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Earnings Call

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Presentation

Operator

Hello, and welcome to the Enterprise Financial Surface Corporation Third Quarter 2024 Earnings Conference Call. [Operator Instructions] I would now like to turn the call over to Jim Lally, President and CEO. You may begin.

James Brian Lally
President, CEO & Director

Well, thank you, Jeremy, and thank you all very much for joining us this morning, and welcome to our 2024, 3rd quarter earnings call. Joining me this morning is Keene Turner, EFSC's Chief Financial Officer and Chief Operating Officer; Scott Goodman, President of Enterprise Bank & Trust; and Doug Bauche, Chief Credit Officer of Enterprise Bank & Trust.

Before we begin, I would like to remind everybody on the call that a copy of the release and the accompanying presentation can be found on our website. The presentation and earnings release were furnished on SEC Form 8-K yesterday. Please refer to Slide 2 of the presentation titled Forward-Looking Statements and our most recent 10-K and 10-Q for reasons why actual results may vary from any forward-looking statements that we make today.

Our strong financial performance continued in the third quarter. Our diversified business model delivered EPS of $1.32, which compares favorably to the $1.19 in the linked quarter and $1.17 in the third quarter of 2023. As important, we experienced a stable net interest margin continued expansion of net interest income and a 25% annualized increase to our tangible book value per share from the linked quarter.

Needless to say, I'm very pleased with these results and they set us up well to finish this year very strong and enter 2025 with a great deal of momentum. Like we've stated during previous earnings calls and investor meetings over the last several years, we've worked diligently to diversify our business model such that we do not have to depend on any one business, market or asset class to produce high-quality earnings. Our third quarter financial performance is a result of this strategy, and we will continue to refine and improve on the strategy for quarters and years to come.

Our financial scorecard begins on Slide 3. For the quarter, we earned net income of $50.6 million or $1.32 per diluted share, and we produced an adjusted return on assets of 1.32% and a pre-provision return on assets of 1.74%. This was an improvement over a very strong result for the first 2 quarters. Our net interest income increased $2.9 million to $143.5 million.

Looking back over the last 2 years, we've been able to hold this number at or around $140 million despite challenging competitive and interest rate conditions. This reflects the strength of the franchise that we've built, and we remain in a position to produce high-quality earnings to consistently improve shareholder value through deep rooted client relationships. Our stable net interest income was aided by the defense of our net interest margin at 4.17%. This is a direct result of our appropriately priced, stable deposit base and our ability to originate commensurate to the needs of our clients but priced well amid the current interest rate environment.

Keene will provide much more detail on these results in his comments, along with our strategy as to how we plan to defend this amid a declining interest rate environment that we expect to continue over the next several quarters. Last quarter, I discussed the wait-and-see mindset of most of our client base with respect to significant financial moves. This continues to have an impact on our loan growth.

For the quarter, we saw loans grow by $80 million or 3% on an annualized basis. This includes a $46 million decline in our Agricultural portfolio, which will continue to widen down. Based on the conversations that we are having with our clients, what I believe is a bit of pent-up demand, I'm confident that we will get back to our mid-single-digit growth in the quarters ahead. In the meantime, we'll maintain our credit and pricing discipline while we continue to sell with our value-added approach.

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Deposit growth continues to be a bright spot for our company. For the second quarter in a row, we're able to grow customer deposits close to $200 million. In fact, we've expanded customer deposit balances in 4 of the last 5 quarters. In addition to our continued strong performance in our national deposit verticals, we experienced solid growth in our geographic markets, too. The cost and composition of the deposit base remains stable and has significantly aided in the continued growth in our earnings and profitability.

The quarterly cost of deposits was 2.18%, and our level of DDA to total deposits remained right at 32%, a level we've maintained for the last 5 quarters. Last quarter, I spoke to my confidence in our ability to grow our balance sheet at the mid- to high single-digit pace with a caveat that loan growth would likely follow -- the block we follow in the mid- to late fourth quarter and maybe even into 2025. 90 days later, I am still confident in this growth rate Loan pipelines are building, and they should only continue to grow with the additions of new RMs and teams.

You will hear much more about where we are seeing opportunities in Scott's comments. Another strength of our company is our well-positioned balance sheet, which provides for great flexibility with respect to capital planning, capital levels at quarter end remained stable and strong, with our tangible common equity to tangible assets ratio of 9.5%, as impressive was our 14.16% adjusted return on tangible common equity, while growing our ratio of tangible common equity to total assets by close to 1% over the last year.

Tangible book value per common share was $37.26, a 25% annualized increase for the quarter. Given the strength of our earnings and our confidence in our continued execution, we increased the dividend by $0.01 per share in the fourth quarter of 2024 to $0.28 per share and will return an additional $9.7 million to shareholders during the quarter through common stock repurchases.

I would characterize the credit quality of our portfolio is strong and stable. Nonperforming assets decreased $15.2 million when compared to the linked quarter. This sizable decrease was primarily attributable to the sale of our largest piece of OREO in which we recorded a gain in excess of $3 million. As you can see from the data presented, our ratios of NPLs on total loans and NPAs and total assets are at the lowest levels in the last year.

We've been able to achieve this while maintaining strong allowance for credit losses of 1.26% of total loans. Slide 5 shows where we are focusing for the foreseeable future. Our focus remains on taking care of the great clients we've accumulated over our 36-year history, while adding those family-owned businesses that cherish high-touch consultative relationships. Doing this day in and day out, will lead to several more quarters of really strong performance and the continued building of franchise value. We will not alter our credit discipline to chase growth and we'll be cognizant of current market pricing trends to make sure we continue to protect and grow our client base.

2 weeks ago, we executed on our core conversion, careful planning and execution of this plan by our team facilitated a smooth transition to our new system. While the core project was a singularly long and extensive project for us, our culture is one of continuous improvement and process innovation. And while we are pleased to have completed this milestone, we will jump back into an array of projects and opportunities that improve the client experience and make us more efficient.

The fruits of our recruiting efforts, especially in our higher growth markets and higher profit specialized businesses are beginning to pay off. We continue to onboard several new RMs and full teams in our Western markets and we'll continue to capitalize on disruption caused by M&A in all of our markets. Similarly, we are being very strategic with our adds to our specialized lending teams and our national deposit verticals, focusing on those areas that provide the greatest shareholder value combined with the businesses that have been the most disrupted due to M&A or banks have decided to disinvest or disregarding the business in total.

We will aggressively pursue more of these opportunities through the end of 2024 and into 2025. Before handing the call to Scott, I would like to provide a little perspective on how our clients are performing and to provide a view of the overall economy from their vantage point. For the most part, our clients continue to do well, from large general and subcontractors to mid-market manufacturers and distributors, 2024 will be another solid year for most. What has changed in the last 90 days is that we are having many

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more strategic conversations about expansion succession and acquisitions than we had in the previous 2 quarters. This informs us the opportunity to exist and that these 2 companies will flex their approach to these opportunities once they understand whether or not the upcoming elections have any impact on them.

Last quarter, I mentioned that our CRE clients were anxious to get new projects underway and take a longer viewpoint, now that the near-term rates have begun to decline. This has manifested itself for several new wins throughout our footprint and most asset classes besides office CRE. Overall, I like the tempo that we are seeing in our business and feel good about our team's ability to consistently produce quality opportunities that will ultimately lead to consistent sound balance sheet growth.

We enjoy great reputation and corresponding market share of middle market businesses in our mature geographies and specialized lending businesses. As such, I am confident that we will continue to get more than our fair share of corresponding opportunities. Our newer markets and higher-growth areas will provide similar levels of opportunities while we continue to build our reputation in these markets. This blend is what gives me high confidence that we will continue to grow and earn at a predictable rate while continuing to compound tangible book value at a higher level than our peers over the foreseeable future.

With that, I would like to turn the call over to Scott Goodman. Scott?

Scott R. Goodman
President

Thank you, Jim, and good morning, everyone. Starting with loans. As you heard, we posted net growth of $80 million in Q3. This growth, which is outlined on Slide 6 and 7 was relatively well balanced Between C&I and Commercial Real Estate, which are our major metro markets this quarter.

At a high level, gross new loan production continued at a healthy pace, but net growth was muted somewhat by the planned runoff of our Ag portfolio and several expected larger paydowns this quarter associated with opportunities to exit marginal credits. As Jim outlined, new C&I lending opportunities centered heavily around businesses, transitioning ownership or investing for growth through acquisition and expansion, while balances on revolving lines of credit were relatively flat from the prior quarter.

With interest rates moving down, we're also seeing the resurgence of some commercial real estate projects that were previously in a holding pattern, particularly within our higher-growth Western markets. Turning to the specialty lending verticals. Life insurance premium finance had a strong quarter, growing $34 million. In addition to scheduled premium fundings on the existing book, we also originated several large new loans from our established base of referral partners.

Despite elevated competitive pressures from the larger regional banks, typically competing on price in this space, our model of consistent execution and speed of delivery, which we've built over several decades, continues to deliver a steady pipeline of new opportunities and consistent growth. The Sponsored Finance portfolio declined by $47 million in the quarter. As I've mentioned in prior quarters this year, growth in this space has been dampened by a number of competitive and environmental factors, namely, radically Sponsors have accelerated the sale of portfolio of companies in 2024, following the previous year of 2023, in which we saw almost no churn in the existing book.

Additionally, elevated short-term rates, which are predominantly used in this space, squeezed the price differentiation between the subordinated and senior lenders, leading to higher usage of unitranche and other mezzanine sources in the capital stack. These factors also created more competition among senior lenders and in some cases, have led to credit structures and pricing that are beyond our risk tolerance.

Over time, this specialty has and will provide growth consistent with our global targets. However, given our nearly 20 years of experience in this space, we understand this can be a cyclical business and we're prepared to exercise appropriate discipline to protect the credit quality of our book, and again, maintain the consistency that is valued by our Sponsor partners.

The Tax Credit portfolio was down modestly due to scheduled paydowns on project loans as expected in a seasonally soft quarter, but is positioned to show some growth as it is traditional heading into Q4. Looking

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at growth by region on Slide 8. Midwestern markets were most heavily impacted by the aforementioned planned reduction on our ag portfolio and the other anticipated paydowns. Aside from these factors, production was solid with originations trending up from the prior quarters of this year.

Highlights for Q3 include the acquisition financing for construction materials client and refinancing of a seasoned CRE project coming out of the secondary marketing structure in Kansas City, as well as an ESAP conversion for a long time C&I specialty manufacturing client in St. Louis.

Growth in our Southwestern market continues at a solid pace, with loans up $31 million or 7.5% annualized in Q3 and posting growth of 14.8% on a year-over-year basis. Generally speaking, this region continues to benefit from the higher level of economic growth within the Phoenix, Dallas and Las Vegas Metro markets. Growth also includes a continuing sale of construction fundings on commercial real estate projects, which we've been originating over the past 12 to 18 months. In addition, we originated new loans for established Phoenix clients in the car Watch, multifamily and health care businesses this quarter.

Our Western region of Southern California posted solid growth of $96 million in Q3 and is up $185 million or 10.5% year-over-year. Growth in this market has steadily increased as we are now seeing traction both from larger legacy acquired clients as well as relationships originated by the new talent that Jim mentioned that has been added over the prior 2 years.

Growth in Commercial Real Estate this quarter is coming from fundings on commercial construction loans originated in prior quarters, as well as additional capacity for new real estate opportunities such as loans to seasoned operators with multifamily, senior living and industrial storage. Alternatively, newer talent is predominantly C&I focused, onboarding new relationships during Q3 in the private lending, aerospace manufacturing and commercial electric spaces.

Deposits are profiled on Slide 9, which shows growth of $183 million or 6% annualized for the quarter. Focusing on core growth, exclusive of brokered funds customer deposits are up $770 million or 6.9% year-over-year. Balances were stable in the lower cost, noninterest DDA and savings account types, while growth was most prominent in interest-bearing DDA and money market accounts. This growth has not come at the expense of an inflated rate or hot money strategy, but rather from continued efforts to add new clients and a value-added sales process to expand our existing account relationships.

You'll hear more from Keene in his comments on our progress and continuing efforts to control deposit costs. Another highlight this quarter is the performance of our geographic regions which contributed nearly 70% of the growth this period. This is broken now on Slide 10. The Midwestern markets increased deposit balances $94 million in Q3 and have now grown deposits 2% year-over-year. In addition to several significant new commercial deposit relationships, we are having focused and intentional discussions with our top clients to aggregate their excess funds with our bank and educate them on the overall rate environment to protect our existing balances as rates fall.

Balances also grew in our Western region of Southern California, increasing $42 million or 14% annualized. Generally, growth came from the onboarding of new commercial and private banking relationships as well as the stabilization of existing accounts that had run down early in the year, from clients deploying excess cash for working capital. The deposit verticals contributed $60 million of growth for the quarter, primarily due to increased balances within the Property Management segment.

These verticals are further broken out on Slide 11, which shows an overall portfolio that is well balanced between the 3 major lines of business. Growth in Q3, all the strong performance trend within the Property Management segment as we attract new accounts to our existing management company relationships. We continue to also benefit from traction relating to the Florida branch, which was opened in 2023, allowing us now to bring on new accounts, both from existing and new clients operating in that state.

Lastly, I'll comment on the funding mix, which is profiled on Slide 12. And highlights both the diversification and steady DDA component of our major client channels, representing 32% of the total. Growth for the year has been weighted in lower cost account types. And we see -- we continue to see a slowdown in the shifting of balances to higher-yielding products. I am encouraged by the proactive

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conversations we are having with clients around the shifting interest rate environment and early behavior has been positive with respect to retention and new opportunities to grow these deposits.

Now I'd like to turn the call over to Keene Turner for the financial highlights. Keene?

Keene S. Turner
Senior EVP & CFO

Thanks, Scott, and good morning, everyone. Turning to Slide 13. We reported earnings per share of $1.32 in the third quarter on net income of $51 million. Reported earnings included the impact of core conversion-related expenses of $1.4 million as well as a $3 million gain on the sale of OREO property.

Excluding these items, adjusted earnings per share was $1.29 per share, an $0.08 increase from the second quarter. Operating revenue contributed a meaningful increase to EPS in the quarter, driven from our continued success in deposit generation an expanded net interest income and an increase in noninterest income. Similar to last quarter, our strong client deposit growth allowed us to modestly decrease usage of wholesale borrowings and to invest excess liquidity in the securities portfolio.

The provision for credit losses decreased from the prior quarter as total loans have remained relatively stable and nonperforming loan balances have declined. Noninterest expense increased in the quarter due to higher compensation expense and an increase in variable deposit servicing costs.

During the third quarter, we had more working days. We were active in recruiting relationship managers and we expanded average balances within the national deposit variables.

Turning to Slide 14. Net interest income was $143.5 million in the third quarter, an increase of $3 million compared to the linked quarter. Interest income increased $4.7 million during the quarter as a result of growth in average earning assets and improvement in asset yields. Loan income grew $2.3 million from the linked period mainly due to higher average balances and an additional day of earnings. This was inclusive of approximately $0.5 million of an unfavorable change in amortization of purchase accounting marks.

The average interest rate on loans originated in the third quarter was 7.84% and continues to add to the overall loan yield of 6.95% for the quarter. Earnings on securities grew $1.4 million from the linked period on higher average balances and improved yields. We continue to invest additional funds during the third quarter while the portfolio yield also continued to benefit from higher rates on cash flow reinvestment. The average tax equivalent yield on purchases in the quarter was 4.97%. The increase in average cash balances generated an additional $1 million in interest during the period.

More details follow on Slide 15. Interest expense grew only $1.7 million in the quarter, primarily as a result of higher average deposit balances. Deposit expense increased $2.4 million, led by higher average balances and a slight uptick in rate on interest-bearing checking and money market accounts. The overall cost of interest-bearing deposits was up 3 basis points from the linked period, while the total cost of deposits has increased by 2 basis points.

Interest and other borrowed funds decreased nearly $1 million in the quarter as a result of lower balances in both customer repo and short-term FHLB debt. The resulting net interest margin for the quarter was 4.17%, a decrease of only 2 basis points from the linked quarter. Earning asset yields declined by 2 basis points, mainly due to the change in the earning asset mix from higher cash and investment balances.

A 2 basis point improvement in loan yield was offset by the negative change in purchase accounting. Our cost of liabilities increased by 2 basis points compared to the linked period as deposit growth was more concentrated in higher cost interest-bearing checking and money market accounts. As note, if we isolate purchase accounting impact, NIM was stable quarter-over-quarter. The Federal Reserve reduced the Fed funds rate by 50 basis points in September, beginning what is expected to be a series of interest rate cuts.

While we observed minimal impact in the third quarter results, we do expect to see modest net interest margin compression moving forward. It's also worth noting that we have some hedges and other structural factors in place that will further delay or mitigate the perceived sensitivity at a 61% variable

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rate loan portfolio. At a high level, we have hedged a part of the portfolio, we have embedded loan floors and a portion of the variable rate portfolio has longer-term reset dates. Adjusting for those items in our investment portfolio, we have approximately $5.4 billion of interest-earning assets compared to $8.8 billion of interest-bearing liabilities that have the ability to be repriced in under 1 year.

As we discussed on our last call, each quarter point reduction in the Fed funds were exposed or 5 to 10 basis points of net interest margin loss or $2 million to $3 million of quarterly net interest income on the existing balance sheet. However, with the initial 50 basis point move already made, we have worked hard to manage to a better impact in the upcoming quarter. As the market adjusts to lower interest rates, we expect funding costs to be more responsive to additional Fed booms.

The declining Fed funds rate will also lead to reductions in deposit-related noninterest expenses. Approximately half of the underlying balances are indexed to the Fed funds rate and each 25 basis points of Fed funds equates to approximately $1 million of quarterly expense, albeit with a brief 1-month lag.

So net, we expect pretax income to decline less than $1 million to $2 million for every 25 basis points of subsequent Fed fund changes on a quarterly basis. At that level, we estimate that our planned balance sheet growth will replace lost earnings from interest rate reductions.

With that in mind, as we look over the course of 2025 and plan for additional multiple Fed cuts within the next 4 quarters, we see net interest margin initially still above 4% and then drifting into the high 3% range thereafter. We also expect that in that time frame to improve the quarterly run rate of deposit costs by more than $5 million to $7 million before any additional growth in balances.

With that, we'll move on to Slide 16, which reflects our credit trends. Credit trends remain well managed and indicate the strength of our diversified loan portfolio. Net charge-offs were $3.9 million or 14 basis points of average loans for the quarter, a level that's below our longer-term average. Nonperforming assets improved to 22 basis points of total assets compared to 33 basis points at the end of June. The improved asset quality trends, along with net charge-offs and improvement in the economic outlook, resulted in a provision for credit losses of $4.1 million, a decline of $1 million from the prior quarter.

Slide 17 presents the allowance for credit losses. The allowance for credit losses represented 1.26% of loans or 1.38% when adjusting for government guaranteed SBA loans. We continue to use a weighted economic forecast that leans more towards a downside scenario, and we believe that's appropriate in this environment.

On Slide 18, third quarter fee income of $21 million was an increase of $6 million from the second quarter, driven primarily by tax credit income, which was higher from a decline in 10-year SOFR's impact on credits carried at fair value, at $3.2 million gain on the sale of other real estate and higher community development income.

Turning to Slide 19, noninterest expense of $98 million was an increase of $4 million from the second quarter driven primarily from compensation and benefits and deposit servicing expenses. Additionally, included in the current quarter was $1.4 million of core conversion-related expenses compared to $1.3 million in the second quarter. Deposit servicing expenses were $2.1 million higher compared to the linked quarter due to $152 million of growth in average balances on the deposit verticals, while the related earnings credit percentage was largely unchanged until the September Fed funds interest rate reduction.

Compensation and benefits was $0.8 million higher due to an increase in the number of working days in the quarter and further investment in the associate base. The third quarter's core efficiency ratio was relatively stable at 58.4% compared to 58.1% for the linked quarter. Our capital metrics are shown on Slide 20. We continue to manage our excess capital and repurchase 195,000 shares at an average price of $49.73 or approximately $10 million in total. We have approximately 1.5 million shares remaining under our existing plan, and we'll continue to monitor our level and manage some of our excess position.

And by that, I mean the amount that's greater than 9% TCE through share repurchases. In summary, this was another strong quarter for the company. Client deposit generation was robust as planned, and we have taken appropriate steps to partially mitigate the impact of declining rates on our earnings, while expenses and credit remain well managed. We have consistently posted strong profitability, and this quarter was no exception. We had an adjusted return on average tangible common equity of over 14%, at

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1.3% adjusted return on average assets, and our pre-provision earnings increased to over $65 million in the quarter or 1.7% of average assets. I think it's also worth noting that the level of pre-provision net revenue is consistent with the prior year quarter. Thanks for your attention today. And with that, we'll open the line for analyst questions.

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Question and Answer

Operator

[Operator Instructions] Our first question comes from the line of Jeff Rulis from D.A. Davidson.

Unknown Analyst

This is actually Ryan Pan on for Jeff today. Going over to the net charge-offs at 14 basis points of average loans. What was the makeup of those charge-offs?

Scott R. Goodman
President

Yes, Ryan. good morning. The charge-offs in the quarter were largely concentrated in one multifamily acquired loan in Southern California. You might recall the relationship in the fourth quarter of 2023, we had some unsecured exposure to a developer. This was the residual commercial real estate secured debt. Exposure of about $17 million that we charged down to $3 million and have a receiver in place and are working through the process right now to control and monetize the asset and dispose of them.

Unknown Analyst

Okay. Got it. On the expense side, so will we see additional expenses from conversion? And what would that 2025 outlook on run rate or year-to-year growth look like there?

Keene S. Turner
Senior EVP & CFO

Yes. So we're at $1.3 million of core-related expenses in the quarter, roughly $1.5 million, and there's another $1.5 million coming in the fourth quarter. But sequentially, given the expected reduction in deposit service charges, we expect noninterest expense to be leveled. And then I think depending on what you're thinking in terms of future cuts, every 25 basis points is going to be a $1 million improvement in the deposit service charge line item. So we actually think that, that will either keep expenses flat-ish next year depending on how many reductions you get or could actually lead to some lower expenses overall. And then I think absent -- we'll get compensation changes and some quarterly items in the first quarter that will be a little bit seasonal heavy. But otherwise, I think generally, we expect the rest of the expenses to not move around a whole lot and be pretty well controlled.

Unknown Analyst

Got it. And lastly, so how is that loan pipeline building quarter-to-quarter? And then what does that momentum look like going into 2025?

Scott R. Goodman
President

Yes, Ryan, this is Scott. I can answer that. As I said in my comments, I feel very good about the production levels of new commitments. Those are solid. I think they're in line with what we would traditionally expect and that would traditionally result in targeted net growth, net of the offsetting factors that I mentioned, right? So the ag portfolio certainly is an offsetting factor. I think we're still not seeing businesses use revolving lines of credit at historical rates, which we would expect to maybe change as rates come down. CRE development has been slow, and I mentioned the issues in sponsor finance. So I think as all of that cycles back around the norms, we're currently producing at levels that would result in our targeted net growth expectation.

James Brian Lally
President, CEO & Director

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I would just add, Ryan, too, that the composition of that is very evenly spread throughout the company. That's intentional that we're not leading in any one market or asset class like I mentioned, this is a plan that in terms of our recruiting and we're focusing that there is a bit of structure relative to that growth.

Operator

Our next question comes from the line of Andrew Liesch from Piper Sandler.

Andrew Brian Liesch
Piper Sandler & Co., Research Division

Sorry if I missed this earlier, did you say the balance of agricultural loans that are still left in the portfolio?

James Brian Lally
President, CEO & Director

We've reduced it by about $50 million this quarter down to about $140 million in total.

Andrew Brian Liesch
Piper Sandler & Co., Research Division

Okay. Very helpful. It sounds like you've been active hiring some C&I commercial business lending teams. I'm just curious what -- are there any regions that you're focusing more on? Are these concentrated in one area? Or is it across the franchise?

Scott R. Goodman
President

Andrew, it's Scott. Predominantly in our Western markets. We added, I believe, 14 client-facing associates this quarter. Some of those did fill open positions. But I would say majority were opportunistic investments. California predominantly, a couple in Arizona, a couple maybe in the specialties. But I think we just see talent is in play, particularly when banks are going through M&A or senior management turnover, or in some cases, stressed banks, predominantly out West that are still dealing with liquidity or concentration issues. And it's just putting talent in play. So positions like Commercial RMs, some private bankers, our treasury management salespeople that support our C&I strategy and some business banking, we've been able to add in all those areas, both from a team perspective as well as individual bankers.

So I think for bankers coming out of those organizations, our model really resonated out West. And I think the window is open now, but it will be closed eventually. So I think we're being opportunistic.

Andrew Brian Liesch
Piper Sandler & Co., Research Division

Got it. That's very helpful. Good to hear Jim, you mentioned your commentary early in the call on some clients looking to expand their businesses as they look into '25. Was that also a comment on credit quality if businesses and your clients are looking to expand, does that mean you feel pretty good about the credit outlook as well?

James Brian Lally
President, CEO & Director

I'm very bullish on our credit outlook as it relates to this client base we're talking about. These are well-established businesses who are looking at generational opportunities from one generation to the next, whether they use ESOP, whether they sell from one generation to the next, whether they use private equity. These conversations are becoming more prevalent day in and day out. In addition to that, Andrew, I think we're seeing opportunities also to attract new clients relative to our posture in that regard. We're not changing how we underwrite. I think it's just being out there ahead of the decision to do this as we talk about stay around the room, call the best companies you know, add value along the way because we know that these opportunities eventually come about, and we want to make sure we're there with the best

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clients so that credit isn't an issue, and we're dealing with the best credit we can possibly get in all of our markets.

Operator

[Operator Instructions] Our next question comes from Damon DelMonte from KBW.

Damon Paul DelMonte
Keefe, Bruyette, & Woods, Inc., Research Division

Just wanted to circle back on the margin commentary, Keene. Could you just kind of go back over what you were saying? So your expectation here for the fourth quarter, do you think you could maintain a 4 handle on the margin? And then with the expectation that we're going to have a couple of cuts this quarter and maybe 25 basis points each quarter going through '25, it will have a drift downward into the -- did you say the high 3.90s for the high 3s?

Keene S. Turner
Senior EVP & CFO

Yes, that's accurate. I would say that in the other factor to consider, Damon, in the fourth quarter is that we're going to probably get some year-end seasonal deposit growth. And so there will also be some margin declination due to remixing. So all else equal, margin down 5 to 10 basis points, and then there might be some remixing in there. And then yes, I think we expect to defend call it, into the 3.90s with future cuts. And what we're looking at here is 5 cuts additionally from today. So I think that generally lines up with what you articulated in your question there.

Damon Paul DelMonte
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. Great. Appreciate that. And then with regards to the fee income, do you still have kind of a full year outlook for the tax credit income to be kind of close to the $9 million to $10 million range?

Keene S. Turner
Senior EVP & CFO

Yes. I would say, Damon, at the very end of the quarter at 9/30, I would have said, yes, 1-year SOFR has moved 30 basis points against us. And so that's going to eat into some of the fourth quarter income we're going to see. I'd say we're in the $3 million range this quarter, and we're probably looking at a similar range for next quarter. So that's -- it's going to be a little bit short, unfortunately, in that line item. But I think when rates settle down, I think that 10% is probably still a good number overall moving forward based on activity, but it looks like we're going to be short this year.

Damon Paul DelMonte
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. Great. And then I guess, lastly, with regards to kind of how we think about provisioning in the reserve level, you had obviously a pretty sizable cleanup there in NPAs and they're down to only 30 basis points of loans in OREO. Do you still feel you're going to kind of maintain the mid-120 reserve level? And do we kind of think about provision as just being more of a function of loan growth?

Keene S. Turner
Senior EVP & CFO

Yes. I would say, I think we feel good about credit quality and where it is. And I think we also want to be prudent with the level of reserves that we have. So I don't see us letting reserves move down and benefiting from that through the P&L. And I don't see us backing away from wanting to have a little bit of what I'll say is some conservatism built into the portfolio. Earnings are good, and we've got the ability to continue to provide and still drive strong earnings.

So some of it is going to depend on just what categories we have to growth in, there's some areas like SBA and Life Insurance where that drives a little bit lighter reserve when there's growth there. But

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otherwise, if you get a current blend of where we are today, I would imagine that on -- with any -- without any deterioration, you're going to put $115 million to $120 million on new loans. So that's how I would think about it.

Operator

Our next question comes from Brian Martin from Janney.

Brian Joseph Martin
Janney Montgomery Scott LLC, Research Division

Keene, maybe just on that deposit related expense line item, I guess, just to be clear, the 50 basis point reduction we saw in rates last quarter, is that -- so the current run rate on the deposit expenses, is that inclusive of that reduction related to that? Or it's not fully in the number right now as you're kind of thinking about that line item?

Keene S. Turner
Senior EVP & CFO

Yes. The third quarter number, Brian, wouldn't really reflect any reduction in that number. We wouldn't have moved rates on those customers until October. So you'll have that reduction coming. I'll say though that if you look at what happened though, there is going to be some overall average balance growth here in the fourth quarter.

So what would be a $2 million on a same-store basis, it's probably more like 1.5 million sequentially just because of the average balance growth. But that, for lack of a better term, ECR rate will be coming down particularly as we've got about half of those accounts in and of themselves index with Fed funds and we know those are going to move down.

Brian Joseph Martin
Janney Montgomery Scott LLC, Research Division

Yes. Got you. And outside of that reduction, Keene, just as far as thinking about the net growth in -- if we factor in the reduction in our rate outlook on the deposit expenses, how much should the deposit expenses just organically grow in a year to kind of either offset or mitigate however you want to look at it kind of what we're going to factor in on the rate reduction side.

Keene S. Turner
Senior EVP & CFO

Yes, Brian, it's probably $2 million to $3 million of when we go a year out with some of the growth rate. If we have another year similar to what we've had this year, you'll get the reduction, but you'll have effectively a couple of million dollars into that because you'll have new deposits that are earning albeit a lower allowance, but still an allowance on those balances. It's a couple of hundred million dollars, $200 million to $300 million of annual production there is what we expect.

Brian Joseph Martin
Janney Montgomery Scott LLC, Research Division

Okay. And if you said earlier, can you just -- if it all makes sense. I mean $6 million to $7 million reduction from those because of the rate cuts and then offset by maybe $2 million or $3 million of growth. So the net is -- the difference on those 2 is just big picture, how to think about were those deposit-related expenses shake out?

Keene S. Turner
Senior EVP & CFO

Yes. I mean I think all of these, Brian, if you don't -- if there was no balance sheet growth, you'd be down something like $8 million loss year-over-year. And I think that $6 million to -- $5 million to $7 million or midpoint of $6 million is sort of where we've got some growth in it, but you've got essentially 5 more cuts

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is kind of the baseline forecast we're using just to characterize around that number and how we're looking at it.

Brian Joseph Martin
Janney Montgomery Scott LLC, Research Division

Got you. Okay. That's perfect. I appreciate all the color, Keene, that's helpful. And then in terms of just -- and maybe you said this Keene, and I didn't catch it, but as far as kind of just the dollars of NII and kind of the stability you've seen, is your expectation right now? It sounds like maybe you said this, was at 25% is above 24% in terms of NII full year?

Keene S. Turner
Senior EVP & CFO

I think that's going to really -- with -- let's say this, if you've got 5 cuts and you have low single-digit loan growth, you're probably with day count and some of the other factors, you're probably going to have a little bit of declination, call it, from the current level of net interest income on a quarterly basis. And it's going to maybe get back to a level by the third quarter of next year.

You've got a little bit more robust growth. There's a chance that you'll grow that quarterly run rate starting in second and third quarter of next year. We don't fully outrun it. But when you look at pretax income, depending on what level of growth is there, you might be neutral to pretax income with the 2 rate sensitive line items being net interest income and then the deposit noninterest expense.

Brian Joseph Martin
Janney Montgomery Scott LLC, Research Division

Got you. Okay. That's helpful. And maybe just one for Jim, I guess, for Scott. It sounds like the new hires, I guess, that you're bringing on, it sounded as though, Jim, your comments that the customers you have are, I guess, more looking optimistic about growth next year, and then given that all the talent you guys articulated brought on board, I mean, is your expectation that can contribute to maybe a little bit greater growth rate than you're thinking, Jim, in terms of what you're seeing from your existing base, which already sounded like it was picking back up.

James Brian Lally
President, CEO & Director

So I say it's better than our expectation is better than the runway we see today. Scott has talked about production, is right on plan. It's also what the mitigants to that production. But I do think given the talent that we're bringing on, we should expect that mid-single-digit return for 2025.

Operator

All right. That does conclude all the questions that we have in our queue. So I'll turn the call back over to Jim Lally and the team.

James Brian Lally
President, CEO & Director

Thanks, Jeremy, and thank all of you for joining us this morning. Thank you for your interest in our company. We look forward to talking to you very soon, if not before the end of the year, we'll talk to you in the first quarter of 2025. Thanks again, and have a great day.

Operator
That does conclude today's call. Have a pleasant day, everybody.

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