MidWestOne Financial Group, Inc.

1st Quarter 2018 Earnings Call

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CORPORATE PARTICIPANTS

Charles Funk – *Chief Executive Officer*

Jim Cantrell – *Chief Investment Officer*

Kent Jehle – *Chief Credit Officer*

PRESENTATION

Operator
Good afternoon and welcome to the MidWestOne Financial Group, Inc. First Quarter 2018 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 touchtone phone. To withdraw your question please press star then two. Please note this event is being recorded.

I would now like to turn the conference over to Charles Funk, President and CEO. Please go ahead.

Charles Funk
Thank you very much, Rochelle, and good morning or good afternoon to everyone, and thank you for joining us on the call. We will begin with our forward-looking statement message to keep our regulators and attorneys happy. This presentation contains forward-looking statements relating to the financial condition, results of operations, and business of MidWestOne Financial Group, Inc. Forward-looking statements generally include words such as believes, expects, anticipates, and other similar expressions. Actual results could differ materially from those indicated. Among the important factors that could cause actual results to differ materially are interest rates, changes in the mix of the Company's business, competitive pressures, general economic conditions, and the risk factors detailed in the Company's periodic reports and registration statements filed with the SEC. MidWestOne Financial Group undertakes no obligation to publicly revise or update these forward-looking statements to reflect events or circumstances after the date of this presentation.

And with that, a few comments before we get to the Q&A. It was, for us, a good quarter overall, and especially after the way we ended 2017. It was one of the better loan growth quarters we've had, and the loan growth, was primarily driven from C&I - good C&I traffic in Denver and also strong commercial real estate origination in the Twin Cities Metro. Deposits ended positively. Deposits were below planned for most of the quarter, but we had a lot of tax money in the bank whenever the quarter ended, and that money has started to flow out a little bit but should stay at the bank for 30 to 45 days. But that said, we had solid deposit growth pretty much throughout our footprint, and I've been very pleased about that.

In our financial results, for those of you who have been on these calls or talked to us over the years, you will remember that we've talked about an ag loan in Iowa that went TDR in 2012, and we've always said that we expected a recovery, it just took a lot longer than we thought. We got a partial recovery in 2017 fourth quarter, but we recovered in full with all our legal expenses this past quarter and, so that is also in these results, and I wanted to close the loop on that, and they always take longer than they should.

In terms of noninterest expense. Wealth management had a decent quarter. Our investment services area, which is our brokerage unit, hurt somewhat by market volatility but they think they're getting beyond that and they seem to have a much better pipeline as we enter the second quarter. And we've also, in wealth management, had a number of discussions with revenue producers elsewhere in our footprint outside of Iowa. These would not be game-changing moves but add-ons, and we're hopeful in the next quarter to, we might be able to add a couple of revenue producers outside of Iowa, which would really help investment services. Mortgage did not have a particularly strong quarter in terms of production, but they benefited from the servicing rights adjustment as our servicing portfolio continues to grow and interest rates continue to go up. We do expect much better mortgage production in quarter two.

Expenses, I think on-track and good. I still think that there could be a slight acceleration as the year goes on in our noninterest expenses, and that's primarily because we will be continuing to invest in fintech and we really haven't made many of those investments yet, but I would expect a little bit of that as the year goes on. Efficiency ratio at the holding company level has climbed above 60, and we do have a large tax-exempt portfolio relative to other banking organizations and we figure that's worth about 120 basis points in our efficiency ratio. So it affects us a little bit more perhaps than other companies. That said, we recognize that it is an important goal to drive that back down below 60, where we were much of last year. In terms of credit, I would say much better. Our NPAs were down significantly from a year ago. We had nominal charge-offs. Our 30- to 89-day past dues were about as low as they're going to be in a company this size. I'm sure that people are interested in agriculture, and the ag renewal season was a tough season as borrowers met with the bank. But I think as we've previewed in the past, we did see more downgrades to watch in the substandard. Many of these loans were past loans three or four years ago. They're now watch or substandard. Ag is about 8.5% of our total loan portfolio, and of our entire ag portfolio right now, 23.6% is either watch or substandard, and the breakdown on that is 9.5% substandard and a little over 14% watch.

I want to repeat what I've said, and for the last 18 months we expect higher reserving, but not large losses in this portfolio. We still have good collateral margins on most of the loans. The margins are narrower than they have been, but they're still pretty good. We had a couple of borrowers that came through the renewal season and we asked them to sell a little bit of land to really protect them and protect the bank. And in the case of at least one of our substandard credits, it's about to be refinanced out of the bank into another institution. There is still some demand out there for ag loans. But overall, I don't think the story has changed. We downgraded a few credits, but we still do not expect losses but there will be higher reserves going forward.

In terms of economic conditions elsewhere in our footprint, I think everybody knows the Twin Cities, Denver, and Southwest Florida enjoy robust economies right now. The Iowa City market has slowed a little bit, although I did note that at 2.5% unemployment, the Iowa City market has the fifth lowest unemployment rate in the United States but it is slow. Procter & Gamble has announced they'll be reducing 500 jobs in our community over the next couple of years, and the University of Iowa due to state budget cutbacks has halted all new construction and that does have a trickle-down effect into the economy. That said, the Iowa City economy is still okay. It's just not as robust as it might've been a couple of years ago.

In terms of the loan-loss provision, we did guide to a $5 million 2018 provision as a run rate. We were higher in quarter one, and I think we will probably exceed that target a little bit this year. But that said, we are still not forecasting significant charge-offs based on what we see right now. And I would also note, I wouldn't take this to the bank, but I do think there is the potential for some positive surprises within the provision this year when you look at the loan portfolio but those are things still to be worked out, and I would conclude by saying we had a much better feeling than we did six months ago in terms of the overall portfolio and whether or not we're properly reserved.

Capital, fine, just fine. We did, you might have noticed, we did use the market weakness to buy back a small amount of our stock early in the quarter. We will continue to evaluate those opportunities going forward as we do have an active buyback plan in place. In terms of the net interest margin, we would guide to the same outlook as we've said in prior calls, is that we're cautious. We've had a number of promotions to keep or attract new deposit dollars into our bank, and I do note that we saw something in the Twin Cities market that we haven't seen for a long time. One of the larger banks, one of the large banks in the Twin Cities moved their CD, all their CD rates to market, and we haven't seen that from the large banks in a long time. That was a first, and if you have more questions on the margin, Jim is happy to cover that as we get into the Q&A.

Looking forward into the second quarter and the rest of 2018, we do expect a few larger-than-normal paydowns in our loan portfolio in the second quarter and that includes a loan that currently is on our watch list and has a little over $5 million in outstanding. We expect that to be paid off in full. And we also, as I've mentioned, have the potential for a substandard paydown in the ag portfolio as well, we'll see on that. That might temper our quarter two loan growth a little bit, but we do still expect 4% to 6% for the year and I think our budget is between 5% and 6% and we feel okay about that. It will be led by Denver and the Twin Cities and Southwest Florida, although we do have some pretty good sized loans in the works in Iowa City as well. We just announced - I'm not sure we've announced it yet, but we do have a commitment from a new banker in Denver coming from one of the large banks, and he will cover an area of specialty that we don't currently have in that market, and we're very excited about that. And we're up to 11 persons in Denver, and May 1st will be the first anniversary of opening our office there and we started out with four employees. They are doing very, very well in that office, and certainly have grasped our culture very well.

Deposits continue to be the name of the game in banking, and we're just scratching our surface in the Twin Cities but I do note that most of our offices in the Twin Cities have nice increases in year-over-year deposits, and we still think that our 88% loan-to-deposit ratio works to our advantage. One other thing that we will be doing, I think, that's of note, in our Company is we'll be rolling out Zelle in, late in the second quarter, and as I understand it we'll be one of only 70 banks in the United States that are able to offer this, and probably one of only 40 or so community banks that are able to offer Zelle. That's probably not a game changer, but it will be a welcome addition to our arsenal in retail banking. A brief comment on M&A. We've continued to look at that. There are banks out there that are for sale, and I think it's just a matter of working out buyers' expectations with sellers' expectations and we understand that we need to do what's right for our shareholders. I think organic growth and top-line revenue growth is what's most important for us right now, but we continue to have our eyes open relative to M&A.

I would end by saying that we did have a completed safety and soundness bank examination, which seemed to be very routine during the quarter. And with that I have our Chief Credit Officer, Kent Jehle; and our Chief Investment and interim Chief Financial Officer, Jim Cantrell in the room, and we would be ready for the Q&A right now, Rochelle.

QUESTIONS AND ANSWERS

Operator
We will 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 Jeff Rulis with D.A. Davidson.

Jeff Rulis
Thanks. Good morning.

Charles Funk
Good morning, Jeff.

Jeff Rulis
Hi. A question on the expenses, Charlie. You mentioned some acceleration on the fintech side possible. I did see, it wasn't a big jump, but the occupancy number sequentially was up. Was there anything that happened in the quarter, or was that just sort of a seasonal blip, particularly that line item, expense growth rate? What are you seeing?

James Cantrell
Yeah Jeff, this is Jim. I'll take that one. I noticed the same thing, about 9% on a quarter-over-quarter basis. I would tell you that our fourth quarter number was probably a little bit low. I looked back to a year ago, when we were almost $3.3 million even on that line item, so we're down ever so slightly on a year-over-year basis. Some of these smaller line items do show a little bit of volatility, I don't have anything in particular for you, but I did note that. I can go back and look, but the first quarter run rate is probably more representative for you than the fourth quarter.

Charles Funk
Yeah, and I would only add to that, that in this quarter, and it probably wouldn't be fully in the numbers, we moved into our new office in South St. Paul, Minnesota, and next quarter, we'll be moving into our office in Fort Myers, Florida. There will be a modest uptick, but...

James Cantrell
Those haven't started to hit yet.

Charles Funk
Yeah, those haven't hit yet, there might be a modest uptick from where we are right now.

Jeff Rulis
So if we broaden it, to just discussion on overall expenses then for the balance of the year, you guys were at $20.4 million this quarter. I guess the suggestion is that you could see some growth for the balance of the year?

James Cantrell
Yeah, I would say at the beginning of the year, we do see our normal salary increases, so we probably had a little bit bigger increase in the salary line item than I would expect to see going forward because of the year-end increases for everybody. But you're exactly right. On some of the other line items, particularly on net occupancy, and really that's the other one where I think we've budgeted but haven't yet spent some additional dollars on fintech and some other things. I do think that, overall, we're going to see a little bit of increase from where we were in the first quarter here.

Jeff Rulis
Got it. And then, Charlie, you mentioned - well, you've got about a 14 basis-point increase in deposit costs in the quarter, was it? Are you surprised by that number? You mentioned some rate movement in the Twin Cities, but was there anything particularly lumpy there to where you think that's going to level off? Or is this kind of the environment we're in?

Charles Funk
Well, the realistic answer, some of that is the CDs are more popular than they have been. We have not really moved our core rates on transaction and savings accounts, and so one of the

things we rolled out was a 45-day CD that pays more, a little bit more of a market rate for larger balances. There's been some traffic there. But realistically, to get large chunks of money into your bank, you're going to probably pay something around the Fed funds rate, give or take 30 or 40 basis points. And we've also noticed that some of our regional competitors have become a little bit more aggressive, whereas two years ago we might not have seen them. They're in there bidding for money right now because their loan-to-deposit ratios are higher than ours, and they need to fund their loan growth. I don't know, Jim, if you want to add to that?

James Cantrell
Yeah. The color I would add would be from a kind of a year-ago perspective to today and versus last quarter. I look at funding costs or deposit costs simply by dollars of expense divided by total dollars of deposits. And when I do that calculation from a year ago, a year ago, first quarter of '17, I show our funding costs were 43 basis points, cost us 43 basis points. I roll forward three quarters to the fourth quarter of '17, and I show an increase of six basis points to 49. So six basis points' increase in deposit costs over three quarters. Roll forward one more quarter then, one more quarter to the first quarter this year, the most recent quarter, and we're up another six basis points to 55 basis points in costs. Clearly, there is an acceleration going on. And as Charlie mentioned, I look at it, and the mix explains a big chunk of that too, because if I look year-over-year, the CD category, which was clearly the most expensive category in the deposit mix, has grown and the other sectors have stayed pretty flat. Rates are up and the mix is working against us a little bit on the cost of funding.

Jeff Rulis
Got it. I had one quick housekeeping. Was there a margin impact or a benefit on the ag loan recovery? The calculation this quarter?

James Cantrell
It was small. Some, less than $100,000, got into interest income of that recovery. Some of it - it wound up in a couple of different places. A tiny bit of it did wind up in the margin.

Jeff Rulis
Okay. That's it for me. Thanks.

Operator
The next question comes from Andrew Liesch with Sandler O'Neill.

Andrew Liesch
Morning.

Charles Funk
Hi Andrew.

James Cantrell
Hey, Andrew.

Andrew Liesch
Hi. Charlie, the release pension, the couple of large deposit accounts that came in in Iowa City late in the quarter. Any details you can provide on these? Are they commercial accounts, municipalities? What deposit types and what rate might they be? Just trying to get a sense on how they could affect funding costs going forward?

Charles Funk
Yeah, mainly public funds. We have strong public funds relationships in the Iowa City market. I don't know, Jim, you can talk about the rate.

James Cantrell
Well, I was thinking a little bit about, when you said big increase at the end of the quarter, I was thinking at the end of fourth quarter, we took in, it was close to $40 million or $45 million from a single depositor who had issued a bond and held the proceeds with us that, starting in the fourth quarter, will start to run out on a ladder that's probably nine months long, so we'll start to see that decline. In the first quarter now, we do see more operating accounts, just money market accounts, checking accounts, balances increased for seasonal reasons, not really any discrete or known increase in deposits, but just kind of normal - a normal flow based on tax receipts and tax payments.

Andrew Liesch
Okay. And then, it does look like you did get a nice pick up in the loan yield. Maybe that was a little bit masked by what you saw on the funding cost, but what are your thoughts, should that continue to increase, but maybe not as fast as funding costs?

Charles Funk
Yeah, I'll start with that. I didn't bring it into the room, but I had a sheet that was provided to me. If you look at the new loans that are coming on the books, they're roughly 50-50 between fixed and variable. And we count variable, anything that has a repricing of one year or less, we consider that to be variable. Not necessarily prime floating, but that part is good, but we've got a fair amount of loans that reprice every time the Fed moves.

James Cantrell
Yeah, we do, you're right. The Fed moved, I think, it was March 21st, the Fed raised interest rates another 25 basis points. I went back and looked at the rate change report. I think the next day we had $425 million or thereabouts that repriced that following day, and then we'll have some follow-on to that based on monthly reprice and quarterly reprice. I expect that happened right at the end of the first quarter. So we'll get a little bit of a kick from that in the first quarter, and the trick will be how quickly will we need to respond on the deposit side, as we've talked about on this call before. There's one other thing that I would mention when it comes to loan yields, and nobody's asked the question, but I will say that we have a purchase accounting amortization that is decreasing over time. We're losing a little bit of yield. When I looked at last year, we were probably close to upper-teens, 20 basis points, nearly 20 basis points in accretion of that discount, and we're, down to 15 or maybe less and heading lower is the point as we move forward. We're going to be fighting a decrease in that loan amortization.

Andrew Liesch
Right, right. Thank you. You've covered all my other questions.

Charles Funk
Thank you, Andrew.

Operator
The next question comes from Damon DelMonte with KBW.

Damon DelMonte
Hey, good morning guys. How's it going today?

Charles Funk
Hi, Damon.

James Cantrell
It’s going well.

Damon DelMonte
Just to kind of follow up on the last comment there by Jim with the accretable yield marks that are included in the margin calculation. If we were to identify how much there was this quarter, did I read in the release that there was around $900,000? Is that correct?

James Cantrell
Just under $900,000, yes.

Damon DelMonte
Okay. And then we should expect that to trend down in the coming quarters?

James Cantrell
That's correct.

Damon DelMonte
Okay. If we look at that component of the margin, and then you hear the commentary about likely higher deposit costs, and you have hopefully a little bit more expansion on the loan yields as the rates go higher. How do we think about the margin from this quarter as the overall margin was, call it 369? Do you think you can at least hold that flat or even maybe see some expansion?

James Cantrell
My personal view, and this is me, I think it is going to be a challenge to maintain it in the current environment, given the trends we see in the mix, which are working against us a little bit, the overall trends, and kind of the acceleration we're seeing on the overall cost side for liabilities and just general rising interest rates, it won't be dollar for dollar. We're going to get some benefit on the loan side. I just think as we balance it out, it's going to be pretty difficult to maintain. We may do it, but we may not.

Charles Funk
Yeah, as you all know, because you've been on the call every quarter, I've been cautious on the margin for quite some time and Jim's exactly right. The other thing that is interesting is when you look at the market for loans, especially for some of the commercial real estate, it's gotten pretty tight at the treasuries, and certainly, tighter than we've seen for a while in terms of spread. I as the Fed continues to raise and if they continue to be aggressive, that may get loosened up a little bit, but we just need to understand that, and I've seen that in other commentaries as well, that the other banks are noticing the same thing. We fight that. We let some deals go, because of price. We've competed on price where we thought it was prudent, but it's a delicate balancing act we walk, and the yield curve's really not helping us very much either. We'd certainly like to see a little more slope to the yield curve.

Damon DelMonte
Okay. Great. That's good color. Thank you. And then, you also commented about the provision you had originally guided for about $5 million this quarter - or sorry, $5 million for this year, and this quarter came in a little bit higher than the run rates to meet that amount. Are you willing to

kind of quantify what your expectation is for the full year now?

Charles Funk
I think it would be very hard. We're pretty close to getting a normalized run rate, but the run rate could be a little bit higher in the second quarter. I'd be willing to guide if I had a good number for you, but it will be more than it was this past quarter. But right now, it's too early in the quarter to know. Kent, if you've got any thought on that?

Kent Jehle
Yeah. The only thing I would add to that is just since we went through the ag renewal season, we have that now behind us, so we are looking to the second quarter as more a stabilized run rate based on the activity that we'll experience in this quarter. After this quarter, we'll have a much better feel of what the run rate will be for the rest of the year.

Charles Funk
Yeah, that's a good point. We won't have many, if any ag downgrades, because they've already been looked at for the coming year. I do want to say to the extent we have watch-rated credits and substandard credits that are refinanced out of the bank, that will be helpful. A lot of moving parts and too soon to say, but I would only guide I don't think the provision will be as much as the first quarter but probably more than our planned run rate.

Damon DelMonte
Gotcha. Okay. That's helpful. I also thought you mentioned in your prepared remarks about a mortgage servicing adjustment, because of the change in rates. Was that a meaningful amount of an adjustment?

James Cantrell
Well, this is Jim. It depends on what you mean by meaningful. It's meaningful to me. It was about, it’s a little over $200,000, so I think that's meaningful.

Charles Funk
That's real money at MidWestOne.

James Cantrell
Yep.

Damon DelMonte
Okay. And that is categorized in the loan origination and servicing fee line?

James Cantrell
It does. That's where it would be. We probably saw less in income; I don't think we had any SBA loans that sold at a gain in the first quarter, and we probably would expect to see that increase some throughout the year. The mortgage production we do think will increase as we move through.

Charles Funk
Yeah, that's a good point that I didn't cover in my opening remarks is that SBA did not have a particularly strong quarter, but they think they'll meet their budget for the year. And we did add what I think is a highly talented SBA banker in Denver who's already got some stuff primed to close. That should give us a little lift as well. Good point.

Damon DelMonte
Okay. Great. And then just one final question, if I can. Charlie, you mentioned about the hiring of a new banker in the Denver market, and I think you said that he's going to be leading an area that you guys don't currently - is it physically operate in? Or is it a line of business that you don't currently lend in?

Charles Funk
It's a line of business that we don't have. He tends to focus on professional and especially medical clinics and doctors, and we think it could be an entree into private banking in that market as well. And again, I'm not sure if he's formally joined our Company yet, but we have a commitment from him and I met with him a couple months ago when I was out there, and I think it's another reason to be excited about Denver.

Damon DelMonte
Gotcha. Okay. That's helpful. Thank you very much. Have a good rest of the day.

Charles Funk
Thanks Damon.

Operator
The next question comes from Nathan Race with Piper Jaffray.

Nathan Race
Hey guys, good morning. Going back to the loan growth discussion, Charlie, it sounds like you guys are expecting some payoffs here in the second quarter, and I imagine that's probably on the commercial real estate side of things. So just curious kind of what you're seeing in that asset class, specifically across each of your geographies, and if you can see that being a contributor to your growth this year more so than it's been maybe over the last year or so or if you're seeing some frothiness in certain areas within commercial real estate and certain pockets of your footprint?

Charles Funk
I'll take the last part of that. Very few issues in commercial real estate, knock on wood, thus far in our footprint. And I would look at the payoffs. Obviously, anytime you have substandard credits that come and are going to pay off, that's usually a good thing, and we regard it as such. The watch-rated credit, is just a normal course of business transaction, where the borrower is transitioning to longer-term financing and, to a financing package that's outside the banking industry.

James Cantrell
And that's C&I.

Charles Funk
And that's C&I, yes. I don't know that there's any major theme on the payoffs. It's just sort of the way things have gone.

Nathan Race
Got it. Can you speak to the growth opportunity that you're seeing within commercial real estate, within the pipeline?

Kent Jehle
Yeah. This is Kent, and I can answer that. Again, the Twin Cities is a very strong market, a very

competitive market on the non-owner-occupied commercial real estate. And then we are seeing a little lift on the owner-occupied commercial real estate out of our Denver footprint as they bring on new clients. So again, competitive, but we see those two main areas, and a little bit in the Iowa City market that we can augment as well.

Nathan Race
Got it. That's helpful color. And just changing gears, as we think about mortgage banking. I know you guys have been working hard in that area trying to improve efficiency and production capabilities. So just curious on how much of a lift you're expecting in terms of production volumes as we get into the kind of the summer, spring seasons here?

Charles Funk
Well, they feel good about meeting their budget for the year. I'm not sure about a number.

James Cantrell
I'm not sure about it, and this is Jim. I'm not sure about a number either. I do think they are challenged right now. We're coming into a good season, but rates are a little higher, so clearly, the volume that they've been able to refinance in the past year or two, those refi numbers are going to come down and the overall production, we're going to have a hard time replicating the total production. I think the other thing is that we're building the servicing book a little bit faster than we had been in the past. So some of those returns will come in through the servicing portfolio.

Charles Funk
Yeah. And Nathan, just so you, the servicing book is right at the $300 million mark, which is up substantially from a couple of years ago. So we think that's a good hedge against if mortgage production doesn't increase.

Nathan Race
Indeed. And just if I could sneak one last one in for Jim, just on the tax rate. It was a little lower than I think what you were guiding to last quarter, around 21%. Is 21% still a good rate to use going forward?

James Cantrell
Yeah, we did guide to 21%. We came in just a little under that, I think 20.3%. And as I look forward, it's going to depend on the mix of tax exempt income to regular income. I would think, my best guess is 21% is going to be a better number than where we were this quarter as we go forward. I just think we'll have a little - the ratio is going to skew a little bit toward more taxable income in the second quarter as compared to the first quarter. So I'd go with the 21%. It could be a hair under, it could be a hair over. But I think that's a good estimate.

Nathan Race
Okay, thank you. I appreciate all the color, guys.

James Cantrell
Sure.

Charles Funk
Thank you, Nate.

Operator

Again, if you have a question please press star then one. The next question comes from Brian Martin with FIG Partners.

Brian Martin
Good morning, guys. Hey, just a couple of things for me. Maybe just going back to the provision for a minute, Charlie, can you - or maybe it's more Kent. Can you just reconcile, I mean, I know it's higher than you guided to and for various reasons, but reconcile what was - what piece - because you just talked about ag for a while. But just reconcile what was growth driven versus what was ag or other driven, just kind of how we're thinking about, how you guys were thinking about that this quarter? It seemed like there's an element of both, obviously, with the growth being a little bit better.

Kent Jehle
Yeah Brian, this is Kent. I think I would point to the increase to budget being driven by the ag portfolio. When you look at the budgeted number and you look at our growth and just the overall mix move that we had during the quarter, what we identified as the need for the additional provision from budget would have been primarily driven by ag, specifically, as we concluded the quarter.

Brian Martin
Okay. And just kind of as you think about it going forward, I mean, if you're still comfortable with kind of the mid, low-to-mid single-digit loan growth, which is a little bit lower than it was this quarter and the ag downgrades are done, it just feels like, and you alluded to some comments whether it was in the verbiage of the report or in your comments today, Charlie, you're looking to some positive things kind of on the horizon. It just feels like that number should go lower. But am I missing something with how you're thinking about it being a little bit lower from the current run rate? Is that kind of what you're suggesting?

Charles Funk
Yes - no, no. Full disclosure, we've got a - it's not a large loan, but we've got a loan in the Twin Cities that, it's a commercial loan that we'll probably have a little impairment on this quarter, and that was unexpected. Typically, the Twin Cities has been very, very clean as far as our portfolio, but this particular one popped up and we'll have to deal with that. And absent any positive surprises, that might drive things a little bit north of where we guided. The flip side of that is if we get some payoffs that - of some substandard credits, which we're told we're going to get, that could mitigate that a little bit. But it's, as I said in my response to another question, it's just too early in the quarter, really, to know for sure.

Brian Martin
Yeah. Okay. I got it. And just in general, would you characterize it, if things kind of go as in big picture you're thinking about them, this may be the high point for the year on the provision?

Charles Funk
We would hope so. Hope is not a strategy, but we would hope so.

Brian Martin
Yep, I gotcha. Okay. I appreciate it. And just a couple of other things, just going back to the mortgage for a minute. Just the volumes and the gain on sale margins in the quarter, how were they? And I guess, how are you thinking about that going better? It sounds like you're still optimistic on mortgage being a bigger contributor here going forward?

Charles Funk
We are optimistic. I agree with what Jim said about the rates, the interest rate environment being a headwind, but what I've heard from our mortgage people is they feel confident in their abilities to meet their goal, and they were under-goal in the first quarter. But we're coming into a seasonably, a seasonal time where we should see an acceleration in revenues. It's interesting, there was an article in the Twin Cities, the Minneapolis paper last week about the fact that housing is in short supply in that market, and a lot of houses are being sold at $20,000, $30,000, $40,000, $50,000 over the asking price. If it's harder to buy houses, that probably has a little bit of a negative impact up there as well, but it's hard to know how that affects MidWestOne, but certainly, in that market, it's tough to buy a house right now.

Brian Martin
I gotcha. Okay. That's helpful. And maybe just as it relates to the fee income, this quarter, I know you called out the one, kind of the one-timer, Jim, as far as what was the benefit on the MSR. I guess, is there more that recapture on that, or are you done with that at this point?

Charles Funk
I think the only thing I can think of is that our insurance agency would have had their contingency payments, which is paid in the first quarter. I believe that was $100,000 or less, and that's not a huge number. So other than that, I can't think of any. Can you, Jim?

James Cantrell
No. That was a positive for the quarter, yeah. A little bit more than the...

Charles Funk
Yes. Right. Less than last year, but that would be a nonrecurring event.

Brian Martin
Okay. But my bigger picture was then, if you back off the couple things that were in there but you also allow for some pickup in mortgage and the SBA, thinking how we see this quarter probably isn't a bad way to look at the coming quarters just within a band of a certain percentage, does that seem fair to think about it?

Charles Funk
That would be the way I would think about it, Brian, and maybe even slightly higher run rate. But that'd be the way I would think about it.

Brian Martin
Okay. All right. And then, maybe just the last one, Charlie. Just, you talked about the M&A, it sounds like there's still a little disconnect out there with expectations from the buyers and sellers. But I guess, more specifically to you guys, I mean, is there an area geographically that you have more interest in? Is it just all of your markets? Or if it's not a geographic area, just more of a dynamic you're looking for of a target as far whether it be applying - supplying more growth, or better deposits, or just in general, if you could just give a little color on those two things, it would be helpful.

Charles Funk
I think the most likely would be in the Twin Cities and Iowa, and there are companies for sale in both those footprints or will be in both those footprints. The one difference, I've said this before on calls, is that there are a number of smaller, I mean $150 million, $200 million, $250 million banks that may be selling that have lower loan-to-deposit ratios and all of a sudden the deposits

are worth quite a bit more than they were a couple years ago; especially in our Company, where we seem to have the ability to make loans. Not only MidWestOne, but other companies might have a little more interest in those companies. And during the first quarter, we looked at a company that would match those characteristics and, but you know, there's nothing to the table, there's nothing that's imminent, but the lower loan-to-deposit companies in non-growth areas have more appeal than they have for a long time.

Brian Martin
I got you. Okay. And last one was for Jim. Just on the margin, Jim, you've given a lot of good color, but just so I'm understanding it correctly, the core margin, when you take out the accretion piece, it sounds as though where we're at today, your hope would be to maintain it, but if anything, it could have a touch of a negative bias from where we sit today, I guess, is how we should think about it?

James Cantrell
That's how I think about it. You're right. The reduced accretion is going to be a headwind, that's going to work against us, and I just think that our beta on deposits has been below models for so long. We're now starting to see an acceleration. So we're probably, in the next 25 or 50 or 75 basis points move up, I suspect we're going to be above model in terms of our beta on our deposit response. I don't think we're going to be hugely lopsided in our margin, that expenses are going to increase a lot faster than we'll see increases on the loan side, but I do think that is a risk, and that's probably where there's a little bit of pressure.

Brian Martin
Yeah, okay. All right. I appreciate the color. Thanks for the update, guys.

Charles Funk
Thank you, Brian.

James Cantrell
Yep, thanks Brian.

Operator
This concludes our question-and-answer session. I would like to turn the conference back over to Charles Funk for any closing remarks.

Charles Funk
Thank you to everyone who joined us on the call this morning, and we wish everyone a good weekend, and hopefully the weather is as good where you are as it is in Iowa City. Thanks for being on the call.

James Cantrell
Bye-bye.

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