Fourth Quarter and Full Year 2018 Earnings Call Transcript

January 29, 2019

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PRESENTATION

Operator:

Greetings and welcome to Amalgamated Bank's Fourth Quarter and Full Year 2018 Earnings Conference Call. At this time, all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation. If anyone should require Operator assistance during the conference, please press star, zero on your telephone keypad. As a reminder, this conference is being recorded.

I would now like to turn the conference over to your host, Drew LaBenne, Chief Financial Officer. Please go ahead.

Drew LaBenne:

Thank you, Operator, and good afternoon, everyone. We appreciate your participation today in our Fourth Quarter and Full Year 2018 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 through 11:59 P.M. Eastern Time on February 5, 2019. Additionally, a slide deck to complement today's discussion is available on the Investor Resource 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 forward-looking information or statements. Investors should refer to Slide 2 of our earnings slide deck, as well as our final offering circular dated November 13, 2018 and our 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. Good afternoon, everyone. We appreciate your time and attention today. I am very proud of our results as 2018 was one of the best years in Amalgamated's nearly 96-year history, highlighted by the closing of our acquisition of New Resource Bank in May, the completion of our initial public offering in August, the de-risking of our balance sheet away from indirect relationships and leveraged loads, a significant year-over-year increase in our net interest margin, and the launch of our foundation. Achieving these significant milestones would not have been possible without the tireless effort of our employees who I'd like to thank for helping us to accomplish so much this past year.

Signs of our success can also be seen in our financial results where we delivered fourth quarter net income of $8.4 million or $0.26 per diluted share as compared to a loss of $23.6 million or $0.13 per diluted share for the year-ago quarter. Given the one-time costs which we are experiencing largely as a result of our acquisition of New Resource Bank, we believe core earnings is a better gauge of our financial performance, as well as the run rate earnings power of the Bank.

For the fourth quarter, core earnings were $9.7 million or $0.30 per share as compared to $4.8 million or $0.17 per share in the fourth quarter of 2017. Core earnings in the fourth quarter of 2018 excludes $1.6 million of expenses related to the New Resource Bank acquisition and other more minor one-time adjustments. Additionally, fourth quarter 2018 net income was impacted by a few unusual items, including a one-time adjustment to write off approximately $800,000 of an accrued interest receivable from the fourth quarter of 2017 which impacted earnings per share by $0.02. We also experienced a one-time tax adjustment due to a decrease in our deferred tax asset which impacted earnings per share by a penny. Lastly, we increased our bonus accrual for 2018 by $1 million in order to properly reward the many employee at Amalgamated who have contributed so much to our successful year and our multi-year recovery from the financial crisis. The additional accrual impacted earnings by $0.02 per share. Taken together, adjusted core earnings per share for the fourth quarter of 2018 were $0.35.

A highlight of the quarter was the continued strength of our Deposit franchise, as we grew deposits 7.2% annualized from the third quarter and 27% for the full year of 2018. Importantly, we experienced minimal repricing through the year as our cost of funds held relatively steady at 27 basis points in the fourth quarter, up only 2 basis points from the third quarter of 2018 and 1 basis point from the year-ago quarter. We continue to benefit from what is one of the lowest cost Deposit franchises in the industry and a key driver of the Bank's strong profitability.

Our deposit pipeline as we get into 2019 remains very strong and we have already seen a few large relationships commit to moving to the Bank this year.

In the fourth quarter, our net interest margin was 3.57% compared to 3.65% in the third quarter and 3.22% compared to the comparable year-ago quarter. As I previously mentioned, our NIM was impacted by a one-time adjustment to write off approximately $800,000 of accrued interest receivables from the fourth quarter of 2017. This adjustment lowered our reported net interest margin by 7 basis points. As a result, and despite the runoff in political deposits during the quarter, our adjusted NIM was 3.64%.

Loan growth was also solid, rising 5.9% annualized in the fourth quarter as compared to the linked quarter, and up for over 15% for the full year 2018 as compared to 2017. This growth was achieved despite our continued success reducing our indirect C&I portfolio, part of our effort to further de-risk our balance sheet. For 2018, we reduced our portfolio by $334 million, which was ahead of our expectations. As Drew will discuss, we will continue to reduce our exposure, so we expect the pace of run off to moderate through the first half of 2019.

As we look to the year ahead, we believe that our business model is uniquely positioned for growth as we work to service the needs of value-based institutions. At Amalgamated, we believe that a financial institution's mission should include using its sources, money, and influence to help move society forward. We are selected to be the banking partner for individuals and companies who share our mission, allowing us to support their financial goals. Consumers, stockholders, and workforces are holding companies to higher levels of social responsibility and requiring them to focus on contributions over and above simply delivering profits and value for shareholders. We consider ourselves industry leaders in this regard and work hard every day to continue to earn our reputation as America's socially responsible bank.

Our market potential is significant. We only have a sliver of what we estimate to be a $90 billion commercial deposit opportunity. Today our core markets are New York City, Washington D.C., and San Francisco where we operate 14 branches as well as commercial banking offices. In our current markets there are thousands of values driven and socially responsible businesses and individuals who are aligned well with Amalgamated's core values. The strength of our brand in these markets can be seen in our Deposit franchise, which has experienced 13% compounded annual growth from 2015 through 2018 while maintaining a low and stable cost of funds over that time period of 24 basis points on average.

Our expansion to San Francisco through the acquisition of New Resource Bank is a significant step in the successful execution of our growth strategy and a key milestone in the history of our Bank. This transaction has provided us access to a very attractive market, as well as a team of lending experts who have significant experience in industries, including renewable energy, sustainable agriculture, affordable housing, and energy efficiency lending. To maximize this opportunity, we have relocated New Resources' former Chief Credit Officer to New York to lead our Relationship Banking Team. I'm very pleased that between the closing of the acquisition in the spring and year-end 2018 we have seen an increase of over $170 million in loans through the industries that the former New Resource Team specialized in. We are seeing the origination in new loans outside of California in Amalgamated's other geographies and we are seeing an upsizing of the facilities utilizing Amalgamated's bigger balance sheet. Looking forward, our direct C&I pipeline is strong.

We also see an opportunity to drive deposit growth and cross sell many of Amalgamated's services in San Francisco, such as our treasury management capabilities and our trust products. Like our direct C&I pipeline, our deposit pipeline is also robust. In November we completed the conversion of all of New Resources' core technology and did a complete brand integration. Both efforts were executed smoothly and resulted in minimal customer disruption and negligible customer loss. The integration of our teams has also gone smoothly and I am very proud of both team's efforts and contributions. Importantly, we have developed an expertise and a playbook from the successful execution in the merger which we can use in future deals.

As I've mentioned previously, we see many attractive geographies for expansion, including Boston, Chicago, Los Angeles, and Seattle where there are institutions that hold a similar vision, mission, and values as Amalgamated. We are continuing to explore potential M&A opportunities, though the timing is always uncertain. Importantly, we will be opportunistic and disciplined acquirers.

To conclude, I am pleased with the progress that we have achieved and I'm excited to continue this journey with our team into 2019. For the year ahead, our priorities are clear: one, continue to drive organic growth in our core markets of New York, D.C., and San Francisco; two, continue to grow our enviable Deposit franchise; three, build our Political Banking franchise into the 2020 presidential election. Of note, we are currently banking the majority of announced presidential candidates; four, continue to replace the indirect C&I runoff with loan growth from new industry verticals; five, remain committed to

doubling the loans and securities in the sustainable industries that New Resource Bank focused on and which we now have considerable expertise; six, continue to look for smart acquisitions where we can replicate our franchise; and seven, and lastly, continue to look for opportunities to improve our efficiencies.

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

Drew La Benne:

Thank you, Keith. I'll 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 4, in the fourth quarter, deposits increased $72.5 million, or 7.2% annualized, to $4.1 billion from the third quarter of 2018 while average deposits for the quarter were $4.0 billion. Our fourth quarter deposits included $326.7 million of short-term deposits from one customer that has since moved off our balance sheet. As a result, our deposits beginning 2019 are $3.8 billion.

As expected, non-interest-bearing deposits declined from the prior quarter due to seasonality related to the election cycle and now represent 38% of average deposits at year-end. Of note, our deposit beta was negligible throughout the fourth quarter as our cost of funds remained relatively stable at 27 basis points, demonstrating the value of our unique Deposit franchise.

Deposits from politically active customers, such as campaigns, PACs, and state and national party committees, decreased $215.9 million from $397.8 million at September 30, 2018, ending the year at $181.9 million, as outlined on Slide 5. Importantly, the trough in our political deposits this election cycle is much higher than the 2016 election cycle where political deposits troughed at approximately $60 million. This trend is particularly encouraging as we look to the 2020 presidential race, and, as Keith highlighted, we are well-positioned to actively support the business needs of Democratic candidates who are officially launching their campaigns.

As seen on Slide 6, we delivered fourth quarter loan growth of $47.0 million, or 5.9% annualized, as compared to the third quarter of 2018, and ended the year with $3.2 billion of total loans. Loan growth was driven primarily by a $65.8 million increase in residential first liens, the purchase of $42.2 million in residential solar loans, and the purchase of a $35.0 million commercial solar pool, offset by approximately $68.7 million of run off of our indirect C&I portfolio and a $28.9 million reduction in our CRE portfolio, driven by a prepayment of our largest multifamily real estate relationship.

Looking to 2019, we forecast the pace of indirect C&I runoff to be approximately $125 million, though there could be substantial variance in that estimate. The yield on average earning assets was 3.95% for the fourth quarter, an increase of 33 basis points as compared to the same period in 2017, driven by rising rates increasing the yield on those assets. The yield on our total loans remains essentially constant at 4.32% compared to the third quarter of 2018. The fourth quarter yield on loans was reduced by 10 basis points due to the previously mentioned accounting adjustment.

Skipping ahead to Slide 8, the credit quality of our portfolio held steady throughout the fourth quarter as nonperforming assets totaled $59.3 million or 1.27% of period-end total assets at December 31, 2018, which was a modest increase of $1.3 million from the linked quarter and a decrease of $29.8 million as compared to December 31, 2017.

The provision for loan losses in the fourth quarter of 2018 was $900,000, which compares to $800,000 of provision in the third quarter of 2018. The provision expense in the fourth quarter was primarily driven by an increase in classified loans partially offset by overall improvements in the historical loss factors.

Turning to Slide 9, the allowance for loan losses increased $800,000 to $37.2 million at December 31, 2018 from $36.4 million in the linked quarter, primarily driven by an increase in the allowance on classified loans, partially offset by improvement in historical loss factors. At December 31, 2018, the Bank

had $58.3 million of prepared loans for which a specific allowance of $9.6 million was made compared to $57.0 million in prepared loans in the linked quarter for which a specific allowance of $9.8 million was made. The ratio of allowance to total loans was 1.15% at December 31, 2018 and 1.14% at September 30, 2018.

Turning to Slide 10, our net interest margin was 3.57% for the quarter, a decrease of 8 basis points from the third quarter and a year-over-year increase of 35 basis points. Net interest margin was impacted by five basis points due to the accretion of the loan mark from the loans acquired in the New Resource acquisition which compares to a 6-basis-point impact in our third quarter. In addition, as Keith discussed, our net interest margin was impacted by a one-time write off of $800,000 of accrued interest receivable which lowered our net interest margin by seven basis points. Without this one-time adjustment, our net interest margin would have held relatively steady at 3.64% compared to the linked quarter's NIM of 3.65%.

Net interest income for the fourth quarter of 2018 was $40.2 million, which compares to $40.0 million in the linked quarter and an approximately $9.0 million increase as compared to $31.3 million in the same quarter of 2017. For the year, net interest income was $149.7 million, which compares to $121.3 million in the year prior.

Now on to noninterest income; noninterest income for the fourth quarter for 2018 was $7.6 million, remaining relatively flat from $7.5 million in the third quarter of 2018, and a $1.3 million increase compared with the fourth quarter of 2017. Noninterest income for the full year was $28.3 million, an increase of 3.5% compared to 2017. The full year increase was due to a $1.4 million increase in fees from service charges on deposit accounts and investment management fees due to an increase in customers and customer activity and the New Resource acquisition. This increase was partially offset by an increase in losses related to the disposition of loans and owned residential real estate.

Turning to Slide 11, noninterest expense for the fourth quarter of 2018 was $35.0 million, which compares to $34.1 million in the third quarter of 2018 and $31.7 million in the fourth quarter of 2017. The linked quarter increase was primarily due to an increase in bonus accrual for employees as a result of strong performance, expenses attributable to the New Resource Bank integration, and an increase in other expenses, including a $700,000 increase in the off balance sheet reserve. These increases were offset by the absence of a $3.4 million of expense from our IPO in the third quarter of 2018. We forecast our expenses to run $31 million to $33 million per quarter in 2019.

Noninterest expense for the year-ended December 31, 2018 was $128.0 million, an increase of $5.7 million or 4.7% from the $122.3 million for the year-ended December 31, 2017. The increase was primarily due to a $10.9 million increase in compensation and benefits, primarily due to the postretirement benefit cancellation in 2017 of $9.8 million; a $3.7 million increase in professional fees, primarily related to our initial public offering and follow-on offering; and a $2.4 million increase in data processing, primarily due to the New Resource Bank integration; and a $1.0 million increase from the amortization of intangible assets due to the CDI from the New Resource Bank acquisition.

The increase was partially offset by a $7.6 million decrease in borrowed funds prepayment fees and a $2.2 million decrease in occupancy and depreciation expense related to branch closures in 2017.

Skipping to Slide 13, our GAAP and core return on tangible common equity were 8.73% and 9.50% respectively. The core return compares to 12.17% for the third quarter of 2018 and 5.56% for the comparable period in 2017. The 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 very pleased with our performance this past year and are optimistic as we look to the year ahead. Turning to Slide 14, we have outlined our expectations for 2019. This guidance assumes January's yield curve, and no Fed rate hikes for 2019 are included in this forecast. For the full-year 2019 we are forecasting pre-tax, pre-provision earnings of $62 million to $67 million. Deposit growth of the full

year is forecasted to be between 7% to 10%, off of the adjusted $3.8 million starting deposit base. We forecast loan growth of 9% to 12% and net interest margin is forecasted in the range of 3.5% to 3.6%.

Thank you again for your time today. 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 lines for any questions. Operator?

Operator:

At this time, we will be conducting a question-and-answer session. If you would like to ask a question, please press star, one on your telephone keypad. A 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.

Our first question comes from the line of Steven Alexopoulos from JP Morgan. Please proceed with your question.

Steven Alexopoulos:

Hi, everybody.

Drew LaBenne:

Hey, Steve.

Keith Mestrich:

Hi, Steve.

Steven Alexopoulos:

I wanted to start on NIM. The starting point for margin looks like it's 3.64%, adding back one-time adjustment, and looking at the full-year guidance, your 3.50% to 3.60%, so call it 3.55% at the midpoint. Maybe for Drew, can you walk us through the expected pressure on NIM that takes us from 364 down to some level well below that?

Drew LaBenne:

Yes. Sure. I think there're a couple of factors to consider in there. First is we still haven't felt the full impact of the political deposit runoff in terms of average balances impacting our NIM. If you think about when the political runoff happened, it happened in November and then continued a little bit after that as well. There will probably be $70 million to $100 million of non-interest-bearing pressure on the average balances in Q1 that will have a downward impact on NIM. Secondly, the rest of it is really just a function of our forecasting in terms of lower rate environment. In our forecast we used the January interest rate environment where obviously long-term rates have come down. Then it's just the addition of the various loan balances coming in and runoff of the Indirect portfolio as well.

Steven Alexopoulos:

Okay. I mean, is there any realistic scenario where you see yourself moving to the lower end of that range, or you're just being conservative?

Drew LaBenne:

Well, that's why we're giving you a range, right, because there are various scenarios out. The yield curve could continue to move downward at the longer end of the curve; we could see more deposit pricing

pressure than we are expecting in our models; we could see a mix shift in deposits. Those are probably the main factors.

Steven Alexopoulos:

Got it. Okay. Then on the political deposits, given how many new candidates are entering the race for 2020, it seems almost weekly, it seems 2019 could be a banner year for political deposits overall. What's the assumption that you guys are using for the political deposits in that 7% to 10% guidance?

Drew LaBenne:

Yes. Let me start off by saying it's a very difficult number to forecast in terms of what's going to happen, and I'll let Keith comment on why this cycle may be more of the same—more different than the last cycle. We view something that is similar to what we saw from the '16 to '17 levels, probably with a slightly lower trajectory than what we saw there given there's more relevant candidates, at least at this stage of the cycle.

Keith Mestrich:

I'll just add, though—it's Keith, Steve—a little color here. You are right. I mean, we've already seen a number of Democratic candidates enter the race. Many, many of them are choosing to bank with Amalgamated. We anticipate many more to be entering the race as well. We look at political deposits daily and we are starting to see some increases in those balances.

I think it's not just presidential politics, though. If you look at even what's happened after the midterms and the shift in the seats, I think there are a lot of Democrats in particular, in particularly vulnerable positions given that they came from traditionally Republican stronghold, they're already beginning to raise money and feeling pressure to do that. I think you're right; it could be a good banner year, or it could be that people will sit back and hedge a little bit in terms of who they will give to because they like multiple candidates. We will watch it closely and see.

But, so far, we are lined up well to take advantage, I think, of any banner year or political deposits that there might be.

Steven Alexopoulos:

Then just to clarify, the guidance that you're giving on loans and deposits, is that on average or period-end balances?

Drew LaBenne:

That's on period-end balances, which is why we're using an adjusted base for the start point to consider for deposits.

Steven Alexopoulos:

Okay. Then just finally, the tax rate was obviously high in the quarter you called out. The reason, when we think about 2019, is 25.5% still a good range?

Drew LaBenne:

Yes. I'll put a number out there, but I'll also just say before I even give you the number that there could be a wide range around this given the permanent differences in the amount of income that we earn. Our full-year rate ended up being about 26.4%, if I'm not mistaken. I think that's probably a good starting point to use knowing that there could be variance around that number.

Steven Alexopoulos:

Okay. Terrific. Thanks for taking my questions.

Keith Mestrich:

Thanks, Steve.

Drew LaBenne:

Thanks, Steve.

Operator:

Our next question comes from the line of Alex Twerdahl from Sandler O'Neill. Please proceed with your question.

Alexander Twerdahl:

Hey, good afternoon, guys.

Keith Mestrich:

Hi, Alex.

Alexander Twerdahl:

First off, could you just remind us on the Indirect C&I that's running off, where the balances were at the end of the quarter and what the yield is in that portfolio and then compare that to the yields on some of the new production that's coming on?

Drew LaBenne:

Yes. The yield or the remaining amount of the portfolio at the end of the year was 2.35% in terms of balances remaining in that book, and what's remaining on the book at LIBOR +3.50%. What we're putting on now, I mean there's a wide range in terms of what's going on. Obviously, residential loans going on are going to go on at a much lower yield than that. the C&I deals that we've done, I think have come in around that range, so the replacement that's happening in C&I, while not one-for-one, is pretty comparable in terms of the yields that are going on.

Keith Mestrich:

I would just add on that, Alex, in some of the categories that we're looking at, particularly in some of the renewable energy categories, we're seeing even higher yields in some of those loans. Those loans have some structure to them. As we've talked about before, we get rewarded a little bit for some of that structure, and we're seeing some nice growth in that area. Then not to be forgotten, replacing indirect relationships with direct relationships have other benefits for the Bank as well.

Alexander Twerdahl:

Okay. Then can you remind us, for the long purchases that you do during the quarter, did those come on—do you have to provide for those or do those come on with merger accounting where they kind of come on with net balances?

Drew LaBenne:

No. We provision for those. Some of them we may purchase at a discount, but that discount is not related to credit, so we're doing full provisioning on those loans.

Alexander Twerdahl:

Okay. Then just final question for me, in 2019, obviously you guys just IPOed in the second half of 2018. Sometimes in the year following IPOs we see some new incentive structures, etc. that cause the share count to start to creep higher. In terms of a diluted share count for 2019, is this kind of $32.5 million that was in the fourth quarter a good average diluted share count to use for the year?

Drew LaBenne:

A couple of things on the diluted share count; first of all, the way that the dilution calculation works, in Q3 we did not have a full quarter of dilution impact from the conversion of the options because they happened mid-quarter. Fourth quarter has a full quarter impact of the dilution of those options. It's a little nuance because they were not equity options until right before the IPO, but the dilution in Q4, the quarterly dilution, is where we are at today for a full quarter impact. For next year, the Compensation Committee hasn't finalized the plan. I think there will certainly be some restricted stock that is issued as part of that, so there will be dilution on that as well. The exact number I can't tell you at this point.

Alexander Twerdahl:

Okay. We should expect that they trend slightly higher, but we don't unknown how much at this point?

Drew LaBenne:

Yes. A dilution increase in—okay, sorry. Let me just add one thing—the dilution impact for Q4 and for Q3 that happened, that was four years of awards that had been granted that converted to equity all at once. I think the impact there was probably outsized in terms of what happened with the dilution share count there.

Alexander Twerdahl:

Good. Thank you.

Operator:

Our next question comes from the line of Matthew Keating with Barclays. Please proceed with your question.

Matthew Keating:

Thank you. Good afternoon. Maybe a question for you, Drew, on the loan growth. I'm just curious; obviously the 9% to 12% expectations for loan growth in 2019 include continued loan purchases. Could you quantify, though, just if that expectation there is to have more loan purchases in '19 than the Bank had in 2018? Thanks.

Drew LaBenne:

Yes. I think the current expectation is that there will be a smaller number of loan purchases, but that is one of our levers to achieving that loan growth. As much as we fall short of our—not that I'm saying we will, but if we did fall short of our expectations in terms of loan originations, we would look to supplement that potentially with loan purchases as well. It's a bit of our lever to maintain the balance sheet growth and composition that we are looking for.

Matthew Keating:

Understood. Then with the Indirect C&I runoff, is there—obviously you're forecasting around $125 million, but do you have some flexibility there too, or is that pretty much set in stone that you guys are looking to run off at least that amount this year? Thanks.

Drew LaBenne:

I would call that an estimate with wide error bars, especially given where the market has gone. I'm sure it's not lost on you, Matthew, or any of the analysts, that the market price for loans, and particularly leverage loans, have come down, so we suspect—we don't know, but we see expect we will see less refinance activity out of our remaining book that is there. That's really what's been driving the decrease in 2018. Now, I think we do have some options to decide to sell some of those loans if we want to do that if we're not seeing the pace of runoff that we want to see. But I would say the $125 million has some wide error bars around it. We will try and manage somewhere around that number, but some of that might be out of our control.

Matthew Keating:

Understood. Leverage lending is sort of a focal point this quarter from an asset quality perspective. Obviously you haven't seen too many issues so far in terms of having to make additional provisions, but maybe you could just talk about any issues you're seeing with the remaining, or maybe even size your remaining leverage lending exposure within that Indirect C&I portfolio?

Drew LaBenne:

Yes. Sure. We have $130 million left in that portfolio of leveraged loans. Just about half of that are unit tranche structure, which means we are the first out on that loan. While the loan is technically classified as a leverage loan, our actual leverage is below, in most cases, almost all cases, what you would consider leverage loaned leverage, if you will, for lack of a better way of saying it. The non-unit tranche is approximately half of that amount, about $130 million that's out there right now, which is where I would call kind of the real leverage loan exposure.

Matthew Keating:

That's very helpful. Finally, I understand that the bonus accrual, the additional to the bonus pool in the fourth quarter of this year was based on strong performance. Is that something we should expect typically going forward, that when the Bank does exceed its budget or plan, that we'll see sort of a true up in the bonus pool in the fourth quarter? Thanks.

Drew LaBenne:

Yes. I mean, this year was a little bit unique. I think as a general statement, if there is performance above and beyond the budget, which I know you don't have, but let's say kind of the guidance range, then there would probably be some level of a bonus accrual that would tick up along with that, that will obviously be subject to our Compensation Committee's discretion on how that's done. I don't know that it would always appear in the fourth quarter. I think we would make adjustments throughout the year as the Compensation Committee felt it was likely that that overachievement was going to happen.

Keith Mestrich:

Matthew, it's Keith here. I think the Compensation Committee is moving to a much more formulaic approach on compensation, so I think Drew is exactly right. Obviously, we had some pretty big outperformance this year that we felt we needed to reward people, but I don't think you'd see one-time issues in the fourth quarter on a go-forward basis.

Drew LaBenne:

Just to clarify, I think you picked up on this, Matthew, but just to clarify, that $1 million doesn't go into our next year run rate. It's kind of a new run rate expectation for bonus compensation. I think you picked up on that, but just to clarify.

Matthew Keating:

That's helpful. Thanks very much.

Keith Mestrich:

Thanks, Matt.

Operator:

Our next question comes from the line of William Wallace with Raymond James. Please proceed with your question.

William Wallace:

Thanks. Good afternoon, guys.

Keith Mestrich:

Hi, Wally.

Drew La Benne:

Hey, Wally.

William Wallace:

I'd maybe like to circle back to the purchase funds, the solar loans. I'm first curious maybe if you could give us a sense as to what kind of reserves you put on those when you purchase them. I'm curious if you treat it as a pool or are you reserving these individually?

Drew LaBenne:

For the residential loans, we are treating them as a pool. Well, let me clarify. Actually, for both the residential and the commercial, they are treated at the pool level because the commercial ones are smaller dollar in nature. The reserves that we're putting on the commercial solar that we purchase are going to be in our general C&I level that we reserve at, which is a little over 1% in terms of the reserve that goes on there. Then the residential go on as a—I believe it's a consumer unsecured, so it's going to be a little higher reserve level that goes on top of that.

William Wallace:

Okay. I mean, how are these generally priced, are they typically floating or are they longer term?

Drew LaBenne:

The consumer residential solar are fixed rate. They can go out as long as 20 years in terms of the contractual maturity, but the weighted average life expectation is significantly lower than that, more like a residential loan. Then the commercial loans are float.

William Wallace:

Great. Thank you. Then I'm curious, for the—I can't remember the dollar amount—the $800,000 or $700,000 adjustment that you made to interest that was accrued in a prior period, was that related to a credit that went to non-accrual or was there something else there?

Drew LaBenne:

Yes. It was one loan that had credit issues over a period of time in 2017 and it was unique in structure and how it was working out in their head to be a manual override done for the normal system treatment on a non-accrual loan. Then we were repaid in full on that loan in Q4 and, unfortunately, due to human error, the amount that was accrued wasn't reversed out when the cash payments came in. It's a unique item in no way systematic and we don't expect anything like that to happen again.

William Wallace:

Okay. Fair enough. Last question is just kind of maybe two in one. I'd like to know as far as your loan growth guidance goes—and I'm sure you have some target of originated loans—are you anticipating that any of your three regions would be driving that more than another on a percentage basis? Then if so, maybe you could tell us where you anticipate to have the most growth. Then also I'd love an update just on the new Resource market in general, how that market is growing since the acquisition has closed. Thank you.

Keith Mestrich:

Wally, let's break our sort of loan categories down into a couple of different areas. I'm not sure I would look to sort of see any one of our regions disproportionately drive regional loan growth. I think you'll continue to see in our commercial real estate bucket, that's largely being driven by multifamily growth, largely in the New York City Metropolitan area. That's historically been where we've seen that growth come from. I think we'll continue to see that in the future, although we have asked our Commercial Real Estate Director to work with the Regional Directors in both Washington and San Francisco to develop appropriate commercial real estate strategies in each of those markets. But, primarily, the growth in that bucket will come from the New York area.

Our Residential Mortgage business is really a national business. It's a little disproportion in New York, New Jersey, Connecticut and California, but the team that we have been able to bring on there has gotten us some nice geographic variety in that portfolio and I think we'll continue to see that. I think a little bit, it will still be in the markets where we are because in addition to whatever we drive in that bucket from an online activity, we do see people coming into our branches and source things locally and particularly in New York where we have a name.

Then, finally, one of the things I think we're really pleased about in the Direct C&I portfolio that has been an outgrowth of the New Resource acquisition is we've seen very, very nice growth. We referenced about $170 million growth in that bucket from the closing of the merger in May to December. What I'm particularly pleased about is that we are seeing the verticals and things like renewable energy, sustainable ag, energy efficiency, go much more national. Some of our bigger deals have actually been on the East Coast this year as opposed to the West Coast, and we're seeing a nice upsizing of those facilities as well. I think it's very much our intent to drive that business not just in the Bay Area but take that expertise and really do it nationally.

William Wallace:

Thanks, Keith. I appreciate the time.

Keith Mestrich:

Thanks, Wally.

Operator:

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

Chris O'Connell:

Good evening. I was just hoping to get a little bit more color on the $327 million of short-term deposits that came in and out, or were in during the quarter and are now falling off the balance sheet. Just what type of customer was driving that and if that's something we could see in the future?

Drew LaBenne:

Sure, Chris. The customer, it was a legal settlements account that was being held in escrow as a client of our Trust business, and as they distributed those funds to the beneficiaries of the lawsuit, those funds moved out of the investment that was in and our Trust business where it sat for two years. It moved for a very short time into our Commercial Banking business for distribution, and within a couple of days was distributed by the law firm to the beneficiaries of that lawsuit. We don't make a tremendous amount of business in that. On occasion we get accounts like that. They're mostly small fee accounts on the Trust side of our balance sheet.

Chris O'Connell:

Got it. Thank you. Then could you give us an update just on where the Workers United deposit balance is at? I think they were at about $205 million at the end of 3Q '18 and it's kind of more than doubled throughout 2018. Just wondering where those balances are at now and maybe what the drivers of that going forward would be.

Drew LaBenne:

Yes. I think you're probably referring to all of our affiliate deposits, or maybe not; I'm not sure. But we did see an increase in Q3, and some of that was actually related to the IPO proceeds that Workers United received, which have since dropped. I don't think all the proceeds have moved off balance sheet, but a lot of them have. That was definitely a bit of a drag on our Q4 deposit number as well, so I think when you see our affiliate numbers come in, what you'll see in the K, you'll see a drop in those numbers.

Keith Mestrich:

I do think important to note, Chris, while that will be a drop in deposit numbers, Workers United is continuing to use those proceeds and they are investing in the Bank's investment vehicles. That will result in additional fee income for our Trust business. Those proceeds are not leaving the Bank, per se, they're just shifting around in a way as Workers United thinks about its own portfolio management.

Chris O'Connell:

Got it. Great. Thank you. Then just to finish up, in terms of—and I know there's been a lot of moving parts with the loan purchases over the past two months and you expect it to be similar moving forward—but maybe over the past couple of quarters on a blended basis, what's the reserve-to-loan ratio of what you're putting on the balance sheet is versus the reserve-to-loan ratio of the C&I that's kind of falling off the balance sheet, or where that might end up as the Indirect C&I becomes a smaller percentage of the portfolio?

Drew LaBenne:

Yes. As the Indirect C&I comes off, depending on if it's leveraged or not, that's going to come off in the kind of 1% up to I think 1.36% range, whereas most of the loans that we're putting on, for example, the

new C&I loans, are going to be at that lower lever, about 1%; residential, multifamily, etc., those are going to be at lower reserve levels. Net-net, when you net out specific reserves, the ALLL (phon) to loan ratio should come down.

Chris O'Connell:

Great. Thank you. That's all I had.

Keith Mestrich:

Thanks, Chris.

Operator:

As a reminder, if you'd like to ask a question, please press star, one on your telephone keypad. Our next question comes from the line of Matthew Breese with Piper Jaffray. Please proceed with your question.

Matthew Breese:

Good evening.

Keith Mestrich:

Hey, good evening. How are you doing, Matthew?

Matthew Breese:

I'm doing great. Thank you. I just want to make sure I more fully understand the $327 million leaving the Bank. Did you say they were only on the balance sheet for a handful of days or longer than that?

Drew LaBenne:

No. I think they came in roughly—because I remember looking at the balance sheet and going what the heck, I think it was like December 28 or something and they left on January 3. I mean, as far as average balance impact, which may be why you're asking, it's pretty minimal.

Matthew Breese:

Okay. But as we think about what will happen into the first quarter, what account will it roll out of; is it non-interest-bearing or—?

Drew LaBenne:

It's money market?

Matthew Breese:

It's money market?

Drew LaBenne:

Yes.

Matthew Breese:

Okay. Because of its short stay in the balance sheet, is there really any NIM impact on it going off?

Drew LaBenne:

No. There's something, but it's unnoticeable in terms of the size.

Matthew Breese:

Understood. I guess where I was going with my initial thinking was that it might have some 1Q impact on the NIM. But maybe going to that line of questioning still, just to level set, where do you think the first quarter NIM will shake out given still some of the moving parts in terms of Political Deposits and Indirect C&I outflow?

Drew LaBenne:

Well, I'm going to avoid giving the quarterly guidance, but I would say the one thing I think you can roughly count on is the Political Deposit, the average balance that I was talking about before, $75 million to $100 million, that will come off, all else being equal. That, as we had guided last time, that's about a 4-basis-point impact to NIM for every $100 million, so I think that number still stands. I think you're looking at 4 basis points and then the rest of it will be in loan yields and deposit growth that happens throughout the quarter.

Matthew Breese:

Okay. Understood.

Drew LaBenne:

I think that range, though, 3.50% to 3.605, should be about the right range based on that.

Matthew Breese:

Okay. The other two questions I had was, first, in the release you mentioned this quarter it included an increase in the allowance for classified loans. I was just hoping you can give us an updated balance for both criticized and classified loans for 4Q and 3Q so we can compare them.

Drew LaBenne:

Yes. Let me pull it up just so I'm giving you the exact right numbers. The combined criticized and classified are going to go up about $9 million on the quarter between the two. There were two loans that entered the credit book, one is a construction loan that is from New Resource, which is very well secured. We're waiting for a payoff there. It may or may not happen this quarter. I guess, it may or may not happen, but we expect that we will get a payoff on that one. Then the other one is a $4.4 million C&I loan that just entered as well, so we're watching that one closely and we will have more of an update on Q1 on what happens there, but not a big balance on the C&I loan that came in.

Then the MPA table was provided. I might as well mention that since we're on the topic. There was a $4.1 million increase in MPAs, which was offset by reductions in the other portfolios, which is a nonaccrual real estate loan. This is actually a nursing home with a very low LTV. As of now at least, we're not expected to take any loss on it, but the kind of sale process on nursing home loans can take some time. We'll see when that one works off as well.

Keith Mestrich:

It takes time because of regulatory approvals needed, etc.

Matthew Breese:

Okay. You think that one is just a matter of time before it goes off your books?

Drew LaBenne:

I think so. I always caveat that anything can happen, but I think so.

Matthew Breese:

Okay. Actually, that was my second question, so you answered it and that's all I had. Thank you very much.

Drew LaBenne:

Great. Thanks.

Operator:

Ladies and gentlemen, we have reached the end of the question-and-answer session and I would like to turn the call back to Keith Mestrich for closing remarks.

Keith Mestrich:

Thanks, Operator. Let me just thank everybody for joining. I think the key takeaway here in many ways is that a lot of you have been with us since August when we took the Company public, and I think all of the key aspects of the investment thesis that we talked about in August held up very well in the quarter. Deposits are still the bright shining light of this franchise; nice deposit growth with very little repricing. I like the story very much and where our loan book is headed, and feeling very good about the de-risking of that, especially as the leverage loan books across the country are sort of seeing some stress on them. I think that move is proving to be a very smart one on our part. We think all of the aspects of the investment thesis have held up very well here. We look forward to talking with you in the days and weeks to come. Thank you all for your time.

Operator:

This concludes today's conference. You may disconnect your lines at this time. Thank you for your participation.