CIT Group, Inc.

Q3 2017 CIT Group, Inc. Earnings Conference Call

Tuesday, October 24, 2017, 8:00 AM Eastern

CORPORATE PARTICIPANTS

Ellen Alemany - Chairwoman, Chief Executive Officer

John Fawcett - Executive Vice President, Chief Financial Officer

Barbara Callahan - Senior Vice President, Head of Investor Relations

Rob Rowe - Executive Vice President, Chief Risk Officer
PRESENTATION

Barbara Callahan
Good morning and welcome to CIT's Third Quarter, 2017 Earnings Conference Call. Our call today will be hosted by Ellen Alemany, Chairwoman and CEO, and John Fawcett, our CFO. After Ellen and John's prepared remarks, we will have a question and answer session. Also joining us for the Q&A discussion is our Chief Risk Officer, Rob Rowe.

As a courtesy to others on the call, we ask that you limit yourselves to one question and one follow-up and then return to the call queue if you have additional questions. We will do our best to answer as many questions as possible in the time we have this morning. Elements of this call are forward-looking in nature and may involve risks, uncertainties and contingencies that may cause actual results to differ materially from those anticipated.

Any forward-looking statements relate only to the time and date of this call. We disclaim any duty to update these statements based on new information, future events or otherwise. For information about risk factors relating to the business, please refer to our 2016 Form 10-K. Any references to non-GAAP financial measures are meant to provide meaningful insights and are reconciled with GAAP in our press release.

Also, as part of the call this morning, we will be referencing a presentation that is available in the investor relations section of our website at www.CIT.com. I'll turn the call over to Ellen Alemany now. Thank you.

Ellen Alemany
Thank you, Barbara. Welcome and thank you for joining the call. Let me start off with an overview of our results for the quarter. We posted $220 million of net income or $1.61 per share. Excluding noteworthy items, we reported $139 million of income from continuing operations, or $1.02 per share. Those measures are up year over year and results were primarily driven by lower operating expenses and lower credit provision, which was partially offset by lower net finance revenue.

Overall, the quarter provided evidence of continued progress on the strategic plan across a number of fronts. But like others in the industry, we did experience challenges with prepayments and loan growth, which affected our commercial finance business in particular. That said, we saw pockets of growth year over year in our business capital and real estate finance units. Our strategic plan, which is outlined on slide two, continues to be our roadmap for the transformation, and I want to highlight a few important advances this quarter.

Our operating expenses declined about 9% from a year ago, as well as we continued to simplify the organization. We reduced unsecured debt by another $800 million, which will improve funding costs. We completed the ASR and repurchased approximately $120 million of incremental common stock. We grew average investments by $800 million. Credit remains strong and we continue to improve our mix of deposits, in particular at the direct bank. In addition to these efforts, earlier this month, we addressed another key legacy issue for the company in reaching an agreement to sell the Financial Freedom reverse mortgage servicing business as well as the portfolio of reverse mortgage loans.

This transaction is expected to close in the second quarter of next year and will allow us to ultimately exit this business. While the sale of the reverse mortgage loan portfolio will reduce our revenue stream, we believe selling these assets is in the best interest of the company, as it
will reduce future risks and enable us to focus our attention and resources on our core businesses.

The previously-announced transaction to sell NACCO, the European rail business, continues to progress. This is our last ongoing overseas business and supports our efforts to simplify CIT. We remain committed to the North American rail business, and while we continue to work through the current market cycle, the business generates good returns, has attractive tax and capital benefits and is well-managed.

As we look across the commercial banking space, the environment has clearly become more competitive in certain sectors and the structure of the deals has gotten more aggressive in middle-market lending. We have remained disciplined in our approach as we compete for the business, and our deep expertise across segments, coupled with our products and service levels, is a compelling package that drives value for our clients.

We have posted 8% growth year-over-year in our business capital unit and nearly 6% growth in real estate, when excluding the legacy runoff portfolio. And we continue to advance our business initiatives across the board and plant seeds for the future by investing in talent and infrastructure that will support our plan. For example, we added nearly 20 client-facing professionals over the last quarter across six business teams dedicated to expanding our market presence in core areas.

We added a team dedicated to aviation and lending, which will help to expand our aerospace offering. We've built out of the industrial team and our equipment finance unit and we have added capability in our sponsored finance business as well as in the new Northbridge JV.

We have also recently closed on several key deals in the business capital unit. The equipment finance business completed three manufacturer programs in the construction and material handling industry as well as beginning a partnership with one of the largest technology integrators in the country, and the commercial services team has added several new clients in the factory business.

The real estate team recently added syndication capabilities to pursue additional avenues of growth. On the deposit front, the direct bank had a very strong quarter, with over 33,000 new accounts and strong growth in the non-maturity savings product of nearly $700 million. OneWest Bank was just recognized for the second consecutive year as the Best Bank in California by Money Magazine on their annual Best Banks List. Overall, we made solid progress in the quarter and delivered on many facets of our plan.

With that, let me turn it over to John for a more detailed account of results.

**John Fawcett**

Good morning everyone and thank you, Ellen. Turning to our results on page 3 of the presentation, GAAP net income for the quarter was $220 million, or $1.61 per common share and income from continuing operations was $223 million or $1.64 per common share. On page four, you will see the financial results continue to be impacted by a number of noteworthy items primarily related to our strategic transformation, most of which working in continuing operations this quarter.

Noteworthy items included a $140 million benefit to the tax provision resulting from strategic tax planning actions taken during the quarter to restructure an international legal entity. These
actions generated capital tax losses and offset taxable gains from the commercial air sale and other activities, preserving approximately $400 million of our net operating loss carry forwards to offset future taxable income. The actions resulted in an increased or deferred tax asset of $140 million, an increase that disallowed for a tax asset and regulatory capital by approximately $70 million.

An updated slide describing the impact to our deferred tax assets from the sale of commercial air and the current-quarter actions is on page 26 in the appendix of our earnings presentation. We continue to be opportunistic in reducing our funding costs. At the end of the quarter, we incurred an after-tax charge of $33 million as we tendered for $800 million of unsecured debt utilizing excess liquidity at a holding company. In addition, earlier this month we reached a definitive agreement to sell Financial Freedom, our reverse-mortgage servicing business and other reverse mortgage assets.

The transaction includes mortgage servicing rights, related servicing assets and liabilities as well as reverse mortgage loans and related secured borrowings, all reported in "Discontinued Operations." The transaction also includes approximately $900 million of reverse mortgage loans and other real estate owned, which are reported in "Continuing Operations." We expect the transaction to close in the second quarter of 2018, following the approval of certain government agencies and the consent of investors related to the reverse mortgage servicing business.

Due to the structure of the transaction, we recognize after-tax charges of $28 million this quarter from the write-down of certain loans and related assets that were priced at a discount to our carrying value, and anticipate a gain at closing to loans priced at a premium.

On a pretax basis, the charges this quarter included $27 million in other noninterest income related to the write-down of home equity conversion mortgage loans, other real estate owned and other mortgage-related assets in continuing operations. In addition, the credit provision included a $15 million charge-off for mortgage loans moved to "Held for Sale," and we recognized a $4 million charge in discontinued operations related to the servicing liability.

We currently anticipate recognizing a pre-tax gain in continuing operations at closing of approximately $25-$35 million net of transaction costs. However, the actual amount will depend on the timing of the closing and the performance of the portfolio prior to closing. The anticipated gain does not include any potential changes to our reserves. The transaction contains customary representations and warranties and certain indemnifications related to any potential loan defects and servicing deficiencies, both of which are subject to certain caps and limitations. We will continue to analyze the adequacy of our reserves related to the indemnifications as we move through the closing process, and may have further adjustments if appropriate.

As for the go-forward earnings impact, the reverse mortgages that are being sold from continuing operations were significantly discounted and earned an average yield of 9 to 10% and there are no incremental direct operating costs associated with these loans. As a result, interest income reported in the runoff legacy consumer mortgage division in continuing operations will decline by about $20 million per quarter after the transaction costs. However, the sale of Financial Freedom and this mortgage portfolio is a significant step in simplifying CIT, enabling us to focus on our core franchises.

With regard to the pending sale of our European real business, NACC, the related operating lease equipment assets have been transferred into "Held for Sale," requiring us to suspend
depreciation on those assets, increasing net finance revenue by approximately $8 million per quarter. While the NACCO sale is progressing, antitrust approvals in Europe are taking longer than expected, and we now anticipate the closing to occur in the first quarter. As a result, we expect fourth-quarter results to also benefit from this suspended depreciation.

Details of all noteworthy items for the current, prior and year-ago quarters are listed on page 20 of the presentation. Turning to page 5, income from continuing operations, excluding noteworthy items, was $139 million, or $1.02 per common share this quarter. This is up from $126 million, or $.68 per common share last quarter and $109 million or $.54 per share in the year-ago quarter.

I will now get into some further detail about our financial results for the quarter. Please note that in this discussion, I will be referring to our results from continuing operations, excluding noteworthy items unless otherwise noted. Turning to page 6 of the presentation, net finance revenue is down $11 million from the prior quarter while net finance margin increased two basis points.

Compared to the year-ago quarter, net finance revenue was down about $25 million while in the margin was down five basis points. I would like to point out a change we made it to the net finance revenue trend chart on the top of page 6. In the past, we separately highlighted the amount of purchase accounting accretion, or PAA, on loans acquired from OneWest in net finance revenue. We are now highlighting PAA net of negative interest income on the indemnification asset, which represents a decline in the expected cash flows from the loss agreement with the FDIC, on $3.9 billion of covered loans acquired from OneWest.

In past quarters, this negative interest income was not as impactful and therefore not separately highlighted. As you can see, our core net finance revenue has been relatively stable over the past year, while the reduction has been driven by the impact of net purchase accounting accretion. Purchase accounting accretion has declined from $71 million in the year-ago quarter to $61 million last quarter and $52 million in the current quarter, reflecting the runoff of the legacy consumer mortgage division and high prepayments in commercial finance and real estate finance.

The negative interest income on the indemnification asset has increased to $14 million this quarter from $10 million last quarter and just $4 million in the year-ago quarter. Due to a decline in expected reimbursable losses under the loss-share agreement from better-than-expected credit performance of covered loans. Next quarter, we expect the negative interest income from the indemnification assets to increase to around $16 million, and the negative yield to increase to about 45%.

We expect the yield to remain negative, but it can increase or decrease as the indemnification asset amortizes over the remaining contract period, which expires in March of 2019. It is important to note that while the restoring of credit performance reduces the yield on the indemnification asset, it increases the yield on covered loans, which has resulted in more purchase accounting accretion than originally expected. This improvement is also evidenced by the reclassification of approximately $300 million of purchase accounting discount from non-accretable to accretable since the acquisition.

Turning to page seven, net finance margin increased by two basis points this quarter due to several factors. Growth in the investment securities portfolio and yield improvements on our loans resulting from an increase in LIBOR and a mix of assets added 18 basis points to the
margin. We also had lower borrowing costs driven by our funding mix. Offsetting these increases were lowered net purchase accounting accretion and prepayment benefits, as well as lower net operating lease revenue from our rail business.

Rail renewal rates priced down on average 16% this quarter, reflecting the mix of cars renewing. We continue to expect leases to reprice down on average 20 to 30% through the next year, reflecting current market conditions and continued pressure from the tank car lease rates, which are coming off peak levels. We expect further reduction in our funding costs next quarter from the $800 million of unsecured debt we repurchased at the end of the quarter, which had an average coupon of 5.4%. This benefit will be partly offset by the reduction in interest income from excess liquidity that was used to fund the redemption, which had a weighted average yield of around 1.5%.

Compared to the year-ago quarter, the decline in net finance margin was primarily due to the same trends described above. In addition, lower deposit costs improved the margin by two basis points, reflecting the growth in non-maturity deposits and reduction in higher-cost, brokered and commercial deposits.

Turning to page eight, other non-interest income increased from prior and year-ago quarters. Compared to last quarter, higher factoring commissions and gains on investments offset lower gains on the sale of loans and leases. The year-ago quarter included a large mark-to-market charge on the total return swap, while factoring commissions declined slightly as higher factoring volumes were offset by lower pricing.

Turning to page nine, operating expenses before the amortization of intangibles were $268 million, down $18 million from the prior quarter and $26 million from the year-ago quarter. You may recall that last quarter's expenses were elevated by $8 million due to a non-restructuring severance and a nonrecurring charge related to the NACCO business. Absent those charges, operating expenses declined $10 million, reflecting lower FDIC insurance and compensation-related costs.

Compared to the year-ago quarter, the decline in operating expenses was driven by lower compensation costs, professional fees and other business-related expenses primarily related to our cost reduction initiatives, partially offset by higher advertising and marketing costs related to our strategy to shift to non-maturity deposits. We continue to be on track with our cost savings target for 2018.

Page 10 describes our consolidated average balance sheet, which includes discontinued operations. With the sale of commercial air, the only remaining items in discontinued operations relate to the Financial Freedom reverse mortgage servicing operations and business air. Adjusted for the noteworthy items highlighted toward the bottom of the page, average earning assets are down $1.5 billion from the prior quarter, reflecting the continued deployment of our cash. Average interest-bearing deposits were down $2 billion while investments grew $800 million and deposits and unsecured debt declined.

Turning to page 11, we have provided more detail on average loans by division within commercial and consumer banking. Commercial banking’s average loans and leases have been relatively flat, with the reduction in commercial finance offset by growth in other divisions. While at the reduction in commercial finance from a year ago was mostly due to our repositioning efforts and higher prepayments, new business volume was impacted this quarter by weaker activity and more aggressive structures in the middle market.
Business capital grew a little over 1% this quarter with average growth across all businesses, but over the past year, this division has grown 8% with double-digit growth or near-double-digit growth coming from direct capital, capital equipment finance and commercial services.

Real estate finances volumes were strong this quarter, but overall average assets remained relatively flat due to prepayments in the runoff of the legacy portfolio acquired through the OneWest acquisition.

Compared to the year-ago quarter, the core portfolio has grown $250 million or almost 6% while the legacy runoff portfolio, which is now approximately $730 million, has declined by $160 million. North America Rail’s utilization remains around 95% and assets are flat. As I mentioned last quarter, the remaining order book to North America is currently $100 million, which is expected to be delivered through 2018. The runoff of the legacy consumer mortgage portfolio continues to be the driver of the reduction in average loans in consumer banking.

Page 12 highlights the improvement in the composition of funding. Deposits are 78% of our total average funding, while unsecured borrowings has declined to 11% from 22% a year ago and FHLB advances increased modestly. Funding costs as a percentage of average earning assets have been relatively constant over the past year, and we continue to evaluate opportunities to reduce these costs. The loan and lease-to-deposit ratio for the company is 127% versus 120% last quarter, while at the bank this ratio increased modestly to 102% from 96% last quarter.

Page 13 illustrates the deposit mix by type and channel. Our strategy is to reduce the amount of time deposits relative to non-maturity deposits, as well as reduce brokered deposits. As you can see on the top chart, while we have been increasing non-maturity deposits, the decrease this quarter in money market and sweeps accounts represents a reduction in higher cost accounts in our brokered and commercial channels, offset by an increase in our savings account.

The lower chart illustrates the deposits by channel where you can also see the progress we were making reducing brokered deposits. Average deposits in the direct bank, our online channel, increased by $500 million this quarter, reflecting a $700 million increase in the savings accounts offset by a reduction in timed deposits. The overall cost increased modestly from prior quarter while reflecting an increase in the average savings account rate offset by a reduction in higher-cost brokered and commercial deposits.

Page 14 highlights our credit trends, which continue to reflect a favorable environment, and we are seeing no substantive changes in overall trends. The credit provision was $15 million this quarter, up from $4 million last quarter, but still below the normalized run rate, reflecting stable charge-off levels and a decrease in reserves due to overall lower loan balances.

The decline in the credit provision from the year-ago quarter, which was $45 million, reflects these trends as well as positive changes in the credit quality. Nonaccrual loans remain at 0.9% of total loans while in the allowance for loan losses in commercial banking is 1.73%, down slightly from the prior quarter and relatively flat from the year-ago quarter.

Turning to capital on page 15, the change in capital ratios are highlighted on the top chart. During the quarter we took delivery of another 1.45 million shares related to the completion of the ASR, resulting in the aggregate repurchase of 10.7 million shares at $47.82 per share.
Additionally, we repurchased $120 million of common stock in line with our capital plan, representing 2.7 million shares at an average price of $44.82. These actions reduced the number of shares from 135 million at the beginning of the quarter to 131 million at September 30th.

We still have $106 million of capital that can be executed in the first half of next year under the existing capital plan. As we highlighted last quarter, we also increased our dividend by a penny per share to $.16 per share. Our capital position remained strong with a common equity tier-one ratio of 14%, down from prior quarter reflecting higher risk-weighted assets. CET 1 was relatively flat as the increase in earnings was offset by share repurchases, dividends and an increase in the disallowed tax asset I discussed earlier.

While overall assets are down, risk-weighted assets increased $1.5 billion, reflecting a shift from cash, which carries a zero risk rating, to investment securities and other assets, as well as seasonally higher on and off-balance sheet factoring balances that carry a higher risk weighting. Adjusting for note-worthy items, our effective tax rate this quarter was 28%, benefitting from a true-up related to the mix of US and international earnings which reduced the year-to-date tax rate.

Page 17 provides our current outlook for the next quarter. We expect net finance margin to drift closer to the middle of the range given the continued runoff of purchase accounting accretion and rail headwinds. Also, while we expect to continue to increase our investment securities book, the pace may be slower as the average increase of $800 million this quarter was above our expected run-rate.

We continue to expect the credit provision to be within the target range of a 25 to 50 basis points of average earning assets. Operating expenses before restructuring costs are expected to be relatively flat for next quarter, as further improvement in our cost-save initiatives will be offset by investment expenditures, particularly in the information technology area.

Finally, our year-to-date effective tax rate is 30%, and we expect this rate to return to a more normalized level next quarter. As Ellen mentioned, we will be back to you on our fourth quarter call with an update on the 2018 outlook. With respect to capital, as I mentioned last quarter, our capital plan submission targeted an 11% common equity tier one ratio towards the end of 2018.

Since that submission, we have announced the sale of NACCO and Financial Freedom, further reduced our unsecured debt and will continue to work within the regulatory framework to return excess capital to our shareholders. In addition, we constantly evaluate opportunities to optimize our debt structure and are taking a comprehensive approach to address the impact from divestitures as well as other actions, including further reducing debt from excess liquidity and/or refinancing with lower cost debt to improve the financial performance of the company.

With that, let me turn it back over to Ellen.

Ellen Alemany
To wrap up, we are pleased with the progress on the strategic plan and are dedicated to consistent education on our five priorities. We remain committed to the 10% ROTCE target, however given the pace of loan growth in certain areas and the divestiture of the reverse mortgage portfolio, we may experience some headwinds in achieving these targets in 2018. There are many facets to the plan and we feel confident with the ability to achieve our 150 million cost reduction goal next year.
In addition, we are focused on optimizing our capital structure within the regulatory framework, improving our funding costs, growing our investment portfolio, remaining disciplined on risk management and maximizing the potential of our businesses. We are currently in the annual planning process and expect to share additional guidance on 2018 during our next earnings call in the first quarter.

With that, let me turn it back to the operator for Q&A.

**QUESTION AND ANSWER**

**Ken Zerbe**

Good morning. I guess just to start off, in terms of the operating lease yields still coming down quite a bit, do you guys see any stability in the near future? Where could that bottom out? I'm just trying to see if there's any stability there. Thanks.

**John Fawcett**

So it's really a function of the cars are actually coming off lease. I expect we're going to see a little bit more of a headwind going into '18, because there's a fair number of tank cars that are coming off lease. So if you don't see any kind of move in oil or more opportunity in the fields, you'd expect that to come down.

I think we're looking probably into '19 before we see a more fulsome bottom. I think that while the tank cars remain a particular challenge, I think as you go to some of the other cars—the more common cars: box cars, flat cars, auto tract—that seems to have stabilized already, but the preponderance of the headwinds are, I think, going to continue to be driven by what we're seeing in tanks.

**Ken Zerbe**

And then just on the expense lineups, it came in a little bit better than what we were looking for. I'm glad you're still committed to the $150, but it seems like some of the reduction, some of the improvement this quarter is it driven by sort of core items, right? Like FDIC insurance costs. Is that a fair statement? Because I guess I was under the impression that a little bit more of the expense reduction is coming from volatile items. I'm just wondering how sustainable some of those core expense numbers are as it gets it driven down. Am I thinking about that the right way?

**John Fawcett**

I guess yes and no. And the reality is that I've taken a very fresh look at this. I'm pretty comfortable with the $150 million. I think this becomes an area of continuous improvement. I don't know that you ever get to the right place and you just have to keep pushing. I think the plan that Ellen laid out back in March of 2016 articulated all the right levers to pull.

If you look at our expenses, it's pretty much like a bank. You forgot 50% of your costs are tied up in people costs, and so if you want to improve significantly, you have to take people out of the process. There's another 12% that's tied up in "Technology and data." And that becomes an enabler to take people out, and so it's necessary to make some investments that will depreciate over time to allow that to happen.

I think the third big lever is around the notion of consultants, which I think there are a lot of them around here and I think we are making a concerted effort to be able to retain institutional
knowledge within the company and push the consultants out of the place. So there’s still a lot to do, but we are literally looking at every single line. I know this is a little bit in the weeds, but in the past quarter we took a look at a comprehensive review of our travel and expense policy and that’s going to get rolled out in the current quarter.

And again, it’s little things but they all have a way of adding up. In terms of the arithmetic going forward, I know we are committed to the $1,050 and there’s a bit of extra, maybe, stranded costs, so if you wanted to do easy arithmetic and we wanted to get to $1,040, you’d be targeting at about $260 a quarter going into 2018. We’re at $268 right now, so that feels pretty achievable to me.

Ellen Alemany
Just a couple more comments on expenses. The FDIC insurance decline is really due to the lower assessment base and also just other factors that go into calculation. Because of the credit improvements, we have lower criticize and classify portfolios, and also improvements in our earnings in tier one affected this ratio. So we think that those changes are sustainable.

There’s so much with expenses you can squeeze, squeeze, squeeze and take out, but we’re really looking at really making fundamental structural changes to get expenses out and I think we’re making good progress there. Head count is down 6%. We just put in a new capacity management program so that we could drive more efficiency with staffing levels. We’re starting to leverage robotics and artificial intelligence. We’re also rationalizing a lot of our technology applications, still working on real estate footprint. But I also want to note that even though our target is the $1,050, we’re still invested in our infrastructure, primarily risk infrastructure, growth initiatives. And so there’s going to be variabilities in that expense line going forward.

Moshe Orenbuch
Great, thanks. You did a pretty comprehensive job going through the kind of one-time notable items, but could you talk a little bit about the areas in which there’s going to be future impacts kind of to net finance, revenue, and when that happens? For example, the NACCO suspended depreciation and the reverse mortgage assets. When do those come out, and is that part of what’s in your fourth-quarter guidance or not? So maybe kind of address that.

John Fawcett
Interestingly enough, I think we modeled NACCO to actually close on November 1\textsuperscript{st}. The antitrust is not something we anticipated. Now, we’re expecting it to close, call it middle of the first quarter. I think we’d be happily surprised if it happens sooner. I think will maintain, the suspended depreciation, until there’s actually closing, and so you could expect a full $8 million benefit in the fourth quarter and then whatever the partial benefit is in the first quarter subject to the closing.

I think the Financial Freedom, we’re still pretty close to actually signing the contract. We expect that that will close sometime in the second quarter, hopefully at the early end of the second quarter. Obviously the big headwind is the $800 million what we characterize as a G3 portfolio and that’s worth about $20 million a quarter. So if you were modeling this, I would say halfway through the middle of the second quarter and on out, so you lose $10 half of the second quarter and another $20 and $20 in three and four.

Moshe Orenbuch
Right, but none of that’s contemplated in the margin guidance that you’ve got for the fourth quarter?
Good morning. Thank you for taking my question. I’m just wondering how much more cash can you move to investment securities? Because when I look at your balance sheet, you have $3.1 billion in the third quarter, down two billion, and you still maintain around $5.7 billion in investment securities portfolio. I’m just wondering how much more cash you can deploy maybe to high-yielding investment securities or pay down debt.

I think on a steady-state basis we’d like to get to around 5% of average earning assets in terms of where cash is. I think if you look at other regional banks, regional banks are high-quality investment portfolios in the 18-20% range. I think over time we’d aspire to get there. I think we have a lot of choices, different choices that we could make in terms of our excess liquidity. I think you saw one of them executed in the third quarter this year where we kind of retired, across three debt stacks, 5.4% paper.

So it’s not a straight line. I think we’re opportunistic in terms of when we’re going to deploy cash, where we’re going to deploy cash. I think given where tens have moved around, buying at 2.30% seems okay, but buying at 2.10% seems less okay, so I think it’s an exercise that we spend a lot of time looking at in terms of how to properly deploy the cash between investment portfolio and opportunistically restructuring debt.

Yeah, thank you. That’s a very helpful. Just one follow-up, high-level strategy question related to your middle-market lending franchise and the railcar leasing franchise. Actually, based on my math, the differential between the loan yield adjusted for credit costs and the rental income yield came down from 5.5% in 2015 to around 2.3% this year. Given where we are in the interest rate cycle, where we are in the credit cycle and where we are in the rail car leasing cycle and also the excess capital you have, those are two very good businesses. But looking into over the next two to three years, how would you position CIT and allocate your resources between these two good franchises? Thank you.

Just commenting, our core franchises in the future are our North American Rail business, our business capital, commercial finance and real estate finance business and then direct capital. And we have hurdles set up for all of those businesses, and I would say that the growth is primarily going to be in those businesses going forward.

I think the one business that we are experiencing weakness in right now is it the commercial finance business, and really that’s a function of the aggressive structures, covenant light, record leverage in these deals now, and we’re really trying to stay disciplined, although that being said we have a pretty good pipeline in the business and I think it’s going to really depend on conversion rates and prepayment levels in the fourth quarter there.

Business Capital, we’re seeing a lot of strength right now in franchise, industrial, office imaging, material handling. We’re investing a lot. I had mentioned earlier we added over 20 front office people. Those are good return businesses and we expect a good growth in business capital going forward. Even our capital equipment finance business was one of our stars for the
quarter where smaller businesses were making large capital equipment purchases, and then direct capital, our fintech business, where we’re processing transactions literally under 30 minutes, we’re seeing good demand from small businesses for equipment leasing in that space.

So we’re going to just keep investing in these core businesses going forward. As John spoke about with rail earlier, I think we’re going to have softness in rail throughout 2018, and it's really going to depend on growth in the industrial and manufacturing sectors for rail to really make a turn, but we’re still making good returns on that business.

**John Fawcett**

And the only thing I would add to on the rail, because obviously we get a lot of questions on the rail franchise, and I'm still relatively new here, but I took the time to actually go back and look at the kind of returns that this business is a generating going back all the way now to '12 and '13, and this is a very long-cycled business. But when it's at the top of its game, it's quite an important franchise, and it's quite a good returning franchise. Given the management team, given the quality of the cars, given the newness of the cars, given in the mix and diversified nature of the portfolio, I think it's well worth it to weather the storm to get through this cycle and see what's on the other side of it.

**Arren Cyganovich**

If you could talk a little bit about—you mentioned the headwinds you're seeing in the commercial finance business, but you're also hiring a decent amount of folks in various verticals. Maybe just talk about your expectations for origination trends as you're adding some new folks and kind of combatting the pressures you're seeing on the commercial finance business.

**Ellen Alemany**

Congratulations on your new role, by the way, Arren. I would say that we've organized our business around our industry verticals. We think that's our biggest competitive advantage, so the teams that we're adding are really in material handling, construction equipment and industrial equipment. We just put on a new air team that will specialize in midrange aircraft, so we are really growing in the areas where we think will have the biggest growth in assets. And we are also adding to our syndication capability where we can play in the larger transactions, and so that's where the growth will be going forward.

**Arren Cyganovich**

I think last quarter you indicated that you'd expected the kind of year-end to grow around in the low single digits for average loan and leases. Has that changed since you had a higher level of prepayments again in the third quarter?

**Rob Rowe**

Yeah, we did expect that, and as you can see over the last year, Business Capital and Real Estate has had pretty good growth. Commercial Finance has not had that quite same level of growth. The pipeline, as Ellen said, is pretty strong in commercial finance, but we've all been around the block a little bit. The markets are pretty frothy and there's fairly loose structures out there, so we will be prudent.

So we don't want to give too much of a caveat because we do see pretty good pipelines, but we're already a month into the fourth quarter. So you should expect growth in most of the business, but commercial finance is still building its pipeline.

**Arren Cyganovich**
It's always better to not chase growth for the sake of it. We appreciate that. The last question I have is just on the tax rate. For the third quarter, the adjusted tax rate was around 28%, and your guiding kind of toward mid-30s, longer-term. I suppose that looked like it added around $.09 or so to the quarter. Why is that not considered more of a one-off from a tax perspective?

**John Fawcett**

It was essentially a year-to-date true-up in terms of the mix between international and domestic income. I think as we've messaged, we don't expect to stay in this ZIP Code, and will probably get more to a 33-35% rate in the fourth quarter.

**James Fotheringham**

Thanks for all the details regarding the current and expected impact from the Financial Freedom transaction. I was wondering, what do you anticipate will be the impact on purchase accounting accretion specifically and PAA gross from the sale of the $900 million in reverse mortgages in the second quarter of next year? Thanks.

**John Fawcett**

I don't know that I have the specifics on that. What I would say is that in terms of the remaining purchase account accretion, it's probably 7 or 8--call it 750-770 [million] on the balance sheet, the vast majority of it in consumer. The pace of runoff is probably 10-15% a year. On the commercial side, it's got a much shorter life. There's probably $150 million dollars or so of remaining purchase accounting accretion and we expect that half that will be gone over the course of the next 12 months.

On the Financial Freedom, I guess it's something you can probably follow up with IR to call and we'll get you that information.

**James Fotheringham**

If you look at Legacy Consumer Mortgage at about 60% of PAA and $900 million being about 20% of that 60%, is the 12% hit to PAA a reasonable assumption. I know it's a lot more complicated than that. I just don't have access to the information to do a more refined analysis.

**John Fawcett**

Yeah. It is more complicated than that. It's probably something better taken off-line with Barb and the IR guys.

**James Fotheringham**

If I can squeeze in one related question then, was there any impact on the PAA this past quarter from the announced sale of the reverse mortgages?

**John Fawcett**

No.

**CONCLUSION**

**Barbara Callahan**

Thank you everyone for joining 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 and the investor relations section of our website at www.CIT.com. Thank you again for your time this morning and have a great day.