CIT Group, Inc.

Q3 2018 CIT Group, Inc Earnings Conference Call

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CORPORATE PARTICIPANTS

Barbara Callahan - *Head of Investor Relations*

Ellen Alemany -*Chairwoman, CEO*

John Fawcett - *CFO*

PRESENTATION

Operator

Good morning and welcome to CIT's Third Quarter 2018 Earnings Conference Call. My name is Nicole and I will be your operator today. At this time, all participants are in a listen-only mode. There will be a question and answer session later in the call.

To ask a question, you may press Star, then 1 on your touchtone phone. To withdraw your question, please press Star, then 2. If at any time during the call, you require assistance, please press Star 0 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, Nicole. Good morning, and welcome to CIT's Third Quarter 2018 Conference Call. The 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 a 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 on the Investor Relations section of our website, at CIT.com.

Now, I'll turn the call over to Ellen Alemany.

Ellen Alemany

Thank you, Barbara. Good morning, everyone, and thank you for joining the call. In the third quarter, we posted strong progress on all facets of our strategic plan, and I'll touch on a few highlights shortly.

We posted net income available to common shareholders of $132 million, or $1.15 per common share, an income from continuing operations available to common shareholders excluding noteworthy items of $131 million, or $1.15 per share. Results reflect core asset growth, lower operating expenses, and continued capital optimization. This led to a return on tangible common equity from continuing operations excluding noteworthy items of about 9.8 percent. And, when normalizing for the semi-annual preferred dividend, it was 9.4 percent, up from 8.9 percent last quarter.

Our roadmap to deliver improved profitability has been the five points of our strategic plan, which are on Slide 2, and I want to share some highlights on each point. Our core average loan and lease portfolio grew 8 percent year over year, and 2 percent from the prior quarter. Pre-payments declined in the third quarter. However, the environment remains competitive and we could see elevated pre-payment levels again in the near term.

Despite the competition, we have found strategic opportunities that align with our core strengths and risk framework. In addition, our growth initiatives across the business have gained momentum, which helped to drive a 38 percent increase in originations from the year ago period. Our market and structuring expertise enabled us to pursue thoughtful growth, while remaining disciplined on credit.

The Commercial Finance business posted strong growth, with average loans and leases up 7 percent from a year ago, driven largely from asset based lending within the energy healthcare and C&I verticals. The Business Capital division posted another quarter of solid growth, with assets of 10 percent year over year, and 3 percent quarter over quarter.

All areas of the equipment finance business saw growth and factoring volumes were up 11 percent year over year. Our expansion into new verticals and investments in technology have gained traction and allowed us to build on our core strengths in this area.

The commercial real estate market remained very competitive in the third quarter. Our origination volume was up from last quarter, but we remain prudent in our underwriting process and continue to monitor market trends closely.

Rail continues to be an important business for us, and we saw utilization remained high in North America, at about 98 percent, which is an increase of 360 basis points from a year ago. While there's still some excess capacity in the marketplace, we have started to see some positive movement in the industrial sector and are monitoring industry trends closely.

On the strategic front, we completed the sale of the European rail business earlier this month. That was our last ongoing overseas business and has allowed us to streamline our operations and focus on the North American market.

Overall, we saw positive growth momentum across our businesses in the third quarter and we are focused on continuing to advance our strategic initiatives.

Our operating costs continue to improve, with expenses down 2 percent from the prior quarter, as we delivered against our key initiatives. We remain on target to achieve our expense goal in 2018.

We took several steps recently to further optimize our funding profile. Most notably, after the sale of NACCO in October, we were able to initiate a series of liability management actions to eliminate higher cost funding sources. Going forward, we expect to fund a greater portion of our rail cars in the bank subsidiary, which offers more efficient deposit based funding.

Over the last 12 months, average deposits at the direct bank have grown by $3.4 billion, which is a 30 percent increase year over year. And, notably, we expanded our customer base by adding about 55,000 new customers in the same time period. As we build a broad base of customers, we are introducing new products to meet their savings goals.

Our capital optimization efforts continue to advance and we repurchased about $291 million in common shares in the quarter and an additional $188 million in shares from quarter end through October 22nd. We expect to complete most of the remaining $750 share repurchase authorizations by the end of the year.

And, lastly, our credit reserves remain strong. Overall, a solid quarter and we remain committed to our profitability goals.

With that, let me turn it to our CFO, John Fawcett.

John Fawcett
Thank you, Ellen, and good morning, everyone. Net income for the third quarter, on a GAAP basis, was $132 million, or $1.15 per common share, while income from continued operations excluding noteworthy items was $131 million, or $1.15 per common share this quarter, up from $125 million, or $1 per common share of last quarter.

Compared to the year ago quarter, although income from continued operations excluding noteworthy items, decreased 6 percent, it is up nearly 13 percent on a per share basis, reflecting the reduction in share count as we continue to return capital to shareholders.

Excluding noteworthy items, the increase in net income from the prior quarter primarily reflects lower operating and income tax expense, and no semi-annual preferred dividend paid in the quarter, partially offset by a decline in other non-interest income and a higher credit provision.

Continued strong new business origination volume resulted in 2 percent average loan and lease growth in our core portfolio. In addition, prepayments moderated this quarter. Total average loans and leases were flat reflecting the impact of the sale of the reverse mortgage portfolio in May, which was nearly $1 billion, along with the continued runoff of the non-core portfolios.

As a reminder, our core portfolios include all Commercial Banking portfolios except NACCO and the other consumer lending portfolio within Consumer Banking. We have also included a page in the back of our earnings release to help you with this reconciliation.

As shown on Slide 5 of the presentation, we had four noteworthy items within the continuing operations, resulting from our strategic initiatives, although they mostly offset one another. Of note, this quarter we took a $16 million after tax impairment charge on the indemnification asset, which represents the projected reimbursable losses due from the FDIC under our loss share agreement related to covered loans acquired from OneWest.

The loss share agreement expires in March of 2019 and during the quarter, we performed a loan by loan review of the underlying mortgages, providing better visibility into the expected cash flows. The impairment reflects a reduction in the indemnification asset to the amounts we no longer expect to receive.

Secondly, we updated our valuation analysis for our held for sale assets in China with new information reflecting better than expected portfolio performance and market pricing, resulting in an $11 million after tax benefit. Both of these items are reported in Other Revenue within Other Non-Interest Income.

The other two noteworthy items included a $3 million after-tax redemption charge related to our liability management actions this quarter, and a $6 million after tax benefit from suspended depreciation related to the NACCO disposition.

We closed the NACCO transaction on October 4th, which is now expected to result in a pre-tax gain of approximately $30 to $35 million in the fourth quarter. We sold $1.2 billion of operating lease assets and received proceeds of $1.1 billion, which was net of local debt that was assumed by the buyer or paid off at closing.

We will use about $300 million of the net proceeds to terminate the remaining total return swap, or TRS, and related rail securitization. The TRS was a legacy holding company financing facility put in place during the financial crisis. It had become highly inefficient in that it encumbered almost $800 million of our North American rail cars in a complicated funding vehicle, yet only provided net funding of about $300 million.

In addition, recent legislative changes in the foreign jurisdiction of the legal entities, where the TRS was based, would have increased our annual tax provision by $3 million this year, and would have added an ongoing impact through the term of the facility.

The termination of the TRS facilitated by the net proceeds from the NACCO sale will enable us to optimize our taxes, as well as our funding structure, as we redeem the underlying ABS designated as a reference obligation within the TRS, and sell $350 million of the newly unencumbered rail assets to CIT Bank, where there is more efficient deposit based financing.

We will also further reduce unsecured debt. On October 19th, we submitted a redemption notice for $150 million of the 5.375% 2020 maturities, and we expect to redeem up to an additional $350 million of unsecured debt once the rail assets are sold to the bank.

In the fourth quarter, we will incur a pre-tax charge of approximately $70 to $75 million on the TRS termination, which reflects the present value of the facility fee on what would have been the remaining facility term of almost 10 years.

We will also incur about $15 to $20 million in pre-tax charges in unsecured debt extinguishment costs. However, with all these actions, we will realize a go-forward benefit in interest expense, which in 2019 is estimated to be about $45 million.

We will also deploy a portion of the remaining net proceeds to repurchase common stock, which was already contemplated in our current $750 million Board approved authorization.

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 6 of the presentation, net finance revenue is relatively flat from the prior quarter, reflecting higher net operating lease income, offset by higher deposit costs. Net operating lease income this quarter included an $8.5 million customer prepayment in our Rail business, where last quarter, we recognized a similar $4 million benefit. Going forward, we do not expect to continue to see meaningful pre-payment benefits in the rail portfolio.

Net finance revenue also benefited from lower lease maintenance costs, which tend to be variable and driven partially from our efforts to reposition rail cars as we renew leases.

Compared to the year ago quarter, net finance revenue is down $12 million, primarily due to a reduction in net purchase accounting accretion, or PAA, as higher funding costs were mostly offset by higher income on our loans, leases, and investments.

Turning to Slide 7, although net finance revenue was flat, net finance margin improved by 7 basis points, compared to the prior quarter to 3.36%, primarily driven by improved asset yields, the deployment of cash, which was elevated last quarter, and the rail prepayment benefit, which was partially offset by the increase in deposit costs.

Higher rates on our loans, investments, and mix of assets benefited the margin by 9 basis points this quarter. The yield on our interest bearing cash improved from a higher average Fed funds rate this quarter, and the investment portfolio yield stayed relatively flat, despite the continued repositioning of our higher yielding, higher risk weighted assets.

Loan yields improved modestly as higher rates in our floating rate loans were mostly offset by the full quarter impact from the sale of the reverse mortgages, which were higher yielding. Also, lower average cash balances, which were elevated last quarter from the reverse mortgage portfolio sale, positively impacted the margin.

The higher customer pre-payment and lower maintenance cost from our rail business that I mentioned before drove a 7 basis point improvement. Deposit rates increased this quarter, reducing margin by 13 basis points, reflecting continued upward market trends.

Lower borrowing costs contributed 2 basis points to the margin, as lower average Federal Home Loan Bank borrowings were offset by the unsecured debt maturity extension trade we executed last quarter. The decline in net finance margin from the year ago quarter reflected lower net purchase accounting accretion, while higher yields on our loans and investments were only partially offset by higher deposit costs.

Turning to Slide 8, other non-interest income decreased $9 million, compared to the prior quarter, which as I mentioned last quarter, included $11 million in aggregate benefits from reverse mortgage business and a reserve release related to the OneWest acquisition. Fee income increased from the prior quarter, reflecting higher capital market fees, while factoring commissions were up, reflecting seasonally higher volumes.

Turning to Slide 9, operating expenses decreased by $4 million from the prior quarter, reflecting lower compensation cost and professional fees, while also taking into account a $5 million benefit in the prior quarter from the reversal of an international tax related reserve. We remain on track to achieve our 2018 annual operating expense target of $1 billion, $50 million. As a reminder, this excludes intangibles and restructuring costs.

Slide 10 shows our consolidated average balance sheet. We’ve made significant progress over the past year, deploying our cash to build out the investment portfolio, grow more loans and leases, improve our funding mix, and return significant capital to shareholders.

Compared to the prior quarter, average earning assets were down approximately $850 million, reflecting the deployment of cash from the sale of the reverse mortgage portfolio in the second quarter of 2018, into liability management and capital actions. The decrease in secured borrowings primarily reflects the reduction in Federal Home Loan Bank debt, while the decline in equity reflects our stock repurchases of $291 million.

Slide 11 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 percent average growth in our core portfolios.

Commercial Banking's average loans and leases were up 1 percent, compared to the prior quarter, and 4 percent from the year ago quarter, both reflecting growth in Commercial Finance, Business Capital and Rail, offset by a reduction in Real Estate Finance.

In Commercial Finance, average loans and leases were up 2 percent this quarter and 7 percent from the year ago quarter. Although the middle market continues to be challenging, we have remained disciplined while finding attractive origination opportunities.

Origination volumes were up significantly from the prior and year ago quarters, and pre-payments moderated. Portfolio yields improved, reflecting the increase in LIBOR, although the competitive environment continues to put pressure on spreads. We have had particular success in growing origination volumes in the healthcare and energy verticals and in various sub-industries within C&I.

In addition, asset-backed originations remain over 50 percent of total new business volume, which we believe will contribute to continued solid credit performance in the portfolio. Finally, the pipeline continues to look good going into the fourth quarter.

Real Estate Finance assets were down 1 percent this quarter and 4 percent from the year ago quarter, reflecting our disciplined approach to the current environment. As I mentioned last quarter, the market has become more competitive, as CMBS and debt funds are more active. We are also seeing a growing presence from the Commercial Real Estate CLO market, as they accept repositioned bridge loans and fully cash flowing loans for the first time, contributing to further spread compression.

Regarding new business originations, we have deep expertise in our target markets and continue to pick our spots amid challenging market conditions.

North American Rail assets were up 1 percent, as new deliveries were partially offset by depreciation and portfolio management activities. We continue to see momentum building in the industrial sector, and rail loadings are up again this quarter.

The general surplus of equipment across North America has declined from last year, but remains high. The rail team has been successful in increasing utilization in the current environment, which remained at around 98 percent this quarter, demonstrating the benefits of our young and high quality fleet, our portfolio management expertise, and our strong customer service.

We continue to see improvement in renewal rates on freight cars and some modest improvement in tank car rates, and terms resulting from opportunities in the Western Canada crude oil markets, refined products in Mexico, and for retrofitted tank cars serving multiple markets.

Overall, lease rates on the mix of cars renewing repriced down 15 percent, which was better than our guidance this quarter. Nonetheless, we continue to expect leases to reprice down, on average, 20 to 30 percent through 2019, driven by continued pressure from tank car lease rates, which are renewing at a faster pace and at rates that are down from peak levels.

Business Capital average loans and leases grew 3 percent this quarter, with growth across all of our equipment lending businesses and seasonal growth in Commercial Services. Compared to the year-ago quarter, Business Capital grew 10 percent.

Origination volume remains strong and business confidence remains high. We continue to gain momentum across all our platforms from the investments we made in our salesforce, as well as our technology that differentiates us in this space.

Pricing has remained relatively constant, as the leases and loans are predominantly fixed rate. As a result, the increase in funding costs has put pressure on margins, but we have recently increased leasing rates in select markets which will take time to work through the portfolio.

In Consumer Banking, growth in our Other Consumer Banking businesses was more than offset by the runoff of the Legacy Consumer Mortgage portfolio and the sales of reverse mortgage portfolio in the second quarter.

Average loans in our core mortgage and small business lending businesses increased by almost $300 million, or 9 percent this quarter from the continued strong originations in the retail and correspondent lending channels, and we continue to experience an increase in loans from our SBA lending platform.

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

Slide 12 highlights our average funding mix. Compared to the prior quarter, total average borrowed funds and deposits declined, reflecting a reduction of Federal Home Loan Bank advances and structured borrowings, partially offset by deposit growth.

Our cost of funds increased this quarter, reflecting an increase in average deposit rates, primarily from the growth of our Direct Bank, which was partially offset by the reduction in secured borrowings.

Overall borrowing costs also reflect the extension of our unsecured debt. During the quarter, we issued $500 million of 4.75 percent, five and a half year debt and used the proceeds to redeem a similar amount of debt, at 3.875 percent due in February 2019.

While the weighted average rate on our unsecured debt increased 10 basis points to 5.05 percent this quarter, we extended our weighted average unsecured debt maturities to almost 5 years from 4.5 years.

Slide 13 illustrates the deposit mix by type and channel. Quarter over quarter, our average deposits increased approximately $275 million, to $31.2 billion, reflecting growth in our direct bank of $700 million, or 5 percent, primarily offset by a reduction in broker and commercial deposits, while branch deposits remained flat.

The cost of our deposits increased 15 basis points this quarter as we took advantage of opportunities to get in front of increases in market rates, and grew short term CDs in both online and branch channels. As a result, the cumulative beta on deposits increased to 44 percent over the past 12 months, and to 21 percent since the first rate hike of the current tightening cycle in December of 2015. And, we expect the trailing 12 month betas to be around 50 percent next quarter, with continued gradual increases in 2019.

Slide 14 highlights our credit trends. The credit provision this quarter was $38 million, compared to $33 million last quarter and $15 million in the year-ago quarter. This quarter's provision reflected 35 basis points of net charge-offs in line with our near term outlook. The provision also included an increase in reserves, resulting from asset growth and a higher level of non-accrual loans within Commercial Finance, where changes in non-accruals have some variability.

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 performance portfolio.

Turning to capital on Slide 15, in the third quarter, we repurchased $291 million of common equity, or 5.5 million shares, at an average price of $52.91 under our current $750 million repurchase authorization. We ended the quarter with 111 million common shares and a Common Equity Tier 1 ratio of 12.3 percent.

So far this quarter, we have repurchased $188 million of common equity, or 3.8 million shares, at an average price of $49.63, and intend to complete most, if not all, of the remaining authorizations by the end of the year.

We expect to achieve a Common Equity Tier 1 ratio of about 12 percent by the end of the fourth quarter, which also takes into consideration the reduction in risk-weighted assets from the NACCO sale and lower on and off balancing sheet factoring assets that were seasonally elevated this quarter.

Our capital levels remain strong, and we remain committed to achieving the upper end of our Common Equity Tier 1 ratio of 10 to 11 percent in 2019. We will continue to review our options to deploy capital as efficiently and as prudently as possible, while working within the confines of the supervisory review process.

Slide 16 highlights our key performance metrics, both on a reported basis as well as excluding noteworthy items. Our return on tangible common equity on continuing operations excluding noteworthy items improved to 9.78 percent and if you normalize for the semi-annual preferred dividend that is paid in the second and fourth quarters, our return on tangible common equity would have been 9.44 percent. We remain committed to achieving a return on tangible common equity of 9.5 to 10 percent in the fourth quarter, and 11 to 12 percent in the medium term.

Before I turn it back to Ellen, I wanted to give you some thoughts on the fourth quarter outlook, which is on Slide 17. We expect low single digit quarterly growth in our core portfolios. That said, we expect total average earning assets to decline from the NACCO sale and run off of the Legacy Consumer Mortgage portfolio.

We expect net finance margins to be closer to the middle of the 2018 target range of 3.2 percent to 3.4 percent, as this quarter included a pre-payment benefit in Rail. This outlook also reflects the impact of the NACCO sale and timing of liability management actions.

We expect operating expenses to be down as we achieve our $1,050 target for the year. We continue to expect net charge-offs to be within the annual target range of 35 to 45 basis points, and we expect the effective tax rate, before the impact of discrete items, to be 26 to 28 percent.

Finally, we do plan to provide 2019 outlook comments on our next earnings call, and with that, I will turn it back over to Ellen.

Ellen Alemany
Thanks, John. In closing, I want to reiterate that we're encouraged by the steady progress we have made on our plan, and remain committed to our return on tangible common equity goals. As you know, we were targeting 9.5 to 10 percent return on tangible common equity at the end of this year, and 11 to 12 percent over the medium term.

We remain committed to the pillars of our plan to maximize the potential of our core businesses, enhance our operational efficiency, optimize our funding costs, optimize our capital structure, and maintain strong risk management.

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

QUESTION AND ANSWER

Operator
Thank you. We will now begin the question and answer session. To ask a question, you may press Star, then 1 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 2.

Our first question comes from Moshe Orenbuch of Credit Suisse. Please go ahead.

Moshe Orenbuch
Great, can you hear me?

Ellen Alemany
Yes.

Barbara Callahan
Yes.

Moshe Orenbuch
Okay, great. Okay, sorry. Just wondering if we could kind of talk a little bit, you kind of outlined some of the elements of the loan growth. Maybe just talk a little bit about the competitive environment and what things you think are getting you that growth and how we should think about kind of margins into 2019 from your commercial loan portfolio?

Ellen Alemany
Sure. I think that the growth is a reflection of a lot of the investments and repositioning that we've made in the business over the last couple of years. I mean, it's competitive out there, but we're continuing to be selective and disciplined despite the market conditions.

We had 2 percent growth in our core businesses this quarter and 8 percent compared to last year. Prepayments were down. I think in Commercial Finance, the pipelines are encouraging. They remain strong, and we've had good growth in Healthcare, Real Estate, Energy, and

Aviation. We had some prepayments in Quarter 3, not as severe as we had in some of the prior quarters, but just in general, year to date, we've funded about $3.1 billion in volume in that business.

In Real Estate, we really are very cautious there and very selectively growing the portfolio. In Business Capital, we've had more technology additions in the business, and in Direct Capital, I think the vendor business showed good growth. We're seeing larger demand for larger equipment in Commercial Equipment Finance.

And then, in factoring, we saw volumes up about 9 percent from the prior quarter last year. A lot of that is in the technology sector. And, even consumer lending, which is a very small base, we saw growth in all of mortgage, small business loans, and CRA.

So, I think it's just reflecting the investments we've made in sales people and the technology that we're putting in the business. John, maybe you want to comment on the margins?

John Fawcett
Yeah, so and Moshe, I think Ellen hit it right on the head. I mean, if you look at where the growth is coming from, it's pretty much across the board. I think the one soft spot has been Real Estate, where we've been very unwilling to compromise on terms and conditions and have seen unprecedented levels of prepayments, and as mentioned in the call script, new entrants coming into the space in a different product set.

But, in the C&I space, we're seeing good pockets of growth in even Healthcare and Energy across the Business Capital space, whether it's Equipment Finance, Direct Capital, or Capital Equipment Finance. They're literally hitting the cover off the ball. And, as Ellen mentioned, it's due in part to some of the investments that she made in the business a couple years back that's starting to bear fruit, some of the technology that's been invested in the business.

In terms of margin, you would expect that as LIBOR started to move, that we'd start to see some of the benefits. It has not been the case. I think things are actually very tight. There's still an enormous amount of liquidity in the market. We've started to pass through in the second quarter and we'll continue to do in the third and potentially into the fourth quarter of this year and first quarter of next year, some pricing increases, but we'll look at those in the context of the impact it has in volumes. And, so we'll be quickly kind of toggling back and forth.

But so far, what we've seen implemented in this second quarter into the third quarter, has started to bear some modest fruit, but it takes a while to work through the entire portfolio and it's largely, mostly in the Equipment Finance and Direct Capital elements of the business. Otherwise, it's just really tight and I think it's going to remain tight into the fourth quarter and potentially until something in the market goes bump in the night.

Moshe Orenbuch
Got it, and just as a follow up, John, you talked about some of the positive impacts of the balance sheet repositioning. Can you talk about just the process for next year? I mean, when will we hear about both capital and liability actions?

John Fawcett
Yeah, so on the capital front, we've actually had a few good conversations with the Fed. We're in the process of actually changing Fed supervision teams. We're working through the process. I think we've looked at it from our side in terms of transitioning from SR 15-18 and 15-19 to SR

09-4. Yeah, I would expect that obviously, we've got to go through our planning process. We've got to get board consent, at the same time, we're working through our budgeting process. I would expect on the fourth quarter earnings call in January, we should be able to provide more visibility in terms of what it is that we'll be able to do on the capital front.

Moshe Orenbuch
Perfect, thanks very much.

John Fawcett
You're welcome. Thanks, Moshe.

Operator
Our next question comes from Eric Wasserstrom of UBS. Please go ahead.

Eric Wasserstrom
Thanks very much. John, maybe if I can just build on Moshe's question for a moment. I'm just trying to make sure I understand all the dynamics that are going to be flowing through the net interest margin over the next several quarters.

So, maybe it sounds like, just to perhaps summarize what you just went through, core growth is good. The end of the balance sheet may be pivoting back towards a modest growth trajectory, but pricing remains competitive. Is that basically the dynamic on the asset side of the equation?

John Fawcett
Yes, and it's in pockets. So, it really becomes very dependent in terms of the mix. So, when you start to look at Rail in the non-tank space, we're actually seeing some okay lift in terms of renewal pricing in the freight space. And, as I said, we'll see how the increases that we've put through in the Business Capital side of the business start to play through. But more generically, I think yeah, that's exactly right, what you said.

Eric Wasserstrom
Okay, great. And, then maybe if we could just focus on the liability side for a moment because it sounds like there's a number of dynamics and I want to make sure I'm understanding them all fully.

So, the $45 million benefit that you talked to in the prepared commentary, did that capture the incremental $350 million of redemption that you're anticipating, or is that only the TRS and the $150 million announced on Friday?

John Fawcett
No, it's everything.

Eric Wasserstrom
It's everything, okay. And, so it sounds like the dynamic on the liability side is going to be those series of actions, which looks to be about a 3 basis point benefit, more or less. Is that in the ballpark?

John Fawcett
The 3 basis points is a reference against what?

Eric Wasserstrom

Just against your current net interest margin.

John Fawcett
It could be, I'd say 3 to 5 basis points, in that range.

Eric Wasserstrom
And, then the other--it sounds like the other significant dynamic will be the go forward benefit of incremental Rail and--well, Rail and just greater deposit funding from the core deposit channel and a lesser degree of dependence on the non-core deposit channels. Is that the other primary dynamic?

John Fawcett
Yeah, I mean that's a big part. But, I mean, to the extent that we can move away from wholesale funding in the holding company and avail ourselves deposit based funding, that's quite valuable. And, so that $350 million means a lot to us.

Eric Wasserstrom
And, then just finally, the pricing, I guess the beta effectively, do you expect any change in beta as we move through the next series of Fed action?

John Fawcett
Yeah, I think over the cycle, I mean, there's no question that we're going to continue to creep higher and we expect at some point, we'll probably get between 60 and 70, or maybe a little bit more through the entire cycle. I think we've been fairly disciplined in terms of the way we manage pricing and if you look at our HYSA pricing or money market pricing or more broadly speaking, just non-maturity deposits, we came out with a 1.85 percent rate in February, literally dragged our feet the entire year until October, and then came out with a new savings rate of 2.15 percent.

So, and at the same time, grew 3.5 billion deposits and added close to 100,000 relationships, or 65/70,000 relationships. So, yeah, the betas are clearly going to be a large driver in the net interest margin and the pacing at which it happens. And, so far, I think everybody who probably uniformly talks about betas being somewhat lower than one might have expected, I think we're all kind of holding our breath to see if that trend can continue, especially those three or four times next year.

Eric Wasserstrom
Thank you for taking all of my questions.

John Fawcett
Not a problem.

Operator
Our next question comes from Chris Kotowski of Oppenheimer. Please go ahead.

Chris Kotowski
Yeah, excuse me, good morning. I missed something on the last one. If there's a $45 million benefit and you have $45 billion of average earning assets, give or take, why isn't that roughly a 10 basis point benefit to your net finance margin, or is there some offset?

John Fawcett

I think there's some puts in takes in there that we're--we just have to wait until it goes through. I mean, I just don't want to get over my skis in terms of over promising.

Chris Kotowski
Yeah, no, but I was just doing simple math--

John Fawcett
--Yeah, if you're just doing the math, then yeah, if you're just doing that straight math. I mean, there's probably some other elements that are going to impact funding costs and deposit betas and PAA up until now, has been pretty well behaved. We think the indemnification asset is substantially behind us, but there's potentially a little fallout from that competition of pricing. I just think there are a lot of elements that can still potentially work the other way.

Chris Kotowski
Okay. And, then just I want to make sure I had all the special items for the fourth quarter. There's $30 to $35 million gain on Nacco. Then, there's a charge on the TRS of $70 to $75 million, and $15 to $20 million on the unsecured debt. So, we should be net-net, something like a $55/$60 million net negative, or did I--

John Fawcett
Yeah, that's exactly right, yeah, $30 to $35 million on the sale of NACCO, TRS pre-tax, $70 to $75 million, and then debt extinguishment plus pre-tax of $15 to $20 million, so $55/$60 million, yeah.

Chris Kotowski
Okay, and then just more on future capital actions. Obviously, I mean, you've been making rapid progress on this share buyback, but I take it for the future, we should not think of capital action necessarily as a one-time thing that's announced just in June. It's kind of an ongoing process with you and the regulators and you're not tied to the CCAR process anymore in any way.

John Fawcett
Right.

Ellen Alemany
We're not, but however, we're continuing to be supervised by the Fed and the OCC, and as John mentioned before, we have new guidance under SR09-4, which really requires that a bank holding company still has to serve as a source of financial strength for its subsidiaries. So, we're going to take very careful considerations on capital, based on our market conditions, earnings, our capital needs, etc. And, I would say that our guidance, if we want to get to the 9.5 to 10 percent return n tangible common equity in the medium term, is that we're going to have core Tier 1 ratio somewhere in the 11.5 to 12 percent range.

John Fawcett
And, of course, the only thing I would add to that is the other dynamic is, I think there's a huge difference going from 14.5 percent common equity tier one down to 12 percent, then it is going from 12 to 11 percent. So, I think we're infinitely more mindful of the way we're going to orchestrate that with our board and with the regulators, because that extra 100 basis points is infinitely more complicated, I think, than the 250 that we've just taken out over the last year and a half.

Chris Kotowski
Okay, so we should look for more of a glide path down.

John Fawcett
Yeah, and the glide path has always been in the mix. I mean, there's no step change.

Chris Kotowski
Right, okay. That's it for me.

John Fawcett
Thanks, Chris.

Operator
Once again, if you have a question, please press Star, then 1. Our next question comes from Scott Valentin of Compass Point. Please go ahead.

Scott Valentin
Good morning. Thanks for taking my question. John, you mentioned that the pipeline was good going to 4Q. Is there any way you can kind of, without, you probably don't want to give a number, but relative to other quarters, higher or lower? Is there any way you can give maybe some qualification around that?

John Fawcett
It's just strong. Scott, I think the real wild card in the fourth quarter is going to be the level of prepayments. I think we feel really good where we're sitting in terms of Commercial Finance and you could expect that there might be the same level of growth in the fourth quarter as you've seen in the third quarter.

I think Business Capital, which encompasses Equipment Finance, Direct Capital, and Capital Equipment Finance, those guys are just hitting the cover off the ball, and there's no indication that anything is moving backwards there. And, so that pipeline remains very strong.

I think Commercial Real Estate, it feels like as much as they put on, that's as much as prepays and comes out of the books. So, I think the driving story is going to be around Business Capital. Now, what I would say is, is that if you looked over the last five or seven quarters, the fourth quarter of '17 was probably our strongest quarter in 10 quarters coming up to that. And, we'll see what happens in this fourth quarter, but it feels, going into it, we're in a pretty good place.

Ellen Alemany
Yeah, I just want to reiterate, we had our best August in the company's history in Business Capital, lots of good momentum there. But, as John said, it's the level of prepayments that we can't predict. Also want to point out that usually in the last quarter, we have the seasonal factor in our factoring business. So, we're going in, at the continued pace that we've been at, but you just never know.

Scott Valentin
Okay, that's helpful, thank you. And then just on credit, it was stable this quarter. You are seeing some ripples out there. Just wondering if you see any changes in your watch list or maybe your sector focuses, maybe where you're allocating capital away from certain sectors.

Ellen Alemany

No, we're not really seeing any industry or secular trend that would indicate anything abnormal here. I think our third quarter provision was kind of in line with our guidance and charge-offs, 35 basis points, are still at near cycle lows. So, we're not seeing any pockets of weakness or any patterns here, and any increase in reserves we've had has really been in relation to the new business volume that we've been booking.

Scott Valentin
Okay, thanks very much.

John Fawcett
Thanks, Scott.

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

CONCLUSION

Barbara Callahan
Thank you, Nicole, and thank you everyone for joining us 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 and have a great day.

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