

Walker & Dunlop, Inc.  
Form 10-Q  
October 31, 2018  
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2018

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF  
1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 001-35000

Walker & Dunlop, Inc.

(Exact name of registrant as specified in its charter)

Maryland 80-0629925  
(State or other jurisdiction of (I.R.S. Employer Identification No.)  
incorporation or organization)  
7501 Wisconsin Avenue, Suite 1200E

Bethesda, Maryland 20814

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(301) 215-5500

(Address of principal executive offices and registrant's telephone number, including area code)

Not Applicable

(Former name, former address, and former fiscal year if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of October 24, 2018, there were 31,238,670 total shares of common stock outstanding.

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## PART I

## FINANCIAL INFORMATION

## Item 1. Financial Statements

## Walker &amp; Dunlop, Inc. and Subsidiaries

## Condensed Consolidated Balance Sheets

(In thousands, except per share data)

	September 30, 2018 (unaudited)	December 31, 2017
<b>Assets</b>		
Cash and cash equivalents	\$ 165,062	\$ 191,218
Restricted cash	16,226	6,677
Pledged securities, at fair value	109,062	97,859
Loans held for sale, at fair value	2,134,190	951,829
Loans held for investment, net	203,824	66,510
Servicing fees and other receivables, net	49,457	41,693
Derivative assets	28,182	10,357
Mortgage servicing rights	647,188	634,756
Goodwill and other intangible assets	157,077	124,543
Other assets	57,968	82,985
Total assets	\$ 3,568,236	\$ 2,208,427
<b>Liabilities</b>		
Accounts payable and other liabilities	\$ 275,460	\$ 238,538
Performance deposits from borrowers	16,122	6,461
Derivative liabilities	524	1,850
Guaranty obligation, net of accumulated amortization	44,413	41,187
Allowance for risk-sharing obligations	4,663	3,783
Warehouse notes payable	2,156,999	937,769
Note payable	163,626	163,858
Total liabilities	\$ 2,661,807	\$ 1,393,446
<b>Equity</b>		
Preferred shares, authorized 50,000; none issued.	\$ —	\$ —
Common stock, \$0.01 par value. Authorized 200,000; issued and outstanding 30,397 shares at September 30, 2018 and 30,016 shares at December 31, 2017.	304	300
Additional paid-in capital	240,721	229,080
Accumulated other comprehensive income (loss) ("AOCI")	(71)	93
Retained earnings	660,102	579,943
Total stockholders' equity	\$ 901,056	\$ 809,416
Noncontrolling interests	5,373	5,565

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Total equity	\$ 906,429	\$ 814,981
Commitments and contingencies (NOTE 10)	—	—
Total liabilities and equity	\$ 3,568,236	\$ 2,208,427

See accompanying notes to condensed consolidated financial statements.

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Walker &amp; Dunlop, Inc. and Subsidiaries

Condensed Consolidated Statements of Income and Comprehensive Income

(In thousands, except per share data)

(Unaudited)

	For the three months ended September 30,		For the nine months ended September 30,	
	2018	2017	2018	2017
Revenues				
Gains from mortgage banking activities	\$ 99,170	\$ 111,304	\$ 282,916	\$ 309,912
Servicing fees	50,781	44,900	148,138	129,639
Net warehouse interest income	3,880	5,358	8,129	17,778
Escrow earnings and other interest income	11,938	5,804	28,562	13,610
Other	18,888	12,370	42,568	33,716
Total revenues	\$ 184,657	\$ 179,736	\$ 510,313	\$ 504,655
Expenses				
Personnel	\$ 79,776	\$ 78,469	\$ 206,475	\$ 198,157
Amortization and depreciation	36,739	32,343	105,863	97,541
Provision (benefit) for credit losses	519	9	842	(216)
Interest expense on corporate debt	2,429	2,555	6,951	7,401
Other operating expenses	14,535	11,664	42,662	34,871
Total expenses	\$ 133,998	\$ 125,040	\$ 362,793	\$ 337,754
Income from operations	\$ 50,659	\$ 54,696	\$ 147,520	\$ 166,901
Income tax expense	12,902	19,988	32,023	54,621
Net income before noncontrolling interests	\$ 37,757	\$ 34,708	\$ 115,497	\$ 112,280
Less: net income (loss) from noncontrolling interests	41	330	(192)	114
Walker & Dunlop net income	\$ 37,716	\$ 34,378	\$ 115,689	\$ 112,166
Other comprehensive income (loss), net of tax:				
Net change in unrealized gains and losses on pledged available-for-sale securities	16	(2)	(164)	6
Walker & Dunlop comprehensive income	\$ 37,732	\$ 34,376	\$ 115,525	\$ 112,172
Basic earnings per share	\$ 1.24	\$ 1.14	\$ 3.83	\$ 3.74
Diluted earnings per share	\$ 1.17	\$ 1.06	\$ 3.60	\$ 3.49
Cash dividends declared per common share	\$ 0.25	\$ —	\$ 0.75	\$ —
Basic weighted average shares outstanding	30,423	30,085	30,219	30,009
Diluted weighted average shares outstanding	32,245	32,312	32,096	32,170

See accompanying notes to condensed consolidated financial statements.





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Walker &amp; Dunlop, Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(In thousands)

(Unaudited)

	For the nine months ended	
	September 30,	2017
	2018	2017
Cash flows from operating activities		
Net income before noncontrolling interests	\$ 115,497	\$ 112,280
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Gains attributable to the fair value of future servicing rights, net of guaranty obligation	(119,313)	(140,985)
Change in the fair value of premiums and origination fees	(2,226)	4,547
Amortization and depreciation	105,863	97,541
Provision (benefit) for credit losses	842	(216)
Other operating activities, net	(1,198,121)	(1,401,593)
Net cash provided by (used in) operating activities	\$ (1,097,458)	\$ (1,328,426)
Cash flows from investing activities		
Capital expenditures	\$ (1,965)	\$ (4,638)
Purchases of pledged available-for-sale securities	(60,088)	—
Funding of preferred equity investments	(1,100)	(16,321)
Proceeds from the payoff of preferred equity investments	30,624	—
Capital invested in the Interim Program JV, net	(890)	(6,184)
Acquisitions, net of cash received	(33,102)	(15,000)
Purchase of mortgage servicing rights	(1,814)	—
Originations of loans held for investment	(225,369)	(167,680)
Principal collected on loans held for investment upon payoff	87,688	117,479
Principal collected on loans held for investment upon formation of Interim Program JV	—	119,750
Net cash provided by (used in) investing activities	\$ (206,016)	\$ 27,406
Cash flows from financing activities		
Borrowings (repayments) of warehouse notes payable, net	\$ 1,228,850	\$ 1,360,969
Borrowings of interim warehouse notes payable	50,455	128,661
Repayments of interim warehouse notes payable	(61,049)	(175,934)
Repayments of note payable	(828)	(828)
Proceeds from issuance of common stock	8,939	2,887
Repurchase of common stock	(26,712)	(28,863)
Cash dividends paid	(23,600)	—
Payment of contingent consideration	(5,150)	—

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Debt issuance costs	(2,550)	(1,689)
Secured borrowings	70,052	—
Net cash provided by (used in) financing activities	\$ 1,238,407	\$ 1,285,203
Net increase (decrease) in cash, cash equivalents, restricted cash, and restricted cash equivalents (NOTE 2)	\$ (65,067)	\$ (15,817)
Cash, cash equivalents, restricted cash, and restricted cash equivalents at beginning of period	286,680	211,359
Total of cash, cash equivalents, restricted cash, and restricted cash equivalents at end of period	\$ 221,613	\$ 195,542
Supplemental Disclosure of Cash Flow Information:		
Cash paid to third parties for interest	\$ 35,315	\$ 34,286
Cash paid for income taxes	37,168	38,707

See accompanying notes to condensed consolidated financial statements.

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NOTE 1—ORGANIZATION AND BASIS OF PRESENTATION

These financial statements represent the condensed consolidated financial position and results of operations of Walker & Dunlop, Inc. and its subsidiaries. Unless the context otherwise requires, references to “we,” “us,” “our,” “Walker & Dunlop” and the “Company” mean the Walker & Dunlop consolidated companies. The statements have been prepared in conformity with U.S. generally accepted accounting principles (“GAAP”) for interim financial information and with the instructions to Form 10-Q and Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. Because the accompanying condensed consolidated financial statements do not include all of the information and footnotes required by GAAP, they should be read in conjunction with the financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017 (“2017 Form 10-K”). In the opinion of management, all adjustments (consisting only of normal recurring accruals except as otherwise noted herein) considered necessary for a fair presentation of the results for the Company in the interim periods presented have been included. Results of operations for the three and nine months ended September 30, 2018 are not necessarily indicative of the results that may be expected for the year ending December 31, 2018 or thereafter.

Walker & Dunlop, Inc. is a holding company and conducts the majority of its operations through Walker & Dunlop, LLC, the operating company. Walker & Dunlop is one of the leading commercial real estate services and finance companies in the United States. The Company originates, sells, and services a range of multifamily and other commercial real estate financing products, provides multifamily investment sales brokerage services, and engages in commercial real estate investment management activities. The Company originates and sells loans pursuant to the programs of the Federal National Mortgage Association (“Fannie Mae”), the Federal Home Loan Mortgage Corporation (“Freddie Mac,” and together with Fannie Mae, the “GSEs”), the Government National Mortgage Association (“Ginnie Mae”), and the Federal Housing Administration, a division of the U.S. Department of Housing and Urban Development (together with Ginnie Mae, “HUD”). The Company brokers, and in some cases services, loans for various life insurance companies, commercial banks, commercial mortgage backed securities issuers, and other institutional investors, in which cases the Company does not fund the loan.

The Company also offers a proprietary loan program offering interim loans (the “Interim Program”). During the second quarter of 2017, the Company formed a joint venture with an affiliate of Blackstone Mortgage Trust, Inc. to originate, hold, and finance loans that meet the criteria of the Interim Program (the “Interim Program JV”). The Interim Program JV assumes full risk of loss while the loans it originates are outstanding. The Company holds a 15% ownership interest in the Interim Program JV and is responsible for sourcing, underwriting, servicing, and asset-managing the loans originated by the joint venture. During the second quarter of 2018, the Company acquired JCR Capital Investment Corporation and subsidiaries (“JCR”), the operator of a private commercial real estate investment adviser. JCR, a wholly-owned subsidiary, is engaged in the management of debt, preferred equity, and mezzanine equity investments in middle-market commercial real estate funds. The operating results of JCR were immaterial for the three and nine months ended September 30, 2018.

NOTE 2—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Consolidation**—The condensed consolidated financial statements include the accounts of Walker & Dunlop, Inc., its wholly owned subsidiaries, and its majority owned subsidiaries. All intercompany transactions have been eliminated in consolidation. When the Company has significant influence over operating and financial decisions for an entity but does not have control over the entity or own a majority of the voting interests, the Company accounts for the investment using the equity method of accounting.

**Subsequent Events**—The Company has evaluated the effects of all events that have occurred subsequent to September 30, 2018. There have been no material events that would require recognition in the condensed consolidated

financial statements. The Company has made certain disclosures in the notes to the condensed consolidated financial statements of events that have occurred subsequent to September 30, 2018. No other material subsequent events have occurred that would require disclosure.

Use of Estimates—The preparation of condensed consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, and expenses, including allowance for risk-sharing obligations, capitalized mortgage servicing rights, derivative instruments, and the disclosure of contingent liabilities. Actual results may vary from these estimates.

Contracts with Customers—Substantially all of the Company’s revenues are derived from the following sources, all of which are excluded from the accounting provisions applicable to contracts with customers: (i) financial instruments, (ii) transfers and servicing, (iii) derivative transactions, and (iv) investments in debt securities/equity-method investments. The remaining portion of revenues is not significant and derived from contracts with customers. The Company’s contracts with customers do not require significant judgment or material estimates that affect the determination of the transaction price (including the assessment of variable consideration), the allocation of the

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transaction price to performance obligations, and the determination of the timing of the satisfaction of performance obligations. Additionally, the earnings process for the Company's contracts with customers is not complicated and is generally completed in a short period of time. The Company had no contract assets or liabilities as of September 30, 2018 and December 31, 2017. The following table presents information about the Company's contracts with customers for the three and nine months ended September 30, 2018 and 2017:

(in thousands)	For the three months ended September 30,		For the nine months ended September 30,		Statement of income line item Gains from mortgage banking activities
	2018	2017	2018	2017	
Description					Other revenues
Certain loan origination fees	\$ 15,981	\$ 13,358	\$ 39,637	\$ 36,811	
Investment sales broker fees, investment management fees, assumption fees, application fees, and other	11,927	7,633	24,345	17,050	
Total revenues derived from contracts with customers	\$ 27,908	\$ 20,991	\$ 63,982	\$ 53,861	

Loans Held for Investment, net—Loans held for investment are multifamily loans originated by the Company through the Interim Program for properties that currently do not qualify for permanent GSE or HUD (collectively, the “Agencies”) financing. These loans have terms of generally up to three years and are all multifamily loans with similar risk characteristics. As of September 30, 2018, Loans held for investment, net consisted of ten loans with an aggregate \$204.6 million of unpaid principal balance less \$0.7 million of net unamortized deferred fees and costs and \$0.1 million of allowance for loan losses. As of December 31, 2017, Loans held for investment, net consisted of five loans with an aggregate \$67.0 million of unpaid principal balance less \$0.4 million of net unamortized deferred fees and costs and \$0.1 million of allowance for loan losses.

In the third quarter of 2018, the Company transferred a portfolio of participating interests in loans held for investment to a third party. The Company accounted for the transfer as a secured borrowing. The aggregate unpaid principal balance of the loans of \$77.8 million is presented as a component of Loans held for investment, net in the Condensed Consolidated Balance Sheet as of September 30, 2018, and the secured borrowing of \$70.1 million is included within Accounts payable and other liabilities in the Condensed Consolidated Balance Sheet as of September 30, 2018. The Company does not have credit risk related to the \$70.1 million of loans that were transferred.

None of the loans held for investment was delinquent, impaired, or on non-accrual status as of September 30, 2018 or December 31, 2017. Additionally, we have not experienced any delinquencies related to these loans or charged off any loan held for investment since the inception of the Interim Program in 2012. The allowances for loan losses recorded as of September 30, 2018 and December 31, 2017 were based on the Company's collective assessment of the portfolio.

Provision (Benefit) for Credit Losses—The Company records the income statement impact of the changes in the allowance for loan losses and the allowance for risk-sharing obligations within Provision (benefit) for credit losses in the Condensed Consolidated Statements of Income. NOTE 5 contains additional discussion related to the allowance for risk-sharing obligations. Provision (benefit) for credit losses consisted of the following activity for the three and nine months ended September 30, 2018 and 2017:

(in thousands)	For the three months ended September 30,		For the nine months ended September 30,	
	2018	2017	2018	2017
Provision (benefit) for loan losses	\$ 4	\$ (100)	\$ 69	\$ (290)
Provision for risk-sharing obligations	515	109	773	74
Provision (benefit) for credit losses	\$ 519	\$ 9	\$ 842	\$ (216)

Net Warehouse Interest Income—The Company presents warehouse interest income net of warehouse interest expense. Warehouse interest income is the interest earned from loans held for sale and loans held for investment. Substantially all loans that are held for sale are financed with matched borrowings under our warehouse facilities incurred to fund a specific loan held for sale. A portion of all loans that are held for investment is financed with matched borrowings under our warehouse facilities. The portion of loans held for sale or investment not funded with matched borrowings is financed with the Company's own cash. Warehouse interest expense is incurred on borrowings used to fund loans solely while they are held for sale or for investment. Warehouse interest income and expense are earned or incurred on loans held for sale after a loan is closed and before a loan is sold. Warehouse interest income and expense are earned or incurred on loans held for investment during the period of time the loan is outstanding. Included in Net warehouse interest income for the three and nine months ended September 30, 2018 and 2017 are the following components:

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(in thousands)	For the three months ended September 30,		For the nine months ended September 30,	
	2018	2017	2018	2017
Warehouse interest income - loans held for sale	\$ 16,684	\$ 15,263	\$ 36,830	\$ 36,616
Warehouse interest expense - loans held for sale	(14,389)	(11,776)	(31,945)	(27,024)
Net warehouse interest income - loans held for sale	\$ 2,295	\$ 3,487	\$ 4,885	\$ 9,592
Warehouse interest income - loans held for investment	\$ 3,169	\$ 3,213	\$ 6,238	\$ 13,205
Warehouse interest expense - loans held for investment	(1,584)	(1,342)	(2,994)	(5,019)
Net warehouse interest income - loans held for investment	\$ 1,585	\$ 1,871	\$ 3,244	\$ 8,186
Total net warehouse interest income	\$ 3,880	\$ 5,358	\$ 8,129	\$ 17,778

Income Taxes—The Company records the excess tax benefits from stock compensation as a reduction to income tax expense. The Company recorded excess tax benefits of \$0.9 million and \$0.3 million during the three months ended September 30, 2018 and 2017, respectively, and \$6.7 million and \$9.1 million during the nine months ended September 30, 2018 and 2017, respectively.

In December 2017, the Tax Cuts and Jobs Act (“Tax Reform”) was enacted. Tax Reform changed the rules related to the deductibility of executive compensation under the provisions of Section 162(m) of the Internal Revenue Code. Tax Reform also contains provisions for determining whether compensation agreements executed prior to Tax Reform follow the guidance prior or subsequent to Tax Reform. During the third quarter of 2018, the Treasury Department issued initial guidance for determining, among other things, whether a compensation agreement in place prior to Tax Reform follows the guidance prior or subsequent to Tax Reform.

The deductibility of certain of the Company’s compensation agreements with its executives may be impacted by the Treasury guidance upon finalization. As of September 30, 2018, the Company has provisionally recorded approximately \$2.6 million of deferred tax assets related to such compensation agreements. The Company expects the accounting for these deferred tax assets to be completed in the fourth quarter of 2018 once the Treasury guidance is finalized.

Pledged Securities, at Fair Value—Pledged securities, at fair value consisted of the following balances as of September 30, 2018 and 2017 and December 31, 2017 and 2016:

September 30,

December 31,

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(in thousands)	2018	2017	2017	2016
Pledged cash and cash equivalents:				
Restricted cash	\$ 3,434	\$ 1,969	\$ 2,201	\$ 4,358
Money market funds	36,891	91,031	86,584	78,384
Total pledged cash and cash equivalents	\$ 40,325	\$ 93,000	\$ 88,785	\$ 82,742
Agency debt securities	68,737	2,102	9,074	2,108
Total pledged securities, at fair value	\$ 109,062	\$ 95,102	\$ 97,859	\$ 84,850

The investments in Agency debt securities consist of multifamily Agency mortgage-backed securities (“Agency MBS”) and are all accounted for as available-for-sale (“AFS”) securities. The following table provides additional information related to the AFS Agency MBS as of September 30, 2018 and December 31, 2017:

Fair Value and Amortized Cost of Agency MBS (in thousands)	September 30, 2018	December 31, 2017
Fair value	\$ 68,737	\$ 9,074
Amortized cost	68,808	8,981
Total gains for securities with net gains in AOCI	43	93
Total losses for securities with net losses in AOCI	(114)	—



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As of September 30, 2018, the Company does not intend to sell any of the Agency debt securities, nor does the Company believe that it is more likely than not that it would be required to sell these investments before recovery of their amortized cost basis, which may be at maturity.

The following table provides contractual maturity information related to the Agency MBS. The money market funds invest in short-term Federal Government and Agency debt securities and have no stated maturity date.

Detail of Agency MBS Maturities (in thousands)	September 30, 2018	
	Fair Value	Amortized Cost
Within one year	\$ —	\$ —
After one year through five years	16,675	16,671
After five years through ten years	41,106	41,152
After ten years	10,956	10,985
Total	\$ 68,737	\$ 68,808

Statement of Cash Flows—For presentation in the Condensed Consolidated Statements of Cash Flows, the Company considers pledged cash and cash equivalents (as detailed above) to be restricted cash and restricted cash equivalents. The following table, in conjunction with the detail of Pledged securities, at fair value presented above, presents a reconciliation of the total of cash, cash equivalents, restricted cash, and restricted cash equivalents as presented in the Condensed Consolidated Statements of Cash Flows to the related captions in the Condensed Consolidated Balance Sheets as of September 30, 2018 and 2017 and December 31, 2017 and 2016.

(in thousands)	September 30,		December 31,	
	2018	2017	2017	2016
Cash and cash equivalents	\$ 165,062	\$ 85,363	\$ 191,218	\$ 118,756
Restricted cash	16,226	17,179	6,677	9,861
Pledged cash and cash equivalents	40,325	93,000	88,785	82,742
Total cash, cash equivalents, restricted cash, and restricted cash equivalents	\$ 221,613	\$ 195,542	\$ 286,680	\$ 211,359

Recently Announced Accounting Pronouncements—In the first quarter of 2016, Accounting Standards Update 2016-02 (“ASU 2016-02”), Leases (Topic 842) was issued. ASU 2016-02 represents a significant reform to the accounting for leases. Lessees initially recognize a lease liability for the obligation to make lease payments and a right-of-use (“ROU”) asset for the right to use the underlying asset for the lease term. The lease liability is measured at the present value of the lease payments over the lease term. The ROU asset is measured at the lease liability amount, adjusted for lease prepayments, lease incentives received, and the lessee’s initial direct costs. Lessees generally recognize lease expense for these leases on a straight-line basis, which is similar to the accounting treatment today. ASU 2016-02 requires additional disclosures and is effective for the Company January 1, 2019. The new lease standard requires entities to use a modified retrospective approach for leases that exist or are entered into after the beginning of the earliest comparative period in the financial statements with a cumulative-effect adjustment to retained earnings recorded at the earliest comparative period. During the third quarter of 2018, Accounting Standards Update 2018-11 (“ASU 2018-11”), Targeted Improvements to Topic 842, Leases was issued. ASU 2018-11 provides companies with the option to apply a

practical expedient that allows adoption of the provisions of ASU 2016-02 prospectively with a cumulative-effect adjustment recorded to retained earnings upon the date of adoption.

The Company intends to adopt the standard when required on January 1, 2019 and to elect the available practical expedients, including ASU 2018-11. The Company has completed its analysis of the new standard and expects to be ready in time for the adoption next year. The Company is also in the process of analyzing the disclosures that will be required for the new standard. The Company expects ASU 2016-02 to have an impact on the Consolidated Balance Sheets similar to the amount quantified in the 2017 Form 10-K when it recognizes ROU assets and the corresponding lease liabilities. The Company expects an immaterial impact on the statements of income. There will be no change to the classification of the Company's leases, which are all currently classified as operating leases.

In the second quarter of 2016, Accounting Standards Update 2016-13 ("ASU 2016-13"), Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments was issued. ASU 2016-13 ("the Standard") represents a significant change to the incurred loss model currently used to account for credit losses. The Standard requires an entity to estimate the credit losses expected over the life of the credit exposure upon initial recognition of that exposure. The expected credit losses consider historical information, current information, and reasonable and supportable forecasts, including estimates of prepayments. Exposures with similar risk characteristics are

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required to be grouped together when estimating expected credit losses. The initial estimate and subsequent changes to the estimated credit losses are required to be reported in current earnings in the income statement and through an allowance on the balance sheet. ASU 2016-13 is applicable to financial assets subject to credit losses and measured at amortized cost and certain off-balance-sheet credit exposures. The Standard will modify the way the Company estimates its allowance for risk-sharing obligations and its allowance for loan losses and the way it assesses impairment on its pledged AFS securities. ASU 2016-13 requires modified retrospective application to all outstanding, in-scope instruments, with a cumulative-effect adjustment recorded to opening retained earnings as of the beginning of the period of adoption.

The Company plans on adopting ASU 2016-13 when the standard is required to be adopted, January 1, 2020. The Company is in the preliminary stages of implementation as it is still in the process of determining the significance of the impact the Standard will have on its financial statements. The Company expects its allowance for risk-sharing obligations to increase when ASU 2016-13 is adopted.

In the third quarter of 2018, Accounting Standards Update 2018-13 (“ASU 2018-13”), Fair Value Measurement (Topic 820): Disclosure Framework — Changes to the Disclosure Requirements for Fair Value Measurement was issued. ASU 2018-13 eliminates the following disclosure requirements; (i) the amount of and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy and (ii) the entity’s valuation processes for Level 3 fair value measurements. ASU 2018-13 adds, among other things, the requirement to (i) provide information about the measurement uncertainty of Level 3 fair value measurements as of the reporting date rather than a point in the future, (ii) disclose changes in unrealized gains and losses related to Level 3 measurements for the period included in other comprehensive income, and (iii) disclose for Level 3 measurements the range and weighted average of the significant unobservable inputs and the way it is calculated. ASU 2018-13 is effective for the Company on January 1, 2020 with early adoption permitted. The Company early-adopted ASU 2018-13 during the third quarter of 2018 with little impact to its disclosures as the Company has not historically had transfers between Level 1 and Level 2 of the fair value hierarchy or adjustments to its Level 3 fair value measurements due to unobservable inputs and does not have any Level 3 assets with unrealized gains and losses recorded in other comprehensive income.

In the third quarter of 2018, Accounting Standards Update 2018-15 (“ASU 2018-15”), Intangibles — Goodwill and Other — Internal-Use Software (Subtopic 350-40): Customer’s Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract was issued. ASU 2018-15 requires a customer in a cloud computing arrangement that is a service contract to follow the internal-use software guidance to determine which implementation costs to capitalize as assets. Capitalized implementation costs are amortized over the term of the hosting arrangement, and the expense related to the capitalized implementation costs is recorded in the same line in the financial statements as the cloud service cost. ASU 2018-15 is effective for the Company on January 1, 2020. Entities have the option to apply the guidance prospectively to all implementation costs incurred after the date of adoption or retrospectively. The Company is in the process of determining the impact ASU 2018-15 will have on its financial statements and when it will adopt ASU 2018-15.

There are no other accounting pronouncements previously issued by the FASB but not yet effective or not yet adopted by the Company that have the potential to materially impact the Company’s condensed consolidated financial statements.

There have been no material changes to the accounting policies discussed in NOTE 2 of the Company’s 2017 Form 10-K.

Reclassifications—The Company has made certain immaterial reclassifications to prior-year balances to conform to current-year presentation.

NOTE 3—GAINS FROM MORTGAGE BANKING ACTIVITIES

Gains from mortgage banking activities consisted of the following activity for the three and nine months ended September 30, 2018 and 2017:

(in thousands)	For the three months ended September 30,		For the nine months ended September 30,	
	2018	2017	2018	2017
Contractual loan origination related fees, gross	\$ 64,197	\$ 64,977	\$ 180,655	\$ 183,599
Co-broker fees	(4,603)	(4,454)	(17,052)	(14,672)
Fair value of expected net cash flows from servicing recognized at commitment	42,811	53,614	129,764	150,608
Fair value of expected guaranty obligation recognized at commitment	(3,235)	(2,833)	(10,451)	(9,623)
Total gains from mortgage banking activities	\$ 99,170	\$ 111,304	\$ 282,916	\$ 309,912

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## NOTE 4—MORTGAGE SERVICING RIGHTS

Mortgage servicing rights (“MSRs”) represent the carrying value of the servicing rights retained by the Company for mortgage loans originated and sold. The initial capitalized amount is equal to the estimated fair value of the expected net cash flows associated with the servicing rights. MSRs are amortized using the interest method over the period that servicing income is expected to be received.

The fair values of the MSRs at September 30, 2018 and December 31, 2017 were \$857.0 million and \$834.5 million, respectively. The Company uses a discounted static cash flow valuation approach, and the key economic assumption is the discount rate. For example, see the following sensitivities:

The impact of a 100-basis point increase in the discount rate at September 30, 2018 is a decrease in the fair value of \$26.7 million.

The impact of a 200-basis point increase in the discount rate at September 30, 2018 is a decrease in the fair value of \$55.4 million.

These sensitivities are hypothetical and should be used with caution. These estimates do not include interplay among assumptions and are estimated as a portfolio rather than individual assets.

Activity related to capitalized MSRs for the three and nine months ended September 30, 2018 and 2017 is shown in the table below:

(in thousands)	For the three months ended September 30,		For the nine months ended September 30,	
	2018	2017	2018	2017
Beginning balance	\$ 638,914	\$ 573,159	\$ 634,756	\$ 521,930
Additions, following the sale of loan Purchases	46,107	48,174	119,588	165,748
Amortization	—	—	1,814	—
Pre-payments and write-offs	(33,157)	(30,174)	(98,119)	(88,398)
Ending balance	(4,676)	(3,250)	(10,851)	(11,371)
	\$ 647,188	\$ 587,909	\$ 647,188	\$ 587,909

The following tables summarize the components of the net carrying value of the Company’s acquired and originated MSRs as of September 30, 2018:

(in thousands)	As of September 30, 2018		
	Gross carrying value	Accumulated amortization	Net carrying value
Acquired MSRs	\$ 185,529	\$ (133,955)	\$ 51,574
Originated MSRs	884,918	(289,304)	595,614
Total	\$ 1,070,447	\$ (423,259)	\$ 647,188

As of December 31, 2017		
Gross	Accumulated	Net

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(in thousands)	carrying value	amortization	carrying value
Acquired MSRs	\$ 183,715	\$ (121,643)	\$ 62,072
Originated MSRs	820,137	(247,453)	572,684
Total	\$ 1,003,852	\$ (369,096)	\$ 634,756

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The expected amortization of MSR's recorded as of September 30, 2018 is shown in the table below. Actual amortization may vary from these estimates.

(in thousands)	Originated MSR's Amortization	Acquired MSR's Amortization	Total MSR's Amortization
Three Months Ending December 31, 2018	\$ 29,615	\$ 2,703	\$ 32,318
Year Ending December 31,			