Walker and Dunlop

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Operator: Welcome to Walker & Dunlop's Fourth Quarter and Fiscal Year 2019 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 Kelsey Duffey, Vice President of Investor Relations. Today's call is being recorded and will be available via webcast on the company's website. [Operator Instructions] It is now my pleasure to turn the floor over to Kelsey Duffey.

Kelsey Duffey: Thank you, Bree. Good morning, everyone. Thank you for joining the Walker & Dunlop fourth quarter and full year 2019 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 the website www.walkerdunlop.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 metric 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 & 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'll now turn the call over to Willy.

Willy Walker: Thank you, Kelsey and good morning, everyone. The fourth quarter of 2019 capped off another extremely successful year for Walker & Dunlop as we delivered strong financial results while investing heavily in new banking and brokerage talent along with new business lines and technology.

We added 26 bankers and brokers during the year, expanding our sales force by 16% and generated record lending and brokerage volumes. We acquired a technology company in Q1 that has become the cornerstone of new products and services for our clients. And we continue to invest in expanding our service offering in the asset management and appraisal businesses.

As we begin 2020 and a new decade for Walker & Dunlop, we feel extremely well positioned to continue expanding our service offering and brand as we become the premier commercial real estate finance company in the United States.

We generated record total transaction volume of $9.8 billion in the fourth quarter. This growth was led by our debt brokerage and multifamily property sales businesses, two areas in which we have made significant investments over the past few years. Record loan and sales volume in the quarter generated diluted earnings per share of $1.34 and adjusted EBITDA of $64 million.

It is wonderful to see such strong profitability in a quarter when we knew our agency lending volumes would be down and we were carrying the cost of all the new banking and brokerage talent that we hired during Q3.

As shown on Slide 3 for the full year we generated $817 million of total revenues, up 13% from 2018. Diluted earnings per share increased 10% to $5.45 the fifth time over the past six years that our team has delivered on our guidance of double-digit earnings growth.

We grew adjusted EBITDA by 13% to $248 million, reflecting the growth in both origination fees and servicing income. If you turn to Slide 4 you can see that during 2019 we added bankers and brokers across the country and entered several new markets. We have carried our 2019 recruiting success into the new year, adding a multifamily property sales team in Austin in early January and acquiring two exceptional mortgage banking companies in New York and Ohio just last week.

The team we added in New York is particularly exciting and something of a game changer for our debt capital markets business. While we have seen tremendous growth in this business over the past several years as highlighted by our record volumes in 2019 when it comes to mega transactions for the very largest commercial real estate owners, we have generally only been competitive financing and selling multifamily assets.

The New York team that we brought on last week has done billions of dollars of financing on office, retail, and hospitality assets for some of the very largest commercial real estate owners. Coupled with the great team we brought to Walker & Dunlop in 2017 with the acquisition of Deerwood Real Estate Capital in Northern New Jersey, our presence in the greater New York metro takes a big leap forward with this addition.

The investments we have made in our multifamily property sales business over the past several years drove record sales volume of $5.4 billion in 2019. We more than doubled the size of our team during the year, positioning us extremely well to reach our 2020 goal of more than $8 billion in brokered sales volume. Our 2019 total debt financing volume was $27 billion led by 23% growth in our debt brokerage business to a record $10.4 billion.

As you can see on Slide 5, we had another very strong year with the GSEs, moving up in the league tables to finish the year as Fannie Mae's largest multifamily lending partner and Freddie Mac's third largest partner. Since 2012, Walker & Dunlop has either been the number one or number two Fannie Mae DUS lender and the number three or number four Freddie Mac Optigo lender every year for eight years.

Over that period of time due to industry consolidation, the tying of property sales with financing by the global real estate services firms and the tying of construction and balance sheet financing with permanent financing by the banks some have questioned whether W&D could stay at the top of the league tables. Yet eight years later we are not only still at the top of the league tables with Fannie and Freddie but we have built a scaled multifamily property sales business and are using our balance sheet and joint venture with Blackstone Mortgage Trust to effectively compete with banks.

We have a number of emerging businesses that are growing very nicely. Our Blackstone joint venture had a terrific year originating $436 million of loans and furthering our partnership with the largest owner of commercial real estate in the world. Our asset management business including JCR Capital ended 2019 with nearly $2 billion of assets under management. We remain very focused on continuing to raise new funds at JCR that can be used by our bankers and brokers across the nation to meet their clients' financing needs.

In the small multifamily loan origination business, we finished 2019 as Fannie Mae's number 4 lender and originated $145 million of loans. The small loan multifamily market is enormous and 2019 was a fantastic start for Walker & Dunlop in this space. And finally we launched Apprise, our new appraisal company in partnership with GeoPhy.

We are offering the market a FIRREA-compliant multifamily property appraisal in under five days when the current market takes two to three weeks. We are extremely excited about the Apprise business not only for the growth and future revenues it will bring to Walker & Dunlop but for the exciting ways the Apprise technology can help our core lending and sales businesses and our customers.

As shown on Slide 6 we ended the year with our loan servicing portfolio just over $93 billion. With a weighted average servicing fee of 23 basis points and an average loan life of nearly 10 years the servicing business generates extremely consistent and high-margin revenues while also keeping Walker & Dunlop in constant contact with our customers over the life of the loan.

We are very focused on completing Vision 2020 and generating $1 billion in annual revenues through the growth of our banking brokerage servicing and asset management businesses. We invested heavily in 2019 in new talent businesses and technologies to not only help us achieve Vision 2020 but to position Walker & Dunlop for continued growth for many years to come.

I'll now turn the call over to Steve to talk through our quarterly and full year financial performance in more detail. Steve?

Steve Theobald: Thank you, Willy and good morning, everyone. By all accounts 2019 was a phenomenal year for Walker & Dunlop. Not only did we achieve another year of stellar financial results, we made tremendous progress towards achieving our strategic objectives and set the stage for growth in 2020 and beyond.

I'm going to briefly provide some color on our Q4 results and a recap of the full year and then focus on what we expect to see in 2020. Strong total transaction volume drove fourth quarter revenues of $217 million diluted earnings per share of $1.34 and adjusted EBITDA of $64.1 million. Our key financial metrics for operating margin of 27% and return on equity of 17% in the quarter were in line with our expectations and closed out a year of fantastic financial performance across the board.

We delivered record Q4 total transaction volume of $9.8 billion as we achieved record debt brokerage volumes of $3.9 billion up 40% year-over-year and property sales volumes of $2 billion nearly double the amount we did in Q4 of last year. Our GSE originations were largely in line with our Q4 forecast of $1.5 billion each with Freddie Mac volume coming in right at the $1.5 billion mark and Fannie Mae volume slightly above our estimate at $1.7 billion.

When the GSEs temporarily pulled back in their lending our scaled capital markets capabilities allowed us to broker multifamily deal flow to alternative capital sources. This helped to boost our brokered loan originations and allowed us to continue to meet our clients' needs with the best available execution during a period of market uncertainty a true testament to the breadth and diversification of our platform today. Fannie and Freddie both have terrific 2020 scorecards, giving them and their partners lots of capital to work with.

As you can see on Slide 7 after doing a combined $35.7 billion of business in the fourth quarter of 2019, Fannie and Freddie have just over $164 billion of lending capacity to be used in 2020 under the current cap setting us up well for another year of strong GSE lending. HUD contributed $197 million for the quarter, while principal lending and investing added $532 million to the total due primarily to strong results with the Blackstone joint venture.

Gain-on-sale margin during the quarter was 159 basis points, right in the middle of our expected range of 150 basis points to 170 basis points. This result is consistent with the year-ago quarter as increased margins on our Fannie Mae originations were offset by the shift in our mix to more brokered originations which are lower margin since we don't record any mortgage servicing rights.

Personnel expenses as a percentage of revenue was 45% for the quarter compared to 42% in Q4 of last year. The significant recruiting that we accomplished in Q3 and Q4 of 2019 was the primary driver of the increase. As we added personnel cost of the new teams, were not offset by any incremental revenue from them during the quarter.

Also during the quarter, we've recorded a $4.5 million provision expense related to a loan on a student housing property at the University of Missouri. Like the loan that defaulted in the first quarter of 2019, the issues that led to this loss were related to university-specific events, including a decrease in enrollment and significant changes in student housing policy.

Fortunately, we did not have any additional exposure to student housing in this market. The remainder of our overall portfolio continues to perform very well from a credit perspective. We continue to see prudent and conservative underwriting standards with Q4 originations underwritten at 64% LTVs and 1.42 times debt service coverage ratios.

Turning now to our full year 2019 results. We generated earnings per share of $5.45, up 10% from 2018 on record total revenues of $817 million, a 13% year-over-year increase. This year's results provide tangible evidence of the diversification of our business as our GSE and HUD originations were down on the year as reflected on Slide 8, while our overall loan origination volumes increased by 5% to $27 billion, driving the increase in revenue and earnings.

Looking at multi-family specifically, our overall multi-family debt financing volume increased in 2019, as our debt brokerage platform grew its multi-family lending from 56% of total brokered originations in 2018 to 61% in 2019. Finally, our property sales volumes nearly doubled to $5.4 billion for the year, driven by the robust market and the benefits of our 2018 hiring, leading to our record transaction volumes for the year of $32 billion.

Expense related to recruiting and onboarding the new bankers and brokers we added to the business in the second half of 2019, totaled approximately $6.7 million including $4.2 million in the fourth quarter. And as Willy mentioned in January, we acquired two capital markets companies, both of which provide deep expertise in strategic markets for W&D and bring over $900 million of life insurance servicing that will be added to our growing portfolio.

We are thrilled to have these new additions to the Walker & Dunlop family and expect both acquisitions to be accretive to our earnings once we get through our three to four-month integration period. Our $93 billion servicing portfolio grew 9% during the year and generated strong cash revenues that helped fuel the growth in adjusted EBITDA of $248 million for the full year, up 13% from 2018.

Our profitable scale-driven business model continues to produce strong margins and even in a year with significant investment we were able to generate a healthy full-year operating margin of 28% and a return on equity of 18% both within our expected ranges. And our sustained strong performance enabled us to lower the spread on our senior debt by 25 basis points in November within a year of having refinanced the debt, saving us over $700,000 in interest expense on an annual basis.

I think it bears repeating that in 2019, we incurred expenses to increase our origination capabilities with 26 new bankers and brokers, absorb the impact of three loan defaults and made significant investments in technology while still delivering strong margins and returns with double digit earnings and adjusted EBITDA growth.

We ended the year with a $121 million of cash on the balance sheet and another $109 million being used to self-fund our agency loans. We will continue investing in new businesses, new bankers and brokers, and new technologies to make us more efficient and more insightful while also having the ability to return a portion of our capital to shareholders. Yesterday, our board of directors voted to increase our quarterly dividend payment by 20% to $0.36 per share, our second consecutive annual increase of 20% since we initiated a dividend in February 2018.

We delivered a total shareholder return of 52% in 2019, and we'll continue to deploy our capital to support future growth while enhancing shareholder returns with dividends and share repurchases. 2019 was a record setting year for our company on many fronts, continuing a long track record of superior growth and financial performance. As we look ahead at 2020, we are very optimistic that we can continue these trends.

Slide 9 lays out our financial targets for the year. Once again, we expect to grow earnings per share and adjusted EBITDA by double-digits as we benefit from our 2019 and early 2020 investments and the strong market environment in which we operate.

We will continue reinvesting in the business, which will naturally temper our overall profitability, since revenue growth typically lags expense growth as our new bankers, brokers and businesses ramp up. We expect to maintain our operating – operating margin between 27% and 30% and return on equity in the 18% to 20% range for the year.

In addition, we expect gain on sale margins to remain between 150 basis points and 170 basis points as broker debt originations continued to become a higher percentage of our overall debt financing volumes.

One last 2020 topic I want to cover before I turn the call back to Willy, is the new accounting standard for loan losses or CECL as it is commonly referred. CECL establishes the life of the loan concept for credit losses, which in most cases will result in higher reserves for credit loss than the previous GAAP requirements.

The new standard will be widely adopted effective with the first quarter of 2020 and requires a onetime adjustment to the allowance based on the new expected loss calculation. We expect the adoption of CECL will result in a onetime increase to our allowance for risk sharing obligations, of somewhere between $30 million and $35 million, with the corresponding after tax decrease to equity.

After that onetime adjustment, we expect our ongoing quarterly provision for credit losses expense will correspond with the net change in our Fannie Mae at risk portfolio along with any changes in either specifically impaired loans or in our expectations for future losses.

Our financial performance in 2019 was fantastic and is the result of previous investments in the platform, our profitable business model that continues to provide strong cash flow and the hard work and consistent execution of our team.

We are very excited about the momentum we are carrying over into 2020 and our outlook for another year strong financial results.

I will now turn the call back over to Willy.

Willy Walker: Thank you, Steve. As Steve just reviewed, our Q4 and full-year 2019 results were extremely strong. We grew earnings per share and EBITDA by double digits once again. We invested heavily in technology and human capital. We diversified our revenues dramatically and we continue to drive the company forward with solid leadership and a unique corporate culture. 2019 was quite a year.

It was very clear from almost every discussion at the National Multifamily Housing Council Annual Meeting in Orlando, Florida, two weeks ago that there is a very bullish sentiment throughout the multifamily industry and more broadly the commercial real estate industry due to low rates, low unemployment, 2% GDP growth and a global search for yield that has made multifamily investing almost a proxy for fixed income.

Every client we spoke with in Orlando is a net buyer, which should push cap rates even lower in the coming year. This strong macroeconomic backdrop should drive robust property sales and financing activity in 2020 and will require W&D to maintain our diligent underwriting standards as cap rates compress and equity yields are pressured.

We have an extremely strong credit culture at Walker and Dunlop, and I'd like to thank our Chief Credit Officer, Richard Warner for his exceptional leadership over the past 20 years. When Richard retires this April, our Chief Underwriter, David Levy, who has tremendous industry experience, will assume the Chief Credit Officer role and maintain our fantastic reputation for risk management.

As I mentioned previously, we are very focused on completing Vision 2020 this year. The components of Vision 2020 are outlined on slide 10. To accomplish this, we need significant growth in a number of our businesses. We lent or brokered $27 billion of debt in 2019 so to reach our Vision 2020 goal of over $30 billion in annual volume, we will need to grow our volumes by just over 10%. With the addition of new teams in New York and Ohio over the last week and the incremental lending volumes that our 2019 hires should add we have the team on the field today to accomplish this ambitious growth objective.

As I mentioned earlier, the growth we have seen in our multifamily property sales business has been tremendous, and here, too, we have the team on the field today to accomplish our 2020 Vision of over $8 billion in annual property sales volume.

As I mentioned during our Q3 earnings call, it is unlikely that our asset management business will achieve our stated objective of $8 billion in assets under management by the end of 2020. But with $2 billion of a AUM today and a fantastic team across the country both raising and deploying capital, we will continue scaling this business to achieve our objective.

And finally, our servicing portfolio should surpass the $100 billion mark by the end of the year given our projected loan origination volumes. If we do all this, we will have made great progress towards generating $1 billion in annual revenue which was the underlying goal when we establish Vision 2020 several years ago.

As we close out on Vision 2020 and set our sights on another five year highly ambitious business plan we will focus on the following areas.

First, we have established a brand new reputation in the commercial real estate industry as one of the very best service providers. We will continue adding the very best bankers and brokers to our company to further expand our client base and transaction volumes. Second, we will continue investing in new products and services for our bankers and brokers to sell. Property sales is a business we weren't in five years ago, and today we are one of the largest multifamily property sales brokers in the country, which has dramatically expanded our service offering and relevance to our customers.

Five years ago, we did very little lending with our balance sheet to compete with banks. Today, our balance sheet lending, along with our joint venture with Blackstone Mortgage Trust are lending over $0.75 billion a year, allowing us to meet our clients' needs and compete head-to-head with banks and specialty finance companies. So, we will continue adding services, such as property sales beyond multifamily and products such as the preferred equity fund we are currently raising at JCR Capital, to broaden our capabilities and meet our clients' needs.

Third, we will use technology to provide new products and services to make us increasingly efficient and insightful. We created our database of commercial real estate debt to focus on refinancing opportunities with existing and prospective clients. We then acquired a technology company, Anoto, to apply machine learning to our loan underwriting to make us more insightful and efficient. And then we built an appraisal business in partnership with GeoPhy that is dramatically faster and more transparent than today's market offering. Each one of these point solutions has a role in our business today. But what is most exciting is how all of these technology solutions combined are making our bankers and brokers more insightful about their clients, what they need today, and how we can help them build for tomorrow.

Given our growth, brand, and capital, there are more opportunities for us to pursue today than ever before. But it's important for us to remain disciplined while adhering to our mission of being the premier commercial real estate finance company in the United States. Using legendary business author, Jim Collins' analogy, the Walker and Dunlop flywheel is spinning at a faster and faster rate as our reputation and financial success grow.

What is fundamental to continued growth are two things. First, we must maintain the corporate culture that has made W&D such a special place to work. We established something called the Walker Way last year, putting words to the core tenets that underpin the unique culture at Walker and Dunlop, caring, insightful, tenacious, collaborative and driven.

And second, we must continue to establish long-term highly ambitious goals and apply the appropriate resources and capital to ensure we achieve them. It's an exciting time for Walker and Dunlop and our team. Many congratulations to all of my colleagues at W&D for a truly fantastic year. The investments we made, coupled with our terrific financial performance, positioned us exceedingly well for continued success in the future. And thank you to everyone who joined us this morning for this call. I'll now turn the line over to the operator for any questions.

Operator: Operator Instructions] Our first question will come from Jade Rahmani with KBW.

Jade Rahmani: Thanks very much. Certainly, very strong performance and growth in the non-GSE businesses, the broker business as well as investment sales. Willie, in terms of your 2020 goals, I was wondering if you could share some insight into how you are prioritizing M&A versus the ongoing recruitment of new producers and or capital markets teams?

Willy Walker: Good morning, Jade, and thanks for joining us. I think as you can see starting out the year by bringing in a team which was a recruiting effort in Austin followed by the acquisition of two companies. We'll continue doing both. I think at as I said in the call, given the brand, given the platform and given the culture of W&D there is very clearly a market impression that W&D is a great place to work.

And that has made it so that A, our recruiting efforts are being extremely fruitful. But then B, we are getting a lot of inbound from people saying we've seen what other companies have benefited from by becoming part of Walker & Dunlop and the growth that the bankers and brokers on those platforms have enjoyed, and maybe we ought to talk. So it's really a combination as Steve underscored Jade we have plenty of capital to be able to continue to invest in both hiring as well as acquiring talent.

Operator: Our next question comes from Jason Weaver with Compass Point. Please go ahead.

Jason Weaver: Hey good morning, and congrats on the quarter. Willy, you mentioned a few key hires briefly in your opening remarks, but after such a big 2019 can you give us an update on if you're still accelerating recruiting efforts here and what geographic areas within the country you're focused on?

Willy Walker: Hey Jason. So we just added two teams in the last week. So the Manhattan, as I outlined in the call, the Manhattan ad was fantastic and broadens us significantly into both that market as well as new asset classes, and when I say new asset classes, it's not as if we haven't done a lot of financing on office, retail and hospitality. But this team has a reputation of doing mega transactions in the largest commercial real estate market in the United States.

So that's that, that is somewhat of a game changer. But as we've outlined before Jason, there are still plenty of markets where we do not have teams operating today. So for instance in the investment sales space, on the multifamily side we don't have teams in Houston. We don't have teams in Phoenix. We don't have teams in Denver. We don't have teams in Seattle to name a few.

On the mortgage banking side, there are plenty of major markets where we don't have mortgage banking talent today out originating loans for us. So, the most exciting thing is we have all this momentum right now. But then, there's still a lot of whitespace out there if you will as it relates to both geographic opportunities as well as product line opportunities for us to continue to add to the platform.

Jason Weaver: Fair enough. And more on that, on the MSR transaction, can you expand a little bit on the rationale behind there, is that a meaningful service expansion for your non-GSE servicing capability?

Willy Walker: What's interesting, I'm sensing from your question of, don't let me put some words in your mouth, you know why Ohio? You'd be surprised how much banking activity there is in Ohio and I'd add one other piece. Columbus, Ohio, was our fastest growing NOI market in the country for 2017 and 2018 in our multi-family portfolio. So Columbus topped NOI growth on the multifamily side for those two years in our, in our servicing portfolio.

So, I'd just say that we're super excited to have that team on board, we have a lot of, if you will, white space in the Midwest to continue to grow. We have fantastic teams up in Wisconsin and in Chicago. But adding this team in Ohio gives us a great presence in a very important part of the country.

Steve Theobald: And I'd say, Jason, this is Steve, with respect to the servicing question. MSF has almost $1 billion of life company servicing, which will add to the portfolio. We already had almost $10 billion of mostly life insurance company servicing already. So, it's not necessarily a game changer, but it certainly adds a lot more scale to that part of the portfolio.

Jason Weaver: Okay. Thank you. And just one more and I'll jump off. With the Scorecard behind us, do you have any new thoughts on the ongoing policy discussion, whether FHFA may look – may continue to rely on a dollar volume cap or perhaps move to a target percent of market share?

Steve Theobald: Yeah. I actually do, because I interviewed Director Calabria last week at the real estate roundtable meeting here in Washington, and asked him point blank whether we should expect any significant change to the 2021 Scorecard. I was honestly expecting the Director to demure on the question and sort of say, you'll see when we put it out.

And instead he looked right at me and said, no you shouldn't expect any changes, it will be – if there are changes, it will be incremental. And so, his comments on that were, I think, quite enlightening to the people in attendance. And to those of us who are in this market, extremely welcome news that we shouldn't expect any significant change to the 2021 Scorecard from the 2020 Scorecard.

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

Steve DeLaney: Good morning, everyone, and congratulations on moving back to number one with Fannie and back to the top three with Freddie. I'd like to start with the big jump in the fourth quarter property sales, you know $2 billion of volume it looks about 90% increase year-over-year. Was there a large portfolio involved there or is this just represents sort of the typical year-end rush to get transactions done? Thanks.

Steve Theobald: I'd say it's more of the latter Steve.

Steve DeLaney: Okay.

Steve Theobald: There weren't any sizable portfolios. I think it's a function of two things; one, we've obviously dramatically expanded the size of the team and--

Steve DeLaney: All right.

Steve Theobald: -the folks we hired in 2018 were contributing pretty meaningfully to the volumes we did in 2019. And then Q4 tends to be as your – I think question alludes to, the high watermark from a transaction volume perspective in the year as folks are trying to get things done before the end of the year. So, I think a combination of strong market time of the year and the increase to the team is what's really propelled that growth.

Steve DeLaney: Yeah. That helps Willy, get us for us the size 2020, 2021 opportunity we can, we can deal with the seasonality but it sounds like you, your base case is much higher point obviously than we were a year ago.

And then moving on to the AKS acquisition, I mean brokered was pretty significant this year, over $10 billion up about 25% year-over-year. But we think of AKS and I'm – you know I read the article and saw some of the multi-hundred hundreds-of-million of dollar sized transactions they do. When we think about that, that impact in 2020 for one, unlike a list out, I would assume pipeline is just whatever pipeline they had is you bought and you have that in place so there is no really six month, nine-month delay and rebuilding a pipeline. And two, larger loan market all of that. When we look at the $10 billion base in 2019, are we thinking a 10%, 15% incremental benefit or should we be bolder and assume this is more like a 25% to 30% impact in your brokered volumes from just this acquisition?

Willy Walker: Let me take a stab at that and Steve can jump at any point that he wants. And good morning, Stephen. Nice to have you on the call. So a couple of things; first of all as with all deals, there is some negotiation on what part of the pipeline that they have been working on stays with them and comes to us. So, I would just say to you that the pipeline they were working on, if you will, stays with them and then anything they're working on today comes to us. And so, I would give it sort of a three-month, sort of, if you will, ramp-up period where the deal flow that they're working on actually contributes to W&D's financials.

So that's point one. But you are correct, unlike a team coming over from another platform where they leave everything and have some adjustment period, the AKS team and platform comes directly into W&D. But I would say, it's not starting day one because the deal flow that they were working on a lot of that stays with them from a financial standpoint.

Steve DeLaney: Got it. Thanks for clarifying that.

Willy Walker: Yeah, sure. The second thing on it is that if you look at their track record, they are a multi-billion dollar a year team; and with their reputation in the market and their client relationships, and the health of the market today, there's no doubt in my mind that they continue to do multiple billions of dollars of transaction volume on an annual basis. Whether that gets us to 20%, 30%, 40% growth on the year, quite honestly, it's very hard to tell. One of the big issues there Steve is the following.

They have access to so much deal flow, and are so prolific in that market that I'm sure their brokered volumes will stay the course, if you will. The big juice in this deal for both of them and us is them becoming a major source of agency originations. And so, one of the things to be seen there is they are now on the very best agency platform in the country. And so, it's up to us to take all of their deal flow and get a certain percentage of that flowing into agency originations, because as you know, the economics behind that are fantastic.

So, what percentage of their big if you will aggregate number? How big that grows? That's – I think that they'll keep, if you will, consistent in their annual origination volumes. I think the big challenge for us and for them is to make sure that we are taking a certain percentage – a good percentage of their business on the multifamily side, and using our platform and reputation with the agencies to be able to put agency debt on those deals.

And the one thing I would also say on that Steve is, as you know, the agencies have not been terribly competitive in the New York marketplace. They are very focused on affordable housing these days. They are very focused on non-trophy assets these days. And so, this team has a reputation of doing trophy assets. So, you shouldn't expect quite honestly a $750 million Fannie Mae or Freddie Mac loan on a, what I call, brass and glass trophy property in Manhattan. But at the same time, the Manhattan market does have huge swaths of affordable housing which is our very big expectation the agencies are very competitive one.

Steve DeLaney: Yeah. That's a great color, Willy. I'd not really – I was focusing just on the big office, hotel, et cetera, not really focused on the fact that your agency business could benefit from having these guys on board. So thank you for that color.

And just one final one for me, the third quarter call we were in a different environment right and with respect to the GSEs I guess we'd just gotten the caps. But I think on that call you touched on kind of alternative ways to serve the multifamily market if the GSE volumes become problematic and you mentioned private CMBS and your comments about continuing to expand product service offerings. I'm just curious if that building a private CMBS team is part of your thinking for strategic development down the road?

Willy Walker: So we have a team today that focuses on CMBS and is doing table funding on CMBS lending with a number of the conduits. I think the Steve said it in his comments during our call Steve and that is the following. If you looked at Q4 2019 and you look at our agency volumes versus 2018 to2019, we did a $1 billion less of Fannie Mae lending in the quarter and we did $700 million less of Freddie Mac lending in the quarter year-on-year, quarter-on-quarter.

Steve DeLaney: Yes.

Willy Walker: And yet at the same time we put up fantastic profitability on the quarter because of the diversification we put in it Walker & Dunlop and the investments we've made to build up our brokerage business, to build up both our property sales brokerage business and our debt brokerage business. If you add to that the loan loss we took in the quarter, it was an incredible sign of the diversification that we put into the company to be able to have our agency volumes come down which we predicted. We told everyone we were going to have lower agency volumes in the quarter. As Steve highlighted in his comments we have a great scorecard for 2020 and they should be back in very robust in the market. But for Q4 we had lower agency volumes our debt brokerage business and our property sales businesses kicked in.

We took a ton of that multi-family business that wasn't going to Fannie and Freddie and found other sources of capital for it and we generated a fantastic quarter from an earnings and EBITDA growth standpoint.

So, I think you take all that together and you've been covering us for quite some time that really demonstrates the diversification and the investments we've made in the platform to move away from being known as just a really, really good agency lender to being a great commercial real estate financing company.

Steve DeLaney: Great. You hit it on the head, Willy. We – your agency numbers were almost spot-on there $1.6 billion behind their new estimate last week and which you did that I had not factored in their model is essentially you were $0.14 better in the non-agency parts of your business. So, you described exactly my reaction when I looked into the numbers this morning, so. Thank you both for your comments. Appreciate it.

Willy Walker: Thanks, Steve.

Operator: Our next question comes from Henry Coffey with Wedbush. Please go ahead.

Henry Coffey: Good morning, everyone and let me add my congratulations. Great quarter, dividend, a wonderful change I think. So a couple of questions, increasing the dividend from $0.30 to $0.37 but not buying back stock, what was the thought process behind that? I mean it's a great news, but I'm wondering how were you thinking about it?

Willy Walker: Yeah. Henry, first of all thank you for the comments and the question. So just to be clear the dividend was increased to $0.36 not $0.37.

Henry Coffey: Sorry.

Willy Walker: And then Henry you shocked me that you are asking about the dividend first question. I – Steve and I both smiled at each other when we heard you come right in on congratulations on increasing the dividend.

Henry Coffey: Well, I am the oldest person on the call. So, you know

Steve Theobald: So with respect to the decision, Henry, when we – first I'll go back to when we first established the dividend two years ago, it was with the, I think, intent to increase that dividend over time to reflect the fact that our expectation is that the business is going to continue to grow and perform, generate the cash flow to support that. So, looking at year one, we did a 20% increase; year two, we've done a 20% increase.

I don't want to necessarily commit to – that's the annual increase, but clearly we're working on establishing a pattern at this point in time. And I think, as I mentioned in my comments, we're very confident that we can sustain that increased dividend and continue to feed the business, if you will, to generate that growth. So, we're sitting on a fair amount of cash. We're generating a fair amount of cash. We've obviously put some of that to work here in the beginning of the year with the two acquisitions we announced. And our expectation is, we'll continue to do so and we have plenty of capital available to do that.

On the share buyback front, I didn't mention this in my remarks, but the board did re-authorize another $50 million share repurchase authorization. Again, as we've done historically, when we see opportunities to buy stock, we do. So, it's really there for those events. I think right now having the consistency of the dividend and the dividend increase is our bias in terms of what's best for shareholders.

Henry Coffey: No, I would agree completely. Willy, in answering your question with Steve. You went down kind of a list of things that involve creating an essence deployment of capital the CMBS stable funding and that group the preferred fund by your investment manager obviously your relationship with Blackstone. So in addition to expanding origination capacity as you start thinking about capital, what are the other projects, possibilities, call them investment funds that you could develop at WD that would continue to expand your ability to touch in markets outside of the GSE business?

Willy Walker: So Henry as we – I hopefully outlined in our call because of the sort of accelerated pace of recruiting and people who want to become part of the W&D platform. We will continue to put capital into that both acquiring origination talent as well as hiring new origination talent.

The second piece to it is the asset management business, which we've discussed previously because we've built up this great distribution network. We now have relationships with borrowers across the country and owners of property across the country that need capital.

So the continued investment, co-investment as well as investment in new funds at JCR, is a very important piece to the strategy and we will continue to raise capital there that we can then deploy out through this great network of bankers and brokers across the country.

The third thing is that we've used our balance sheet and balance sheet lending extremely strategically over the past several years to really differentiate ourselves from the competition as it relates to moments where our clients need something for us – from us, that gets them either an opportunity or positions them to be able to move their company forward.

And so, I can run down a list of four or five examples over the past couple of years where a client has called us up and said could you do this for us. And we've used our balance sheet to be able to step in and basically allow them to do something that others wouldn't allow them to do. And that has not only differentiated us, but it's also brought in a significant amount of interest income off of using that balance sheet to be able to lend in that manner. So, we want to maintain capital on the balance sheet to be able to sort of, if you will, do those special situations.

And then the final piece is technology. As I tried to run through in my remarks without basically giving all of our competitors a complete X-ray of what we're doing, we've invested in technology that I believe is making our bankers and brokers highly, highly insightful to what their clients not only need today, but where they're going tomorrow. And I believe that continuing to invest in the technology solutions that make our bankers and brokers better than the rest of the market will only help them and help our clients and make Walker & Dunlop that much more relevant to our clients. So, those are sort of the four areas of continued capital investment for 2020.

And the final thing I'd say to you is that we will spend this year developing our next five-year business plan with some very significant BHAGs, as Jim Collins says, as we have historically done. And so, I think one of the other exciting things is, as we build that strategy during the year, we will roll that out to investors sometime in the fall to kind of paint the picture of what W&D will look like in 2025. And as you can imagine, we've already started doing a lot of work on it. And some of the things we've been investing in are going to play into that business strategy for the next five years.

Henry Coffey: Another part – thank you very much for that. Another big part of the theme of this quarter is not only all this good news but you also were able to deliver significant results with bad news. So you had a default. You've had a couple, would you say, three this year. Can you walk us through the process? You have a default, you have a provision, what goes on next? How do you resolve that? It's not something that happens that often. So, I'd be interested to hear what the flight path on a default looks like?

Steve Theobald: Yeah. Henry, with respect to the defaults in the at-risk portfolio that's pretty straightforward -- when the default happens. Fannie basically steps in and takes over management of the asset at that point in time. So, they in essence do the special servicing work in terms of working-- working out that asset they manage the foreclosure process, they manage the asset and then typically, you know, it takes about two years for the asset to be stabilized, remarketed and sold. So we won't actually settle the two defaults that happened at the University of Missouri until likely 2021.

Willy Walker: And Henry, if I can I just want to quickly jump in there and just we said in the call, these are both very location-specific defaults. These are not market defaults. And so the underlying fundamentals of our portfolio are fantastic. The University of Missouri after the Ferguson riots has enrollment for significantly the University changed their on-campus housing policy to require all freshman to live on-campus and that has made it so that all the student housing off-campus has had low occupancy numbers and we suffered to defaults.

As Steve said in our comments we do not have another student housing loan at the University of Missouri. So we are out of that market. We've taken our lumps, but it is very much a university specific issue here and not a broader issue on the overall multifamily market.

Henry Coffey: No, I get that. I – though appreciate you highlighting it, that we keep – we all keep asking when does multifamily slow down and I think the answer is not yet. So Thank you.

Willie Walker: Yeah that's right.

Stephen Theoblad: Henry, the third default is the loan in our interim loan portfolio which we are still working through that with the borrower trying to get a restructuring in place.

Henry Coffey: Thank you.

Operator: Our next question comes from Jade Rahmani with KBW.

Jade Rahmani: Thanks very much. Sorry for getting cut off earlier. I still have a bunch of questions I wanted to ask about. Just on the loan default, are you seeing any broader trends on student housing? Can you also quantify what percentage of the at-risk portfolio is student housing? CMBS is showing a notable increase in defaults in student housing not just in Missouri. So if you could provide that color it'd be helpful.

Willy Walker: Yeah, Jade, I don't have – we don't have that, but we'll get it to you as it relates to the percentage on student housing. And I think your comment as it relates to CMBS pools, there's no doubt from a pricing standpoint right now on student housing that both Fannie and Freddie are, if you will, have their antennae up as it relates to student housing Freddie's pullback in that space quite a bit. And so I think your comment is correct. While these are both University of Missouri related defaults, generally speaking, there is some concern about the overall student housing market. I can't, I don't have right in front of me what percentage of our at-risk portfolio is student housing but we can get that to you.

Jade Rahmani: Thank you. Just turning to the earnings drivers this quarter and we try to be as meticulous as possible in our models, the other operating expense was significantly lower than what we are projecting. It was about 23% lower than a year ago, about similar percentage lower than the third quarter and about 25% lower than what I projected. Considering the 16% growth in brokerage headcount, could you give any color on why that fell sequentially and what kind of quarterly run rate we should expect going forward? It was about $14.9 million in the fourth quarter.

Willy Walker: Yeah. Jade, I'll take that one. So, last year, we had a couple of one-off charges. One related to the refinancing of our term loan so we wrote off the unamortized issuance costs and original issue discount when we did the refinancing. So, that's part of why in Q4 of last year the expenses were elevated.

The other thing is we had a true up with respect to the earn-out calculation on one of our acquisition deals. Again, we disclose that and talked about it last year. So, that fourth quarter of last year, you had a couple of expenses that were elevated to this year's expenses look more in line relative to that. With respect to the third quarter, that's the timing of some of our events and expenses.

So, there's always a little bit of variability from quarter to quarter. But given the timing of our summer conference and our all employee meeting, we had an elevated level of expenses in Q3 as a result of that, which again was different from Q4 of last year when overall employee meeting was late in the quarter. So that’s – nothing else going on there.

Jade Rahmani: So looking ahead, would something on an average rate be $16.5 million or so? $16.5 million or $17 million and should we also expect that to grow in line with headcount?

Willy Walker: Yeah. That doesn't necessarily grow in line with headcount. Some of those costs are I would say independent of headcount. You got professional fees in there. Obviously, if we're working on acquisition deals and what not, that can drive some professional fees, recruiting the expenses et cetera. So your average is probably a good one to use in terms of modeling the go-forward and yeah, I don't know what else to tell you on that.

Jade Rahmani: Okay. Just on the AKS team, what percentage of the historical production has been multifamily?

Willy Walker: We got two people looking at each other shaking their heads. We'll find that out, Jade, but I don't know the actual percentage but as I said previously, they have access to a lot of deal flow and now that they are on a really, really great agency platform it's our expectation that they'll become even a bigger team in the multifamily space in New York.

Steve Theobald: It has not been the dominant part of their business, I can tell you that. It's mostly been office.

Jade Rahmani: Okay. Thinking about the Freddie Mac relationship, would you guys be interested in buying B pieces and the K Series deals, which have similar risk characteristics as your risk sharing component in the – on the Fannie Mae side? But you don't have to put out the direct capital, would you be interested in the BP space?

Willy Walker: Not on our own balance sheet, Jade. That's something that we might be interested in raising a fund and investing through that, and then obviously be a co-investor in that. But as far as a direct ownership interest on our balance sheet, unlikely that we'd be interested in doing that.

Jade Rahmani: Would that JCR be a – would there be a fund product that could be dedicated to that space? Or it have to be a multi-strategy commercial real estate data?

Willy Walker: No, it could be dedicated to that. There are other – there are plenty of examples out there of folks who have raised money around strictly BP's buying in the predicted.

Jade Rahmani: Okay. Just on our price, I wanted to ask if there's any parameters around eventual revenue production that you might expect out of that business, considering I think that you've mentioned around $700 million in annual multifamily appraisals, we could make some margin and market share assumptions to drive towards some revenue calculation. Anything you could share on that?

Steve Theobald: I think that nothing more than we have at this point, Jade. I think we obviously are just not launching the business, and building out the team to deliver on the business. So, I think we're focused on what's the market opportunity and how much of that we can capture. But we haven't really quantified that beyond what we've talked about already.

Willy Walker: Yeah, I read your note on it, Jade and I think you're back at the envelope number, is a good place holder as we get into the space. And we'll obviously give you and others updates as we sort of see how the market reacts to it. But given the transparency and the speed with which we can deliver appraisals, we obviously have very ambitious goals here and at the same time it's a completely new business for us. So for us to put a stake in the ground and say we expect X amount of revenues of it is, I think a little unwise at this point.

Jade Rahmani: Okay. And lastly on CECL reserve something KBW is very focused on, I think looking at your – at risk servicing portfolio it implies about a 75 basis point potential default rate assumption and maybe 25% loss severity. Is that in line with what you're underwriting?

Steve Theobald: Yeah. Look the CECL, as you know is a life of the loan loss concept. So as we look at the expected life of our existing portfolio we have a lot of loss history to develop the historical perspective on. And then looking ahead and adding the forecast element to that is essentially how we've gotten to the $30 million to $35 million adjustment that I mentioned. So yeah, we'll have more – more to say about that in Q1 once KPMG gets through the rest of their audit work on this and we make the adjustment and then we'll have the first quarter provision expense to talk about as well.

Jade Rahmani: Okay, thanks very much for taking the questions.

Steve Theobald: Thanks Jade.

Operator: And there are no further questions at this time. So I'll turn it back to Mr. Walker for any closing remarks.

Willy Walker: Great. I want to reiterate my thanks to those who joined us on the call this morning and my congratulations to the W&D team for a fantastic quarter and a fantastic year. And I wish everyone a terrific Wednesday. Have a great one. Thank you.

Operator: This does conclude today’s program. Thank you for your participation. You may now disconnect and have a wonderful day.