

Walker & Dunlop

**February 06, 2019
08:00 AM EST**

Operator: Good day, and welcome to Walker and Dunlop's Fourth Quarter and Full Year 2018 Earnings Conference Call and Webcast. Hosting the call today from Walker and Dunlop is Willy Walker, Chairman and CEO. He is joined by Steve Theobald, Chief Financial Officer, and Kelsey Duffey, 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 open for your questions following the presentation. If you'd like to ask a question at that time, please press star and one on your touch-tone phone. If at any point your question has been answered, you may remove yourself from the queue by pressing the pound key. We do ask that you please pick up your handset to allow optimal sound quality. Lastly, if you should require operator assistance, please press star and zero.

Now, it is my pleasure to turn the floor over to Kelsey Duffey. Please go ahead.

Kelsey Duffey: Thanks, Keith. Good morning, everyone. Thank you for joining the Walker and Dunlop Fourth Quarter and Full Year 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 archive webcast. This morning we posted our earnings release and presentation to the Investor Relations section of our website, www.walkeranddunlop.com. These slides serve as a reference point for some of what Willy and Steve will touch on during the call.

Please also note that we will reference the non-GAAP financial measure, 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 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 describe our current expectations and actual results may differ materially. Walker and 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, and thank you for joining us today for our first earnings call of 2019 to review Q4 and full-year 2018 performance. We had an exceptional fourth quarter which allowed us to finish off the year with top-line growth and strong profitability. Our team really performed in Q4, generating record transaction volume with \$9.4 billion and record quarterly revenues of \$215 million as shown on Slide 3.

This surge of activity in Q4 was the result of Walker and Dunlop working collaboratively with our clients, along with the evolving macroeconomic environment that gave commercial real estate investors the confidence to move forward with acquisitions and refinancings. The strong activity in Q4 coupled with the Fed's recent commentary on interest rate policy going forward gives us a positive outlook for 2019 and Walker and Dunlop's ability to continue executing on our Vision 2020 of generating \$1 billion of revenues while marching towards our mission to become the premier commercial real estate finance company in the United States.

Strong fourth quarter transaction volumes pushed our 2018 total transaction volume to a record \$28 billion. As you can see on slide 4, we have grown total transaction volumes at a compound annual growth rate of 27% over the past five years by expanding our client base and consistently adding bankers and brokers across the country.

84% of our 2018 transaction volume came from the multifamily sector, where our standing as one of the largest Fannie Mae/Freddie Mac and HUD lenders has created a wonderful brand and defensible market presence. Our GSE originations were strong for the year but we slipped in the lead tables from number 1 with Fannie Mae to number 2, and from number 3 with Freddie Mac to number 4. While we were disappointed to drop down in the league tables, we are very well-positioned to maintain or increase our market share in the coming years.

Our HUD volumes were strong in Q4 at \$218 million, yet overall our HUD volumes were down year-over-year by 26% to \$999 million. We recently welcomed Sheri Thompson as the new head of our HUD business and are extremely pleased to have her leading this team going forward.

We added another fantastic mortgage banking company to Walker and Dunlop in Q4 with the acquisition of iCap Realty Advisors in Atlanta, Georgia. Our consistent focus over the past five years to build out our debt brokerage business has broadened our client base, increased our access to deal flow, and led to record brokered loan originations of \$8.6 billion in 2018, up 17% from last year and up 27% on a compound annual basis over the past five years.

We entered the multifamily property brokerage business with the acquisition of Engler Financial in 2015 and have spent the last several years building out a national footprint with talented brokers who match our client base and culture. While overall property brokerage volumes were down year-over-year by 10% to \$2.7 billion, we significantly expanded our property brokerage business in 2018 with the addition of talented teams in Boston, Los Angeles, and Dallas. We are very pleased with the success of our recruiting efforts and are looking for significant growth in our multifamily property sales business in 2019.

We had a very strong fourth quarter and year using our balance sheet and joint venture with Blackstone Mortgage Trust to meet our client's borrowing needs. This lending included three bridge loans for very important clients in Q4 that differentiated W&D from the competition. Our ability to underwrite risk and execute rapidly paid off.

One of these loans brought with it servicing rights to a large pool of Freddie Mac loans. These new servicing rights along with the acquisition of iCap and record Q4 transaction volume pushed our servicing portfolio to \$86 billion by quarter's end, a dramatic step up in just one quarter from \$80 billion at the end of Q3.

The record Q4 loan volume was very healthy from a credit quality standpoint, with an average loan-to-value of 64% and an average debt service coverage ratio of 1.44 times. Our full year loan-to-value ratio on the \$25 billion of lending we did at Walker and Dunlop was 65%, and the average debt service coverage was 1.43 times. As we have said in the past, we will continue to do as much business as we possibly can under these types of conservative underwriting metrics.

Q4 EPS was extremely strong at \$1.44 per diluted share, pushing our annual EPS to \$5.04 per share compared to 2017 earnings per share of \$6.56 which included a \$1.80 one-time benefit due to tax reform. Excluding the one-time tax benefit, we grew EPS by 6% in 2018. While 6% EPS growth fell short of our annual target and historic performance of double-digit EPS growth, it was a very solid year given interest rate movements, the underlying market performance, and the significant investments we made in bringing on banking and brokerage talent. We have grown EPS over the past five years at a 33% compound annual growth rate, and given our relatively small size, enormous market opportunity, strong balance sheet and cash generating business model, we expect to continue growing faster than the market and our peers.

The cash generating capabilities of Walker & Dunlop's business model was most apparent through the growth in adjusted EBITDA in 2018 which increased by 10% year-over-year to \$220 million. As you can see from the growth of our servicing portfolio shown on slide 5, we have added over \$1 billion of net new loans to the portfolio per month over the past three years. This dramatic growth in servicing rights generated \$200 million in cash servicing fees in 2018, up 14% from 2017. These cash servicing fees, coupled with the \$43 million in interest income from escrow deposits, allowed us to exit 2018 generating roughly \$20 million of adjusted EBITDA per month.

Due to our strong market position, positive outlook and cash generating capabilities of our business model, Walker and Dunlop's Board of Directors voted yesterday to increase our quarterly dividend payment by 20% to \$0.30 per share.

I will now turn the call over to Steve to walk through our quarterly and full-year financial results in more detail before coming back to discuss our outlook for the future. Steve?

Steve Theobald:

Thanks, Willy, and good morning, everyone. 2018 ended on a high note with our most profitable quarter of the year due to record volumes and the continued strong performance of our servicing portfolio. I will focus my remarks on the financial highlights for the quarter along with our key metrics.

Q4 '18 EPS was \$1.44 per share, up 14% over Q4 '17 when you exclude the \$1.80 one-time tax benefit Willy just mentioned. This quarter's earnings also included a few one-time items worth mentioning. First, we recorded additional income tax expense during the quarter related to the deductibility of executive compensation under tax reform. At the time the new tax bill was enacted, we believed that our existing performance share plans would be fully deductible under the grandfathering rule included in the Act.

The IRS has subsequently released a draft interpretation that raises questions about whether the grandfathering applies to our plans. The IRS was expected to release final guidance in Q4 but has not yet done so. After review of the draft guidance and discussions with our outside advisers, we adjusted our deferred tax assets related to these plans resulting in the increase to income tax expense of \$2.8 million, or \$0.08 per share.

We also took a one-time charge of \$2.1 million to write off the unamortized discount and issuance costs related to our original term loan, which was refinanced in November. This charge is included in other expenses and has been added back into adjusted EBITDA due to its non-cash nature.

Offsetting much of this additional expense is a gain of \$1.6 million related to the sale of a technology company in which we had a small ownership interest. This gain is included in other income.

We posted record total lending volume of \$8.3 billion, up 22% from Q4 '17, which included record brokered originations accounting for 34% of our financing volumes during the quarter. This mix of business generated a fourth-quarter gain on sale margin of 160 basis points within our expected range of 150 to 180 basis points. Margins on our Fannie Mae business during the quarter were consistent with those achieved last quarter, as tight spreads and price competition between the GSEs persisted. We have not seen any change to this dynamic, and we also expect that brokered loans, our lowest gain on sale margin product, will continue to be a significant percentage of our overall lending volume.

In addition, we are likely to see a much lower volume of HUD business here in the first quarter of 2019 as a result of the prolonged government shutdown. HUD loans happen to be our highest gain on sale margin business but have not been a high percentage of our overall volumes in recent years. Based on all of these factors, we are projecting a gain on sale margin in the range of 150 to 170 basis points over the near term.

Our fourth quarter performance resulted in an operating margin of 30%, an improvement over Q3's 27% as increases in transaction and servicing related revenues outpaced

expense growth during the quarter. Personnel expense as a percentage of revenue was 42% in Q4, in line with our historical averages. While expenses grew along with our platform in 2018, the operating leverage of our scale business model is apparent from our healthy full-year operating margin of 29%. We expect that the investments we made to grow our sales force in 2018 will drive additional transaction volumes and revenues in 2019, but we also expect to continue investing heavily for growth. As a result, we believe the operating margin for 2019 will remain in the range of 27% to 30%.

Q4 '18 return on equity was 20%, bringing our annual ROE to 19% as shown on slide 6. Our strong Q4 results benefited ROE as did the nearly \$42 million of share repurchases we did in November and December. For the year, we repurchased over \$1.2 million shares for \$57 million, an average price of \$45.64 per share. Yesterday our Board authorized a new share repurchase plan totaling \$50 million, that we can execute over the course of the next 12 months. Including dividend payments we returned \$88 million to shareholders in 2018, yet still grew shareholders' equity by over \$90 million due to our strong performance.

As Willy mentioned, our Board voted yesterday to increase our quarterly dividend by \$0.05 to \$0.30 per share. The annual \$1.20 dividend represents a modest payout ratio of only 22% of 2018 net income. We believe that we can retain sufficient capital to deliver on our growth agenda, fund the increased quarterly dividend payments, and continue to deliver an ROE in the high teens to low 20s for 2019.

We ended the year with \$90 million of cash on the balance sheet after putting a significant amount of capital to work during the fourth quarter to originate interim loans, repurchase shares, pay our fourth quarterly dividend, and complete the acquisition of iCap. Q4 was a record quarter for our interim lending program, with \$590 million of originations. We had a very successful quarter originating loans for our joint venture with Blackstone, while also using our own balance sheet for a number of shorter-term lending opportunities including one large, \$150 million transaction that initiated a relationship with one of the largest owner-operators of commercial real estate in the United States.

At the end of the year, our balance sheet portfolio had a remaining weighted average life of just eight months compared to 24 months for the JV portfolio. We are comfortable using our balance sheet for these short-term lending opportunities as it allows us to effectively utilize our existing cash balances to strengthen our customer relationships and create additional opportunities for our permanent financing business without creating long-term risk.

During 2018 we continued to deploy capital into growth opportunities with significant investments on the hiring front to bring on 19 net new bankers and brokers. We remain focused on bringing top bankers and brokers to Walker and Dunlop, and are targeting to increase the team by at least 10% in 2019.

We also made a strategic acquisition of alternative asset manager JCR Capital in February, which was our entry point into the fund management business. At year-end, our assets under management totaled \$1.4 billion inclusive of loans held through the Blackstone joint venture and JCR's managed funds.

After closing Fund Four in November, JCR is now pre-marketing its fifth fund which will offer a yield-only preferred equity product. We are very focused on continuing to grow our AUM and will use our capital to coinvest in JCR's future funds.

Our stated strategy has been to continue growing our origination platform in order to increase our servicing portfolio, adjusted EBITDA, and cash flow. With record transaction volume, a servicing portfolio of \$86 billion, record adjusted EBITDA and cash servicing fees in excess of \$200 million, we saw the benefits of this strategy play out in our 2018 financials. Strong cash flow and origination fees, driven largely by our growth in brokered originations, coupled with significant growth in servicing-related revenues, drove quarterly and annual adjusted EBITDA records of \$60 million and \$220 million respectively.

We expect the upward trajectory of our adjusted EBITDA generation to continue as our business expands. And for 2019 we are targeting double digit adjusted EBITDA growth for the third consecutive year. We focus internally on adjusted EBITDA is one of our most important performance metrics as it removes the non-cash MSR component of our revenues along with the related amortization expense.

Our strong cash flow and historical financial performance gives us confidence to keep investing for the long term as we strive to achieve Vision 2020. As we manage our business with long-term growth objectives in mind, our 2019 annual goal of double-digit EPS growth remains, having achieved that target in four of the last five years.

As those of you who have followed us for a long time know, this growth is unlikely to be linear over the course of the year, particularly with the significant variability in commercial real estate volumes from quarter-to-quarter.

Overall, we like where the market is today and we're excited about the prospects for our business in 2019. Our cash generation capabilities give us incredible flexibility to make thoughtful investments that play to our strengths as a company and complement our existing best-in-class multifamily financing business, while also returning meaningful capital to shareholders.

I'd like to thank our entire Walker and Dunlop team for their strong finish in 2018 and with that, I'll turn the call back to Willy.

Willy Walker:

Thank you, Steve. The dramatic growth of Walker and Dunlop's platform over the past several years has broadened our client base and strengthened our brand as one of the best commercial real estate finance firms in the country. As slide 8 shows, Mortgage Bankers' Association forecasts that the size of the total commercial real estate financing market will be \$541 billion in 2019, a 2% year-over-year increase. The multifamily portion of the market is expected to be \$313 billion, based on an average of the Mortgage Bankers' Association and Freddie Mac estimates, implying 4% year-over-year growth.

In 2018, Fannie Mae provided \$65 billion of capital to the multifamily market and Freddie Mac provided \$78 billion, for a total of \$143 billion of GSE multifamily financing. The 2019 scorecard was issued with only slight changes from 2018, leading us

to believe that the GSEs will have similar volumes in 2019 and will remain the dominant providers of capital for the multifamily market going forward.

Our business continues to benefit from a healthy macroeconomic environment and strong multifamily fundamentals. The current economic outlook points to moderate GDP growth and inflationary pressure, which should keep interest rates relatively low, providing a very positive backdrop for commercial real estate transaction activity, particularly in the multifamily sector.

The US added more than 2.5 million jobs in 2018, driving an increase in renter household formation that helped absorb the nearly 300,000 new apartment units that were completed during the year. The persistent demand for multifamily should keep 2019 vacancy rates in line with the historic average based on Freddie Mac's vacancy projection of 5.1%.

Industry sources vary in their estimates of the 2019 rent growth, but are in agreement that it will remain at a very healthy level, well above the FOMC target inflation rate of 2%.

Renter demand continues unabated largely due to the fact that many Americans are priced out of owning a home despite a strong job market and growing wages. The single-family market is feeling the pressure of higher interest rates, a lack of affordable single-family supply, and historically-high debt loads. This point is evident in the large decrease in single family home sales in November and December that contributed to the weakest year of existing home sales in three years. Freddie Mac recently published an analysis on the historic cost of renting compared to home ownership, which showed from 2013 to 2018, rents have risen by 30% while the cost of home ownership has risen by 60%. Freddie predicts that this trend will continue in 2019 with the cost to own rising nearly 10% compared with 4% rent growth.

Expected wage increases and moderating home prices should offset some of this higher home ownership cost, but with US credit card debt at an all-time high and the student debt load topping \$1.5 trillion, saving for the down payment needed to purchase a home is simply not possible for many Americans. These dynamics should support continued strong demand for multi-family housing and drive acquisition and refinancing activity going forward.

Walker and Dunlop's long-term growth plan, Vision 2020, centers around the goal of generating \$1 billion of annual revenues by the end of 2020 through continued growth in our property sales, lending, servicing and asset management businesses. As you can see on slide 9, the first two objectives are growing our annual loan originations to \$30 billion to \$35 billion and our annual property sales to \$8 billion to \$10 billion. Hitting these targets will require that we continue to recruit talented bankers and brokers to the platform as we have been very successful doing in the past. With only 164 mortgage bankers and brokers today, our relatively small size compared to most of our competitors, provides us with significant opportunities to break into new clients and markets and increase our coverage of those markets where we are currently underweighted.

With steady growth in loan originations, our servicing portfolio will continue its upward trajectory to reach \$100 billion by the end of 2020. Maintaining \$100 billion portfolio at the current weighted average servicing fee of 24 basis points and a weighted average 10-

year life implies over \$2 billion of high margin, cash revenues over the life of those loans, the vast majority of which are prepayment protected.

The servicing portfolio is an incredible asset that differentiates our business model from many of our competitors due to the long-term revenues that we can count on for many years to come.

The final piece of Vision 2020 involves building an \$8 billion to \$10 billion asset management business that will produce recurring management fees similar to the revenue streams from our servicing portfolio. The scaled asset management platform will allow us to meet the wide range of customer needs that we see on a day-to-day basis with capital we have raised and controlled. Similar to the strategic benefits we gain from our bridge lending program, the asset management business gives us another point of connectivity with our clients, that deepens those relationships and creates an additional source of revenue.

We continue to make progress towards achieving this goal in 2018 and ended the year with \$1.4 billion of assets under management. Although we still have a lot of work to do to grow our platform to the size we aspire to achieve in Vision 2020, we ended 2018 with strong momentum and are very focused on driving towards these goals over the next two years.

I spent last week at the National Multifamily Housing Council annual meeting with all the major players in the multifamily sector in attendance. The client relationships, market presence, brand and team that Walker and Dunlop has built in this sector is nothing shy of astounding. One happy client after another complimented me on our team and execution in 2018. I would like to thank the entire W&D team for their exceptional performance in 2018 and for making our company such a great place to work.

We have really built something special and what is most exciting is that it will continue to grow and prosper for many years to come.

Finally, I'd like to thank your shareholders for your continued trust and confidence in our business model, management team and company. With that, I'll now turn the call over to the operator to open the line for any questions. Thank you.

Operator: And at this time if you have a question or comment please press star and one on your touch-tone 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. We can take our first question from Jade Rahmani with KBW. Please go ahead.

Jade Rahmani: Thanks very much. The decline in the lead table rankings you cited, do you attribute most of that to the absence of large deals? And can you discuss the pipeline for large deals in 2019?

Willy Walker: As you know, Jade, we didn't do a mega transaction in 2018 whereas we've done mega transactions in '17 and '16 and '15. And so yes, one large transaction with either Fannie

or Freddie would have changed our placing in the lead tables. And so the positive to all that is that our flow business had an outstanding year. The negative to all that is that we didn't do a billion-plus financing during 2018, and then as it relates to 2019 the reputation and the size and scale of W&D puts us in the mix for many, many large deals. We competed on several of them in 2018 and unfortunately we didn't win. But nothing to share on this call as it relates to large deals, but we're out there. We have great client relationships with most of the people who can transaction on deals at that level, and we continue to be a great partner to many of those borrowers.

Jade Rahmani: And was there any fee pressure on some of those large deals that made it, you know, a hypercompetitive environment? I know that some of your competitors have put out numbers, targets, to the Street in terms of their volumes and have depended on some of those large transactions.

Willy Walker: As you know, when you do those mega deals, fees do come down significantly on a, if you will, per dollar transaction volume. But I would put forth that what other competitors who did those deals are reporting is obviously their own economics. But if the question is really, did we back away from any of those deals due to the economics, I would say no. We lost competing effectively for them and at the end of the day, for various reasons, on various deals, we didn't end up winning.

Jade Rahmani: Okay. Can you give any color on how December and January volumes may have looked? Was there any disruption or pause in the market considering the volatility, I think investors, you know, would benefit from sort of a real-time update?

Willy Walker: So we won't talk about Q1. But I will talk about December, which is in these numbers, which reflects an extremely active end of the year where interest rates ended the year and the typical surge of activity in the commercial real estate industry on the financing front were what really propelled the volumes in Q4. And I think the numbers speak for themselves as it relates to what that translated into as far as economic returns.

Jade Rahmani: In terms of your 2020 goals, how much capital is needed to achieve them, and is the main driver of those goals essentially going to be M&A?

Willy Walker: So as Steve highlighted in his comments, we have a significant amount of cash on the balance sheet and then have also taken a lot of cash and redeployed it in short-term loans which is a great use of that cash. And as I mentioned in a number of instances, that was highly strategic as it relates to meeting the needs of both existing customers as well as at that time, prospective, now, existing customers.

So we have plenty of capital to be able to invest and continue to grow, and I hope the various component parts of Vision 2020 that I just reviewed as it relates to growth in the loan origination business, the investment sales business, the servicing business and the asset management business, kind of, if you will, give a roadmap to how we plan to grow and what we need to do to get there. It requires continuing to recruit bankers and brokers across the country and as Steve said, we plan to add more than 10% to our banker and broker base in 2019. That will drive origination volumes, which then drives the servicing portfolio.

On the asset management side, we most likely will need to do more acquisitions of platforms and portfolios to be able to reach our long-term objective and goal. And you pull all that together and you will be at north of \$1 billion if we hit those targets.

Jade Rahmani: In terms of the gain on sale margins, what do you think's a reasonable assumption going forward?

Willy Walker: I think Steve gave that at 150 to 170 basis points in the near term.

Jade Rahmani: And lastly, just the BXMT joint venture, or the interim loan originations excluding the BXMT joint venture, I think you mentioned that you chose to deploy some cash into short-term loans. Can you just give any color in particular on the \$150 million outsized loan and what the expected duration is for that?

Steve Theobald: It's less than 12-month loan, Jade, when we did it it was actually probably more like 10. The expectation is the duration of that will be less than 10.

Jade Rahmani: Okay. Thanks. I'll get back in the queue.

Operator: We'll take our next question from Steve Delaney with JMP Securities. Please go ahead.

Steve Delaney: Good morning, everyone, and congratulations on the strong close to 2018. Traveling today so just a couple quick things for me. I was really curious about the late January press release with your expanded initiative, or maybe it was, just call it a new initiative, with small balance multifamily loans with the new team in LA. Willy, can you talk about that decision to enter that market, which you really had -- had not gone into? It's very much a different business, of course. Do you see that as something more defensive in the light of potential GSE reform, or are you attracted more to the relative profitability of small balance versus the larger agency business? Thank you.

Willy Walker: Good morning, Steve, and safe travels.

Steve Delaney: Good morning. Thank you.

Willy Walker: As you may recall, when we acquired CW Capital in 2012, they had a small balance lending operation which we acquired and ran for about a year, and made the decision that we couldn't effectively compete in that space. And so we exited the small balance lending space. The subsequent year, Freddie Mac decided that they were going to really focus on the small balance lending space, and came to Walker and Dunlop to be one of their sort of, if you will, anchor partners in the small balance lending space. And since we had just exited the business, we said thanks, but no thanks, that's not a space that we feel like we have a real competitive advantage over the likes of Chase.

So we sat back and didn't get into the space, and over the past three years, Freddie Mac's volumes in the small balance lending space have gone from I think it's \$1 billion, to \$3 billion, to \$6 billion on an annual basis. I think my numbers are right on that. Don't quote me, but it's directionally correct. And so both Fannie and Freddie have become very competitive in the small balance lending space, and it is also a space that the regulator likes having them grow market share.

Steve Delaney:

Right.

Willy Walker:

To the point that you made, they are distinct borrowers. And the regulator has given Fannie and Freddie a lot of space to grow there. So it's been a very big growth component to their businesses. And so given that they now have such competitive programs, we made the decision that we wanted to get into it. So we hired a team in Q3 of 2018 to bring in originators who had done a great amount of business at one of our competitor firms, and the announcement you saw at the end of January was adding to that team and we will -- we're focused on it, and given the breadth of our brokerage origination business where with the acquisitions of Johnson Capital and Elkins and Deerwood and now iCap, we're seeing lots and lots of deal flow. And so to have that small loan lending operation is a wonderful outlet for a lot of the deal flow that we now have access to.

Steve Delaney:

That's great. And Willy, would you say that when you think about your lead tables on large business, when you look at small balance, and obviously it's a much smaller -- I think you mentioned \$10 billion in annual business. So less than 10% of what the GSEs do, but would you view that as a more fragmented market than you currently deal with in the larger loans? And how many license -- do you know how many licensed lenders there are?

Willy Walker:

Four or five for each, Fannie and Freddie.

Steve Delaney:

Got it.

Willy Walker:

I think that's about right, maybe six. So there's actually a high concentration of the licenses from Fannie and Freddie as it relates to the SPL space. By the way, we are licensed with Fannie Mae. We are not licensed with Freddie Mac yet.

Steve Delaney:

Okay.

Willy Walker:

And so to your point, Steve, if you will, look at the 2018 lead tables. We started on January 1st, 2018 without the ability to put billions of dollars of small loans into those numbers. So for instance, CBRE who does have a small balance lending operation. CBRE starts the year with a built-in advantage of a couple billion dollars because they're doing small loans and we aren't. So as we move into this space as it relates to vis-à-vis lead tables, it will be very helpful to that if and when we get this cranked up to the size and scale we want it to be.

Steve Delaney:

Great. Good color there. And just to close out, on the stock buyback you had some opportunities, obviously, the fourth quarter gave a lot of people opportunity to buy back stock. But your average price, you know, wasn't anywhere near sort of the low, if you will, when it broke below \$40. I'm curious about how to think about this, the stock is marginally higher. But -- and you know, I think you've got a -- obviously a nice report today. Should we assume that the buyback, while it could be just opportunistic, is it also sort of a commitment by the board to return capital to shareholders out of your adjusted EBITDA and should -- if the stock were just to sort of be in a range of, say, 45 to 50, should we still expect that additional \$50 million to be utilized in 2019?

Steve Theobald: Yes, Steve, I'll take that one. I think first of all with respect to what we executed on, our approach has been to be in the market over time as opposed to doing a specific transaction to repurchase shares. I think part of that is managing our average daily volumes, etc. But we felt in certainly November and December that stock was at pretty attractive levels, so we were in the market at that point in time. I would say that our strategy around this hasn't really changed so it's still opportunistic and I think the expectation is, when we feel like the stock is at an attractive level we'll be in the market buying. But we're not -- we're not buying just to buy.

Steve Delaney: Got it. That helps. Okay. Well thanks very much for the comments today.

Willy Walker: Thank you, Steve.

Operator: I'd like to remind everyone it is star and one on your touch-tone phone for questions. We'll go next to Henry Coffey with Wedbush. Please go ahead.

Henry Coffey: Good morning everyone, and let me add my congratulations to Steve's comments. It was -- one of my clients e-mailed me, "Wow." So obviously people are pleased with the quarter. If we focus in on our margin issues, how volatile -- and I know you gave guidance and that's very helpful -- but how volatile is this competitive issue going to be? Or is it just going to be kind of the new normal and we'll all adjust to, you know, what's going to be coming out? I know the third quarter was a big shock but obviously there is some volatility here, and you gave very solid guidance on it.

Willy Walker: Henry, good morning and thanks for your comments and thanks -- thanks for your comment on the quarter. You know, if you look at slide 7, which is in -- which was posted to the website today and it shows the gain on sale margins, they've been in kind of a band over the last two years between sort of 150 and 175 basis points, and you can see that they go up above that a little bit to 180, 190, doesn't clear 200 since Q1 of 2017. But during that period of time, we've been able to manage our operating margin into the low 30s, high 20s. And so I think that one of the things that I would posit is that there's a heck of a lot of focus on gain on sale margin, but as this slide very clearly shows, the amount of Fannie Mae business we do one quarter, the amount of Freddie Mac we do one quarter, the amount of brokered business we do one quarter, and HUD business, varies significantly. And for any investor to be kind of trying to track whether Q1 or Q2 is going to be a strong Freddie or HUD or Fannie or capital markets, is -- there's no way to do it. And so what we're very focused on doing is making sure that we've got our team out there doing as much business as we can in all executions, and then managing the business to generate operating margins in the range that Steve gave in this call, which is in the high 20s, low 30s. And we feel very confident with the sales force we have out there and with our access to deal flow, that we can do just that.

More specifically to spreads and gain on sale margin, we clearly had in 2018 a market where with rising interest rates and tightening spreads, the ability for -- what that did was, that put downward pressure on servicing fees. We are seeing a normalization, if you look at where the 10-year is and has been for about the last three or four weeks, it's been hovering in this sort of band of 265 to 275. That sort of normalization on the 10-year should allow for pricing to normalize. And when I say normalize, that doesn't mean go

back to where it was previously, but what it means is, that that sort of downward drive of tightening spreads and increasing interest rates isn't there. And so I think that what that says, and what Steve said in his comments was, what we saw in Q4 was a consistent servicing fee on our Fannie Mae business to Q3. And what he gave as far as guidance on our gain on sale margin of 150 to 170, that is what our expectation is. It sticks around in that same kind of range.

Henry Coffey: And so when you look at the consensus view on interest rates which is one increase, which is -- that's what we're -- you know, everything we read says that. So that will be a more stable environment for you, less sort of volatility around the servicing issue, and if we see it -- you know, if we see a stable rate environment we can count on reasonable stability in the gain on sale portion of your business. Is that sort of the takeaway?

Willy Walker: I think that's the takeaway and I would also say that the other takeaway is a stable rate environment allows for investors to transact and not worry about fits and starts, stops and starts, as it relates to acquisition activity. And then I would also say that as it relates to the pricing of securities, a stable rate environment allows for the pricing of not only agency securities very well but also CMBS. If you think about the band that existed on the 10-year back in the mid-2000s before the crisis, the 10-year sat in a band of 4 to 450 for a three-to-four-year period there. That was a great environment for CMBS to price, because there weren't wild fluctuations.

And so there's -- you know, that competitive threat from CMBS could come back if you got into a much more stable rate environment. I don't know about in multifamily, but as it relates to CMBS being a provider of capital to commercial real estate, they should have a more competitive bid in a more stable interest rate environment.

And then the final thing to it all is, it's nice and good to look at it over a three-to-four-week period where we had a relatively calm macroeconomic and geopolitical environment, but if there is one thing we've seen over the last two years, is that to think that everything's going to stay in this sort of calm is I think probably not realistic.

Henry Coffey: I won't comment on that. Obviously just a more mechanical thing, what's the update on the buildout of your own servicing platform?

Steve Theobald: We're making good progress on that, Henry, as I think I mentioned in the last call. We're going to essentially be building out the new platform this year while operating under our existing co-sourcing arrangement which is set to expire at the end of this year. But we're tracking as we expected at this point.

Henry Coffey: And then finally, I hate to sort of ask it this way, but we're into multiple years of growth in multifamily. When we talk to all our single-family people, they're, well yeah, it's going to be bad for a couple years but wait until these millennials come crashing in. You know, what -- what is your thought in terms of how this conflict between we'll call it multi-family and single-family, plays out? Is it growth for both? Is there going to be some influx, and outflow, out of multifamily into single-family as millennials hit childbearing years? How do you think it plays out three or four years from now?

Willy Walker: That was a really easy answer until you said three or four years. And that's only because

if you look at housing starts right now, the next two years are really good for multifamily because you just don't have the single-family housing starts. If the macro environment changes, Henry, to the point where single-family developers feel that there has been a real shift in the underlying economics of building entry-level, single-family housing, that will at some point with a two-year lead time present a competitive threat if you will to multifamily. There is nothing from a macro environment that leads us to believe single family homebuilders are going to start doing that anytime soon for a number of the reasons that we outlined in the call.

And as such, the multi-deliveries will grow in 2019 from 2018. Previously we thought that '18 was going to be the peak on deliveries at 300,000. 2019 will deliver more than 300,000. Nothing we are seeing or hearing says that that 300,000-plus will not be absorbed as I outlined in my comments on the call. But then in 2020, in 2021, multifamily deliveries tail off and so what you will have there is, who's going to continue to build? Is it on the multifamily side or is it on the single-family side? Right now, the macro environment and the fundamentals look a lot more positive for multi than they do for single, but that can obviously all change depending on the underlying economy, interest rates, construction costs, getting a trade deal done with China which should bring down the cost of some of the component parts for construction. But those increased construction costs are hitting both multifamily as well as single-family.

Henry Coffey: It should be interesting. Thank you.

Willy Walker: Thank you.

Operator: Next we'll take a follow-up from Jade Rahmani with KBW. Please go ahead.

Jade Rahmani: Thanks very much. I was wondering if you could share your thoughts on near-term to medium-term potential changes at the FHA, and the status of the GSEs, that we've seen some chatter in the market, some articles in the media. Ultimately is it your expectation that the GSE's footprint will shrink? Do you expect that any reform will include explicit government guarantees, which I believe requires congressional approval? And what do you think the administration had in mind regarding releasing the GSEs from conservatorship?

Willy Walker: I would start, Jade, on commenting that both Fannie Mae as well as Freddie Mac have had changes in their CEOs as well as chairmen of the boards, and neither enterprise has skipped a beat. And so I would take my hat off to the boards and the leadership teams at both Fannie and Freddie for having managed transition exceedingly well. We've also, as you well know, had a change in the director at FHFA, and with Acting Director Joseph Otting in there right now, his first comments to his team at FHFA was that the administration was very focused on reform and that they were going to do something administratively and not wait for a legislative solution, if you will. As you probably know, the Trump administration last week walked that comment back, saying that they wanted to work with legislators to come up with a solution for the GSEs. And then Senate Banking Chairman Mike Crapo came out last week as you saw, with a -- basically an outline of what GSE reform would look like from his perspective. And I would put forth that all of the major trade associations commented on Chairman Crapo's draft outline, with very positive remarks as it relates to where that would take the housing

finance industry and many of the specifics to it.

Included in that outline was an explicit government guarantee, and so there is -- we have a new congress, and one thing that that new congress has is Congressman Jeff Hensarling from Texas is no longer in the United States Congress, and he is no longer Chairman of the House Financial Services Committee. It was Chairman Hensarling who was the lone voice calling for the elimination of the explicit government guarantee. And so I think that it is truly a new chapter as it relates to Chairman Crapo's draft proposal. You clearly have a very focused Trump administration with Secretary Mnuchin knowing a lot about the mortgage markets and having a very clear vision, I would put forth, to the privatization of Fannie Mae and Freddie Mac with an explicit government guarantee and attracting multiple guarantors to the space. And obviously, there is a tremendous amount of work to be done between here and whatever they come up with from either an administrative solution or a legislative solution.

Jade Rahmani: So I guess in the near term, let's say 2019, you're expecting flattish to modest growth in Fannie and Freddie volumes?

Willy Walker: So I would put forth the scorecard is out there. Right now the volumes on aggregate financings are that the commercial space grows by about 2% and the multifamily space grows by 4% year-over-year. And as I said in my prepared remarks, it's our expectation that Fannie and Freddie remain the dominant providers of capital in the multifamily space. They've got a scorecard that allows them to do a redo on 2018, and nothing that acting director Otting has said or done so far leads us to believe that there's any change to that. When the Senate takes up the confirmation of Mark Calabria, is still a question mark. The -- it appeared that that was going to be fast-tracked at the beginning of the year. Then the government shutdown presented a lot of other issues, obviously, that the government had to focus on. And subsequent to the government opening back up, I haven't heard anything as it relates to whether the majority leader is going to -- whether McConnell is going to put his nomination back on a fast track or whether they're going to leave Otting in the role for some time to come.

Jade Rahmani: Okay. Thanks for that. Understandably there's still a lack of clarity in how this plays out, but we'll stay tuned. Just turning to your commentary --

Willy Walker: I would then -- Jade, I would just say on that, directionally, everything we're seeing and hearing is very positive but this isn't the first time that either Congress or an administration has tried to get their arms around housing finance reform. And so there is still a tremendous amount of wood to chop before anything actually happens or that we can actually comment on anything that's being acted upon.

Jade Rahmani: Incidentally, do you know what percentage of outstanding multifamily loans are 10-year, fixed-rate loans?

Willy Walker: I don't.

Jade Rahmani: Okay. Because that seems, you know, one aspect of liquidity that the GSEs provide for the market is that capacity to hold those loans, and other sources of capital seem reluctant to hold fixed-rate longer-duration loans on their portfolios.

- Willy Walker: That's correct.
- Jade Rahmani: Just in terms of the guidance I've gotten a couple of investor questions around the margins, I guess. What would drive the margins to the lower end of the range that you provided? And is that, if that did happen, would that be a near-term phenomenon driven by head count growth, because there's always a latency period where -- before new brokers start to add, you know, add revenues?
- Steve Theobald: Yeah. I think, Jade, from a -- what would drive to the lower end would be, yeah, I think hiring a significant number of folks sooner rather than later. Keep in mind that at least from a first-quarter perspective, because with the turn of the calendar all of our production staff starts their year off at zero and they've got to earn their way into the higher end of their split. So typically, compensation expense is at the lower end of our range in Q1 than it is in Q4.
- Jade Rahmani: Okay. Turning to the double-digit EPS target, are you -- are you looking at it excluding any of the one-time tax adjustments that occurred in 2018 including the first quarter as well as the fourth quarter? I think you had a lower-than-expected tax rate in the first quarter, and a higher-than-expected tax rate driven by a one-time charge in the fourth quarter. So are you -- the double-digit is excluding that?
- Willy Walker: No. I would say we're not looking at that necessarily, Jade. So with respect to the first quarter adjustment, keep in mind that that's a function of where our stock price happens to be when the majority of our equity vests on an annual basis because to the extent that the equity vests at higher prices than what it was issued at, there's a tax benefit associated with that, that's recognized through the tax provision again in first quarter. Because that's where the majority of our equity is vesting. So you can look at that as a one-time item, but it will happen every year so long as the stock price is going up relative to when we granted the price.
- Now the magnitude of that is probably going to be lower.
- Jade Rahmani: Okay.
- Willy Walker: Given the fact that with the change in the tax laws, less of our equity compensation is deductible than it used to be. But there's --
- Jade Rahmani: And the fourth quarter -- the fourth quarter tax rate came in above 30%. That was -- that included the one-time charge?
- Willy Walker: Yeah. That's due to the one-time charge. I think that we -- if you just annualize the tax expense, it's going to be somewhere in the 25% to 27% range.
- Jade Rahmani: Okay. So your operating EPS excluding the gain in your debt charge and using a 26% tax rate, it would have been something like \$1.54?
- Willy Walker: That's about right, yeah.

Jade Rahmani: Okay. And then you also said that your double-digit EPS growth, it won't be linear through the year. I mean, is that to imply that the comps in the first half, you know, are tougher but then the growth kicks in in the back half?

Willy Walker: No. I think it's just meant to remind everybody that our EPS doesn't grow quarter-over-quarter in a linear fashion over the course of the year.

Jade Rahmani: Okay. Thanks for taking the questions.

Steve Theobald: Thank you, Jade.

Operator: It does appear we have no further questions. I'll return the floor to Willy Walker for any closing remarks.

Willy Walker: Great, thanks, Keith. I just want to once again congratulate the W&D team on such a strong finish to 2018 and also thank everyone who participated in the call today, and to all of our shareholders for their continued confidence and trust in W&D and our company. And I wish everyone a very happy Wednesday. Have a great day.

Operator: And this will conclude today's Walker and Dunlop Fourth Quarter and Full Year Earnings Conference Call. Please disconnect your lines, have a wonderful day.