit it. So we're in that revisiting stage. What do we do to create a permanent capital source?

Behind all of that, I think, is something that we have to show investors, and we have shown investors in the past couple quarters. Which is that our ROE -- when we went and did our Term Loan B and issued a lot of stock to Fortress --

Our ROE in Q1 of 2014 was 7%. Our ROE in Q1 of 2015 was 19-point --

Steve Theobald: 7.

Willy Walker: 7%.

Okay? So we raised capital and we issued a lot of stock to buy a company that was very strategic to us. And our ROE dropped down, as it would. We have fully deployed that capital. We bought CW. We fully integrated CW, and we're getting great advantage from the scale it brought us.

So, our ROE has moved up. We've told investors, "Target a mid-teens ROE return."

Steve will tell you "low- to mid-teens." I want to make sure that my wording is exactly right.

But we have to continue to show investors that we are a capital-light lending business.

Cheryl M Pate: Right.

Willy Walker: And I think as we do that, and as we continue to show the growth that we've been able to exhibit in our origination growth and our revenue growth, they will sit there and say, "These guys are a lot more like the 22- / 23-times earnings brokerage firms than the 1.2-times book-value depositories."

Then we'll get multiple expansion, and hopefully that will reward us as well as our investors.

Cheryl M Pate: I think some of the opportunities that you've spoken about as part of this drive progressed (ph), obviously, CMBS joint venture and driving originations -- up to the billion-dollar mark. That's sort of still the target over the medium term? Or how should we think about it?

Willy Walker: Yes. We missed the mark that we wanted to do. So we wanted to do a billion dollars from when we started the conduit, until a year later, which would be July-to-July. We'll be somewhere between $250 million and half a billion during that period of time. So, falling well short of the mark that we'd set for ourselves as far as the aggregate origination volume.

With that said, the deal-flow that we have done has been far more profitable than we had expected. So Steve's really pleased with it from a returns standpoint. I'm not that pleased with it from a market-presence standpoint. Because you can't do --

I'll just pick a number -- $300 million of conduit-origination -- in a market that's probably going to do $100 billion this year, and be a player. You're just not even on the radar screen.

So we and Fortress are very focused on growing originations. I think one of the problems that we had is -- and no Walker & Dunlop investor would call this a problem -- but from May of last year, when we launched the conduit in June, the agencies have just been on fire.

Cheryl M Pate: Right.

Willy Walker: So as a result, all of our agency originators --

I could have given them 3-x commissions for doing a deal with our conduit. They wouldn't even think about it. Because they just know the agency process. They can do so much deal-flow. They could take a deal to a conduit that, "Oh, by the way -- wasn't competitive." It was just -- it didn't make any sense.

Cheryl M Pate: Right.

Willy Walker: So there's a little bit of the counterbalancing of the conduit that -- should the agencies pull back from the market --

And when they have pulled back recently with pricing going up, we had a big inflow of multifamily deals that came to our conduit. But that whole origination sales force is very focused on the agencies. If the agencies were to pull back, they can then take deal-flow and put it to the conduit.

Then we're pulling deal-flow from our overall brokerage network, and we've also hired direct originators to the conduit.

So I feel great about where we are with the conduit right now, given the profitability. But would I have liked to have seen us do in-between half a billion and a billion -- rather than between $250 thousand and half a million? Very much so.

Cheryl M Pate: Got it.

Maybe I'll just sneak in one last one before I open it up to the audience.

One of the other opportunities you had talked about previously that I'd love to get your updated thoughts is something in sort of a REIT structure. Is that something that's become more interesting over time? Or sort of how are you thinking about that opportunity?

Steve Theobald: So, Cheryl, the short answer is "yes." It's something that is interesting. I think from the standpoint of having access to a permanent capital vehicle would really round out our business.

Right now, Willy mentioned, we've got about $300 million of loans on our balance sheet that would work very well inside of a REIT balance sheet.

Given the nature of how we think about risk -- how we manage risk -- we probably wouldn't build that portfolio too much larger than that. And we've been specifically focused on only multifamily and loans that have permanent takeout with Fannie, Freddie or HUD.

Through our salesforce, we have access to way more deal-flow than what we're saying "yes," to. So we end up either losing some of that deal-flow to banks, primarily, or we broker it off to other people. So having access to a capital source like a REIT would be ideal for that.

We also have -- through the CMBS JV -- the access to mez financing. Preferred equity and also some high-yield opportunities in the non-multifamily space. That, again, would be ideally suited for a REIT structure.

So we thought a lot about this. It's something that would be interesting in addition to what we have in the toolkit today.

Cheryl M Pate: Got it. I'll just pause for a moment if there are any questions from the audience.

Unidentified Audience Member: Yes. How are you funding the conduit? And the $300 million of assets on the balance sheet -- are they -- ? They're independent from the assets in the conduit; correct?

Steve Theobald: That's correct. Yes. So the $300 million on our balance sheet are our loans. The conduit, we fund with warehouse financing. While the loans are being aggregated pre-securitization. And then we're contributing them to another securitization.

Willy Walker: So just specifically to that, it's an 80/20 joint venture with Fortress.

Steve Theobald: Right.

Willy Walker : So the equity in the conduit is $20 million of profit from W&D and $80 million of capital from Fortress. And then warehouse lines against that to aggregate and then contribute.

On the balance sheet lending, it's all our own capital. And we're getting 70% to 75% advance rates on warehouse lines. And importantly, as Steve said previously, it's only multifamily.

So we both lived through 2008, and saw what happened to warehouse lines during 2008. One of the reasons why we're strictly focused on multi is that were there to be some type of displacement in the capital markets, Fannie and Freddie play a counter-cyclical role and provide takeout financing for those loans.

So we wouldn't be sitting there with a grocery-anchored retail mall in Warrenton, Virginia that we couldn't place with somebody. So we've been very, very conservative as we've been growing our balance sheet lending, to make sure that we don't get caught in a warehouse situation.

The only other piece of that is, we are a huge user of warehouse lines on our agency financing. And during the last downturn, there were no calls on any of those warehouse lines. They were tightened down somewhat, as far as the expansion capability. But given that it's Fannie and Freddie paper, there was no sense that the collateral that was going into those lines wasn't going to be taken out with --

We also forward-sell those securities. So that's just an interim-financing before the buyer of the security takes them. So the security's already been sold; it goes on to the warehouse line and then gets taken off of it.

Unidentified Audience Member: Kind of a follow-up on that. How do you think about your corporate leverage right now? So, the term loan outstanding. Any expansion on that?

Steve Theobald: Sure.

So we have, as you mentioned, a term loan on the balance sheet. It's the only -- I'll call it "corporate debt" that we have. All of our other borrowing is warehouse-related.

So, right now it's about $170 million. We raised that back in December of 2013. At the time we raised it, I think our 12-month trailing EBITDA was somewhere around $56 million or $58 million. It's now in-excess of $100 million.

If you believe that you could leverage that up at least 4-times, clearly, we have the ability to expand leverage beyond the $170 million that we have today. I think we're comfortable that we could actually get a transaction done at that level, if the right opportunity came along, with respect to use of proceeds.

So, plenty of capacity to borrow above and beyond where we are today.

Cheryl M Pate: Any last questions?

Willy Walker: This woman had a question, right here.

Cheryl M Pate: Okay. Well, great. Then I'd like to thank both Willy and Steve for speaking with us today.

Willy Walker: Thank you, Cheryl!

Cheryl M Pate: Thanks.