

S&P Global
Market Intelligence

**Alerus Financial
Corporation** NasdaqCM:ALRS

Earnings Call

Thursday, July 27, 2023 5:00 PM GMT

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Presentation

Operator

Hello, and welcome to the Alerus Financial Corporation Earnings Conference Call. All participants will be in listen-only mode. [Operator Instructions]. Please note, this event is being recorded. This call may include forward-looking statements, and the company's actual results may differ materially from those indicated in any forward-looking statements. Important factors that could cause actual results to differ materially from those indicated in the forward-looking statements are listed in the earnings release and the company's SEC filings.

I would now like to turn the conference over to Alerus Financial Corporation, President and CEO, Katie Lorenson. Please go ahead.

Katie A. Lorenson

President, CEO & Director

Good morning, and thank you, Bailey. Thank you to our research analysts for joining our call this morning as well as our investors, employees, directors for taking the time to listen in. We appreciate your interest and investment in Alerus. This morning, I will provide some commentary on Alerus' foundational strength in addition to the execution of our strategic evolution to a top-performing commercial wealth bank and a national retirement provider.

Today, I am joined by Alerus' CFO, Al Villalon, who will discuss our financial performance and results for the quarter. In addition, Karin Taylor, our Chief Risk and Operating Officer; and Jim Collins, our Chief Banking and Revenue Officer, will join us to answer any questions you may have about the quarter.

Alerus is well positioned to emerge from the current headwinds as a clear winner in value creation and returns for our shareholders. We are building off the unique strength of the company's diversified business model while optimizing our infrastructure to return the company to delivering strong profitability while continuing to grow a tangible book value. Most notably in our path to transformation is our continued and significant success in adding well-respected and widely sought asset bankers and professionals to our franchise. This momentum in attracting and retaining talent continued to build in the second quarter as we added more experienced mid-market and specialty commercial bankers. These team members joined the dozens of professionals we've hired this year and our tenured team of SBA, CRE and business banking professionals.

In the last 6 months, we've doubled the size of our treasury management team, and the team has hit the ground running as we have had early success in deposit wins, critical retention of relationships, and they continue to work closely with our mid-market and Specialty Commercial Banking Group. Last week, we listed out a seasoned team of bankers in Minneapolis, who will formally launch our private banking franchise. These team members will leverage our One Alerus business model and provide an integrated experience for the client with wealth, mortgage advice and products.

Along with the continued momentum in talent acquisition, we are balancing our investments by optimizing our infrastructure with urgency, we remain disciplined in our investments and are focused on talent on expense management. This was evidenced by our 4% linked-quarter decline in noninterest expense. Today, we have reduced our total headcount in the company by 10% year-over-year, which includes the whole bank acquisition of Metro Phoenix Bank.

Our fundamental strengths include our fortress balance sheet anchored by strong capital, credit and reserve levels and a strategic and fundamental focus on diversification. This diversification is across the enterprise and multifaceted. Alerus' diversification is highlighted by our best-in-class business model to over 50% of revenues coming from fee income. Over 90% of those revenues are annuitized and recurring in nature and require minimal capital allocation, along with virtually no balance sheet risk. The majority of these revenues are derived from our National Retirement and Benefits business, which was again ranked in the top 30 in the country. These durable revenue streams will continue to support capital build and

shareholder returns despite the challenging operating environment faced throughout the banking industry. Diversification goes well beyond our business model as portfolio diversification remains a critical strategy. Alerus' loan portfolio is diversified by loan type, geography, industry, asset class, loan price and clients.

Throughout the second quarter, we continue to conduct ongoing stress testing and review of our credit portfolio. Given the current environment, it is worth noting our investor theory as a percentage of capital is at 173% compared to the regulatory threshold of 300%. Alerus' office -- exposure to office is limited to 3.9% of loans, none of which are secured by properties located in the Central Business District. Asset quality remains pristine with minimal nonperforming loans and a year-to-date net recovery. Reserves remain robust with 1.41% of total loans and \$6.2 million of the remaining mark on the acquired Metro Phoenix portfolio.

On the funding side of the balance sheet, our deposit portfolio remains well diversified among markets, products and clients. Our uninsured deposits are 23.6% and 1/4 of our deposits are sourced synergistically through our retirement and Wealth Management areas. We continue to see good retention of deposit dollars driven by our relationship approach. In our commercial client base, 68% of our deposits are integrated with treasury management offerings. We had several key wins and retentions during the quarter within the Consumer Wealth Bank because of our holistic service model and constant collaboration between our Wealth Management and banking teams.

During the second quarter, we experienced seasonal outflows from our public funds accounts. This activity was as expected, and we anticipate inflows in the second half of the year to follow their typical seasonal pattern. We are pleased to report several large new client wins and overall net new accounts to Alerus' for \$83 million higher than those of closed accounts. We consistently monitor our deposit portfolio and do not see any unusual or unexpected activity. However, generally speaking, clients are continuing to draw down in [indiscernible] balances versus utilizing their lines of credit.

In our fee income business, we saw a rebound in originations in mortgage and market value in retirement and wealth. Strategically, we have engaged in experienced consultants as we look to prioritize and maximize the opportunities within our Retirement business. This engagement is targeted at efficiency and operational enhancements, which will position us to take our large nationally scaled business to the next level through organic growth and acquisitions. We believe we have significant embedded value in this annuitized cash flow business with the passage. And with the passage of SECURE Act 2.0, we believe there's tremendous opportunity to continue to expand our client base and further improve margins and gain market share across the company for the country.

From a capital standpoint, we continue to build on our strong capital levels, with TCE 7.72% and CET is 13.3%. During the quarter, we were active in share repurchases. And we also continued our long history of paying a dividend and in the second quarter increased that dividend by 5.6%. While there continues to be near-term pressure on margins, we are prudently managing expenses with urgency across the enterprise. We're having significant success executing on our strategic plan focused on key talent adds and restructuring. And each move we do is purposeful in positioning Alerus' to bring expertise and value-added knowledge to our clients in a fast, frictionless and highly responsive matter.

This differentiated approach in a diversified business model, including the higher levels of client acquisition and client expansion. We are continuing to build tailwinds and synergistic expansion in our Wealth Management and retirement platform and continue to believe the long-term embedded value in these businesses is substantial, as a differentiator in the community bank space. We are focused on client and talent acquisition and delivering top-tier shareholder returns.

With that, I will turn it over to AI to talk about our financial performance.

Alan A. Villalon
Executive VP & CFO

Thanks, Katie. I'll start my commentary on Page 14 of our investor deck that is posted in the Investor Relations part of our website. Let's start on our key revenue drivers. On a reported basis, net interest income declined 6% on a linked quarter basis. The decline was driven primarily by continued increase

in funding costs. Net interest income represents now 46.3% of revenues. Switching to fee income, noninterest income increased 2.1% on a linked-quarter basis as we saw improvement across our fee income businesses. The income continues to provide revenue stability despite interest rate challenges. I'll go into details of each of our fee income segment in later slides.

Turning to Page 15. Net interest income was \$22.2 million in the second quarter. Net interest margin was 2.52%, a decrease of 18 basis points from the prior quarter. A 27 basis point increase in our asset yields was offset with a 46 basis point increase in our rates for our liabilities. Impacting the net interest margin was about 7 basis points of accretion from the Metro Phoenix deal.

Based on potentially more Fed hikes, which was not in the Fed dot plot at the beginning of the year, we continue to expect our net interest margin to compress in the third quarter. The magnitude of compression will be determined by whether the Fed hikes by another 25 basis points from here. When the Fed pauses eventually, we expect earning assets yields to continue to improve with mix shift and loan repricing as our cost of funds stabilize.

Let's turn to Page 16 to talk about our loan portfolio. Total loans grew 1.9% from prior quarter, driven by growth in commercial real estate and residential real estate, offset by a decline in construction and consumer loans. For 2023, we continue to expect modest loan growth.

Turning to Page 17. On a period-ending basis, our deposits declined 5.9% from the prior quarter. As we guided to in the last earnings call, we experienced a seasonal outflow by public funds, which was the main cause of a decline in deposits. Despite the seasonal outflow, client retention remains very high, and we continue to attract new clients. For the remainder of the year, we continue to expect deposit balances to rebound from the second quarter as we expect the seasonal inflow from public funds in the back half of the year and continued client wins.

Turning to Page 18, you can see a further breakdown in our deposit characteristics. Our synergistic deposits, so those fund sourced from our wealth and retirement businesses grew 27% over the prior year and 7.5% over the prior quarter. The strong year-over-year growth in synergistic deposits was driven mainly by strong organic client growth within our wealth segment. Synergistic deposits sourced from our retirement and wealth businesses now account for 26% of our deposit base. Continued growth in our synergistic deposits shows the strength of our unique and differentiated business model.

On this Slide too, you'll see our uninsured deposit exposure. Our liquidity coverage to uninsured and not collateralized deposits now exceeds 300%.

Turning to Page 19, you'll see details about our investment portfolio. Currently, almost 69% of our securities are available-for-sale versus 31% in held-to-maturity. Within the held-to-maturity portfolio, approximately [42%] are in municipal securities, while the rest are in MBS. We continue to look investment portfolio run down and remix the balance sheet towards commercial lending relationships that will add higher-yielding loans and treasury management relationships.

On Page 20, I'll start talking about our fee income businesses. On this page, I'll provide some highlights on our retirement business, which accounts for approximately 32% of our total revenues. In the quarter, assets under management and administration increased 4.9% due to higher domestic equity markets in the second quarter and continued client wins. Participants within retirement have grown 2.5% year-to-date. Revenues increased 2.6% on a linked quarter basis, mainly due to higher average assets and organic growth. Our retirement business continues to be a strong source of funding quarter with the bank. Retirement now accounts for over 71% of our synergistic deposits. For the third quarter, excluding any market impact, we expect fee income for return business to be up slightly.

Turning to Page 21. You can see highlights of our Wealth Management business. On a linked quarter basis, revenues increased 4.9%, while our end-of-quarter assets under management and administration increased 5%. We continue to see strong client acquisition in our geographic markets and from retirement rollovers in our national and established markets as we execute on our One Alerus strategy. Like retirement, we also provide a strong source of funding for the bank as it now accounts for over [20%] of

our synergistic deposits. For the third quarter, excluding any market impact, we also expect the income here for our wealth business to be up slightly.

Turning to Page 26. I'll talk about our mortgage business. Mortgage revenues increased over \$1.2 million or 69% from the prior quarter as originations rebounded from a seasonally low quarter. Mortgage originations increased over 43% from the prior quarter, which was slightly better than the MBA purchase index, which saw a 39% increase. For the third quarter, we expect mortgage originations to remain stable versus the MBA purchase index forecast of 1% growth as inventories of homes for sale remain low in Twin Cities. However, we continue to expect a seasonal decline in originations in the fourth quarter.

Page 23 provides an overview of our noninterest expense. During the quarter, noninterest expense decreased 4% as we remain committed to improving our profitability. Compensation expense decreased due to a reduction in headcount, while professional fees increased due to higher FDIC assessments. Despite inflationary pressures, we do expect expenses to be now down low to mid-single digits for 2023 on a year-over-year basis. We continue to be focused on improving our profitability by reducing expenses and increasing our capacity throughout our organization. We recently made continued progress on rightsizing our expense infrastructure through numerous initiatives. Some of these expenses will be reinvested into efficiency improvement and revenue production initiatives.

Turning to Page 24. Credit continued to remain very strong. We had net recoveries of 7 basis points in the second quarter. Our nonperforming assets percentage was 7 basis points compared to 5 basis points in the prior quarter. Our allowance for credit losses on loans to total loans remained stable at 1.41%. The [indiscernible] reserve currently provides over [1,300%] coverage to nonperforming loans, as you can see on the bottom left.

I'll discuss our capital and liquidity on Page 25. Our capital remains well above regulatory minimums even after share repurchase done during the quarter. On the bottom right, you'll see the breakdown in the sources of the \$2 billion of potential liquidity. Overall, we continue to remain well positioned from both a liquidity and capital standpoint to weather any economic uncertainty.

To summarize on Page 26, we remain committed to making fundamental improvements and improving the returns for our stakeholders. Despite the challenging headwinds from our rapid rise in interest rates, our fee income businesses continue to provide stability to our revenues and continue to be a strong source of funding. Our capital remains strong, and we remain committed to returning capital prudently. With that, I'll now open it up for Q&A.

Question and Answer

Operator

[Operator Instructions]. Our first question today comes from the line of Ben Gerlinger from Hovde.

Benjamin Tyson Gerlinger

Hovde Group, LLC, Research Division

Alan, in your prepared remarks, you said that noninterest expense to be done about single digits or so percentage. So my back of envelope math says 2Q is probably lower or goes up a little bit from here. I was curious is that more kind of complication, but you also did talk about investment. I'm just curious if you -- more granular, is it technology? How should we think about where that money is going?

Alan A. Villalon

Executive VP & CFO

Yes. So in the back half of the year, there's going to be some timing there because just in terms of -- number one, we have some intensive comp, especially in our mortgage business. So that will be 3Q will be a little bit higher on that side versus 4Q. And there also is going to be some accrual from the compensation when it comes as we go through the year. So [indiscernible] timing differences there.

Benjamin Tyson Gerlinger

Hovde Group, LLC, Research Division

Got you. Okay. And then when you think about just the margin here, deposit flows and noninterest-bearing deposits were going to play a big factor. But if you just kind of assume the terminal rate is where we're at. I think that's a fairly safe assumption. Maybe we'll get another quarter here. But I don't think you're going to see a material move. When you just think about the cadence of the repricing on both the left and the right end of the balance sheet, I know it's early, and I don't think you were going to [indiscernible] but do you think that it's probably like a 6 months until you hit the floor and then the repricing influx, your favor of margin expansion. I'm just trying to think about the magnitude of which each side is moving.

Alan A. Villalon

Executive VP & CFO

Yes. So the way we're thinking about it here is that we do have about 15% of our deposits that are indexed. And given the recent rate move yesterday, if there's one more in the quarter, both -- any rating in this quarter will be repriced in October that basically hits our money market funds. So that timing will happen in 4Q. But with that being said, though, we continue to see a very attractive spreads in our loans. So as stock matures on our back book or more maturing book and then we reprice it to higher rates, we're expecting hopefully that we'll see that margin uplift in the later half -- later months of this year.

Benjamin Tyson Gerlinger

Hovde Group, LLC, Research Division

Got you. And then finally, just kind of big picture, Katie, or Jim, whoever want to say, when you think of just the banking environment today, it seems like the Minneapolis market has been more competitive than one would guess relative to some of the other Midwest areas. I think partially is due to the amount of banks, so the number of banks in the area, especially small and private ones. When you think about just the lending in areas for growth, are there any risk-adjusted returns that have become more appealing because some banks have pulled out or the -- like are there any pockets of the loan categories that are areas are a little bit more appealing now that some competitors have stepped away or getting priced out?

Jim Collins

Executive VP and Chief Banking and Revenue Officer

Yes, thanks for the question. I would say it this way, we're focused on some very specific verticals, not

only because some banks are retracting on offering credit, but also because they're more generally, we can get a better spread and they come with a lot more deposits. So some of the verticals we're going after, i.e., government nonprofit or professional services would be an area where we can get a lot of deposits and loans versus just going after regular mid-market C&I, which is predominantly heavy loans, a smaller amount of deposits. So from a competition standpoint, all banks are kind of looking at that, but because a number of banks have their balance sheet, we're in a position and are just not lending as much. We're finding a lot more activity and a lot more success in those specific areas. Does that help with your question?

Operator

Your next question today comes from the line of Jeff Rulis from D.A. Davidson. Your line is now open.

Jeffrey Allen Rulis

D.A. Davidson & Co., Research Division

Checking in on the loan growth conversation. Al, I think you mentioned kind of for the full year, maybe, I don't know, low to mid-single digit. I didn't know if I caught that, but I guess, being that we're were up 3% or 4% year-to-date, does that suggest kind of back half of the year pretty muted or flattish?

Alan A. Villalon

Executive VP & CFO

Yes. So the low to mid-single digits was on the expense side. But on the loan growth side, I basically comment on modest. The thing we're seeing right now is that there's as interest rates have risen here, we're just seeing a bit of slowing demand for loans at these interest rate levels. So hence, there's been a little bit of slowing demand from our clients and just appetite for it. So that's why we're still trying to really see the pipeline out there and what we think it can be done. So hence why the modest comment.

Jeffrey Allen Rulis

D.A. Davidson & Co., Research Division

Okay. And I guess out of payoffs trended as well? I mean is that -- is that a net sort of a benefit to the net if that churn is slower? Or are you seeing pretty consistent payoff activity as well?

Alan A. Villalon

Executive VP & CFO

Yes. We're seeing just consistent payoff activity. I mean there's nothing really jumping out at us right now.

Jeffrey Allen Rulis

D.A. Davidson & Co., Research Division

Okay. Got it. Circling back to capital, you had the buyback during this quarter, you've hiked the dividends, you're well above regulatory minimums on capital. Just again, checking in on, it sounds like the appetite for the buyback is ongoing and Katie, if there's any conversation about M&A, whether that be bank or within a product line, anything to touch on there?

Katie A. Lorenson

President, CEO & Director

Okay. So in regards to capitalize the priorities remain the same, but very much focused on maintaining strong capital levels, maintaining a strong balance sheet and then organic growth, which includes the -- and the continuous [indiscernible] of talent, as well as returning capital to shareholders via the dividend and repurchase where the numbers make sense, where it's penciled out. And on the M&A front, same sentiment as first quarter, I would say, in regards to continuing to have conversations and continuing to expand the awareness across the country in terms of our history of acquisitions and our reputation for strong execution in acquisitions, particularly in the fee income space.

Jeffrey Allen Rulis

D.A. Davidson & Co., Research Division

Got it. And one last one, if I could. A little creep-up in the nonperformers. I guess, maybe not much to tell there, but any segments or footprint that you're a little more cautious on that you could detail.

Karin M. Taylor

Executive VP & Chief Risk Officer

Sure, Jeff. This is Karin. We're not seeing a pattern in terms of any deterioration. I think we're beginning maybe to see just a little bit of normalization. The credits that are experiencing stress seem to be pretty specific and not indicative of any particular pattern. But I do think we're still at historically strong credit metrics, but would expect over time that we'll begin to see some of that.

Operator

The next question today comes from the line of Nathan Race from Piper Sandler.

Nathan James Race

Piper Sandler & Co., Research Division

Katie, going back to your comments earlier on the engagement of consultants to look at the retirement platform. Just curious, as you look out longer term, the opportunity or impetus behind this engagement more on kind of the revenue growth side of things? Or are there may be some expense synergies that you're looking to perhaps harvest down the road? I would love to just get any color on the expectations with that engagement going forward.

Katie A. Lorenson

President, CEO & Director

Sure. Absolutely. It's both on the revenue side as well as on the efficiency and just optimizing our infrastructure within that division. So really, as we look at the opportunity that existed prior to the passage of SECURE Act 2.0, it was already significant in the retirement space in terms of the number of new plans and the number of new participants. The passage of SECURE Act 2.0 just takes that to the next level. And so our engagement is very much targeted at positioning us to continue to take market share and continue to be highly successful in growing new plans and participants given the amount of opportunity that's out there. So it's really twofold and will allow us to take on more new plans faster as well as grow with those plans and that opportunity.

Nathan James Race

Piper Sandler & Co., Research Division

Okay. Great. And then it sounds like you're having good sales momentum on the retirement platform lately. Is there any way to kind of parse out how much of the AUA growth in 2Q was driven by new client wins versus just the appreciation in equity markets?

Alan A. Villalon

Executive VP & CFO

Thanks for that question. If you look at our revenues, typically on the retirement side, about 1/3 of it, the way I think about it is market sensitive, so then you can attribute the rest of it to be organic.

Nathan James Race

Piper Sandler & Co., Research Division

Okay. Great. And AI, is that the same case on the wealth side of things as well?

Alan A. Villalon

Executive VP & CFO

The wealth is going to be a little bit higher there. But I would say, though, wealth has been really doing great for us because we have seen a lot of organic client wins there. As I did note in my commentary, we did see some synergistic deposit growth that really came from our wealth side. So that was a big growth in synergies in deposits because I'd say the majority of that growth came from wealth.

Nathan James Race*Piper Sandler & Co., Research Division*

Got it. That's great to hear. And then just on funding. It looks like the short-term borrowings came up in the quarter. Any thoughts on how we should think about the wholesale funding levels going forward? And just kind of how you guys kind of -- loan growth, what is your expectations are for more modest growth in 3Q, 4Q?

Alan A. Villalon*Executive VP & CFO*

Yes. We're continuing to utilize overnight borrowings to fund loan growth right now. It's just deposits right now. We have the seasonal outflow come out. So we look to have more deposits come in the door, and we're focused on that. We're also letting the investment portfolio mature and roll that over and remix that into loans. But if we have to continue to use overnight borrowings to fund loan growth we'll probably do so, we still have a lot of capacity there.

Nathan James Race*Piper Sandler & Co., Research Division*

Okay. And can you remind us how much cash flow you have come out of the securities book each quarter?

Alan A. Villalon*Executive VP & CFO*

So the way I think about it is that we have about, our investment portfolio has about a duration of about 5 to 6 years. So you'd say maybe like 20% of the portfolio is going off on yearly basis. The quarterly is going to be a little bit lumpy here and there, but I would just look at it like a yearly basis. And then you can just take an average of that for the quarter so.

Nathan James Race*Piper Sandler & Co., Research Division*

Okay. Great. And then just going back to some of the earlier comments around kind of deposit growth expectations. I appreciate a lot of the decline in the second quarter was tied to public fund clients. But just kind of overall, any kind of deposit growth expectations? And when we may see noninterest levels will flatten out?

Alan A. Villalon*Executive VP & CFO*

That's difficult to predict right now given where -- I mean, the risk-free rate in the short term is multiplied. And there's just -- everybody is parking money into this high rate accounts right now. So I think there's going to be still more pressure to come on noninterest bearing because that is being experienced not just by us, but across the whole industry. So I think we're not going to see that pressure subside in the near term until rates get -- start coming down significantly. But on the deposit side, though, we're still expecting public funds to come back in, the back half of this year. And hopefully, we -- we'll still see some growth from here. But I think from the second quarter levels, we'll probably see some growth from at least where we are from second quarter levels.

Nathan James Race*Piper Sandler & Co., Research Division*

Okay. Got it. And then are you guys seeing any easing in kind of deposit pricing pressures across the company footprint these days. We've heard from some other banks that it's monitoring to some degree more recently. Is that the case with you guys?

Alan A. Villalon*Executive VP & CFO*

Yes. We're seeing some moderation there, but the one thing we've noticed too in our footprint, we've definitely seen an uptick in more banks where the loan-to-deposit ratio has exceeded over 100%. And that's putting more pressure on loan growth for them. So they're trying to meet that by pricing up deposits more. But I would say, though, that there's definitely more deposit beta in the first quarter than there was in the second quarter. So we're seeing that definitely moderate.

Nathan James Race

Piper Sandler & Co., Research Division

Got you. And just maybe one last one for Karin. Is there a tail to the recoveries that we have seen periodically over the last several quarters now? Or do you think that's kind of largely run its course?

Karin M. Taylor

Executive VP & Chief Risk Officer

I think the larger recoveries need, have kind of run its course. We continue to get some monthly payments on some things, but I would expect that level to decrease in coming quarters.

Operator

The Next question today comes from the line of Eric Spector from Raymond James.

Eric Paul Spector

Raymond James & Associates, Inc., Research Division

This is Eric on the line for David Feaster. Most of my questions have already been asked and answered. But just curious with the loan growth in the quarter and obviously now those public funds, the loan-to-deposit ratio ticked up quite a bit to almost like 89%. Just curious where you're comfortable with that going forward.

Alan A. Villalon

Executive VP & CFO

Yes. I mean, we definitely want to target a ratio probably a little bit south of 100%. And ideally, it'd be 90% to 95%. But we also understand that there's a lot of liquidities coming out of the system that might gravitate a little bit higher, the net range.

Eric Paul Spector

Raymond James & Associates, Inc., Research Division

Okay. Makes sense. And then just if you -- probably some more color just on the mortgage market, you did a little bit in the prepared remarks, but just kind of how volumes are trending early in the third quarter and how you think about portfolio versus gain on sale and how margins are trying to...

Alan A. Villalon

Executive VP & CFO

Yes. So margins are pretty stable there. I'd say they'll be similar in the third quarter as they do in the second. And I'd say volumes too, our outlook is probably similar in the third quarter. But then again, when that snow comes in Minnesota, we're going to see a downtick in the fourth quarter. And the snow sometimes comes early, unfortunately, in Minnesota.

Eric Paul Spector

Raymond James & Associates, Inc., Research Division

Makes sense. And then just how are new loan yields trending in CRE and other segments? Have you been able to push rate and what was the competition for new loans then?

Jim Collins

Executive VP and Chief Banking and Revenue Officer

I would say that in general, they're pushing up a little bit. There's more and more banks are pulling out

or slowing down, which is allowing the banks that are currently in the market to have a little bit better pricing. So I think that has probably happened in the last month and a half and probably will continue a little bit as more and more banks are still just tightening the screws down on production.

Operator

Thank you. The next question today comes from the line of Damon DelMonte from KBW.

Damon Paul DelMonte

Keefe, Bruyette, & Woods, Inc., Research Division

I just want to start off with a question for you, actually, on the margin. I think you noted that there was about 7 basis points of accretable yield this quarter from the recent transaction. So should we just kind of model a similar level going forward? I think I thought first quarter was a little bit lower than that.

Alan A. Villalon

Executive VP & CFO

Yes. So the way I would think about it is that we previously guided to about margin accretion around 2 to 4 basis points from the Metro Phoenix Bank acquisition. So the difference this quarter, we had about now 3 or 4 basis points coming in from a loan payoff in the quarter, which is typically something that you see in these deals.

Damon Paul DelMonte

Keefe, Bruyette, & Woods, Inc., Research Division

Got it. Okay. So more like 2 to 4 basis points a quarter. Okay, that makes sense. And then kind of with regards to the direction of the margin here, it seems like it's still going to trend lower. And did you say in your answer to one of your other questions that you think by the end, like the last couple of months of this year, you could see the monthly margin like stabilizing?

Alan A. Villalon

Executive VP & CFO

Yes, that's what I commented on. Actually, I think it's going to rebound. So previously, we thought this quarter was going to be the quarter where we saw the rebound. But given the Fed's, 1 to 2 more Fed hikes that came down the pipe, I'm calling quite a little bit of a rain delay right now on that rebound. So we'll see that kind of happening in more of the fourth quarter.

Damon Paul DelMonte

Keefe, Bruyette, & Woods, Inc., Research Division

Okay. And then can you just remind us kind of how you're going to be positioned if the Fed were to cut rates in 2024, given your position, will you see immediate benefit to the margin?

Alan A. Villalon

Executive VP & CFO

Yes. So in our ALM modeling, you'll see that typically, when rates go down 100 basis points, I'd say somewhere in the high single digits, we see improvement in NII. But that's on an annualized basis. So the big thing there is still maintaining loan disciplined pricing on the asset side, but then also addressing our deposit side and being able to cut rate there. So that's where our -- sensitivity plays into our favor.

Damon Paul DelMonte

Keefe, Bruyette, & Woods, Inc., Research Division

Got it. Okay. And then just one last question on the provision outlook, with the prospect that loan growth would probably slow a bit here in the second half and just continued just strong underlying credit trends and limited visibility on any NPL formation. Do you think you're going to be needing to book a reserve -- any meaningful reserve in the next couple of quarters?

Karin M. Taylor

Executive VP & Chief Risk Officer

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Damon, this is Karin. It's really going to be depend on I think on what happens -- I think it's going to depend really on what happens with the macro environment and the related forecast. And then to your point, loan growth, if we see that moderate here in the second half, that certainly would probably be a driver to not have significant provisioning.

Operator

[Operator Instructions]. Our next question today is a follow-up question from Ben Gerlinger from Hovde.

Benjamin Tyson Gerlinger

Hovde Group, LLC, Research Division

I figured -- I was going to ask this -- this is kind of a follow-up call, probably add some shareholder value. Okay, you took this role about 1.5 years ago, I feel like the biggest and main task was enhancing core bank, more specifically the deposit franchise. I mean the fee income opportunity you guys had in front of you are pretty phenomenal, especially relative to the bank you had. The hires you've made and the people that you put in place over the past 1.5 years seem to have done a good job. But then again, with rates moving up 550 basis points over the course of the past couple of years, are there any key performance indicators that we should be looking at to really assess what is the new relationships are core rather than potentially just saying they are core and [indiscernible] once rates get lower?

Katie A. Lorenson

President, CEO & Director

Thanks, Ben, for the question. And I think your analysis is spot on in terms of where we are focused and the reason why. Building our commercial Wealth Bank is a strong priority, you look historically from an organic growth standpoint, we believe we've got tremendous opportunity. Even in this environment, very much focused on client selection and bringing over experience bankers, as well as professionals to support those and then positioning ourselves to focus very much on specific segments, so we can really be responsive, fast and bring value to those client relationships. And that absolutely grows relationships. That is not transactional business.

And I think the way that you can view the success going forward is seeing the commercial wealth bank growth. Full relationships, both on the lending, the deposits, the private banking, the wealth side. That will become evident, and we're already seeing those early successes. Certainly, in this rate environment, the opportunities will be coming from those loans and credits that are coming to maturity, and they're looking for a refinance, and they're going to follow their banker that they've been doing work with and relationships with over a long period of time. Does that answer your question, Ben?

Benjamin Tyson Gerlinger

Hovde Group, LLC, Research Division

Yes. And just kind of following off that, it seems like the people you have, the cultures is intact, in fact, they probably upgraded in terms of the personnel. Are there any verticals that you could see additional hires in or any potential add-on that you might not already have or deepening in your relationships?

Jim Collins

Executive VP and Chief Banking and Revenue Officer

I can handle that one. Yes, we've already started to build out the verticals. We're probably not going to expand to any more additional ones, but we will be adding additional talent in those verticals as we continue to have success. So we're not going to overstaff, but we're certainly going to keep the talent pool ready to add staff as we start winning in various segments all over the place.

Benjamin Tyson Gerlinger

Hovde Group, LLC, Research Division

I assume after a continuous plan, it's not like a 12 or 18 months, correct?

Jim Collins

Executive VP and Chief Banking and Revenue Officer

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Yes. No, that's continuous. I think as we continue our growth, we'll be strategic on those verticals and those hires. But like I kind of commented earlier, some of those verticals are key to deposit gathering as well as loans, and they are key to synergistic private banking wealth and I'm specifically talking about the kind of the mid-market verticals. We'll find a lot of success. And to your original question about those relationships are core, and they've become core, not only in commercial C&I but in private banking and wealth and in private mortgage. So that's where you can see those -- that growth going all over those areas, you can see that, that clearly is a core growth.

Operator

[Operator Instructions] There are no additional questions waiting. So this concludes our question-and-answer session. I would like to turn the conference back over to Katie Lorenson for any closing remarks.

Katie A. Lorenson

President, CEO & Director

Thank you. And thank you to everyone for joining our call this morning. Thank you for listening, and thank you for the questions.

Our unique and highly diversified business model is a substantial differentiator in driving long-term value for our shareholders, serving our clients as well as attracting and retaining top talent. We thank you, our shareholders and our clients for the trust that you put in us and to our team members for your service mindset and client focus for helping us to evolve Alerus into a top-performing commercial wealth bank and national retirement benefits provider and in the long term, delivering top-tier shareholder returns and performance. Thank you, everyone, and have a great day.

Operator

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

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