HomeStreet, Inc.

Q1 2019 Earnings Conference Call

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CORPORATE PARTICIPANTS

Mark Mason - *Chairman, Chief Executive Officer*

Mark Ruh - *Chief Financial Office*

PRESENTATION

Operator
Good afternoon and welcome to the HomeStreet Earnings Conference Call. All participants will be in a listen-only mode. Should you need assistance, please signal a conference specialist by pressing the "*" key followed by "0." And I apologize the title of the conference is HomeStreet Incorporated First Quarter 2019 Earnings Call.

After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press "*", then "1" on your telephone keypad, to withdraw your question, please press "*", then "2." Please note that 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 2019 Earnings Call. Before we begin, I'd like to remind you that our detailed earnings release was furnished this morning to the SEC on Form 8-K and it's now 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.

On today's call, we will make some forward-looking statements. Any statement that isn't a description of historical facts is probably forward-looking and is subject to many risks and uncertainties. Our actual performance may fall short of our expectations or we may take actions different from those we currently anticipate. Those factors include conditions affecting our financial performance, the actions, findings, or requirements of our regulators, our ability to meet all of the closing requirements for the pending sales of our assets related to our standalone home loan center mortgage business and general economic conditions that affect our net interest margins, borrower credit performance, loan origination volumes, and the value of mortgage servicing rights.

Other factors that may cause actual results to differ from our expectations or that may cause us to deviate from our current plans are identified in our detailed earnings release and in our SEC filings, including our most recent quarterly report on Form 10-Q as well as our various other SEC filings. Additionally, information on any non-GAAP financial measures referenced in today's call, including a reconciliation of those measures to GAAP measures may be found in our SEC filings and in the detailed earnings release available on our website. Please refer to our detailed earnings release for more discussion of our financial condition and results of operations.

Further I would like to inform you that the company, its directors and certain of its executive officers are participants in the solicitation of proxies from the company's shareholders in connection with the company's 2019 annual meeting of shareholders. The company intends to file proxy statement and proxy card to the SEC in connection with its solicitation of proxies for the 2019 annual meeting.

Shareholders of the company are strongly encouraged to read the proxy statement, the accompanying proxy card, and all of the documents filed under the SEC carefully and in their entirety, as they contain important information, important information regarding the identity of the company's participants and their direct or indirect interests by security holdings or otherwise to set forth in the proxy statement and other materials filed by the company with the SEC which can be found for free at the company's website ir.homestreet.com or through the SEC's website at www.sec.gov.

Last week, we released a statement commenting our activist shareholder Blue Lion's Director nominations and proposals. As is our normal practice in such situations, we will not take questions regarding or comment on the potential proxy contest with Blue Lion Capital on this call.

Yesterday, Dwight Capital published a letter to our board of directors expressing an unsolicited interest in acquiring our Fannie Mae DUS multifamily origination and servicing business. HomeStreet was not aware of Dwight Capital's interest until their press release, as they had not previously contacted us. HomeStreet has been a Fannie Mae DUS lender and servicer since the initiation of the program by Fannie Mae over 30 years ago and this business has and continues to be a profitable and important part of our commercial real estate lending business. The board of directors will review the letter from Dwight Capital and respond as appropriate, and as such, we will not be making any initial comments on or after on this call.

Joining me today is our Chief Financial Officer, Mark Ruh. We are conducting today's call from two separate locations, so please excuse any additional background noise or possible cross talk [technical difficulty] any questions later on this call.

In a moment, Mark will present the financial results, but first I'd like to give an update on our results of operations and review our progress and execute on our business strategy.

During the past several months, we have made significant progress towards achieving our long term strategic goals. We're executing a series of transactions that, when completed, will redefine our business. The board of directors approved a plan of exit of our standalone home loan center-based mortgage origination business and related mortgage loan servicing. This decision resulted in recasting our financial results to reflect the discontinued operations in the form of mortgage banking segment. The earnings results released this morning reflect those changes for the current quarter and the comparative historical quarters.

In conjunction with the board of director's decision to exit or dispose of the large scale mortgage banking business, in the first quarter we sold the majority of our single-family mortgage servicing rights and in April of this year, we entered into an agreement to sell substantially all of our home loan centers and related fulfillment centers.

In connection with the home loan center sale, we expect a significant number of our mortgage personnel will transition to positions with the buyer. Closing conditions include minimum levels of employment offer acceptance and loan officer and branch licensing requirements. Any home loan centers or fulfillment centers not sold to HomeBridge will be closed in the second quarter. To the extent that minimum closing conditions are not met for home loan centers and fulfillment centers expected to be sold in part or in total, loss on disposal may materially exceed current estimates.

We thank those employees that are part of the transaction for their work at HomeStreet and contribution to our success. We expect a significant number of our mortgage personnel will transition to positions with the buyer. Other personnel in corporate positions supporting the mortgage banking business will be reduced in the remainder of 2019, primarily in the second quarter.

We also announced that we sold approximately $10 billion of Fannie Mae and Freddie Mac single-family mortgage servicing rights and sold approximately $4 billion of Ginnie Mae's single-family mortgage servicing rights in the first quarter. Together the sales of these servicing rights represent $177 million of MSR fair value and approximately 71% of our portfolio with single-family servicing rights as of December 31, 2018.

We have retained the servicing associated with loan officers that will continue with the company as well as the more specialized or niche loan programs for which there is not a liquid secondary market.

Nevertheless, we expect the remaining portfolio to shrink over time as future additions will be less than expected amortization and prepayments. This transition will provide more portfolio space for commercial lending going forward. These transactions are in line with our long-term strategic goal of reducing the impact of this cyclical and volatile earnings stream.

Our remaining single-family mortgage business will be reported going forward within continuing operations, substantially smaller, focused on our retail deposits and regional markets and positioned for ongoing profitability. As part of the plan of exit, the company recognized $12.1 million of loss on exit or disposal and restructuring charges during the first quarter. We expect to incur additional expenses of $7 million to $12 million during the remainder of 2019 primarily in the second quarter.

Under generally accepted accounting principles, we are unable to recognize the results of discontinued operations. All of the corporate overhead and support costs such as information technology and resources, legal and accounting that we incurred to support these businesses, and previously reported in the results of our former mortgage banking segment. These corporate overhead and support costs have been recast in our historical resource of operations and are now included in continuing operations. In our presentation, we refer to these costs as stranded costs.

These stranded costs were identified in the financial tables in today's release, and totaled $8.3 million during the first quarter of this year. As part of our plan of exit or disposal, our home loan center-based mortgage origination and servicing business we've already identified approximately 45% to 50% of these stranded costs for immediate reduction, the majority of which will occur during the second quarter of this year. Included in these initial reductions are approximately 100 employees in corporate overhead positions, whose positions will be eliminated prior year end in 2019. And we provide notice to those affected employees earlier this month.

In addition to these initially identified reductions, we have initiated the corporate-wide efficiency improvement project to go beyond the current restructuring plan to improve the operating efficiency of the entire company. As part of this initiative, we have engaged the services of a well known consultant, Dan Davis and CEC for profits. We have successfully helped many West Coast Banks identify opportunities for cost reductions and process improvements improve their overall operating efficiency.

In addition to these restructuring activities during the quarter, we also completed the acquisition of retail deposit branch in San Marcos, California, with approximately $75 billion in deposits, along with $112 million of commercial loans and San Diego County focused commercial lending team. We look forward to continuing our growth in that large and diverse market with a high-quality commercial banking team with a great track record.

We also opened two de novo branches in San Jose and Santa Clara, California. These locations are an important expansion of our retail deposit branch footprint is a sizable number of our retail customers that we acquired in the acquisition of Simplicity Bancorp are located in the region. These branches are also an important addition to our commercial lending business located in Northern California.

Our investment in the branches have been planned and committed for some time. Going forward, we are suspended future de novo deposit branch openings consistent with our strategic shift towards lower growth, improved efficiency, and profitability improvement. While we have a business with strategic changes, and related transactions, our core business has continued to perform well. We grew loans held for investment 5% during the quarter, 3% excluding loans acquired with our new San Marcos branch.

Total deposits increased 7% during the quarter, 5% excluding the deposits acquired with our new San Marcos branch, and non-interest bearing deposits increased 12%...5% excluding acquired deposits during the quarter. Asset quality remains stronger in the quarter with our non-performing asset ratio ending at 23 basis points of total assets.

Lastly, the board of directors has approved the share repurchase program for up to $75 million of our common stock. This shared repurchase and the ongoing growth and success of our core business supported by the outlets for continued economic strength in our primary markets underscores our confidence in HomeStreet's future performance and long-term value creation for our shareholders.

Once these transactions are complete and the total financial impact are known, the board of directors will consider potential uses of any remaining excess capital, which may include additional share repurchases, establishing a regular cash dividend, and other measures intended to improve long-term shareholder value.

And now, I'll turn it over to Mark who will share details of our financial results.

Mark Ruh
Thank you, Mark. Good morning, everyone and thank you again for joining us. As Mark stated, the earnings results release this morning include the recap of our financial results to reflect the change to discontinued operations accounting for the former mortgage banking segments.

Regarding our results, our net consolidated loss, which includes the results of both continuing and discontinued operations for the first quarter of 2019, was $1.7 million, or $0.06 per diluted share, compared to net income of $15.2 million or $0.56 per diluted share for the fourth quarter of 2018.

One-time items included in net income for the first quarter of 2019 were non-core expense of $9.6 million of loss on exit or disposal and other restructuring expenses related to the decision to exit the large-scale mortgage banking business and $290,000 of acquisition-related expenses net of taxes. This compared to one-time items in the fourth quarter of 2018, which included a non-core $4.9 million income tax benefit, a $676,000 recovery of restructuring related expenses net of tax, and $54,000 of acquisition-related expenses net of tax.

Excluding the impact of these charges core net consolidated income, which includes the results of operations for both continuing and discontinued operations for the first quarter of 2019 was $8.1 million, or $0.30 per diluted share, compared to core net consolidated income of $9.7 million, or $0.36 per diluted share for the fourth quarter of 2018.

Net income from continuing operations for the first quarter of 2019 was $5.1 million compared to net income from continuing operations for the fourth quarter of 2018 of $12.5 million. This decrease in net income from continuing operations was primarily due to the $4.9 million income tax benefit recognized in the fourth quarter of 2018 and a $2.3 million decrease in non-interest income.

Net interest income decreased by $1.4 million to $47.6 million in the first quarter of 2019 from $48.9 million in the fourth quarter. This decrease in net interest income is primarily due to the compression of our net interest margin to 311 basis points in the first quarter from 319 basis points in the fourth quarter of last year, largely as a result of the flattening yield curve and rising deposit and borrowing costs exceeding increasing loan yields.

Loans held for investment increased by $269.8 million, or 5% during the first quarter. Included in the increase for the quarter were $86.4 million of acquired commercial industrial loans and $23.5 million of non-owner-occupied commercial real estate loans. Non-including acquired loans grew organically by 3% during the quarter.

Non-performing assets increased to $16.7 million, or 23 basis points of total assets at March 31st compared to 17 basis points of assets at December 31st. The increase from December 31st, 2018 was primarily due to the downgrade to non-accrual of a $4.7 million SBA 504 construction loan. Note, however, that construction on this property is complete, the business is operating, and the underlying real estate is contracted for sale. We believe we are sufficiently collateralized to avoid potential losses.

We recorded a $1.5 million provision for credit losses in the first quarter, compared to $500,000 provision in the fourth quarter. This increase in provision was primarily due to higher loan portfolio growth and lower recovery during the first quarter.

Deposit balances, excluding those related to discontinued operations, were $5.2 billion in March 31st, an increase of 6% from December 31st. The increase includes $75 million in deposits related to the acquisition of the Silvergate deposit branch previously mentioned, including $42.7 million of non-interest bearing accounts and $31.8 million of money market in savings accounts.

Non-interest bearing deposits increased 12% to $683 million from $604.5 million at December 31, 2018. Excluding acquired deposits, non-interest bearing account balances increased 5% during the quarter. Non-interest income decreased $2.3 million from $10.4 million in the fourth quarter of 18 to $8.1 million in the first quarter of 2019.

The decrease was primarily due to a decrease in other non-interest income from lower investment income. Specifically, the distribution from one of our small business investment companies funds in the fourth quarter of 2018 and a decrease in Fannie Mae DUS loan origination and sale income due to seasonally lower activities during the first quarter.

Non-interest expenses decreased slightly to $47.8 million in the first quarter of ‘19 from $47.9 million in the fourth quarter, primarily from savings associated with our ongoing reductions in headcount and overhead expenses. Our effective income tax rate of 19.8% for the first quarter of ’19 differs from our combined federal and blended state statutory tax rate of 23.6% primarily due to benefit we received from tax exempt interest income on municipal securities.

Net loss in discontinued operations was $6.8 million in the first quarter of ’19, compared to net income of $2.8 million in the fourth quarter of ’18. This decrease is primarily due to a $9.6 million net of tax in loss on exit or disposal and restructuring expenses in the first quarter versus the one-time $2.5 million net recovery of Washington State Business & Occupation or B&O tax, we recovered in the fourth quarter of 2018.

I will now turn it back over to Mark Mason.

Mark Mason
Thank you, Mark. During the past several years, we have made substantial changes in our business, as part of our long-term strategic plan to convert a troubled thrift into a leading west coast major market footprint regional commercial bank.

Recent decision to exit large scale mortgage banking was made only after we felt we have exhausted opportunities to improve performance. Additionally, after mortgage segment breakeven here in 2018, lower volume and profit margins in 2018 and absent near-term regulatory capital for the mortgage servicing rights and improvement in the industry conditions, we made the painful decision to exit the business.

This decision has certain costs and opportunities, but on balance our board of directors believes that this significant strategic change creates the opportunity for meaningful near term shareholder value creation. As you know from our discontinued operations reporting we have a substantial amount of residual corporate overheads now remaining within our continued operations to address going forward. A significant amount of this overhead will be reduced in the second quarter.

As I stated earlier, the remainder of these stranded costs, as well as our all of our corporate expenses are part of corporate-wide efficiency improvement project to which we now turn our full attention. We will be adopting peer levels of return on assets and return on equity and operating efficiency along with interim milestones. However, until the HomeBridge transaction is complete and we complete our initial assessment of opportunities for cost reduction and process improvement, we are not prepared to discuss the targets or timing to achievement at this time.

Nevertheless, we expect our loan portfolio book to average between 1% and 3% per quarter throughout the remainder of this year. We expect single-family mortgage production volume from continuing operations to total approximately $500 million in the second quarter, $450 million in the third quarter, and $300 million in the fourth quarter of this year. We expect approximately 85% of this volume will be sold in the secondary market, while the remaining 15% will be retained in our loan portfolio.

Reflecting the yield curve as of the end of the first quarter after changes in market rates and loan prepayment speeds, we expect our consolidated net interest margins to remain in the range of 305 to 315 basis points throughout the remainder of this year. Due to the uncertainty of timing as a home loan center sales and the expense reductions associated with our discontinued operations, we will not be providing expense guidance at this time. We anticipate providing expense guidance in future quarters.

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

QUESTION AND ANSWER

Operator
Thank you. We will now begin the question-and-answer session. To ask a question you may press "*" and then "1" on your telephone keypad. If you are using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question please press "*" and then "2." At this time, we will pause momentarily to arrange our roster.

The first question comes from Jeff Rulis from DA Davidson. Please go ahead.

Jeff Rulis
On the fee income line, just to kind of get a sense for the loan origination and sale line item and loan servicing, those two kind of run rate and kind of what's been…what changes in maybe what your expectations are for the run rate on those two?

Mark Mason
Jeff, I am sorry, I didn't hear the first part of that question. Could you repeat it?

Jeff Rulis
Yes, looking for detail on the fee income line item. So, the net gain on loan origination and sale activities was 2.6 this quarter and loan serving income of a million, just looking at the run rate of those for the balance of the year, given the changes that you have made?

Mark Mason
So, I would see…now I am going to just probably have to make same apology a couple of times. Unfortunately, the changes to create continuing operations and discontinued operations are going to create a little bit of confusion in the transition. Part of that question relates to the non-interest…standard costs that we just discussed. The other part relates to the transition of the residual or remaining mortgage banking operations origination and serving that historically have been reported as a part of the mortgage banking segment or discontinued operations.

In the second quarter, that continuing mortgage origination and servicing component, which relates to the $500 million in originations next quarter that we will provide guidance on, will move from discontinued operations to continuing operations. So, what you see in continuing operations in the first quarter relates solely to commercial activities, SBA loan sales, commercial real estate loan sales, and the US loan sales, and the like. Second quarter and going forward, that line will also include revenue, both serving and origination gain on the sale from continuing mortgage banking operations.

Jeff Rulis
So, what is that outlook? Assuming that, that was good detail, but what is the number that your look for the balance of the year?

Mark Mason
We are not giving guidance yet on that number, we've provided origination estimates and an estimate of that the amount of that origination that will be sold in the secondary market. Additionally, from a personal standpoint, you can take prior servicing income and reduce it by

the proportion sold that are pretty good start on making those estimates. But at this time, we are not giving specific dollar guidance.

Jeff Rulis
Okay. Move on to expenses, I understand, you're not giving guidance there, but just want to…given the stranded costs sort of phrase that the 47.8, if you were to remove, as you said that a good portion of the 45% to 50% of the stranded costs going forward, this would imply a little over $3 million decline if you capture that. Would that assume a core run rate of $44.5 million, is that in the ballpark of what you would…I guess agree?

Mark Mason
The stranded costs number we detailed in the non-GAAP reconciliation, it is a little over $8 million, I believe. Mark, do you have that number?

Mark Ruh
Yes, I do Mark, its $8.3 million, and it is on the second page of the non-GAAP table, Jeff.

Jeff Rulis
Right. I see the number, I guess, I am looking for the itemization and the run rate. You guys, kind of, how it's presented on page 15 of your PowerPoint, you've got non-interest expensive of 47.8, am I to assume that the stranded costs are included in that 47.8 and then that is the run rate, we take the savings, or it's not a piece of that?

Mark Mason
Well, that's correct. So the 47.8 includes $8.3 million, what we call it stranded costs. Our current estimate is that we'll be reduced in the second quarter by about 50%, right? That will occur in the quarter though, so there won't be a clean immediate reduction for the quarter, but sort of third quarter forward you can reduce that number by that amount. And then further, as we work on the remainder of the corporate expenses.

Jeff Rulis
Okay. I'll step back. Thank you.

Operator
The next question comes from Steve Moss from B. Riley FBR. Please go ahead.

Steve Moss
Good afternoon.

Mark Mason
Hi, Steve.

Steve Moss
I just want to start with the slower growth comments you made, Mark, in your prepared remarks. In particular it seems like you are slowing loan growth a little bit, looks like judging by originations probably on the construction side of the business, but just kind of want to see where you guys are thinking about slowing the growth down and your focus on profitability?

Mark Mason
So in the investor deck, we published this morning we provided average quarterly net loan portfolio growth of 1% to 3% in the second quarter and then decreasing somewhat the third and

fourth quarters. That reflects in part the run-off of the single family portfolio, lower additions to the single family portfolio from current loan productions offset by growing commercial production.

Steve Moss
Okay. And just in terms of the, I mean, and just on the construction business in particular, you know, it does look like it's the trend has been lower balances. Just wondering if we're going to see that going forward or just what your thoughts are with that line of business?

Mark Mason
We're still active custom home construction has been strong to this point, but that will slow as we finish the mortgage banking origination business sale.

On commercial construction, we have slowed intentionally as we've seen a cooling in the Pacific Northwest markets. And in our home building business, demand has declined moderately as builders have slowed somewhat their current building schedule. We're not expecting a meaningfully significant further decline at this point, but our volume, at least in the first quarter, was a little more than 10% lower than we expected in homebuilding, still strong markets, still very profitable, but a little slower demand.

Steve Moss
Okay. That's helpful. And then on the margin here, I know you guys gave 305- to 315-type guidance. Just kind of wondering what you are thinking in terms of the impact from the inverted yield curve, how that may change your behavior and your thoughts, especially around the investment securities portfolio and should we think about it perhaps close to low end in the near term?

Mark Mason
Well, we gave a range that we think we can perform within of course. It's hard to assess the balance of risks at this point. We have raised guidance from last quarter on the net interest margin, I believe, it was 300 to 310 last quarter. And so, we feel a little better about going forward margin as interest rates have settled sort of for the time being. It's hard for me to assess the balance of risk there, Steve. I've never been a good predictor of rates.

Steve Moss
Alright. I appreciate that. Thank you, guys.

Mark Mason
Thank you.

Operator
The next question comes from Tim O'Brien from Sandler O'Neill & Partners. Please go ahead.

Tim O'Brien
Thank you. Just a question about, I guess, through the remainder of year, do you have FTE addition plans for the commercial business, given that free-up of capital?

Mark Mason
We have additions we are making, we also have reductions we're making. So I don't believe we are planning any material net additions to commercial lending. We've been doing some restructuring, some top grading if that's the right phrases I am supposed to use, and watching

our expenses. So I think that with the addition of the team in San Diego in the commercial lending area our current size is going to be what you're going to see for a little bit.

Tim O'Brien
And then, could you also…just again, I guess, revisit thoughts on contractual timing and any updates or refinements you can make to that timing with regard to pending closures and milestones with regard to the Mortgage Bank exit process that's underway, what comes here in the second quarter obviously with regard to the internal aspects of it, but with regard to the counterparty aspects, can you give us any…just some more color on that and also remind us of what's contractually in the works.

Mark Mason
Sure, to the extent I can. I mean, we are fairly far along with the process of getting our loan officers licensed. I think we have talked about those requirements before. HomeBridge is well on the way in getting branches. We are transferring licensed, so what remains to be seen is ultimately the full pull-through of employees, loan officers in particular, who have received offers from HomeBridge. The acceptance rate, the show up rate if you will, and whether or not those numbers will exceed the hurdle amounts or not by region, and then what reconciliation of that might occur.

I want to tell you that we feel very good today that we have had strong acceptance and there is a lot of enthusiasm for the migration to HomeBridge. You know, that may vary by individual office. We have had some attrition. I have to tell you one of the most surprising things about this process has been the recruiting competition for our best talent, and the amount of money that other lenders, independents in particular, have offered our best people to change companies. And just to put that in perspective, some of our largest producers have received offers that look like 50% of your 2018 W-2 is a sign on bonus, a commission plan of 155 to 180 basis points initially for six months, and near that thereafter paid assistance in marketing budget, it is unbelievable to me that anyone can make money paying those amounts.

So, for the very best people, the level of competition for that talent and what people want to pay is really, I think gone beyond economic reality, and that has been challenging for us how to deal with. But I think that the significant majority of our personnel are excited and enthusiastic about moving to HomeBridge with the leadership, with their fulfillment personnel continue to do great business.

In terms of timing, these closing are to occur during the second quarter. Our comments earlier described all of this completing during the second quarter to the extent our individual branches of personnel, we don't…decide to go with the HomeBridge transaction, those branches will be closed in the second quarter, but we are very optimistic that will hopefully be a small minority of the branches at this juncture.

Tim O'Brien
Will the transfers, Mark, take place on a home…loan production office basis? Will it be kind of done at one time or will it be rolling transfers, you know, how is that process unfold?

Mark Mason
Contractually, we have set two transfer dates. As we go closer to the first one, that may migrate in terms of the actual date of those two transfer dates, one is currently expected in late May and other in mid-to-late June. And so, as we get closer to those dates, we get to know more about how this is going to close-up.

Tim O'Brien
Great, and then just shifting gears, last question. As far as, the repurchase process and prospects for that, what's the lock-up like on that and when can you guys consider executing on that authorization?

Mark Mason
Great question. We are prepared to get started. We are going to be adopting a, I believe it’s 10B5 compliance program. That has to be initiated in an open window period. We expect to initiate that repurchase program later this week after the market has had a chance to digest our earnings release. It may slide into next week. We are also expecting to file additional proxy materials and so depending upon the data those things may move, but in near term, we are expecting to initiate that program.

Tim O'Brien
Last question, I know you kind of suggested you don’t want to talk about this, is there a proxy date calendar to remind that you can remind us however, is that still to be decided? I mean not a proxy date but an annual meeting date.

Mark Mason
The board of directors has yet to determine that date, but there are considerations about how long you can wait to hold that after your last year’s date. So we expect the board will make a decision in the near term and of course make it public.

Tim O'Brien
Thank you very much.

Mark Mason
Thanks, Tim.

Operator
The next question comes from Jackie Bohlen from KBW. Please go ahead.

Jackie Bohlen
Hi, good morning everyone.

Mark Mason
Good morning Jackie.

Jackie Bohlen
With regard to the expected loan contraction in 3Q and 4Q, I am understanding that growth will be slower in the single family, and so that’s part of the driver. Does any of that involve any transferred loans within portfolios or perhaps any sales you are anticipating to work on the mix?

Mark Mason
We are a consistent seller of small house commercial real estate loan. I saw the first quarter we had a sizable amount of activity, we expect to continue going forward. Additionally SBA loan sales, they may be less loan sales. So I think that you can expect consistent activity in those areas that will tend to keep loan portfolio balances down. I don’t think that we are expecting meaningfully higher volume, but that’s…it is somewhat dependent upon our success originating and the demand from buyers.

Jackie Bohlen
Okay. So those portfolio sales are no different than they have been in the past, so that doesn't have an impact on the outlook for the later half of 2019…

Mark Mason
Generally, no. But it's important, those sales are important part of our business and allows us to originate more and I think we're forecasting or expecting the market to be similar. Of course, that could change.

Jackie Bohlen
Okay. Understood. And in terms of…I know, you've provided guidance in terms of how to think about the servicing income from the single family that will transition to continuing ops and with the volume and everything. From a gain on sale margin perspective, can we use prior guidance on the composite margin? I think it was 310 to 320, in terms of what you would expect on those portfolio sales or the single-family generation sales.

Mark Mason
Yes, we decided not to provide guidance, because, we were thinking the number wasn't going to be as material. But I understand your need to consider that, when making those estimates. I think that the prior guidance, while appropriate for the periods, also was a decline from the [indiscernible] part of the last guidance. And I think that trend continues. So I think that people should take a conservative view of gain on sale during this timeframe.

Jackie Bohlen
Okay. That's good color. Thank you. And then just lastly, the remaining piece of what's in loans held for sale, I think it was roughly $56 million give or take that was included in the continuing operation balance sheet. Is that a pretty good go forward estimate for where we should expect those loans to be?

Mark Mason
It's going to go up a little because of the transition of single-family mortgage banking, right. Those, the entirety of those balances might go up a little.

Jackie Bohlen
Okay, so it's. So what's in that bucket right now is related to commercial portfolio sales and not related to single family?

Mark Mason
I think that's correct. Let me check with Mark. Mark, is that correct?

Jackie Bohlen
Sorry, I know that's really a technical question.

Mark Ruh
Yes, that's correct.

Mark Mason
Okay, good. So it will rise a little bit. But again, thinking about the lower volume, we were estimating $500 million next quarter, with only a small amount of that being held for sale. I think our estimate is 15%. I think we've footnoted. So that's a small addition.

Jackie Bohlen
Okay, great. Thank you very much.

Mark Mason
Thanks, Jackie.

Operator
Again, if you have a question, please press "*", then "1".

Our next question comes from Tim Coffey from FIG Partners. Please go ahead.

Tim Coffey
Great, thank you, Mark. Good afternoon, Mark.

Mark Mason
Good afternoon, Tim.

Tim Coffey
As we look at that slide in the presentation on the key drivers, are we…it somewhat implies a origination…analyze origination as single-family residential of about $1.5 billion to $1.6 billion a year? Is that kind of what you're aiming for?

Mark Mason
I guess what I should say is, it is what it says. Obviously, first quarter is similarly, historically, seasonally, a lower quarter. And if you extend those numbers, I guess you could assume that we have not made an estimate of first quarter '20. But this is our best estimate of the next three quarters.

Tim Coffey
Right. But excluding from the sale of the mortgage business is a piece of it that you did want to keep for origination activities, right?

Mark Mason
Right. And that's this…that's this line item you're talking about on the guidance page?

Tim Coffey
Yes. Okay. Do you plan to sell, can you sell 85% of that production?

Mark Mason
That's our current estimate. And that's the footnote to that table.

Tim Coffey
Oh, yes. What I mean, is beyond the three quarters that you've outlined in that table.

Mark Mason
Oh, it is and that's our current estimate Tim. I think a lot of it remains to be seen, including what our portfolio needs are.

Tim Coffey
Okay. And then circling back on the gain on sale question, where… are you going to be selling the…are you going to be retaining the servicing on this?

Mark Mason
That is something we're still discussing. On a great deal of EBS [ph], we are still talking about whether or not we will continue to retain Ginnie Mae's servicing, as an example. The Ginnie's servicing is more involved and more costly, while the revenue is higher, the cost of servicing are higher as well. So that is still under analysis by us.

Tim Coffey
Okay. And then you mentioned wanting to do more improving efficiency at the ongoing enterprise. And I wonder what kind of things are coming to mind when you talk about that?

Mark Mason
Well, we're sort of at the front end of that company-wide analysis. But it runs really the full gamut of renegotiating technology agreements, real-estate restructuring, lines of reporting, process improvement. A whole, I mean, I can almost not think of an aspect of the business, that we will not reevaluate, and we're going to do it thoughtfully. We have a lot of savings already slated for implementation. It's probably hard for people to imagine the difference. But it is significant between an organization that was built to grow 20% a year on the balance sheet, and run a multibillion-dollar mortgage banking business, to one focused on efficiency and profitability.

Our prior strategy was necessary because of the influence of the large mortgage banking business's cyclicality and seasonality. And our strategy previously had been to outgrow it, that's a significant change. And the cost of supporting a growth business versus the cost of running an optimized business is the infrastructure is much different. And that's a transition we're going to go through thoughtfully.

Tim Coffey
Okay. And as you are nearing completion of selling the mortgage business, do you have a new estimate or another estimate on what your restructuring expenses might be in the second quarter?

Mark Mason
We do, it was in my conference call comments. You can go back and look… let me go back…Mark, do you remember that?

Mark Ruh
Yes, it was $7 million to $12 million, Tim, is what we had in the script, is what we expect in the in the range, we expect for the second quarter.

Tim Coffey
Okay, yes. I did have in my notes, I apologize for that. And then…

Mark Mason
Just a caution on that number. To the extent that we close less of the branches that we are selling to HomeBridge than our current estimate, that number could go up.

Tim Coffey
Okay. Alright. Okay, I think those were all my questions. Thank you.

Mark Mason
Alright. Thanks, Tim.

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

CONCLUSION

Mark Mason
Thank you again for attending and participating in our call this quarter. We look forward to speaking with you again after the second quarter results. Have a great day.

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