CIT Group

Earnings Conference Call

January 29, 2019 at 8:00 a.m. Eastern

CORPORATE PARTICIPANTS

Barbara Callahan – *Head of Investor Relations*

Ellen Alemany - *Chairwoman & Chief Executive Officer*

John Fawcett – *Executive Vice President and Chief Financial Officer*

PRESENTATION

Operator
Good morning, and welcome to CIT's Fourth Quarter 2018 Earnings Conference Call. My name is Keith, and I will be your operator today. At this time, all participants are in listen-only mode. There will be a question-and-answer session later in the call. When the question session begins, if you would like to ask a question, press star and then one on your touchtone phone. Press star and then two to withdraw yourself from the list. If at any time you require assistance, please press star and zero and an operator will be happy to assist you. As a reminder, this conference call is being recorded.

I would now like to turn the call over to Barbara Callahan, Head of Investor Relations. Please proceed, ma'am.

Barbara Callahan
Thank you, Keith. Good morning, and welcome to CIT's Fourth Quarter 2018 Earnings Conference Call. Our call today will be hosted by Ellen Alemany, Chairwoman and CEO; and John Fawcett, our CFO.

After Ellen and John's prepared remarks, we will have a question-and-answer session. As a courtesy to others on the call, we ask that you limit yourself to one question and one follow-up and then return to the call queue if you have additional questions. We will do our best to answer as many questions as possible in the time we have this morning.

Elements of this call are forward-looking in nature and may involve risks, uncertainties and contingencies that may cause actual results to differ materially from those anticipated. Any forward-looking statements relate only to the time and date of this call. We disclaim any duty to update these statements based on new information, future events, or otherwise.

For information about risk factors relating to the business, please refer to our 2017 Form 10-K. Any references to non-GAAP financial measures are meant to provide meaningful insights and are reconciled with GAAP in our press release.

Also, as part of the call this morning, we will be referencing a presentation that is available in the Investor Relations section of our website at cit.com.

I'll now turn the call over to Ellen Alemany.

Ellen Alemany
Thank you, Barbara. Good morning, everyone, and thank you for joining the call.

2018 was a milestone year for CIT. Through steady execution of a multi-year transformation plan, we successfully delivered on our financial targets and created long-term value for shareholders. On Slide 2, you can see the highlights. We grew average core loans and leases by about 6%. We hit our operating expense target and took out more than 12% of expenses over the last three years. We made substantial progress in right-sizing our regulatory capital, reducing our Tier 1 common equity ratio to 12%, down from more than 14% a year ago. And, we met our return on tangible common equity goal, excluding noteworthy items, ending the quarter at 10.1%. These actions and more allowed us to increase our tangible book value per share by 3% and grow earnings per share from continuing operations by more than 30%, excluding noteworthy items.

Our roadmap has been our five point strategic plan, which is summarized on Slide 3. In addition to the points I mentioned, we also delivered on several other fundamental initiatives that advanced our plan. For example, we largely completed our simplification efforts following the closing of the NACCO and reverse mortgage deals. Exiting non-core operations enabled us to focus more deliberately on growing our core business and, as a result, we increased funded volume 28% year-over-year.

We optimized funding by terminating costly legacy vehicles, and our next unsecured debt maturity is not until 2021. We reduced higher-cost brokered and commercial deposits and grew consumer deposits. We repurchased $1.6 billion of stock and increased our common dividend per share by 56%, and we prudently managed risk. As a result of the divestitures, our operating risk decreased, and as we made the strategic shifts in our Commercial Finance business, we reduced cash flow lending commitments to be about 10% of our total loan and lease exposure. We have focused primarily on deals with strong collateral values, which can be more predictable over the cycle. Credit remains stable and reserves remain strong. We're encouraged with the progress and are focused on continuing to build on our momentum.

Financial results for the year and quarter were solid. Net income available to common shareholders for the year was $428 million or $3.61 per diluted share, and income from continuing operations available to common shareholders was $453 million or $3.82 per diluted share. For the fourth quarter, net income and income from continuing operations available to common shareholders was $82 million or $0.78 per diluted share.

John will go into a detailed account of financial performance, but highlights for the quarter include core average asset growth of 2%, which was driven by strong originations in all core businesses. We posted the highest volume in five years in our Commercial Banking segment, with $3.2 billion of originations, but asset growth was somewhat muted by high prepayment levels in the Commercial Finance and Real Estate Finance divisions. Lending overall remains competitive, but we are being disciplined and participating in parts of the market where we have deep expertise and competitive strengths.

Despite the high prepayments I mentioned, the Commercial Finance division still posted solid growth with average loans and leases up 7% year-over-year. This was largely driven by the Energy, Healthcare, C&I verticals. We also continued to see good opportunities in Aviation Lending where the LTVs and loan structures are strong.

As I mentioned earlier, the majority of the portfolio in this division is asset-backed lending as we have deliberately reduced the cash flow portfolio. We recognize that this has been a prolonged favorable credit cycle and we're being thoughtful on the deals we're doing. We are not seeing any signs of broad credit deterioration, but we remain disciplined in our approach.

Originations in the Real Estate division were strong, but prepayments continued to be a headwind. The market is extremely competitive, and we are being selective in our originations. About half of our new business is driven by existing customers who value the CIT relationship and our ability to deliver. Our Business Capital division continued to achieve strong growth with average loans and leases up 9% from the year-ago quarter. We outpaced the market growth and posted nearly $1 billion in volume in the fourth quarter, the highest in nine years. We have innovative technology in this division that helps us to drive value for our customers and create long-standing, integrated relationships. For example, 50% of our new origination growth was driven by leveraging our technology in equipment financing.

On the Commercial Services front, factoring volume reached $30 billion, up 10% from last year. In the Rail division, we continued to actively manage the portfolio and utilization rates remained high at 98%. Loadings ended the year up about 2% as the industrial sector showed some positive momentum.

There is still excess capacity in the industry, which puts pressure on utilization and renewal rates, but we have a young and diverse fleet and strong customer relationships.

The Consumer Banking segment continued to build the deposit franchise and provide incremental lending opportunities. The direct bank increased deposits by 25% in 2018 and welcomed more than 60,000 new customers to CIT Bank. This growth is a result of delivering competitive savings products in a digital platform that appeals to a growing audience. The launch of the Savings Builder product last year helped to drive strong growth from a mix of customers, including Gens X, Y and Z, as these groups built their savings strategies. On the mortgage front, average loans were up significantly from a year ago and helped to offset the runoff of the legacy portfolio.

I'm proud of what we've accomplished as a management team in a fairly short timeline to grow our business, build our banking capability and transform CIT at every level. As part of the multiyear plan, we made fundamental improvements to our financial profile, lines of business, operations, and technology platforms. This allowed us to build momentum in 2018 and position CIT to accelerate the next phase of its plan as we go forward. We are simpler, stronger and growing. We know; however, that there's still more to do, and we are committed as ever to keep powering forward to create long-term value.

In that spirit, we've identified additional opportunities to reduce our operating expenses as we take steps to more fully leverage the work we have done around digital process automation and other efficiency strategies. We plan to take out at least $50 million in annual operating expenses over the next two years. In addition, we plan to further optimize capital, and we just received a non-objection from our regulators to repurchase $450 million of common stock, as well as increase our dividend to $0.35 per share beginning in the second quarter, which is subject to board approval. We are also focused on continuing to thoughtfully grow our business, improve risk-adjusted returns and achieve our return on tangible common equity target of 11% at the end of this year and at least 12% by the end of 2020. We have a demonstrated track record of delivering on our objectives and are committed to creating long-term shareholder value.

With that, let me turn it to John.

John Fawcett
Thank you, Ellen, and good morning, everyone. Net income for the fourth quarter on a GAAP basis was $82 million or $0.78 per common share and $428 million or $3.61 per common share for the full year. Excluding noteworthy items, which related to our strategic initiatives, income from continuing operations was $127 million or $1.21 per common share this quarter, compared to $131 million or $1.15 per common share last quarter and $130 million or $0.99 per common share in the year-ago quarter.

On a full year basis, earnings from continuing operations, excluding noteworthy items decreased, however, earnings per share increased by more than 30%. The reduction in earnings reflected non-strategic asset dispositions over the past two years, growth in our core businesses and a lower effective tax rate, while the earnings per share improvement reflect the reduction in share count as we continued to return capital to shareholders.

Funded origination volume in the fourth quarter of $3.6 billion was particularly strong in our Commercial Banking segment. However, higher prepayments, especially in Commercial Finance and Real Estate Finance, tempered growth in average loans and leases in our core portfolio, which grew 2% compared to the third quarter.

Total average loans and leases decreased, resulting from the strategic sale of our European Rail business, NACCO, in early October, which represented $1.2 billion of assets as well as the continued runoff of the LCM portfolio.

As shown on Slide 7 of the presentation, and as I previewed last quarter, we had three noteworthy items, all in continuing operations that aggregated to a net after-tax charge of $45 million. All three items were related to the sale of NACCO and the related liability management actions. These included the gain on the sale of the NACCO business, a net charge related to the termination of the high cost, legacy TRS funding facility and debt extinguishment charges, which were primarily related to the redemption of just over $430 million of unsecured debt. The benefits from the liability management actions included our ability to reduce our international taxes and move $350 million of rail cars from the bank holding company to CIT Bank, enabling us to continue to optimize our funding costs with more efficient, deposit-based financing for these assets.

I will now go into further detail on our financial results for the quarter. Please note, that in this discussion, I will refer to our results from continuing operations, excluding noteworthy items, unless otherwise noted.

Turning to Slide 8 of the presentation, net finance revenue declined from the prior quarter as lower net operating lease income from the sale of NACCO, the absence of any prepayment benefits in our North American Rail portfolio and higher deposit costs, were partially offset by an increase in revenues on our loans and investments. Compared to the year-ago quarter, net finance revenue was down $17 million primarily due to lower average earning assets from the NACCO and reverse mortgage portfolio sales, and higher deposit costs, partially offset by higher income on our investment portfolio and loans in Commercial Banking.

Turning to Slide 9, while net finance revenue declined, net finance margin improved 3 basis points compared to the prior quarter to 3.39%. This increase was primarily driven by lower average cash balances, improved yields on our loans and investments, higher net purchase accounting accretion and lower borrowing costs, partially offset by the reduction in rail net operating lease yields and higher deposit costs.

Higher rates on loans and investments, as well as the reduction in our cash balances benefited the margin by 14 basis points this quarter. Loan yields benefited from the increase in market rates, and we are starting to earn higher yields in select areas of our equipment lending businesses within Business Capital. In addition, the yield on our investments increased reflecting a $1.5 million special cash dividend from the Federal Home Loan Bank.

Lower net rail operating lease revenue reduced margin by 12 basis points as higher revenue from year over year favorable usage collections were more than offset by the absence of a prepayment benefit recognized last quarter. In addition, NACCO portfolio yields were slightly higher than the overall portfolio, and the absence of the NACCO portfolio reduced the Rail portfolio gross yields by approximately 12 basis points.

The increase in Net Purchase Accounting accretion benefited margin by 8 basis points, mostly driven by a reduction in the negative yield on the indemnification asset. Our loss share agreement with the FDIC expires on March 31, 2019. As a result, the indemnification asset will decline to zero, and the first quarter will be the last where we recognize the negative interest income.

Increasing deposit rates reduced margin by 9 basis points, reflecting continued upward market trends. Lower borrowing costs contributed 2 basis points to the margin reflecting our liability management actions, partially offset by an increase in Federal Home Loan Bank costs. The decline in net finance margin from the year-ago quarter reflected similar trends.

Turning to Slide 10, other non-interest income decreased $5 million compared to the prior quarter, reflecting lower capital markets fees and lower revenues from customer derivatives, partially offset by an increase in gains from the sale of operating lease equipment, mostly from the Rail business. Compared to the year-ago quarter, other non-interest income declined $16 million as lower capital markets fees, lower gains on the sale of investments related to the legacy, private label MBS investment portfolio and lower gains from the reverse mortgage portfolio were partially offset by higher gains on the sale of operating lease equipment. We have now completed the sale of the private label MBS portfolio acquired in the OneWest acquisition, which had higher yields and higher risk weightings. Going forward, the gains on the sale of investment securities are expected to be modest, more opportunistic and dependent on market conditions.

Turning to Slide 11, operating expenses, excluding intangible asset amortization, decreased by $5 million from the prior quarter, primarily driven by lower compensation costs and deposit insurance costs, which were down $2 million primarily related to the reduction in the FDIC surcharge. These reductions were partially offset by higher professional fees and technology costs, which will vary from quarter to quarter, depending on the timing and progress of various projects.

The sale of NACCO contributed to a $3 million decline in operating expenses, the majority of which was in employee costs. As Ellen indicated, we achieved our full year operating expense goal of $1.050 billion, which excludes intangibles, representing a full year reduction of approximately $65 million in 2018 and approximately $150 million over the past three years.

We remain focused on further reducing costs, while continuing to invest on our business. As Ellen indicated, with our 2018 operating expense goal met, we are targeting an additional reduction of at least $50 million over the next two years, which will be primarily driven by continued organizational efficiencies and digital process automation.

This reduction does not reflect the impact from two changes that are being implemented this year related to new lease accounting rules. The first restricts the lease origination cost that can be capitalized, and the second changes the financial presentation of the amount of property taxes billed and collected from customers by grossing up both revenue and expense. These adjustments do not result in any changes to the actual cash flows. Based on current estimates, we expect these accounting changes will increase annual operating expenses by $40 million to $50 million; $25 million to $30 million of this increase will be offset in non-interest income related to the property tax gross up, and $15 million to $20 million will benefit net finance revenue over the life of the lease as there will be less capitalized costs to amortize.

As we gain greater clarity into the estimated size of the impact of these accounting changes, we will update our estimate. In the meantime, we will continue to keep you apprised of how we are doing against our new operating expense reduction commitment.

Slide 12 shows our consolidated average balance sheet. Over the past year, we deployed our cash to build out the investment portfolio, grow our core loans, improve our funding mix and return significant capital to our shareholders. Compared to the prior quarter, average earning assets were down approximately $1.3 billion, reflecting the sale of NACCO and the deployment of cash proceeds into liability management and capital actions.

Slide 13 provides more detail on average loans and leases by division. As I mentioned earlier, we saw strong origination volumes this quarter, which resulted in 2% average growth in our core portfolios. Commercial Banking's average loans and leases were down slightly this quarter, reflecting the sale of NACCO in Rail, partially offset by growth in all the other divisions. Excluding NACCO, Commercial Banking portfolio grew 2% compared to the prior quarter and 5% from the year-ago quarter, primarily driven by growth in Business Capital and Commercial Finance.

Our North American Rail portfolio grew modestly compared to the prior and year-ago quarters, as new deliveries were partially offset by depreciation and our portfolio management activities. Utilization remained strong at 98%, despite the excess capacity in the industry and lease renewals repriced only slightly down this quarter, reflecting the mix of cars renewing and our portfolio management capabilities. We believe market railcar lease rates have generally stabilized, and we have recently seen a modest improvement in tank car lease rates. And, with the exception of covered hoppers carrying sand for fracking, freight cars are generally repricing at levels similar to, or in some cases, higher than that of expiring leases.

We continue to work through the cycle, and for 2019, we believe expiring leases will continue to reprice down, but are now expecting only 15% to 20% lower, although the quarterly levels may vary depending on the number and types of cars renewing.

In Real Estate Finance, we are maintaining our underwriting discipline which is especially important in light of current market conditions. Quarterly changes in average loans have been running plus or minus 1% to 2%, impacted by variability in timing of new deal closing and prepayment activity. While the average portfolio grew 2% from the prior quarter, when compared to the year-ago quarter, this portfolio has declined 2% as new originations were more than offset by prepayments and run-off of the legacy non-SFR portfolio.

In the Consumer Banking segment, growth in our Other Consumer Banking businesses more than offset the run off of the Legacy Consumer Mortgage portfolio when compared to the prior quarter. Compared to the year-ago quarter, the reduction in the Legacy Consumer Mortgage portfolio also reflects the sale of the reverse mortgage portfolio. Average loans in our core mortgage and small business lending businesses increased by over $200 million or 7% this quarter, due to continued strong originations in the retail and correspondent lending channels. Most of the loans we originate are jumbo loans in California, and this quarter's origination had an average FICO score of around 760 and an LTV of around 70%.

Overall, the lending environment remains highly competitive across our businesses, but as Ellen mentioned, despite these challenges, we are leveraging our proven origination and asset management capabilities, deep industry and collateral expertise and strong credit and structuring skills to find attractive opportunities to put our capital to work.

Slide 14 highlights our average funding mix. Compared to the prior quarter, total average borrowed funds and deposits declined, reflecting a slight reduction in deposits, as we managed our deposit costs, as well as lower secured and unsecured borrowings associated with the liability management actions we took with the sale of NACCO. The declines were partially offset by an increase in Federal Home Loan Bank advances. Overall cost of funds increased by 7 basis points reflecting an increase in deposit costs and Federal Home Loan Bank advances, consistent with rising market rates, which more than offset the benefits from our liability management actions.

Slide 15 illustrates the deposit mix by type and channel. Quarter over quarter, our average deposits decreased by approximately $375 million to $30.9 billion, reflecting slight reductions in our online branch and broker channels. Our cost of deposits increased 10 basis points this quarter, reflecting the increase in market rates in our savings products and CDs in both the branches and the Direct Bank. The trailing twelve month beta on total deposits increased slightly to 45%, as we managed the amount and timing of our rate increases, while the cumulative beta since the first rate hike of the current tightening cycle in December 2015 is 23%.

Moving into 2019, as we grow our deposits, we expect deposit rates to trend up in the first quarter reflecting the recent increase in online savings account rate and higher CD costs. Also, with the launch of our new Savings Builder product, which added an additional $1.2 billion in new deposits in the first three weeks of January, we also expect to see customers continue to migrate deposits into this new product in 2019.

If there are no additional Fed hikes in 2019, we think it could take up to six months for the recent rate increase, along with the migration to higher savings rate products, to mostly cycle through. As a result, we think the cumulative beta since the start of the rate cycle will increase from 23% today to 40% to 50% by the end of 2019, with about three quarters of the increase in the first half of the year. This cumulative beta reflects the product remix strategy we deployed earlier in the rate cycle to reduce higher cost brokered and commercial deposits, as well as our pricing strategies to optimize costs. Ultimately, market rates and asset growth will impact our cost of deposits, and we remain focused on optimizing these costs through targeted marketing strategies and disciplined pricing strategies.

Slide 16 highlights our credit trends. The credit provision this quarter was $31 million, towards the low end of our near term outlook. This quarter's provision reflected 32 basis points of net charge-offs, also at the low end of our near term outlook. Reserves increased slightly to 1.59% of total loans. Our reserve on Consumer Banking assets is relatively small as the Legacy Consumer Mortgage portfolio, which is about half the total loans in the segment, is carried at a significant discount.

Within Commercial Banking, the reserve grew modestly to 1.90%, which includes an increase in specific reserves within Commercial Finance. Non-accrual loans declined this quarter to under 1% of total loans, reflecting the sale of a criticized asset near its carrying value. Net charge-offs and non-accruals are not demonstrating any particular pockets of weakness. The credit environment remains stable, and new business originations continue to come in at better risk ratings than the overall risk rating of the performing portfolio. Our reserves remain strong and are more than four times the last 12 months' charge-offs.

Turning to capital on Slide 17, at the end of November, we completed our $750 million common equity share repurchase authorization of $459 million or 9.7 million shares at an average price per share of $47.45. We ended the quarter with 101 million common shares outstanding and a Common Equity Tier 1 ratio of 12%. We recently received a non-objection from our regulators to repurchase up to $450 million of common stock through September 30, 2019. We also received a non-objection to increase our dividend, subject to Board approval, starting in the second quarter, from $0.25 to $0.35 per common share, a 40% increase.

Our capital levels remain strong, and we expect to continue to reduce our capital levels at a more moderate pace in 2019. We remain focused on achieving a Common Equity Tier 1 ratio of 11% by the end of this year, the upper end of our target CET1 ratio of 10% to 11%.

Slide 18 highlights our key performance metrics. In the fourth quarter, our tax rate was 21%, benefiting from the cumulative impact of state and local tax planning actions and tax credits related to research and development costs, which in aggregate reduced the full-year effective tax rate to 26%. Excluding these discrete items, the effective tax rate would have been about 24% in the current quarter.

In the fourth quarter, our ROTCE from continuing operations excluding noteworthy items, improved to 10.1% and if you normalize for the semi-annual preferred dividend that is paid in the second and fourth quarters, and adjust for the tax benefit this quarter, our ROTCE would have still been 10.1%, meeting our 2018 year-end target of 9.5% to 10%. As Ellen indicated, we remain committed to continuing to improve our returns and are focused on achieving an ROTCE of 11% in the fourth quarter of 2019 and at least 12% by the fourth quarter of 2020. Further improvements will come from capital optimization, revenue growth in our core businesses and reductions in operating expenses.

Before I turn it back to Ellen, I wanted to give you some thoughts on our outlook for 2019 which is on Slide 19. My commentary will focus on full-year 2019 targets when compared to full-year 2018, excluding noteworthy items, and actual results may vary by quarter. Our outlook assumes no rate hikes in 2019, annual GDP growth of 2.5% to 3%, and credit markets to remain relatively stable.

With the sale of non-core portfolios behind us, we expect total loans and leases to grow in the low single digit area. This includes mid-single-digit growth in our core portfolios partially offset by the continued run-off of the Legacy Consumer Mortgage portfolio, which has recently been running around 15% to 20% annually. We expect net finance margin to decline to 3.10% to 3.30%, primarily driven by: continued pressure from rail repricing in the absence of rail prepayment benefit in 2019, which are expected to negatively impact margin by 5 to 10 basis points; the full-year impact from the sale of the reverse mortgage and NACCO portfolio, which were higher-yielding; an increase in average funding costs on our savings deposits and CDs as well as Federal Home Loan Bank advances resulting from higher market rates when compared to full-year 2018. These headwinds will be partially offset by: higher yields on loans driven by higher market rates when compared to full-year 2018 as well as recent pricing increases in our equipment financing business, and, a reduction in borrowing costs from our recent liability management actions.

Core operating expenses, which exclude intangible asset amortization, are expected to decline around 3%. This guidance does not include the impact from changes in lease accounting rules, which as I mentioned earlier, we estimate will increase operating expense by $40 to $50 million. We expect our net efficiency ratio to remain in the mid 50% range excluding lease accounting rule changes. Based on our view of the economy and our risk profile, we expect net charge-offs to remain within our near-term target range of 35 to 45 basis points and the provision to average $30 to $40 million per quarter. We expect the effective tax rate before the impact of discrete items to improve slightly to 25% to 26%, given the tax planning actions we embarked on this year.

Page 20 highlights our outlook for the first quarter, which also reflects these trends and is compared to our 2018 fourth quarter results. We anticipate low single-digit quarterly growth in our core portfolio. Net finance margin is expected to decline to the mid to upper end of our 2019 outlook range, primarily due to a reduction in rail net yields from repricing pressure in the absence of revenue from year over year favorable usage collections; higher deposit cost, reflecting the recent increase in the savings account rate in the Direct Bank; partially offset by benefits from higher yields on loans and investments.

In addition, we expect operating expenses to increase from the current quarter by about $15 to $20 million, primarily driven by elevated charges related to annual benefit restarts and the acceleration of costs from retirement eligible employees. This increase excludes the impact from the lease accounting changes which we estimate will increase expenses by an additional $10 million with a partial offset in other non-interest income of about $6 to $7 million.

We expect operating expenses to return to a more normal level in the second quarter, but will still be impacted by the lease accounting changes. The net efficiency ratio is expected to be in the high 50% area, reflecting the trends I just mentioned and excludes the impact of the lease accounting changes.

Credit metrics and the effective tax rate are consistent with our full-year outlook.

And with that, let me turn the call back over to Ellen.

Ellen Alemany
Thanks, John. In closing, I want to reiterate that it's been a strong year. We did what we said we would do, and we know there is still more to accomplish. CIT has a deep heritage -- about 110 years of working with customers to navigate their goals. We're proud of the contributions we've made so far, motivated by our momentum, and committed to delivering for our customers and shareholders.

With that, we're happy to take your questions.

QUESTIONS AND ANSWERS

Operator
Thank you. We will now begin the question-and-answer session. To ask a question, you may press star then one on your telephone keypad. 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 the roster.

And the first question comes from Ken Zerbe with Morgan Stanley.

Ken Zerbe
Great. Good morning. I just wanted to start off, actually, it's back on Slide 15 where you showed your deposit growth by channel. And, I guess, what caught my eye was the reduction in the online deposit balances. I know you guys are still sort of at the higher end or at least certainly very competitive with other online savings accounts. Can you explain a little bit more why the online deposits fell this quarter? Thanks.

John Fawcett
Yes. So, Ken, just from a perspective of history, recall that, last year, we went out with an offer rate of about 1.85 in February. And notwithstanding the fact that we saw Fed hikes in March, June and September, we actually held on to that 1.85 offer rate through to the beginning of October.

When you got into October, you started to see a lot more competition come into the space. And I think, as most online banks are doing, we experimented a little bit with rates. And so, we've tried to move from 1.85 to 2.15, quickly moved on to 2.25 where we were met with competition from about eight other online banks, and so there was a fair bit of competition in the space.

That said, I think we started to get a little bit of our mojo back. And then very early in the first quarter of this year, post the December rate hike, moved our online offer rate from 2.25 to 2.45, and we've seen good pickup in terms of online acquisition of accounts.

Ellen Alemany
Ken, this is Ellen. We're also trying to balance our deposit needs with the other side of the balance sheet, the funding needs, as well, keeping that balanced.

Ken Zerbe
All right, makes sense. And then, I guess, just going back to the stock repurchase, I think I heard Ellen, you mentioned $450 million of buybacks. Was that just for this like upcoming year, 2019? Is there any chance—and I want to make sure I'm right about that—but is there any chance you could front-end load

that? Or is that also subject, presumably, to loan growth that you may or may not do the full amount if loan growth is better or worse than expected?

John Fawcett
Yes. So the $450 million is a commitment through the first nine months of the year. And so we've just recently received the authorization or the non-objection from the Fed. It's not necessarily tethered to any limits or restrictions in terms of what we do. Obviously, we prefer to be buyers at below tangible book value, as I think we have been and we've been very judicious in terms of the pacing of returns. So we'll see. The $450 million covers us for nine months, and I think we'll be as opportunistic as we can to maximize shareholder value.

Ken Zerbe
Okay. Perfect. And then just one last question, just in terms of the operating expenses, I understand the guidance were down 3%. I think you'd mentioned $50 million reduction over the next two years. It looks like a big chunk of that comes in the first one year. Can you just give a little more detail? I mean, you guys have been so good about actually cutting expenses on an absolute basis, like where are **you** seeing more of these cuts coming from? Like what are the underlying businesses or expenses that you are reducing? Thanks.

Ellen Alemany
Sure. So, Ken, one is just want to make sure that we're balancing this with investment in the business and then the lease accounting changes that John mentioned, but this is a story of continuous improvement. We probably still have a little of stranded costs from some of the businesses that we divested that we still want to get out. Most of these expenses are coming through the functions, not from the core businesses themselves, and we're using technology and digitization to provide for some of this efficiency.

So, for example, some of the projects around data, there's many parts of the company that provide the same data to different people for different reports. By centralizing data, you'll have one source for all of that.

We've launched a major credit reengineering project in the company. We're working on records management, vendor contract negotiation. We're trying to migrate more jobs to lower-cost locations. We think there's still some more opportunity to expand some layers in real estate. So, this is a story of continuous improvement. We're building it in the DNA and the culture of the company, and we're working all of these items.

John Fawcett
Yes. And I think Ellen said it exactly right. I mean, this is all about continuous improvement. And this is a company, I think under Ellen's leadership over the last three years, we've proven we can take $150 million out, and so if you just take $50 million a year, this new run rate gets us down to about $25 million or $30 million a year. And again, focus on the fact that we said at least $50 million, and so we're going to continue to look for more opportunities.

But, this becomes a little bit of diminishing returns. As you go through these programs and you've taken out $50 million a year over three years, I think, on the face of it, 3% of $1 billion doesn't sound that impressive. But the reality is, is that when you think about what it costs to keep the lights on in the bank, the 3% is actually multiples, given what your fixed cost base is in actually running a bank. And so this is going to be another daunting challenge, but I think we've made good progress in terms of identifying the pockets that we have to go at and we're just not going to relent. It's just going to be continuous improvement, as Ellen said.

Ken Zerbe
All right, that's great. Thank you very much.

Operator
Thank you. And the next question comes from Moshe Orenbuch with Crédit Suisse.

Moshe Orenbuch
Great. Kind of two little ones and then a follow-up kind of from a big picture. I guess, John, can you just clarify some of the stuff you said about the railcar? You said that it was pretty stable this quarter, but it's going to be still down 15% to 20% in 2019, maybe just explain why that is. And also, you mentioned the loss sharing arrangement ends. So what happens after that from a net interest income perspective? And then I've got a follow-up.

John Fawcett
Yes. So on the rails, Moshe, what's happening is, this is the pig and the python, and so it's principally around tank cars. And so, as an example, about a third of what repriced in 2018 were tank cars, and so we're still going to have another 25% of tank cars reprice in 2019, and then that diminishes further into '20. But it becomes a smaller and smaller number and it becomes less and less relevant in terms of the impact because what you're seeing is the top rate is coming off as the floor rate is starting to move up and so there's been a convergence in pricing.

The other thing is that in 2018, we've seen some pretty substantial prepaid benefits to the pass-through of the Rail business, which if they come, that's great, but they're not built into the forecast, and so that's the big part of what's going on in the rail program. That said, the other thing I would mention is that while last year we guided down 20% to 30%, we actually wound up kind of around 20% or maybe a little bit under that on a full-year basis. So I think we approached this fairly conservatively. Again, as I've said in the past, the offset to tanks is the freight or infrastructure cars. And if the economy continues to chug along and rail loadings continue to increase, we think that there's potentially more opportunity there, but we haven't necessarily built it in.

And then the second question around the indemnification, so when the indemnification goes away, essentially, we have a modest allowance against these. These are well-marked positions. What essentially will happen is the risk weighting of these will change, which would increase risk-weighted assets by about $1 billion, but at the same time, we expect that there's a benefit that will come the other way from applying new HVCRE standards. And so, net-net, from a risk-weighted asset perspective, it just becomes a big push. Does that help?

Moshe Orenbuch
I guess it did. The kind of big picture question I was thinking about is you've obviously done all the things that you set out to do, but in the idea that you want to become more bank-like and the comments about being incrementally harder to kind of just chop away at expenses, are there any other big-picture restructuring thoughts that you have in terms of the process of becoming more bank-like? I mean, any ways to either accelerate the transition of the railcar business either away or into the bank or other things that could make the company more bank-like?

John Fawcett
Yes. Look, there's no silver bullet. This is going to be a grind. I mean, so the guidance was 9.5% to 10% this year, 11% in the fourth quarter next year, 12% in 2020. I think we all, internally, think of these things are floors.

Yes, on the rails, we look at this all the time with the cessation of the total return swap. We moved $350 million of rail cars from the bank holding company into the bank. And so we're always looking for opportunities to do that within the regulatory framework, which limits us from 23A perspective, on the one hand, but also from a residual asset perspective on the other hand. I think, as we sit right now, probably about 60% of the railcars are in the bank, and we're always looking for more opportunities to kind of move those in.

But other than that, I mean, this is just going to be a grind, and we're looking at every lever all the time. Right now, the big levers are grow the business, and I think we've proven that we can do that, and adjust the mix to higher yields, small, middle market businesses. At the same time, we continue to optimize expenses and return capital to shareholders in the most thoughtful way possible.

Moshe Orenbuch
Great. Thanks very much.

John Fawcett
You're welcome. Thanks, Moshe.

Operator
Thank you. And the next question comes from Eric Wasserstrom with UBS.

Eric Wasserstrom
Thanks, and good morning. I just wanted to follow up on some of the components of the net interest margin guidance. I think you were very clear on the first quarter effects. But just more broadly, to end up at the lower end of the guidance, would that be because of a change in the broader environment? Or would that be a function of something more specific to your mix in terms of assets or funding structure?

John Fawcett
Look, I think the two big wildcards are really going to be around deposits and where we go on rail lease renewal rates. I mean right now all the visibility on rail lease renewals is, we think we have a pretty good view on where things are going and feel pretty good about that. I think what remains to be seen is what happens with deposit costs, even with no Fed hikes, you would expect that elements of the existing book of business would continue to migrate to the higher offer rate, and so that becomes a challenge. And I think it also depends on where are the banks wind up going, what competition does vis-à-vis deposit costs. So, those are the big things.

And to the extent that rates do remain somewhat flat, the larger benefit of rate increase is going to be on pricing power, which we've started to push a little bit in Business Capital, and we should get a little bit of modest lift of the carryover of the December increase into the first quarter. But beyond that, I think things are going to be pretty flattish if the budget plays out, which contemplates no rate increases at this point.

Eric Wasserstrom
Great. Thank you for that. And just a related question, just in terms of the core asset growth, can you just help us maybe get a little bit of a more granular understanding of specifically which asset classes you think will be growing and which may remain perhaps at the softer end?

Ellen Alemany
Sure. I mean, as we've said before, right now, we've got tremendous momentum in Business Capital. All of our leasing, we have differentiated technology there. Our Commercial Services and Business

Capital businesses have recorded record volumes this year. We've really tempered the growth on the real estate side of the business. We're being very, very careful there, and it's really almost flattish. And then in Commercial Finance, again, we're really staying very, very disciplined on the credit side and we don't expect a tremendous growth in that segment of the marketplace. And then I would say normal outlook for Rail that was talked about already.

Eric Wasserstrom
Excellent. Thanks very much.

Operator
Thank you. And the next question comes from Owen Lau with Oppenheimer & Co.

Owen Lau
Good morning, and thank you for taking my questions. I have a question about capital ratio guidance and buyback. How flexible is your 11% CET1 ratio guidance in 2019? Your median guidance is 10% to 11%. If the stock continues to trade at the current valuation, which is below tangible book value, so what does it take for CIT to accelerate the rundown further in '19, say, to the middle of the range and enhance more buyback after third quarter '19 and be more opportunistic to the discount we are seeing? Thank you.

John Fawcett
Yes, there's a bit of an oxymoron there in terms of being opportunistic in the context of a partnership with the Fed. I think we've been actually quite judicious in terms of the way we've described capital and the way we're returning capital. Our guidance last year was to get to 11.5% to 12%. This year, we got to 12%. Our guidance next year is to get to 11%, and we're not moving off that.

I mean, we continue to enjoy a good working relationship, I think, with the Fed. It's a very balanced, thoughtful relationship. There is a regulatory framework that we are part of with these guys. And so in terms of opportunity, we've been very clear with the market, we've been very clear with the Fed in terms of what we're going to do, and that's what we're going to do. So I would say there is not a lot of opportunity to go below 11% before the end of '19. And after that, we'll take a look. We'll look at our capital planning process and we'll have conversations with our regulators in terms of what the art of the possible is.

Owen Lau
Okay, that's helpful. Just one follow-up on the railcar leasing side. I know it's still very early, but could you please give us some color on how the PSR implementation might affect your fleet? Do you find it more difficult to remarket box car? And also, how do you manage the risk from future PSR implementation? But again, I know it's very early, but any color would be very helpful. Thank you.

John Fawcett
Yes, it really is very early. And just for the uninitiated, this is around precision scheduling railroading, so it's an approach the railroad operations have on improving operating ratios through greater car utilization and it entails establishing a train schedule of departures and a plan for each shipment within that train schedule.

I really do think it's just too early in the process to comment on. I think, like a lot of implementations, even within Rail or apart from Rail, the devil is in the details. Typically, as these things go, there's some bumps in the road, which actually reduces velocity and maybe creates some near-term opportunity in terms of car utilization. But over time, you would expect that to the extent that the railroads become more efficient, there would be less need for cars. But the timing and the types of cars that are going to be impacted or not impacted is very hard to say.

That said, we are aware of it; we are working through it. And as it becomes a more, I guess, notable event on the horizon, I think we'll come back to you with better guidance.

Owen Lau
Okay, thank you.

John Fawcett
You're welcome.

Operator
Thank you. And, once again, if you have a question, please press star then one on your touchtone phone. All right. And the next question comes from Arren Cyganovich with Citi.

Arren Cyganovich
Thanks. It seemed like your loan volumes were pretty strong. I think you said something like the best in five years, but the actual growth was a little muted. Was there a large amount of pay-downs or what was the PE movement there?

Ellen Alemany
Sure, Arren. We had a large amount of prepayments in the Commercial Finance and the Real Estate divisions, which has been typical. It's the same pace that we've been operating on. But pipelines are very strong.

I do want to say, though, that customer sentiment is more cautious. Customers are really being careful with capital spending, given trade wars, the equity market performance, a perceived economic slowdown and some of the geopolitical issues that are going on. But as I mentioned before, the strongest volumes we have right now are in the Business Capital division and our Commercial factoring, and most of the growth is coming from our technology-based businesses and most of the growth is in asset-based lending.

Arren Cyganovich
Okay. And I think you mentioned that the pricing in this quarter in certain areas and pockets were a bit better. Are you seeing any benefit from credit spread widening we had back in the fourth quarter? Is that impacting at all on the pricing dynamic that you're seeing on new commercial loans?

John Fawcett
Yes. Most of the pricing benefit that we're seeing is actually coming through Business Capital. And I think we've had our toe in the water in terms of pushing price probably since the third quarter, pushed a little bit more in the fourth quarter and having seen a trade down in volumes. But, I mean, that's the yin and the yang of this, which is how much price can you push without compromising volume, and so far, so good. So we'll continue to push where we can.

Arren Cyganovich
Great. Thank you.

John Fawcett
You're welcome.

Operator
Thank you. And as there are no more questions at the present time, I would like to return the floor to management for any closing comments.

CONCLUSION

Barbara Callahan
Great. Thank you. And thank you, everyone, for joining our call this morning. If you have any follow-up questions, please feel free to contact me or any member of the Investor Relations team. You can find our contact information, along with other information on CIT in the Investor Relations section of our website at cit.com.

Thank you again for your time this morning, and have a great day.

Operator
Thank you. That concludes today's call. Thank you for participating.