MidWestOne Financial Group, Inc.

Q3 2021 Results Conference Call

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CORPORATE PARTICIPANTS

Charlie Funk – *Chief Executive Officer*

Gary Sims – *Chief Credit Officer*

Barry Ray – *Chief Financial Officer*

Jim Cantrell – *Treasurer and Chief Investment Officer*

Len Devaisher – *President*

PRESENTATION

Operator
Good day, and welcome to the MidWestOne Financial Group, Inc. Third Quarter 2021 Earnings Call. All participants will be in listen-only mode. Should you need assistance, please signal a conference specialist by pressing the star (*) key followed by zero (0). After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press star (*) then one (1) on your touchtone phone and to withdraw your question, please press star (*) then two (2).

The presentation contains forward-looking statements relating to the financial condition results of operations and business of MidWestOne Financial Group, Inc. Forward-looking statements generally include words such as believes, expects, anticipates and other similar expressions. Actual results could differ materially from those indicated among the important factors that could cause actual results to differ materially, or interest rates, changes in the mix of the company's business, competitive pressures, generic -- excuse me, general economic conditions and the risk factors detailed in the company's periodic reports and registration statements filed with the Securities and Exchange Commission.

MidWestOne Financial Group, Inc. undertakes no obligation to publicly revise or update these forward-looking statements to reflect events or circumstances after the date of this presentation, and please note, this event is being recorded.

I would now like to turn the conference over to Mr. Charlie Funk. Please go ahead, sir.

Charlie Funk
Thank you very much, Chuck, and good morning or good afternoon, as the case may be, to all of you, and thank you for joining us on the call this morning.

In the room in Iowa City, we have Gary Sims, our Chief Credit Officer; Barry Ray, our Chief Financial Officer; Jim Cantrell, our Treasurer and Chief Investment Officer; and Len Devaisher, our President.

Just an overview of the quarter and then the acquisition that we announced yesterday. I think in summary, we're very pleased that we had loan growth ex PPP of a little bit more than 1% linked quarter. We continue to see good deposit growth, and I'm happy to report about 75% of that deposit growth was core deposits. Clearly, that has a negative impact on the margin, but a positive impact on net interest income.

Asset quality continues to improve, and I think we will give you a positive outlook going forward as well. I think we have an excellent story in our company on wealth management, both legacy and prospective, and we did have a few onetime expenses that distorted our noninterest expense run rate, and I'll cover that in my comments. It was also covered in the earnings release.

We also announced what we believe is a solid and well-conceived acquisition and yesterday also announced that a wealth management team from Eastern Iowa has opted to join our company.

So with that, if I go over the quarter, very pleased despite the headwinds that we faced that we were able to increase loans ex PPP. Line of credit usage continues to be low at 32%. That did tick up a bit during the quarter, but that's about 10% to 15% below what we would consider to be normal in terms of LOC usage.

In terms of markets that seem to be producing in terms of lending activity, we will start as we have in the past with Denver, which continues to hit on all cylinders and continues to enjoy a very good pipeline going forward. We are starting to develop a good pipeline in the Twin Cities and very pleased with the commercial bankers we've been able to hire in that market, and I think over the next 6 to 9 months, you will see very good growth from the Twin Cities footprint.

We also have seen good activity in Southwest Florida, Naples and Fort Myers as well as the Iowa City market, and the rest -- the remainder of our company tends to be flat to slightly down in terms of loan activity. We do see some payoffs coming in the fourth quarter, and all of the payoffs we see right now are from the sale of businesses, either commercial industrial businesses that have been sold or commercial real estate properties that have been sold, and it's really hard to say what the fourth quarter will bring, but as I said earlier, I think the 6- to 9-month outlook is pretty good from our perspective in terms of loan growth.

We feel, as I said, very good about our hires -- our commercial banking hires in the Twin Cities. In terms of PPP, we would expect most of that to be out of the bank in the fourth quarter. There will probably be some stragglers as we go into the first quarter, but essentially, we expect a high percentage of the PPP loans to be forgiven and off our balance sheet by year-end.

Turning to noninterest income. Mortgage had a good quarter by traditional standards. It was down from prior -- from the boom of prior quarters, but still very solid, and we expect that to continue in the fourth quarter. We do note a negative mortgage servicing rights adjustment of $400,000, and if interest rates hold where they are at the present time, we would expect a positive adjustment in the fourth quarter, but there's still some time to go before we measure that.

Great story, in my opinion, in wealth management. Top line revenue continues to grow. Our investment services area, which is our LPL brokerage unit, continues to set all-time records it seems each quarter and they will have an all-time record year this year, and I believe that's the third in a row for them.

Our trust department has also continued to see top line revenue growth and also some organic growth perhaps that we haven't seen as much of in the past. You will recall a year ago, we hired 3 professionals in the Twin Cities to help us in wealth management, and they work for our trust department, and they have produced according to expectation in the first year despite being hampered somewhat by nonsolicitation agreements. Those are almost over now, and we expect really good things from them, even better things in 2022.

During the last quarter, we began talking to a team of 5 wealth professionals, 4 trust professionals and 1 private banker who were operating for the most part in the Cedar Rapids market. These wealth professionals have about 120 years of combined experience, and today, I'm happy to report as their second day of employment at MidWestOne Bank, 4 of them will be working in Cedar Rapids, 1 in the Iowa City market, 4 are trust professionals and 1 is a private banker, and we see significant upside from this acquisition of talent over the next 12 to 24 months, and we think it will be a good catalyst for even better revenue growth from wealth management in 2022 and beyond.

The early returns on this team coming to our bank have been very, very good, and we could not be more excited about this acquisition of talent. The other components of noninterest income have been good, and I would just say that card revenue continues to surprise us pleasantly on the upside.

Turning to the net interest margin and net interest income, the margin continues to be problematic for us, 3% for the quarter. We calculate the core at 2.94% and would note that, that core includes the PPP revenues that come in. As we've said before, the expanded balance sheet does mean higher net interest income, but that's at the expense of a little bit narrower margin.

I believe on the last quarterly update -- quarterly call that I referred to pricing competition on good loans as brutal, and I would echo that this quarter, and to give you an idea of that, just in the last couple of weeks, we saw a 10-year loan, 10-year fixed rate loan priced at 2.5% in one of our markets for a very, very solid credit and yet at the time, probably less than 100 basis points over the 10-year treasury fixed. We would call that brutal competition.

We think the rise in the 2- to 5-year area of the yield curve really continues to help us, and we continue to invest our excess cash into shorter cash flow instruments, which give us a lot of liquidity, but certainly beat the return that we get on cash held at the Fed.

Turning to noninterest expense. I would highlight 3 themes. The first would be that we did have some onetime expenses. We had building write-downs and building write-offs of about $290,000 during the quarter. We had litigation settlements of around $700,000 during the quarter. We don't expect those to be recurring themes, and looking forward, the second theme would be that we continue to see pressure on salaries and benefits as most businesses in America do today but would also note that we expect our vacancy factor probably to be a little bit higher going forward just because it's very, very competitive whenever we hire new people into our company.

So, we expect salary increases could be up a little bit going forward compared to the past. Maybe one positive element of that is that we continue to have what I would call very, very good success at hiring at the officer level in our company, and some of the people we've been able to attract to our company in 2021, I think, will really help us in the years ahead. So, I think we have a good story to tell at MidWestOne, and that's reflected in the people we're hiring.

The third theme would be that we did just note that we did close -- announced the closing of one office, and we expect that office to be closed before the end of the year. A positive element in that office closure is that all of the employees were offered jobs with our company. We continue to evaluate our offices and would note that since 2019, we've closed 5 offices and 1 loan production office. So that continues to be an ongoing focus for us and something that we will continue to analyze going forward.

Very positive story to tell in asset quality. I would highlight that we had a net recovery for the quarter. If you look at our nonperforming assets, they were down 6 basis points quarter-to-quarter, and they're down 15 basis points year-over-year, and notably, we expect continued progress on the NPAs in the quarter and quarters ahead.

I would commend our special assets unit for doing a really good job of bringing many of these troubled credits to conclusion. Our reserve coverage seems to be very appropriate for our risk profile at this point in time, and I would note that we reported in the earnings release that our classified assets were up slightly, and that's really due to one hotel that's located in Florida, and the problem there is not with occupancy, but that the hotel is undergoing a remodel, and they are caught in the supply chain issues right now, and so really not able to operate at full capacity. We think the management of this particular hotel chain is very good, and we don't expect it to be a long-term problem, but we did move it to classified status during the quarter. So short term -- a little short-term pain. Long term, we think it will be just fine.

Ag, agriculture, has had a very good year this year. We don't really see anything negative on that horizon as we enter 2022, and I do commend our Chief Credit Officer, Gary Sims, and our bankers for staying on top of our asset quality, and I think that's reflected in the last 18 months or so of results. I also think it will be reflected in improved results over the next 6 to 12 months.

Turning to capital. Tangible equity sits right now at 7.7%. That suits us just fine. I think given our risk profile and especially our improved credit outlook, 8% to 9% remains our preferred comfort zone, but so long as we continue to build equity each quarter, we think we're fine with current levels, and we think the acquisition that was announced will fit in, in terms of adding equity to our capital deck. Regulatory capital is in good shape. I do note that we repurchased stock on almost each available day during the last quarter and bought back 235,000 shares just over tangible book value at 29.25, and that's roughly 1.5% of our shares that were purchased during the last quarter. We will continue to repurchase when we think that the conditions warrant that.

Turning now to the Iowa First acquisition, just a small recap or a short recap. Iowa First operates 2 banks, First National Bank of Muscatine, Iowa, which is the larger of the 2 banks, and First National Bank in Fairfield, Iowa. We are -- we at MidWestOne are already in the Fairfield market, and the Fairfield market has been one of the better growth markets for us in rural Iowa over the past 5 or 6 years. First National Muscatine has long been one of the leading community banks in Southeast Iowa. They're just south of the Quad Cities, and we are already in Muscatine County in West Liberty, Iowa, and have an office about 20 miles from Muscatine.

When the acquisition is completed, the transaction is completed, we will have the #1 deposit market share in Muscatine County, Iowa, and also in Jefferson County, Iowa, which is where Fairfield is located. We see a good cultural fit, and we see a good strategic fit. This folds right into our existing footprint. We did use what we thought were conservative assumptions whenever we modeled this particular transaction, and I will also note that we did thorough, if not more than thorough credit due diligence.

Clearly, we've had to be selective at MidWestOne as we've evaluated acquisitions and make sure that whatever we evaluated was something that we could pay for in a way that would be beneficial to our shareholders. We're very pleased that we did not give up any of our currency in this transaction, and I think also this gives us much better earnings visibility as we look to 2022 and 2023.

One last thing about First National Bank of Muscatine and I think a key to this transaction was that we were able to retain a 30-year employee, Wayne Johanson, to be our market president. Going forward, Wayne is respected both inside and outside of the bank. He's a community leader. He's a leader in the bank, and we think that Wayne's assistance will be invaluable to us as we seek to go through merger integration, and we do expect timely approval from the regulatory authorities.

So, in summary, I think, a very good outlook for our company. Again, the fourth quarter is probably a little bumpy in terms of loans and -- because of the payoffs that are coming, but we think the 6- to 9-month outlook is very promising as we have a growing pipeline in Denver and in the Twin Cities.

We think that the wealth acquisition bolsters an already strong wealth management unit in our company, and I would just remind everyone on the call that 2 years ago, we had no wealth management presence in the Twin Cities or in Cedar Rapids, Iowa and -- which is the second largest city in our state, and now we have a strong presence in both markets.

Asset quality continues to improve with a good outlook, and I think we are folding in a manageable acquisition in -- during 2022, which, as I've said, gives us a little bit better earnings visibility.

We think we are leveraging our capital appropriately, which is important to our shareholders, and again, I would argue that the risk profile of our company has improved significantly during the past 2 years.

So, with that, Chuck, I think we are ready for Q&A, and we will take any questions you might have.

QUESTIONS AND ANSWERS

Operator
Yes, sir. We will now begin the question-and-answer session. To ask a question, you may press star (*) then one (1) on your touchtone phone. If you are using a speakerphone, please pick up your handset before pressing the keys, and to withdraw your question, please press star (*) then two (2). At this time, we will pause momentarily to assemble our roster.

The first question will come from Brendan Nosal with Piper Sandler. Please go ahead.

Brendan Nosal
Hey, good morning, folks. How are doing?

Charlie Funk
Good morning, Brendan.

Gary Sims
Good morning, Brendan.

Brendan Nosal
Maybe just to start off on the team on M&A here. I think in the past, your approach to deals was to do larger transactions but with a good bit more time in between those deals, and obviously, this marks a bit of a smaller deal, a little bit sooner after the last one. So just kind of curious if that was the start of a purposeful strategic shift in the M&A playbook or if this is just more of an opportunistic chance to add a smaller partner in those markets?

Charlie Funk
I think it would be the latter, Brendan, and I had intended to say this in my opening remarks, but we've had discussions on and off with Iowa First for the last 10 years, and so we know them very well, and I think the timing was appropriate for them and appropriate for us and I think the fact that we've done larger acquisitions has been more -- that's kind of what came to pass. I don't know that we set out to avoid smaller transactions, but it's just the ones we -- the prior 3 that we had done tended to be a little bit larger relative to our size, but I don't -- I think that we are always willing to evaluate any opportunity, and this one seemed to be the best one that was in front of us.

Brendan Nosal
All right. That's very helpful color. Thanks. Maybe one more for me. Maybe just a little bit more color from you folks on asset quality at Iowa First. I guess that it's a smaller deal in terms of your size overall, but it does seem like they're kind of working through a few credit issues and trying to resolve those there, and I know you mentioned a very thorough diligence process. So just walk

us through what you saw in their portfolio and any cleanup efforts that you folks think you might have to undertake once the deal closes.

Gary Sims
Hey, Brendan, Gary here. So, you recognize what clearly, we recognize as well, given some challenges that they have had on the credit side in the past couple, 3, 4 years, we took a pretty proactive approach to the due diligence. Our initial due diligence request from them for file review while we were still in the initial due diligence before we signed the LOI was credits down -- relationships down to 750. This is obviously on the commercial side, and then once we signed the LOI -- so that was the initial due diligence and ran through that, and then once we signed the LOI, we took a more in-depth approach to our due diligence and engaged with the leadership of both of the banks in Muscatine and Fairfield and did a very thorough review of all the watch list credits as well as which would obviously include the nonaccrual credit, and based on that -- that was a one-on-one review of each credit. Based on that review, that really is what drove our development of the credit marks that you see in -- on the transaction, and based on that work, we feel very comfortable that we've, a, identified the problem credits in the portfolio; and then b, mark them accordingly to what we believe the ultimate resolution of those credits are, and I'll say one last thing before I stop talking on the subject. Throughout the process, one of the things that did impress us was even though we did recognize they've had credit issues and they acknowledge it -- we acknowledge it, what we've seen is an ability on our leadership team from the acquired banks, their ability to recognize the problems, put resolutions in place and work towards resolution. We've actually got -- they have actually got a couple of resolutions in between signing the LOI and the definitive agreement. So, all told, we recognize there's some problems that we'll partner with them to work through, but we feel good about the direction we're going there.

Brendan Nosal
Alright, fantastic. Thanks for taking the question, Gary.

Gary Sims
Yes, sir.

Operator
The next question will come from Jeff Rulis with D.A. Davidson. Please go ahead.

Jeff Rulis
Thanks, good morning.

Charlie Funk
Good morning.

Jeff Rulis
Charlie, I wanted to start maybe on the -- just following up on the timing of the transaction. Did I miss a conversion date or expectation there? It sounds like you're fairly positive with the regulator outlook to get this done by -- well, in the first quarter, but just timing of when you convert.

Charlie Funk
Well, that can always change, but right now, we would expect the closing to be sometime around the end of the first quarter, give or take. It could be April. It could be February, but we used the end of the first quarter to close the transaction, and we're still talking about how we might convert the 2 banks on to our system, but I think the conservative approach right now would be to say that that would happen for each bank in the third quarter of 2022.

Jeff Rulis
Great, and then, Charlie, you touched on the capital side, the comfortability on TCE and 8% to 9%, the preferred area. How do you view the buyback as you've got a pending transaction here, you pump the brakes, or you continue on staying active?

Charlie Funk
I think we will continue to be active repurchasing our shares, but the question might be what to what degree will we be active, but we don't expect to discontinue buying back our shares at these levels during the quarter. However, maybe not quite as many shares in recognition of the TCE that's moving in the 7.5% range to 7.75% range.

Jeff Rulis
Okay, and last one for me with -- just on the core margin, I think you mentioned 2.94% includes PPP, either specific or just broad level as PPP winds down, expectations on the core margin and as that trends into '22.

Barry Ray
Jeff, Barry, I'll start. Yes, we've got the information in the earnings release that includes all the PPP information. As Charlie said, we have the 2.94% in there. We kind of view it as if you take out all the PPP and the purchase accounting, we landed at 2.73%, I think, is what we would call a true core margin, and that was up a little bit from the prior quarter, a couple of basis points. Reflective of the fact that the cost of fund earning assets was down about 4 basis points and the yield on earning assets was down 2.

So, what we're seeing on the liability side is really the benefit from time deposits continuing to reprice lower, and so that's been helpful. The pressure with respect to the go-forward margin could be what we see, obviously, on the asset side because the benefit on the liability side will ultimately start to attenuate. So, what happens on the asset side and so to the extent that we continue to see downward pressure on the asset side, and I would say that currently, we are originating loans, for example, at a little bit below our portfolio coupon. There could continue to be pressure on the margin, is what I would say.

Jeff Rulis
Okay, and I think you mentioned the brutal pricing on loans. So maybe that continues on for a bit. Reinvesting, I guess it's more of a mix question on earning assets then, if you kind of deploy some of that cash, but overall, it sounds like a net pressure in the interim?

Barry Ray
That's how I would view it, yes.

Jim Cantrell
This is -- Jeff, this is Jim. I don't have a whole lot to add. I think Barry is right on it. If you look at what's going on in the loan yields, there's a slight downward movement on the loan yield, slight downward movement on the investment portfolio yield, and there is -- in the last quarter, we were down 4 basis points on cost of fund earning assets. So that's good. I worry that we are running out of runway on how low we can move that, but really the only category on the deposit side that's moving is CD book, and there's a terminal value that I have in my mind is probably 30 basis points, and as we get closer to that, it's just going to slow down the rate of decrease. So it may turn into an asset, and as Charlie mentioned, in the next quarter, we may have a little bit of a challenge on the loan production side, but beyond that, I think -- and if I look at net interest income, I think we'll

be flat to up a little bit, but margin itself, a couple of basis points down possibly, but income probably flat to up a little bit.

Jeff Rulis
Okay, thanks for the detail.

Charlie Funk
Thank you, Jeff.

Operator
The next question will come from Terry McEvoy with Stephens. Please go ahead.

Terry McEvoy
Maybe start with a question on expenses. If I back out the items noted in the press release and in Charlie's prepared remarks, I'm about $28.8 million in the third quarter. How should we think about the next few quarters given the commentary on wage inflation, the hiring of the new wealth management team? Maybe help us on that topic. Thanks.

Barry Ray
Terry, I'd say the -- what we've talked about in the past, I think if you back out those items that we highlighted in the earnings release, you get to a run rate that we think is a good run rate to utilize adding on to that. The fact that we do expect there could be some pressure on the compensation side as Charlie alluded to that could increase that number a bit, but that's kind of what I can -- that's what I would share with you. I feel like the core expense number backing out those items that you highlighted in the press release and adjusting upward a bit for normal merit increases, but those -- the size of those normal merit increases could be larger.

Terry McEvoy
Understood, and then on the acquisition news, when I looked at the 73% efficiency ratio, and I believe that was just the third quarter, I was a little bit surprised that the cost saves were just 30%, could you just talk about maybe the third quarter? There were some elevated expenses at Iowa First, but where do you come up with that 30% cost savings? And I guess I'll ask are you being conservative in your outlook there?

Barry Ray
Yes, certainly, we believe that the 30% is a very achievable number of cost savings with respect to where we come up with that. More than half of that is going to be personnel-based costs, and then the rest of it kind of goes down from there with respect to things you would anticipate in a typical acquisition, legal and professional, data processing, et cetera, and so the story is we believe the 30% that we disclose is very achievable.

Terry McEvoy
And then lastly, if I could, it just looks like both of the banks owned by the seller have some OCC outstanding actions that I pulled up. Maybe expand -- I guess, do those present a risk to closing the deal or anything between now and when the deal closes? Thank you.

Charlie Funk
We have done our diligence on that, and we do not expect delays in approval.

Terry McEvoy
Thanks again, I appreciate it.

Charlie Funk
Thank you.

Operator
The next question will come from Damon DelMonte with KBW. Please go ahead.

Damon DelMonte
Good afternoon guys. I hope everybody is doing well today.

Charlie Funk
Hi, Damon.

Damon DelMonte
Hi. My first question regarding the loan growth outlook. So, Charlie, is the message here that you're expecting loan balances to probably be flat to slightly down in the fourth quarter, just given the elevated payoffs?

Charlie Funk
Yes. I didn't know how to give guidance on that because we do have a decent pipeline, but we also see some payoffs coming. So maybe minus 2 to plus 2 for lack of a better guidance and flat is right in the middle of that.

Damon DelMonte
Got it. Okay, and then you seemed optimistic looking out 6 to 9 months. Do you think you get back to that mid-single-digit growth rate that we've seen in the last couple of quarters?

Charlie Funk
Yes. I think what we'd like to see for the company as a whole in 2022 -- and of course, a lot depends on the economy, but we'd like to see anywhere from 4% to 5% loan growth in our company, and again, I can't emphasize enough that the bankers we've hired in the Twin Cities are good bankers with proven track records, and we're still looking to hire a couple more, but I think the early returns are going to be really good from that market, which has underperformed the last couple of years.

Damon DelMonte
Got it. Okay, and then with regards to the wealth management team that you hired, roughly how much of a book of business do they have? And are there any noncompete associated with that?

Charlie Funk
What was the last part of your question, Damon?

Damon DelMonte
Is there any noncompete associated with that book of business?

Charlie Funk
Yes. 4 of the 5 have nonsolicitation agreements, and they -- I'd hesitate to give you an amount of their book of business other than to say that in the long tenure they had -- at this particular institution, they had a nice book of business, and the -- it's interesting that even before our company made an announcement, the word was out in the Cedar Rapids market, and I think the response is going to be very, very good over the next year. Clearly, they will honor their

nonsolicitation agreements, but I think, again, as I said, for the next 6 to 24 months, the needle is pointing up for Eastern Iowa in wealth management.

Damon DelMonte
Got it. Okay, and then just lastly, kind of going back to the deal, looking at the expected accretion in 2022, it's pretty sizable and there's a BPO gain, a bargain purchase gain of $3.3 million. Could Barry just explain that a little bit?

Barry Ray
Yes, this is Barry, Damon. Yes, we're paying below book value. So that's -- I'm understanding you're correct, your question correctly, that's what's driving the gain rather than typically you would record goodwill, and that gain is what's driving the 14.4% accretion or a portion of the accretion that we referenced in the related press release, and that's why in the future period, it goes down from the 14% to closer to 10%. Does that answer your question, Damon?

Damon DelMonte
Yes, no, it does, exactly. I just wanted to clarify that point. I probably didn't ask it clearly, but you explained it clearly. So, we're all set. Okay. Thanks, that's all I had.

Charlie Funk
Thank you, Damon.

Operator
The next question will come from Ross Haberman with RLH.

Ross Haberman
Good morning, gentlemen. Thanks for taking my call. I just had 2 questions. On your -- is there much room going forward over the next quarter or 2 to further lower deposit rates or like many banks, you guys are very much close to where the bottom is out? That's my first question. Thanks.

Jim Cantrell
Ross, this is Jim. I would answer that. I think we've -- in terms of the nonmaturing types of accounts like checking accounts, savings accounts and even largely, money market accounts, we've reached kind of bottom terminal value in our marketplace. We are priced pretty even with where competitors are at those low rates. The only area where we've seen a little bit of downward movement in the book of business is CD rates. We're continuing to reprice maturing CDs a little bit lower than where they're rolling off, but that's a game that probably comes to an end here. As that CD book -- memory serves, I think the book yield is below 50 basis points. As we get closer to 30 on the CD book, I think we're going to see an end to that. So that's probably in the next quarter or 2, and then we'd be bottomed out without some kind of dramatic change. I'll just leave it there.

Ross Haberman
And just one -- and just 2 quick questions about the deal you announced. One, was it a negotiated? Or was it an auction type of process?

Charlie Funk
It was negotiated.

Ross Haberman

Okay, and is there any outs for you in terms of asset quality, anything like that? A lot of questions in the past were on asset quality of the bank. If it got worse between now and when you're supposed to close in the first quarter, do you have an out? Do you have an adjustment, anything like that in terms of outs for the deal or risk that it drops, you might say, or you want it to drop, I should say?

Barry Ray
This is Barry. We have -- we do have some outs to the deal. If there's a target tangible book value and a minimum tangible book value to the extent that closing tangible book value is below target, there is a dollar-for-dollar reduction in the price, dropped below a certain minimum tangible book value, then that's an out for us. It's also outs related to the -- any decline in below a certain amount for pass-rated loans, we also have announced for that as well. Those are a couple of examples of outs that we have.

Ross Haberman
Got it. Okay. Thank you very much. It looks like a pretty accretive deal. Thank you, guys.

Barry Ray
Thank you, Ross.

Operator
The next question will come from Brian Martin with Janney Montgomery. Please go ahead.

Brian Martin
Hey, good morning, guys.

Charlie Funk
Hello, Brain.

Barry Ray
Hello, Brian.

Brian Martin
Just one question back to the margin, and I don't know for whom, either Barry or Jim, I guess, but just on kind of the balance sheet itself. I mean, I guess, how are deposit flows trending today? And I guess I'm not sure what's kind of baked in kind of how you're thinking about the margin of your comments earlier, but just kind of what's happening with the deposit flows? And then just maybe when you're thinking maybe the puts and takes on when the margin could begin to inflect upward. We've got a couple -- a quarter or 2 here of maybe some pressure, but kind of when do you think it might reach an inflection point or just kind of the drivers of that?

Jim Cantrell
Brian, this is Jim, and I'll start this, and Barry may have some thoughts as well. He and I discussed the margin pretty regularly. So, in terms of deposit growth, I think deposit growth since the end of the year has been, if memory serves, about 9%. A big chunk of that is in public funds, but if I look at nonpublic fund deposits, we're probably still talking about 4%, 4.5% on to 5% for commercial and consumer deposits. So that's a pretty good number. We don't really see -- I haven't seen any indication that would lead you to believe we're going to see a drop off in deposits. So, we sit here -- as we sit here today, we're at high-water mark for total deposits on the balance sheet.

So that's part of the reason for my comment that I think net interest income in the fourth quarter and then maybe beyond is going to be -- it will be at least as high as we were in the third quarter -- second and third quarter. So, I think positive trends for net interest income, and we may see 1 basis point or 2 of deterioration in the margin, but it's almost noise. I mean it's a small amount, and it would be based on some fluctuation in assets. The trends in the yields and the major components of the margin, like loans and like securities, are pretty well established, and they're pretty much canceling each other out. I mean I look at those I'd say, if balances stay where they are now, we'll have a flat margin. So, any change in margin is going to be due to change in volume, and we have a little downtick in the fourth quarter we might, but probably not enough to offset the income -- increased income we'll see from the larger balance sheet. So, I just see a larger balance, slightly larger balance sheet as we move forward, which is helpful.

Brian Martin
Okay, and as far as when you kind of, I guess, start to see some -- maybe a little bit of pickup, I guess, what would be the driver? I guess when would you think that's potential?

Jim Cantrell
Well, I think Charlie said, I think once -- if we could see 4%, 5% loan growth, when you start to see that year over year, then we can stop buying securities, and we'll see the asset mix change favorably for us, and I think that would be an impetus. The yield curve stays as steep as it is now, and we see a little rising in rates, that will also be helpful, but that tends to be slow in coming. It happens slowly over time, but it would be positive, net positive.

Brian Martin
Okay. Perfect. That's helpful, and just maybe just one on the reserve side, Charlie, or just whomever. Just kind of, given credit quality, the positive story, and just kind of what you're kind of signaling here at least – it's as good now, it's getting better, how do we think about the reserve levels as we move forward here?

Gary Sims
Hi, this is Gary, and I'll take a start to answer the question. Barry, step in if I start talking accounting out of school, but what you've seen from our reserve is really a reflection of, as we've managed through the pandemic the large reserves that we took at the beginning of the pandemic, we've recognized that the economic conditions have improved, and then we've released those reserves as we dealt -- as we deemed appropriate.

Of course, we have a model, a CECL model that we utilize, and it guides the direction that we go, and so based on what we're seeing in the portfolio today, in terms of -- as Charlie was saying, continued improvement momentum in the asset quality, we do expect that trend to continue on a go-forward basis, but a lot of it will continue to be driven by what the economic forecasting turns out to be in the model itself.

Brian Martin
Okay. Yes. I guess just are you kind of targeting -- if you kind of go back to day 1 CECL where that was? And -- or is that kind of where the trend is back towards is how you would view it today, given that things are -- assuming the economy continues to recover?

Gary Sims
Yes. I mean our kind of perspective on it right now is that the economy is really not where it was pre-pandemic, and so I think that you're going to see us really kind of have a bias towards carrying a bit more reserve than we had pre-pandemic.

Charlie Funk
Yes. Brian, traditionally, we've been in the 120 to 150 range in terms of reserve coverage, and when you perform an acquisition, sometimes those drop below those levels, but absent any circumstances such as that, I think 120 to 150 is probably a good place, given where we are right now.

Gary Sims
Yes.

Barry Ray
Yes.

Brian Martin
Okay. Perfect. Understood, and then just maybe the last 1 or 2, just for -- maybe for Barry, just on the fee income outlook or maybe if Charlie weighs in, but just the kind of how we should think about that baseline on the fee side? And then just maybe the contribution from the new wealth team, I guess, how we think -- maybe how frame up, how we should think about that progressing over the next 12 months?

Barry Ray
I'll start, Brian. I think with respect to fee income, really, I anticipate that we're still a little bit above what I would call historical levels with respect to mortgage banking, and so that could potentially be a headwind for us for fee income over the near term, but we've also, as Charlie alluded to, we're getting good performance from wealth management as well as card revenue, and so there are some puts and takes there, and obviously, this quarter in fee income was impacted by the mortgage servicing right, but anyway, I think the levels that we're at are probably pretty good levels to contemplate going forward, acknowledging that the mortgage servicing, the mortgage revenue is probably still a little bit elevated compared to historical levels.

Brian Martin
Okay, and as far as just the ramp-up as the wealth team comes on board, I mean, is it more back half of this year? I guess you started -- it sounds like you're starting to see some good things early on, potentially but ...

Charlie Funk
Yes. I'd say, Brian, that you probably won't see much in the fourth quarter because we sit here on November 2nd. There's probably a little bit in the first quarter of 2022, and I think where you'll see the bigger boost will be in the Twin Cities because the nonsolicitation agreements are gone there, and those folks are free to call on whoever they wish. So, I think it's -- we would hope and foresee it being a gradual upward sloping trend in terms of top line revenue in 2022.

Brian Martin
Got you. Okay. Perfect, and then last one was just for me was just on accretion, Barry. I guess just that's going to continue -- should continue to just creep lower. Is that nothing else to expect on that line item?

Barry Ray
Yes. No real new story on that, Brian.

Brian Martin

Okay, perfect. Thanks for taking the questions and congrats on the transaction guys.

Charlie Funk
Thank you, Brian.

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

CONCLUSION

Charlie Funk
Well, we're excited about what's happening in MidWestOne, and we thank all of you for joining the call this morning. We thank the question -- all the questions we received and wish everyone a good rest of this month, a great Thanksgiving season. I'll send it back to you, Chuck.

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