Second Quarter 2022
Earnings Call Transcript

July 28, 2022

CORPORATE PARTICIPANTS

Jason Darby, *Chief Financial Officer & Senior Executive Vice President*

Priscilla Brown, *President, Chief Executive Officer & Director*

CONFERENCE CALL PARTICIPANTS

Christopher O'Connell, *Keefe, Bruyette, & Woods, Inc.*

Janet Lee, *JPMorgan Chase & Co.*

PRESENTATION

Operator

Greetings, ladies and gentlemen, and welcome to the Amalgamated Financial Corporation Second Quarter 2022 Earnings Call.

During today's presentation, all parties will be in a listen-only mode. Following the presentation, the conference will be open 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. Jason Darby, Chief Financial Officer. Please go ahead, sir.

Jason Darby

Thank you, Operator, and good morning, everyone. We appreciate your participation in our second quarter 2022 earnings call.

With me today is Priscilla Sims Brown, President and Chief Executive Officer.

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

ViaVid has made considerable efforts to provide an accurate transcription. There may be material errors, omissions, or inaccuracies in the reporting of the substance of the conference call. This transcript is being made available for information purposes only.

1-888-562-0262 1-604-929-1352 www.viavid.com

forward-looking information or statements. Investors should refer to Slides 2 and 3 of our earnings slide deck as well as our 2021 10-K filed on March 11, 2022, 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. A 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.

Let me now turn the call over to Priscilla.

Priscilla Brown

Thank you, Jason, and good morning, everyone. We appreciate your time and interest today. This morning, I will provide an update on the success that we are achieving highlighted by a quarter where we posted record earnings as we execute our growth for good strategy. Our strategy is designed to accelerate loan growth and improve our profitability while managing our risk exposure prudently and growing our positive impact on society. I will then ask Jason to provide a more in-depth review of our financial results.

The key highlights that I'd like you to take away from today's call are that we had record earnings of $0.63 per share of a full $0.18 from the first quarter of 2022, and our third consecutive quarter of nearly 5% net loan growth as our bankers generate new opportunities and we expand into new market segments. We had strong deposit growth of 4.6% to $7.3 billion and an enviable total cost of funds at 8 basis points, which is 1 basis point lower than the previous quarter. We had 27 basis points of net interest margin expansion to 3.03% and a strong increase in our return on average assets to 1.01% from 0.78% in Q1.

As I reflect on my first year as CEO at Amalgamated Bank, we have done what we said we would do. We have implemented our lending strategy and financed those investments through our earnings. We lean deeper into our mission by lending to customer segments focused on sustainability, economic justice, community financing and other social causes. We built a reliable lending platform staffed with experienced bankers, enabling us to sustain profitable growth, and we continue to develop our industry-leading deposit franchise. All of these accomplishments have resulted in a financial performance that proves socially responsible banking and profitability can coexist to create our uniquely valuable franchise.

One of our goals for this year is to become the most improved bank in the country as it relates to financial performance metrics. I want to emphasize that we are taking a disciplined approach to our growth with a keen eye on expense control and how investment decisions affect our financial targets.

As Jason will discuss further, we have worked hard to drive operational efficiencies and balance costs across the bank while adding new bankers and support infrastructure over the last four quarters.

ViaVid has made considerable efforts to provide an accurate transcription. There may be material errors, omissions, or inaccuracies in the reporting of the substance of the conference call. This transcript is being made available for information purposes only.
1-888-562-0262 1-604-929-1352 www.viavid.com

Living up to and building our brand nationally is another goal for our team, as this provides a significant competitive advantage in attracting talent to Amalgamated. You can see this in the success we had recruiting experienced executive bankers and underwriters over the last year as Amalgamated moves closer to $10 billion in assets.

Now, while we normally spend most of our time speaking about our financial performance during these calls, the world around us continues to evolve and important social issues that we care about are taking center stage. I have said since I joined Amalgamated that profitable growth grows hand-in-hand with having a positive impact on issues that matter. Therefore, I'd be remiss if I didn't spend just a few minutes on this call sharing some thoughts on some of the more important topics on which this bank has been active since we last met with you.

The Supreme Court's decision to strike down Roe v Wade had a ripple effect throughout the country. We appeared in the media to talk about our view of the impact of Court's decision. We want to hire and retain qualified women. We want to give them opportunities to advance in their careers and we want to deliver on our DEI commitment. The Court's ruling impacts not just Amalgamated's ability to do so, but many other employers. So as a financial institution we choose to lead on this issue from the perspective that our employees and their dependents have access to reproductive health care services.

Accordingly, we've decided to provide financial assistance to our employees who seek related healthcare and are supporting organizations which want to do the same. Gun violence prevention is another issue that has sadly remained at the forefront. At Amalgamated, we are strong advocates for gun safety and better enforcement of laws. To make our case, I again had a chance to speak with both CBS News and CNBC to discuss our proposal for a merchant category code for gun stores. We have this for other retailers across every other industry.

It allows us to identify suspicious activity made through the credit card network and we can alert authorities when we see it. Doing so has helped us to mitigate mortgage fraud, human trafficking, and other crimes, and we recognize our obligation to mitigate gun-related crimes as well.

The last issue I'd like to comment on is climate change. We are again taking a leadership role in this critical area because of the outsized influence the finance industry has in curbing the world's carbon consumption. By way of example, we provided affirmative commentary on the SEC's proposed climate disclosure rules as we believe strongly in the intention of the rules, and we've been managing our business in this way for quite a while.

We will continue to speak loudly and passionately regarding climate change. During the quarter, we released our 2021 Annual Corporate and Social Responsibility Report. This is our sixth edition where we showcase our environmental, social and governance efforts to customers, employees and to you as shareholders, and we announced our climate-related lending data with 31% in 2021 going to climate solutions.

ViaVid has made considerable efforts to provide an accurate transcription. There may be material errors, omissions, or inaccuracies in the reporting of the substance of the conference call. This transcript is being made available for information purposes only.
1-888-562-0262 1-604-929-1352 www.viavid.com

Given our support of these issues, I'm increasingly asked if the pursuit of advancing our mission and values could adversely impact our business. This is a natural question from the investment community in the current environment given the experience of other public companies. I must highlight that our customers deeply and passionately share our mission and our values. They care greatly about doing business with a bank that invests their deposits in line with these values. This strong customer intimacy is a true competitive advantage for Amalgamated and one that is sustainable through a number of business cycles.

While the issues I briefly touched on are complex and some rather somber, there were also some social moments to celebrate during the quarter. In May, we celebrated the contributions in influence of Asian Americans and Pacific Island or Americas to our history, culture, and achievements in the United States. Juneteenth, we celebrated another national holiday and afforded our employees a day of restoration, reflection, and strength. Pride Month also occurred during the quarter and was a wonderful opportunity to celebrate the LGBTQ+ community and advocate for continued improvement and protection of their rights. Taken as a whole, our social advocacy makes our record financial results feel all the more meaningful.

Continuing to build our brand nationally is another goal for our team. Our mission and values also provide a significant competitive advantage in attracting talent to Amalgamated. You can see this in the success that we had in recruiting experienced executive, bankers, and underwriters over the last year as Amalgamated moved closer to the $10 billion mark in assets.

As I mentioned in previous calls, our four-pillar growth for good strategy is the fulcrum for our strategic decisions. Centered on building our business through our mission, focusing on segments that share our values and where we can take market share, developing and expanding our product offerings to grow our lending platform, and improving the management of our data and technology to drive better efficiencies and effectiveness, we believe we are creating a differentiated bank.

We are now increasing our focus on that fourth pillar. In the second quarter, we recruited a highly talented individual from a major bank to lead our digital strategy, and we took steps to upgrade our information technology capabilities and talent. This sets the stage for the next phase of our strategic execution, and I'll have more to share on our planned investments during our third quarter call.

While there is economic uncertainty ahead, we remain cautiously optimistic as our bankers continue to open Amalgamated to large new markets with significant loan growth potential that we believe are less subject to economic or cyclical factors. Our loan growth and credit quality trend over the past three quarters has been exciting. Our bankers are quickly ramping their pipelines and deploying the liquidity that our deposit franchise generates to maximize risk-adjusted returns.

This market opportunity, combined with our financial performance year-to-date provides confidence in our ability to achieve the higher end of our revised earnings guidance. We will also likely exceed our high single-digit loan growth guidance for the full-year 2022. As we execute our growth for good strategy

ViaVid has made considerable efforts to provide an accurate transcription. There may be material errors, omissions, or inaccuracies in the reporting of the substance of the conference call. This transcript is being made available for information purposes only.
1-888-562-0262 1-604-929-1352 www.viavid.com

successfully, we believe that the market has begun and will continue to recognize the value in our bank. The best part is it feels like we're just getting started.

Now, let me turn the call over to Jason for greater depth on our financial performance. Jason?

Jason Darby

Thank you, Priscilla. Net income for the second quarter of 2022 was a record $19.6 million or $0.63 per diluted share compared to $14.2 million or $0.45 per diluted share for the first quarter of 2022. The $5.4 million increase for the second quarter of 2022 compared to the preceding quarter was primarily driven by an $8.1 million increase in net interest income, partially offset by a $0.6 million increase in provision for loan losses, a $0.6 million loss on sales of securities and a $2 million increase in income tax expense related to our increased pretax income.

Beginning on Slide 5, we did not make any additional solar tax-equity investments during the second quarter of 2022 and maintained a total of three solar tax-equity investments. Since these investments are mission-aligned and offer attractive returns over time, we expect to make more solar investments in the future. Because of the income statement volatility associated with the accounting for these investments, we believe metrics, excluding the timing impact of tax credits or accelerated depreciation, is a helpful way to evaluate our current and historical performance.

Exclusions related to solar tax-equity investments were a $0.9 million loss in accelerated depreciation for the second quarter of 2022 compared to $0.1 million of tax credits in the first quarter of 2022. Core net income, excluding the effect of tax credits and accelerated depreciation from our solar investments, a non-GAAP measure, for the second quarter of 2022 was $20.9 million or $0.67 per diluted share compared to $14.3 million or $0.45 per diluted share for the first quarter of 2022.

Turning to Slide 7. Deposits at June 30, 2022 were $7.3 billion, an increase of $317.7 million from the first quarter of 2022. Non-interest-bearing deposits represent 56% of average deposits and 54% of ending deposits for the quarter ended June 30, 2022, contributing to an average cost of deposits of 8 basis points in the second quarter of 2022, a 1 basis point decline from the previous quarter.

Deposits held by politically active customers were $1.3 billion as of June 30, 2022, an increase of $131.5 million as compared to $1.1 billion as of March 31, 2022. Although difficult to predict, we anticipate political deposits to rise by another $100 million to $150 million during the third quarter and then run off approximately $500 million to $600 million in the fourth quarter when the congressional elections conclude.

Turning to Slide 11. Total loans, net of deferred loan origination costs at June 30, 2022 were $3.6 billion, an increase of $178.2 million or 5.1% compared to March 31, 2022. The increase in loans primarily driven by a $92.9 million increase in residential loans, mainly from direct originations, a $39.8 million increase in multifamily loans, a $36.9 million increase in our consumer and other loans due to solar loan originations

ViaVid has made considerable efforts to provide an accurate transcription. There may be material errors, omissions, or inaccuracies in the reporting of the substance of the conference call. This transcript is being made available for information purposes only.
1-888-562-0262 1-604-929-1352 www.viavid.com

from existing flow arrangements and a $19.2 million increase in commercial and industrial loans, offset by a $13.2 million decrease in the commercial real estate portfolio as we selectively derisk our exposure in metropolitan areas.

Our continued focus on credit quality improvement in the commercial portfolio resulted in $15.6 million of payoffs of criticized loans in addition to certain other pass grade loans. The yield on our total loans was 3.86% compared to 3.85% in the first quarter of 2022.

On Slide 12, net interest margin was 3.03% for the second quarter of 2022, an increase of 27 basis points from 2.76% in the first quarter of 2022. The significant increase in yields was a result of increases on floating rate yields from interest-earning assets, while cost and interest-bearing liabilities remained flat. Prepayment penalties earned as loan income added 2 basis points to our net interest margin for the second quarter of 2022 as compared to 3 basis points in the first quarter of 2022.

Core non-interest income, excluding the effects of tax credits and accelerated depreciation from our solar investments was $8.7 million for the second quarter of 2022 compared to $7.2 million in the first quarter of 2022. The increase of $1.5 million was primarily related to onetime beneficiary income on BOLI, as well as higher gains on sale of nonperforming commercial loans.

Non-interest expense for the second quarter of 2022 was $34.3 million, a decrease of $0.1 million from the first quarter of 2022. The decline of $0.1 million from the preceding quarter is primarily driven by a $0.9 million decrease in data processing expense related to the pass-through of certain trust department operating expense to related funds, offset by an expected $0.3 million increase in compensation and employee benefits and a $0.4 million increase in residential lending foreclosure expense.

Moving to Slide 16. Non-performing assets totaled $65.3 million or 0.82% of period-end total assets at June 30, 2022, an increase of $4.2 million compared with $61.1 million or 0.80% of period end total assets at March 31, 2022. The increase in non-performing assets was primarily driven by the restructuring of $6.5 million in loans that are part of one borrower relationship as well as two loans totaling $5.2 million that were moved to nonaccrual in the second quarter of 2022, partially offset by one $3.5 million nonaccrual multifamily loan that was paid off. While non-performing assets increased, overall credit quality improved as criticized assets declined $43.5 million or 24.3% to $135.8 million on a linked-quarter basis.

The allowance for loan losses increased $2 million to $39.5 million at June 30, 2022, from $37.5 million at March 31, 2022, primarily due to increases in loan balances, offset by improved credit quality. At June 30, 2022, we had $60.1 million of impaired loans for which a specific allowance of $6.1 million was made compared to $58.2 million of impaired loans at March 31, 2022, for which a specific allowance of $4.6 million was made. The ratio of allowance to total loans was 1.08% at June 30, 2022, and 1.08% at March 31, 2022.

ViaVid has made considerable efforts to provide an accurate transcription. There may be material errors, omissions, or inaccuracies in the reporting of the substance of the conference call. This transcript is being made available for information purposes only.

1-888-562-0262 1-604-929-1352 www.viavid.com

Provision for loan losses totaled an expense of $2.9 million for the second quarter of 2022 compared to an expense of $2.3 million in the first quarter of 2022. The increase in the provision expense on a linked quarter basis is primarily driven by a specific reserve from the downgrade of one legacy commercial and industrial loan.

Moving along to Slides 17 and 18, our core return on average equity and core return on average tangible common equity, excluding the impact of solar tax-equity investments were 16.2% and 16.8%, respectively, for the second quarter of 2022. We repurchased $8.8 million of common stock under our $40 million share repurchase program that we announced during the first quarter. We also announced a $0.02 increase to our quarterly dividend, raising it to $0.10 per share. Importantly, we remain well capitalized to support our ongoing growth initiatives.

Slide 19 shows a reconciliation of the change in tangible common equity and related tangible book value. As expected, during the second quarter, the Federal Reserve Board continued its cycle of interest rate increases with a 50 basis point increase at the May meeting, a 75 basis point increase at the June meeting and a 75 basis point increase at yesterday's July meeting. The increases were expected and follow the initial 25 basis point increase at the March meeting, which began the current cycle. Further, the Board messaged the increasing likelihood for additional rate increases through the remainder of 2022 with a potential retraction in 2023.

As a result of long-term interest rates rising significantly during the quarter, our tangible book value per share declined by 4.6%, primarily driven by a tax-affected mark-to-market adjustment to the fair value of our available-for-sale securities portfolio. While we are cognizant of our decline in our tangible common equity, we are comfortable with our average tangible common equity at 6.07% for the fourth quarter, which was a modest decline from 6.68% from the previous quarter. Additionally, to reduce exposure to further interest rate volatility, we also transferred $277.3 million of available-for-sale securities to held to maturity during the quarter.

We will continue to drive earnings through prudent deployment of our liquidity and believe our strong on-balance sheet liquidity position, borrowings capacity and low-cost deposit gathering franchise well protects us from the realization of these recent market price declines. Importantly, fluctuations from mark-to-market adjustments have no impact on our Tier 1 capital position. As a reminder, and evident through our strong second quarter earnings performance, the current rising rate environment provides a significant benefit in net interest income to Amalgamated, which I will discuss further in a moment.

Turning to Slide 20. We are now seeing the benefits of executing on our growth strategy through a combination of deployment of liquidity and securities and increasing loan originations to drive earnings. Additionally, our asset-sensitive balance sheet structure was a significant factor in our record earnings in the second quarter as rates have materially risen. Although the forward curve suggests substantial rate increases through the remainder of 2022, we are leaving our full-year 2022 guidance unchanged as there is much economic uncertainty looking forward to the second half of the year.

ViaVid has made considerable efforts to provide an accurate transcription. There may be material errors, omissions, or inaccuracies in the reporting of the substance of the conference call. This transcript is being made available for information purposes only.

1-888-562-0262 1-604-929-1352 www.viavid.com

That said, we feel confident that we will achieve the high end of our proposed ranges of core pretax pre-provision earnings of $110 million to $120 million, which considers the effect of the forward rate curve for the remainder of 2022 and net interest income of $220 million to $230 million, which considers the effect of the forward rate curve for the remainder of 2022.

Generally speaking, we estimate a range of $4 million to $4.5 million increase in annual net interest income for each 25 basis point increase related to yesterday's Fed decision and a range of $3 million to $4 million increase in annual net income for each 25 basis point move in short-term forward curve rates for the remainder of this year.

As Priscilla noted, we are thrilled with the bank's record second quarter results and the consistent loan demand we've experienced is further supported by our robust loan pipeline as we look to the second half of the year.

In addition, our balance sheet remains well positioned for rising rates, and we expect our deposit beta to remain low and in line with prior interest rate tightening cycles, which points towards continued margin improvement and earnings growth as we look to the second half of the year.

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

Operator

Our first question comes from the line of Chris O'Connell with KBW. Please proceed with your question.

Christopher O'Connell

Good morning. I just want to start on the PPNR and NII guide. I guess I am a little surprised that it didn't increase, either on both the rate hikes through June relative to the ranges before with just the March hike? Then also on the forward curve for 2022, which has also gone up since last quarter. So, I was just hoping to get any color around that?

Jason Darby

Sure. I think right now, at the last quarter when we gave the guide, we gave a fairly wide range. Moving us to the top end of the range in this particular quarter felt appropriate at this time. I think the biggest thing that we are still cautious of is exactly what's going to happen with the rate environment even as the forward curve predicts, there's never any absolute certainty where the Fed is going to move in terms of the upcoming rates. I think that's kind of one thing to think about.

Then the other is that is there going to be a behavior in deposit expense or deposit beta that might be different than what we've seen in the past. So, I think we just try to take a little bit more of a conservative

ViaVid has made considerable efforts to provide an accurate transcription. There may be material errors, omissions, or inaccuracies in the reporting of the substance of the conference call. This transcript is being made available for information purposes only.
1-888-562-0262 1-604-929-1352 www.viavid.com

approach in the kind of the update to our guidance for this quarter. But we do feel very strong that the top end is attainable and there's certainly potential for it to exceed if things continue on a current trajectory.

Christopher O'Connell

Okay, got it. On the deposit beta front, what are you guys assuming in the guidance? Do you have plans to move up deposit rates this quarter? And if so, any magnitude or quantitative color would be great.

Jason Darby

Yes. That's fine. I's interesting because we really didn't have a cost of funds change in the second quarter. If you think about beta in that sense, there was almost no move to it. But we know that that's not going to hold. We actually did do some deposit repricing in the middle part of June and you'll start to see that deposit interest expense take hold as it moves throughout the second half of the year. I think in our model, the implied beta on that simple deposit reprice was about 5%. But we look at it kind of at a 10% blended total cost of funds for the first 75 basis points that we just saw yesterday.

Then any incremental rates we're modeling out at 25% total cost of funds beta. So that might be a little bit conservative. But again, us not really knowing how the whole situation is going to play out, we want to take the most conservative assumptions possible in deposit betas past this recent 75 basis point rate rise.

Christopher O'Connell

Okay, that make sense. For the political deposit moves, what are your expectations on how to fill the gap in the fourth quarter there? Are you going to be trying to let cash or assets run off? Or do you expect to utilize short-term borrowings until the pickup in the next quarter?

Jason Darby

Great question. Right now, we're definitely seeing balance sheet contraction, or we are modeling, I shouldn't say definitely, we're modeling balance sheet contraction for the fourth quarter as the political deposits run off as the congressional elections conclude. That said, we're not really seeing any need to get into borrowings. We feel the combination of the, let's call it, $500 million we have in cash right now, $230 million or so of that is in short-term maturing repo agreements that, or resale agreements, that we see turn to cash as we head into the fourth quarter to fund the growth initiatives.

Then any offsets to growth that we would need that isn't funded through cash, we still think we're going to have modest non-political deposit growth through our normal customer channels. In the event that we still need additional cash to support growth initiatives, we have a fairly significant amount in our short-term AFS portfolio that we could trade out of, at close to par value. So, we feel on a liquidity basis, we're pretty well covered and that the likelihood of borrowing is fairly small.

ViaVid has made considerable efforts to provide an accurate transcription. There may be material errors, omissions, or inaccuracies in the reporting of the substance of the conference call. This transcript is being made available for information purposes only.
1-888-562-0262 1-604-929-1352 www.viavid.com

Christopher O'Connell

Okay, that's helpful. If you could just go through what the loan origination yields are coming on at now and where you see the drivers of loan growth in kind of the back half of the year?

Jason Darby

Sure. The yields have been pulling up as we're bringing loans on. Our yields kind of were flat a little bit this quarter, and that's mainly the result of a couple of our portfolios having a little bit of a lower yield than the previous quarter. So, when we think about kind of what's coming on right now, we're still seeing multifamily coming on in the low to mid-4s right now. Our PACE is rising to sort of mid-4 or maybe even in the upper mid-4 range right now and the solar that we're doing is still in the 5 to mid-5 range. So, we're seeing a lift kind of across the board on the assets that are coming on, and I would expect our loan yield to continue to pull up as we get into the following quarters.

Christopher O'Connell

All right. Similar drivers of growth in the back half of the year that you guys have seen so far in the first half?

Jason Darby

Yes, I would say the mix of the growth might flip a little bit. I think we've been heavily led by resi and consumer in the first half of the year. We may take a little bit more of a hawkish view on resi and consumer as we get into the second half of the year just to make sure that there's no fractures in the consumer market or in consumer sentiment that would maybe prevent us from being able to lend a little bit more aggressively.

So, I would expect that maybe to be a little bit of a slower growth rate in the second half and maybe a little bit more of a pickup on the commercial and the C&I space to fill the growth, particularly in the multifamily and in the C&I space, not so much in CRE. I think we're still very, very cautious in CRE and not really actively moving in that space probably for the rest of this year.

Christopher O'Connell

Okay. Then if I could just do one last one. You guys made a number of comments on credit items. One, the derisking of the CRE, what metro areas? I guess, where and what types of CRE? It seems like you're backing off the whole asset class. So, maybe just kind of the thought process there? Then, do you see any loss content in some of the NPAs and non-accrual pick-ups this quarter and just framing what drove the classified early criticized asset decline?

Jason Darby

ViaVid has made considerable efforts to provide an accurate transcription. There may be material errors, omissions, or inaccuracies in the reporting of the substance of the conference call. This transcript is being made available for information purposes only.

1-888-562-0262 1-604-929-1352 www.viavid.com

Yes. So, I'll take the CRE side of it first. The majority of our CRE is centered in the Manhattan market. Really, we don't have that much that's outside of our core geographies, which also includes San Francisco, D.C. and Boston. I don't believe we have any CRE in Boston and maybe a very, very small amount in D.C. But I think more importantly, it's really the office space that we've got our eyes on and making sure that the properties that we have are properties that are going to be able to withstand an economic downturn.

So, when we look through office right now, we have about, let's say, $140 million in our CRE portfolio that is office. That's really the asset class within CRE that we're watching and kind of taking a very cautious approach on. We have actually done a CRE deal, an office deal during this quarter for about $7 million. So, I wouldn't say that we're out of that business. It's just we want to make sure we're finding the best quality deals you can find with strong security.

But back to kind of those office deals, right now, of that $140 million, every one of them is in a pass grade situation right now that we're watching. I'm sorry, everyone except for one. One is a special mention. So, from a performance point of view, they're all paying and none of those particular assets are trending towards non-performing or non-accrual at this time. But again, I think we're just taking a cautious approach on the portfolio overall and selectively refinancing away credits that we don't think would be strong in an economic downturn.

Then kind of moving towards the question on non-performers, I think we had a little bit of an uptick in our non-performers. I think it's largely driven by the restructuring of one asset that's part of our legacy leverage portfolio from years ago that we kind of sold down as much as we possibly could. It's one of the last four credits that we have. We did a modification on that particular deal. The good news is that the deal is it's still paying. We only have a very small reserve that's set up against that particular credit. It's about $6.5 million of book balance.

Really, the modification, we kept it as an accruing TDR, but the modification is just designed to extend the term on this credit as the equity sponsor is working at a company sale. So, we feel pretty good about our ability to be repaid in full on that particular deal. I think that's the primary driver of our nonperforming uptick for this quarter. Otherwise, I felt like we were stable to even slightly down in terms of the asset move.

Christopher O'Connell

Just the criticized asset decline driver?

Jason Darby

Oh, I'm sorry, criticized asset decline driver. Right. So that, again, I think this is us really getting through a lot more of our portfolio reviews. I think, again, this is a little bit of a function of us being overly critical on

ViaVid has made considerable efforts to provide an accurate transcription. There may be material errors, omissions, or inaccuracies in the reporting of the substance of the conference call. This transcript is being made available for information purposes only.
1-888-562-0262 1-604-929-1352 www.viavid.com

certain credits during our COVID period and moving a lot of assets into a substandard category, even though technically, they were still performing and still accruing. I think kind of being in that spot led us to a place where moving credits down or back to pass grade was probably a more likely outcome than the fact of them staying in substandard.

But, I also hand it to our credit team, and I really give a lot of credit to the credit folks and also the new relationship bankers that we brought on board. They've really gone through the portfolio and done the annual analysis and gotten with these customers to make sure that these credits are, in fact, what we think they are and that's been a huge driver for us being able to kind of continue to move that criticized asset quality back to a normal space.

When I look at the remainder, I still think there's about $50 million to $75 million of room for improvement. I don't think we'll continue to improve at this clip because the numbers are just shrinking. But between what we have in classified and criticized and what's already reported as nonaccrual, there's about $75 million in total assets there, Chris. I think there's a space within that, between that $50 million and $75 million, where we can continue to see criticized improvements. That's, of course, barring any movements to the other direction.

Christopher O'Connell

Great. That’s all I had. Thank you.

Jason Darby

Thanks Chris.

Operator

Our next question comes from the line of Janet Lee with JPMorgan. Please proceed with your question.

Janet Lee

Hello. I want to start with the noninterest-bearing deposits. I know that there is some seasonality to your deposits given political. So, in the second quarter, your noninterest-bearing deposits were 54% of your total. Given the ongoing that's quantitative tightening, where do you think this number will go by the end of next year?

Jason Darby

I'm sorry, by the end of next year, meaning 2023?

Janet Lee

ViaVid has made considerable efforts to provide an accurate transcription. There may be material errors, omissions, or inaccuracies in the reporting of the substance of the conference call. This transcript is being made available for information purposes only.

1-888-562-0262 1-604-929-1352 www.viavid.com

Right.

Jason Darby

I'm sorry, just to make sure I got your question. So, you're talking about the mix between our DDA and IBA by the end of 2023?

Janet Lee

Non-interest-bearing deposits to total deposits.

Jason Darby

Yes. So, I would love for this ratio to stay at 54%. I do think it'll normalize back to 50-50, maybe even slightly below. I really haven't modeled it out, so I'm sort of taking a little bit of a flyer on this. But I think for us to get below 45%, there would be a pretty significant shift in the overall mix. The other thing is I think we're somewhat insulated from a move to rate because we're able to drive so much through fundraising. In a lot of cases, the fundraising activities are less sensitive to rate and kind of more placement in terms of the bank that is lining up with the values of whatever the fund raise is for.

So, when we think about kind of overall interest expense, it's certainly going to change. It will definitely change too as the political deposits run off heading into the fourth quarter because that's a significant chunk of the DDA. But as we've seen in the past, we've been able to rebuild the political deposit base pretty well. Our normal segmented customers really are very tuned into being able to bank with the bank and a little bit less so on rate. I don't know, Priscilla, if you have anything you want to add on the nature of the company.

Priscilla Brown

No, I think that's absolutely right. They're with us because they want to be here and are not thinking of these deposits as much. There's still a fairly low interest rate environment as being as much of a driver of their—the rate being a driver of their participation.

Janet Lee

All right. That's helpful. Just to clarify on your resi loan comment before, are you still expecting growth in this area in the back half, but at a slower pace? Or do you expect this line item to see declines in the back half of 2022? Can you also comment about the demand for consumer solar loans and whether this is more resistant to sort of the economic ebbs and flows?

ViaVid has made considerable efforts to provide an accurate transcription. There may be material errors, omissions, or inaccuracies in the reporting of the substance of the conference call. This transcript is being made available for information purposes only.
1-888-562-0262 1-604-929-1352 www.viavid.com

Jason Darby

So, on my resi comment, I think we'll still grow. I think it will be at a slower pace than what we've been able to do in the first half of the year. So, I don't think we're going to be in a declining portfolio position. I think the origination pipeline that we've generated and the team that we have in the residential space is strong. I think also it will be a bit of a product of us connecting our consumer business to our commercial franchise under our common leadership of our Chief Revenue Officer.

I think business banking, in general, is going to be something that we're looking a little bit more, as we get into the back half of this year and teeing up the business for the future years to come. So, I don't see us as kind of shutting down the business or going in a negative direction. I just think it will be much slower in the second half of the year than the first. But I would not signal, and I hope I didn't that we're exiting or just going to stop completely on the resi side.

On the consumer, I think the demand has still been there. I think we're kind of thinking of consumer solar very similarly, watching credit standards, right? I don't think we've been in a spot where we're willing to lower standards to get some volume. We've seen some more competition that's entered the market for some of the flow. In certain cases, we've passed. In other cases, we've been able to stick to what we've expected or what we want in terms of credit quality or credit security on those deals.

But again, kind of looking into the second half of the year and with the consumer being a significant question mark, I think we'll be very cautious about the quality of the packages that come off these flow arrangements. But I don't think we'll be exiting that business either, just might be at a much slower pace.

Janet Lee

Okay. That’s helpful. Can you comment on the trajectory of NIM assuming the forward curve through 2023? I know there's a lot of things that come into play, but just combining the fact that your earning asset yields are going to keep going up and then if your deposit cost increases, but probably obviously at a lagging pace versus earning asset yields, can we still see NIM expansion continuing through the end of 2023?

Jason Darby

Yes. Very difficult to predict. But I do feel comfortable that we should see continued expansion in the NIM. Where that tops out at, I'm not exactly sure of it. Where we're sitting at 3.03% right now, I think there’s still room to move on the upside from a NIM expansion point of view. I think the primary drivers there are there's still pull-through that's going to happen on the yield side from our loan portfolio.

I don't think we've seen all the full effect of some of the bookings we've had at higher rates towards the second half of this quarter. So, you'll start to see that coming through. I think there's still a mix process

ViaVid has made considerable efforts to provide an accurate transcription. There may be material errors, omissions, or inaccuracies in the reporting of the substance of the conference call. This transcript is being made available for information purposes only.
1-888-562-0262 1-604-929-1352 www.viavid.com

that will occur in the back half of the year as we shift a little bit out of our securities portfolio and more into loans. So, in that sense, I think there's an opportunity to expand the top line of the NIM.

Obviously, the deposit expense will rise, and it's a little bit difficult to predict. But if past betas proved to be reflective of current betas, I think the margin could benefit quite nicely from that. I think one last thing that could contribute to margin expansion would be a little bit of balance sheet contraction as we get into the fourth quarter. Right now, we still have excess deposits. We're carrying on average about $200 million, probably more than we would like and we would see that cash balance coming down, deposits coming down in the fourth quarter with the political run-off and that should free up a little bit of margin return as well.

Priscilla Brown

The only thing I would add to that is just to maybe to give the historical view, when we look back to that 2017, 2018 time period, our deposit beta was only 3% compared to the market at approximately 20%. So, we don't see any reason why our deposit betas should behave differently from that past rate rise cycle because our customer mix is essentially the same as it was back then.

Janet Lee

Okay. I don't know if this was covered if it was, I apologize. So, the expense $138.5 million is that still maintained for full year 2022?

Jason Darby

Yes. I think we've been a little bit ahead of where we thought we'd be in terms of expense management on the good side. We're still expecting some pressure to come through on our compensation and benefits lines and some other investments that we're looking to make in infrastructure to help keep this business well positioned for growth and thinking about $10 billion down the road and the type of infrastructure we need. So, we're going to keep making those investments.

I think the target of that $138.9 million or $139 million is very good. If we come in under, it will probably be just on run rate saves through data processing which we're hopeful for. But right now, we're still sticking on the target. So, we might see some quarterly expense expansion in Q3 and Q4 from where we've come in for the first two quarters.

Janet Lee

Okay, great. Thanks.

Jason Darby

ViaVid has made considerable efforts to provide an accurate transcription. There may be material errors, omissions, or inaccuracies in the reporting of the substance of the conference call. This transcript is being made available for information purposes only.
1-888-562-0262 1-604-929-1352 www.viavid.com

You're welcome.

Operator

We have reached the end of the question-and-answer session. I'll now turn the call back over to Ms. Priscilla Brown for closing remarks.

Priscilla Brown

Thank you, Operator, and thank you, everyone, for joining our call this quarter. We look forward to working with you to answer your questions individually as we move through the next few days. Have a good day.

Operator

This concludes today's conference. You may disconnect your lines at this time. Thank you and have a good day.

ViaVid has made considerable efforts to provide an accurate transcription. There may be material errors, omissions, or inaccuracies in the reporting of the substance of the conference call. This transcript is being made available for information purposes only.
1-888-562-0262 1-604-929-1352 www.viavid.com