Kelsey Montz

May 02, 2018
08:30 AM EDT

Operator: Welcome to the Walker & Dunlop First Quarter 2018 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 Kelly Montz [sic, Kelsey Montz], Assistant Vice President of Investor Relations.

Today's call is being recorded and will be made 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 opened for your questions following the presentation. If you would like to ask a question at that time, please press the star and one on your touchtone phone. If at any point your question has been answered, you may remove yourself from the queue by pressing the pound key. We ask that you please pick up your handset to allow for optimal sound quality. Lastly, if you should require operator assistance, please press star-zero.

And it's now my pleasure to turn the floor over to Kelsey Montz. Please go ahead, ma'am.

Kelsey Montz: Thank you, Erica.

Good morning, everyone. Thank you for joining the Walker & Dunlop First Quarter 2018 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 webcast.

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 will reference the non-GAAP financial metrics, adjusted EBITDA, during the course of this call. Please refer to the earnings release posted on our website for a reconciliation of this non-GAAP financial metric.

Investors are urged to carefully read the forward-looking statement 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 describe our current expectations and actual results may differ materially. 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 annual and quarterly reports filed with the SEC.

I will now turn the call over to Willy.

Willy Walker: Thank you, Kelsey, and good morning, everyone. Thank you for joining us today to discuss another strong quarter at Walker & Dunlop.

Q1 2018 results are emblematic of the investments we have made to scale and diversify Walker & Dunlop since going public in 2010. I'd like to immediately turn your attention to slide 3, which shows the growth in Walker & Dunlop offices from one office in 2008 to 29 offices today. As you can see on this slide, as we have grown the platform we have acquired a number of companies that have allowed us to scale our operations and also diversify the services we provide.

If you turn to slide 4, you can see that in 2010 Fannie Mae and HUD accounted for 69% of our transaction volume, while over the last 12 months those two capital sources have only accounted for 32% of total transaction volume as we have grown volumes in our other product offerings. And this is an extremely important point, for Fannie Mae had a very slow start to 2018 with multifamily lending volumes off 35%. Yet Walker & Dunlop grew origination volumes in every other product line to generate the second-highest Q1 origination volume in our history of $4.8 billion as shown on slide 5.

As slide 5 also shows, in a quarter where Fannie Mae originations, which are shown in light blue, were down dramatically, we grew volumes everywhere else, which produced $1.16 of diluted earnings per share and over $52 million of adjusted EBITDA. These financial results demonstrate the diversification and growth we have achieved in our Freddie Mac, HUD, capital markets, and investment sales businesses as we have continued to scale Walker & Dunlop. And they also show the value of the long-term prepayment protected revenue streams that our $76 billion servicing portfolio generates.

As you can see on slide 6, we have grown our servicing portfolio by 18% over the past year, from $64 billion to $76 billion, and increased servicing revenues on the quarter by 17%, from $51 million last year to $60 million this year. It is extremely rewarding to see such robust financial results due to the growth of our platform, diversification in our service offerings, and strength of our business model.

As it relates to the rest of 2018, we have already seen Fannie Mae come back into the market and it is our clear expectation that Fannie will capture its historic market share of total multifamily lending this year. As Fannie's largest lending partner for four of the last six years, our volumes with Fannie should benefit going forward.

Interest rates moved dramatically during the first quarter, from a low of 2.46% at the beginning of the year to an intraday high of 2.95% in late February. A 49 basis point increase in the cost of debt financing in such a short period of time would typically freeze the investment sales market as buyers wait for cap markets to adjust-- cap rates to adjust.

Yet due to the amount of equity capital looking to be deployed into commercial real estate, and particularly in the multifamily, the markets didn't freeze and transactions continued forward, albeit at a somewhat sporadic pace.

W&D's multifamily investment sales volumes were up 18% in Q1, significantly outpacing the broader commercial real estate market's 5% growth. The current multifamily market environment is very active. For example, we are working on a value-add, multifamily listing in the southeast right now that has 40 qualified bidders, which is a much broader investor base than either of the past two years. It's pretty clear from what we are seeing in the multifamily space that the amount of equity capital, coupled with spread tightening, is offsetting the increased cost of debt and supporting a robust acquisitions market which should continue to drive financing volumes going forward.

Given these strong dynamics and general health of the commercial real estate markets, we are seeing a significant amount of capital enter the debt financing space, particularly for transitional properties. Unlike other forms of first-debt lending, bridge lending has minimal barriers to entry and there seems to be a new debt fund popping up every day to deploy capital into this market. This has made the environment quite challenging for our bridge lending joint venture with Blackstone. For example, we quoted $2.3 billion of financing opportunities in the first quarter and closed just two loans totaling $25 million. We lost a significant portion of those loans due to proceeds and rates being offered by other lenders that would compromise our credit and return standards.

We entered the bridge lending space to use our capital on opportunities with strong sponsors, good credit, and the potential for an agency permanent takeout, but we will not chase deal flow for deal flow's sake. One of the benefits of the breadth and diversity of our lending platform is that we are not forced to deploy capital. There are still good, transitional multifamily loans out there to be done and we are focused on building our portfolio with Blackstone, but only when the sponsor and deal fundamentals meet our standards.

While the multifamily bridge lending space may be a pocket of the market causing concern related to credit quality, Fannie Mae and Freddie Mac have enforced disciplined underwriting standards in their multifamily lending such as a debt service coverage floor of 1.25 times, which has been an important driver of the strong credit fundamentals underlying the multifamily market.

Overall, Walker & Dunlop's underwriting standards have remained conservative and exceedingly healthy as evidenced by the average 66% LTV and 1.47 times debt service coverage ratio for all the loans we originated in the first quarter. These underwriting metrics have remained consistent quarter after quarter, reflecting the healthy lending standards that differentiate this cycle from the last one.

I'd ask you to turn to slide 7 to look a little deeper at W&D's credit metrics on our Fannie Mae and Freddie Mac portfolios. As you can see, we have had very solid net operating income growth in the portfolio every year for the past eight years with a 4.15% increase in 2017, and extremely healthy debt service coverage growing steadily over the past eight years from 1.44 times in 2009 to 2.07 times at the end of 2017. We feel extremely good about both the credit fundamentals of our existing portfolio and the loans we're originating today.

In March we posted Walker & Dunlop's 2017 annual review video to the investor relations section of our website which I encourage you to watch if you haven't had the chance. In that video we outline our 2020 vision, with the goal of generating $1 billion in annual revenues through continued growth in our lending, brokerage, servicing, and asset management businesses.

Two of the most ambitious growth objectives are building an $8 billion to $10 billion asset management business and generating $8 billion to $10 billion of investment sales volume. We made significant progress towards achieving these two goals with the recent acquisition of JCR Capital and the hiring of a fantastic team of investment sales professionals in Boston.

JCR is an alternative asset manager that provides commercial real estate sponsors with equity and debt capital to make opportunistic investments in all classes of commercial real estate. When combined with our Blackstone joint venture, the acquisition of JCR significantly increases our assets under management. We have long been talking about our desire to grow our assets under management by acquiring a registered investment advisor whose strategy, growth outlook, and culture align with ours. We are thrilled to have found that in Jay Rollins, Maren Steinberg, and the entire JCR team.

On the investment sales front we hired an exceptional team which, coupled with W&D's existing team of financing professionals in Boston, have the very real opportunity to be the market leader in multifamily sales and financing throughout New England. We will continue to focus on adding teams of professionals to Walker & Dunlop across the country, particularly when their track record, personality, and professional capabilities match well with W&D's existing footprint.

Along with setting a goal to expand our national investment sales presence, we also laid out a strategy to grow our debt financing platform by recruiting and hiring teams in markets where W&D's market share is not commensurate with our national average. We have a proven track record of acquiring and hiring talented mortgage bankers and brokers, efficiently and effectively integrating them into W&D, and then providing them with the brand and support to exceed expectations for both their clients, ours, and in many instances their own.

We recently announced the addition of talented mortgage bankers in both South Florida and Philadelphia, two markets where we do not have a dominant presence. And we are excited about deepening our footprint in these markets and the future contributions those teams will make to W&D.

As we have focused on continued growth, we were excited to be named one of Freddie Mac's initial partners in a $1.3 billion pilot program to provide financing to owners of single-family rental homes, from here on called SFR. We love the SFR market, for as we have been saying for many years now, the American dream of living in an attached single-family home with a garage and dog in the yard is not gone. It is increasingly hard to achieve that dream by purchasing a home due to stagnant wages, student debt, and a lack of supply of entry-level, single-family housing.

The SFR market is huge, accounting for over $3 trillion of the single-family housing stock, and Freddie's SFR pilot meets a big market need. The Freddie pilot is designed for single-family rental pools of greater than $5 million with collateral that meets a high affordability threshold. Private equity and institutional capital have entered the single-family rental market over the past several years, and Freddie's entry into this space affords us the opportunity to deploy capital in a new market segment to both existing and new Walker & Dunlop clients.

With that, I'll turn the call over to Steve to discuss our first quarter financial results in more detail. Steve?

Steve Theobald: Thanks, Willy, and good morning, everyone.

We are very pleased with how the year has started in what is typically a slow quarter for the business. Our results in the quarter benefited from solid transaction volumes of $4.8 billion, strong adjusted EBITDA of over $52 million, and a reduced corporate tax rate from the recently-enacted tax cuts and JOBS Act.

We earned $1.16 per diluted share in the first quarter of 2018 compared to $1.35 in last year's first quarter. As you may recall, last year's Q1 results included a benefit of $0.27 from reduced tax expense associated with the vesting of employee stock awards. This compares to a smaller benefit of $0.13 in this year's first quarter from a combination of fewer shares vesting and a lower overall tax rate this year versus last. Including the stock-vesting benefit, our effective tax rate in the first quarter was 16.4%. Going forward, I would expect our effective tax rate to be in the range of 25% to 27% for the remainder of this year.

We had a very strong first quarter with Freddie Mac with 14% growth in volume over Q1 2017. Our Fannie Mae volumes were down from last year as we originated two large portfolios totaling $800 million in Q1 2017. The relatively low volume of Fannie Mae originations is the reason our net mortgage servicing rights declined slightly during the quarter.

Brokered originations topped $1.5 billion, an increase of 18% from the prior year as we continue to benefit from the growth in our capital markets team. HUD volumes were $352 million compared to $207 million in 2017, an increase of 70%, with construction loans comprising 47% of this quarter's volume as HUD remains an important source of multifamily construction lending in the market.

Investment sales volume of $338 million was up 18% year over year as we continue to see strong appetite for multifamily assets.

We were pleased with our overall execution in the quarter as our team expertly navigated a period of interest rate volatility and intense competition to deliver solid transaction volume and financial performance.

Q1 annualized return on equity was 18%, just below our long-term target range of 20% to 25%. Operating margin for the quarter was 30%, within our expected range of 30% to 35%. Finally, gain on sale margin was 180 basis points, comfortably within our expected range of 160 to 190 basis points.

Adjusted EBITDA was $52.1 million in the first quarter, up from $50.3 million in Q1 2017. Adjusted EBITDA continues to grow along with our servicing portfolio, which at $76 billion is up 18% on a year-over-year basis. The combination of our servicing fees and interest income from the related escrow balances totaled $55.4 million during the quarter, an increase of $10.6 million, or 24% over the same metric in the prior year.

The year-over-year growth of the portfolio and related escrow balances, along with increases to short-term interest rates, provides a nice tailwind for growth in both revenue and adjusted EBITDA going forward, and helped contribute to the $194 million of cash on the balance sheet at the end of the quarter.

We remain confident in our future cash flow generation and the ability to both sustain and grow our dividend over time. To that end, yesterday our Board authorized the payment of a $0.25 dividend per share to stockholders of record on May 18th. The second quarter dividend represents a payout ratio on Q1 earnings of approximately 21% and only 15% of adjusted EBITDA.

With respect to share repurchase activity, we did buy back 244,000 shares early in the quarter, which we highlighted in our last call. We have not bought any shares since then and continue to have our full $50 million authorization for future repurchases.

Our steady cash flow and adjusted EBITDA generation give us a strong financial position to continue to execute on acquisition opportunities that would help drive achievement of our long-term strategic goals. As Willy mentioned, we recently announced the acquisition of JCR Capital which closed in mid-April. We have been seeking an entry point into the asset management space for some time and are very pleased to have the opportunity to bring JCR into Walker & Dunlop.

Our core business has historically been first trust debt lending and brokering and we have successfully established a reputation as one of the very best in this space. With over 140 mortgage bankers and brokers on the platform, the amount of deal flow we see on an annual basis is enormous. Included in this deal flow are opportunities that we broker off to other capital sources, but for which we retain no long-term economic benefit, unlike our agency lending where we record and retain our valuable servicing assets which turn into long-term revenue streams.

The JCR acquisition now gives us a platform that combines our access to deal flow with sources of capital looking to invest in not just debt, but preferred equity, mezzanine equity, and JV equity in the commercial real estate space. JCR has successfully raised third-party capital for three funds, with a fourth fund well on its way to completing the fund-raising process. In addition, JCR has a separately-managed account with a life insurance company for which JCR is originating fixed rate, first-lien loans on transitional properties.

The asset management and servicing fees generated from the funds and separate account will be additive to our ongoing recurring revenue, similar to the servicing fees from our own portfolio. In the near term we will work closely with the team at JCR to prudently accelerate the pace at which existing funds are invested so that we can get out and raise the next fund as soon as possible. JCR gives us a solid foundation upon which we can grow the business from just under $1 billion of AUM towards our long-term goal of $8 billion to $10 billion under management.

Before I turn it back over to Willy, let me summarize what I think are the key takeaways for this quarter. First, we had a solid start to the year with $1.16 of earnings per share and EBITDA of $52 million in spite of a relatively slow quarter for Fannie Mae. We grew volumes in nearly every other transaction category and fully expect Fannie to be one of the dominant sources of capital over the remainder of the year.

Our capital markets and investment sales teams continue to grow and diversify our earnings, and we have now added an asset management platform into the mix to drive further diversification and enhancement to the economics of our brokerage business.

And finally, the cash that we have available today and expect to generate going forward continues to provide us significant financial flexibility to both sustain a long-term dividend while continuing to reinvest in the growth of the business to achieve our strategic goals.

Thanks for being with us this morning. I'll now turn the call back over to Willy.

Willy Walker: Thanks, Steve.

I'd like to spend some time discussing Walker & Dunlop's business model and what we believe differentiates W&D from our competitors in the commercial real estate services and financing space.

If I can get you to turn to slide 8, since 2013 we have grown our employee base by roughly 190 employee. And over that time, revenues per employee have increased from $740,000 in 2013 to $1.1 million in 2018. When you look at this metric compared to our industry competitors, Walker & Dunlop generates two to five times the amount of revenue per employee, a difference that is a direct result of our business model and operational efficiency.

I want to remain on slide 8 for a moment for it tells a great story about W&D's growth and financial performance.

As we have integrated employees onto the platform and increased the Company's overall productivity, we have also consistently grown revenues at a faster rate than expenses, allowing us to expand our operating margin through 21% in 2013 to 32% in 2018 on a trailing 12-month basis. So let me summarize this slide for a moment.

We've added 190 employees and grown revenue per employee from $740,000 to $1.1 million while increasing operating margins from 21% to 32%. We have been able to deliver these enhanced operating metrics by remaining disciplined about who we hire and how we integrate them into our business. It is our intension to continue expanding W&D's platform to drive both top- and bottom-line growth while maintaining the best-in-class service that has allowed us to expand our client base so dramatically.

Beyond our tried-and-tested growth model and our durable business model, our core business is underpinned by strong demographic and macroeconomic trends in the multifamily market that should continue to drive demand for many years to come.

If you'd turn to slide 9, it shows that in 2017 it was a record year for multifamily deliveries in the United States. But according to RealPage, absorption maintained its 2016 pace of 95% across the top 150 markets. Even with peak deliveries coming online, the market saw rent growth of approximately 2.5% in 2017. And as I mentioned previously, we saw 4.15% NOI growth in the Walker & Dunlop portfolio.

2018 deliveries are scheduled to be around 354,000 units, slightly down from 2017, while demand for multifamily remains as strong as ever with a growing number of millennials reaching the prime renter age of 20 to 24, and baby boomers beginning to downsize as they reach retirement age.

The demand for apartments is also being driven by the lack of supply and affordability of single-family homes. If you turn to slide 10, it shows that home construction per household remains near the lowest level in 50 years. And the National Association of Home Builders estimates that builders will start fewer than 900,000 new homes in 2018 compared to roughly 1.3 million needed to keep up with population growth.

At the same time, home prices have been on a steep, upward trajectory. If you turn to slide 11, on the left-hand side of the chart you can see that 54% of the new homes sold in 2002 had a sale price of less than $200,000; whereas by 2017, the entire graph has shifted to the right dramatically, with 56% of the sales at greater than $300,000 per home. The increased cost of single-family homes is far outpacing the economic growth as indicated by 2017 home prices growing at two times the rate of income and three times the rate of inflation based on the S&P CoreLogic Case-Shiller National Home Price Index.

While it's also true that multifamily housing has become more and more expensive, the bottom line is that renting continues to be far more affordable than home ownership for a large portion of the American population. This economic reality, coupled with steady household formation, should keep rents and occupancy levels at healthy-- keep rents and occupancy at healthy levels, maintaining positive fundamentals for multifamily properties, which will drive investment sales and financing activity to the foreseeable future.

Walker & Dunlop has grown in a disciplined manner to build a platform that has captured 7.3% market share of the overall US multifamily financing done in 2017, and we are focused on growing our market share to over 10% in the coming years.

We continue to grow our capital markets platform with volumes up 18% in the first quarter. With less than 2% market share of the non-multifamily commercial real estate financing market in 2017, we have a huge opportunity for continued growth in this space to gain market share commensurate with what we have in multifamily.

We are excited about the opportunities ahead of us as we continue to execute on our strategic initiatives and deliver financial outperformance to our shareholders.

I would like to thank my colleagues at Walker & Dunlop for a strong start to 2018 and our investors for your continued confidence in Walker & Dunlop.

With that, I'd like to ask the operator to open the line for any questions.

Operator: Thank you. The floor is now open for questions. At this time, if you have a question or a comment, please press the star and one on your touchtone phone. If at any point your question has been answered, you may remove yourself from the queue by pressing the pound key. Again, we do ask that while you pose your question that you pick up your handset to provide optimal sound quality. Thank you.

Our first question is coming from Jade Rahmani from KBW. Please go ahead.

Jade Rahmani: Thanks very much. On your 2018 guidance that you previously gave last quarter, are there any changes that you are making? You previously cited 10% to 15% producer headcount growth, double-digit operating income and EBITDA growth, for example.

Steve Theobald: No. No changes, Jade.

Jade Rahmani: Okay. Can you characterize the kind of mood and tone in the market from multifamily investors? Maybe you could give some color on if there's any pull-forward in volumes as bars maybe look to lock in today's rates, or if you're seeing any mix shift in acquisition versus refinancings.

Willy Walker: I guess from our prepared comments, Jade, the market commentary on investment sales was that it's an extremely active market. I do think that rates moving as much as they did in Q1 made it so that the transaction volumes from both the financing and investment sales standpoint were a bit sporadic. I was quite interested that when rates got up close to 3% and then backed off a little bit at the end of Q1 that we didn't get kind of a flurry of financing activity at the end of the quarter to meet that rally in rates, but we didn't. And I at the same time would say to you that the general outlook is very positive from an economic standpoint and from a commercial real estate as an asset class standpoint. And if investment sales is any, if you will, general indicator of interest in the asset class and transaction volumes, things are very healthy right now.

Jade Rahmani: And any color on the mortgage banking side mix of refinancings versus acquisition financing?

Willy Walker: I don't have that number. Do you have it? You don't have it, do you? No?

Steve Theobald: No. I don't think there' really been much change on that, Jade.

Jade Rahmani: Okay. In terms of the servicing portfolio, do you have any color you could provide on what percentage of adjusted EBITDA comes from servicing? Is it well more than half? Considering the size and duration of the servicing portfolio and the prepayment protected profile, I think this information would help investors gain insight into the stability of W&D's earnings.

Steve Theobald: Yes. Jade, as we've discussed in the past, we don't provide that level of detail.

Jade Rahmani: In terms of how you think about valuation when you're underwriting M&A transactions, what multiple do you think that servicing EBITDA should trade at?

Willy Walker: I really depends a lot, Jade. As you know, we've acquired companies that are predominantly agency-origination companies, like Column Financial and CW, and then we've also purchased pure brokerage firms that don't have an agency component to them today. And as we've discussed in the past, the difference in the value of agency servicing versus non-agency servicing is dramatic. And as a result of that, the fact that our servicing portfolio is the majority servicing, which is-- what are we at? We're at 86% or 87% prepayment protected on our servicing portfolio today. And also at an average servicing fee of 26 basis points?

Steve Theobald: Yes.

Willy Walker: The asset value there is dramatically different. So as we look at acquisitions, it really depends on the composition of the servicing. And we haven't done a GSE, if you will, a GSE-focused acquisition since CW. And how we valued that servicing portfolio was very different from some of the brokerage firms we've acquired recently that may have hundreds of millions or billions of dollars of servicing. But if it's general commercial servicing on CMBS loans or life insurance company loans, those not only come with a much, much lower servicing fee, but they're also not prepayment protected to us. So as a result of that, if the loan pays off, the servicing goes away.

Jade Rahmani: And just in terms of 1Q's production headcount growth, can you give any color on how many producers overall you hired and just the mix between the agency business and investment sales?

Steve Theobald: Jade, we've had nine production folks through today. So rather than just talk about Q1, but to date we've had nine new additions to the team.

Jade Rahmani: And what's the mix between investment sales and agency lending?

Steve Theobald: Yes. It's about one-third, two-thirds investment sales. And then I'd say it's capital markets, not necessarily agency l ending. But as you know, our capital markets brokers do a fair amount of agency business as well.

Jade Rahmani: Okay. So two-thirds capital markets?

Willy Walker: Two-thirds capital markets, one-third investment sales. And on the capital markets, as we've talked through before, as Steve just said, many of those people who join us-- for instance, the team that just joined us in Philadelphia, they are on a platform today that does not have access to the agencies. They're coming to W&D and will have access to Fannie's largest partner and Freddie Mac's third-largest partner. I can guarantee you that that team that just joined us is a capital markets team and will start originating agency debt.

Jade Rahmani: Okay. Thanks for taking the questions.

Willy Walker: Thank you, Jade.

Operator: Thank you. And once again, if you do have a question, you may press star and one on your touchtone telephone at this time. We'll go next to the line of Steve DeLaney from JMP Securities. Please go ahead.

Steve DeLaney: Good morning, everyone. I'd like to start with JCR Capital. I know that's a positive development on one of your important long-term goals. Can you comment on funds available today where they can call capital from their investors? So what do they have available to them today to deploy? And also, Willy, where do you see in the capital stack as far as borrowers or clients their developers/owners of multifamily, where's the greatest need in the capital stack? And along with that, probably the best return profile for that product capital? Thank you.

Steve Theobald: Yes. Steve, I'll handle the first part, so with respect to what's available.

Steve DeLaney: Okay.

Steve Theobald: So again, a little bit of history here. They're on Fund IV at the moment. Funds I and II have both kind of cycled through and paid back at this point in time successfully. So Fund III is in the kind of recycling phase, if you will. And then Fund IV, they've had their first closing on Fund IV. The fundraising process is still open through probably the next few months but they, when it's done, should have about $300 million available in Fund IV and probably half that in Fund III still available for investment. So one of the things that we were excited about in terms of the acquisition was the fact that they actually did have a fair amount of dry powder available to invest. So it's not like we bought a fully-invested firm that was starting over with the fundraising process.

Steve DeLaney: Okay, got it.

Willy Walker: Steve, on--

Steve DeLaney: And-- yes, Willy.

Willy Walker: Yes, on where the market is looking for capital. I mean I would honestly say to you that given the breadth of our platform today it's sort of all over in the sense that there's no one specific need that I continue to hear about. Clearly, if you go back to what we put forth as far as our underwriting standards on our Q1 agency business of 66% LTV and a 1.47 debt service cover, the agencies are holding very, very tight as it relates to the leverage that they're putting on their assets. Which is meaning that that's their market for really sort of established developers/owners and not one where people who are trying to stretch a dollar can really access that capital, if you will, at those lower leverage levels. And so as a result, there is a significant amount of need for mezz debt. There's a significant amount of need for preferred equity.

And the thing that's so exciting about JCR is that we've done preferred equity investments in multifamily. We've done mezzanine loans in multifamily and we have our Blackstone joint venture focused on multifamily bridge loans. What JCR allows us to do is to focus on providing that type of capital to the rest of the market; in office, in industrial, and hospitality. And so we did $7 billion of brokerage, debt brokerage last year at W&D and, as you saw, we had very significant volume increases in Q1 in our capital markets group. This provides all of those brokers with an additional source of capital to meet the needs of their clients. And as Steve walked you through, the greatest part about that is when we put that financing on there we're going to continue to make ongoing revenue streams out of that financing rather than just brokering the deal off to somebody else.

So, that's the strategy. We're really excited to have them. And specifically to what the market is looking for today, I would just say to you that people are looking for sort of every dollar they can get.

Steve DeLaney: Yep. Willy, given your comments on the Blackstone joint venture and the competitiveness of that market, I think that's widely understood in the marketplace with these new debt funds coming in. Is it possible that-- I think you made a 15% commitment to a $1 billion fund there. Don't know where that stands as far as the amount deployed exactly on your books. But would you consider allocating W&D capital more to mezz loans or preferred equity? Do you think the returns there might be more attractive to W&D than the capital you have committed to the bridge loan joint venture?

Willy Walker: So Steve, we have-- there are two things. One, we reiterated in our comments how focused we are on growing our joint venture with Blackstone. We want to see that partnership grow and it's a fundamental piece to our overall platform.

Steve DeLaney: Okay.

Willy Walker: With that said, deals that don't size for the joint venture, we have in the joint venture agreement the ability to do them on our balance sheet should Blackstone say this doesn't meet our return threshold and Walker & Dunlop might say, hey, we-- it's strategic for us. It will meet our return threshold, what have you. So there is sort of the ability in that partnership for deals that go to that joint venture that for whatever reason don't go into the venture can come back and find their way to Walker & Dunlop's balance sheet, or can find their way to another source of capital.

So I would just reiterate our very clear focus on continuing to grow that joint venture and put additional capital to that joint venture, but it did not limit us in our ability to do other things that may meet our criteria that might not meet the joint venture's criteria.

Steve DeLaney: Great. Thanks for clarifying that, Willy.

Steve Theobald: Yes. Steve, if I could add to that as well that--

Steve DeLaney: Please.

Steve Theobald: I think one of the other things to consider here is, in the asset management space-- and I'll talk specifically about JCR, in future fundraising efforts I would expect that we'll be one of the lead investors in new funds. And so through that mechanism we actually would be allocating capital towards preferred equity, mezz equity, JV equity through that--

Steve DeLaney: Exactly. I had assumed you would be, just whether your name is involved or whether-- but it would obviously help with the fundraising if you guys are putting your own money into the deal, sure.

Steve Theobald: Okay.

Steve DeLaney: Steve, I noticed in the income statement in the mix of revenues, obviously mortgage banking down, but dramatic increase in escrow earnings and interest income. I think that's something investors tend to overlook in W&D. Can you give us a sense, like for each 25 basis point Fed hike, do you know off the top of your head sort of what that means as far as incremental revenue, either in dollar terms or per share?

Steve Theobald: Yes. So Steve, our average escrow balances have been kind of bouncing around between $1.8 billion and $2 billion over the last few months. And most of that money is tied to short-term rates, whether it's Fed funds or Libor. I don't think we're necessarily getting 100% lift every time you get a 25 basis point increase, but we are capturing a significant portion of that increase every time it happens.

Steve DeLaney: Okay. We'll just--

Willy Walker: Steve--

Steve DeLaney: Double check what we've got in our model there as far as rate sensitivity.

Willy Walker: Hey, Steve, just one quick thing on that. I would keep in mind the following, that as the yield curve flattens, our warehouse interest income goes down. So one of things just as you get-- you continue to get a flattening of the yield curve and--

Steve DeLaney: Got it.

Willy Walker: And what we make in our warehouse interest income will go down and will eat into some of the increase interest income we make off of our escrows. So it's just a-- as Steve just said, it's not a one-for-one, as you raise by 25 basis points, you're going to get all of that into it. But A, we watch those numbers very closely. We think we are maximizing the returns on those escrow deposits. And at the same time, the flattening yield curve does take out on the warehouse interest income line.

Steve DeLaney: Yeah, it makes sense. So thanks for the comments, guys.

Steve Theobald: Thanks for your questions.

Operator: Thank you. As a reminder, it is the star and one if you'd like to ask a question. We'll go next to the line of Ben Zucker with BTIG. Please go ahead.

Ben Zucker: Good morning and thanks for taking my question. Willy, I appreciated your opening comments about the level of competition you're seeing in the JV. I think that's a nice reminder that you guys get a very nice benefit from barriers to entry for your GSE businesses.

When I was looking through the release, I had a quick question on the expenses and how we should think about those. I know that you've called out an increase in the fixed expenses due to hiring of support staff and recent acquisitions. And I think we've spoken about a natural lag time or ramp up for when a new hire starts generating revenues. So is it fair to assume that as a fixed expenses percent of total revenue that that would marginally improve in the later parts of the year as those new hires actually start generating revenue for the platform?

Willy Walker: So Ben, first of all, great to have you on the call and thanks for joining us this morning.

The second thing is that your comments about barriers to entry on our core lending business are exactly right and it does allow us to be extremely disciplined in what we're doing.

As it relates to overall expenses and when those people come on and the time to ramp it up, first of all, the people at W&D who are responsible for the majority of our recruiting are very clearly trying to do as much as early as possible to get the maximum benefit from those hires in 2018. So there's very much a-- if you want until November or December to do all of the annual hiring, you're not going to get any benefit from it during the year. So there's very much a focus on that.

The second thing I'd point out is that competition expense as a percentage of revenue in the first quarter was 38%. I've looked at a number of our competitor firms and that percentage is dramatically lower than our competitor firms. And that is due to our business model and the amount of revenues that we make off of our servicing and, if you will, financial income that Steve DeLaney just asked about. And so we have managed this business to a range of competition expense as a percentage of revenue between a band of sort of 37% up to 43%-44%. And it obviously will vary quarter to quarter depending on what origination volumes are, where our producers are in their annual splits, etc., etc. But we feel very, very comfortable that the business model works for our ability to continue to grow earnings and remain increasingly profitable as I pointed out in that slide as it relates to the growth in revenue per employee and how we've driven operating margins up very steadily over the last five years.

So, the model's working really well. And specifically to your question, we want to get as many people on the platform as quickly as possible to get the benefit of their revenues in 2018.

Ben Zucker: That's great. I appreciate that. And since we've just kind of touched on it and Steve opened up with it, on the servicing portfolio, when I try to think about revenues generated from that portfolio, would it be fair to include the escrow balance income as cash servicing fees? And I only ask because maybe a year or two ago it wasn't such a big number. But now that short-term rates are increasing and where they are, we're starting to get a very nice contribution from that line item that feels like it shouldn't be left out of the valuation approach.

Steve Theobald: Yes. I would agree with that, Ben. I think we've always viewed the-- servicing fees is obviously the primary component of revenue from the portfolio. But in addition to that, we also get the earnings off the escrows. We also earn fees off the processing assumptions of loans that are in our servicing portfolio. So that's another revenue stream that comes through (inaudible).

Ben Zucker: That's great. And then also, I know in the press release that you mentioned strength for Freddie Mac [floaters] in 1Q 2018. And in your prepared remarks I think I heard your expectation that Fannie will eventually capture its historic share in the market. What's now pushing or going to push that marginal borrower to Fannie? Is it just the curve tightening that's making that fixed-rate debt a little more attractive right now?

Willy Walker: Ben, it's just a-- it's sort of a historic-- it's a historic pattern where the agencies both are very competitive against one another on a day-to-day basis. But at certain times during the year, one is more competitive on a certain product that the market really wants. And then lo and behold, that agency is sort of filled up and they slow down a little bit and the other steps in. And you can see it, quite honestly, and it happens. So Fannie Mae comes of the first quarter where their volumes were off 35%, and they come into Q2 saying, okay, we've got work to do. And guess what? They get to work and we get to work with them.

So it's a-- and in that, the one thing that is I think very important to keep in mind is, A, both Fannie and Freddie have the opportunity to do a huge amount of lending 2018. And the second thing to all that is Freddie has traditionally been better on floating-rate debt and Fannie has traditionally been better on fixed-rate debt. They're both really good at both, but typically that's where it's been. You got a borrower who wants floating rate, chances are that Freddie probably is going to have the more competitive bid due to their securitization model. You want a fixed-rate loan, on the margin Fannie might be a little bit better.

So one of the things there is that as rates start to move, you would think that many people want to lock in rates and go with fixed rate, except for the fact that there is so much private equity out there in funds waiting to be deployed. And those borrowers are almost always floating-rate borrowers because they want the flexibility that floating-rate debt gives them to be able to trade the assets. So, you could be sitting there in a rapidly-increasing rate environment and still have a huge amount of capital deployed in floating-rate debt because the big sponsor groups are the big buyers at that time in the market and they want the flexibility that floating-rate debt will bring them. So it's very difficult to look at any sort of macro drivers to determine specifically who's going to be most competitive at that time because it really gets back to the financing needs of the acquirer of the asset.

Ben Zucker: I think that makes a lot of sense and it's not as easy as just thinking about rates and the macro trend as much as who has the dry powder and is looking to deploy it.

Well, I appreciate your comments, guys, and congratulations on your recent hiring efforts and definitely excited to hear more about this Freddie Mac SFR program in the future.

Steve Theobald: Thanks, Ben.

Operator: Thank you. And we'll go next to the line of Fred Small from Compass Point. Please go ahead.

Fred Small: Hey, good morning. Thanks for taking my question. Just on market share, what do you estimate your market share was -- sorry if I missed it earlier -- between-- or with Fannie and Freddie each in the first quarter?

Willy Walker: We had that. What was it?

Steve Theobald: It's about 11% combined, Fred. So pretty much in line with--

Fred Small: 11% combined? Is that--

Steve Theobald: yes.

Fred Small: And that's on originated volume or securitized volume?

Steve Theobald: Securitized. Delivered volume, right, where we deliver to the agencies because that's what their number is based on, as you know.

Fred Small: Right, when they report their-- do you know what it was on originations?

Steve Theobald: No. There's no way to know that.

Fred Small: Okay, great. Thanks a lot.

Operator: Thank you. And we'll go next to a follow-up from Jade Rahmani. Please go ahead.

Jade Rahmani: Thanks very much. In terms of Fannie Mae, do you attribute the 1Q decline to a tough year-over-year comparison since they took delayed deliveries in 1Q 2017? And I guess anything you could provide on say April volumes or what gives you confidence that their volumes are going to pick up?

Willy Walker: So on Q1 year on year and their 35% fall off in overall volumes, I don't-- Jade, you may be correct. They carried business over from-- what was that? That would be '16 to '17?

Steve Theobald: There's some element of that in the number. That doesn't explain all of it.

Willy Walker: Right. As it relates to us, if you look at our flow business with Fannie Mae, it was actually up on a quarter-to-quarter basis. The real delta in our numbers if that in-- as Steve said, in Q1 of 2017 we did two large portfolios for $800 million. And as investors in Walker & Dunlop know, we don't do a big deal every quarter. We're very luck to be one of the few lenders who the big deals come to, but they-- you don't build your business based off of next quarter we're going to do a mega transaction. We're in the mix. We're constantly looking for them and we get phone calls from time to time to focus on very, very large transactions, but we did not have a large transaction in Q1.

As it relates to the confidence on Fannie coming back into the market, as I said in our-- in my prepared remarks, we are seeing Fannie back in the market. And what gives us confidence about it? Just look at their track record. They've got huge amounts of dry powder. They've got the ability to deploy massive amounts of capital. And we've been their largest partner for four of the last six years. So chances are that they'll put their money out and chances are that Walker & Dunlop will get its commensurate share of that capital.

Steve Theobald: Yes. And I'd just add to that. I think just look back historically. Since they've had caps they've worked pretty hard to get to the max on the caps each year, plus do as much business outside of that. And Fannie did over 60% of their Q1 business outside the cap, so it's certainly our expectation that history will continue on that front.

Jade Rahmani: Okay. On the JCR deal, what level of annual accretion do you expect? Previously estimated around $0.13 a share, around $0.03 to $0.04 a quarter. Is that reasonable? And also, do you anticipate any 2Q impact, either positive or negative from transaction expenses?

Steve Theobald: So Jade, I think we incurred a fair amount of legal expense in Q1 associated with the transaction itself. I wouldn't expect a significant impact in Q2 from that. Going forward, I think your number is probably a little high, certainly with respect to the first year as we do work to integrate and bring them fully into Walker & Dunlop from an infrastructure standpoint.

Jade Rahmani: Thanks very much.

Willy Walker: Thank you.

Operator: Thank you. And at this time we have no further questions so I'd like to turn it back over to Willy Walker for any additional or closing comments.

Willy Walker: great. Thanks, everyone, for joining us today and have a terrific day.

Operator: Thank you. This does conclude today's conference call. Please disconnect your line and have a wonderful day.

Steve Theobald: Thanks.