Second Quarter 2019 Earnings Call Transcript

July 29, 2019

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PRESENTATION

Operator:

Greetings. Welcome to Amalgamated Bank's Second Quarter 2019 Earnings 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. Please note this conference is being recorded.

I will now turn the conference over to Drew LaBenne, Chief Financial Officer. Thank you, you may begin.

Drew LaBenne:

Thank you, Operator, and good morning, everyone. We appreciate your participation today in our second 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 Investors section of our website for an extended period of time. 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 2018 10-K filed on March 28, 2019, and other periodic reports that we file from time to time with the FDIC, for a list of risk factors that could cause actual results to differ materially from those indicated or implied by such statements.

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

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

Keith Mestrich:

Thank you, Drew, and good morning, everyone. We appreciate your time and attention today. We are excited to be with you again to discuss our second quarter 2019 results. On today’s call, I’ll run through the high level details of the quarter, before providing an update on our unique deposit franchise, the progress we have made growing our loan portfolio and a review of our capital allocation strategy. Drew will then discuss our financial results in more detail.

There are a couple of key themes I want to pull out from a very positive quarter for Amalgamated. First, we are pleased with our second quarter results; second, our net interest margin held steady on a quarter-over-quarter basis; third, our deposit franchise remains vibrant, posting significant quarter-over-quarter growth in non-interest-bearing deposits, with minimal re-pricing pressure; fourth, we significantly decreased the risk in our lending portfolio by continuing our strategy of running off non-relationship C&I and leverage loans. It still saw a net increase in overall loans; fifth, we successfully executed upon one recent initiative to improve expenses with the closure of an unprofitable branch. We also continue to work on reduction in vendor expenses; and finally, our capital position remains strong, providing us with ample capital to complete an acquisition or return capital to shareholders in other ways.

For the second quarter, we delivered net income of $11.2 million, or $0.35 per diluted share, which compares to net income of $10.8 million or $0.33 per diluted share in the linked quarter, and net income of $11.6 million or $0.39 per diluted share for the second quarter of 2018.

Core earnings were $11.6 million, or $0.36 per diluted share, as compared to $10.7 million or $0.33 per diluted share in the linked quarter, and $11.8 million or $0.40 per diluted share in the second quarter of 2018. Core earnings this quarter exclude severance, loss on the sale of securities, and the tax effect of such adjustments. As a reminder, we believe core earnings are the best representation of our financial performance, as well as the run rate earnings power of the bank.

Turning to Slide 4, our deposit franchise continues to be a competitive advantage for the bank, as we continue to benefit from what is one of the lowest cost of funds in the industry. For the second quarter, deposits grew by $29.4 million or 2.9% annualized. As we have discussed on previous earnings calls, there are often short-term deposits that have the potential to cause volatility in our period-ending balance. As a result, average deposits are a better view of our franchise, and were $4.1 billion for the second quarter, representing an increase in average deposits of $190.4 million for the linked quarter. This growth was largely in average DDA balances which now represent 42.9% of our deposit base, up from 41% at the end of the first quarter.

Looking forward, our deposit pipeline remains strong across our core markets as our bankers work to expand our commercial relationships, while our political business continues to be strong. Both our New York and Washington markets are experiencing deposit growth in all of our customer verticals. Additionally, we have hired a new Regional Director in our Western region office, who we are confident will help accelerate growth in our deposit franchise in California.

Lastly, customers, particularly those in a nonprofit and impact business space, are expanding their relationships with us across business lines as they grow more interested in partnering with a socially responsible financial institution.

As anticipated, political deposit growth remained strong through the second quarter, and they increased by $148.5 million to $419.4 million, as compared to the first quarter of 2019's deposit balance of $271 million, as shown on Slide 5. The race for the democratic picket is in full swing, and fundraising activities have seen a marked acceleration since the debate several weeks ago. In fact, we've seen a further $37 million of political deposit growth through July. It is encouraging to see Amalgamated playing such a critical role with a vast array of the candidates running for office.

As we look to the 2020 election, we expect deposits to grow through the fall of 2020. We then anticipate a reduction in balances after the election, as candidates pay off their expenses. Overall, we have been very pleased with the sticky deposits that exist in the accounts today.

Our cost of funds increased slightly to 34 basis points in comparison to 31 basis points for the first quarter of 2019, and up 10 basis points compared to the year-ago period. Our cost to deposits, excluding broker funds, was 31 basis points. Our deposit base remains a stable, low-cost source of funds. For the full year of 2019, we expect deposit growth of 10% to 14%, adjusting for the $327 million of short-term deposits at year-end 2018.

Moving on to loans, which increased 2.9% on an annualized basis for the second quarter, were $23.9 million, as compared to the linked quarter, and were up 6.6% as compared to the year-ago quarter. This growth was achieved while we continued to aggressively reduce our indirect C&I portfolio in an effort to further de-risk our balance sheet, which I will leave to Drew to discuss in more detail momentarily.

I'm excited to share some news about a few recent accolades that we have received. Earlier this month, Euromoney magazine named Amalgamated their 2019 Best Bank in North America for Corporate Social Responsibility. The bank was awarded this honor based on our work in the impact lending space, our internal policies, our status as the largest B Corp bank in the U.S., and the work that we have done on the carbon measurement initiative, aimed at assessing the impact that bank balance sheets have on the climate.

We are thrilled to have been awarded this honor, and believe that this third-party validation is a great recognition of our strategy and mission, especially given the much larger global banks with even greater resources that we are competing against for this award.

In addition to the Euromoney award, the bank was also named one of the Best Banks in California by Forbes. This second award highlights our recent growth in the state with last year's acquisition of New Resource Bank. California provides a significant runway and opportunity for growth, and we are honored to be recognized by both Euromoney and Forbes for our continued efforts in growing our footprint and expanding the bank in a socially responsible way.

Turning to our capital allocation strategy, I would like to review our priorities for capital, as well as provide an update on our M&A pipeline as we work to enter attractive markets where Amalgamated's socially responsible, values-based culture will resonate.

Along those lines, our first priority for capital remains strategic M&A, where we continue to have an active pipeline and remain in discussion with several attractive candidates. We will continue to be disciplined as we strive to maximize value for all of our stakeholders.

Our second priority is to provide a steady return of capital to shareholders through a consistent quarterly dividend. Our goal is to steadily grow the dividend over time as we successfully increase the earnings power of the bank.

Our third priority is to return capital through our $25 million share repurchase plan, which was recently approved by our shareholders. We did not repurchase shares in the second quarter given our decision to hold capital to maintain flexibility and optionality, but will continuously evaluate that decision.

We continue to remain diligently focused on our capital allocation strategy. To recap, our priorities remain as follows: to commit capital to attractive and accretive acquisitions; a steady return of capital to shareholders; and finally, opportunistic share repurchases. Our ultimate goal is to create long-term value for our shareholders, and thus, our execution of the aforementioned is directly aligned with this mission.

To conclude, I am pleased with the growth we achieved during our second quarter, and even more excited with the opportunities that lie ahead. We're in a really good place as our brand awareness continues to grow, and the upcoming 2020 election is expanding our reach as we strive daily to build on our reputation as America's socially responsible bank.

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

Drew LaBenne:

Thank you, Keith. As Keith has already detailed with the success that we have achieved growing our deposit franchise, I will start with loan growth on Slide 6.

For the second quarter, we delivered loan growth of $23.9 million, or 2.9% annualized, as compared to the first quarter of 2019, and ended the quarter with $3.3 billion of total loans. Loan growth was primarily driven by an increase in residential first lien and Property Assessed Clean Energy, or PACE loans, and growth in commercial real estate. This growth was largely offset by the continued strategic reduction of our indirect C&I portfolio, which declined by $137 million in the second quarter through a combination of sales and payoffs. The portfolio has now been reduced by $166 million year-to-date, and currently stands at $70 million, as outlined on Slide 7.

Looking forward, we expect the portfolio to run off at a more measured pace. In the third quarter, we have already seen one of our substandard credits from this portfolio pay down the majority of its outstanding balance, and we expect an approximate $1 million release of allowance related to this credit in the third quarter. Our updated guidance on loan growth for the entire portfolio is 6% to 10% for the full year, which includes the impacts of the faster pace of indirect C&I runoff.

Skipping ahead to Slide 10, our net interest margin was 3.66% for the quarter compared to 3.65% in the first quarter of 2019, and 3.56% in the year-ago quarter. The yield on average earning assets was 4.07% for the second quarter, a decrease of three basis points as compared to the linked quarter. The yield on loans decreased two basis points to 4.42% compared to 4.44% during the first quarter. The loan yield for the current quarter had eight basis points of accretion from the loan mark, or three basis points higher than the previous quarter. Funding costs also decreased three basis points from the previous quarter, primarily due to lower federal home loan bank borrowings.

Our full year NIM guidance is now 3.55% to 3.65%, which assumes a 25 basis point rate cut from the Federal Reserve this week. The assessment also includes the impact of the de-risking of the balance sheet from the reduction of the indirect C&I portfolio and the benefit of a growing deposit base. This obviously implies that we expect NIM to decline in the third and fourth quarter of this year, due to all the previously mentioned factors.

Now on to non-interest income; non-interest income for the second quarter of 2019 was $6.3 million, a decrease from $7.4 million in the first quarter of 2019, and a $145,000 increase compared with the second quarter of 2018. The decrease from the previous quarter was primarily due to the loss on the sale of securities in the current quarter compared to a gain in the previous quarter.

Turning to Slide 11, non-interest expense for the second quarter of 2019 was $31.0 million, which compares to $31.4 million in the first quarter, and $30.1 million in the second quarter of 2018. We are pleased with the successes we have achieved in reducing costs in the quarter, and see further opportunities to reduce expenses over the near-term.

We will be closing our Chelsea branch in August, which will result in an approximate run rate savings of $800,000 annually. Negotiations are also underway on some key vendor contracts, and we hope to announce some progress there in the near future. We expect to continue to manage our cost structure and find additional opportunities over time.

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

Skipping ahead to Slide 13, nonperforming assets totaled $73.9 million, or 1.50% of period-end total assets at June 30, 2019, which was an increase of $17.4 million from the linked quarter. The change was primarily caused by a $6.8 million increase in loans 90 days past due and accruing, and a $9.8 million increase in accruing troubled-debt restructured loans.

The restructured loan is an indirect C&I loan that was rated substandard in the previous quarter and has since been modified, which we view as a positive development for this credit due to more equity being committed by the sponsor. The loans that were 90 days past due and accruing are all in various stages of documentation for renewal and should clear up over the next quarter.

The provision for loan losses in the second quarter of 2019 was $2.1 million, which compares to $2.2 million of provision in the linked quarter. The provision expense in the second quarter was primarily driven by an increase in provision due to a downgrade in the indirect C&I portfolio, and an increase due to qualitative factors related to our multifamily portfolio, given the change in New York City regulations. As a reminder, qualitative factors do not necessarily imply that the quality of any loan has deteriorated, and no multifamily loans in our portfolio were downgraded in the second quarter.

In the indirect C&I portfolio, one loan of $9 million was downgraded to substandard during the quarter, and another loan for $6.1 million was upgraded to special mention.

Turning to Slide 14, the allowance for loan losses decreased $3.6 million to $33.6 million at June 30, 2019 from $37.2 million at year-end 2018, primarily due to a charge-off on an indirect C&I loan in the first quarter, which had specific reserves against it. At June 30, 2019, the bank had $59.3 million of impaired loans, for which a specific allowance of $3.9 million was made, compared to $48.1 million of impaired loans in the linked quarter, for which a specific allowance of $1.5 million was made. The ratio of allowance to total loans was 1.01% at June 30, 2019, and 0.95% at March 31, 2019.

Turning to Slide 15, our return on average equity and core return on tangible common equity were 9.65% and 10.45% respectively. The core return compares to 10.18% for the first quarter of 2019 and 13.08% 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 expectations for the full year results, which are included on Slide 16. We are expecting pre-tax pre-provision earnings of $66 million to $72 million, deposit growth of 10% to 14%, loan growth of 6% to 10%, net interest margin of 3.55% to 3.65%, which assumes a rate cut of 25 basis points this week, and expenses of $31 million to $33 million per quarter.

To conclude, we are extremely pleased with our performance during the second quarter and are cautiously optimistic about the outlook for the remainder of the year as we take into account the anticipated fluctuations in the rent environment.

Thank you again for your time today. We look forward updating everyone on our third quarter results in October. 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. 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.

Keith Mestrich:

Hi, Steve.

Drew LaBenne:

Hey Steve. Good morning.

Steven Alexopoulos:

To start on the margin, maybe you can help us parse out the impact of the Fed. How do we think about, for every 25 basis point cut, what's the impact to NIM, just from that?

Drew LaBenne:

Well, in terms of NII, we anticipate about $2.5 million impact for each 25 basis point decrease, so obviously there's a lot of assumptions that go into that estimate, but that's where it stands right now.

Steven Alexopoulos:

Okay, that's actually helpful. Then if the Fed continues on a path of rate cuts, I know you're only baking July into the guidance. Can you talk about some of the levers you have available, something you might pursue to offset some of the pressure if it goes on longer?

Drew LaBenne:

Yes, absolutely. I think there's some positive impacts that we expect on NIM regardless of a rate cut, which is the continued deposit growth, and in particular, growth in DDA deposits as well, non-interest-bearing deposits.

The other thing is, right now we're sitting at a loan to deposit ratio of 80%, which is below, I think, most of the peer groups in the banking set right now. Now that we've largely finished the indirect C&I runoff, we should have less drag on our loan growth going forward, so I think that's an opportunity as well to hopefully replace securities with loans, which should have a positive impact on NIM.

Steven Alexopoulos:

Okay, that's helpful. Then maybe just on credit, if we look at the increase in 90 day past due, I think I heard you say these are mostly timing, is that right, and these should all clear up in terms of the $6 million or so increase quarter-on-quarter?

Drew LaBenne:

Yes, they're all 90 day…

Steven Alexopoulos:

Or by the end of next quarter? Yes.

Drew LaBenne:

Yes, they're all 90 days past due and accruing, and they're all paying—they're all past due maturities, basically, is what's causing it. It's delays in re-documentation, but all loans are paying and accruing.

Steven Alexopoulos:

But it's not related to credit stress on any of these, it's just really timing, is that what you're saying?

Drew LaBenne:

Yes, I think there's one loan in there that is also in our substandard bucket, but it's not anywhere else in the NPA table. That one, it's already in substandard. That one, I think, has some work to do on the credit, but it's still paying and accruing and has a very good LTV as well, so I think should be fine on that one, at least from what we know right now.

Steven Alexopoulos:

Okay. Then…

Keith Mestrich:

Yes, Steve, this is Keith on that. Our Head of Residential Mortgage is not up in my office every day saying, "I've got credit quality problems to worry about."—in fact, is continuing to underwrite in a very conservative fashion, and very proud of, I think, the credit quality of that book, and I think he continues to think that it's very solid.

Steven Alexopoulos:

Okay. Then finally, we haven't seen many of your peers increase the reserve on the New York City multifamily. Can you talk about what drove the decision to do that this quarter?

Drew LaBenne:

Yes, so there are a number of factors that go into the qualitative reserve, and one of those is the value of the underlying collateral. We had a specific event, or New York City had a specific event where the regulation was passed, and we felt like that—certainly, I think, the LTVs, not that we can quantify that on any specific property and I think the market's still in discovery mode on where value is on multifamily properties, but with that action, we believe that the value of multifamily properties has taken a hit in the New York City area, and therefore it was prudent to increase our qualitative backing related to that.

Steven Alexopoulos:

Okay. Terrific, thanks for all the color.

Drew LaBenne:

Thanks, Steve.

Operator:

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

Alexander Twerdahl:

Hey, good morning, guys.

Drew LaBenne:

Hi, Alex.

Keith Mestrich:

Good morning, Alex.

Alexander Twerdahl:

Hey, just first off, I wanted to ask about expense and the expense guidance, which was unchanged to $31 million to $33 million, yet you came in just below that this quarter. You have the branch closing in Chelsea, which should be a little bit of a help to expenses, and you kind of talked about a few other things that should further reduce expenses from here. Can you just maybe tell us why the expense guidance shouldn't be even a little bit lower than the $31 million to $33 million?

Drew LaBenne:

Yes. First of all, we do contemplate some more hires for the bank, right, so I think that will put—that will increase our salary and benefits expense a bit; some other things that are underway, which are change initiatives at the bank, I think. But then, we always want to make sure we have enough room on the upside to feel good about where our guidance is.

Keith, anything you want to add to that?

Keith Mestrich:

No. Alex, I think you're centering in on all the right things, right, continuing to look hard at occupancy expense and vendor expense, those are places where we think we have opportunities. I think it's fair to say a little bit—we might have to spend a little money to save a little money, too, on some of those initiatives, and do that. I do think we have some openings at the bank that have been unfilled for a little while through the recruitment phase, and those are going to sort themselves out in the second half of the year, so we'll see a little lift in some employment expense as well.

Alexander Twerdahl:

Okay, great, that's helpful. Then just secondly, since you didn't repurchase any shares in the second quarter, is that just a function of the price not necessarily getting below a certain level, or is that because there was—and maybe you're a little bit more advanced in some conversations, where you found some better uses in terms of M&A than maybe you had anticipated when you authorized the share repurchases.

Drew LaBenne:

Really, a combination, I think, of all of those things. I'm constantly looking at, what's the appropriate price to re-buy at. But, we did see a little continuation of an uptick in a number of conversations in the M&A space. We think that, over the long-term, using our capital wisely to make a smart, strategic acquisition that makes economic sense for the bank is the best thing to do. We are very selective in the places we want to go and the kind of banks that we want to buy, and the economic assumptions that would go into any deal. But we have had some uptick in conversations and it felt very prudent to hang on to that capital in case those opportunities presented themselves in the quarter or later this year.

Alexander Twerdahl:

Then, in those conversations, is the obstacle more of a—whoever's selling is not quite ready to sell yet, or is it more of, we can't really come to the right price yet, or what's kind of the biggest obstacle to actually getting something announced in the near-term?

Drew LaBenne:

Different conversations sort of have different reasons for that, but you hit on the two, exactly the two that are the barrier to getting to some agreement.

Alexander Twerdahl:

Very good. Thanks for taking my questions.

Drew LaBenne:

Thanks, Alex.

Operator:

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

Brian Morton:

Hi, good morning.

Drew LaBenne:

Hi, Brian.

Keith Mestrich:

Hey, Brian.

Brian Morton:

Hi, thanks. Was there anything maybe specific to the indirect C&I loan that drove the migration to the criticized (phon) and classified risk rating?

Drew LaBenne:

The one loan that was downgraded?

Brian Morton:

Mm-hmm.

Drew LaBenne:

Anything specific; the credit just got weaker in terms of revenue performance, so it went below our thresholds, and therefore needed to be downgraded. But nothing that—I would call it isolated, if maybe—if that's where your question is going. It's not related to…

Brian Morton:

Sure.

Drew LaBenne:

…anything else in the loan portfolio.

Brian Morton:

Okay, and do you continue to see favorable conditions in the market for these indirect C&I loans?

Drew LaBenne:

You mean for disposing of them?

Brian Morton:

That's correct, yes.

Drew LaBenne:

Yes. No, I would say—well, the credits that we have left are—now, keep in mind we started with, so over $600 million in this portfolio, and we're down to $70 million. As you're taking down the size of the portfolio that rapidly, you're going to be left with a couple credits that have some warts on them and need to be worked out, and that's part of what we have left.

The remainder is, it's a very tight club deal, and there are restrictions on just selling it to—bringing a new person into the club, if you will. Unless the existing lenders in the club are looking for a larger position, there's nowhere that you'd sell that loan. That's what's left in the portfolio now that we're working through.

Brian Morton:

Okay, great. Thanks.

Drew LaBenne:

Thanks, Brian.

Operator:

As a reminder, it's star, one on your telephone keypad if you would like to ask a question.

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

Christopher O'Connell:

Good morning, guys.

Keith Mestrich:

Hey, Chris.

Drew LaBenne:

Hey, good morning.

Christopher O'Connell:

Morning. Just wanted to kind of drill down on the provision outlook, I guess, just near-term. Next quarter, with the expected $1 million reserve release on that $8.6 million pay down, just thinking about where the blended kind of reserve is coming on for the core originations or core portfolio, or what level that's coming on at?

Drew LaBenne:

Yes, so there were really three major factors on the provision this quarter, which we talked about. The first is the C&I loan migration, the second is the qualitative factors on multifamily. The third one, which I know you all understand and pick up on, but I'll just say it on the call for clarity is, the amount of accretion from the loan mark that comes through also influences the ALLL because as that mark is running off from loans that we acquired leaving, the new loans have to build allowance on them that are coming and replacing those loans. We did have a higher level of accretion this quarter, which also impacted the ALLL by about $400,000.

Going into next quarter, what we're putting on the books, in the resi, the PACE space, those are going to be kind of 50 to 60 basis point coverage from an ALLL perspective. The relationship C&I loans are going to be a little over 1%, I think 1.1%. The blended rate is probably going to be in the 70s to 90s, depending on what that mix is and where it comes in.

Now, obviously, as we look into Q3, it's nice to have that one loan payoff, so we're kind of a million dollars ahead already going into the quarter. We'll have to see what happens with the rest of those credits, so we're not ready to give any specific guidance at this point on the rest of the portfolio.

Christopher O'Connell:

Got it. Thinking longer-term I guess, as the indirect C&I portfolio comes off over time, it sounds like it might be slower going forward. You would expect, all else equal, that reserve to kind of drop down into the 90s?

Drew LaBenne:

Yes. Yes, I think that's right.

Christopher O'Connell:

Then I noticed that you guys had about—are holding $239 million of the $750 million in the New York multifamily at a 50% risk weighting. But I believe the most restrictive policies are mostly debt service coverage that were 120 and LTVs below 80. Just given your guys' average debt service coverage at 147, loan-to-value 57%, which seems pretty strong overall, just wondering why more of that isn't held at the 50% risk weighted level?

Drew LaBenne:

I'll have to get back to you on that one, Chris. I mean, I think it's a combination of, it's not meeting—I think there's a couple more criteria on top of that, but it's obviously not meeting one of the criteria but probably the other. I'd have to go back and look at that. I don't know the breakdown of the reasons why they're falling out of that risk weighting bucket, off the top of my head.

Christopher O'Connell:

Got it. Then, just thinking more about multifamily loan growth going forward, there's obviously been a slowdown in the first half of the year for the New York City multifamily given the rent law changes. How are you guys thinking about that portfolio growth, kind of from here on out?

Keith Mestrich:

Well, we're still looking for opportunities in New York, obviously. We still have an origination team that works in New York and is continuing to work on pipeline, and we are continuing to see new deals come into the pipeline, so the market hasn't dried up completely. It feels like it will tighten, but I'm not sure we'll quite have a good sense of it.

We definitely like the multifamily space as a conservative space to be as we move into what's anticipated to be a different part of the credit cycle. I do think, in terms of trying to think about that portion of our asset bucket, we are looking at continuing to deepen our relationships with CDFI lenders who are making loans in that space, particularly in the CRA space. Remember, we do have two other cities where we have commercial real estate origination teams, both San Francisco and Washington, and we've asked our teams there to look at the possibility for expanding some of our multifamily opportunities in those markets as well.

We're liking the space and knowing that the competition may get fierce in New York, trying to look at other opportunities there, and we'll be spending more time in the third quarter honing those strategies.

Christopher O'Connell:

Got it.

Drew LaBenne:

Hey, Chris, just coming back to you on your other question. I think the biggest factor, by the way, why they're not included, is because you have to have over seven years—it has to be—have a life of over seven years at origination, and we have a lot of five-year loans on the books in multifamily. That's the biggest kick out part, so.

Christopher O'Connell:

Okay. Thanks. Thank you. Then just finally in terms of the loan growth this quarter and then here on out, how much of the loan growth, I guess, was purchased this quarter, and then what's the breakdown of West Coast versus East Coast franchise, the breakdown of originations this quarter and where you think the majority of the driver for future loan growth is going to be coming from?

Drew LaBenne:

Yes, so on the purchases, we had—we did a $30 million PACE purchase, we had $30 million of government guaranteed loans that we purchased, and then we had another $18 million of resi solar and another smaller loan category in there as well, commercial PACE.

A fair amount of purchases going on there within the same categories that we've been doing historically. As far as the originations by geography, it's probably not our primary focus when it's not real estate. More so it's the industries that we're going into and doing originations, especially by—either the credit type, collateral type or the mission alignment that the lending is happening in.

Keith Mestrich:

Yes, Chris, from our conversations, as you know, one of the key drivers and one of the key reasons we bought the San Francisco bank was for the opportunity to think about a couple of those lending verticals and the ability to use a much larger balance sheet with a national amount of exposure to do that.

In the renewable energy space in particular, we are seeing that happen. While some of those originations come out of our "Western region office", those are deals that are being done across the country and we're very happy with that. What is really starting to happen is exactly what we wanted to happen; we are becoming, really, a go-to bank for people doing solar and other renewable loans of a particular size. We're getting the reputation of being a bank with a sophisticated team of lenders in that space who can do that, and given that those loans have multiple parties and some structure to them, having been through scores of those loans and being able to withstand the brain damage of a new kind of loan for a lot of other banks, people are increasingly seeking us out as partners in that space, with some very attractive yields. I think we will continue to put emphasis there.

That's not a geographic emphasis, that's really a sectoral (phon) emphasis. I think we will continue to look for opportunities in those spaces. If multifamily shrinks a little bit, we should see some nice expansion in those areas, hopefully at more attractive yields than what the multifamily space presents for us.

Christopher O'Connell:

Great, that's really helpful. Thanks, guys.

Drew LaBenne:

Thanks, Chris.

Keith Mestrich:

Thanks.

Operator:

Our next question is from Matthew Breese with Piper Jaffrey. Please proceed.

Matthew Breese:

Good morning.

Drew LaBenne:

Hey, Matt.

Keith Mestrich:

Hey, good morning.

Matthew Breese:

Hey, I just wanted to hone in on the multifamily bucket, that exposed to the rent-regulated changes. I just wanted to make sure, the $750 million of your total, that's your New York City multifamily, and then 60% of that are rent-regulated, so therefore, exposed to some of these changes. That's $450 million, is that correct?

Drew LaBenne:

Yes. Well, it's the units—60% of the units of the $750 million. All of the $750 million—well, I shouldn't say it that way, because there's going to be some that have no rent-regulated units. But I wouldn't read it as 60% of the $750 million directly, because I think there's still properties that have units that are regulated and not regulated as well.

Matthew Breese:

Understood, okay. The $750 million, all of it might have some exposure to this, we're just not 100% sure.

Drew LaBenne:

Well, no. There's going to be some pure market rate deals there, property there that we'll have no exposure.

Matthew Breese:

Right.

Drew LaBenne:

But 60% of them have some exposure, yes.

Matthew Breese:

Okay. Then just honing in on the qual changes, so what was the allowance directly tied to multifamily prior to this quarter, and then what is it now? What was that change?

Drew LaBenne:

The change in the allot—well, the change due to the factor was $500,000, approximately, call it half a million approximately, related to the qualitative change.

Matthew Breese:

Okay. In that qualitative factor change, did you take into consideration, or make some estimate as to what the rent-regulated apartment valuation changes could be, and if so, could you share that with us, what the range was?

Drew LaBenne:

We did not; we don't have the information available to do that. That would require us to go out and do a whole new set of appraisals. I think over time, we'll get market color. Obviously, we've been reading the same market reports you've probably been reading that have sort of wide estimates of what the change could be.

Matthew Breese:

Okay. Then just thinking about the NIM, you noted that accretable yield this quarter was a bit elevated. Could you remind us—I know you've mentioned this in your comments, what the accretable yield was this quarter and how much of that you deem was, maybe, unusually high?

Drew LaBenne:

Yes, so last quarter, it was five basis points, this quarter it was eight basis points. That's about a $400,000 difference, rounding it off. I think the five basis points is probably the better level to assume in the near-term, and obviously, that will be decreasing over time.

Matthew Breese:

Okay. Then given the move in LIBOR, I know we have the Fed cut potentially happening here soon, but given the move in LIBOR, would you say that some of the Fed cut has already been kind of front-ran into your margin, and if so, how much? Just considering, just thinking about the 3Q NIM, all things considered, how much it could be down; want to get a better sense for the mid-quarter cut, plus what's already happened with LIBOR.

Drew LaBenne:

Yes, I think some of it's in there. For example, in the investment portfolio—there's so many factors, Matt. But for example, in the investment portfolio, a lot of thing's price off three months LIBOR. Three months LIBOR has reacted, obviously, in anticipation of what's happening there, but they also don't reset on a dime, they reset every three months. Some have gone through a reset, some have not, so it sort of blends itself in over the course of a quarter.

Then I think what you've seen on loans, non-floating loans, fixed rate loans, is obviously the long end of the curve came down a while back and it seems like it sort of stabilized it to some lower levels. But obviously that compression is already pricing into the new loans that were originating.

Matthew Breese:

Understood, okay. Then just trying to square some additional comments you provided on the securities portfolio, on the one hand it's an area where you could shift and defend the NIM, but on the other, it has been an area of growth recently. How should we be thinking and modeling the securities portfolio going forward?

Drew LaBenne:

I think flatter than it has been, flattish to maybe down, it depends on what happens with our loan growth and what we're actually able to achieve within that guidance range going forward. But, a lot of the factor here has been the increased runoff of the C&I portfolio that we've had to replace, and that is going to be much more muted going forward.

Matthew Breese:

Okay, understood. All right. That's all I had, thanks for taking my questions.

Drew LaBenne:

Thanks, Matt.

Keith Mestrich:

Thanks.

Operator:

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

William Wallace:

Thanks, morning, guys.

Drew LaBenne:

Thanks, Wally. Morning, Wally.

William Wallace:

I'm trying to think about your loan portfolio and maybe what would strategically be an optimal mix for you guys, if you think about it just from a retail versus commercial perspective. It looks like all of the commercial and industrial indirect loans that have run off have kind of gone into the retail side, and it looks like some of the other portfolios have also seen their portions—the commercial portfolios are shrinking as a percentage of total loans. Are you guys—do you have a target, strategically, that you'd like to see, commercial versus retail, in your loan portfolio?

Drew LaBenne:

Yes, so I think, Wally, us, like a lot of other banks, right, are trying to figure out, as the interest rate environment here changes, where are we actually going to find some yield, without taking unacceptable levels of additional risk in the market, given where we are in the credit cycle. Which would normally auger you out of, right, commercial lending, and more into sort of your real estate classes.

We obviously are struggling, right, with both those real estate classes now, as we have the pressure that we're talking about in the New York market, and with yields coming in on the residential market. They've been a little bit better of late, but thinking ahead, they're going to come in.

Overall, I think our general strategy is not necessarily that we have a number of where we want to get that direct C&I bucket to, but that we would largely keep our real estate buckets roughly where they are as a proportion of the overall assets, and look to continue to increase our commercial bucket with really well underwritten, direct C&I loans in the verticals that we are increasingly getting comfortable with that are in that renewable energy space and some of the other spaces that we've seen, with the kind of fulsome relationships that really bring a very advantageous relationship to the bank. Looking at that, that piece of the asset pie, if you will, is the increase at the expense, really, of the securities bucket, I think is how we're thinking about the loans.

But constantly, constantly reevaluating that to look at where yields are and coming in and what the overall risk factors are. But, I think the best way to think about it is the expansion of that direct C&I bucket at the expense of the securities portfolio.

William Wallace:

Okay, that's helpful. Then going back to some of your comments about some of the specialized lending that you're doing out of the West Coast region around some solar projects, do you have, at your fingertips maybe, the amount of loans in the portfolio that are originated or purchased out of market versus the ones that are originated in market?

Drew LaBenne:

For a C&I portfolio?

William Wallace:

Well, not just C&I. I assume a lot of the PACE loans and a lot of the resi solar loans are probably out of market as well. I'm just kind of curious, how much of the portfolio is out of the market? Ultimately, I'm curious if there's any concentration in any other regions from ones that you're purchasing?

Drew LaBenne:

Yes, so the resi solar and the PACE loans are going to be more concentrated in California and Florida, so there's definitely more geographic concentration there. The commercial loans, off the top of my head I would say that there's not any real strong concentration. I mean, obviously, there's—you're going to see concentration of New Resource, but I think we do—we're less geographically constrained on the relationship C&I portion of the portfolio.

William Wallace:

Okay. If you were to exclude those solar projects that are being originated out of the West Coast office, is the San Francisco market growing for you, exclusive of that specialty lending unit?

Drew LaBenne:

On the lending side?

William Wallace:

Yes.

Drew LaBenne:

We're growing in the commercial segment in California.

William Wallace:

Okay. Then, if I heard correctly, the NIM guide includes five basis points of purchase accounting accretion in the back half of the year?

Drew LaBenne:

Correct.

William Wallace:

Okay. That's all I had, everything else was asked. Thanks, guys.

Drew LaBenne:

Terrific. Thanks, Wally.

Keith Mestrich:

Thanks.

Operator:

We have reached the end of our question-and-answer session. I would like to turn the call back over to Management for closing remarks.

Keith Mestrich:

We just want to say, thanks to everybody for taking a little bit of time. We're pretty happy with the quarter, how it came out. We think it's the continuation of the story that we've been telling for the last year, and that's what we hope to continue to do in the quarters going forward. I hope everybody has a nice remainder of the summer. Thanks again.

Operator:

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