# Third Quarter 2019 Earnings Call Transcript

*October 28, 2019*

## CORPORATE PARTICIPANTS

**Drew LaBenne,** *Chief Financial Officer*

**Keith Mestrich,** *President and Chief Executive Officer*

## CONFERENCE CALL PARTICIPANTS

**Steven Alexopoulos,** *J.P. Morgan*

**Alexander Twerdahl,** *Sandler O'Neill*

**Brian Morton,** *Barclays*

**Christopher O'Connell,** *KBW*

**William Wallace,** *Raymond James*

## PRESENTATION

**Operator:**

Good morning, ladies and gentlemen, and welcome to the Amalgamated Bank Third Quarter 2019 Earnings Conference Call. During today's presentation, all parties will be in a listen-only mode. Following the presentation, the conference will be opened for questions, with instructions to follow at that time.

As a reminder, this conference call is being recorded.

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

**Drew LaBenne:**

Thank you, Operator, and good morning everyone. We appreciate your participation in our third quarter 2019 earnings call. With me today is Keith Mestrich, President and Chief Executive Officer.

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

Before we begin, let me remind everyone that this call may contain certain statements that constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. We caution investors that the 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 2018 10-K filed on March 28, 2019, 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, and good morning everyone. We are excited to be here today and look forward to discussing our results with you.

This morning, I will discuss the high-level details of the third quarter, and then provide an update on our strategy to grow the franchise value of the Bank. Drew will then discuss our third quarter financial results in more detail.

To start, there is a few highlights I'd like to emphasize from what was a very solid quarter for the Bank.

First, we surpassed $5.0 billion in assets, which is an important milestone for Amalgamated and speaks to the dedication and hard work of our employees.

Second, our deposit franchise continues to experience strong, broad-based growth, as we benefit not only from the run up to the 2020 Presidential election, but also robust growth across the many business sectors that we focus on, including unions and their funds, non-profits, social enterprises, and philanthropies. Importantly, we saw deposit growth in all three of our major markets of New York City, Washington, DC and San Francisco.

Third, loan growth was very strong in the quarter, as our expansion into sustainable lending continues to gain traction and the headwind from our strategic decision to run off our indirect C&I portfolio abates. Additionally, our residential mortgage business had an excellent quarter.

Fourth, we made strong progress reducing our future expenses, which positions the Bank for improved profitability and will help to mitigate the headwinds from a lower interest rate environment looking to next year.

Lastly, as we work every day to build on our reputation as America's socially responsible bank, we are proud to have announced a number of ESG-related commitments this quarter, including becoming the first U.S. bank to endorse the United Nations' Principles for Responsible Banking and joining the Collective Commitment to Climate Action.

Turning to the third quarter, we delivered net income of $13.2 million, or $0.41 per diluted share, which compares to net income of $11.2 million, or $0.35 per diluted share in the linked quarter, and net income of $9.4 million, or $0.29 per diluted share, for the third quarter of 2018.

I continue to be quite pleased with the performance of our deposit franchise. As you can see from Slide 5, deposits grew by $185.9 million, or 17.8% annualized from the second quarter. As we have noted previously, given the volatility in our period-ending balances, we believe average deposits provide a better view into our deposit franchise. For the third quarter, average deposits grew $117.4 million, representing a rise of 11.3% annualized from the linked quarter. This growth was largely in DDA accounts, which now represent 46% of our deposit base, up from 43% at the end of the second quarter.

As we look forward, our deposit pipeline remains robust, and our bankers continue to expand our commercial relationships across verticals, while our political business continues its upward trajectory.

As the 2020 election approaches, we continue to experience an increase in political deposits, as seen in the growth experienced during the third quarter of $91.5 million to $510.9 million as compared to the second quarter deposit balance of $419.4 as shown on Slide 6.

Our deposit franchise remains a competitive advantage for the Bank. In the quarter, we continued to experience healthy growth and continued to benefit from what is one of the lowest cost of funds in the industry. During the third quarter, our cost of deposits was 37 basis points which was modestly higher than the 34 basis points that we reported for the 2019 second quarter. Although our cost of funds has ticked up over the course of the year, the overall deposit cost increase was mitigated by an increase in DDA balances.

Additionally, although we did see some end of the cycle pricing increases in MMA accounts, we have implemented programs designed to mitigate this pressure and expect a more stable cost of funds going forward. For the full year of 2019, we have already reached the upper end of our previously-guided range for deposit growth and are now expecting 14% to 18% growth, adjusting for the $327 million of short-term deposits at year-end 2018.

Moving on to loans, we experienced very strong growth in the third quarter, as loans increased $176.3 million, or 21.4% annualized from the linked quarter. Drew will touch on this growth in more detail, but as I mentioned earlier, this was the first quarter in which we did not experience the headwind from the runoff of our indirect C&I portfolio that we saw in the first two quarters of the year.

As we continue to grow our franchise, organic growth will remain a priority. Another driver to growth is our strategic expansion into regions of the country where our culture and values will resonate with like-minded people and institutions. During the third quarter, we performed extensive due diligence on three potential M&A opportunities. Unfortunately, the targets did not meet our strict economic and strategic criteria to move forward, and we decided to pass on these opportunities. We will continue to explore acquisition opportunities, but are also looking seriously at organic growth through the formation of commercial banking offices in our target markets. To successfully start a de-novo office, we need to find the right banking team who understands our core customer base. This will be an additional focus for growth as we look to 2020.

I would like to spend a few minutes highlighting a number of recent ESG initiatives in which the Bank continues to expand its commitment to promote and advance a more sustainable future.

First, Amalgamated was one of only three U.S. based banks to sign the UN Principles for Responsible Banking. As part of the Company's ongoing leadership position in social responsibility and sustainability, I had the pleasure of representing Amalgamated at the United Nations' announcement of the Global Launch for the UN Principles for Responsible Banking, or UNPRB, in New York last month.

In conjunction with the announcement of the UNPRB, the Bank has also united with partners to endorse the Collective Commitment to Climate Action in order to help facilitate the economic transition necessary to achieve climate neutrality. As such, Amalgamated is committed to implementing and reporting a set of metrics and targets, including setting science-based targets that will support and accelerate the shift towards low-carbon, climate-resilient technologies, business models and societies.

Amalgamated also led the launch of the Partnership for Carbon Accounting Financials, or PCAF, and I am proud to serve as the Chair of the International Steering Committee. PCAF enables financial institutions to assess and disclose greenhouse gas emissions of loans and investments. The partnership currently consists of 50 plus financial institutions representing more than $3 trillion in assets, which is the

first global initiative ever created that allows these institutions to measure their carbon emissions across all asset classes in order to reduce their climate impact.

In addition to efforts to reach climate neutrality, Amalgamated bank also received the Small Cap Board Diversity Award by the National Association of Corporate Directors. This award recognized our efforts in support of greater diversity and inclusion at the Board level and throughout our organization.

The aforementioned commitments are yet another example of our commitment to advancing environmental sustainability through our operations, the clients we partner with, and our balance sheet. The banking industry has an important role to play in achieving a low-carbon, more sustainable future, and we hope that other industry partners will follow our lead and join us in meeting this goal. As our brand continues to gain recognition through our sustainability leadership, we believe pursuing a de-novo strategy to extend our geographic reach will enhance our organic growth over time.

Another area for growth is the enhancement of our fee income, with a focus on our Trust business. Currently, we have nearly $45 billion in assets under management and assets under custody. For many of our commercial clients, this is seen as a significant competitive advantage, as we can handle the custody aspects of their investment funds, but also the disbursement of those funds to their clients, an ideal wholesome package to our commercial clients. As we have detailed in past calls, this business is largely a breakeven business for us, but this past quarter we launched two major initiatives designed to increase profitability in this area. We have initiated a study to determine if we can deliver our custody business in a more cost-effective manner by partnering with a major outsourcing partner. Additionally, we are exploring ways to more effectively deliver the investment management funds that are currently on our platform and to expand our offerings that our values-based clients desire in the ESG space. We have several months of hard work ahead of us, and we will update you on those efforts on future calls.

We will also continue to maximize shareholder value through a steady return of capital through a consistent quarterly dividend, which remains a top priority for the Bank.

We will also be opportunistic with our $25 million share repurchase plan. We have repurchased $3.8 million of stock, or 237,000 shares, through the end of the third quarter at an average price of $15.84. To date we have repurchased a total of $5.7 million of stock, or 355,000 shares, at an average price of $16.01.

To conclude, I am pleased with the growth that we have achieved during our third quarter, and am excited with the long runway for growth that we see ahead of us. Our brand continues to resonate with our customers, both current and future, as we continue to do our part to better the communities in which Amalgamated serves while building and delivering upon our reputation as America's socially responsible bank.

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

**Drew LaBenne:**

Thank you, Keith. As Keith has already detailed the success that we have achieved in growing our deposit franchise, I will start with loan growth on Slide 7.

For the third quarter, we delivered loan growth of $176.3 million, or 21.4% annualized, as compared to the second quarter of 2019, and ended the quarter with $3.5 billion of total loans. Loan growth was primarily driven by an increase in residential first lien and PACE loans, multifamily and SBA/USDA loans in the C&I category. For the first six months of the year, our loan growth has been hindered by the strategic reduction of our indirect C&I portfolio, which year-to-date has declined by $175 million. The third quarter was the first quarter in which we did not experience substantial runoff in that portfolio, and the loan growth that we have been experiencing is now visible.

Looking forward, we expect to run off—we expect the runoff to be at a more measured rate, with only $61 million left in the portfolio. Our loan growth guidance for the year was 6% to 10%, and, given our expectation to be at or above the high end of the range for the year, we have updated our loan growth guidance. We now expect 9% to 12% loan growth for the full year, which includes the impact of the indirect C&I portfolio runoff.

Skipping ahead to Slide 9, our net interest margin was 3.5% for the quarter compared to 3.66% for the second quarter of 2019, and 3.65% in the year-ago quarter. The yield on average earning assets was 3.92% for the third quarter, a decrease of 15 basis points as compared to the linked quarter. The yield on loans decreased 20 basis points to 4.22% compared to 4.42% during the second quarter as the result of the runoff of the indirect C&I loans in the second quarter and the impact of lower market rates on our loan portfolio.

Our most recent full-year NIM guidance was updated to 3.55% to 3.65%, and we are currently running at 3.60% for the first nine months of 2019. We expect to be near the low end of that range for the full year, and have tightened our range, anticipating our full-year NIM to be in the range of 3.55% to 3.60%.

Now on to non-interest income; non-interest income for the third quarter of 2019 was $7.7 million, an increase from $6.3 million in the second quarter of 2019, and a $100,000 increase compared to the—with the third quarter of 2018. The increase from the previous quarter was primarily due to growth in Trust and Asset management fees and fees on deposits and a lack of losses on security sales and OREO properties that occurred in the previous quarter.

Turning to Slide 10, non-interest expense for the third quarter of 2019 was $31.9 million, which compares to $31.0 million in the second quarter and $34.1 million in the third quarter of 2018. The slight increase in our non-interest expense was due to higher expense from projects, such as SOX implementation, and an increase in the bonus pool for employees.

As mentioned on our second quarter call, we closed our Chelsea branch in late August, which will generate an approximate $800,000 run rate annual savings. In terms of headcount related to this branch, positions were relocated or re-determined. There was no reduction in headcount attributed to the Chelsea branch closure.

As previously disclosed, we have successfully finalized one of our vendor contract negotiations, which will, in turn, generate an annual savings of $1.6 million annually. Those savings will start to be realized in the fourth quarter of this year. We anticipate further cost savings opportunities in the future. We are quite pleased with the progress made thus far as we manage our cost structure.

Our previous guidance for expenses was $31 million to $33 million per quarter, and that is unchanged.

Skipping ahead to Slide 12, nonperforming assets totaled $71.6 million, or 1.42% of period-end total assets at September 30, 2019, which was a decrease of $2.4 million from the linked quarter. The decrease was primarily caused by the expected removal of $13.9 million in loans that were 90 days past due and accruing. This was partially offset by the addition of a $9.3 million accruing TDR loan that was the result of restructuring the one indirect C&I loan that had moved to substandard in the previous quarter.

During the third quarter, we did have one $3.7 million substandard construction loan from the NRB acquisition move to non-accrual, which we hope will be a fast workout, as the loan has a low LTV and no specific reserves were required for this loan.

The overall classified and criticized loans from the Bank decreased by $17 million to $71.6 million in the third quarter compared to the previous quarter. The improvements were mainly in C&I and CRE loans.

During the quarter, our provision for loan losses totaled a release of $600,000, compared to a $2.1 million provision in the linked quarter. The release in the quarter was primarily driven by the recovery of $1.7 million related to one indirect C&I loan that had previously been charged off in 2016, offset by $800,000 in net charge-offs in C&I due to a couple small loans from the NRB portfolio.

Turning to Slide 13, the allowance for loan loss was approximately flat at $31.7 million compared to the previous quarter end.

At September 30, 2019, the Bank had $71.0 million of impaired loans, which includes performing TDRs, for which a specific allowance of $6.2 million was made, compared to $59.3 million of impaired loans in the linked quarter, for which a specific allowance of $3.9 million was made.

The ratio of allowance to total loans was 96 basis points at September 30, 2019, and 101 basis points at June 30, 2019.

Turning to Slide 14, our return on average equity and core return on tangible common equity were 10.9% and 11.4%, respectively. The core return compares to 10.5% for the second quarter of 2019 and 12.2% for the comparable period in 2018. Lastly, we remain well-capitalized to support future growth.

Before I turn the call over to the Operator, I would like to summarize our full—our expectations for our full-year results, which are included on Slide 15. We continue to expect pre-tax pre-provision earnings of $66 million to $72 million and expenses of $31 million to $33 million per quarter. As mentioned, we have updated our expectations for deposit growth to 14% to 18% adjusted for the $327 million of year-end deposit flows in 2018, loan growth expectations of between 9% to 12% and net interest margin for the full year of 3.55% to 3.60%.

To conclude, and before we open up for questions, we are pleased with our third quarter results and remain conservative regarding our outlook for the remainder of the year, as we take into account the current rate environment.

Thank you again for your time today. We look forward to updating everyone on our fourth quarter results in January.

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

**Operator:**

Thank you. 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, and for participants using speaker equipment, it may be necessary to pick up your handset before pressing the star keys.

Our first question is from Steven Alexopoulos with J.P. Morgan. Please proceed.

**Steven Alexopoulos:**

Hey. Good morning, everybody.

**Drew LaBenne:**

Good morning.

**Keith Mestrich:**

Hi Steve.

**Steven Alexopoulos:**

I wanted to start on the deposit side. You saw a pretty notable increase in interest-earning deposit cost again this quarter. Give some color on what drove the increase in 3Q, and why wouldn't we expect deposit cost to continue rising, particularly given you're still so far below peers?

**Keith Mestrich:**

Yes. Good question. We did see a little bit of, what I would call, end-of-cycle adjustments that we made for a handful of customers that were still looking for some interest rate increases at the end of what is—was their perception of a rising-rate environment. I think what you'll see in the future, and obviously this is somewhat predictive, but we have done some additional adjustments in terms of our across-the-board promotional (phon) pricing that should ameliorate any kind of additional increases, and have looked at a number of the one-offs, and anything that we were seeing has definitely slowed, and I would not anticipate any continued increase in the interest-bearing deposits of our current customer base.

**Steven Alexopoulos:**

Okay. That's helpful, and then to switch gears, I wanted to follow up on this potential for de-novo offices in 2020. Maybe to start, what are you thinking in terms of target markets, and is the thought at this point a larger presence in one market, or maybe some more presence in several markets? How are you thinking about that?

**Keith Mestrich:**

Yes. I think more the latter. We continue to look at the kind of markets that we've talked about that have a significant concentration of our core customers in the political, non-profit, and union sectors. We've been pretty clear that we think the best markets for that are L.A., Boston, and Chicago, as we have not been successful in funding satisfactory M&A opportunities in those markets. We are looking at, in 2020, putting de-novo staff in those markets. I do think it is not going to be the kind of classic loan production office that you would think, because we would not want to lead in loans in these markets. This would really be deposit gathering operations, and really the folks working on expanding trust opportunities for us to drive that non-interest income, so I'd look for us to do a couple of markets. Those are plans that we're sort of hatching as we speak, and really beginning to build into our 2020 budget projections.

**Steven Alexopoulos:**

Okay, so these would be actual branches, Keith, at this point?

**Keith Mestrich:**

Well, it'd be commercial offices. I don't think we'll staff them with a full branch, Steve, in terms of actually taking cash in the operations. It would be cashless commercial offices focused on commercial deposit acquisitions.

**Steven Alexopoulos:**

Okay, and then a final one for Drew. I was hoping CECL would get delayed, but it's not looking likely. Assuming that it takes place here shortly, what are your thoughts on the day one impact?

**Drew LaBenne:**

Well, so for CECL, Steve, we are actually now eligible to be a 2023 adopter, which we've come to that conclusion after the FASB release there—or took the road on the revised guidance, so we're still talking about when we will actually implement. Our current project plan, as you know, has us implementing in 2021, a year later, that we now have an option to go longer, and we're going to evaluate that option, and certainly it's an advantage. I don't think there's a first-mover advantage in CECL, so us being—waiting at least a year to adopt I think will allow us to look at what's happening with banks and in the industry as it's being implemented.

**Keith Mestrich:**

Just as a reminder, Steve, too, we already had the year delay opportunity as an emerging growth Company, and now we may have a longer—we believe we have a longer delay if we choose to take it.

**Steven Alexopoulos:**

Okay, but it sounds like you would take it, from what Drew was saying.

**Drew LaBenne:**

No, I wouldn't say that yet, Steve. I think we're—literally last week kind of—our legal counsel came to the conclusion it's not as straightforward as you might think, like most things with CECL, but yes, so we did—they did come to the conclusion and advised us we're a 2023 adopter. I think the trade-offs here are—obviously it's advantage to wait a year and watch what happens. At some point, though, you become the one Bank our size that hasn't adopted, and we need to figure out if that's a place we really want to be or not in the future.

**Steven Alexopoulos:**

Okay. Terrific. Thanks for taking my questions.

**Drew LaBenne:**

Thanks, Steve.

**Operator:**

Our next question is from Alex Twerdahl with Sandler O'Neill. Please proceed.

**Alexander Twerdahl:**

Hey. Good morning, guys.

**Keith Mestrich:**

Hey. Good morning, Alex.

**Alexander Twerdahl:**

Just one first quick housekeeping item; do you have, Drew, the amount of the FDIC credit that you got in the third quarter?

**Drew LaBenne:**

Yes. That was just over $400,000.

**Alexander Twerdahl:**

Okay, and then as we think about expenses and some of the things that you did during the third quarter to lower your costs, and in some of your prepared remarks you talked about the further cost-saving opportunities into 2020, as we weigh that against some of the de-novo branch opportunities and considerations that we just talked about a minute ago, how do you think about expenses going into next year? Do you think that those two will be able to offset each other and expenses should remain flat, or are these de-novo opportunities going to push expenses higher, even with these cost-saving initiatives?

**Drew LaBenne:**

Yes, I think we're—well, we're not ready to give 2020 guidance, which I think is what you're asking, and I don't know if it'll be a direct offset between the two, but I certainly think that there's some progress that can be made on the expense side that will go a long way to offsetting some of those increases from the de-novo offices.

**Alexander Twerdahl:**

Okay, and then just to switch gears to margin here for a second, the margin guidance kind of being revised lower, is that more a function of just the timing of anticipated rate cuts? I assume that you have an October cut baked into your—the margin guidance for the full year, and then just a second part to that question, now that the indirect C&I portfolio is kind of in—mostly in the rearview mirror, how do you think about rate cuts impacting the margin on a ongoing basis?

**Drew LaBenne:**

Yes, so there's the immediate impact of the rate cut on the short term of the curve, which is really going to be felt more in the investment portfolio than on the loan side, because with the indirect C&I runoff that happened, those were almost entirely floaters, except maybe one loan, so taking that out has added a lot more duration to the loan side of the balance sheet, so the immediate effect's going to be on the investment portfolio.

The shape of the curve, as you well know, obviously impacts where NIM is going to go over the longer term, and I think the middle to the long end of the curb is already baked in a number of cuts. It'll be interesting to see how it reacts when we finally get the next Fed decision. I've given you all the variables here, Alex, sorry, and then the last one I think is actually just the risk premium on the loans that we're originating, and so, while, for example our interest rate risk modeling assumes parallel shifts impacting income, it also assumes parallel shifts in the risk spread on different asset classes, and so we haven't seen those risk premiums come in as much as the curve might otherwise indicate, so that's been helpful as well, so a lot of variables there.

If you think of the disclosures we've given previously, we've said $2.5 million for every 25 basis cut, assuming a parallel shift in the curve and in the risk premium, so that number's probably gone up a little bit to closer to $3 million because of all the DDA that we've added on and where we're at with the convexity portion of the curve, especially on residential mortgage, but the guidance is largely the same as it was before.

**Alexander Twerdahl:**

Okay, and then just the final question for me just to clarify; you increased the guidance for deposits into the end of the year, increased loan growth guidance, margin lower end of the range, but range unchanged, expenses basically flat. You have the pre-tax pre-provision income. I would have thought

maybe, given all these things put together would actually tick a little bit higher, so is this kind of just suggesting that maybe there's a little bit of increased confidence just to hit the upper end of that $66 million to $72 million range, or would that be too bold of a statement?

**Drew LaBenne:**

Maybe a little bit bold. Let's see what the Fed does and where things come in in Q4, but the range we didn't adjust. We have NIM, obviously, has gone lower, balance sheet has gone up, so I think that's maybe a little positive for NII, while NIM is impacted by the rate environment, costs staying the same. We're kind of in the same range we were when you add it all up.

**Alexander Twerdahl:**

Okay. Thanks for taking my questions.

**Operator:**

Our next question is from Brian Morton with Barclays. Please proceed.

**Brian Morton:**

Good morning. Thanks for taking my questions.

I think we'll start maybe on the loan side. Can you talk about where you're seeing your origination yields across the different products (inaudible)?

**Drew LaBenne:**

Yes, so for example residential, we have moved away from 30-year origination, though I will say the recent refi boom that has been happening impacting Q3, and will certainly carry over into part of Q4. I think we picked up a little more 30-year there than we anticipated, and we've taken some steps to move away from that, but the shorter end on residential is probably 3.25% to 3.50%; certainly lower than where our loan yields are right now, but higher than where anything is coming on the securities portfolio sets; still a positive trade versus the securities' portfolio.

The multifamily market pricing anywhere from 3.25% to 3.75%, depending on the duration of the deals and where you're at on the—on DTI and LTV, and then the other deals we're doing, PACE originations, commercial loans, those are coming in in the—anywhere from 4% and higher yields, so that's a place where we're getting more attractive yields and more differentiated yields from the rest of the market.

**Keith Mestrich:**

Then Brian, I would just add, kind of putting your analysis question together a little bit, that focus for us is really in that higher-yielding part of the portfolio, though, as we shift—make some moves to try and shift our loan-to-deposit ratio, very, very focused on what an (inaudible)—conservative portfolio still remains at a relatively higher margin yield than that—in the energy efficiency space, and the PACE lending space in particular.

**Brian Morton:**

Okay, great, and then maybe what's the mix between fixed and floating on these loans?

**Drew LaBenne:**

Most of what we're putting on is fixed now, in fixed. For example, in residential I'm going to say a 5.1% arm is a fix, not a floating. I think you're looking—talking about pure floaters, but for the most part what's coming on is fixed rate, and that's where we've certainly been targeting our loan originations.

**Brian Morton:**

Okay, great, and then maybe you could talk a minute about the SBA/USDA—your SBA/USDA loans that are coming on. Is this a new program that you guys started?

**Drew LaBenne:**

We've been doing it over the past several quarters, so we've put on about $50 million this quarter, and those are coming on—or at least this quarter they came on at 3.50%. I think the spreads have come in a fair amount over the past couple of quarters, but very attractive. They're obviously pretty much riskless from a credit standpoint, and with the exception of some we put on at the beginning, they have very good prepayment protection as well, so an attractive asset class, and again, when we compare it to alternatives in the securities portfolio, it looks like a good addition to the loan portfolio.

**Brian Morton:**

Okay, great. Maybe moving on—a quick one on expenses. I saw there's a tick up in the kind of legal and professional fees, it looks like driven by some SOX or related expenses. How long do you expect this to continue? Is this going to—or is this like a one-time type of item?

**Drew LaBenne:**

Well, I don't know if I'd call it one—certainly the SOX work is, I think, mostly one time. There's the pretty big implementation costs there that that needs to happen and SOX will be finished at the end of this year, so that will go away. I think where—and I think there will be some decrease in those costs. I think where there will still be some professional services spend is—Keith alluded to some of the projects that were going on in the trust and asset management department, and I think there will be some projects spend there over the next, Keith, what, six months probably?

**Keith Mestrich:**

Six to nine months, yes.

**Drew LaBenne:**

Six to nine months that might keep that number a little bit elevated, but we think the benefits of those projects will more than justify the cost increase that's—that'll happen in the near term.

**Brian Morton:**

Okay, great. That's it for me. Thanks.

**Keith Mestrich:**

Thanks Brian.

**Operator:**

Our next question is from Chris O'Connell with KBW. Please proceed.

**Christopher O'Connell:**

Good morning, everyone.

**Keith Mestrich:**

Hi Chris.

**Drew LaBenne:**

Chris.

**Christopher O'Connell:**

Just wanted to see if you guys could give the breakdown on what the loan purchases were this quarter, and maybe what the yield was on those purchases, and then also what the yield is on the remaining space at $61 million of indirect C&I?

**Drew LaBenne:**

Sure. Yes, so we did $12 million in purchases on the residential solar, which is sort of finishing up a flow agreement that we had in place with one of the companies there, and that was a—about a 6% yield on those loans. We did $16 million in PACE, which I will add is a space where we're doing some work to increase our origination—I'm sorry, increase our purchases and partnerships in that space, so I think we'll maybe have more to talk about that in the future. I'm not going to give the pricing there, because we're in some negotiations, but it's well within the range of our existing portfolio in terms of yields, and then the government guarantees that we—the $50 million I previously mentioned, those were at 3.5%, and then the $60 million we have in the indirect portfolio, those are going to be LIBOR plus 3.80% is where those are right now.

**Keith Mestrich:**

Then Chris, I would just add just as a reminder, why we like the purchase space here is the all-in cost of acquisition of these assets is significantly lower than the origination of anything we directly source ourselves, and these were all servicing retained options for us, so very, very efficient way for us to originate and service loans.

**Christopher O'Connell:**

Got it, and what was the breakdown, I guess, in the originated loans for the West Coast franchise and the East Coast, and have you guys been seeing the ramp-up in kind of the West Coast like I see in your resource build-up that you kind of wanted to see coming into the year?

**Keith Mestrich:**

Yes. I don't know that we look at it really in terms of geographically where they're located. I would say that the team that we brought in from New Resource, very, very pleased with what's happened on the loan production side on that; exactly what we wanted to do, particularly in the energy efficiency and in the—in renewable energy space, seeing loan originations, really, across the country in that space generated by that—sometimes sourced by our commercial bankers, and then handled by that team, and using our bigger balance sheet to really put on significantly larger-sized facilities in those spaces. Whether it's a purchase package or individual loans, we're very, very happy with what's happening from that transaction. That's where the vast majority of our C&I activity is being—is coming from. It may not be in California, but it really comes as a result of that—the acquisition of that team.

**Drew LaBenne:**

Yes, and the one thing I'll—I didn't mention, or I didn't make entirely clear, but of the $78 million that we purchased in Q3, all of that was energy efficiency related, so it was residential solar. PACE obviously we've talked about before, but then the government guaranteed were all USDA solar farm loans as well, so (inaudible) our purchase loans are going a long way towards our mission on the renewable energy standpoint.

**Christopher O'Connell:**

Got it, and just thinking about the credit outlook going forward, I don't know if the—if you guys can speak to whether any of this indirect C&I has fallen off or been paid down in the fourth quarter already, or if you have any thoughts as to kind of the normalization of the recoveries or net charge-offs, and any thoughts, and if we could see kind of a more normalized provisioning charge-off and kind of reserve quarter in the fourth quarter this year.

**Drew LaBenne:**

I would say, generally, we're not seeing any trends that concern us from a credit standpoint. Obviously, we had to pay down a $17 million reduction in criticized and classified loans. We actually had another $6 million reduction here in Q4, so feeling pretty good on where the criticized and classifieds are going as well. The only loans out there that I think cause any concern are really those three indirect C&I loans that are part of that $61 million out there, and we continue to watch them every quarter and we'll see what happens to those three, but I think that portfolio is—it had a pretty fast run down. I think it's probably just going to dribble from here on out, but we might be surprised and get a payoff here or there.

**Christopher O'Connell:**

Got it, and then just last one here. I mean, you announced some pretty good progress on the share repurchases already in the fourth quarter. Can you remind us if there's any TC ratio or capital ratios that you want to keep at a certain level, maybe with some margin or safe tier buffer there in terms of capital to keep in the wheelhouse for M&A, or a comfortable level that you'd like to operate at?

**Drew LaBenne:**

Well, the range that we have talked about in the past is operating in the 7.5% to 8.5% tier one capital ratio, which we're at 9.03% this quarter, so we're at the higher end and we feel like we have some room to deploy capital. The share buyback's one way. We meet with our Board this week to discuss the dividend, so we'll see where that comes out later this week. By that I mean—I don't mean it—there may be an opportunity to raise it. We'll see what the Board decides to do there.

I think every quarter we have a conversation with our Board on capital and what we want to do on the buyback and on the dividend, and we'll continue to do that thoughtfully and think about how best to use capital, but our metrics remain the same.

As far as M&A, I think we've run through the main potential targets we had and really didn't come up with the yield, as Keith said, that made our economic—met our economic criteria, so I think right now there's really nothing in the pipeline that we're staring at to do a deal on, but if we were it would still be that three-year or less payback that we'd be looking for, and then we think share buybacks as sort of an opportunity to acquire more of ourself, so that metric certainly wouldn't be higher than 3.5 year—three years in terms of where we would do a buyback as well.

**Keith Mestrich:**

Then obviously, like every Bank, we're just watch and see, slowly figure out what we may have to reserve from a perspective there.

**Christopher O'Connell:**

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

**Keith Mestrich:**

Thanks, Chris.

**Operator:**

Our next question is from William Wallace with Raymond James. Please proceed.

**William Wallace:**

Thanks. Good morning, guys.

**Drew LaBenne:**

Hi Wally.

**Keith Mestrich:**

Good morning, Wally.

**William Wallace:**

Hi. We talked a lot about a lot of the moving parts with all the line items when it comes to net interest margin and what happens with the cut. I'm just wondering if maybe you can help us just put a bow on this as we think about our models. So, if the Fed cuts this week and then pauses, once we get past the impact of the Fed cut, with your loan mix potentially shifting, but your deposit mix also shifting as you continue to build up the political deposits, would you anticipate that margin would be stable, or do you think there'd be pressure moving on, or do you think the deposits that you're bringing on could actually drive expansion?

**Drew LaBenne:**

I think it's going to be tough to get NIM expansion unless the curve makes a pretty dramatic move from where it's at. Most of the long end of the curve—because over time it's going to be tough to not have those lower rates at kind of the 3 to 10-year point bleed into your margin, right, and I mean we have the leverage we've talked about in the past, which is the loan-to-deposit ratio, deposit growth, and I think those can definitely help offset, but most things going on the books now are coming on lower than where our loan yield is right now, with the exception of the commercial loans, and we've—we have a pretty good pipeline there in the near term, so I think we can help offset a lot of that pressure, but I think we're not going to be immune to gravity over the longer term if the curve still stays low like this.

**William Wallace:**

Okay. Thank you. That's helpful.

Keith, in your prepared remarks you talked about diligence on three potential transactions that ultimately didn't meet your criteria. Can you tell us, was the criteria that you missed on, was it all around pricing, or did you find when you sat down and started to dig in that culturally these transactions didn't work out?

**Keith Mestrich:**

Yes. I would say strategically really. I mean we could probably have made some of the deals work from an economic perspective, but when you stared at what we were actually getting for the transaction from a sort of deposit quality and composition standpoint, and then really from an asset quality and composition standpoint, for relatively small transactions we were looking at things and we just said for the strategic value that we're actually getting from these transactions, the degree of difficulty of doing this, especially when we're staring at the possibility of using that same capital to buy back our own Company, it just didn't make sense for us at the end of the day, and that—and the failure possibility right from an operational and integration standpoint just felt not right for us, so I'd call it strategic rather than cultural, but maybe that's the same thing in your head.

**William Wallace:**

No, that's fair, and then should we take your kind of initiation of commentary around looking to enter some new markets on a de-novo type basis, should we take that to mean that you feel like M&A opportunities are perhaps less attractive than maybe you thought 6 or 12 months ago?

**Keith Mestrich:**

I'd say we're still looking for M&A opportunities that come in our markets. We've always said we're going to be choosy, but I would also take it to say we're not going to wait. We're not going to wait for an M&A opportunity to get in those markets. We think, right, we have significant runway in other markets, and we think—we've been able to achieve growth in a market, i.e. Washington, without having to do it through an acquisition. We think we can do it in other markets, and while there's certain advantages to being able to have an acquisition to give yourself a head start, we think next year is a year we can just go into those markets and begin working our tails off to actually build our business.

**William Wallace:**

For what it's worth, I mean what about looking to invest more in markets like DC and San Francisco where you have a very small presence relative to the size, the overall size of the market?

**Keith Mestrich:**

Yes, not really an either/or decision in our minds, but really a both, and how do we actually grow the franchise, both in our organic markets and add some inorganic opportunities as well.

**William Wallace:**

Okay. Fair enough, and then one—just one last housekeeping; you said there was $400,000 FDIC credit in the fourth quarter. Do you anticipate, or are you going to be accruing that credit in the fourth quarter as well, or did you take it all in the third quarter?

**Drew LaBenne:**

What we took as a credit just directly offset what our assessment was in Q3, so I believe if the FDIC fund stays where it's at, that credit should be available continuing into Q4 as well, and probably into Q1.

**William Wallace:**

Okay. Thank you. That's all I have. Appreciate it.

**Keith Mestrich:**

Thanks, Wally.

**Operator:**

Ladies and gentlemen, we have reached the end of our question-and-answer session. I would like to turn the conference back over to Management for closing remarks.

**Keith Mestrich:**

Thanks. I just want to, again, thank everybody for taking a little time this morning joining us. Again, we are very, very happy with the quarter. I think a lot of great clarifying questions came from the folks who had questions this morning. We appreciate it and look forward to talking to you all in the future. Thank you.

**Operator:**

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