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Walker & Dunlop, Inc. (WD)

Q2 2016 Earnings Call

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Charles Nabhan
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Steve C. DeLaney
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MANAGEMENT DISCUSSION SECTION

Operator: Welcome to Walker & Dunlop's Second Quarter 2016 Earnings Conference Call and Webcast. Hosting the call today from Walker & Dunlop is Willy Walker, Chairman and CEO. He is joined by Steve Theobald, Chief Financial Officer; and Claire Harvey, Vice President of Investor Relations.

Today's call is being recorded and will be available for replay at 11:30 A.M. Eastern. The dial-in number for the replay is 800-388-9074. The archived call is also available via webcast on the Company's website. At this time, all participants have been placed in a listen-only mode and the floor will be open for your questions following the presentation. [Operator Instructions]

It is now my pleasure to turn the floor over to Claire Harvey. Please go ahead Ma'am.

Claire Harvey
Vice President-Investor Relations

Thank you, Erica. Good morning, everyone. Thank you for joining the Walker & Dunlop second quarter 2016 earnings call. I have with me this morning, our Chairman and CEO, Willy Walker and our CFO, Steve Theobald. This call is being webcast live on our website and a recording will be available later this morning. Both our earnings press release and website provide details on accessing the archived call. This morning, we posted our earnings release and presentation to the Investor Relations section of our website www.walkerdunlop.com. These slides serve as a reference point for some of what Willy and Steve will touch on this morning.

Please also note that we may reference the non-GAAP financial metric, adjusted EBITDA, during the course of this call. Please refer to the earnings release and presentation posted on our website for a reconciliation of this GAAP and non-GAAP financial metric and any related explanation. Investors are urged to carefully read the forward-looking statements language in our earnings release. Statements made on this call which are not

historical facts may be deemed forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995.

Forward-looking statements including statements regarding future financial operating results, involve risks, uncertainties, and contingencies, many of which are beyond the control of Walker & Dunlop and which may cause actual results to differ materially from the anticipated results. Walker & Dunlop is under no obligation to update or alter our forward-looking statements whether as a result of new information, future events, or otherwise. We expressly disclaim any obligation to do so. More detailed information about risk factors can be found in our reports on file with the SEC.

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

William M. Walker

Chairman & Chief Executive Officer

Thank you, Claire and good morning everyone. We ended the second quarter with a deep pipeline, low interest rates and capital markets that have recovered from the equity sell-off earlier in the year. We felt confident in our ability to execute during the quarter to meet our clients financing needs and stay on track towards meeting our financial goals of delivering double digit EPS growth and a mid-teens return on equity.

As we announced this morning, we delivered the strongest quarter in our company's history including the first ever quarter with over \$5 billion in total transaction volume, and first ever earnings per share of over \$1. The \$5.4 billion of transaction volume generated \$148 million of total revenues, a record and 30% growth over the same quarter last year.

The growth in revenues pushed our diluted earnings per share to \$1.05, again a record and 57% over the same quarter last year. Extremely strong top line and bottom line performance coupled with significant capital deployment pushed our return on equity to 25%.

Year-to-date, our revenues have grown 7% over last year's incredibly strong first half to \$242 million and our diluted earnings per share have grown 17% year-on-year to \$1.55 per share. We continue to run an efficient business for both the capital and cost perspective as evidenced by our 19% year-to-date return on equity and 31% operating margin.

It is very clear that the combination of our team, brand, and market position are generating record deal flow and in conjunction with solid management are generating spectacular financial results.

During the second quarter, several discreet events occurred that have us feeling very good about how we are positioned to succeed in the coming quarters and years. First, at the start of the quarter, the Federal Housing Finance Agency, FHFA proactively increased the combined multi-family lending caps of Fannie Mae and Freddie Mac from \$62 billion to \$70 billion.

That move signaled that the FHFA expects the multi-family financing market to be larger than initially expected in 2016, that the FHFA wants the GSCs to play an active and growing role in financing America's affordable rental housing.

The U.S. continues to shift further towards a renter nation, and multi-family has become the largest asset class in commercial real estate mortgage debt outstanding at over \$1 trillion. The FHFAs move in May sent a positive

message to borrowers, lenders and buyers of GSE Securities that Fannie and Freddie will have plenty of capital, and regulatory support to meet the growing market demands throughout the remainder of the year.

The FHFA's view of a growing multi-family market is supported by the Mortgage Bankers Association's June survey, which shows that multi-family debt originations are expected to grow from \$262 billion last year to \$273 billion this year to nearly \$280 billion by 2018.

As one of the top multi-family lenders in the country, we have a tremendous opportunity for continued growth in the coming years. The second discreet event during the quarter was the weak May job support. Two things happened around the weak jobs report, debt yields fell dramatically and the timeline for a Fed funds rate increase was pushed back. Many Walker & Dunlop clients benefited handsomely from a drop in rates, particularly as spreads on agent CMBS did not gap out nearly as significantly as CMBS and Corporate bonds.

As we continue to operate in an extremely low interest rate environment, W&D customers are benefiting from low financing costs and the option to float their financing over the coming years as rates appear poised to stay incredibly low or fix their financing for the next decade at historically low rates.

As slide four shows, the majority of our clients during Q2 decided to put long term fixed rate financing on their properties. Not only is this the most profitable business for Walker & Dunlop due to the size of the MSR's we book on long term fixed rate deals. But it is also very encouraging from a credit perspective. These are deals owners want to hold long term where they have removed interest rate risk for many years to come.

The third discreet event of the quarter was the Brexit vote. Once again, like after the May jobs reports investors flock to treasuries and push down yields to levels never seen before. As well, similarly to after the jobs report, spreads on agent CMBS did not gap out as widely as other debt instruments due to the government guarantee.

But unique to Brexit was the fact that one of the world's real estate safe haven London lost some of its glimmer, and while it is far too early to draw conclusions, one of the winners of the Brexit boat is likely U.S. commercial real estate, particularly multi-family properties in gateway cities such as Washington, New York and San Francisco.

Walker & Dunlop's brand, client relationships and execution capabilities position us to be a long term beneficiary of continued international capital flows in to U.S. commercial real estate.

Beyond the specific events of Q2, that make us feel very good about the long term prospects for our business, there has been a lot in discussion recently with regard to where we are in the commercial real estate cycle, with some believing we are nearing the end. We disagree.

The two most common reasons for believing we are at the end of the cycle is that we are in year eight of a recovery and most recoveries/expansion only last eight years, and second, that cap rates have reached levels where assets must be overpriced.

With regards to eight year cycles, history is history. Yet as we all know, this recovery has been slower than anticipated and not produced the three and four percent quarterly GDP growth that was the hallmark of the late 1980s, late 1990s and mid-2000s.

Slow growth has tempered new construction and although there are clearly pockets of overbuilding in the U.S. there is not a glut of supply of new commercial real estate properties. The typical cycle could easily be extended if

slow, moderated growth continues in the broader economy and banks continue to regulate their construction lending.

With regard to cap rates, when people start seeing properties trade at 4% and 5% caps, they start to think that asset values are inflated and the end is near. Though we have never been in a sustained, low interest rate environment like this in anyone's lifetime and relative returns on stocks, bonds and commercial real estate have never been more compressed.

Low cap rates today are not the result of excess supply of new properties or excess debt. They are result of strong fundamentals and strong relative returns versus other investment options, which is driving asset prices up and cap rates down. And investors continue to buy reflected in the amount of acquisition financing we did in Q2.

As slide four shows, 51% of our Q2 financing activity was for acquisitions compared to only 21% in Q2 of last year. Such a strong acquisitions market is also benefiting our investment sales business. Given the relatively small size of our investment sales team, any growth we see in that group over the coming quarters and years will provide increased exposure and opportunity to W&D to do even more acquisition financing.

As it relates to cycles, it is important to remember that Walker & Dunlop is a financial services firm that specializes in multi-family lending and investment sales solely in the United States. Over the last three years 83% of all of our debt financing has been on multi-family properties.

As the left hand chart on slide five shows, there is over \$1 trillion of multi-family debt outstanding and as the right hand chart on slide five shows as the multi-family market has continued to grow, Walker & Dunlop has continued to gain market share.

Further, the American Home Ownership rate is at a near 50 year low at 63% and is projected to fall even further due to demographic shifts, cultural preferences and economic realities. Financing multi-family properties will continue to be a fantastic business and we think rather than asking where are we in the commercial real estate cycle investors should be asking how much more financing can Walker & Dunlop do and how much bigger can their platform become.

It is also important to keep in mind the opportunities for growth that especially finance companies have as banks deal with increased regulation. In July, the Office of the Comptroller of the Currency came out with a report stating the OCC is concerned about banks commercial real estate lending.

Interestingly, although the OCC made broad comments about "looser under eight standards". The OCC did not release any hard data to support whether underwriting standards have gone from conservative to less conservative or from conservative to problematic.

What we know is that Walker & Dunlop's underwriting standards have remained conservative. For example, this quarter the average loan to value on loans we originated was 67% and the average debt service coverage ratio was 1.52 times. That credit profile is almost identical to where it was a year ago and we will continue to do as much lending as we can at 67% LTVs and 1.52 times debt service coverage ratios.

Regardless of whether you agree or disagree with the OCC's statement on credit standards, their view on banks' exposure to commercial real estate will clearly require banks to deal with an increasingly burdensome regulatory environment, which presents a wonderful growth opportunity for non-bank lenders like Walker & Dunlop.

We entered the second half of the year feeling very good about our business, our client base and our ability to generate double digit EPS growth and returns on equity that are at the very high end of most financial services institutions.

With that, I will turn the call over to Steve to run through our financial results in more detail. Steve?

Stephen P. Theobald

Chief Financial Officer, Treasurer & Executive Vice President

Thank you, Willy and good morning everyone. In many respects, this quarter's results speak for themselves, so I plan to keep my remarks brief. Our exceptional second quarter was marked by record deal flow and strong execution by our team.

Highlighted on slide six is a return on equity of 25% and operating margin of 35% for the quarter, both substantially ahead of our targets. Earnings of \$1.05 per share were up 57% over last year's second quarter putting us well on pace to achieve our goal of double digits' earnings growth in 2016.

As we discussed in our first quarter call, the year got off to a slow start amidst economic uncertainty and capital markets volatility, but by March it began to stabilize, and by April it began to gain momentum. This momentum continued throughout the second quarter, with June representing the highest monthly volumes in company history, driven by continued low interest rates, strong multi-family fundamentals and the strengths of our brands in the marketplace.

Second quarter was widely successful in a number of fronts, but there are two primary themes that stand out with respect to our overall performance that I want to highlight. First, we had a record quarter for Fannie Mae originations, which benefited our top and bottom line as well as all of our key financial metrics. And second, we took advantage of the opportunities in front of us to deploy capital during the quarter to drive future growth.

As shown on slide seven, we grew total transaction volume 42% to a record \$5.4 billion this quarter. We did over \$1 billion each in Freddie Mac and brokered executions, but the real story was the \$2.4 billion of Fannie Mae lending, representing 45% of total transaction volume for the quarter.

Fannie Mae was the winning bid on much of our fixed rate business with 80% of our Fannie volume growing fixed rate compared to 44% of our Freddie volume. The increase in Fannie Mae volume drove the 72% increase in gains attributable to mortgage servicing rights propelling our gain on sale margin for the quarter to 2.15% up 14 basis points from the prior year and well above our target of 160 to 180 basis points.

\$669 million of our Fannie Mae volume was a large student housing portfolio that we closed in June. The remainder of our Fannie Mae volume was what I would call garden variety flow business done at very attractive margins, indicative of a fully functioning and healthy multi-family market place as well as the strength of the broad national brand and platform we have built.

Our pipeline for Q3 is quite strong and we expect to see an increase in our Freddie Mac and HUD production in the second half of the year, along with continued strong growth and brokered transactions. Given the healthy product margins we are enjoying at the moment and the strength of the multi-family market, we are increasing our gain on sale margin expectations to the range of 170 to 190 basis points for the remainder of the year.

Our year-to-date market share with the GSEs now stands at 8.1% with Fannie Mae and 11.3% with Freddie Mac. We expect our market share with Fannie to increase substantially in the third quarter that this significant volume we rate locked in June will be delivered in July and August.

Investment sales activity grew nicely in the second quarter with \$624 million of closed transactions. Our current pipeline of deals factored over 50% of our loan origination volumes during the quarter were acquisition related, further suggest the multi-family market remains robust.

Servicing fees increased 17% from last year to \$32.8 million and all servicing related revenues during the quarter totaled \$38 million, a 14% increase from Q2 of last year. With the surge in our loan origination volumes and the acquisition of \$3.8 billion of HUD servicing, our portfolio grew to over \$57 billion with an MSR fair value of \$576 million at the end of the quarter.

We closed the acquisition of the HUD portfolio on June 20, so there was very little impact to net income for this quarter. The weighted average portfolio servicing fee remained 25 basis points even with the addition of 3.8 billion of HUD servicing at a weighted average servicing fee at 17 basis points. The weighted average life of the portfolio extended to 10.4 years, while over 80% of the servicing fees remain pre-payment protected.

Our acquisition of the HUD servicing with both financially and strategically attractive, from a financial standpoint we expect the portfolio to add roughly \$0.06 a share to annual earnings and to achieve the cash-on-cash return in excess of 15%. While also reducing the unit cost of our HUD servicing by 21% due to the scale benefits of adding such a large portfolio to our existing business.

In addition, the portfolio added approximately \$230 million of new escrow balances bringing our total escrows to over \$1.4 billion. With the weighted average earnings rate in excess of 65 basis points our escrow deposits generate a nice amount of annual revenue even in this low interest rate environment.

From a strategic perspective over 50% of the acquired portfolio represents new customers to Walker & Dunlop expanding our customer base and with it opportunities to finance additional business.

Finally, we believe there are opportunities to refinance several hundred million dollars of the acquired portfolio, which will not only generate current mortgage banking gain income, but further lock in the long-term servicing fees from the portfolio.

In addition to making the \$45 million investment in the servicing portfolio, we also used \$19 million of capital to grow our interim loan portfolio during the quarter to \$242 million at June 30. We continue to see strong deal flow and attractive returns that allow us to not only achieve strong economics within the portfolio but capture and control future agency financing business as well.

During the quarter we repurchase another 121,000 shares of stock for \$2.7 million, bringing our year to-date purchases to 396,000 shares for \$9.2 million. This leaves us with \$65.8 million of repurchase capacity under our current authorization.

Our available cash decline \$37 million during the quarter reflecting the deployment of \$65 million of cash for the aforementioned investments and share repurchases offset by \$28 million of cash generation during the quarter.

We expect to continue deploying our free cash flow back into the business with a preference to investing in attractive growth opportunities versus buying back stock. We could not be more pleased with our second quarter results and the momentum we are carrying into the second half of the year.

Our team is executing well and our brand is winning in the multifamily space. We continue to see opportunities to deploy capital to generate attractive returns and remain focused on simultaneously maintaining our industry leading growth on delivering mid to high-teens ROE to our shareholders. Two things we have been very successful at over the past few years.

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

William M. Walker

Chairman & Chief Executive Officer

Thanks, Steve. With the financial results Steve just detailed we are on pace to achieve our financial goals for 2016. On our last earnings call we laid out several strategic initiatives that we are focused on achieving this year.

The first was to grow the number of debt financing and investments sales professionals at Walker & Dunlop by 25% before the end of the year. During the second quarter we made great progress towards that goal by hiring nine financing professionals.

The second goal was to continue to grow the servicing portfolio both organically and through acquisition. The purchase of the Oppenheimer portfolio increased our servicing by 7% would generate mid-teens cash-on-cash return and provide us with access to a number of new clients and financing opportunities.

Finally, we establish the goal of creating a scaled asset management business at Walker & Dunlop. I would like to take a few moments to explain what that goal means for us and our investors.

In 2007 when our company turn 70 years old, we established the five-year growth plan called the Drive to 75, but we aimed to increase revenues and earnings by five times in five years. We accomplished that goal in 2012.

That same year when W&D turned 75, we established another five-year growth plan called Onward to 80. That plan set a goal of expanding our loan origination sales force to capture as much deal flows as possible, and once established to raise third-party capital, so Walker & Dunlop control the underwriting and investment decision to lend on commercial real estate.

The Onward to 80 Strategy was launched in November of 2012. That same year we acquired CWCapital which increased our loan origination sales force to 72 professionals who originated \$7.1 billion of mortgages.

Since then, we have added five officers, 32 loan originators and increased our annual transaction volume 150% to \$17.8 billion at the end of 2015. As we were dramatically expanding our loan origination network we also begin lending of our balance sheet and have originated almost \$1 billion of loans over the past four years, achieving low teens returns on our equity and having not a single delinquency.

Our goal now is to expand this lending operation off balance sheet by raising debt funds in the form of a separate account or commingle funds or acquiring the manager of a mortgage REIT.

Whether it would be in the form of funds or mortgage RIET it is our goal to build the business between \$8 billion and \$10 billion in assets under management over the next several years.

That kind of scale will do several things. First it will provide our loan originators with capital we control to meet almost any financing need of their clients. First trust debt, mezzanine debt, interim debt, preferred equity, and joint venture equity.

With this breadth of capital, we are certain that Walker & Dunlop will continue to be viewed as one of the very best financing platforms for commercial real estate. Second by controlling the capital and earning origination fees, exit fees, servicing fees, and asset management fees we'll enhance the margins of our lending business.

And finally, with \$8 billion to \$10 billion in assets under management coupled with the ever increasing revenue off of our servicing portfolio, we believe we will generate over 50% of our revenues from long-term stable revenue streams causing investors to classify Walker & Dunlop as an alternative asset manager which will expand our earnings multiple accordingly.

With our scaled access to deal flow, long standing underwriting track record and a 191% shareholder return in our first five years as a public company. We believe raising capital around this initiative will be achievable and scalable.

We've made great progress during Q2 at vetting potential partners, meeting with institutional investors and determining our long term fund raising and asset management strategy. And we are confident that we will have our first fund, our investment in an asset management platform raised or completed by the end of this year.

The strength of our core business is evident from the financial performance Steve and I have outlined during this call. The multifamily debt financing market is growing with very favorable macro trends. Interest rates are at historic lows allowing borrowers to lock-in long term fixed rate financing for the next decade. The U.S. is a safe haven for investors around the globe and U.S. multifamily assets are seen as a source of stable and attractive returns for those investors.

Finally, regulatory oversight and risk retention rules are expected the limit banks and conduits ability to support the growing market demand providing opportunities for the GSEs and non-bank lenders to continue to grow and expand.

With these tailwinds supporting our core business and with the strategic objectives we have outlined, we look forward to the coming months and years with a great deal of excitement.

With that, I'd like to thank everyone for joining us this morning. And I'll turn the call over to Erica for questions.

QUESTION AND ANSWER SECTION

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

Jade Rahmani

Keefe, Bruyette & Woods, Inc.

Q

Good morning. Thanks for taking my questions. I was wondering if you could provide any color on what drove the outsized Fannie Mae originations in the quarter, maybe you could offer us some color on transaction size and also if there are any other large deals in addition to the student housing portfolio.

Stephen P. Theobald

Chief Financial Officer, Treasurer & Executive Vice President

A

Good morning, Jade. As it relates to the Fannie business, I think the biggest driver of that was fixed versus flow as we tried to outline in the call. Borrowers move towards fixed rate financing during the quarter and also that was driven by the amount of acquisition activity that we finance.

And both Fannie and Freddie obviously lend on – have both float and fixed rate products. But during the quarter and year to-date we really seeing on the floating rate products, Freddie Mac be the most competitive and on the fixed rate Fannie Mae be the most competitive.

And so, during the quarter when investor demand was up for long-term fixed rate financing, Fannie was the chosen execution. And then, behind that the large student portfolio we did in Q2, we mentioned to investors that we expected to do large transactions. As you know, we did a number of large transactions in 2015. The transaction we did in Q2 was another one.

And I would just say to you, what is extremely rewarding for us to see is that whenever large transactions in this space are happening Walker & Dunlop is on a very, very shortlist of borrowers who have the scale and execution capabilities to meet the financing needs of those types of borrowers and to work on those transactions. So, without talking about anything in the pipeline specifically I would just say to you that it is our expectation that we continue to work on large transactions in the future.

William M. Walker

Chairman & Chief Executive Officer

A

But specifically, Jade, with respect to the second quarter that large student housing portfolio was really the only large transaction in there.

Jade Rahmani

Keefe, Bruyette & Woods, Inc.

Q

And excluding that deal what's the average Fannie Mae transaction size?

Stephen P. Theobald

Chief Financial Officer, Treasurer & Executive Vice President

A

I don't think we've disclosed that, what is interesting is the overall transaction size Jade, is continuing to move up quarter-by-quarter and year-over-year and we've moved from \$12 million in average size to \$14 million average size and I believe it's in Q2 we were on \$18 million average transaction size.

Jade Rahmani

Keefe, Bruyette & Woods, Inc.

Q

Given the strong 2Q volumes do you still anticipate typical seasonality to play out this year where volumes historically have increased sequentially in the third quarter and the fourth quarter has been the outsized quarter for the year?

Stephen P. Theobald

Chief Financial Officer, Treasurer & Executive Vice President

A

Yes. We – the cyclical or if you will, seasonality of the business is still there with Q2 and Q4 historically being the strongest quarter as Q1, Q3 being historically softer quarters.

Jade Rahmani

Keefe, Bruyette & Woods, Inc.

Q

Okay. Can you just comment on the decline in adjusted EBITDA year-over-year, was that mainly driven by hiring that took place over the -- say, the last two quarters? And was there a negative impact from professionals that have come on to the platform that you've started to accrue expenses for, but they're not yet booking revenues?

Stephen P. Theobald

Chief Financial Officer, Treasurer & Executive Vice President

A

Yes. So, Jade, couple of comments, so one there's obviously a reconciliation of our net income to EBITDA in the back of the slide presentation as well as a table in the 10-Q that outlines the components of projected EBITDA which I think will be pretty helpful to you.

I wouldn't say that the decline in adjusted EBITDA was due to hiring per say, I mean, obviously we have hired a number of folks over the past year, but that's generated I think and supported the generation of the additional volumes we've done. But there are two components to personnel -- variable compensation related both commissions and our company bonus pool that given our financial performance and given the production volumes are higher this year than last year. So that's I think part of the explanation for you.

Jade Rahmani

Keefe, Bruyette & Woods, Inc.

Q

Okay. Thanks very much for taking my questions.

Operator: Thank you. Our next question comes from Steve DeLaney with JMP Securities. Please go ahead.

Steve C. DeLaney

JMP Securities LLC

Q

Thanks. Good morning, everyone and congrats on the record quarter. With respect to the investment sales, I mean, it was a nice increase compared to last year. It's \$624 million. We looked -- we didn't see where the revenue associated with investment sales is specifically broken out in the press release. Is that something, Steve, that you're able to comment on?

Stephen P. Theobald
Chief Financial Officer, Treasurer & Executive Vice President

A

Yes. It's in other revenue, Steve.

Steve C. DeLaney
JMP Securities LLC

Q

Got it. And that's a \$7.1 million figure, okay. I guess we're just trying to get a handle on kind of the average margin if you will on investment sales from a revenue standpoint versus deal size?

Stephen P. Theobald
Chief Financial Officer, Treasurer & Executive Vice President

A

Yes. So, Steve, on the size of the investment sales revenue, it's not broken out but its \$2.7 million of that number.

Steve C. DeLaney
JMP Securities LLC

Q

Okay. Excellent. That's very helpful, Steve. Thank you. In addition to obviously the revenue opportunity, I'm curious you know, thinking back to when you bought Engler, I think you commented 51% of originations were acquisition transactions. Did you see any examples of synergy in the second quarter where Engler well it's not Engler anymore – your investment sales division actually represent was involved in a property sale transaction and Walker & Dunlop was able to provide financing?

Stephen P. Theobald
Chief Financial Officer, Treasurer & Executive Vice President

A

We're seeing a lot of it, Steve.

Steve C. DeLaney
JMP Securities LLC

Q

Okay.

Stephen P. Theobald
Chief Financial Officer, Treasurer & Executive Vice President

A

And we – I would put forth to you that next quarter we probably will give you a number on what percentage of our investment sales activity we're able to finance. We had a number of transactions that were Q2 sales that have gotten financed in the beginning of Q3 that made it, so that we decided because it was going over quarters, we weren't going to give that statistic. But the sort of, if you will, the punch line to it is, we are seeing fantastic synergy between the investment sales group and the debt financing group.

Steve C. DeLaney
JMP Securities LLC

Q

Got it. Okay. Thank you. And appreciate the comments on investment asset management were very helpful, because I was wanted to ask you sort of about the interim lending opportunity and how you are going to be able to finance that and really scale that up.

Just a couple of questions around that though. Is it your thought that there will be a primary focus on multifamily properties just for the obviously ability to refi that – you know those transitional loans down the road. Or will you be more of a generalist in terms of your bridge lending effort?

William M. Walker

Chairman & Chief Executive Officer

A

As you know Steve the only loans that we have on our balance sheet today are multifamily loans and we have kept that lending specific to multifamily. It is our very clear intention that whether it be in raising capital as I said in either a separate account of commingle fund or if we do acquire the manager of a mortgage REIT that we would use those vehicles to finance all commercial real estate asset classes.

But as we pointed out in the call over the last three years, 83% of our financing volume has been multifamily. And so, we're very focused on the long-term vision of being the premier commercial real estate finance company in the United States and that means bringing on originators who finance not only multifamily but office and retail and hospitality.

But at the same time any investor in those funds or investor in the REIT that we're managing will know that Walker & Dunlop has a fantastic brand reputation and market position in multifamily and therefore I would put forth the majority of the loans that go into whatever vehicle we end up managing would be multifamily.

Steve C. DeLaney

JMP Securities LLC

Q

Okay, great. Thank you, Willy. One final question if I may. We haven't touched this during the call on your conduit lending activity and we see you were active in the quarter with selling \$30 million of loans. Can you talk about – obviously CMBS was down, it's back kind of your outlook and view towards conduit lending as part of the franchise going forward? Thank you.

William M. Walker

Chairman & Chief Executive Officer

A

Yes, sure. As you know Steve, Q1 was a typical quarter for all of the capital markets, equity, debt, as well as the conduit market. And Q2 there was, if you will, a healing process that took place.

Steve C. DeLaney

JMP Securities LLC

Q

Right.

William M. Walker

Chairman & Chief Executive Officer

A

And we have a fantastic team that has been out originating loans and providing that offering to the market. As you also know, conduit volumes for the first half of the year overall were down I think 44% year-on-year. And pricing has come in significantly from where it was in Q1. So, we feel good about the overall conduit market. But it's been interesting in the sense that the deal flow that has been coming in has not really been looking for the conduit bid.

As I underscored in my comments, our average LTV on our loans in Q2 was 67%, and our average debt service coverage ratio was 1.52 times. As you know, conduit lending is typically at higher leverage levels and lower debt service coverage than those numbers and that's an average across all of the lending we did in Q2. And that's very similar to past quarters including the [ph] Comp Act (37:30) in Q2 of 2015.

So, I think one of the things that we're seeing is that W&D as a company has a client base that on an average is looking for lower leverage deals and isn't "the typical conduit borrower". And so, I would just put forth to you, we love being in the conduit space. We have a fantastic team and we're obviously focused on trying to grow origination volumes and at the same time we're also there to provide the market with what it needs and the market right now has not been a big if you will, a requestor of conduit loans.

Steve C. DeLaney
JMP Securities LLC

Q

Great. Well, Willy thanks and Steve, everybody thanks for the comments. Very helpful.

William M. Walker
Chairman & Chief Executive Officer

A

Thank you, Steve.

Operator: [Operator Instructions] At this time, we'll go next to Charles Nabhan from Wells Fargo. Please go ahead.

Charles Nabhan
Wells Fargo Securities LLC

Q

Hi, good morning. I understand that the borrower preference for fixed rate originations provided a tailwind to margins in the quarter. But if you look at the percentage of fixed rate transactions in first quarter versus second quarter, they are relatively in line with one another, but the margin for the quarter was significantly higher this quarter.

My question is, could you talk about some of the factors driving the – that increase this quarter and the degree to which the student lending transaction might have impacted that on the gain on sale margins quarter?

Stephen P. Theobald
Chief Financial Officer, Treasurer & Executive Vice President

A

Hey Chuck, good morning this is Steve. I'll take your question. The explanation really is the percentage of business that was done Fannie Mae versus Freddie, so while the overall percentage fixed versus floating may not have changed much the percentage of business we did Fannie versus Freddie changed significantly quarter-to-quarter. And that drove the change in the margin.

Charles Nabhan
Wells Fargo Securities LLC

Q

Okay.

Stephen P. Theobald
Chief Financial Officer, Treasurer & Executive Vice President

A

The student housing portfolio, had really good economics for us but that wasn't the driver of the performance.

William M. Walker
Chairman & Chief Executive Officer

A

I'd also just add Chuck as we highlighted in the call both the May jobs report as well as the Brexit both kept investor spreads on agency MBS tight, and as a result unlike in the past whereas rates move and spread move our servicing fees would move in conjunction with that because we had real strength on the MBS investor market that allowed us to maintain our servicing fees on the Fannie Mae business we did.

Charles Nabhan

Wells Fargo Securities LLC

Q

Okay. As a follow up last quarter you guided to brokered originations at the high end of the \$3 billion to \$5 billion range, and it looks like so far about half way through the year you are trending towards the midpoint of that range. I wanted to see if you had any updates on those expectations and you know get a sense for if you still expect volumes to be at the high end of that range?

William M. Walker

Chairman & Chief Executive Officer

A

So in that business Chuck, it's typically back end loaded if you will on the year Q4 and in the brokerage space is typically the strongest quarter of the year, so we are at as you accurately put out had a run rate of about \$1 billion a quarter and if we end up getting typical seasonality to it you can see us move towards the high end of that range.

To be perfectly blunt with you, we don't have visibility right now on what our Q4 pipeline looks like in that business because we are basically at a sort of 90-day forward look. But if you look at a typical year on where we are from a quarterly run rate in that business, no reason we shouldn't be able to get to the high end of that range if we have typical seasonality.

Charles Nabhan

Wells Fargo Securities LLC

Q

Okay. And if I could sneak one more. In terms of the volume, the Fannie and Freddie volume, the fixed rate volume that you have done this year, is any of that business coming from borrowers that you may have gotten into -- floating rate products a few years ago that are currently re-financing in a fixed rate product?

William M. Walker

Chairman & Chief Executive Officer

A

So, there's not a lot of that Chuck. I think one of the things that is interesting is that if a couple of years ago it was funds being the very active buyers where they were buying properties and putting on shorter term floating rate debt to buy the property, potentially fix it up, try and change something with it and then turn around and resell it. The typical profile of our client during Q2 was a longer term holder and potentially a fund, but someone who owns commercial real estate and as I said in my comments is buying a property hold it for the next ten years and potentially the next 30 years.

And so from a -- not only from a -- that's the most profitable business for us but also from credit stand point we love the characteristics there of someone buying the property and saying this is a long term hold for me and I want to put long term fixed rate debt on it to take the interest rate risk out of it.

Charles Nabhan

Wells Fargo Securities LLC

Q

Okay. Great, thanks guys.

Operator: Thank you. At this time, I would like to turn the conference back to Mr. Walker for any closing remarks.

William M. Walker
Chairman & Chief Executive Officer

I want to thank our team for a fantastic quarter and thank everyone who participated in the call this morning. Have a terrific day.

Operator: Thank you for your participation on today's conference call. Please feel free to disconnect your line at any time.

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