S&P Global
Market Intelligence

Flushing Financial Corporation NasdaqGS:FFIC FQ1 2023 Earnings Call Transcripts

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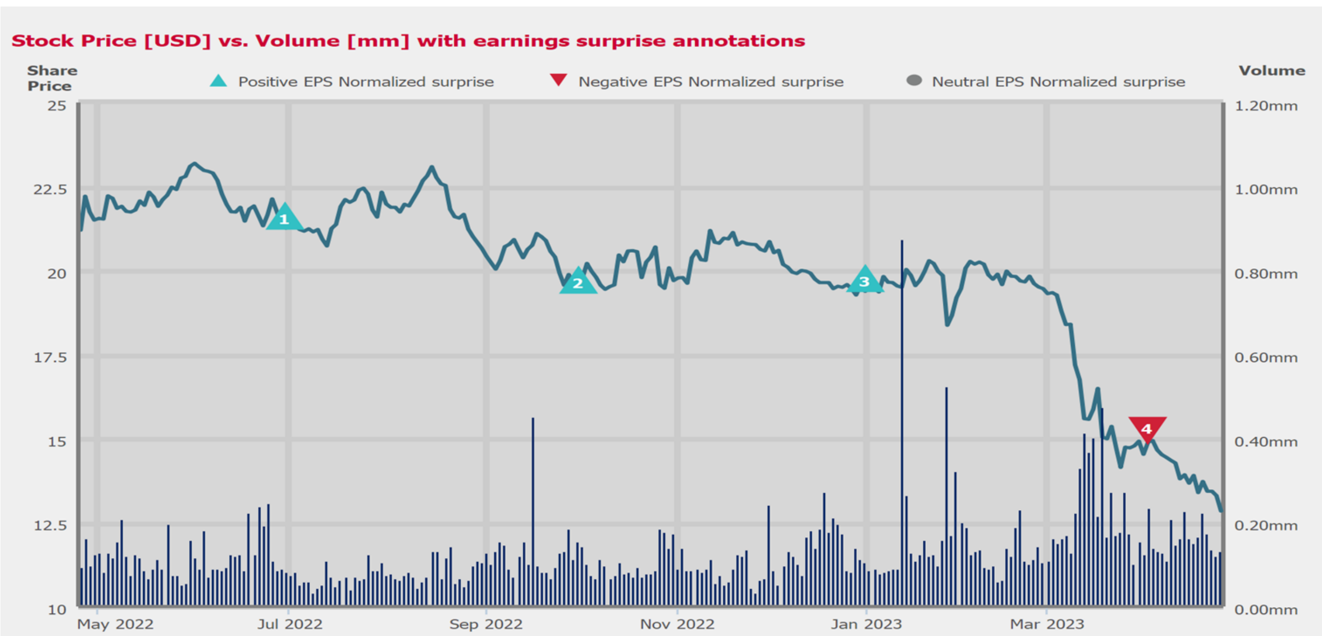
S&P Global Market Intelligence Estimates

	-FQ1 2023-			-FQ2 2023-	-FY 2023-	-FY 2024-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.32	0.10	▼ (68.75 %)	0.40	1.39	NA
Revenue (mm)	55.11	49.55	▼ (10.09 %)	54.55	221.39	NA

Currency: USD
Consensus as of Apr-06-2023 12:40 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2022	0.69	0.70	▲1 1.45 %
FQ3 2022	0.60	0.62	▲2 3.33 %
FQ4 2022	0.50	0.57	▲3 14.00 %
FQ1 2023	0.32	0.10	▼4 (68.75 %)

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Call Participants

EXECUTIVES

John R. Buran
President, CEO & Director

Susan K. Cullen
Senior EVP, Treasurer & CFO

ANALYSTS

Christopher Thomas O'Connell
Keefe, Bruyette, & Woods, Inc., Research Division

Manuel Antonio Navas
D.A. Davidson & Co., Research Division

Mark Thomas Fitzgibbon
Piper Sandler & Co., Research Division

Presentation

Operator

Welcome to Flushing Financial Corporation's First Quarter 2023 Earnings Conference Call. Hosting the call today are John Buran, President and Chief Executive Officer; and Susan Cullen, Senior Executive Vice President, Chief Financial Officer and Treasurer. [Operator's Instructions]

A copy of the earnings press release and broad presentation that the company will be referencing today are available on its Investor Relations website at flushingbank.com. Before we begin, the company would like to remind you that discussions during this call contain forward-looking statements made under the safe harbor vision of the U.S. Private Securities Litigation Reform Act of 1995. Such statements are subject to risks, uncertainties and other factors that could cause actual results to differ materially from those contained in any such statements, included as set forth in the company's filings with the U.S. Securities and Exchange Commission to which we refer you.

During this call, references will be made to non-GAAP financial measures or supplemental measures to review and assess operating performance. These non-GAAP financial measures are not intended to be considered in isolation or as a substitute for the financial information prepared and presented in accordance with U.S. GAAP. For information on these non-GAAP measures and for a reconciliation to that, please refer to the earnings release for the presentation. I'd now like to introduce John Buran, President and Chief Executive Officer, who will provide an overview of the strategy and results.

John R. Buran
President, CEO & Director

Thank you, operator. Good morning, and thank you for joining us for our first quarter 2023 earnings call. Following my prepared remarks, Susan will review the financial trends, and we will then answer any questions. The company reported first quarter 23 GAAP EPS of $0.17 and core EPS of $0.10. The quarterly results were impacted by net interest margin compression and a charge-off of a previously identified credit placed on nonaccrual in the second quarter of 2022. We were disappointed with these results, and we've implemented an action plan to enhance the resilience of our business model and improve future profitability. First, we're taking significant steps to move the balance sheet to more interest rate risk neutral and have already achieved 40% of our goal. Second, we are increasing our focus on risk-adjusted returns and overall profitability. While this will take some time, we're encouraged by the results seen so far.

Third, we're looking to expand our client base and build loyalty by emphasizing our brand of customer service and deep community relationships while capitalizing on the recent market disruptions. Our bankers are seeing more activity in gathering both loans and deposits. Fourth, we are tightening up on expenses. We've taken actions to reduce noninterest expense growth, and we'll continue to focus on reducing discretionary expenses. Fifth, we are preparing for the next credit cycle. We are focusing more on recession-proof industries, and we'll continue to take early actions on weaker credits. Sixth, we will continue to focus on our strong liquidity and capital. Deposits are up for the quarter, and we have $3.7 billion of available liquidity. Overall, we expect these decisive actions to result in an improved earnings profile over time.

These actions, along with our strong liquidity will also allow us to continue our long track record of dividend payments into the future. Please turn to Slide 4. The actions we are taking will also allow us to advance our 4 areas of focus for long-term success. We incurred a $9.2 million loss on a business participation, which was placed on nonaccrual in the second quarter of 2022. This domestic borrower has a customer who shipped products to Russia that were canceled due to sanctions. The credit protection for the shippers receivables that was in place became more questionable during the quarter. So we decided to charge off the loan. Absent this isolated credit, we would have recorded small net recoveries for the quarter. Credit quality is one of the foundational pillars of the bank. Our loan portfolio overall comprises low-risk loans to stable borrowers. Over 88% of the loan portfolio is secured by real estate with an average loan-to-value of less than 37%.

Current debt service coverage ratio has improved to 1.9x. Midtown Manhattan office space exposure is only 1/10 of the loan portfolio. Interest rate risk is another priority, and I outlined our actions on the previous slide. While I also touched on liquidity on the previous slide, I want to highlight the liquidity is strong. We increased deposits by nearly $250 million during the quarter. Our liquidity is over 3x the uninsured and uncollateralized deposits. Customer experience and our ties to the communities are also key to our success.
-- due to a major competitor Signature Bank leaving the market, additional opportunities are emerging, particularly with shared relationships. We are also expanding our Asian banking franchise and see nice deposit growth there. Our digital engagement is

strong and growing. These areas of focus will position the company to withstand the short-term macro turmoil while rebuilding our foundation for long-term success.

Slide 5 highlights our performance for the quarter. Average deposits increased 6% year-over-year and 2% during the quarter, a positive metric for Flushing Financial given the current banking environment. Our uninsured and uncollateralized deposits are only 16% of total deposits. Analysts have noted that we're one of the strongest versus peers. We expect a similar or better position this quarter. The cost of deposits reached 2.29% and the overall cost of funds was 2.47%. As we indicated last quarter, loan growth is expected to be challenging. Loans were flat quarter-over-quarter, while loan closings were lower than recent quarters, yields increased to over 7% and the loan pipeline increased 6% quarter-over-quarter. We expect the market disruptions will provide opportunities for loans, especially given the absence of a major competitor. Core loan yields expanded 17 basis points during the quarter due to higher rates repricing of the real estate loans and new loans coming on at rates above the portfolio yield.

Nonperforming assets declined 21% and criticized and classified assets decreased quarter-over-quarter. Additionally, delinquencies, which were already low, declined 16 basis points during the quarter. We continue to realize strong growth in digital engagement by leveraging our technology platform. In fact, in the first quarter, we originated approximately $7 million of loan commitments through our digital platform. We also expanded our relationships with fintech players as we have partnered to offer customers assistance with filing and processing, employee retention tax credit refunds. Earnings from this partnership will be realized once the customer receives the refund. To date, we're pleased with the activity. As outlined previously, we put in place several steps to improve overall earnings performance. The market believes the Fed is nearing the end of its increasing cycle, which implies margin improvement on the horizon for us. Additionally, there are opportunities due to the market disruption and the absence of a major competitor.

Slide 6 presents our liquidity profile. We have $3.7 billion of available liquidity from a variety of sources, including Federal Home Loan Bank, the Federal Reserve Bank, cash on hand and unpledged securities. Additionally, we have relationships with interpin network and others to offer customers greater FDIC insurance versus the $250,000 minimum. We are working to expand borrowing capacity from existing relationships by pledging different types of collateral. Deposit flows over the course of the quarter were similar to past trends. uninsured and uncollateralized deposits totaled about 16% of total deposits. Our available liquidity is over 3x the amount of uninsured and uncollateralized deposits. We have a high degree of comfort in the stability of funding due to deposit stability and available liquidity. Our loan portfolio is outlined on Slide 7. As you can see, 65% of the loan portfolio is concentrated in multifamily and investor commercial real estate. Our overall office portfolio is about 4% of loans with Midtown Manhattan office space exposure at 0.1% of net loans.

In general, the real estate portfolio has strong sponsor support and excellent credit performance. Overall, we remain very comfortable with the quality of our loan portfolio due to an average loan-to-value of less than 37% and a debt service coverage ratio of 1.9x for the multifamily and investor commercial real estate portfolios. Slide 8 provides a detail on our Asian markets. About 1/3 of our branches are in Asian markets where we have $1.2 billion of deposits and $810 million of loans. These deposits are 18% of total deposits, and we have only 3% market share. So there's plenty of opportunity. Our approach to this market is supported by our staff that speaks many different languages, our Asian advisory board and support of cultural activities. This market continues to be an important opportunity for us. Slide 9 depicts the growth in our digital banking platforms. We continue to see high growth rates in monthly mobile deposit users, users with active online banking status and digital banking enrollment. Based upon data from our service provider for 2022, we had above meeting enrollment growth and top quartile performance for active users' annual growth and mobile remote deposit capture annual growth compared to the 26 banks in our peer group of assets of $5 billion to $10 billion.

The numerated platform, which digitally originates small dollar loans as quickly as 48 hours continues to grow. We originated approximately $7 million of commitments in the first quarter. These commitments have an average rate greater than the overall portfolio rate. We continue to explore other fintech product offerings and partnerships. On Slide 10, first quarter had several important events to highlight. As pictured, our employees participated in the Lunar New Year parade, which is great visibility to our Asian markets. We were involved in other community events, including Manhattan Neighborhood network ribbon cutting and providing scholarships for NYC Kids rise. Our new Hot hog branch in a major Long Island industrial park opened during the quarter. And we expect Bensonhurst which extends our Asian business to open later this year. Participating in these types of initiatives builds on our already strong ties with our local communities, which is a key differentiator for our business, enabling us to drive customer loyalty. I will now turn it over to Susan to provide more detail on our key financial metrics. Susan?

Susan K. Cullen
Senior EVP, Treasurer & CFO

Thank you, John. I'll begin on Slide 11. Deposit growth has been a challenge for the industry as the Fed raises rates and recent bank failures tightened financial conditions. Despite this backdrop, we were able to increase average total deposits 2% during the quarter and 6% year-over-year. As expected, balance growth was driven by CDs, which help extend our funding to better match the duration of the assets, while growing noninterest-bearing deposits is a priority for us and has become more challenging given the higher rate environment. Average noninterest-bearing deposits declined both quarter-over-quarter and year-over-year. However, checking account openings increased 30% year-over-year. The recent market disruption has provided opportunities to attract more deposits and customers. The increase in the deposit base assisted in lowering the loan-to-deposit ratio to 102% from 107% at the end of the year. In terms of mix, about half of our deposits are from consumers and the other half are from business and government.

I also want to note that we have seasonality in certain segments of our deposit base and the seven months are generally lower than the rest of the year. On Slide 12 outlines our loan portfolio and the yields. Net loans increased 5% year-over-year but were down less than 1% quarter-over-quarter. Loan closings were lower than the recent run rate, but the yield on the closings was over 7% for the quarter. Core loan yields increased 17 basis points during the quarter. And for the second consecutive quarter, yields on loan closings exceeded the yields on the satisfaction by 113 basis points. Prepayment penalty income declined to $610,000 in the quarter from $1.2 million in the fourth quarter and $1.6 million from a year ago. There's been some disruption in the market as a major competitor has exited, contributing to the increased activity resulting in loan pipeline that increased 6% during the quarter. Slide 13 provides more detail on the contractual repricing of the loan portfolio. Approximately $1.1 billion or 16% reprices with each Fed move. In the first quarter, approximately $272 million of real estate loans repriced upwards of 193 basis points to 6.63%.

For the remainder of 2023, another $660 million is due to reprice at a rate of 184 basis points higher than the current yield. Another $765 million or 11% of loans will be priced in 2024 with a similar amount in 2025. These values are based on the underlying index value as of March 31, 2023, and do not consider any future rate moves. This repricing is what should drive net interest margin expansion once funding costs stabilize. Slide 14 outlines the net interest income and margin trends. The GAAP net interest margin declined 43 basis points to 2.27% during the quarter. As we stated previously, we expect the NIM will continue to compress as long as the Fed raises rates. After a lag, we expect the NIM would begin to expand as the pressure on funding costs, ease and loans continue to reprice higher. Of course, if the Fed cuts rates, our funding costs should reprice lower faster than the declines on the asset yields. Turning to Slide 15. One of our goals for 2023 is to significantly move towards more interest rate neutral. The goal for the balance sheet is to match the duration of our assets more closely, which is approximately 3 to 4 years and the duration of our funding was about 1 to 2 years.

The asset swaps convert fixed rate assets of 3.17% into floating rate assets of 5.62%, and the effect of funding swaps go from 4.84% to 2.55%. We added some swaps late in the quarter, so the full benefit has not been realized in the run rate and the forward funding swaps will be priced lower during the year. We expect to continue to monitor market opportunities to take additional actions, if warranted, to help close the duration gap. Slide 16 shows there's another benefit of the swaps portfolio as it serves as a mitigant for changes in interest rates that flow through AOCI. The change in the value of the swap portfolio is generally the inverse of the change in the value of the available for sale securities. As you can see, this has been our history and has helped to keep our tangible capital ratio stable versus others who have experienced more pressure from the rising rate environment. Slide 17 outlines our high quality and liquid investment security portfolio. The overall investment security portfolio is $886 million or just over 10% of assets.

Our securities portfolio is mostly classified as available for sale, so the value is largely reflected in our tangible capital. About 53% of the portfolio is floating rate, which includes a $200 million of fair value swap added during the quarter. Security yields increased 44 basis points quarter-over-quarter to 3.15%. Moving on to net charge-offs on Slide 18. We have a long history of solid credit quality as a result of our low-risk credit profile and conservative underwriting. Net charge-offs were 54 basis points for the quarter, which primarily relates to the one business credit John mentioned earlier. Absent this credit, we would have reported small net recoveries for the quarter. During the quarter, we provided additional provisioning to fully reserve for previously identified $4 million line of credit. Historically, loss has been well below the industry due to our low-risk credit profile and conservative underwriting. We expect limited loss content in the loan portfolio if there's an economic downturn given the greater than 88% of the portfolio is secured by real estate with an average loan-to-value less than 37%. Additionally, the weighted average debt coverage ratio is 1.9x at over 1.15x in stress scenario.

The stress scenario consists of a 200 basis point increase in the rate and a 10% increase in operating expenses for our multifamily and investor commercial real estate loans. These factors contribute to our expectation of loan loss content within the portfolio. Slide 19 shows our credit metrics that are trending in the right direction with declines in nonperforming assets, lower criticized and cost-wide assets and increases in the nonperforming loan coverage ratio. Our allowance for credit losses is presented by loan segment in the bottom right chart. The higher risk portfolios have reserves greater than 1% of that portfolio. Overall, the allowance for current losses to loan ratio decreased 2 basis points to 56 basis points during the quarter. Despite the significant charge-off this quarter, we remain very comfortable with our credit risk profile. Our capital position is shown on Slide 20. Book value and tangible book value per share increased year-over-year. We took advantage of the stock price trading below tangible book value to repurchase approximately 160,000 shares during the quarter. The tangible come equity ratio decreased 9 basis points quarter-over-quarter to 7.73%.

Our regulatory capital ratios are strong. Overall, we view our capital base as a strength and a vital component of our conservative balance sheet. Before turning it over to John, let me provide some color on our revised outlook. As a reminder, we do not provide guidance, so this discussion is meant to provide a high-level perspective on performance in the current environment. We expect loan growth to remain challenging given the high rate environment and our increased emphasis on risk-adjusted returns. While we have a liability-sensitive balance sheet, we are taking more actions to shift the portfolio towards neutral. As John mentioned, we achieved approximately 40% of this goal during the first quarter. With that said, the NIM is likely to continue to compress as long as the Fed is raising rates. At this point, we expect the Fed to increase by 25 basis points in May. The core NIM in March was 2.17%, and with the lack of loan growth, there is no pressure to fund the balance sheet growth at high rates. Given these assumptions, we believe the amount of NIM compression going forward has the potential to be significantly lower than seen in prior quarters.

Overall, the longer term, we expect the NIM will benefit from the contractual repricing of the loan portfolio. Last quarter, we mentioned that noninterest expense was expected to increase by low double-digit percentage points. Given the actions we have taken to improve the outlook, we are now expecting 2023 expenses to remain flattish versus 2022. As a reminder, we had $4.1 million of seasonal expenses in the first quarter that are not expected to repeat and a $1.7 million benefit related to employee retention tax credit refunds. Lastly, the effective tax rate should approximate 24% to 26% for 2023. I'll now turn it back over to you, John.

John R. Buran
President, CEO & Director
Thank you, Susan. On Slide 21, I'll wrap up with our key messages. Results in the first quarter were below our expectations, and we have implemented an action plan and areas of focus to help improve profitability in the short and medium term and build on our foundation for long-term success. We're looking to position the balance sheet to become more neutral to changes in interest rates. We will continue to take advantage of market opportunities, including a major competitor leaving the market, which should provide opportunities for loans and deposits. Our liquidity and capital are strong. We remain comfortable with the low-risk loan portfolio as criticized and classified assets and delinquencies improved. While the environment is challenging, we expect the decisive actions we are taking to improve the overall performance and allow us to continue our long and consistent track record of dividend payments. Operator, I'll turn it over to you to open the lines for questions.

Question and Answer

Operator

Thank you.

[Operator's Instructions]

Our first question comes from Mark Fitzgibbon with Piper Sandler.

Mark Thomas Fitzgibbon
Piper Sandler & Co., Research Division

Thank you.

[Operator's Instructions]

Our first question comes from Mark Fitzgibbon with Piper Sandler.

John R. Buran
President, CEO & Director

It's -- first of all, it's minimal. Most of what we do is in market and real estate based, as you know. The largest is probably this loan.

Susan K. Cullen
Senior EVP, Treasurer & CFO

I think that's right. And then when we get into a participation mark, we re-underwrite the loan to our own conservative underwriting standards before we agree to participate in the credit.

John R. Buran
President, CEO & Director

Yes. I just want to emphasize, this is a very unusual set of circumstances we're involved in a war and a sanction that is clearly not typical of what we do on a day-to-day basis. So highly unusual.

Mark Thomas Fitzgibbon
Piper Sandler & Co., Research Division

But in total, roughly what are the C&I participations?

Susan K. Cullen
Senior EVP, Treasurer & CFO

They're about less -- right around 5% of the portfolio.

Mark Thomas Fitzgibbon
Piper Sandler & Co., Research Division

5% of total loans or 5% of C&I loans...

Susan K. Cullen
Senior EVP, Treasurer & CFO

Total loans, 5% of total loans.

Mark Thomas Fitzgibbon
Piper Sandler & Co., Research Division

Okay. Secondly, you had talked about in the past having a target TCE ratio of around 8%. I guess I'm curious if that's still your target and if it is, should we assume that buybacks will slower cease in coming quarters since you're below that?

John R. Buran

President, CEO & Director

We'll probably slow down buyback activity, but we're obviously always alert for what's going on in the market. I would say that 8% we've viewed as being a more intermediate term goal.

Mark Thomas Fitzgibbon
Piper Sandler & Co., Research Division

Okay. And then, Susan, just following up on your margin comments, assuming that we sort of follow the forward curve and given the balance sheet changes that you're making, where do you think the margin sort of bottoms out roughly what level?

Susan K. Cullen
Senior EVP, Treasurer & CFO

Well, we ended March with -- for the month NIM, about 217, but that does not include the full run rate of about $350 million worth of swaps we put on. So everything else being equal, Mark, I would think maybe a couple of more basis points down from where we are. But I think the Fed is mostly finished raising rates, at least I hope they are closer to the end than the beginning. And I think the majority of the NIM compression is baked in, but there's still a potential a little bit more to go.

John R. Buran
President, CEO & Director

I would also add that in the last quarter or so, there's been very, very intense competition associated with 2 players in the market that we're trying to get out of the crypto exposure, one of which is no longer out there. So I think we'll see a little bit less intensity in terms of the deposit competition. These are direct competitors of ours.

Mark Thomas Fitzgibbon
Piper Sandler & Co., Research Division

And then given your comments about the Fed being close to the end, and we've already got rates up with 475 basis points, it strikes me that this is an odd time to be changing your liability-sensitive position. Wouldn't it be arguably the worst time to becoming less liability sensitive?

John R. Buran
President, CEO & Director

So when you look at our balance sheet, as Susan mentioned, we've got assets that reprice quite a bit more slowly than the liabilities. So we think over time, we need to bring those things are into alignment. Certainly, we're going to be cognizant of what's happening on a day-to-day basis as we move toward a more intermediate-term goal, but we do want to have a more balanced balance sheet, a more safe interest rate risk position. And as you know, we -- none of us know where rates are going to go. They certainly can go down shortly. And they could clearly go up again if inflation rears is head again. But the hedging is very, very valuable to us. one of the other positive aspects of our hedging strategy is that it has protected us from an AOCI perspective as well. So all in all, we think there's been great benefit with our hedging strategy that now has about $1.6 billion, $1.7 billion worth of protection in place.

Operator

Our next question comes from Chris O'Connell with KBW.

Christopher Thomas O'Connell
Keefe, Bruyette, & Woods, Inc., Research Division

Just following up on one of the last questions. If I heard right, did you say only 2 basis points, give or take, of margin conversion expected beyond the 2017 NIM at March?

Susan K. Cullen
Senior EVP, Treasurer & CFO

No, I do not say that I would put a quantity on it, Chris. There are some moving parts, as we talked about, John mentioned the less the lessening of competition but there's rate moves still to occur. These feds are closer to the end than the beginning. But I think there's still some compression to come in our NIM, but it won't be as great as what we've seen in the past.

Christopher Thomas O'Connell

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

Got it. And how late in the quarter were the hedges and the derivatives put on?

Susan K. Cullen
Senior EVP, Treasurer & CFO

The second half of March, really. So they only have a couple of weeks baked in.

Christopher Thomas O'Connell
Keefe, Bruyette, & Woods, Inc., Research Division

And I was just hoping you could provide a little bit more color as to the overall expense plan that you've taken a look at and what areas you're looking to keep expenses more contained versus previously? And perhaps if there's any further opportunities that you'd be looking at as you get further on into the year into 2024.

John R. Buran
President, CEO & Director

There's a series of initiatives that we will either -- that we've either canceled or delayed to a later date. Clearly, all of our compensation structures are associated with performance. So that would be impacted. We're reducing marketing expenses, we're reducing compensation expenses. There's a whole variety of more discretionary expenses that we're able to reduce without really disrupting the core of the business. We do have a very valuable franchise that we're looking ahead to 2024 and making sure that we are in a good position to take advantage of a better environment.

Christopher Thomas O'Connell
Keefe, Bruyette, & Woods, Inc., Research Division

And then just on the credit commentary. I believe you said there's 4 million specific reserve this quarter for a line of credit. Is that fully reserved for?

Susan K. Cullen
Senior EVP, Treasurer & CFO

Yes. At this point, there was a little bit of provision taken in prior quarters, but it is now fully as a specific allowance associated with it for the full $4 million.

Christopher Thomas O'Connell
Keefe, Bruyette, & Woods, Inc., Research Division

And I know you guys said you've taken a closer look at kind of overall credit quality and risk framers going forward. Just maybe any details as to what specifically you're looking at? And any kind of color you could give there?

John R. Buran
President, CEO & Director

Obviously, we're very focused on looking at recession-proof industries and maintaining a -- maintaining our traditional strong standards with respect to real estate, which we're very, very comfortable with. I think it's mostly in the area of anticipating possible recessions and staying away from industries that travel discretionary spending industries. We don't have any exposure to consumer. We have very, very limited exposure to Midtown Manhattan office space, less than 0.1%. So in general, we're in very good shape in that regard, but there's always little nuances that take place associated with what's going on in the market on a day-to-day basis.

Christopher Thomas O'Connell
Keefe, Bruyette, & Woods, Inc., Research Division

Great. And then last one for me, just switching back to the balance sheet. I think you mentioned a little bit of seasonality in the deposits for the summer periods. If you could just go over and remind us as to what that seasonality is and maybe obviously, a difficult environment, but what type of moves kind of you're expecting there for the next couple of quarters, that would be great.

Susan K. Cullen
Senior EVP, Treasurer & CFO

So there's seasonality in our government banking portfolio, Chris. A lot of places get the money and then it flows back out. So the summer months are just a low period for us historically because of the government funding.

Christopher Thomas O'Connell
Keefe, Bruyette, & Woods, Inc., Research Division

Yes. Any quantitative qualifiers as to what the typical impact is as far as outflows?

Susan K. Cullen
Senior EVP, Treasurer & CFO

I want to say I would have to go back and look to be sure, but it seems to me that last year for the second quarter, our loan-to-deposit ratio was probably the highest it was all of last year. So it has that same expectation this quarter.

Operator

Our next question comes from Manuel Navas with D.A Davidson.

Manuel Antonio Navas
D.A. Davidson & Co., Research Division

If the Fed pauses as kind of expected, and there's a lag before your NIM starts to benefit, how fast or how quickly could the NIM benefit when it does start to move up on a pause?

John R. Buran
President, CEO & Director

We expect within a couple of quarters that we can start to see the NIM start to recover.

Susan K. Cullen
Senior EVP, Treasurer & CFO

Historically, it's been about 2 quarters. So we would -- we don't see any reason why that history would not repeat itself to give you some context.

Manuel Antonio Navas
D.A. Davidson & Co., Research Division

Is the speed going to be similar to the past? Or can we put out like 5 to 10 basis points? What would be after those 2 quarters in the third quarter, how fast could the NIM rise?

Susan K. Cullen
Senior EVP, Treasurer & CFO

It's -- it depends on what it stops and what we have repricing on the loan side, but it's not going to be a sharp V up. It's going to be a longer slope to get us back up on the NIM side.

Manuel Antonio Navas
D.A. Davidson & Co., Research Division

Did any of your actions slow that slope, like moving to neutral, adding hedges? Or are you trying to thread the needle where you can still have that same slope recovery of NIM with your current hedging actions?

John R. Buran
President, CEO & Director

So that slope that we're talking about in the absence of a reduction in the Fed's rates is really dependent upon the movement of our contractual loan repricing. If you're talking about the Fed reducing rates from the end of the quarter, our liability sensitivity would override any type of hedging strategy that we put in place over that time period. So we would expect in an environment where the Fed reduced rates, we would expect that the margin improvement would accelerate. As it will be the slower movement...

Manuel Antonio Navas
D.A. Davidson & Co., Research Division

No, no, I'm just wondering because there is trade-offs to some of your actions. I'm just trying to identify if there's any loss of potential recovery down the road and if there's any way to quantify it, like NIM recoveries down the road.

John R. Buran
President, CEO & Director

If rates are reduced, so nothing that we're doing should impact our ability to recover the contractual repricing of the loan portfolio. On the other hand, if the -- some of the funding swaps that we put in place could somewhat mute the ability to gain from the repricing downward that the Fed might take. However, given the degree of liability sensitivity, that liability sensitivity even today far outweighs the -- and would give a much more significant benefit than any hedging strategy that we put in place. So the net-net would be a positive for us.

Susan K. Cullen
Senior EVP, Treasurer & CFO

So Manuel, if we look at like the funding swap -- we are -- the underlying is at 484, and we're paying $255 million. So the Fed would have to drop rates, 230 basis points, if my math is correct, before we've had any detriment to our earnings stream for that specific hedge item. So you're right, there are trade-offs. But when we put this on, we very carefully evaluate in various rate scenarios what would happen with the various actions we're taking.

Manuel Antonio Navas
D.A. Davidson & Co., Research Division

To shift topic a little bit, is the line of credit that has come up in questions. Is that -- where that 9% reserve on $23 million in SBA loans sit -- if not, any color on that high reserve portion for that portfolio?

Susan K. Cullen
Senior EVP, Treasurer & CFO

No, it is not that, that portfolio has a high reserve ratio because of the amount of losses we have historically had in that before we -- there was an older program we were in and the losses are encapsulated in there, and it's still bleeding, if you will, through the CECL calculation.

John R. Buran
President, CEO & Director

Our SBA portfolio, by the way, it's very small.

Manuel Antonio Navas
D.A. Davidson & Co., Research Division

Yes, it is very small, and you fully reserved there. It's just sitting there.

Manuel Antonio Navas
D.A. Davidson & Co., Research Division

Is there any ability to time some of the signature benefits, your pipeline is already going up on the loan side. It seems like you believe that deposit competition might come down a bit on pricing side. And then there's talent out there. Am I thinking about it the right way for those 3 dimensions? And kind of can you speak to the timing of those 3 dimensions for the Signature benefit?

John R. Buran
President, CEO & Director

So I don't think we can really talk specifically about the timing, but we are seeing activity in all 3 of those dimensions at this time.

Operator

This concludes our question-and-answer session. I'd like to turn the conference back over to John Buran for any closing remarks.

John R. Buran
President, CEO & Director

Well, thank you, everybody, for joining us today on our first quarter 2023 earnings call. We appreciate your continued support of Flushing Financial Corporation, and we look forward to talking to you next quarter. Thank you again.

Susan K. Cullen
Senior EVP, Treasurer & CFO

Thank you.

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