Byline Bancorp, Inc.

1Q 2020 Earnings

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CORPORATE PARTICIPANTS

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Lindsay Y. Corby - *Executive Vice President and Chief Financial Officer*

PRESENTATION

Operator
Good morning, and welcome to Byline Bancorp's First Quarter 2020 Earnings Conference Call. All participants will be in listen-only mode. Should you need assistance, please signal a conference specialist by pressing the star key followed by zero. After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press star then one on your telephone keypad. To withdraw your question, please press star then two. Please note that this event is being recorded.

I'd now like to turn the conference over to Mr. Tony Rossi of Financial Profiles. Please go ahead.

Tony Rossi
Thank you, Nick. Good morning, everyone, and thank you for joining us today for the Byline Bancorp First Quarter 2020 Earnings Call.

We will be using a slide presentation as part of our discussion this morning. Please visit the Events and Presentations page of Byline's Investor Relations website for access to the presentation. Before we begin, I'd like to remind you that this conference call contains forward-looking statements with respect to the future performance and financial condition of Byline Bancorp that involve risks and uncertainties, including the impact of the COVID-19 pandemic. Various factors could cause actual results to be materially different from any future results expressed or implied by such forward-looking statements. These factors are discussed in the company's SEC filings, which are available on the company's website.

The company disclaims any obligation to update any forward-looking statements made during the call. Management may refer to non-GAAP measures, which are intended to supplement, but not substitute for the most directly comparable GAAP measures. The press release available on the website contains the financial and other quantitative information to be discussed today as well as the reconciliation of the GAAP to non-GAAP measures.

And with that, I'd like to turn the call over to Alberto Paracchini, President and CEO. Alberto?

Alberto J. Paracchini
Thank you, Tony. Good morning, and welcome, everyone, to our first quarter earnings call. We appreciate all of you joining us this morning. For all of you on the call, I trust you and your families are healthy and safe under these unprecedented circumstances.

Joining me on the call today is Lindsay Corby, our CFO; and Owen Beacom, our Chief Credit Officer. I think it's fair to say that the first quarter will be one that we will remember for the rest of our careers. What started out as a fairly typical quarter, quickly became atypical and extraordinary as a result of this pandemic. Given the changes in the operating environment brought on by COVID-19, we want to spend most of the time on our call today, providing an overview of our response, discussing the impact we are seeing on our business and providing some additional color on our loan portfolio. After that, we will open the call up for questions. As a reminder, you can follow our comments with the help of an investor deck you can find in the Investor Relations section of our website.

Before we get into the COVID-19 discussion, I want to provide you with an overview of the first quarter.

Net income for the quarter came in at $3 million or $0.07 per diluted share. Our bottom-line results were impacted by a significant provision, leading to an increase in our allowance to reflect the weakening economic conditions, disruption in the market for government-guaranteed loans and a fair value writedown to our servicing asset despite a significant slowdown in prepayment speeds.

The quality of our deposit franchise was evident and reflected in our net interest margin, which, excluding accretion income, remained stable from the prior quarter at 388 basis points, as we were able to reduce funding costs to offset declines in earning asset yields. The fee income component of our revenue declined by $5.3 million from the prior quarter and was primarily impacted by lower gain on sale revenue and their fair value charge to our servicing assets that I mentioned earlier. Our efficiency ratio increased to 66%, with the increase entirely driven by lower revenue given flat expense levels on a quarter-over-quarter basis.

Balance sheet growth for the quarter was healthy and saw the loan portfolio grow by 7.9%. A portion of that growth was driven by commercial customers drawing on their lines, particularly at the start of the crisis. Total deposits increased by $91.3 million or 8.8% annualized with noninterest bearing holding steady at 30.5% of total deposits. The loan-to-deposit ratio remained essentially flat at 91.4% as deposit growth slightly outpaced loan growth for the quarter. In terms of asset quality, nonperforming loans increased by $12.7 million for the quarter. The increase was driven, primarily by three acquired commercial loans and one government-guaranteed construction loan that fell into nonaccrual status during the quarter. Provision expense covered charge-offs of $4.6 million by more than 3 times, which resulted in the allowance for loan losses increasing to $41.8 million or 1.08% of loans at the end of the quarter.

Turning to slide 4. I want to provide an overview of how we've responded to the COVID-19 crisis to support employees, customers and communities. Since day one of the crisis, our primary concern has been protecting the health and safety of our employees and customers. The technology investments we've made in our platform over the past few years allow us to quickly transition all of our non-retail employees, more than 640 of them or 64% of our workforce, to a work-from-home environment, while maintaining business continuity, high productivity and service levels. We've put a number of programs in place to support our employees during this time, including providing paid time-off for anyone dealing with COVID-19, either personally or within their family, and have expanded our health benefits to cover the cost of COVID-19 testing and treatment.

From a retail standpoint, customer activity has been stable, and the environment has remained very manageable. We have obviously experienced a significant reduction in branch traffic, as we have temporarily closed some of our locations and seen a corresponding increase in the use of digital and alternative delivery channels by our customer base. We have continued to provide branch access through a combination of by-appointment services and drive-thru locations.

In terms of our borrowers, we're closely monitoring line of credit utilization as we saw customers' increase draws on credit lines by $117 million relative to the prior quarter, which pushed line utilization rates to 63%. Our focus during the quarter shifted from managing new business pipelines to focusing on existing customers and establishing relief and support programs to help them navigate through this period.

Turning to slide 5, I would like to provide a bit more detail on the support programs we have put forth in place for our customers. As one of the largest SBA lenders in the country, we have been an active participant in the PPP program with a focus on our existing customer base. We have processed more than 3,600 loan requests, resulting in approximately $718 million in approved loans. To date, we have funded approximately $436 million and expect to get the remaining funds to customers over the next week. Customer participation in the program was broad and covered all of our business lines, including SBC, commercial banking as well as retail customers. The average size of a PPP loan was just over $200,000, with the median coming in at $65,000. We expect to generate approximately $23 million in fees from the program.

Outside of the PPP program, we have been proactively working with borrowers and granting relief on a case-by-case basis. The modifications we've granted have primarily been 90-day deferrals of either/or principal and interest payments. Through April 29, we have granted $396 million of deferrals, representing just over 10% of our portfolio, with the majority of that being for our commercial banking clients. In terms of industries today, we have granted the most deferrals to borrowers who rent nonresidential properties, manufacturing companies, retail enterprises and accommodation and food service companies. At this point, I would like to turn the call over to Lindsay to walk you through some additional information regarding how we are positioned to manage through the crisis. Lindsay?

Lindsay Y. Corby
Thanks, Alberto. I will start on slide 7 with a review of our liquidity and capital position. Our liquidity remains strong. We ended the quarter with $120 million in cash and equivalents, and an investment portfolio representing 22.7% of total assets. In addition, we currently have $2 billion in funding availability, excluding the Fed PPP liquidity facility, and we plan to utilize to fund our PPP portfolio.

In terms of our capital, our strong operating performance has steadily increased our capital ratios over the past year, while supporting our balance sheet growth and return of capital to shareholders through both our share repurchase program and our quarterly common stock dividend. Total capital and tangible common equity ratios exceed [indiscernible] levels at the end of the quarter at 14.5% and 10.3%, respectively. As part of our capital planning process and as a result of the uncertain environment, we ran several adverse scenarios resulting in projected capitals, all above well capitalized, including the continuation of our common dividend. However, given the uncertainty around the current environment and our commitment to support our customers, we have paused our activities on the share repurchase program.

Turning to slide 8, we have provided some additional information around the composition and diversification of our portfolio. In terms of concentrations within the portfolio, the real estate and rental and leasing segment and the manufacturing segment represents the largest percentages of our total loans at 30% and 14%, respectively. Generally, our real estate portfolio has a minimum debt service coverage ratio of 1.25% with a maximum LTV of 75%. Our retail and office space generally carries a minimum debt service coverage of 1.3%, with a maximum LTV of 70%; 57% of our loans are variable rates, split fairly between loans tied to LIBOR and loans tied to prime, and 43% are fixed rate.

Our total commercial lines of credit exposure is $2.1 billion, with $786 million of that being unfunded commitments. In terms of line utilization, we saw a four-percentage point increase in our utilization rate during the first quarter to 63%. Since the crisis started, we have implemented a proactive approach to credit risk management that has included direct contact with our customers to get real-time information and assess the impact of COVID-19.

Turning to slide 9, we have provided information on our exposure to the industries that we have identified as early impact and sensitive to COVID-19. In aggregate, these industries represent approximately 10% of our total loans. To date, we have granted deferrals on approximately $76 million of the outstanding balances on these loans, about 19% of all deferrals approved to date. Our largest exposure is restaurants, which represents 3.4% of our total loans. It's a very granule portfolio with average loan size at approximately $227,000 and 12% of the outstanding amount carries the government guarantee. We have minimal exposure to the hotel industry with these loans representing just 1.6% of our total loans. The two largest relationships in this portfolio have a combined total of approximately $21 million outstanding and have strong credit profiles and sponsorship.

Moving to slide 10, we'll discuss our government-guaranteed lending business. As Alberto mentioned earlier, the disruption we saw in the first quarter impacted our level of loan production with closed loan commitments coming in at $79.9 million. The total balance of the government-guaranteed loans that we manage was essentially unchanged in the quarter, and the largest concentration in our retained portfolio continues to be manufacturing retail trade and food services, which each account for between 14% to 16% of total loans in this portfolio. Under the CARES Act, the SBA will pay all principal and interest for six months on all existing SBA loans and regular servicing status as well as new loans disbursed prior to September 27. As such, our SBA borrowers will have a bit of breathing room to absorb the initial impact of COVID-19.

Turning to slide 11, we look at our net interest margin. We have consistently generated net interest margin above our peer group, which, we believe, will help us to offset some of the impact that this crisis will put on other revenue-generating areas. While the full quarter impact of the recent Fed rate cuts will continue to pressure our earning asset yields, we believe there will be a number of factors that will help us offset a portion of this pressure. We have been able to steadily reduce our cost of deposits by improving our deposit mix, being proactive with our deposit pricing in the declining rate environment and benefiting from the CD repricing that occurred during the first quarter.

Our March average cost of deposits came in at 62 basis points compared to an average cost of deposits of 75 basis points for the first quarter. With this lower starting point, we should continue to see a decline in deposit costs in the second quarter. Over the rest of 2020, we have $810 million in CDs maturing at an average rate of 1.66%. As these CDs renew at lower rates, we expect to see further declines in our deposit costs. In addition, as a result of the PPP program, we estimate fee income to be 3.3% of the loans processed over the life. Yield on the loans at 1% will cause compression initially for the NIM. However, the processing fees will positively impact our net interest income and possibly our net interest margin in the future quarters as well, depending on how quickly the loans are forgiven or repaid. We may see accelerated recognition of these fees during the third quarter.

At this point, I will turn the call back to Alberto.

Alberto J. Paracchini
Thank you, Lindsay. And turning to slide 12, I want to wrap up with a few comments about areas of focus in the current environment. Our immediate focus will be to continue to protect the safety of our employees and customers, particularly as we eventually plan for a return to a more normal work environment, maintain expense discipline and operate the business with the utmost safety and soundness in mind.

On the business front, we expect that during the coming quarters, our efforts will be centered on helping clients navigate through a difficult period. Although the duration and severity of the COVID-19 pandemic is uncertain, we're well positioned from a capital and liquidity standpoint to support our clients and communities during this unprecedented period.

With that, operator, I'd like to open the call up for questions.

QUESTIONS AND ANSWERS

Operator

We’ll now begin the question-and-answer session. To ask a question, you may press star, then one on your touchtone phone. If you are using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question, please press star, then two. At this time, we will pause momentarily to assemble our roster. Our first question comes from Ebrahim Poonawala of Bank of America. Please go ahead.

Ebrahim Poonawala
Good morning, guys. So, thanks for all the detail. I guess if you could just go back to the slide 9 where you lay out all the sort of COVID-impacted sectors, I guess. Just talk to us, Alberto, around the restaurant finance book around just what the borrower base looks like ex sort of the guaranteed portion and your visibility around just sponsor guarantees, quick service versus casual dining, like which is the type of restaurant and your comfort around how some of these borrowers may navigate these lockdowns?

Alberto J. Paracchini
Sure. So EB, the I would categorize it in when you look at the total, I would say that there's a conventional component. I believe the number is, let me just kind of just give you the breakdown, what is kind of the small business piece. So about $80.9 million of that $125.2 million that you see there is really kind of small business capital. So that there is the essentially the bulk of the exposure, and I would say that's very granular. That's a mixture of all sorts of quick service restaurants, different franchises as well as smaller restaurants operating generally within the Midwest footprint that we typically originate government-guaranteed loans in.

The balance of that is more restaurants that fall in what I would call our conventional book. And as you can see from the difference, that's more limited, and that's typically we're not there financing so much as franchises or quick service restaurants, but rather more established restauranteurs, operators of multiple facilities. In some cases, we've financed the building for the restaurant owner as well as provide financing for the restaurant. In other cases, we're just essentially just financing the building, not necessarily the restaurant. So hopefully that gives you a little bit of color in terms of what you have in that category.

Ebrahim Poonawala
That's helpful. And you mentioned, Lindsay, that you ran also a stress test in this term of measuring capital adequacy. When you think about just reserves, and obviously, you're still on the incurred loss model, talk to us in terms of how you see that reserve ratio evolving beyond this point. Like, do you expect to see some credit migration as we think about the second quarter and that will be a bigger factor in informing the reserve build from here on?

Lindsay Y. Corby
Yes. We're not going to give exact guidance on this, but I'll give you our view in terms of what we think. We did obviously have a reserve increase related to COVID-19 in the first quarter. Right now, given the uncertainty and everything that's going on here, and just frankly, the unknown, we really believe that it's going to depend on the severity and the duration here in terms of what's ahead. So, we do think that the future will be robust in terms of what's going to be needed to be provided, but in terms of how much, EB, time will tell.

Ebrahim Poonawala
Got it. And if I may, just one last one. Sorry, I understand your focus is on serving customers and focusing on just getting through this over the next few months. Do you see, like within your footprint, dislocations being created by this, which eventually feeds to your business model of rolling up, acquiring potential smaller banks? If you can talk to that, Alberto.

Alberto J. Paracchini
That's a good question, EB. I think as with any type of situation like we've gone through before in terms of a crisis, I think there's a plenty of fog in the horizon right now. And I think as that fog clears, there are likely to be opportunities. I think what our focus is right now is really just trying to see the city here in Chicago and also in your city as well, we're not open for business yet. I think we want to see what the environment looks like after we start returning to some degree of normalcy and be able to, at that point, kind of assess what the environment is going to be on a go-forward basis. But to answer your question, in times of stress, opportunities usually will present themselves as the dust starts to settle and they become more evident. And I do believe that that will be the case this time around as well.

Ebrahim Poonawala
Got it. Thanks for taking my questions.

Operator
Next question comes from Nathan Race of Piper Jaffray. Please go ahead.

Nathan Race
Hi, everyone. Good morning and hope you all are doing well.

Alberto J. Paracchini
Thank you, Nate.

Lindsay Y. Corby
Thanks, you too.

Nathan Race
Just going back to the PPP discussion, I appreciate all the details in the deck along those lines and it makes sense to see you guys are very active in that space just given your scale on the SBA side of things. I'm just curious, based on the disclosures you guys provided on slide 9, just in terms of the early impact industry exposure, curious, what amount of those PPP loans are going to those restaurant and hotel operators within the portfolio that are maybe more at risk near term from a liquidity and capital standpoint?

Alberto J. Paracchini
So Nate, I would say that for the vast majority of our customers, unless I mean, there were really exceptions where customers decided that they didn't want to participate in the program or they didn't qualify for the program for x and y reason, we really strive to get participation and make sure that our customers were offered the opportunity to participate in the program and then hopefully, for us to be able to get them an allocation in the program. I think we were able to do that. So, I would say, broadly speaking, for the vast majority of the customer base here, including those that you see categorized there on slide 9, they were all participants in the PPP program.

Nathan Race
Got it. That's great to hear. And then kind of changing gears along the SBA side of things, sold volumes were obviously down in the quarter and some of that could be seasonal and whatnot. But just curious, given your focus near term seems to be on just funding, PPP loans help a lot of these small clients, both new and current kind of get through this turbulent time, but just any thoughts, generally speaking, just how those non-PPP SBA volumes trend into 2Q and to 3Q as well to some extent.

Alberto J. Paracchini

Yes. I mean there we the interesting thing about the quarter is kind of like a tale of two cities. We had the kind of the pre-March quarter and then we had, obviously, the massive change in the environment that happened during the month of March. So, I can tell you, the quarter was a typical quarter through essentially the month of February. Pipelines were building, both on the SBC side, as you know, the SBC side is a little bit more seasonal and slower during the first quarter, but pipelines were building there, and we had an active pipeline going into the month of March. Some of those loans will continue and will resume and we'll eventually fund those loans. And we can talk about the secondary market and kind of the state of the secondary market in a bit, but clearly, the focus during the month of April in earnest, but really after the onset of the crisis, was more internal as opposed to external.

That being said, I mean there's business, there's a pipeline there that will continue. And I think we'll have to see how things develop from here. As you know, the current 7A [ph] appropriation is tied with the Payment Protection Program appropriation at this point. That funding hasn't run out, but there's a potential that funding potentially could run out and whereby the funding would not be reestablished until July 1. We will see. We've gone through those periods before, and we'll see what happens with ultimately the funding of the PPP program.

The other thing is, as you know, there's another stimulus bill that's being discussed in Congress. There are rumors that additional language or language in that bill could potentially expand the guarantees for the existing program, so for the 7A as well as for the SBA Express programs. I don't we don't have any visibility into that language and a lot of stuff can happen certainly before that bill, hopefully or eventually becomes a law. But we'll have to see how the environment as it pertains to funding for the programs and what changes to the programs become available.

That being said, the environment is certainly a stressed environment. It is fair to say that we believe that a number of borrowers here will be going through difficult periods in the months and quarters ahead. And SBA programs in the past, particularly coming out of crises have been very useful in providing financing to companies that are not able to access conventional financing at that time. And we expect that this environment and ultimately, as we come out of the environment that, that will be no different.

Nathan Race
Got it. That's great color. Very helpful. And if I could just ask one more on the core NIM. Obviously, a bunch of various moving pieces. But I guess if we kind of strip out the PPP impact that's going to occur over the next few quarters, core deposit growth is pretty strong. You guys brought down deposit costs pretty noticeably in the quarter as well. So just curious how we should maybe think about the core NIM into the second quarter. Obviously, the recent Fed cuts won't help. But just curious within that context, what amount of floating rate loans are maybe nearing floors at this point. And I know you guys have done a good job over the last several quarters getting floors in a lot of those loans. So just curious, again, with deposit costs coming down and the strong core deposit growth in the corner, how much more opportunity exists to kind of improve the funding mix and also bring down core deposits or I'm sorry, deposit costs just given the earning asset yield headwinds.

Lindsay Y. Corby
Sure. So, Nate, I'll take that. We're not going to be giving specific guidance on the NIM, just given all the moving parts with the PPP and everything that you described. But I can give you some general directions in terms of what we're seeing. I gave some color around deposit pricing and gave you where we ended in March. And I think that should help in terms of giving you a sense of what's going on with our deposit pricing on that side. That should help offset some of the compression we'll see on the earning asset side of the balance sheet. So, I do think that you'll see compression just given where rates are right now. On the earning asset side, it's just tough.

So, I think that's sort of my outlook in terms of the NIM. I do think the PPP program will add some drag just on the 1% yield that they have. So, I think you'll see some drag there. And then you'll obviously see some offsets as there's forgiveness and repayments of those loans as that comes through. So again, it's murky. So, we're not giving complete guidance like we have in the past around the NIM. So, in terms of the floors, we have about $2.1 billion in variable rate loans. So approximately $430 million of those loans have floors, and almost half of that is currently at the floor.

Nathan Race
Okay. That's super helpful. And obviously, understandable, just given all the dynamics at play on the core NIM. So, I appreciate all the insights. Thank you, guys.

Alberto J. Paracchini
Thank you.

Operator
And next question is from Terry McEvoy of Stephens. Please go ahead.

Terry McEvoy
Good morning. I guess let me start with credit. What contributed to the increase in non-government guaranteed NPLs? Were these loans that were more than 30 days past due at the end of 2020 and just couldn't be then modified?

Alberto J. Paracchini
Different circumstances on each one, Terry. One was simply, it's a commercial property. They lost the tenant. They haven't been able to find a tenant, so they just basically could not make payments and they just went past due. That happened a little bit earlier in the quarter.

Another situation was essentially, and these were from acquired loans, but another situation was a restaurant operator. In this particular case, the restaurant was struggling going into the year. They wanted to repurpose the restaurant into a different concept. They closed the restaurant. And it was a multi-restaurant operator. However, the global cash flow from the rest of the restaurants after the pandemic started coming into play was nowhere near sufficient. We had an opportunity to work out the asset very quickly, so we took that opportunity on that.

The other situation is really a construction loan, and this is more on the government-guaranteed side, construction loan of a storage facility where we think the value is there. We have collateral value. They had trouble leasing. It's a specialized refrigerated facility. They had trouble leasing it, so they were struggling to make payments. So, we just decided to put it in nonaccrual and nonperforming.

So that's three very different set of circumstances in each one of the cases.

Terry McEvoy
Okay. And then just following up on one of Nathan's questions. Could PPP change the longer-term economics of SBA lending from either supply or demand side? And once PPP kind of works its way through the system, is it your view today that it's business-as-usual and loan commitments will come back and gain on sale margins will likely recover?

Alberto J. Paracchini
Let me try to unpack that question, Terry, into multiple parts. So I think as we got into the PPP program, I think, one thing that we realized is we certainly have knowledge and expertise in doing SBA

lending, and there's a lot of deep institutional knowledge that comes into understanding, the SOPs, understanding the agency, understanding how to document, how to originate and how to service and work out and liquidate loans in accordance with guidelines. We felt going into the PPP program that that was going to be certainly a leg up from others that had never really done SBA lending or really did very little SBA lending.

I think what we realized is that we approached it as we would normally and typically approach an SBA loan. So, a lot of adherence to the guidelines, the protocols, the details that are involved in that business. And I think what you're going to find is that this program eventually became less of really an SBA program and more of a program that really was designed almost like a grant from the government, facilitated by financial institutions acting as transfer agents to get money quickly to small businesses.

So, with that background, what I would say is, I don't know that the PPP program would change in terms of, is it going to change the landscape of people that do SBA lending or people that didn't do SBA lending and now want to do SBA lending. I'm not sure that it will. Perhaps it would encourage some to try it because they've had some experience now doing it. But I think it's too early to tell. We still have to go through this forgiveness cycle that we're all thinking about that's coming up in the next six weeks, and I think that's going to be a lot of work. So, I think some folks in the space are going to think long and hard after we get through that cycle, if that is something that really, they want to pursue on a long-term basis.

Now going back to your question to the second part of your question about the 7A and the more traditional SBA program, I do think those programs will come back even if they are not further enhanced by Congress, albeit, temporarily with higher guarantees or higher loan amounts or what have you. I do think those programs in the past have provided a very good bridge from borrowers that went through difficulties, could not get access to conventional financing, and therefore, were able to rely on SBA loans to get them over the hump, so to speak, to then be able to go back and become conventional borrowers. I don't see why this environment would be any different, given the amount of stress that we're likely to see here over the coming quarters.

In terms of the secondary market, I do think the market premiums were severely impacted, I would say, in the middle, right around when the market essentially collapsed. I view that as really no different than what happened in every other asset class in the market at that point in time, right? You saw spreads for everything from investment-grade to all sorts of different assets. We're trading at levels that were not consistent with previous near-term or kind of midterm historical precedent.

So, I think what happened here was you have some circumstances that are unique to the SBA business. I think it's really hard for people to pool loans today, so what you have is you have essentially primary loan buyers that are kind of long-term fundamental buyers in the market today, and that's what's setting the price today. So, I think as pooling resumes, you're going to have more buyers come in the market. And I do think that spreads will compress a bit and premiums will come back. So, I do think the market will and has already started from what we've seen so far in the second quarter, the market is a little bit better than it was certainly during the latter half of the first quarter.

Terry McEvoy
Thanks for your thoughts, Alberto.

Operator
Our next question comes from Michael Schiavone of KBW. Please go ahead.

Michael Schiavone

Good morning, thanks for taking my questions. Just go back to the restaurant book real quick. Can you guys give us more detail on what kind of collateral these loans have, and also how much of the book might be on deferral?

Lindsay Y. Corby
I can give you the deferrals in terms of the restaurant book right now, about $28 million is on deferral of that book. And Owen, can you give them some detail on the collateral piece?

Owen E. Beacom
Yes. Of the $125 million real estate mortgages secured $67 million, and really, the bulk of it is UCC blanket lien on business assets.

Michael Schiavone
Okay. Thank you, and then can you provide more detail on the traditional 7A loans that you guys have already underwritten? How are they impacted from a credit perspective under the CARES Act? Do you guys expect charge-offs to drop next quarter because of the less SBA-related losses?

Owen E. Beacom
Well, this is from the deferral payments on payments from the SBA—

Lindsay Y. Corby
No are you asking about the six months of the SBA picking up principal and interest?

Michael Schiavone
Yes. And just how and then on a go-forward basis, how you expect the traditional SBA to perform.

Lindsay Y. Corby
Sure. So, the SBA is paying for the next six months all principal interest for loans that are in regular servicing. So, for the next six months, they will get a breath. And then from there, time will tell how they emerge out of that period. And really, it's going to depend on the severity of what's coming and the duration of what's coming. So, if things are more of a V-shape, they may be OK. And then if things are more prolonged, we'll have to address it and go from there. So, I think there's different bills that are being discussed, as Alberto outlined, for additional relief that could apply to them as well. So again, too soon to tell. But for the next six months, they will have P&I covered by the SBA.

Alberto J. Paracchini
Yes. And I would say, Mike, the other thing I would add to that is so if you think about it, just conceptually, so you have a borrower now that is an SBA borrower, has a 7A loan, and that borrower is essentially getting six months' worth of relief for payments that the government or the SBA is essentially picking up for them. After that, and certainly before that, we'll start reassessing and looking at how that business is going to emerge from the crisis, what are the prospects going forward, what is the cash position, what were they able to do during this period, how much cash on hand do they have, is it at that point in time business-as-usual, they just resume operating, perhaps they need some working capital to get started, and we can certainly look at doing that. Or is it a question of does the business need some additional relief? Do you need to defer for 60 days, because they need the working capital in order to get the business started?

So when you think about this, think of it in terms of, you're essentially buying six months to get through the crisis and allow these businesses to not have to be worried about debt service payment, so to speak, and hopefully, after that period, the business can look to an environment that is not, call it, the shelter-in-place environment that we're operating in today. But if there's need for additional flexibility or additional financing, we'll evaluate that certainly at that time.

I hope that kind of helps you think through it.

Michael Schiavone
Yes, that's very helpful. And just to switch over to expenses. With rates back at zero, does that change your approach on the expense side? And are there any like branch rationalization or expense initiatives to look at once the pandemic starts to calm down?

Alberto J. Paracchini
Yes. I think our position on that hasn't changed, Mike. I mean, I think, a couple of things, and we're—it's too soon to tell right now, but there's a couple of things that are clearly evident is that, for you, the environment today has essentially forced people that were slowing or slower in adopting technology to have to adopt it and use channels that maybe before they didn't feel like they needed or wanted to use. We've seen an increase, for example, on the different digital channels and even calls through the call center from people that before would just rather either call the branch or stop by at the branch.

And now the branch is closed, or they don't feel it's safe, so they downloaded mobile apps that before they didn't. So, we've seen an increase in the usage of digital channels, and that's just accelerating, in our view, what was already happening. So, we'll look at that. And as you know, today, we have a number of locations that have been temporarily closed. And at this point, I think, it's a bit too early still, but the underlying approach that we've communicated in terms of constantly evaluating our network and constantly looking to make sure that we're optimizing our network in that regard, I think, remains the same, and we'll continue to do that.

One thing I should point out, if you look one metric that we talk about, and we've talked about since being a public company, is average deposits per branch. So, if you look at the jump where we are today from even the end of last year, we went from, I believe, like $67 million on average, we're over $70 million, $74 million today. And that's a number that we want to continue to see inch higher going forward.

Michael Schiavone
Okay. Great. And lastly, do you have any color on the commercial loan pipelines at this point, and like if you're expecting slower growth in Q2?

Alberto J. Paracchini
I think it's fair to say, Mike, that our focus right now is our existing customer base. It's not to say that we will not look at new opportunities, but we are going to be incredibly selective on those opportunities because I think the focus today should be on making sure that your customer base can navigate through this period, and we need to be prepared to work with our customers to get them through this. So, I think I would say I would be careful in terms of projecting growth. I mean, as you know, you're going to see significant growth as a result of the PPP program in the second quarter, but outside of that and outside of just selective opportunities here and there, I think the focus is really on our existing customer base and making sure that we can help them navigate through this period.

Michael Schiavone
Thanks, that's helpful. And that's all I have. Thanks, and be well.

Operator
If you have a question, please press star then one. Our next question comes from Brian Martin, Janney

Montgomery. Please go ahead.

Brian Martin
Hi, good morning, Thanks for all the added disclosures today, guys.

Lindsay Y. Corby
Welcome, I thought you'd like it.

Brian Martin
Yes, thanks. Just a couple of things for me, Lindsay. The PPP, just that benefit you guys expect to realize and just kind of how it plays out in the coming quarters, is much of that going to be kind of third and fourth quarter? Is that how you guys are viewing it based on the forgivability? Or just, in general, if you could give some thoughts on how you're thinking about it.

Lindsay Y. Corby
Sure. So, there's still a lot of unanswered questions right now around it, Brian. So, I'm going to caveat, what I say here. But in terms of how we're looking at it, I think you may see some toward the end of Q2, but I think the bulk of it will come in Q3, and then it just remains to be seen on how long our customers want to keep these loans outstanding. So, we've been hearing more discussions of people saying, "Hey, this is a low-cost source of financing, maybe I hang on to it a little bit longer." So again, time will tell, but I think the bulk of it will be Q3 based upon how I see the world right now. But again, that could change depending on additional information as it becomes available.

Brian Martin
Got you. Okay. No, that's helpful. And just, Lindsay, back to margin for one minute. Just on the core side, the rate cuts that occurred with the Fed, how much of that do you assess was in, given they occurred late in that in the March time period, as far as when the loans and earning assets repriced, I mean, was it pretty minimal? I mean if we looked at your sensitivity in the K and then kind of look at what happened with the core margin, fair to assume the bulk of the impact there wasn't felt? I mean, obviously, you had what you talked about, the mitigants on the funding side and kind of the change in the mix as well, but just as we try and understand or think about that core margin and net impact from those cuts, as we look primarily to second Q, just trying to understand that.

Lindsay Y. Corby
Yes. I think you're going to see more of it here in the second Q than you saw in the first. LIBOR remained elevated, and that’s helped us out tremendously. And so, I think now that, that's coming down fast here, you're going to see more of the impact here in Q2.

Brian Martin
Okay. And your added disclosure on that on the accretion, just one question on that. The kind of the outlook or just the general parameters you outlined there, if you compare it to what actually happened this quarter, so I guess, the $3.6 million this quarter had some prepayments in there, or was that pretty standard relative, as a comparable to that $2.3 million as you look, at least, the start to next quarter?

Lindsay Y. Corby
Great question. The $3 million that we saw this quarter was all basic. There was no onetime nothing that was an accelerated payment or anything like that or a recovery. So, it was just a straight number, and I'd say it's comparable to what I included in the materials.

Brian Martin
Okay. Did I hear you say—I thought it was $3.6 million this quarter. Did I miss that?

Lindsay Y. Corby
$3.6 million.

Brian Martin
$3.6 million. Okay. So, $3.6 million is comparable to the $2.3 million. Okay. That's perfect. And then just on the maybe back to Alberto for a minute, on the loan sale volume, it sounded as though January and February were pretty normal. March, obviously, we saw a decline there. As you look to April, I mean, has April been more like March would suggest, I guess, as we look at least the next near term, that decline persists for at least the near term?

Lindsay Y. Corby
So, I can take that one, Brian. In terms of the volume, obviously, the volume is a lot lower, right? So, I look at the gain on sale in twofold volume and then also premiums. So, Alberto talked about the premiums a little bit earlier, and they were low in March. That was where we saw the flight to liquidity and premiums definitely came down. Here in April, toward the end of the month, we are seeing some signs of improvement. So, are they back up to where they used to be? No, but they are definitely showing signs of improvement.

Alberto J. Paracchini
I think it's going to be, to add to what Lindsay said, Brian, you're asking for our opinion on this. Look, I think, things have to return to some degree of normalcy here. I think the ability to pool is really important in the secondary market because not everybody wants to buy SBA-guaranteed loans outright. They'd rather own the certificate. And when you have a market that's primarily driven by really kind of deep fundamental kind of whole loan guys that are buying paper at predetermined levels, I mean, it's a pretty good market for them.

So, I think more as you get more participants in the market, I think the pooling component—in order to get more participants in the market and more dollars flowing, I think the attractiveness of the asset still remains. It's full facing credit, it's a floating rate asset. So, the attractiveness hasn't gone away, but that ability to pool loans efficiently and sell these participation certificates is important.

Brian Martin
Yes. Okay. No, that's helpful. And maybe just the last one for me was just as it pertains to credit, and you guys outlined the limited exposure to some of these early industries. But as you guys look now going forward, can you just talk about where you guys view or I guess, what you're more closely watching today? You could expect to see a little bit more stress in the portfolio. Are there particular areas that you've kind of turned your attention to in the short-term here that I guess, are more closely being watched or you think there could be more potential risk?

Alberto J. Paracchini
Yes. I think we're watching—this is a general answer, but I think we're watching everything. I mean, we really don't know, given the magnitude of what has changed here in the short run, given the magnitude of the contraction that we're likely to see here in the second quarter, we're not even operating back to any semblance of normal. We're starting to talk about it. I do think that as we start to recover, we will see quickly a recovery just from the resumption of economic activity. That being said, I think the longer run kind of growth outlook, I think, that's still we're still very fuzzy on that. One thing I would say to kind of give you a caveat on that comment is that we do have customers right now in specific segments and specific industries that are doing quite well.

And certainly, we're not too worried about those because they're an essential supplier or manufacturer of something and they're doing well. We offered them the PPP program, they decided to pass on it because they don't need it, and they felt that other businesses should benefit. So, in those circumstances, we're obviously not too worried about those situations. But everybody else, I think the key is staying close to the customers and understanding not just the current impact, but really the reemergence, how our supply chain is going to get reestablished. How are your suppliers going to be able to produce? Are your end buyers in business? How have they been disrupted? I think there's a lot of questions that we just don't know the answers to at this point.

Brian Martin
Yes, okay. Well, no, I appreciate it. Thanks for taking all the questions, guys.

Operator
Next, we have a follow-up question from Ebrahim Poonawala of Bank of America. Please go ahead.

Ebrahim Poonawala
Hi, guys, just one quick one. So, I appreciate, Lindsay, not wanting to give any guidance on the margin given all the moving pieces on PPP. But do you think on a relative basis, the NII spread revenue should stay relatively stable given just the balance sheet expansion we'll see in the second and third quarters?

Alberto J. Paracchini
We do, EB. That's fair.

Ebrahim Poonawala
Ok, alright. That's all I had. Thanks again for all the clarity today.

Operator
This concludes our question-and-answer session. I'd now like to turn the conference back over to management for any closing remarks. Please go ahead.

Alberto J. Paracchini
Thank you, operator. I just want to thank, everybody, for participating in the call this morning. I hope you continue to remain safe and healthy, and we look forward to talking to you again, hopefully, in a much more normal environment next quarter. Thank you for participating. Operator?

Operator
The conference is now concluded. Thank you for attending today's presentation. You may now disconnect.