CIT Group, Inc.

Fourth Quarter 2019 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 fourth quarter 2019 earnings conference call. My name is Alyssa and I will be your operator today. All participants will be in a listen-only mode.

After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press star then one on your touchtone phone. To withdraw your question, please press star then two. If at any time during the call you require assistance, please press the star key followed by 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 conference over to Barbara Callahan, Head of Investor Relations. Please go ahead.

Barbara Callahan
Thank you, Alyssa. Good morning and welcome to CIT's fourth quarter 2019 earnings conference call. Our call today will be hosted by Ellen Alemany, Chairwoman and CEO, and John Fawcett, our CFO. During this call, we will be referencing a presentation that is available on the Investor Relations section of our website at CIT.com.

Our forward-looking statements, disclosures, and non-GAAP reconciliations are included in today's earnings materials and within our SEC filings. These cover our presentation materials, prepared comments, and the question and answer segment of today's call. Thank you, and 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. 2019 was a pivotal year for CIT. We made solid progress on our strategic plan and we began to lay the foundation for future value creation through the acquisition of Mutual of Omaha Bank.

First, let me touch on our performance for the year. We reported net income available to common shareholders of $511 million, or $5.27 per diluted share. Earnings per share was at $5.06, excluding noteworthy items, which is a 28% increase over last year.

We achieved our growth target for 2019 with core average loans and leases up to 7%. We exceeded our operating expense target and achieved our $50 million 2020 goal a year early. We continued to optimize our funding mix and grew our direct bank customer base by 45%.

We improved our credit profile and received an investment grade rating from Fitch. We further strengthened our risk profile, bringing our criticized loans down 28%. And we completed the acquisition of Mutual of Omaha Bank on an accelerated pace, 54 days for regulatory approval and 140 days from signing to closing. As a result, we will recognize a full quarter of earnings from Mutual of Omaha Bank in quarter one.

Our capital ratio was 12%, a little higher than planned for the year, and that is due to the reduction in share repurchases as we made the decision to acquire Mutual of Omaha Bank. As previously discussed, we have returned to $6.5 billion to shareholders over the last five years, and we believe the investment in this acquisition will help us create longer term sustainable value.

Our return on tangible [common] equity was 9.8% for the year when a normalized for the preferred dividend and was 10.6% on a pro forma basis, excluding the actions we took related to the acquisition. While this is a bit lower than our original target, it does include three rate cuts that were not part of the original plan at the start of 2019.

Overall, it was a solid year that has allowed us to enter 2020 as a stronger company. In fact, just last week, CIT was added to the S&P Mid-Cap 400 Index, which is another testament to our progress in transforming the company and delivering steady results for shareholders.

John will provide a detailed account of financial performance for the quarter, but first I'll touch on a few highlights. We posted net income available to common shareholders of $121 million, or a $1.27 per diluted share. In the commercial banking segment, we saw strong origination activity as we continued to prioritize direct originations and primary bank relationships. Average loans and leases were up 4% year-over-year in the segment, and we continued to take a disciplined approach to asset growth and balance risk-adjusted returns.

Capital market fees were up 20%, and we led about 94 deals in 2019, with 78 of those being leftlead or sole lead. Key drivers were deals in the healthcare and power and energy sectors, where we have leadership positions. We were number four in healthcare sponsored deals and number three in power and renewable deals in 2019. In addition, we moved up 10 spots in middle-market sponsored deals to number 14.

We doubled our assets under management to about $340 million. It will take some time for these vehicles to begin to meaningfully contribute to earnings, but the growth trajectory is gaining momentum. Pipelines are strong, and we're seeing good opportunities in the technology and aerospace and defense verticals as well as our asset-backed businesses. We have added origination capacity in these areas to further enhance our presence in these markets.

We continue to manage through the cycle in the rail business, and we expect the trade agreement to be beneficial to this industry. Our high-capacity fleet remains ready to respond to any increased demand, and our improvements in maintenance costs have helped to offset some of the softness in renewal rates.

In the consumer banking segment, we continue to optimize deposit costs by improving our mix and delivering innovative products to customers looking for a digital banking experience. Our average deposit cost decreased 14 basis points compared to the prior quarter. Our non-maturity deposits increased to about 70% of total deposits, which has aided our optimization efforts in this part of the cycle.

We have adjusted pricing in some of our leading direct bank products and continue to see strong retention levels. We launched a new e-checking product at the direct bank, which is a fully digital account that can offer customers another way to expand their relationship with CIT Bank.

As I mentioned earlier, we completed the acquisition of Mutual of Omaha Bank at the start of the year, and our integration work is well underway to fully unlock the value in these new franchises. The deal brings a largely complementary businesses to CIT. Chief among them is the community association banking business.

This is a new, lower cost deposit channel for us and one that we intend to significantly grow in the coming years. Our goal is to double the deposits in this business in the next five years.

Creating this kind of funding improvement will increase our competitiveness and addressable market, and create a more sustainable and profitable model for CIT going forward.

In addition, we added 34 middle-market bankers across the country as part of the deal, and that team is focused on regional relationship business that will deliver more primary bank business. This will also allow us to expand our deposit growth, increase our fee income, and create a more holistic and profitable relationship to complement more of the transactional and project deals that we have done historically.

We believe these divisions, along with the efforts we already have underway in expanding our commercial banking capability, will help to accelerate our goals and enable us to build sustainable momentum over time. To fully realize these goals, we need to continue to drive towards improved operational efficiency.

Some of that will happen through the integration process, but we believe there is still an opportunity to do more. To that end, we plan to reduce operating expenses by an additional $50 million in 2021, and John will share more details on this shortly. We believe this, along with our other business goals, will bring us more in line with peers.

CIT is in one of the strongest positions it has been for some time. We have the team and the tools to be one of the top commercial banks in the country. We're excited about the opportunities ahead and are focused on continuing to deliver for our customers and shareholders.

With that, let me turn it to John.

John Fawcett
Thank you, Ellen, and good morning, everyone. We reported another solid quarter and a strong finish to the year as we continued to deliver on our strategic priorities, including closing Mutual of Omaha Bank acquisition on January 1st and, as Ellen mentioned, just 140 days from when we signed the deal.

As Ellen indicated, we grew average loans and leases in our core portfolios 1% over last quarter and 7% for the year. Our credit provision and metrics continue to reflect the stable credit environment and an improved risk profile and continued underwriting discipline.

This quarter, we issued subordinated debt and preferred stock to fund a portion of the Mutual of Omaha Bank acquisition, both at very attractive levels, and we also received an investment grade rating from Fitch.

The average deposit rate fell 14 basis points as we continue to focus on optimizing costs by balancing pricing strategies and funding needs. We reduced 2019 operating expenses by $52 million after adjusting for noteworthy items, lease accounting changes, and costs associated with Mutual of Omaha Bank, exceeding our $50 million expense reduction target a full year ahead of schedule. We grew earnings per share 46% for the full year 2019 and, excluding noteworthy items, it grew by 28% to $5.06.

We grew tangible book value per share 11% this year to $56.77, and we continue to improve our return on tangible common equity. In the fourth quarter, we posted a return on tangible common equity just under 10% after normalizing for the semi-annual Series A preferred dividend.

If you also adjust for the additional costs incurred and the buildup of capital in support of the Mutual of Omaha Bank acquisition, our fourth quarter return on tangible common equity would have been 10.6%. While short of our original 11% target, reflecting the impact of three unbudgeted cuts in 2019, it highlights continued improvement over the 10.1% we posted in the fourth quarter of last year, excluding noteworthy items.

I will now discuss the fourth quarter results. There were no noteworthy items this quarter. However, I will refer to our comparative results excluding noteworthy items in prior periods unless otherwise noted.

Turning to slide eight of the presentation, net finance revenue declined modestly from the prior quarter, primarily driven by lower interest income from lower market rates on our floating rate loans, interest-bearing cash, and investment securities. Net operating lease revenues benefited from higher rental income and lower maintenance costs this quarter while interest costs declined, reflecting lower deposit costs and lower borrowing costs.

Slide nine is our net finance margin walk. Net finance margin was 3.01% in the quarter. While down 5 basis points from the prior quarter, reflecting the trends I just mentioned, it came in slightly better than our fourth quarter guidance. We remain laser focused on optimizing our deposit costs, and the margin benefited from a 14 basis point decline in deposit costs this quarter.

We reduced our Savings Builder rate by 35 basis points in the fourth quarter and another 5 basis points on January 1st for a total of 65 basis points since we began reducing rates last May. CDs also repriced down, reflecting the current rate environment. We expect deposit costs to decline further next quarter as we continue to manage our mix and execute on our target marketing and pricing strategies.

Borrowing costs also declined, reflecting lower average balances as we reduced our Federal Home Loan Bank and ABL facility balances temporarily with liquidity raised to fund the Mutual of Omaha Bank acquisition. Higher prepayments and interest recoveries in commercial banking more than offset lower purchase accounting accretion this quarter.

I would also mention that our rail business added 1 basis point to margin from lower maintenance costs and $3 million in excess mileage charges, which are generally nonrecurring and difficult to predict.

Turning to slide 10, other non-interest income improved $10 million compared to the prior quarter, reflecting a $9 million gain on about $50 million in book value of mortgages sold from the legacy consumer mortgage portfolio. These loans were performing, but many had been modified and had lower FICO scores. We will continue to look for opportunities to selectively prune the legacy consumer mortgage portfolio and generate similar results across 2020 as part of our portfolio risk management activities.

Compared to the year-ago quarter, the increase of $19 million also reflects higher capital markets fees. We have several initiatives to improve our non-interest income. In 2019, we grew gross revenues from our capital markets and customer derivatives activities by 20%, and we expect to continue to grow these fees in 2020, including providing solutions to our new Mutual of Omaha Bank clients.

Turning to slide 11, operating expenses, excluding intangible asset amortization, decreased $8 million from the prior quarter, driven mostly by lower advertising and marketing costs related to our deposit gathering activities. The current quarter also included $7 million in merger and integration costs related to the Mutual of Omaha Bank acquisition, for a total of $17 million in 2019.

We ended 2019 with total operating expenses, excluding intangible asset amortization of $1.046 million, unchanged from 2018. Operating expenses this year included $35 million in costs related to lease accounting changes and $17 million of merger integration costs related to the mutual of Omaha bank transaction. Excluding these items, we reduced our cost base by $52 million compared to 2018 to $994 million, exceeding our 2020 cost reduction target one year ahead of time.

We are committed to continuous improvement and, as Ellen just indicated, we have announced an additional $50 million in cost reductions in 2021. This is in addition to the cost synergies we will achieve with the Mutual of Omaha Bank acquisition. We have included a couple of slides in the appendix of the presentation to illustrate our progress.

Slide 12 shows our consolidated average balance sheet. Average earning assets were up modestly from the prior quarter, reflecting 1% growth in core loans and leases and modest growth in interest bearing cash and investments, offset by the continued runoff and sale of loans from the legacy consumer mortgage portfolio.

To limit negative carry from the pre-funding of the Mutual of Omaha Bank acquisition, we temporarily reduced our secured facilities during the quarter. Our year-end cash balance was elevated by $850 million and held in restricted cash ahead of the transaction close.

Slide 13 provides more detail on average loans and leases by division. We continue to see good origination activity across our businesses and pipelines are strong. In commercial banking, new business volume increased 9% over the prior quarter, although market liquidity and refinancing activity drove the highest prepayment levels we have seen in the last four years.

We are maintaining a disciplined approach to asset growth, balancing risk-based margins and fee income opportunities as we continue to recycle capital away from lower returning, non-accretive relationships into growth areas that leverage our expertise.

Commercial finance average loans and leases were relatively flat this quarter and up 7% from the year-ago quarter. While risk-adjusted spreads have remained relatively stable, the reduction in portfolio yields this quarter reflects the decline in LIBOR rates and our ongoing efforts to improve our risk profile.

Growth in business capital was flat this quarter and up 6% from the year-ago quarter as we continue to outpace the industry, while repositioning away from lower risk-adjusted returning sectors.

New business yields in certain areas continue to be pressured from low swap rates and the competitive environment. Our advantage in technology helps us remain competitive in the current environment.

Real estate finance declined modestly this quarter and 3% from a year ago, reflecting disciplined originations and elevated levels of prepayments. Portfolio yields declined this quarter as a result of lower LIBOR levels.

Our rail portfolio grew this quarter as new deliveries more than offset depreciation and asset sales. Rail loadings in most industrial sectors remain under pressure, and excess capacity in the North American fleet industry continued to increase to 24% at the end of the year, up from 18% at the beginning of the year.

Despite the persistent weak market environment, our rail team has been able to manage fleet utilization to 94% at year-end, and our efforts to reduce maintenance costs have offset some of the repricing weakness. Lease renewals repriced down 24% this quarter, reflecting the mix of cars renewing. For the full year, lease renewals repriced down 17%, slightly above our guidance range of 10% to 15%.

We continue to see strength in tank car lease rates, while sandcars continue to show the most weakness within the freight market. We expect lease renewals on the total fleet to reprice down 10% to 15% in 2020, but we expect this to vary quarter to quarter depending upon the number and type of cars renewing. We expect the average utilization in 2020 to be in the 95% area, dipping a little in the first quarter and then improving over the rest of the year.

The quality of our young, diverse fleet, our strong market position and management team, as well as our customer service positions us well to navigate the current environment. We remain vigilant on asset readiness. And as Ellen indicated, we expect the phase one trade agreement to be beneficial to this industry. And to the extent we see increased demand, we will be ready to meet that demand with ready to load cars.

In consumer banking, average loans were flat, reflecting growth in the core business offset by the sale of loans and continued runoff of the legacy consumer mortgage portfolio.

Slide 14 highlights our average funding mix. The reduction in funding costs reflects lower deposit costs and lower borrowing costs. The lower borrowing cost primarily reflects lower average balances at our Federal Home Loan Bank and structured borrowings, partially offset by higher unsecured borrowings.

The increase in unsecured borrowings includes a full quarter impact of the $550 million in bank notes raised at the end of September at 2.96% and a partial quarter of $100 million of sub debt at 4.125% to fund the Mutual of Omaha Bank acquisition. As I mentioned earlier, we deployed excess liquidity raised ahead of the acquisition and reduced our Federal Home Loan Bank and structured facilities to limit the negative carry.

Slide 15 illustrates the deposit mix by type and channel. Overall deposit rates declined 14 basis points, reflecting a reduction in rates in our non-maturity deposits and downward CD repricing.

With the closing of the Mutual of Omaha Bank transaction, we acquired approximately $4.5 billion of stable HOA deposits and $2.5 billion of commercial and retail deposits. The blended rate of the Mutual of Omaha bank deposits will immediately reduce our current deposit costs by approximately 16 basis points.

As Ellen indicated, we have a number of growth initiatives in place to meet our commitment to double the HOA deposits over the next five years, such as expanding into new markets as well as increasing our share of wallet with existing relationships. Starting in the first quarter, we will add another reported deposit channel called HOA to the bottom of the chart where you will clearly be able to see our progress.

Turning to capital on slide 16, our common equity tier 1 ratio grew to 12% at the end of the year, reflecting the retention of quarterly earnings and the suspension of share repurchase activity, which essentially ended at the end of the second quarter due to the pending Mutual of Omaha Bank acquisition.

In addition, this quarter we raised $200 million of tier 1 qualifying preferred stock and $100 million of sub-debt, which is included in tier 2 capital, both to partially fund the Mutual of Omaha Bank transaction.

Pro forma for the closing of the acquisition, including the impact of CECL, our common equity tier 1 ratio is approximately 10%, the lower end of our target range of 10% to 11%. Our intention is to remain out of the market for common shares in order to increase our common equity tier 1 ratio to 10.5%, the middle of our target range, and continue to pay our common dividend at the current level until that time as well.

We estimate that it will take approximately four quarters to reach a common equity tier 1 level of 10.5%, at which time we will reevaluate our target levels as well as our share repurchase and dividend payout levels.

Slide 17 highlights our credit trends. The credit provision this quarter was $23 million, modestly below our guidance range of $25 million to $35 million, and net charge-offs were $32 million or 40 basis points, the midpoint of our guidance of 35 to 45 basis points. Net charge-offs continue to be primarily driven by commercial finance and popular transportation related lending and small business solutions within business capital.

Non-accrual loans increased by $29 million, and was mostly driven by a few unrelated loans in commercial finance. The majority of the non-accrual portfolio continues to be current, and we are not experiencing any notable trends in any specific industry or geographic area.

New business originations reflect our continued efforts to enhance our risk profile and, as a result, continue to come in at better risk ratings than the overall risk rating of the performing portfolio. Our reserves remain stable and strong at 1.56% of total loans and 1.89% for commercial banking, and reflect about four times the last 12 month net charge-offs.

We added $6.3 billion of loans from Mutual of Omaha bank and, apart from approximately $80 million of energy loans that are heavily marked and classified as PCD, we expect the portfolio to perform well.

We adopted CECL at the beginning of 2020. We estimate the day one impact on tangible book value from CIT's portfolio at $75 million to $100 million. Based on that range, the pro forma impact to our CET 1 ratio would be 15 to 21 basis points on a fully phased in basis, although we intend to adopt a three-year phase in period for regulatory purposes.

We're in the process of reviewing Mutual of Omaha's loan portfolio, and currently estimate the capital impact of CECL adoption to be [$20 to $40 million corrected] representing the reserve on the non-PCD loans which will flow through P&L as credit provision and reduced capital.

This reserve build essentially represents a double counting of credit risk in both the purchase price and the allowance build. Because the acquisition closed on January 1st, we will incur the full impact from the Mutual of Omaha Bank's portfolio on regulatory capital in the first quarter with no opportunity to phase in.

We currently estimate the total reserve increase in CIT's portfolio to be $225 million to $275 million and the Mutual of Omaha Bank's portfolio to be an increase, an incremental $75 million to $100 million, which is flat to a modest increase when compared to the reserve balance at year-end.

The difference when compared to the capital impact reflects the reserve on the PCD loans, which will be offset by an increase in the loan balance. The PCD loan reserve on CIT books are related to legacy consumer mortgages, formerly called PCI loans, where the PCD reserve in the Mutual of Omaha Bank portfolio primarily relates to their energy portfolio.

Our current estimates assume moderate economic growth, continued low levels of unemployment, and a stable credit environment. There is a slide in the appendix that illustrates our latest thoughts on CECL.

Slide 18 highlights our key performance metrics, reflecting the trends we just discussed. Our effective tax rate was 27% and was negatively impacted by $3 million in discrete items this quarter, primarily driven by a true up of state and local taxes.

Page 19 and 20 highlights our outlook for 2020. Unless otherwise noted, my commentary will focus on full year 2020 targets when compared to full year 2019, excluding noteworthy items, and actual results may vary by quarter.

Our outlook assumes one rate cut in late 2020, GDP growth declining from current levels at the end of 2020, stable unemployment, and stable credit markets. The Mutual of Omaha Bank acquisition will add $6.3 billion of loans, which includes $2.1 billion in middle-market C&I loans and $2.3 billion in commercial real estate loans to commercial banking, and $1.9 billion in commercial banking loans, which are primarily correspondent consumer mortgages.

Core average loans and leases, after including the $6.3 billion of Mutual of Omaha loans, are expected to grow in the mid to single-digit area, which will be slightly offset by LCM, loan sales, and portfolio runoff.

Net finance margin is expected to be 2.90% to 3.05%. This range reflects continued pressure on rail repricing. And while maintenance costs were down this year, reflecting our productivity initiatives, we expect it to be 2% to 3% higher in 2020 given the number of cars going on and off lease, which the industry calls portfolio churn.

Pulling all this together, we currently estimate a 5 to 10 basis point drag on the margin from Rail. However, while uncertainty remains, there could be a pickup in renewal rates if there is a positive impact from the phase one trade agreement.

On the asset disposition side, as we manage our fleet we expect to continue to sell railcars outside the bank. We expect these actions to reduce funding costs over time and provide an additional $5 million to $10 million of gain on sale revenue in 2020. Excluding the impact from Rail, net finance margin should remain relatively constant, with a number of puts and takes.

The acquisition of Mutual of Omaha Bank immediately benefits margin by about 3 basis points. We also expect continued downward repricing of CIT's deposit base, reflecting a full quarter benefit of the fourth quarter and January 1st reductions, as well as a downward CD repricing. Offsetting these benefits is the impact of the 2019 rate cuts on loan yields.

In addition, we expect our continued portfolio management activities, designed to improve our risk profile, to modestly negatively impact margin with offsetting benefits in other non-interest income. We expect the first quarter margin to be in the low to mid area of our guidance, reflecting lower net operating lease revenue in rail from lower repricing levels and higher maintenance costs that I just mentioned, as well as the absence of excess mileage charge that benefited the fourth quarter.

We expect a reduction in loan yields from the full quarter impact of the October rate cut as well as lower PAA from the sale of the LCM loans to be offset by a benefit from the Mutual of Omaha Bank portfolio and lower repricing benefits from the online channel.

Operating expenses, excluding intangible amortization and merger and integration costs, is expected to be $1,210,000,000. This reflects the addition of the Mutual of Omaha Bank's operating expenses, cost synergies of $16 million, and the absence of $17 million of expenses we incurred in 2019 associated with the acquisition.

In addition to this core operating expense base, we expect to incur $80 million of merger and acquisition costs, which we will highlight as noteworthy items in each quarter.

Intangible asset amortization is expected to increase to approximately $10 million per quarter. As I mentioned before, we are committed to continuous improvement and are targeting an additional $50 million of expense reductions in 2020 over and above the net cost synergies already planned. Slides 32 and 33 in the appendix illustrate these changes and the impact of the synergies and merger and integration costs.

For the first quarter, operating expenses are expected to increase when compared to the fourth quarter of 2019 with the addition of Mutual of Omaha Bank and seasonal benefit restarts. The net efficiency ratio, excluding noteworthy items, is expected to remain in the mid 50% area for 2020 although, similar to last year, we expect it to increase to the 60% area in the first quarter, reflecting the elevated benefit restarts.

Net charge-offs are expected to remain between 35 and 45 basis points as higher risk assets are expected to continue to cycle through the portfolio. We anticipate that the provision will be more volatile in 2020 with the adoption of CECL, as the day two impact will be driven by many factors.

For now, we estimate the provision will increase to an average of $35 million to $45 million per quarter post CECL implementation compared to our most recent guidance of $25 million to $35 million per quarter.

The effective tax rate is expected to remain between 25% and 26% excluding discrete items. We are targeting the CET 1 ratio for the fourth quarter to be 10.5%, as I indicated earlier. We are targeting the return on tangible common equity, excluding noteworthy items and normalizing for the semi-annual preferred dividends, to be at least 11% at the end of 2020, and continue to focus on opportunities to improve further.

And with that, I will turn the call back over to Ellen.

Ellen Alemany
Thanks, John. We started the year was strong momentum, and we look forward to this next phase of the plan. We're poised to achieve an 11% return on tangible common equity in the fourth quarter of this year, and we're focused on further closing the profitability gap with our peer group.

With the acquisition, the investments we've made in the front end of the business, and the additional cost targets we have set, we believe we can achieve a return on tangible common equity of 13% to 14% in the medium term. The improvement in profitability over the medium-term will come mainly from lower deposit costs, additional capital optimization, improved operating efficiency, funding more of our business in the bank, and additional opportunities for fee income.

We will continue to provide updates on our progress as we go through this next stage of the plan. And 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 one on your touchtone phone. If you are using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question, please press star then two.

At this time, we will pause momentarily to assemble our roster. And the first question today comes from Ken Zerbe of Morgan Stanley. Please go ahead.

Ken Zerbe
Great, thanks. Good morning.

Ellen Alemany
Morning, Ken.

Ken Zerbe
Maybe just starting off, in terms of expenses, I just want to make sure I heard the numbers right, because I think I heard the additional $50 million of cost savings both in 2021 and 2020. I want to make sure I got the right year there, but I also want to make sure because I think you said that's in addition to the Mutual of Omaha Bank cost savings. So, I'm just trying to figure out what is--when we think about the core expenses X the amortization in '20 and '21, what is the right number that we should be targeting? Thanks.

John Fawcett
Yes. So, Ken, this is John. So, there's two elements to this. The first is the $54 million, which is consistent with what we had guided when we announced the deal on August 13th. So, that's $54 million and that'll be realized over the course of a couple of years. And there's a slide, actually, in the back of the deck, I'm not exactly sure what page it is, but 32 and 33, that articulates that motion.

So, the $54 million is phased over three years. The expectation is is that more of that will come in faster. So, that's the bit that relates to 2020, and that's the cost synergies that come from Mutual of Omaha Bank.

Apart from that, we've embarked on a separate program to look at larger synergies that, once we actually run the place and get the whole thing together, there's another $50 million that we're signing up for. And I would say is still early days, but $50 million, as we said last year at least $50 million, will come into 2021. So, those are the two discrete buckets.

Now that said, those aren't necessarily bright lines in the sand. I think as we've done and demonstrated, we will attempt to over index on the $54 million in 2020 and we will continue to over index on the $50 million in 2021.

Ken Zerbe
Okay. So, just to be clear though, including all these items, X merger charges, of course, the core expenses are $1.21 billion in 2020 and then $1.6 billion. Is that the right way of thinking about it? Or $1.16 billion in 2021? And those are all-in numbers?

John Fawcett
Yes. So, if you took 2020 core operating expenses of $1.210 billion, you'd expect the expenses to minimally be $50 million lower than that, so you'd be the $1.160 billion.

Ken Zerbe
Got it, okay. That is actually very helpful.

And then just really quickly, in terms of the provision expense, just want to make sure I get this right. I thought I heard $40 million to $60 million of Mutual of Omaha Bank provision expense due to the CECL impact in first quarter. I want to verify that number, but also--.

John Fawcett
No.

Ken Zerbe
No? Sorry. Go ahead, please.

John Fawcett
Yes. So, it was a mistake in my script. And so, it's $20 million to $40 million, which is consistent with whatever the page is in the back in terms of the CECL guidance page, 34. So, it's $20 million to $40 million, not $40 million to $60 million.

Ken Zerbe
Of just Mutual of Omaha provision? Okay.

John Fawcett
Correct.

Ken Zerbe
So, if you take the midpoint of that, say $30 million, and then you add it to roughly your $30 million to $40 million of normal provision, so we should be looking at a $70-something million provision in first quarter, then dropping down going forward. Is that the right way of thinking about it?

John Fawcett
Well, the provision that's going to come through in the first quarter is going to be noteworthy, and so that's going to be a one-time to kind of catch up. I think the guidance that we've given for the full year is it's $35 million to $45 million per quarter, including Mutual of Omaha Bank.

Ken Zerbe
But not the noteworthy items?

John Fawcett
But not the noteworthy, right, which comes through in the first quarter. So, had we acquired this in the fourth quarter, I think that would have been able to pass through equity. By virtue of closing on it on January 1st, it's a little kludgy because it's actually going to pass through the P&L.

Ken Zerbe
Understood. Okay, very helpful. Thank you.

John Fawcett
Thanks, Ken.

Operator
The next question today comes from Moshe Orenbuch of Credit Suisse. Please go ahead.

Moshe Orenbuch
Great, thanks. John, you talked a lot about the margin walk into Q1. I guess maybe when you think about the margin of Mutual of Omaha, you said it would help by 3 basis points. Is that kind of consistent with what you had thought before? Are there changes because of purchase accounting? And how does that--as we go forward, does that number grow? Can you flesh that out a little bit?

John Fawcett
Yes. So, the purchase accounting, Moshe, we're still working through. And so, I think by the time we file the K, that should all be kind of reflected in there. But there's still moving pieces in terms of ultimately what the purchase accounting accretion is going to be.

I think one of the things that's happened from the time that we announced the deal in August, their cost of deposits has moved up in terms of the CAB deposits. And so, I think when we guided originally, we said that the benefit to deposit costs would be 20 basis points. It turns out it's 16 basis points.

All of their lending activities are essentially floating rate, and so as LIBOR goes, so goes that book of business. And similarly, we were adversely impacted a little bit by increasing rates on their portfolio.

I think on a go-forward basis looking at this, there's a few moving pieces. I think the big ones are going to be around rail and what happens there. And apart from rail, just pure banking, we would expect that our net interest margin would be pretty range bound right around 3% and not move a lot.

But rail is going to create, at least the way we're looking at it right now, a 5 to 10 basis point drag, and that's more or less, we believe, kind of a worst case scenario. If phase one of the trade deal actually manifests into something, we potentially believe there's some opportunity there to kind of claw back.

I think other instance that's really important here is that we're going to continue to manage down our online costs. And so, in the script we say we're down 65 basis points against 75 basis points of Fed cuts. We did another 5 on January 1st. The expectation is we'll do a little bit more into the second quarter and we'll--into the first quarter, and we'll continue to tease this out.

The most important thing about that is that, notwithstanding the fact that we've so aggressively reduced our deposit cost and non-maturity deposits, particularly in the online, we haven't seen any meaningful levels of attrition in relationships. And so, that's kind of all holding on. And again, that goes back to the way we've remixed the mix of depositors transitioning from baby boomers to generation X, Y, and Z.

And then apart from that, the only other thing that's kind of out there that is at the margin, and we've done two of these LCM trades already, and we continue to look to opportunistically manage the risk profile of the business. To the extent that we sell these assets, they're relatively high yielding assets. You're going to see a reduction in net finance margin or net interest margin and an offsetting increase one-time gain that'll flow through non-interest income. And so, we're kind of mindful of that. And that could, at the margin, impact NIM on a quarter to quarter basis.

Ellen Alemany
Yes. But I just also want to add, John, that the benefit of the lower deposit cost savings that we're going to get from Mutual of Omaha Bank is really going to have an impact on helping us expand our commercial lending addressable market. And that, combined with the 34 relationship managers that we're adding, etc., is really going to help our addressable market and business volumes.

John Fawcett
Yes. And I guess the last thing in terms of opportunity, we've still got that $1.8 billion in correspondent mortgages there that probably has a mid-3 handle on it. If we're actually able to kind of recycle correspondent lending into higher gross yields on commercial lending, that also presents an opportunity that we would avail ourselves of.

Moshe Orenbuch
Right. Kind of following up on those points, when you think about overall earning asset growth, against which that margin is calculated, you talked a fair bit about the loan growth assumptions. Any sense as to whether you'll be increasing or decreasing the other assets and, maybe as a corollary, how much of those kinds of loan sales you might be seeing during 2020?

Ellen Alemany
Just in general, our guidance is low single digit quarterly growth. We've been really pivoting our whole commercial banking business under Bob Rubino's leadership with really a focus on driving growth, efficiency, profitability, and returns in the business.

And one of the things we've been doing is we've been recycling capital away from lower yielding credit-only relationships. We're continuing to reduce our criticized assets. And in fact, in the fourth quarter, we were at $2.2 billion, which is roughly around 7% of our commercial loans and leases. It's kind of our lowest level of criticized assets. There's definitely been a shift in focusing on deepening customer relationships through consultative selling and investing in new client channels.

We've added seven bankers in capital markets. We had a really strong finish of the year in capital markets in the business. We had fee growth of about 20%, we had the lead table improvements in the business, and we hired new bankers. We've been investing in some of the new industry verticals in commercial banking and we've had some good momentum there. And in business capital, we added about 14 salespeople there. So, we have a lot of good front-end momentum in the business.

John Fawcett
And Moshe, just to add a couple of things, the only thing I think we're consistently looking at in terms of opportunistically is loan sales out of the legacy consumer mortgage portfolio. As we continue to look at capital or risk-weighted assets, I think we could potentially be opportunistic in other places.

But just to follow-on on one of the points that Ellen made, our pipelines remain very strong across all of the suite of businesses. Our fourth quarter originations were our second strongest quarter in 16 quarters, only beaten by the fourth quarter of last year. So, origination activity remains at pretty elevated levels, but one of the challenges we continue to face, I think everybody faces, is the level of prepayments.

So, while the fourth quarter was our second strongest quarter out of 16 quarters, the fourth quarter of '19 was the highest level of prepayments that we've seen in 16 quarters. And so, there is still tons of liquidity in the market.

Moshe Orenbuch
Got it. Thank you.

John Fawcett
You're welcome.

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

Eric Wasserstrom
Thanks very much. So, John, I hate to do this, but just looking at slide 34 on the CECL discussion--.

John Fawcett
--Yes--.

Eric Wasserstrom
--I just want to make sure I understand the capital impact component in terms of the Mutual of Omaha contribution. I guess in terms of the phase-in, is it correct that the CIT portion in that upper part of the slide is phased in, but the Mutual of Omaha portion is direct to capital in the first quarter? Is that correct?

John Fawcett

Yes, that's correct. So, the $75 million to $100 million you see related to CIT is phased over three years on a regulatory basis, and the $20 million to $40 million below related to Mutual of Omaha Bank is going to run through our P&L.

Eric Wasserstrom
Okay, in the first quarter.

John Fawcett
In the first quarter, and we'll present that presumably as noteworthy.

Eric Wasserstrom
Got it, okay. And then just on the lease renewal rates that you talked about, it seemed as if there was some sort of slowing in the compression of lease renewal rates, but this guidance suggests perhaps some reacceleration, or maybe that's just my impression. But I guess the core of my question is that it seemed to be improving. And has that changed in some way?

Ellen Alemany
Well, I would say that in business capital we were flat for the quarter, but really 6% year-over-year. Are you talking about business capital or the rail business?

Eric Wasserstrom
Sorry, I was just doing the rail.

John Fawcett
Yes. So, on the rail business, Eric, I think we've been messaging for a couple of quarters that, while tanks continue to improve, there's been some softness in the freight market. You can kind of see that in utilization as it's kind of come down. The messaging is I think fairly consistent with what it was last year, down 10% to 15%. But I think to the extent that there's a silver lining here, it's the benefit of the trade deal.

Ellen Alemany
Right. But in general, the rail fleet utilization and market rates are pressured as we're heading into the year, and the industrial production sector is continuing to slow. And we've had negative momentum in 2019.

One of the things that I like to take a look at, at every review, is railcars in storage. And railcars in storage is about 24%, so we are expecting declines. The renewals are being pressured in most segments in rail, but I think that we're doing a lot to manage that. And I think that the China phase one trade agreement could potentially be beneficial to the business.

I think the second thing about our management team is that we're really being vigilant on asset readiness, and we had started this ready to load the program with our covered hopper cars to allow us to take some incremental deal volume last year. I think in some of our cars, we're shortening up the lease rates. And we're making a lot of operational improvements in the business and we're continuing to drive down maintenance costs. So, despite the slowdown, I think the team is doing all the right things to mitigate the slowdown in the business.

John Fawcett
Yes, I couldn't agree more. The reality is, look, this is a very long-lived useful life on these assets, and it goes through pretty long cycles. I think as we've said many times before, it's a young fleet, an average life of 13 years. It's a diversified fleet that serves dozens of industries.

It's a well-maintained fleet. It has a higher concentration of larger 286,000 pound GRL cars. 98% of our fleet car is that.

And so, to the extent that PSR is around efficiency, you can fit more stuff in a larger car. And it's a very efficient operation with a strong management team that is very service oriented. So, we feel good about the business, but it's a long cycle business and you've just got to go with the ebbs and flows.

Eric Wasserstrom
Great. And John, if I may sneak in one last question, just with respect to the CET 1 guidance that you provided, 10.5% by the end of this year, 2020, I'm just trying to think through the contributing factors to that, because obviously that suggests an accretion at about 12.5 basis points a quarter, which is a bit less than what it's been in the past. And so, I just want to make sure I understand the puts and takes through the CET 1 math over the next four quarters.

John Fawcett
Yes. So, look, it's going to be principally driven by earnings, but don't forget we're going to have $80 million of integration charges that are going to go through that are going to be in the real P&L. I think the way we model this out, I think the end of the fourth quarter but probably even a little bit sooner than that, and it could be sooner than that, but I think we're trying to be mindful that we don't over promise and under deliver. So, we guided to the fourth quarter, but we feel pretty good about that.

And I think the other point, Eric, that we don't have perfect visibility on is that you have to be very mindful that, as we close this transaction and actually deliver the $150 million in equity to the Mutual of Omaha parent, that we had a hard floor at 10% CET 1 that we had committed to to our regulators, the Fed and the OCC. And so, we're a very mindful of that.

And as you're trying to manage risk-weighted assets through the fourth quarter dividing originations and prepayments, which nobody's really good at, we might wind up a little bit long that 10.0% CET 1 ratio, so we could finish at 10.1%-ish even. So, it's going to depend a lot on the starting point as well as the ending point.

Eric Wasserstrom
Got it, 10.1% for Jan 1, you're saying?

John Fawcett
Well, 10.1% at the end of the first quarter, yes.

Eric Wasserstrom
By the end of the first, okay. Yes.

John Fawcett
Yes. Yes.

Eric Wasserstrom
Got it. Okay. All right. Thank you for the explanation.

John Fawcett
Thanks, Eric.

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

Chris Kotowski
Yes, good morning. I'm looking at page 36 in your slide deck and then also at page 14 from your August presentation where you were looking at the tangible book value dilution. And actually, just as a coincidence, you had in August projected end year intangible book at $56.77, which to the penny turned out to be what it was. But anyway, in August you had said that the dilution to tangible book would be $3.14. And then when I look at page 36, I see goodwill of $110 million versus $57 million. So, we should assume it's an extra $0.50 cents of intangibles.

John Fawcett
Yes. Yes. But Chris, look--.

Chris Kotowski
--But $3.14 turns into--right? I'm just trying to back into what roughly a pro forma tangible book is. And then I figure that we also need to take out about $1.00 for your own CECL charge and $0.30 -$0.40 for the Mutual of Omaha CECL charge, so I up getting a tangible book just under $52 million, something like that. Am I thinking about that correctly?

John Fawcett
Well, I wouldn't do it just quite yet. Look, I think there are still some moving parts. We're still working through the fair valuation work and we'll have that. It should be available when we submit the K. So, I wouldn't get too far ahead of myself, but the logic of your arithmetic is right. It's just a question of what the starting points are in terms of numbers.

I think the other thing is that the difference between the goodwill estimate on the page, and I don't obviously have the page that you have going back to August 13th, but the difference between the $110 million and the $57 million that you're seeing is largely around what we had divined at the time CECL impact would be.

So, that's the big difference between the $110 million and the $57 million. We didn't have perfect visibility into it. And as we live with CECL and we live with their portfolio, we're obviously getting better visibility into it.

Chris Kotowski
Okay. And then next, on the additional--the $10 million higher loan loss provision with Mutual of Omaha in it, can you break that out between what is the Mutual of Omaha add to it and what is the ongoing CECL impact to it? Because it just seems to me, if historically you would have, say, had a reserve addition of 1.5% to the loan loss allowance for $100 million of loan growth, you'd have $1.5 million of reserve additions. Now it'll be $2 million. Is that the main impact?

John Fawcett
It's probably something you better follow up with Barb on. Look, I think CECL remains kind of a little bit of a wild card. While we've done an extensive a bit of modeling around our portfolio, I think it's still very early days in terms of what it is that we are working through on CECL as it relates to Mutual of Omaha.

I think the other thing too is that I think were pretty satisfied with all elements of what's kind of coming over with the portfolio from Mutual of Omaha Bank with the exception of some challenges that we face in the reserve base lending portfolio which, again, it's well marked. We understand it. It's nothing especially unique to Mutual of Omaha. It's just something that I think the market's going through. And to the extent that we're in the same space, we're seeing it in our book as well in a very modest way because we're not very much exposed to that, but more to follow.

Chris Kotowski
Okay. All right, that's it for me. Thank you.

John Fawcett
Thanks, Chris.

Operator
Again, if you have a question, please press star then one. Our next question today comes from Arren Cyganovich of Citi. Please go ahead.

Arren Cyganovich
Thank you. Ellen, you had mentioned that your medium-term target for tangible common equity returned about 13% to 14%. It's a pretty big improvement relative to where the target is for the end of 2020. You mentioned some of the things that would be driving that, but is there anything in particular that would be more notable? Is it expected scale of the business, growing the loans, more cost efficiency? I'm just trying to see how we can get 200 to 300 basis points. And then what do you refer to as medium-term? Is that three years? Is that five years?

Ellen Alemany
Yes. So, we refer to medium-term as three years. And I think one of the nice parts about coming out with this new guidance is that it's coming from all over the company. I think that CIT right now is the best positioned that we've ever been. And we talked about the pivot. We had been through a couple of years where we were just shrinking the company, etc., and I think with the Mutual of Omaha transaction and a lot of the investments we've made in the business, we've pivoted.

We have leading market positions in most of our core businesses. And with the acquisition of Mutual, we're getting the number one HOA business, so we add another business to that chart. We have a stronger balance sheet with improved risk profile. Our criticized are at the lowest level it's ever been at the company.

We've got a great management team. We've added a lot of talent in commercial banking this past year. And this team can execute. We completed the deal in record time, 53 days regulatory approval. I don't think any deal has been approved as quickly by the regulators, and 140 days from signing to closing.

We still have a lot of work to do, because don't forget that we had to separate from the parent, so it's not just a normal deal where it's an acquisition. It's a separation and then it's an integration. And we're getting the 34 banking teams. That really helps us expand our middle-market banking franchise.

So, we've got a lot of momentum at the company. I think the key levers that we have to get to this medium-term target is reductions in OpEx. This was the first acquisition this management team is doing. I think the team was very conservative. And as John said, we're trying to expedite some of the saves from the transaction. We're working on getting factoring and more assets into the bank, which will be funded more efficiently.

There's a lot of emphasis on the fee income initiatives and this whole shift in primary bank strategy, leading bank deals, selling treasury management. We're recycling capital away from lower yielding relationships. We're continuing the work to optimize deposit costs. And now with the CAB deposits, that's going to take some pressure away from--even though the online bank is going to still stay our primary deposit channel, it's going to take away pressure from the online channel.

And then lastly, we're hoping that we're going to be able to lower our capital rates from improvement in our risk profile at the company and then through share repurchase. So, were really optimistic about the--absent any major market conditions, we're very optimistic about our future.

Arren Cyganovich
Great. Thank you.

Operator
The next question today comes from Brian Klock of KBW. Please go ahead.

Brian Klock
Hey, good morning, Ellen and John.

John Fawcett
Hey, Brian.

Ellen Alemany
Hi, Brian.

Brian Klock
I'm wondering if I could just follow up a little bit on some of the guidance around average earning asset growth, I guess pro forma. I know you gave guidance specifically around the core average loan growth and then adding in the acquired assets from Mutual of Omaha. Should I think about let's say a starting point of you had $46.5 billion of average earning assets in the fourth quarter, and you add about $8.1 billion of earning assets coming from Mutual of Omaha, and so let's call it $54.6 billion? Should that be something that's a low single-digit growth throughout the year because you got some of the runoff in the non-core portfolio?

John Fawcett
Well, the guidance is mid-single digits. We're pretty comfortable with where we're at. As I said before, I think all the pipelines are strong. We've actually already started to see some synergies between the Mutual of Omaha Bank lending business and what we're doing here.

And apart from investment securities, loan growth is the driving impact of it. The LCM runoff drops it a little bit, but it's not going to be significant. It's a $2.2 billion portfolio. If we sell it in $50 million or $60 million or $70 million trunks, that'll modestly impact it. And then we'll see if there's any moving pieces.

I think between RWAs, if we migrate away from the correspondent lending, the $1.8 billion in correspondent lending and can kind of recycle that into higher gross yield commercial lending, that'll provide some increase as well because you'll be going from presumably 50% risk-weighted to 100% risk-weighted. So, we feel pretty comfortable about the guidance that we've given in terms of average earning asset growth or, actually more particularly, loan growth.

Brian Klock
Okay. So, really, I guess the security portfolio probably remains relatively stable. Your core average loan growth of mid-single digits has that kind of lead-through all the way through to earning assets.

John Fawcett
Yes. The securities portfolio is not going to appreciably change. It's HQLA. And I think we're always looking for opportunities to be mindful of liquidity, but at the same time being efficient with the use of the balance sheet in putting dollars where we can generate a more substantial return.

Brian Klock
Got it. All right, that's helpful. Thanks, John. Thanks for your time.

John Fawcett
Okay. Thanks, Brian. Okay.

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
Great. Thank you, everyone, for joining this morning. If you have any follow-up questions, please feel free to contact the Investor Relations team. You can find our contact information, along with other information on CIT, at CIT.com. Thank you again for your time and have a great day.

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