HomeStreet, Inc.

Q1 2020 Earnings Conference Call

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CORPORATE PARTICIPANTS

Mark K. Mason - *Chairman, President, and Chief Executive Officer*

Mark R. Ruh - *Executive Vice President and Chief Financial Officer*

PRESENTATION

Operator
Good day. And welcome to the HomeStreet, Inc. First Quarter 2020 Earnings Conference 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. After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press star, then one, on your touchtone phone. To withdraw your question, please star, then two. Please note, this event is being recorded.

I would now like to turn the conference over to Mark Mason, Chairman and CEO. Please go ahead.

Mark Mason
Hello. And thank you, for joining us for our first quarter 2020 earnings call. Before I begin, I'd like to remind you that our detailed earnings release and an accompanying investor presentation was furnished yesterday afternoon to the SEC on Form 8-K and is available on our website at ir.homestreet.com, under the News and Events link.

In addition, a recording and a transcript will be available at the same address following our call. Please note, that in the course of our call today, we may make certain predictive statements that reflect our current views and expectations about the company's performance and financial results. These are likely forward-looking statements that are made subject to the Safe Harbor Statements included in yesterday's earnings release, the investor deck, and the risk factors disclosed in other public filings. Additionally, reconciliations to non-GAAP measures referred to on our call today can be found in our earnings release available on our website.

Joining me today, is our Chief Financial Officer, Mark Ruh. Mark will briefly discuss our financial results and then I'd like to give an update on our response to the current COVID-19 pandemic, the results of operations, and review our progress in executing our business strategy.

Mark?

Mark Ruh
Thank you, Mark. Good morning, everyone, and thank you again for joining us. Our consolidated net income for the first quarter of '20 was $7.1 million dollars, or $0.30 per diluted share, compared to net income from continuing operations of $13.1 million dollars, or $0.54 per diluted share for the fourth quarter of '19. Note, that we are comparing current period consolidated net income to prior period net income from continuing operations, as HomeStreet terminated discontinued operations accounting treatment effective January 1, 2020.

Core net income for the first quarter of '20 was $8.1 million dollars, or $0.34 per diluted share, compared with core net income from continuing operations for the fourth quarter of '19 of $14.9 million dollars, or $0.61 per diluted share. Our core pre-provision income before taxes was $24.1 million dollars for the quarter. Excluded from core net income, in the first quarter, was approximately $1 million dollars of restructuring-related expenses, net of tax. A decrease in net income compared--correction, our decrease in net income compared to the prior quarter, was primarily due to a $14 million-dollar allowance for credit loss provision estimated under the new CECL methodology to be discussed later in the presentation.

While net interest income decreased in the first quarter of '20 due to decreases in both the rate and volume on our loans held for investment, our net interest margin increased by 6 basis points, due to significantly lower interest expense. While loan rates declined during the quarter, approximately 29% of our variable rate loan portfolio was at contractual interest rate floors at quarter-end, which mitigated the impact of the general decline in interest rates on our net interest margins.

Deposit balances were $5.3 billion dollars at March 31st, decreasing 1.6% from December 31st. This decrease in deposit was primarily driven by a decrease in certain high rate brokered deposits and the maturity of promotional certificates of deposit that we previously issued, to fund the transfer of servicing-related deposits in 2019. This deposit decrease was offset by increases of $72.6 million dollars, or 4.5%, and $170.5 million dollars, or 6.1%, of business and consumer core deposits, respectively.

Our interest costs decreased due to our proactive reduction in rates paid on interest-bearing deposits, lower balances of higher cost brokered deposits, lower rates paid on FHLB advances, and the maturity of higher rate promotional certificates of deposit. In fact, our cost of deposits was 72 basis points at quarter-end versus 122 basis points at year-end. As a result of these changes, our net interest margin increased to 2.93% for the quarter, up from 2.87% in the fourth quarter of last year.

On January 1st, '20, we adopted the Current Expected Credit Losses Accounting Standard referred to CECL. CECL replaced the allowance for loan and lease losses incurred loss model with an allowance for credit losses methodology that reflect lifetime expected credit losses and requires consideration of a broader range of reasonable forecast information to inform credit loss reserve estimates.

The adoption of CECL resulted in a Day-1 increase in our allowance for credit losses of approximately $3.7 million dollars at January 1st, 2020, or 9%, as compared to our December 31st, '19 aggregate reserve levels. This adjustment was recorded in retained earnings and did not impact net income, in order to materially impact regulatory capital ratios. The $14 million-dollar Day-2 provision for the first quarter was entirely due to the forecasted economic impact of the COVID-19 pandemic. Absent the crisis, we would have recovered approximately $2.3 million dollars of provision in the quarter.

Asset quality remained strong, as evidenced by our low non-performing loan-to-total loan ratio. However, note that loans most at risk have not yet been downgraded or designated as troubled debt restructurings, based on regulatory guidance. Non-interest income increased from $21.9 million dollars in the fourth quarter of '19, to $32.6 million dollars in the first quarter of '20. This was primarily due to a significant increase in single-family gain on loan origination and sale activities related to higher interest rate lock commitments. And due to higher profit margins from strong refinancing activity, fueled by historically low mortgage rates during the quarter.

Our increase in loan servicing income was caused by higher risk management results. A sharp decrease in market interest rates in March, initially caused mortgage rates to fall to record lows, triggering a surge in mortgage refinance activity toward the end of the quarter. Single-family rate locks were $566 million in the first quarter of '20, compared to $303 million in the fourth quarter of '19. Participants in the primary mortgage market, HomeStreet included, have responded to both capacity constraints created by the large volume surge and market uncertainty, by increasing gain on sale margins. This change in mortgage pricing, resulted in primary mortgage rates not declining to the same extent as secondary mortgage rates during the quarter, driving the positive variance between the change in the fair values of our single-family MSRs and our related hedge instruments.

Noninterest expense increased $2 million dollars, to $55.2 million dollars in the first quarter of '20, from $53.2 million dollars in the fourth quarter, primarily due to a $2 million-dollar recovery of stock-based compensation expense in the fourth quarter of '19. The number of full-time equivalent employees fell below 1,000 during the quarter, ending at 996, an 18.4% decrease since June 30th, 2019.

Thank you for your attention. I will now turn the call back over to Mark Mason.

Mark Mason
Thank you, Mark. As you know, beginning in February, our markets have been significantly impacted by the Coronavirus pandemic. Stay-at-home orders in all states where we do business, have contributed to significant business disruption and created substantial increases in unemployment. Our customers and our company will be adversely affected by the crisis, in ways we are still trying to quantify. Nevertheless, we feel strongly that HomeStreet is well positioned to navigate this crisis successfully.

We have a strong capital base with consolidated Tier 1 at-risk-based capital ratios of 10.15% and 13.5%, and bank Tier 1 at-risk-based capital ratios of 10.06% and 13.9%, respectively. Additionally, we have substantially increased our allowance for credit losses in anticipation of potential credit losses that may occur as a result of the crisis. Beyond our strong capital base and increased allowance for credit losses, our current earnings provide meaningful additional capacity to absorb future credit losses.

Additionally, today we have ample on-balance sheet liquidity and access to more from our contingent sources. Today, our available borrowing capacity from the Federal Reserve and the Federal Home Loan Bank, including existing lines and additional unpledged collateral is $3.7 billion dollars. During the crisis, we expect some deterioration of our loan portfolio credit quality, with certain commercial loans most at risk. Our loan portfolio has, by design, limited concentrations by product type, industry, and geography, in order to limit our risk of exposure to any one part of the market.

To mitigate additional risk to our portfolio, we have among other things, suspended lending to borrowers who're operating in the most adversely affected industries, suspended most new commercial lending, commercial construction lending, and certain mortgage products. We've tightened our commercial real estate underwriting standards and increased our margins.

As a result of our history and portfolio composition, most of our loan portfolio is secured by high-quality real estate, in some of the strongest, fastest growing economies in the nation. Our conservatively underwritten single-family and multifamily mortgage portfolios are performing well, despite assisting some homeowners with forbearance. These portfolios performed substantially better than portfolios at other banks during the Great Recession. Additionally, our residential construction portfolio continues to perform well, given the continued scarcity of new homes in our markets and the conservative lending standards with which we operate this business. Accordingly, our credit risk to-date is concentrated in our commercial lending portfolio and certain business segments most impacted by the shelter-in-place and shutdown orders in the states in which we operate.

Our investor deck, also published yesterday, contains good data on our underwriting standards and portfolio composition. We added a few slides, further disaggregating the information and providing additional detail on the parts of our portfolio most at risk today. Our risk has manifested itself in requests by our borrowers for loan payment forbearance, to allow them to get past the shutdown orders and get back to business.

Let me summarize these requests by loan type. As of April, the 23rd, we have 150 single-family mortgage customers that have requested and have been granted this forbearance, for an aggregate $58.5 million dollars, representing 3.7% of our on-balance sheet mortgage portfolio. For comparison, we have granted 1,068 customers forbearance, for balances representing 3.5% of our loans serviced for others. This compares to current industry forbearance levels of approximately 7% nationally, as of April the 19th for bank services.

In the Great Recession, we also substantially outperformed the industry as a whole, on single-family mortgage forbearance and default, reflecting disciplined underwriting, and strict adherence to our conservative policies and application of agency guidelines. We also have 291 commercial customers, with aggregate loan balances of $211 million dollars, that have requested payment forbearance. Included in this amount is $88.8 million dollars of owner-occupied real estate, underwritten at conservative loan-to-values. And $86 million dollars of loans, primarily to dentists, who we believe, will successfully restart their practices relatively soon after the shutdown orders are lifted.

Also, in this total are $61 million dollars of restaurants and bars, of which one regional restaurant and brewpub operator represents $52.7 million dollars. 61% of this balance, is real estate secured. And we recently arranged the $4.5 million-dollar liquidity line for them, secured by another $11.7 million dollars of real estate collateral. Additionally, we just funded a maximum $10 million-dollar Paycheck Protection Program loan for them.

We have historically benefited from an extremely loyal customer base, which gives us a higher level of confidence in their ability to resume operations at an appropriate time in the future. The remainder of this risk pool includes a very well operated church, a regional transportation company, and other quality companies. To-date, of the 291 forbearance requests, 156 loans with balances totaling $123.7 million dollars, have been granted. Not all borrowers who request forbearance need it, in our experience. We evaluate actual borrower liquidity and cash flow before granting forbearance. In our experience, some borrowers request forbearance well in advance of actual need, which may never occur.

We have 18 commercial real estate loans, totaling $98.6 million dollars that have requested forbearance. But none of those requests have yet been granted. In April, we had only one portfolio commercial real estate loan, only one, that didn't make their April payment. All Fannie Mae (INAUDIBLE) loans that we service were current in April. This strong performance reflects our conservative underwriting, which should generally allow these loans to stay current under current conditions. We have provided detailed underwriting on portfolio characteristics on Page 19 of our Investor Deck published yesterday.

Additionally, one borrower, with 11 residential construction loans, totaling $10.3 million dollars, has requested forbearance. To-date, this request has not been granted. Our underwriting of residential construction loans is substantially more conservative than that in common use before the Great Recession. We have provided detailed underwriting and portfolio loan characteristics of these loans on Page 20 of our Investor Deck. These numbers only represent our experience to-date, and we like everyone, cannot predict with certainty the duration or impact of the shelter-in-place and state shutdown orders on these businesses.

It is clear to us that our risk concentrations are today well defined. And we believe manageable with current reserves, capital, and earnings. Adding to our current confidence level is the fact that much of the team that initially came to HomeStreet to guide the bank out of the credit challenges of the Great Recession, including me, remain at the company today in key positions. This experience and capability will be invaluable as we navigate the current crisis.

We are working hard to support our communities and our customers, while also protecting our employees. We, like our peers, have devoted significant time and resources to processing loans backed by the Small Business Administration, under the Paycheck Protection Program. We began taking applications for these loans on April 3rd, and as of April 16th, when the Treasury Department advised that all funds available had been allocated, we approved and registered 396 loans for a total of $158.2 million dollars.

Yesterday, the SBA opened their portal to begin accepting registrations of Paycheck Production Program loans under the current appropriation. We hope to register and fund 1,100 additional loans, for approximately $160 million dollars for these customers that we were not able to get registered before the first allocation of funds under the program was exhausted.

Unfortunately, the SBA portal, E-Tran, has experienced uptime and throughput challenges since opening. And it is unclear at this time whether we'll be able to input successfully all of our customer applications. But we are working, literally 24 hours a day to do so.

We're also taking steps to protect our employees, customers, and vendors. We've committed to no COVID-19-related layoffs. All of our employees who are able to work remotely are doing so, with only certain operationally critical employees, including branch employees working on-site.

Additionally, we have limited our branch lobbies to appointment-only access, with social distancing procedures, provided personal protective equipment, provided COVID-19 paid sick time, and additional paid-time off for our frontline workers, and eliminated out-of-pocket costs for employee COVID-19 medical care. While it has been an adjustment, the business of the Bank has continued without significant interruption. There is still much work ahead of us and the ultimate impact of the pandemic is largely unknown. Management is working closely with our Board and our advisors as we plan and execute our response to the significant disruption caused by the crisis.

Reflecting our strong first quarter results, even with the impact of the pandemic, as well as confidence in our ability to successfully navigate the crisis, the Board of Directors declared a $0.15 per share common stock dividend, to be paid to shareholders of record on May the 4th.

On behalf of the entire Board of Directors, I want to commend the courage and dedication of our employees, in pursuing our goals, and serving our customers and communities during this time of personal risks and uncertainty. As a regional community bank, HomeStreet Bank plays an important role in supporting our communities through this crisis. And we believe HomeStreet is well positioned to help our customers and communities move past this pandemic.

Looking forward, we have made some revisions to our guidance. Our prior guidance called for flat-to-slightly increasing average loans held for investment. For the second and third quarters of this year, as a result of the temporary suspension of certain lending activities and expected ongoing runoff in our loan portfolio, we now expect a flat balance of average loans held for investment. This will somewhat be offset by continued growth in our multi-family portfolio and SBA originations related to the Paycheck Protection Program.

Our prior guidance called for a decrease in average deposits, which we are continuing. We expect the continued meaningful reduction in broker deposits, mitigated by the continued growth of business and consumer core deposits. Our prior guidance called for increasing net interest margin, which we are continuing. Assuming the current low level of market interest rates and shape of the yield curve, we expect our net interest margin to increase this year, reflecting our now meaningfully lower deposit costs. The rate of increase we now expect, is likely to be more meaningful than we previously expected.

Last quarter, we expected recurring non-interest expense to decrease these same periods, reflecting lower headcount, resulting in lower base salaries and related occupancy expense. These reductions are still expected. However, they may be offset by continuing higher commission expense, as our single-family mortgage business continues to originate higher levels of refinance loans, and as the current log pipeline is closed.

Finally, due to the high level of uncertainty surrounding the ongoing COVID-19 pandemic, we are withdrawing our previous profitability and efficiency ratio guidance. However, it is important for me to stress that, excluding any further loan loss provisioning, we continue to believe that we have the opportunity to achieve our previous targets at the timeframes previously stated.

I would like to offer some color here. Consider our just completed first quarter, pre-provision pre-tax core income of $24.1 million dollars. If we applied a 20% effective tax rate to that $24.1 million dollars, it would imply an after-tax annualized return on assets of 1.13% and return on average tangible common equity of 11.8%. Our core efficiency ratio in Q1 was 69%, and we continue to have efficiency improvement opportunities to realize going forward. Compare these ratios to our now withdrawn prior guidance, which was to achieve a core return on average assets of approximately 95 basis points, a core return on average tangible common equity of approximately 11%, and an efficiency ratio in the low 70% range, all by third quarter of this year.

Obviously, all three measures are already superior to that guidance and two quarters early. There are, of course, many factors to consider. Maybe the most meaningful one is that we should acknowledge that we are currently benefiting from a much higher level of profitability in our single-family mortgage business than we had previously expected. It is anyone's guess of how long that will remain to be the case. But I do note, that both origination volume and margins remain robust today, and recent economic forecasts predict a continuation of low rates for the foreseeable future. Which should extend this mortgage refinancing period and support any weakness in the purchase market.

Additionally, going forward, our substantial reduction in deposit and borrowing costs should support an improving net interest margin, mitigating potential lower levels of earning assets. So, the bottom line is this, credit will undoubtedly remain the big question mark for the entire banking industry for at least the rest of this year. Hopefully, among other things, the characteristics of our loan portfolio that we have provided in our quarterly Investor Deck and have discussed on this call, reflect our disciplined approach to credit, and we are well positioned as we enter this COVID-19 crisis environment.

The experience and preparation of our lenders and credit management team, and the diligence with which we have addressed our clients' unique circumstances to-date, will otherwise mitigate losses. The markets in which we operate were the strongest in the nation going into the crisis, and we expect the damage to be less than a recovery faster in these markets. Hopefully, this background provides you with a foundation for the cautious optimism that we have today at HomeStreet to successfully navigate this environment.

This concludes our prepared comments. Thank you for your attention today. Mark and I would be happy to answer any questions you have at this time. Operator?

Operator
We will now begin the question-and-answer session. To ask a question, you may press star, then one on your touchtone phone. If you are using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question, please star, then two.

Our first question will come from Jeff Rulis, with D.A. Davidson.

Jeff Rulis
Thanks, good morning.

Mark Mason
Good morning, Jeff.

Jeff Rulis
Just a question on the provision. Trying to get a sense for the thought behind that and timing. And clearly, as we progressed over the last month, there's been a pretty volatile view of the macro economy. And so just, as that's posted for the first quarter, was that more a 3/31 read or something kind of mid, or late April, on economy and how you adjust for a CECL provision in the first quarter?

Mark Mason
Well, the first quarter provision is based upon the March--substantially, on the March Moody's Economic Forecast. Maybe, if you look at our deck on Page 22, we describe the key drivers of the provision, which is substantially, almost exclusively, the economic forecast by Moody's, as of the end of March, for their pandemic forecast.

In our model, we also compared the results using the Moderate Recession forecast. And then later, after we close the books, we took April's pandemic forecast, which is much more severe than March's, and took a look at what impact that would have had as of March, and we came up with substantially the same numbers, right.

So, that is driving the reserving today. And it's important to know what's not driving it, is loan migration and probable expected losses. Which ultimately, is the real answer, right? How much of our sensitive, or risk pools, will ultimately migrate to loss, and what will that imply about total losses?

At this point, it's really unclear. The regulatory guidance to all of us has been not to downgrade and not to migrate these loans. Absent the virus, we would have been reversing $2.3 million dollars of provision, based upon performance in loan balances. So, a $14 million-dollar provision this quarter, frankly, is $16.3 million-dollar delta, from where we have been.

Jeff Rulis
Appreciate the detail. It's a pretty fluid environment. Just, that's helpful to know your positioning on how you establish the provision this quarter and how it might trend going forward. Maybe, switching gears on, it's kind of an expense backdrop, but trying to get the head count. I guess, reductions separate from any COVID-related impact. Just trying to get a sense. I think you're down 75 full-time employees year-to-date, or through the quarter. Is there much more to go there, or is that largely right-sized? And then if you could, kind of, dovetail that into the core expenses, understanding your guidance, is to continue to decrease that. But, kind of, where are we at on the headcount figure?

Mark Mason
We have a number, below the current headcount number, that is a current target. It's a little fluid, because we're having to add some personnel, primarily in the single-family mortgage area, because of the, I mean, substantial increase in volume. That, of course, will last until this refinancing wave abates, right? So, the numbers you see on FTE over the next couple of quarters, are going to be a little volatile because of that.

Having said that, we are nearing the end of the FTE reductions, from an efficiency standpoint. Yes, we will end up, on a stabilized basis, a little below this. I would give you a number today, but it's kind of fluid because of one, single-family; and two, some other business changes. But the substantial changes have occurred.

We would love to get into the mid-900s. Maybe, just as, sort of, a target downstream someday. But that's going to require some system changes and clearly a change in the mortgage business. The greater amount of dollar cost changes over the next year and a half, let's say, will be coming from, first, technology, and to a lesser extent from real estate.

We've been frustrated, as we've talked about on prior calls, by the inability to get our primary technology providers to restructure and renegotiate these contracts early. There has been some recent discussion that suggests, perhaps in 2021, we will be able to get a restructuring of our core service provider agreement. I'm not relying on that yet, because we're so far from that being a reality. I can't count on that. But most recent discussion suggests, that instead of waiting to 2022, we may be able to get some meaningful help in that agreement in 2021. And perhaps with some of the lesser agreements as well. So, I'm holding out hope that we will be able to pull some of those changes into '21.

And the real estate environment, unfortunately, has gotten worse, right? If you think about subleasing office space in this environment, it's clear to me that those savings are going to get pushed out a little bit. Right? There are companies that will fail, who will create greater vacancy. And pricing the cost is probably going to get readjusted. So, that part of the savings may make it delayed or not happen, at least in our timeframe.

Jeff Rulis
Thanks, Mark. I'll step back.

Mark Mason
Thanks, Jeff.

Operator
Our next question comes from Steve Moss, with B. Riley FBR.

Steve Moss
Good morning.

Mark Mason
Hi, Steve.

Steve Moss
I want to start with, just on the mortgage banking side, just wondering if there was any hedging impact on gain on sale income this quarter, and what were total mortgage originations for the quarter here?

Mark Mason
That's a very good question, Steve. There was, if you have been monitoring other mortgage banking results this quarter, I assume other people have talked about mortgage pipeline hedging and mortgage servicing, right, hedging effectiveness during the quarter. The fixed income markets were substantially disrupted. I'm not sure that's even a strong enough description.

The volatility that we experienced in the fixed income markets, particularly in early March, was greater than we've ever seen. It may be, historically, the largest amount of volatility. And the disconnect, or the widening of normal spreads between instruments, was very challenging for hedging. Particularly anything related to mortgage yields.

A combination of significant increase in supply; of much lower rated mortgage-backed securities, because of the refinancing volume; the de-levering and liquidation of investment funds, all led to a significant decline in demand for mortgage rated product, which widened spread significantly. Mortgage rates actually increased, accordingly, during that period, to levels that shocked even us. Now, they've come back down since then.

All of that, created ineffectiveness. Particularly, in our mortgage origination pipeline hedge. We actually lost a certain amount of money on that hedge. The impact on our gain-on-sale for the quarter was about 60 basis points a gain. That's how significant that impact was. Our margin, our profit margin for the quarter, in the first quarter, was approximately the same as the fourth quarter. But it would have been about 60 basis points higher.

So, what does that imply going forward? Mortgage profit margins are historically wide. I want to repeat that statement. Historically wide today. Example, fixed rate Ginnie Mae loans, FHA/VA loans are priced at profit margins in excess of 600 basis points. Fixed rate agency, Fannie/Freddie loans, 30-year conforming, in excess of 500 basis points.

So, you got to understand what that implies to profit margins today. And thankfully, the fixed income markets have settled into reasonable approximations of prior spreads. So, hedging is much more effective today. Today, we're in a positive position on our pipeline hedge. And so, everything is, sort of, hitting on all cylinders. That's today.

We live in very volatile times and I don't want to predict the outcome for the quarter, but things are substantially better for the month of April. In March, our servicing hedge was even more volatile. And at times, was down as much as $3 million dollars, relative to our change in the value of the asset. And ended up, well, you see our risk management results for the quarter, up about $3 million dollars. That's how wild and volatile it was.

Again, I'm happy to report that those markets and spreads have settled substantially. And all of this is a consequence of the Federal Reserve stepping into the fixed income markets and providing a steady and sufficient bid. Otherwise, they would still be just as volatile, we believe, maybe worse.

Steve Moss
Okay, that's helpful. And then, I guess in terms of just, thinking about production here, is that a similar level to the first quarter, as you look at your pipeline here today?

Mark Mason
The quarter was quite strange, as you would imagine, given the changing environment and changing interest rates. Right? So, we produced--was it for the quarter? Was it total locks? $565 million, right? But versus about $300 million in the fourth quarter. But that $565 million, $300 million or so, over $300 million was in March alone, right? And in April, our production is going to be, it looks like a little better than half of that. Maybe, $160 million, right now, 'ish. But we got a few days to go. But that would imply, if it were consistent across the quarter, something less than last quarter's locks, right?

And remember, we're going to now be closing this quarter, not all but most of the locks from the first quarter. And that is going to increase our expenses. Right? Commission expenses, for example. Most significant, upon closing. So, mortgage banking profitability next quarter may or may not be as good. I think profit margins will be better, as we just discussed. That might substantially offset the additional cost. We don't really know. We have to see where we end up.

Steve Moss
Okay, that's helpful. So, then if I just take a look, imply from the numbers here for April production and your gain on sale margin, you're running around, call it, $9 million to $10 million in gain-on-sale income for the month of April; is that about right?

Mark Mason
Hold on one sec, let me do some math. What did you say? That's too high.

Steve Moss
Nine is too high? Okay.

Mark K. Mason
Yes. Nine is too high. I mean, given the numbers I gave, it could be in excess of $7 million, but that's a very gross estimate, right?

Steve Moss
Okay. Okay, that's helpful. And then, in terms of, shifting gears here, just on the construction portfolio here. Wondering if you see--you had a pretty significant decline this quarter. I'm wondering what your expectations are for that portfolio in the next couple of quarters, given the mix of, probably, commitments and what you expect in normal time during paydowns? But then, is there any impact from the shut down here, in terms of continuing to build?

Mark Mason
There is an impact. I mean, obviously projects have slowed down, most of our construction is in Washington, and no progress has been made on it until they restarted this week. Right? Which means, no draws either. But most of our commercial construction projects are nearing completion.

We slowed down new construction loans many, many months ago. And most of those balances are nearing completion, in commercial construction and multifamily construction.
Custom home construction, that's just, kind of, an ongoing business. We have houses in many phases of construction. We did suspend custom home construction new lending last month, and we're considering reopening it sometime soon. But there will be a lull there.

Homebuilding, obviously, any homebuilding in the State of Washington has come ground to a halt until this week, but sales have continued. The traffic, as you would expect, is lighter than it was, but sales continue. And we feel pretty good at this point, about the build out and sale of our projects. The great part about that equation is, most of these builders have pretty substantial profit margins in these projects, at least on a pro forma basis. So, if they need to decrease pricing to move these houses, they have a lot of room to do so.

Steve Moss
That's helpful. Thank you very much very for all that. I'll step back in the queue, here.

Mark K. Mason
Thanks, Steve.

Operator
Our next question comes from Matthew Clark, with Piper Sandler.

Matthew Clark
Hi, good morning.

Mark K. Mason
Good morning, Matt.

Matthew Clark
Maybe just first on the guidance, I can understand pulling the ROA and ROE guidance for the outsized provisioning. But on the efficiency ratio, which doesn't incorporate those credit costs, I guess, why wouldn't you be able to still hit those targets mid this year, mid next year? It seems like the margin is going to see some more substantial expansion here, just based on the deposit costs at the end of March. I think they were down 50 basis points. I guess what else are we missing here, that wouldn't allow you to achieve to those prior efficiency ratio goals?

Mark Mason
We believe we can. My comments, regarding, with growing guidance, really, we’re an overarching comment. And maybe I should have been more specific on efficiency. We believe we can.

Matthew Clark
Okay.

Mark Mason
We believe by a larger margin, today.

Matthew Clark
Yes. Okay. And then just on these securities yields, I think they were down 38 basis points. Can you give us a sense if there was anything unusual there, premium AM, quarter-to-quarter, or new purchases, or just repricing? Just want to get a sense for where that 2.14% yield might go.

Mark Mason
Well, up. I mean, again, an excellent question. Our accounting standard for mortgage-backed securities, is the retrospective method. I have different names for it, but that's the official one. It literally requires us to recalculate, from the date we purchase the security, through the current date and then forward as if we had perfect knowledge.

And so, when you have spikes in prepayment speeds, that imply a different forward balance, you must recalculate a level yield for the birth to grave ownership of that security. And so, when rates fall like they did, and of course that implies a faster run off, you have to write down the yield you have recognized life-to-date. And that was about $1 million dollars of net interest income. A million, in our securities portfolio. And we expect the yield to recover. Not to the yield it was before, of course, because the life yield came down slightly. But you can expect a meaningful recovery in yield, and net interest income from the securities portfolio next quarter.

Matthew Clark
Okay, great. And then just, last one from me, on Slide 23, the forbearance request, and the amount you've granted, can you give us an overall sense for how large those portfolios are, the dentists, the restaurants, bars, entertainment, transportation, so forth? I know some of this can quickly recover, like the dentists. And then, maybe, kind of, within the real estate industry and investor CRE that's asked for request, what specific industries those are? Just to get a better handle on the overall exposure that's getting some increased scrutiny these days.

Mark K. Mason
Sure. We added Page 18 in our deck. which breaks down the C&I portfolio by these groups. And you can see that healthcare, which includes dentists, it's mostly dentists, frankly, is 22% of the $662 million-dollar C&I component and that excludes owner-occupied real estate. Right?

The $211 million includes owner-occupied real estate. So, there's a little bit of a correlation there. But I think in total, we have approximately $180 million dollars, roughly, of healthcare. Including owner-occupied real estate. May not be quite that high. I could have Gerhard get back to you on that.

But the $86 million dollars of that component, obviously is not 100%, or near 100%, which means that we have a lot of dental practices that have sufficient liquidity, they think, to get through the shutdown order.

When we republish this again, we will probably add the total portfolio here to give you some proportionality. That's a fair criticism of this slide.

Matthew Clark
Okay. And then, just thinking about hotels as another example. That's on CRE portfolio breakdown. I don't recall seeing it.

Mark Mason
If you look on the detailed slide of permanent CRE, in Other, there's a footnote. So, the other category includes loan secured by schools, $81 million dollars, and hotels $36 million dollars. Of

that $36 million, the largest loan, I believe, is $27 million. I think a single loan, which is a large, well-known flag hotel in Bellevue. And yes, $26.7 million. It's in the bullets under Other, largest dollar loan. That $26.7 million dollars is 40% of the land value of that property.

So, we're very, very well secured. Obviously, they're not operating today. Right? But they are a very, very strong owner and we feel very good about loss risk in that loan. And obviously, the difference between that and the total hotel exposure of $36 million dollars, we have a couple of smaller exposures. We have one participation, which is relatively small, of a flag franchise hotel with another one of our peer banks. And then, another even smaller one. So, relatively little exposure.

Matthew Clark
Okay. And then just last one from me. I guess, how are you modeling the PPP loans? You expect them just come and go by the end of the third quarter on most of them?

Mark Mason
I'd love to hear your view on that. Yes, mostly, right? I think we're going to experience somewhere between 50% and say, 80% forgiveness. I think that there will be some companies who can't accomplish 100% forgiveness, or spend within that period, or at least subject to the 75% payroll requirement on forgiveness. I haven't seen much analysis on it yet. But we have analyzed profitability, assuming a forgiveness period of three months, six months, nine months, and forgiveness amounts between 50% and 75%. And I will tell you, that the return on equity of those various levels of fees, right, 1%, 3%, 5%, runs between 60% and over 100%. And return on assets accordingly, obviously, quite high. Right?

So, this is a program that should be highly profitable. Will certainly be highly aggravating. It's miserably run. I can't even express to you my aggravation and true sadness for our customers and what they've been through. Aggravation for our employees and what they're going through, as we speak. It is a real shit show of a program.

Matthew Clark
Understood. Thank you.

Operator
As a reminder, if you would like to ask a question, you can press star, then one. Our next question will come from Jackie Bohlen, with KBW.

Jackie Bohlen
Hi, good morning.

Mark Mason
Good morning.

Jackie Bohlen
Sticking with the PPP, I just want to make sure that I have those numbers right. So, you had $396 million in loans for $158 million that were approved as of 4/16. And then, an additional 1,100 applications for $160 million that you're working through for round two. Do I have that right?

Mark Mason
That's correct. That's what we decided just now on script. I will add to that, that in the last 24 hours, we've only been able to enter 144 loans for $35.1 million dollars, with 20 people working 24 hours straight.

Jackie Bohlen
I can see why you are frustrated.

Mark Mason
I'm sorry. Just, sorry, for my level of aggregation.

Jackie Bohlen
No. No, that's very helpful information to have. So, thank you.

Where I'm getting at with my question is, I'm just trying to think of the fee breakout between the first round and the second round. Because just using the numbers that you have, it seems like the average loan size was a lot higher for the first round. And I know that that $10 million loan you spoke of is part of that. So, I'm assuming there's some other larger loans, with the 396 loans. And then, with the additional 1,100 application, I'm assuming that these are much smaller loans. Is that accurate?

Mark Mason
That's accurate. And I think people have gotten the wrong idea, maybe, politically or otherwise, about why that occurred. A couple of reasons, one, the more sophisticated borrowers were ready the minute we could take applications. With complete packages that were tied out, made sense, fully documented.

As you get into smaller loan sizes, you get much less sophisticated business owners. They often forget to provide back up, or they provide backup that doesn't tie to the calculation of the loan. And while it seems like we're supposed to just accept any representation of the borrower, we actually have a responsibility, delineated by the SBA, to make, just minimal reasonable sense of the application and do certain things.

And what that did do, is force a delay in many of these smaller applications to get reconciled. And we spent the last week and a half doing that with about 800 of these 1,100 left.

Jackie Bohlen
And that, I mean, that all makes perfect sense. And when I think about how to apply the fees that you're receiving for that, obviously, with an average loan balance for the first tranche of those over $350,000. I would assume that the fee is probably somewhere between, maybe around 2%, as it would be between 1% and 3%. And then, maybe, with the second round is probably somewhere between 3% and 5%. So, maybe an average of around 4%. Is that a reasonable way to think about it?

Mark Mason
I think it's probably a little better than that. Right? If we're averaging, what, $330,000, $340,000 in the first group, the cut-off was $350,000, right, to go from 1% to 3%? I mean, from 5% to 3%, right?

So, that would imply there's a lot in that 3% to 5% bucket, because the lumpiness of some of the larger ones. Like a $10 million loan, I know. We've processed a couple of $5 million or $6 million deals. Things like that. We expect it will probably be closer to 3%, maybe even a little better.

Jackie Bohlen
Okay. Okay. And then, I would assume higher in the second round, to the extent that you're able to fund some of those?

Mark Mason
Yes.

Jackie Bohlen
Okay.

Mark Mason
Yes, because the difference between the average and the median is much closer in the second group.

Jackie Bohlen
Okay. That's helpful. And then, just lastly. In the past, we've talked a significant amount, in terms of heat maps and how you're thinking about just the overall state of the economy and how it relates to your loan portfolio. And obviously, no one expected this to happen and with the speed that it happened. When you think about reentering loan segments that you are no longer doing right now, what kind of indicators are you looking for and able to get back into those markets? And I know this is a very open-ended question, relates on a lot of factors outside of your control, but how are you thinking about potential timing?

Mark Mason
Well, I think there are some obvious steps. One, they have to reopen their businesses. Two, we need to understand their level of activity, relative to their prior profitable level of activity. And this may be the biggest hurdle, right. We may have companies who reopen, who are reopening at a marginal loss, right? If you just look at cash flow, maybe they can make positive cash flow, but it's not fully absorbed net income. Right? Probably not ready to lend into that circumstance, except in certain cases.

And so, I think some of these industries are going to struggle for credit for a while. The one's that I worry most about, are those that will require additional capital for starting working capital. Who exhausted their working capital reserves in paying final payroll, and in paying suppliers to the extent they could.

Well, they've got to refill that cash pipeline, or those that working capital reserve, in order to restart. And I think that that's an area of the market that Congress really hasn't focused on. Right? There's this restart capital. It's not enough to keep employees employed and cash flowing to consumers. But you have this restart need that, I think, is as yet unaddressed.

Jackie Bohlen
Okay. And when you think about the timing of that, my assumption is that when you gave your average growth forecast for 2020, that assumes that the segments that you have exceeded, you won't be reentering them during that period of time, is that fair?

Mark K. Mason
It is, generally. I think our portfolio is going to end up different at the end of 2020 than we had expected. I hope, I can say that for certain, right? We were expecting higher levels of C&I lending, than we will surely accomplish as a consequence.

We may experience lower levels of homebuilding. Surely, homebuilding will not be immune from this, even in our markets. I'm not worried about credit risk, but the velocity of homebuilding will probably decline somewhat.

Mortgage lending, obviously, will be up. And we are currently reviewing our targets on multifamily lending, with an eye, potentially to, actually, increasing our mortgage lending activity over the remainder of the year. It's an area we feel that we could operate in, not just successfully but safely, and something we're quite good at.

So, these are the things we're thinking about right now, as we think about what our earning assets are going to be for rest of the year.

Jackie Bohlen
Okay. No. Thank you for the extra color. I appreciate it.

Mark Mason
Thanks, Jackie.

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

Mark K. Mason
Thank you. I know this is a busy week for everyone, from an earnings standpoint. We appreciate you joining us today. Appreciate you listening to our view on our market. Good luck. Look forward to talking to you next quarter.

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