Velocity Financial, Inc.

First Quarter 2025 Conference Call

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CORPORATE PARTICIPANTS

Chris Oltmann--*Treasurer*

Chris Farrar--*President & Chief Executive Officer*

Mark Szczepaniak--*Chief Financial Officer*

PRESENTATION

Operator
Good day, and welcome to Velocity Financial, Inc.'s. First Quarter 2025 Conference Call. [Operator Instructions] Please note this event is being recorded. I would now like to turn the conference over to Mr. Chris Oltmann, Treasurer. Please go ahead.

Chris Oltmann
Thanks, Kaley. Hello, everyone, and thank you for joining us today for the discussion of Velocity's first quarter 2025 results. Joining me today are Chris Farrar, Velocity's President and Chief Executive Officer and Mark Szczepaniak, Velocity's Chief Financial Officer.

Earlier this afternoon, we released our first quarter results, and you can find the press release and the accompanying presentation, we will refer to during this call on our Investor Relations website at www.velfinance.com. I'd like to remind everyone that today's call may include forward-looking statements, which are uncertain and outside of the company's control and actual results may differ materially.

For a discussion of the results, please see the risk factors and other cautionary statements made in our communications with shareholders, including the risk factors disclosed in our filings with the Securities and Exchange Commission. Please also note that the content of this conference call contains time-sensitive information that is accurate only as of today, and we do not undertake any duty to update forward-looking statements.

We may also refer to certain non-GAAP measures on this call. For reconciliations of these non-GAAP measures, you should refer to the earnings materials on our Investor Relations website. Finally, today's call is being recorded and will be available on the company's website later today.

And with that, I will now turn the call over to Chris Farrar.

Chris Farrar
Thanks, Chris, and we appreciate everyone joining our first quarter earnings call. The strong momentum we experienced in 2024 carried into the first quarter of this year as we originated $640 million in new loans, an increase of 69% versus the prior year, which drove a 27% increase in net revenue and a 17% increase in core pretax earnings.

Our team grew production and remained disciplined by preserving our spreads and credit standards. We continue to see increased demand for all property types with a more recent tilt towards commercial loans versus the investor 1-4 residential loans and robust margins in both products. Looking forward, our pipeline is strong and growing across the board. With respect to the portfolio, we continue to realize a consistent net interest income and healthy cash flows, and our special servicing team is doing a great job of resolving delinquent assets favorably.

Our real estate markets remain healthy with plenty of dry capital ready to deploy in reasonably priced assets. From a capital markets perspective, we've been very busy this year with four successful debt transactions already completed and we issued three new securitizations, paid down debt and collapsed one of our re-REMICs and also sold new shares through our ATM program.

Despite the recent volatility, we are very encouraged to see healthy investor demand and participation in our offerings. We appreciate all our partners that have supported our platform for so many years. Although the markets are choppy, our team is well prepared to operate in this environment, and we believe we offer a great platform for investors to earn consistent compelling returns. I want to congratulate all Velocity team members on another fantastic quarter. And as always, we'll continue to work hard to deliver shareholders value.

With that, I'll turn over to the -- today's presentation, starting on Slide 3. As I mentioned, strong net income, core earnings of $0.55 a share, up from $0.51 a share a year ago. And our second best quarterly earnings in the company history, just a little bit below what we did in Q4 of last year.

I mentioned the production. On a net basis, the portfolio is up 27% and nonperforming loans continue to be relatively stable at 10.8%. Most importantly there, NPA resolutions again in the quarter of 102.4% above par resolutions continue, which is great.

In the financing and capital section, I mentioned the first securitization we completed with a weighted average rate of 6.7%, collapsed the re-REMIC, which freed up $52.6 million of retained securities that are available to us to do with whatever we want. We issued 1.6 million common shares, just under $29 million of proceeds and those shares were accretive to book value. In terms of our liquidity and warehouse capacity, you can see we're in great shape there.

On Page 4, one of the other securitizations we did in early April was a short term -- backed by our short-term loans and that was another successful transaction. And the third one listed here on this page was the second deal that we did, and I highlight this one for a very important reason, it priced April 8 and that was in the heart of all of the disruption in the market. And as you can see, our weighted average rate actually was 30 bps better than our first deal in the first part of the year. So again, although there's all this volatility, we continue to see strong support from our investors, and we're very pleased with the execution we've seen so far this year.

On Page 5, walk you through just the simple adjustments that we make to get to core earnings and then on the right, we have a bridge showing the build-up in book value. And to the far right, we make an adjustment, if GAAP allowed us to adjust all of our held-for-cost loans to fair value, we would be reporting an adjusted book value of $18.50 a share. That is reflective of all of the assets that are in place and on the balance sheet at 3/31. So, you can see we've been getting nice growth in book value as we retain our earnings and execute on our strategy.

And with that, I'll turn the presentation back over to Mark to continue.

Mark Szczepaniak
Thanks, Chris, and good afternoon, everyone. In the first quarter, as Chris mentioned, we saw continued strong production, actually setting a record for the company for a single quarter's production of approximately $640.4 million for the quarter, which is a 13.7% increase from Q4 last year and we had 1,500 loans funded in the first quarter. That was an increase of almost 18% on the loan count basis over the previous quarter.

The strong production growth during Q1 included the weighted average coupon and new held for investment originations continuing to be strong at 10.5% and the weighted average coupon on our held-for investment originations for the last five quarter average trend was at 10.8%. The growth in originations in Q1 also continued the tight credit levels with the weighted average loan to value ratio just being under 63%, 62.6% and the last five quarter average trend at 63.4%. So, the strong Q1 production and record growth, a healthy WAC, and low LTV continues to show borrower demand for our products through all different market cycles and environments.

If we go to Page 7, as a result of the continued growth in production, Page 7 shows the growth in Q1 for our overall loan portfolio at the end of the quarter. Total loan portfolio as of March 31 was just under $5.5 billion in UPB, and that's a 7.8% increase from year-end 2024 and a 27.3% increase year-over-year.

The weighted average coupon portfolio at the end of the quarter was just under 9.6%, at 9.59% which is 6 basis points increase from the WAC at the end of the year and 52 basis points increase from the same time in the first quarter last year. The total portfolio weighted average loan-to-value remained consistently low at 66.1% at the end of the quarter.

Going to Page 8, our Q1 portfolio NIM was 3.35%, representing one of our -- more normalized NIMs compared to Q4 of '24 -- Q4 of 2024, it was a little bit higher NIM due to cash interest received on non-performing loans. So, the cash that comes in on non-performing loans tends to come in kind of sporadically and lumpy, and that can cause some spikes in the NIM. Our Q1 NIM was consistent on a year-over-year basis.

Our portfolio yield for Q1 of this year decreased by 23 basis points quarter-over-quarter, again, due to the high cash nonperforming loan interest received in Q4, but an increase year-over-year by 40 basis loss, while our cost of funds increased by 9 quarter-over-quarter and increased by 30 basis points year-over-year.

On Page 9, our non-performing loan rate at the end of Q1, as Chris mentioned, was 10.8%, that's been relatively flat. It was 10.7% at the end of 2024 and it's been consistent for the last five quarters at an average of about 10.5%. We continue to see strong collection efforts by our special servicing department that resulted in favorable gain resolutions of our NPA assets -- by NPA assets with our NPL loans, as well as the REO assets.

The table on Page 10 shows the continued positive results of our in-house NPA resolution efforts. Our Q1 NPA resolution gains were $1.9 million or 2.4% of the $76.4 million in overall UPB resolved. And on a trend basis, we've been averaging about a 3.3% quarterly NPA resolution gain over the last five quarters.

Page 11 presents, on the left-hand side, our CECL loan loss reserve and on the right-hand side, our net loan charge-off gain loss on REO activity. The CECL reserve at the end of the quarter was $5 million or 22 basis points of our outstanding amortized cost, health investment portfolio. The CECL reserve at the end of Q1 was slightly above our expected normal range of 15 to 20 basis points and that is due to the latest national economic forecast.

CECL requires you to do a macroeconomic forecast using a modelling system and the outside model that we use, given all the kind of uncertainty and the movement around in Q1 in the markets, it just had a little more severe step on the macroeconomic forecast, it's only 2 basis points, so instead of 20 basis points at year-end, it's 22 basis points. The CECL loan loss reserve number does not include our loans being carried at fair value, just amortized costs.

And then in the table to the right of this page shows our net gain loss from both loan charge-offs and REO-related activities during the quarter. And for Q1, the gain on REO activities offset the net loan charge-offs.

Page 12 shows our durable funding and liquidity position at the end of the quarter. Total liquidity as of March 31st was $75.6 million that’s comprised of $51.7 million in cash and cash equivalents and another $23.9 million in available liquidity on our unfinanced collateral. In addition, the available warehouse line capacity at the end of the quarter was $238 million, with the maximum line capacity of $810 million.

As Chris mentioned previously, in Q1, we issued our first securitization of 2025 for $342.8 million in securities issued. And then subsequent to first quarter, in April, we issued our second long-term securitization, 2025-2 and we also issued a short-term securitization, 2025-RTL1 as the securitization of our short-term loans. And remember the very first short-term securitization we ever did was in 2023. So, in 2025, we simultaneously collapsed the 2023-RTL1 short-term securitization and issued the 2025-RTL1 securitization.

And the RTL1 securitization, I only want to add about that it includes $59 million in UPB from the old 2023 securitization that was freed up when it was collapsed and it will go to the RTL1 for 2025. That concludes my first quarter financial recap. I'll turn the presentation back to Chris now for an overview of our '25 outlook.

Chris Farrar
Thank you, Mark. I think from a market perspective, you can see that we're seeing very strong healthy demand. Real estate markets are functioning well. So, we feel good there. Our credit perspective -- still seeing very good positive resolutions. I think, remains to be seen what happens with all of the tariff talk and those types of things. But from our perspective, we don't think it's going to have an impact on our business materially.

In terms of capital, we've been very active there and markets are supportive of us. In terms of earnings, we feel very good about the future and the rest of this year. And I'm excited to continue on our path. So, with that, that concludes our prepared remarks, and we'll open it up for questions.

QUESTION AND ANSWER

Operator
We'll now begin the question-and-answer session. [Operator Instructions] Our first question comes from Don Fandetti with Wells Fargo. Please go ahead.

Don Fandetti
Hi, good evening. Just wanted to clarify, it sounds like the NIM is more normalized now. So, would you think Q2 would be sort of in the same ZIP code as Q1?

Chris Farrar
Hi, Don, I think that's right. I mean we generally target around 3.5%. So, 3.35% to 3.50% right in there is what we would say is pretty normal.

Don Fandetti
Got it. And then also on new origination yields. They've been steady, ticked down a little bit. Are you thinking that we hold in this range as we go through 2025?

Chris Farrar
Yes, I think that's right. We took coupons down a little bit to reflect the underlying reduction in our cost to borrow. So, we're maintaining our spreads. That's what drove the coupon down. But I think it all depends on where sort of three to four year treasury -- we price off of three to four year interpolated rates. So, wherever those rates go, we'll price our spread accordingly. But I think our expectation is that they should be fairly stable with the possibility, I guess, of going down later in the year if the Fed continues to cut, which remains to be seen.

Don Fandetti
Great. Thank you.

Chris Farrar
Sure.

Don Fandetti
Got you. Okay, really helpful. Thank you, guys.

Chris Farrar
Thank you.

Operator
And the next question comes from Eric Hagen with BTIG.

Eric Hagen
Hey thanks. Good afternoon. You noted some more commercial demand, I think, in your opening remarks. We know that transaction volume for the market is down, right? So, are you guys seeing more demand because borrowers are being shut out of other channels? And on maybe like a related note, is there a level that you expect for overall origination volume through, call it, the end of the year? And then maybe like at this point, what would maybe catalyze your origination volume to be meaningfully higher than whatever you're currently projecting?

Chris Farrar
Hi Eric, thanks for the questions there. Yes, in terms of commercial aspect, we just year and half ago, started a small commercial division that focuses just purely in commercial type lending. And so, I think the vast driver there has just been their ramp-up in their growth in production. So, it's less, I think, of a demand story and more of us opening up a new channel. That channel focuses almost exclusively on owner-occupied commercial real estate. And so, I think that's the driver there. Over the years, we've seen it's modulating back and forth between the one to four and the small commercial. We're comfortable with both and it sort of ebbs and flows, but this one is more tied to our direct effort.

In terms of run rate production, I think -- we think that this current pace is sustainable. So, I think that's a good run rate, if you want to project out for the rest of the year. And something that would meaningfully drive volumes significantly higher. I think it would only be probably just a very large drop in rates back to kind of like what we saw during the COVID levels. I don't expect that, and I don't think that is in the cards. But if it were to happen, that would probably be the single largest boost we could get.

Eric Hagen
Okay. That's good color. I appreciate that. Can you say what you did with the capital that you raised? Like was it to de-lever a little bit? And then when you come in to maybe raise additional capital from here, is there an expectation for what you plan to maybe do with that capital?

Chris Farrar
Yes. So, we just used it to continue to make more loans. I think any capital that we do raise will be solely for the purpose of growing the portfolio. We take, as you know, all of our earnings and retain them and put them back in. So that marginal return on capital is very attractive. And we're seeing very high ROEs there. So, we think the smartest thing to do is allocate capital back to new

assets. And we have a number of levers we can pull there, and we'll just continue to support the growth.

Eric Hagen
Yes. That's good to hear. Sorry if this is a naive question, but when you look at gain on the REO sales, does that include the back interest from like the borrower initially defaulted? Or is it just a gain relative to the UPB of your cost basis?

Chris Farrar
You want to take that, Mark?

Mark Szczepaniak
Yes. When we look at the gain on the REO, we're showing those resolution tables and all that will just be the gain ion the REO and does not include the back interest. Keep in mind that back interest has already been taken out of the financials. It's already been reversed, right? So, when the loan goes non-performing, we take all the accrued interest at that point, and we reverse it and back it out. So that interest kind of hits so to speak, as it has already been taken out. So probably in every quarterly interest. So, then we show the REO being disclosed in any gain over and above anything else we have already backed out.

Chris Farrar
Yes. And I would add the same thing happens on the gain on transfer when that loan first transfers to REO, same concept.

Mark Szczepaniak
Once the loan stops being a loan that the previous interest on that loan that was received has already been backed out and is reflected in the financials by reducing earnings.

Eric Hagen
Got you. Okay. Really helpful. Thank you, guys.

Mark Szczepaniak
Thank you, Eric.

Operator
And the next question comes from Steve Delaney with Citizens JMP. Please go ahead.

Steve Delaney
Right. Hello, everyone. Congrats to a great start to 2025. Chris, I guess – Chris, no, excuse me, Chris Farrar. What is your current total headcount in terms of employees?

Chris Farrar
We're 323.

Steve Delaney
323, okay. And how many office locations do you have folks sitting in around the country?

Chris Farrar
So, we have five office locations. We kind of have a hybrid model. So how many folks are sitting in those office locations is a wildcard, Steve, but...

Steve Delaney
You can't see who's there anyway…

Chris Farrar
Right.

Steve Delaney
It'd be kind of a virtual business, I know. But I was trying to get a sense for the footprint. And as you think about growth versus execution, I mean, you had a great -- you're executing. You're knocking the ball out of park I mean, in terms of the start to 2025. So, as you talk with the Board, I mean -- I guess I'm trying to get a picture Chris for the three, five years from now. Where do you want the company to be? Other than having been very profitable and everybody done -- has done it. Is there a vision for -- a vision out there for, say, five years for where you'd like to take the company?

Chris Farrar
Yes. I mean I think we'd like to see the portfolio at $10 billion in five years. So, we expect to continue to grow. That will require headcount, and we are generally concentrated sort of East Coast and West Coast, probably add -- maybe we might potentially add some space in the Midwest or Texas area, something like that, maybe. Trying to use a lot of technology to scale the business without adding too much headcount. I mean you always have to add some headcount, but we've been very successful if you look at our sort of average balance funded per loan officer or account executive, that balance is going up.

So, we're making our existing people more productive which is great because you don't have to hire headcount for that. But you do have to support it on the back end with the credit and support functions. So, I would hope that we would add maybe a couple of hundred people over five years, but we're going to really try to implement as much technology as we can to minimize that.

Steve Delaney
Sure. And you do all your servicing in-house, don't you?

Chris Farrar
So, we do all of our special servicing in-house. The primary servicing is outsourced to bill collection, the payments, the insurance and the administration, all of that is outsourced. We just manage delinquent assets because we own that risk, and we think we're the best people to resolve those risks.

Steve Delaney
Great. Well, look, thanks for those comments. I just want to get kind of a picture what the company looks like. Where you plan to go with that. I appreciate it, Chris. Thanks.

Chris Farrar
Yes. Thank you, Steve. Take care.

Conclusion

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

Chris Farrar
Thanks again, everyone, for joining the call, and we appreciate your support. We'll talk to you again after the second quarter. Thank you.

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