Fourth Quarter 2019 Earnings Call Transcript

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PRESENTATION

Operator:

Good morning, ladies and gentlemen, and welcome to the Amalgamated Bank Fourth Quarter and Full Year 2019 Earnings Conference Call.

During today's presentation, all parties will be in a listen-only mode. Following the presentation, the conference will be opened for questions, with instructions to follow at that time.

As a reminder, this conference call is being recorded.

I would now like to turn the call over to Mr. Drew LaBenne, Chief Financial Officer. Please go ahead, sir.

Drew LaBenne:

Thank you, Operator, and good morning everyone. We appreciate your participation in our Fourth Quarter and Full Year 2019 Earnings Call. With me today is Keith Mestrich, President and Chief Executive Officer.

As a reminder, a telephonic replay of this call will be available on the Investor section of our website for an extended period of time. Additionally, a slide deck to complement today's discussion is also available on the Investor section of our website.

Before we begin, let me remind everyone that this call may contain certain statements that constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. We caution investors that actual results may differ from the expectations indicated or implied by such forward-looking information or statements. Investors should refer to Slide 2 of our earnings slide deck, as well as our 2018 10-K filed on March 28, 2019, and other periodic reports that we file from time to time with the

FDIC for a list of risk factors that could cause actual results to differ materially from those indicated or implied by such statements.

Additionally, during today's call, we will discuss certain non-GAAP measures which we believe are useful in evaluating our performance. The presentation of this additional information should not be considered in isolation or as a substitute for results prepared in accordance with U.S. GAAP. A reconciliation of these non-GAAP measures to the most comparable GAAP measure can be found in our earnings release, as well as on our website.

At this point, I'll turn the call over to Keith.

Keith Mestrich:

Thank you Drew and good morning everyone. We appreciate your time and attention today.
This morning, I will discuss the high level results of the fourth quarter and provide an update on our strategy to grow the Bank before turning the call over to Drew to discuss our financial results in more detail.

To start, there are six key highlights of the fourth quarter and full year 2019 that I would like to focus on today:

First, I am thrilled with the performance of the entire Amalgamated Team in achieving the best financial results in the 97-year history of this great institution and propelling the Bank past the $5 billion asset mark in 2019. I am also very happy with our quarterly and full-year earnings which show the earnings potential of this Bank going forward. These are historic achievements and have motivated our entire organization to do even more in the coming year.

Second, I am thrilled with the success that our team achieved in growing our loan portfolio in 2019. I would note that we made the decision in the fourth quarter to move our PACE assets to securities given their structure, but not change has been made to the assets that we hold. As a result, we delivered 7% annual loan growth on top of the addition of $264 million in PACE assets. Taken together, our portfolio grew 15% for the full year 2019 which exceeded our expectations especially when you consider the substantial run off that we achieved in our indirect C&I portfolio as we continue to de-risks outr balance sheet. Amalgamated’s mission and values remain a critical differentiator in the market and have positioned us for growth in the sustainable lending sector, which was a key driver to our success this past year. More importantly, we are poised for continued growth as we enter 2020.

Third, our deposit franchise has again proved to be a competitive advantage that Amalgamated enjoys as we continued to experience healthy growth through the fourth quarter and full year 2019. This success was broad based having achieved strong political deposit growth and expansion in our core relationships in the non-profit, labor and philanthropic sectors. The percentage of non-interest bearing deposits expanded nicely in the quarter and the full year and our cost of fund positioning remains a long-term strategic differentiator for us.

Fourth, our non-interest expense was slightly elevated in the quarter primarily associated with SOX readiness and we started to invest in new business initiatives in the Trust Department which represent exciting growth opportunities for the Bank that we expect to accelerate in 2020 given the opportunity that we see ahead. We will discuss these initiatives in more detail in a moment.

Fifth, credit remains very stable with the exception of one previously modified indirect C&I credit that we moved to non-accrual. Over the course of 2019, we reduced the indirect C&I portfolio by approximately $177 million and only $60 million remains in the portfolio

And, lastly, we continue to work hard, every day, to build upon our reputation as "America's Socially Responsible Bank" and are proud to announce our recent ESG accomplishments this quarter, including the launch of our cross-departmental Corporate Social Responsibility committee with Board oversight, making additional ESG related disclosures, and continued support of policy advocacy efforts that help build a more inclusive and sustainable world. We believe that our long-term positioning as a socially-responsible company and a solid ESG investment will be especially important in this era where more and more consumers are demanding that the companies they do business with hold themselves accountable to a broad set of stakeholders.

Turning to the quarter, we witnessed nice growth in our residential portfolio as well as continued strengthening of our position in the renewable energy and energy efficiency space. Towards the end of the quarter, we added approximately $1717.5 million in residential PACE assessment – a category that we like for its mission alignment, its relatively favorable returns and the credit strength of the assets in the portfolio. We have provided more details on these assets on slide 9 of the presentation. We also saw additional activity in commercial solar and commercial PACE – again categories of assets that we like for their returns and safety as well as the mission alignment with our overall business positioning as America's most socially responsible bank. We are also pleased to announce that post our acquisition of NRB, we doubled our commitment to impact lending and investing to $700 million. This initiative, a two year goal, was achieved this past December, delivering upon our goal 8 months ahead of schedule.

Our unique deposit franchise continues to deliver, achieving 29.5% annualized growth during the quarter and 13.0% for the full year, or 23% after adjusting for the $327 million of short-term deposits at year-end 2018. At quarter end, our political deposits totaled $578.6 million which is a record high for Amalgamated. I am particularly encouraged by the strength of our brand and the success that our bankers have achieved over the course of 2019 as we continued to take share in the political deposit market as we greatly expanded our share of both political candidates and major party committees. In order to further expand our franchise, we hired an experienced political banker in our San Francisco office in the fourth quarter who has made very good progress expanding our reach in California where we have an opportunity to grow our presence.

Beyond our political deposit franchise, we also experienced broad based deposit growth in our other key verticals. We brought in new labor relationships in our Western Region office and as I mentioned, hired a banker this month to focus on our union relationships in the West. We also saw a nice increase in our lending to labor unions in our Northeast Region and opened new relationships with major unions in our Mid-Atlantic region. Our non-profit banking team has grown and they had an excellent year in 2019, adding new relationships with environmental organizations, LGBTQ groups, women's organizations and community development groups. We hired a lender to focus on building relationships with the CDFI community and towards the end of the year we saw those relationships starting to bear fruit. And 2019 was the year we really began to solidify our presence with philanthropies, adding robust cash management relationships, some innovative lending partnerships and we are well poised to discuss investment management opportunities with their endowment managers in the future. Looking ahead to 2020, our deposit pipeline is strong and all of our teams in all three regions are off to a strong start. As we announced on our last call, we plan to open commercial offices later this year in Boston and LA and I expect to see us adding new relationships in those markets as well.

Our deposit cost of funds held relatively steady at 36 basis points in the fourth quarter, down one basis point from the third quarter of 2019 and up 11 basis points from the year ago quarter. Looking forward, we would expect our political deposits to remain relatively stable before declining towards the latter part of the third quarter as campaign funds get spent through the election. If the past is prologue, and I fully expect it to be, the funding cycle seen in previous elections should repeat itself and campaign fundraising will begin again in earnest in the first and second quarters of 2021.

Our non-interest expense for the quarter was $33.5 million, an increase of $1.6 million from the linked quarter, primarily as a result of non-core expenses consisting of $1.1 million related to the acceleration of expenses associated with the closing of two branches in New York City in 2020, and the previously mentioned costs related to SOX and our Trust department work.

Of note, our trust study is an example of the investment spending that we are undertaking to expand the growth potential of the Bank. We believe that we have the opportunity to grow our Trust business and have been exploring ways to more effectively deliver the investment management funds that are currently on our platform and to expand our offerings. During the quarter we announced our agreement with Invesco to become a sub-adviser for our Investment Management business. This relationship is based on our mission to expand opportunities for socially responsible investments. Given Invesco's leadership in providing ESG and mission focused products we believe our clients will benefit from the breadth and depth of Invesco's passive equity, fixed income, and alternative investment capabilities. We are coupling this expanded investment capability with a serious commitment to improving the delivery of our core custody offering. I am personally very focused on the transformation of our trust business as I believe the value of our franchise can be greatly enhanced through a vibrant set of investment and custody offerings that can increase the Bank's non-interest income – something I think is extremely important in the current, and perhaps prolonged, low interest-rate environment.

Looking to the year ahead, we also see an opportunity to expand our geographic reach as well as our product offerings given the large market opportunity that we see. Amalgamated continues to be the banking partner of choice for individuals and companies who share our strong values and mission and we continue to estimate that there is a $90 billion commercial deposit opportunity in the U.S. To tap into this large market, and as I referenced earlier, we continue to move forward with our strategy to open commercial banking offices in Boston and Los Angeles in 2020. We are currently recruiting bankers and securing commercial office space, as we will not be opening branches to support this effort.

We will also continue to return capital to shareholders and are pleased with our Board's approval of a 33% increase in our quarterly dividend to $0.08 per share. Importantly, we will maintain a disciplined capital allocation strategy as we remain focused on maximizing value for our shareholders.
To conclude, we are entering 2020 very well positioned for the future. I am pleased with the progress that our team has achieved and the strides we have made to prudently grow our franchise this past year. Additionally, 2019 proved to be a year where our reputation as "America's socially responsible bank" started to become more widely recognized in the market as we were recognized with several notable awards including EuroMoney's best bank for corporate social responsibility in North America and Forbes Best Bank in California.. I am very excited with the year ahead given the many opportunities that I see and I would like to thank all of our employees for their hard work.

I would now like to turn the call over to Drew for a more detailed review of our financial results.

Drew LaBenne:

Thank you Keith. I will begin by reviewing our fourth quarter and full year results, before turning the line back to the operator to open for questions.

Turning to slide 6, in the fourth quarter, deposits increased $318.6 million, or 29.5% annualized, to $4.6 billion from the third quarter of 2019 while average deposits for the quarter were $4.4 billion. As expected, average non-interest bearing deposits increased $87.6 million from the prior quarter primarily due to seasonality related to the election cycle and now represent 46% of average deposits, at year end. Our deposit cost of funds remained relatively stable at 36 basis points. Deposits from politically active customers, such as campaigns, PACs, and state and national party committees, increased $67.7 million from $510.9 million at September 30, 2019 ending the year at $578.6 million, as outlined on slide 7. The election environment continues to be a source of growth for our deposit franchise. The focus for the year ahead will be the presidential race, and, as Keith mentioned, we have and continue to be a partner, supporting the business needs of the majority of Democratic candidates.

As seen on slide 8, we delivered annual loan growth of $228.1 million, or 7.1%, as compared to December 31, 2018, and ended the year with $3.4 billion of total loans. This loan growth was achieved while following through on our diligent efforts to run-off our indirect C&I portfolio. Additionally, as Keith mentioned, we increased our balance of PACE assessments, which are now reported in the held-to-maturity securities portfolio, to $263.8 million, which is inclusive of approximately $171 million in purchased residential PACE assessments this quarter. Looking forward, we continue to like the yield and credit profile of the PACE assets and see this as an important driver to our portfolio growth in 2020 and beyond.

The yield on average earning assets was 3.81% for the fourth quarter, a decrease of 14 basis points as compared to the same period in 2018, driven by lower market rates on loans and securities. The yield on our total loans was 4.10% compared to 4.22% in the third quarter of 2019, due to lower market rates on new loan originations and the impact a lower Fed Funds rate.

Turning to slide 10, our net interest margin was 3.43% for the quarter, a decrease of seven basis points from the third quarter and a year-over-year decrease of 14 basis points. The decrease in NIM compared to the linked quarter was primarily due to the decrease in yield on interest earnings assets. Fourth quarter NIM includes five basis points of accretion of the loan mark from the NRB acquisition.
Net interest income for the fourth quarter of 2019 was $42.3 million, which compares to $41.8 million in the linked quarter, and an approximately $2.0 million increase as compared to $40.2 million in the same quarter of 2018. For the year, net interest income was $166.7 million, which compares to $149.7 million in the year prior.

Now onto non-interest income. Non-interest income for the fourth quarter of 2019 was $7.8 million, increasing slightly from $7.7 million in the third quarter of 2019 and a $221 thousand increase compared with the fourth quarter of 2018. Non-interest income for the full year was $29.2 million, an increase of 3.1% compared to 2018.

Keith has already hit on many of the drivers for our expense increase in the fourth quarter. For the full year of 2019, our non-interest expense remained relatively flat at $127.8 million, a decrease of $177 thousand or 0.1%, from $128.0 million for the year ended December 31, 2018. The slight decrease was primarily due to increases in compensation and benefit costs of $2.9 million, some of which was temporary workers for special projects. Occupancy and depreciation also increased $0.7 million due to the scheduled branch closures in 2020. The increases were offset by a decreases of $1.8 million in professional fees associated with the IPO and NRB acquisition in 2018, there was also a $1.6 million decrease in other expenses associated with lower FDIC expense and release of off balance sheet provision.

As we head into 2020, we will continue a moderate level of strategic investment in the Trust business and the expansion into Boston and Los Angeles. Additionally, there are always some inflationary pressures on normal expenses. These increases will be mostly offset by the savings we have secured in 2019 and the two branch closures in early 2020. We estimate the branch closures will average run rate expense savings of approximately $2 million annually. We forecast our core expenses to run at approximately $32 million per quarter in 2020 with some variation in the quarters.

Skipping ahead to slide 14, the credit quality of our portfolio held steady throughout the fourth quarter as non-performing assets totaled $66.7 million, or 1.25% of period end total assets at December 31, 2019 compared to 1.42% as of September 30, 2019, a decrease of $4.9 million from the linked quarter and an increase of $7.4 million as compared to December 31, 2018. Criticized and Classified loans decreased by approximately $9 million in the fourth quarter compared to the linked quarter.

The provision for loan losses in the fourth quarter of 2019 totaled an expense of $83 thousand which compares to a recovery of $600 thousand in the third quarter of 2019. The provision expense in the fourth quarter was primarily driven by an increase in specific reserves from our indirect C&I portfolio due to one loan moving to non-accrual, partially offset by a release in allowance related to the reclassification of PACE assessment to held-to-maturity securities.

Skipping to slide 16, our GAAP and core return on tangible average common equity were 9.87% and 10.7%, respectively for the fourth quarter of 2019. The core return compares to 11.4% for the third quarter of 2019 and 9.5% for the comparable period in 2018. The modest decrease in core return on tangible equity in the linked quarter was primarily due to the previously discussed factors. Lastly, we remain well capitalized to support future growth.

To conclude, we are pleased with our 2019 results in terms of growing the business and positioning ourselves for increasing profitability. Turning to slide 17, we have outlined our expectations for 2020. This guidance assumes year-end 2019 yield curve with no change in the Fed funds target for 2020.

- Pre-tax pre-provision earnings of $70 to $78 million
- Targeting 10% balance sheet growth
- Core efficiency ratio of 64% or better

Thank you again for your time today and we look forward to updating everyone on our first quarter results in April.

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

Operator:

Thank you. We will now be conducting a question-and-answer session. If you would like to ask a question, please press star, one on your telephone keypad. The confirmation tone will indicate your line is in the question queue. You may press star, two if you would like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the star keys. One moment, please, while we poll for questions.

Alexander Twerdahl:

Just first question on the political deposits. I appreciate your commentary and expecting those to kind of level off early in the year and then decline into the election, which seems like it's pretty obvious. But do you have a sense for, one, where do you think those might decline to as we approach the election? And then, two, Drew, maybe you could remind us kind of what the implications on the margin would be when those deposits actually do flow out?

Keith Mestrich:

So sorry, on the first question, just what will the timing be on those deposit outflows? Or is that...

Alexander Twerdahl:

Yes, and then maybe where you envision -- I mean after the fourth quarter of '18 that went down -- others we're not getting in the year.

Drew LaBenne

Yes, absolutely. So the timing, if we just look back to the last cycle, it was really at the very end of Q3 and then the beginning of Q4 where we saw that outflow happen. So almost no impact on Q3. I think this cycle may or may not be different just given the number of candidates that are out there, and we're still very unclear on who's going to be the lead democratic candidate going into the election.

Keith Mestrich:

Yes. I mean, Alex, I think it's a great question. It's a little hard to try and put a specific pin in it. Our money is not all money that's being raised for the current election cycle, right? There's 6 years kind of campaign money in there. Some of the campaign committees don't spend down to 0. I think one of the important things to remember is we have adequate liquidity on the books to make sure that we can cover any runoff that there is. But it will go down substantially, several hundred million dollars, and then it should start to build up again in the first and second quarters of 2021. But pretty hard to put a real specific pin on exactly where that number lands on the middle of November.

Alexander Twerdahl:

Okay. And I mean it doesn't really matter which democratic candidate winds up carrying the ticket, right? I mean a lot of this money is PAC money and kind of not necessarily the money that's raised by the specific candidate. Am I correct in that thinking?

Ketih Mestrich:

That's right. In fact, the presidential election money is just a small portion of the overall dollars that are in the political dollars. It's money that PACs and super PACs are raising. It's money that other candidates are raising. It's money that the political campaign committees like the DNC and others are raising. So it's a variable base and -- but again, hard to put an exact pin on where it lands in mid-November.

Drew LaBenne:

And then as far as the margin impact, when it goes out, our current plan is certainly subject to change as that will backfill the outflow with borrowings in the short-term and then, hopefully, fill it back up with deposits, both political and nonpolitical -- political as the cycle starts again in terms of fundraising.

Alexander Twerdahl:

Okay. And then just in the guidance for full year net income. What -- and I appreciate the yield curve commentary. But can you just remind us maybe how you're positioned from a NIM standpoint and kind of how we should expect that NIM to progress now that all the rate cuts are kind of factored into -- seemingly all the rates are kind of now on the table now and kind of how you expect your loans to reprice, new loans coming on the books and deposit repricing?

Drew LaBenne:

Yes. So on the -- I think with the last cut, there may still be a little bit of bleed in or lag effect from that last cut coming into the next quarter. As far as assets coming on the books, it will really depend on the mix. But I can tell you, resi, multifamily, those are all coming in kind of the low to mid-3s at this point in terms of the yields that are coming on the books. So I think there's going to be pressure on asset yields as far as those asset categories. And I think some of the other assets, such as PACE have higher yields and as much as we're able to -- and I'm sure we'll talk about that more in a minute. But assuming we can add more PACE assets as well that will help to offset some of the pressure from those lower-yielding assets coming on the books. With our deposit cost, in particular, we had a 4% beta -- deposit beta cumulatively in the upcycle. So in the downcycle, we're not going to see a large amount of extensive repricing because it is going to -- it's not going to go up slow and come down fast. So I think our repricing options on the deposit side, while there are some are probably going to be more limited to some of the banks that had much higher betas in the uptrend of the cycle.

Alexander Twerdahl:

Okay. So is that kind of a long way of saying that you expect the margin to be mostly stable, maybe a little bit of downdrift early in 2020, just based on some additional bleed through from the last rate cuts?

Drew LaBenne:

I would say that there will be NIM pressure going into 2020. Let me just put it that way. I would -- I think it will be more than a couple of basis points that we'll see going forward. But you can see kind of how NIM compression happened from Q3 to Q4 that obviously had rate cuts in it. But I think we will have some NIM compression going into next year as well.

Operator:

Our next question is coming from the line of Brian Morton with Barclays.

Brian Morton:

Yes, I was hoping maybe to get a little bit more detail on your 2020 guidance? And kind of what are the factors that could drive us to the high end of the guidance? And then conversely, what could drive us to the low end?

Drew LaBenne:

No, I think balance sheet growth. And we've obviously put a 10% target out there for overall asset growth. Exceeding that asset growth, I think, could be one of the levers, obviously, that would drive earnings higher. Fee income is another opportunity for us. We are doing some work in our trust and asset management space, where that could be a spot where we could grow at a faster pace than we expect. Just so I can get the comment in there, we are still expecting runoff of that 1 fund from our Trust department. So there will be some downward pull from that fund as well, but that's factored into our guidance already. And then expenses, I think we've -- we're always looking at expenses. I think we are -- we've taken a lot of actions this year. We'll continue to look at what's possible in -- I'm sorry, in 2019, we took a lot of actions. In 2020, this year, we'll continue to look at what opportunities are out there as well.

Keith Mestrich:

Yes. And I would add too. I think just the vibrancy of our deposit growth, particularly in the noninterest-bearing space has really allowed us to keep the small amount of borrowings that we keep on the books at a very, very modest level. And as long as that pipeline, which is pretty robust right now stays robust, that will help us even though we don't have, as Drew said, a lot of downward levers that we can use in the fund pricing space, the minimization of borrowings until we see the political runoff happen will be something that I think will really guide into the higher ranges of the guidance.

Brian Morton:

Okay. Just one quick question. Did you repurchase any shares this quarter?

Drew LaBenne:

Not as much as last quarter. We purchased a little over 100,000 shares, which happened really at the beginning of the quarter and then the price moved up pretty rapidly, and we were no longer in the market repurchasing.

Brian Morton:

All right. And that totaled to how much in dollars, you're saying?

Drew LaBenne:

It was -- I think it was about a little under $2 million, $1.5 million, somewhere in that range.

Brian Morton:

Okay. Great. And then maybe my final question. Have you guys really looked into kind of the impact and timing of doing a CECL adoption?

Drew LaBenne:

Well, we know what a back-end timing is, obviously, with 2023. Part of our evaluation process is going to be looking at how smoothly CECL rolls out in Q1 for all those banks who are adopting in this next quarter here. So I think after we do that evaluation, we'll think about our timing. We're also talking to our investors as well and just trying to understand their thoughts on the timing.

Operator:

Our next question comes from Chris O'Connell with KBW.

Christopher O'Connell:

So I was hoping to drill down on some of the provision impact in this quarter. Do you have the exact impact of the PACE reclassification on the provision? And then alternatively, the impact of the single C&I loan moving to nonaccrual?

Drew LaBenne:

Yes, absolutely. So with PACE, I was waiting for a question so I could expand upon this a little bit. We did determine and we're speaking with the various constituencies that we work with that the appropriate place to put the PACE assets was in securities. The space between loans and securities for an asset like this is somewhat gray because they are bonded assessments from various municipalities, but they don't have CUSIPs. They don't freely trade in the market. But after that evaluation, we determined that moving them to the securities portfolio was appropriate. As a result of that, we released the allowance on the PACE assets that we had on the balance sheet in Q3. And that released $700,000 from our allowance related to those assets. So it's important to note that for the securities we have now we do not have any provision against them. We think they are very solid assets with very low LTVs or, I guess, assessment to values, but there's no longer any provision against those.

Keith Mestrich:

Before Drew goes on and talks about the one C&I loan, let me just add a little extra commentary on the PACE piece. Regardless if they're considered a security or a loan, we think that we are very bullish on this asset class. We like the yields. We like the mission alignment that comes with it that has additional both reputational and public relations aspect that helps us build our deposit business as well. We like the credit quality of the asset very, very, very much. We like the efficiency with which we can put these assets on the books and the lack of servicing capacity that we have to have with them. And to be very frank, now, the classification with them as a security, and this was not the driving impact in any way, but the fact that we have to set little or no allowance with them just makes them even better in our mind. So securities, loans, we like the asset class. We will continue to be bullish on them. That's why we will talk more and more about asset growth as opposed to just loan growth because we think this is an important part of our strategy moving forward. And frankly, one that we don't have a ton of competition in right now. So we feel like we've got some expertise here. This can actually be very, very valuable to our franchise. I'm going to turn it back to Drew to talk about the C&I loan.

Drew LaBenne:

Yes. So with regards to the indirect C&I portfolio as a whole, we're still just under $60 million in terms of the balances outstanding in that portfolio. And we've talked in the past about the 3 loans that had some issues in that portfolio. This is one of those 3 loans which we downgraded to nonaccrual in the quarter. It -- we built $1.7 million in specific reserves on that loan. One of the other loans actually started performing a little better, and we released $0.5 million on that loan. So net-net between to $1.2 million in specific reserves on the indirect C&I portfolio.

Christopher O'Connell:

Got it. Great. And then looking forward toward, I guess, excluding the indirect C&I reserves where the actual reserve to loan will trend toward, especially now that PACE isn't really going to be a part of the provisioning going forward?

Drew LaBenne:

Yes. If everything stays as it is today, the allowance to loans, excluding specific reserves, should generally trend downward, right? You're continuing to expand your look back period. If you have no adverse credit impacts happening, then the general trend will be probably small improvements in the factors leading to a release, and then we'll have the normal balance build on top of that, but most of our growth has been lower factor loans that we put on the books.

Christopher O'Connell:

Got it. You said earlier I guess you know what the reserve to loan is excluding the indirect C&I book right now?

Drew LaBenne:

I didn't do that math. But it's -- let me get back to you on that. I don't want to do it quick and get it wrong. But I think the specifics are about $7 million sitting in the portfolio.

Christopher O'Connell:

Got it. And then in terms of the balance sheet growth, the target of 10% for next year. Given the opportunities that you're seeing within the PACE space, and I think you mentioned partnership with Columbia Solar as well in the deck. Given the opportunities you're seeing there, what -- or how do you see that coming in between loans versus securities growth?

Keith Mestrich:

Yes, I think it's more heavily weighted to loans and PACE assessment than it is to securities. We do have some level of securities growth in our forecast for next year as well. But I think that is all subject to change in opportunities based on what we see available in the market and the relative risk-adjusted returns of those assets at the given time.

Christopher O'Connell:

Got it. I kind of was including PACE in the securities there. I guess, I kind of meant what's going to be coming into the actual loans on the balance sheet versus the PACE and securities together as a whole?

Keith Mestrich:

Yes. I think if you look at our balance sheet, we will continue, right, adding loans, both in the residential space, both from an origination standpoint and a purchase perspective. We'll continue adding loans in the multifamily space in New York. That market continues to be under some pressure post rent reform regulation, although we do have some pipeline, and we are putting additional opportunities on the books. And then in the C&I bucket, we will continue to see opportunities to do non-PACE-oriented solar and renewable energy deals that would be traditional C&I loans, commercial solar installation and other things -- and other sector we continue to be quite pleased with and seeing a lot of opportunities upcoming. And in the last quarter, and I referenced this in the beginning part of the thing, we did hire a lender who is really focused in the community development space, and we have opportunity in the affordable housing and working with other CDFI opportunities, we have a nice pipeline of activities to do there. Those feel like very traditional C&I loans. So we're not just putting everything in the sort of new securities bucket, if you will, and just relying on PACE. We like that a lot. But our lenders are very active in the renewable energy and community development space as well.

Christopher O'Connell:

Great. And just last one for me. But do you have any idea on the timing of the two branch closures in this quarter?

Keith Mestrich

Yes, they've been announced. Both branches will close at the end of February. I think actually, literally the last day of February.

Operator:

Our next question comes from the line of Steven Alexopoulos with J.P. Morgan.

Steven Alexopoulos:

Wanted to first follow-up on the NIM commentary. So if we look at loan yields and potential compression drove given the new loan yields you called out, what's a reasonable pace of loan yield compression, like on a run rate basis, if the Fed is not cutting rates?

Drew LaBenne:

Well, it's going to depend on the mix again and the prepayments that come in as well. The 12 basis points of loan yield compression that we had this quarter, a little bit of that was caused by the movement as well of PACE going into HTM securities. So I think that was a little bit elevated. We obviously had the rate cut in there as well. So I think it should be less than that, but it will depend on the pace and speed of new originations coming on. I think the other thing probably worth mentioning is, for example, when we look at multi-family prepayments, which have actually -- they're not where they used to be, but in Q4 there actually was a couple more prepayments, whereas in Q3 there were none. A lot of what is coming off the books is kind of the same rates as what's coming on the books. So it's not as though, at least in the multifamily space, we're having a big trade at this point in terms of yields rolling off and yields coming on. In residential mortgage, Q4 was a big -- as I'm sure you know was a big quarter for refi activity. And so there was a little bit of yield compression that happens there whenever you get that refinance activity in mortgage. Seems to have slowed down, but if rates continue to trend down it's the long end of the curve, I'm sure it will pick back up.

Keith Mestrich:

And Steve, I'd just as you know, I mean, although the Fed hasn't cut rates, we've lost 32 basis points in treasuries, right, over the last two weeks. So it's including two more -- 2 basis points today. So it's a tricky thing that we're looking at because some of our loans, particularly in the multi-families are pegged to that rate. So...

Steven Alexopoulos:

Right. So when you think about the NIM guidance for 2019, I think, it was 3.55% to 3.60%. You came in at the lower end of that range, but you're in the range. How are you thinking about a range of NIM? Sounds like you could have much more pressure in 2020 than in 2019?

Drew LaBenne:

Yes. And if you think about our original guidance -- that was our last guidance. So I think our original guidance was probably still 3.50% to 3.60% and that included no rate cuts. So I think we outperformed the original guidance pretty well, given what happened in the marketplace. Yes, I mean, we're not going to give guidance on NIM because there are so many factors going on. I think we are expecting our NII to grow. We are expecting our NIM to compress, but I think we will probably see that for most banks in the sector, especially if the yield curve starts -- keeps looking as it is over the past week or so.

Keith Mestrich:

Just to make the point too. I mean, I'm encouraging, Drew is encouraging our team right to think less about NIM and more about earnings and make sure that we make decisions that are good from an earnings perspective even if they may have an adverse impact on NIM in the short term. So -- and I think that's wise for us to do that, particularly as we look to balance both issues in our securities portfolio and our -- and other opportunities that we have in front of us.

Steven Alexopoulos:

Right. Okay. And then I just want to make sure I understand the commentary around PACE loans now being in securities. So you're guiding to double-digit balance sheet growth. Do you think you could do double-digit loan growth without PACE loans? And with PACE now being in securities?

Drew LaBenne:

I think it's possible, certainly. And we can -- and I say this a little bit flippantly. We could buy our way to any loan growth that we wanted to. That's not what we're going to do. We're going to be very careful on credit as we've continued to do. And we're going to make sure we're putting on at least a large portion of mission-aligned assets at the same time that have attractive risk-adjusted returns. So I do think it's possible. What we don't have this coming year or in 2020 that we had in 2019 was $177 million of indirect C&I runoff that we had to also work through in 2019. So that's a big headwind that's actually out of our way for the most part in 2020.

Keith Mestrich:

And it's obvious, but less to be said, we're not going to sort of make any sacrifice on credit, right, in order to just drive loan growth. Just not going to do that. I mean we had a loan term last night that we could

have put on the books, I'm sure, and it would have deteriorated our credit standards completely, and we're just not going to -- we're not going to do that.
And I think that's an important principle given where we are in the cycle right now, especially.

Steven Alexopoulos:

Okay. I wanted to drill deeper into the payoffs in the commercial real estate book this quarter. So one of your peer New York banks had good loan growth this quarter and called out how they had repurchased loans that they previously participated out to other banks. Are any of your paydowns from a phenomenon such as that one?

Drew LaBenne:

That -- because we don't really have any participations and maybe one in that space. So the answer would be no.

Steven Alexopoulos:

No. Okay. Got it. And then finally, good to hear you talk about expanding, right, moving forward with Boston and L.A. I assume that's in the $32 million per quarter guidance for expenses. Can you give us an update there? Where are you with hiring and when should those offices be up and running?

Keith Mestrich:

Yes. We are talking to the lead candidates in both cities. I think we're a little further ahead in Boston than we are in L.A. And my desire is to make sure I get a nice array of potential candidates to look at. So I don't want to just take the first opportunity. But I'm hopeful that we will be able to make offers to somebody at least in Boston pretty soon. A little bit negotiating depending on when availability is. But I would imagine Boston should be up and running easily in the second quarter. It would take somebody some time, right, to get a little finer things developing. L.A. is a little bit behind that. But L.A. will also have a base given our presence in California already. But we're moving aggressively on this and want to get a lead banker on. Our model has the addition of a junior banker in each city and then somebody who really deserves an account executive role to do that.

Again, stressing, we're not opening branches. So we don't have a big search that we have done to go for commercial office space and things. And so I'm looking to do this pretty quick.

Operator:

It appears we have no additional questions at this time. So I'd like to turn the floor back over to management for any additional concluding comments.

Keith Mestrich:

Thanks, operator. I just want to thank everybody for taking a little time bearing with us for the day change here. I appreciate everybody taking the time to hop on a day later. We're really happy about the quarter, and we look forward to a pretty vibrant first quarter of 2020 as well. We will talk to many of you in the coming days and see many of you at the end of April. Thank you.