# HomeStreet, Inc.

## Q3 2019 Earnings Conference Call

## Tuesday, October 22, 2019, 1:00 P.M. Eastern

**CORPORATE PARTICIPANTS**

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

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

## PRESENTATION

**Operator**
Good day, and welcome to the HomeStreet, Inc. Third Quarter 2019 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 (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 telephone keypad. To withdraw your question, please press star (*), then two (2). Please note this event is being recorded.

I would now like to turn the conference over to Mark Mason, Chief Executive Officer. Please go ahead.

**Mark Mason**
Hello, and thank you for joining us for our third quarter 2019 earnings call.

Before we begin, I would like to remind you that our detailed earnings release was furnished yesterday to the SEC on Form 8-K and is available on our website at ir.homestreet.com under the News & 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 is not a description of historical fact 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 cost savings expectations or to realize those cost savings at the pace we expect and general economic conditions, such as a declining interest rate environment and flat or inverted yield curve that affect our net interest margin, 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.

Joining me today is our Chief Financial Officer, Mark Ruh. In a moment, Mark will briefly discuss our financial results. But first, I would like to give you a summary update on our results of operations and review our progress in executing our business strategy.

HomeStreet's third quarter results reflect the early success of our strategic changes. Total assets declined in the quarter primarily due to the closing and sale of the pipeline of loans remaining from our home loan center sale, and an increase in loan prepayments as a result of lower interest rates. The decline in total assets in conjunction with increasing deposits drove a meaningful decrease in wholesale funding, which helped offset margin pressure in the quarter.

Our retail branch network continued to perform well, with total deposits of continuing operations increasing 4% during the quarter, and deposits in our de novo branches, those opened within the past five years, increasing 12% during the quarter.

In addition to closing the pipeline of loans from our second quarter Home Loan Center Sale, we also completed the final transfer servicing deposits related to our first quarter mortgage servicing sales. We now have substantially completed these very complex transactions.

As a result of our strategic changes and our focus on efficiency and profitability, our noninterest expense decreased meaningfully during the quarter. This decrease was driven in part by a decrease in full time equivalent employees of 7.3% during the quarter, and we expect further reductions as we execute on the suggested changes in our operations being made by our efficiency consultants

Additionally, in the quarter, we consolidated our Lake Oswego, Oregon retail deposit branch into our nearby Lake Grove branch, and we continue to analyze additional opportunities to reduce our occupancy cost across the organization. We also made progress for our longer-term goal of improving the efficiency and profitability of the company as we implemented the initial phases of the efficiency plan, we continue to develop with our consultants. Based on the work completed to date, we continue to believe we can achieve the cost reduction goals that we established last quarter.

However, like our peers, we are experiencing the impact on our net interest margin of lower interest rates, higher deposit costs, and changes in the yield curve. These changes negatively impacted our net interest margin in the quarter, and while deposit costs are already declining, the interest rate environment may continue to impact future results.

Notwithstanding the impact of the changing interest rate environment, we are pleased with our third quarter results, and we are committed, subject to the challenges presented by the current environment, to achieving the profitability and efficiency goals we established last quarter.

In recognition of our progress and our strong capital position, our Board of Directors has authorized a new common stock repurchase plan for up to an additional $25 million in stock repurchases, the commencement of which is contingent on the receipt of approval or non-objection from our regulators, which we expect to receive in the near-term.

Asset quality remains strong in the quarter, with non-performing assets increasing slightly to 21 basis points of total assets at the end of the third quarter from 16 basis points at the end of the second quarter. Our markets remain some of the strongest in the country with large diverse economies. However, we are keeping a careful eye on fundamentals and remain focused on controlling credit risk.

As part of our work to prepare for the adoption of the current expected credit losses accounting standard, or CECL, at the beginning of next year, we have been running parallel analysis to determine what the impact of adopting CECL would be on our loss reserve requirements and capital ratios. Based on our preliminary analysis and subject to final adoption of the standard, we currently estimate the impact of adoption to be approximately 5% to 10% increase of our allowance for loan losses and an immaterial impact to our capital ratios. The ultimate effect of adopting CECL will depend on the size and composition of our loan portfolio at the time of adoption. The portfolio's credit quality and economic conditions at the time of adoption, as well as any refinements to our model, methodology or key assumptions.

Also, as the industry experiences credit cycles, we anticipate more volatility under a life of loan reserving approach versus the incurred loss approach currently used.

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

**Mark Ruh**
Thank you, Mark. Good morning, everyone, and thank you again for joining us. Our consolidated net income, which includes the results of both continuing and discontinued operations for the third quarter of 2019 was $13.8 million, or $0.55 per diluted share, compared to a net loss of $5.6 million, or $0.22 per diluted share for the second quarter of 2019.

Net income from continuing operations for the third quarter of 2019 was $13.7 million, or $0.54 per diluted share, compared to net income from continuing operations for the second quarter of 2019 of $8.9 million, or $0.32 per diluted share. The increase was primarily due to an increase in our net gain on loans origination selectivity, driven by both improved volume and margin on commercial loan sales, along with a decrease in noninterest expense.

Net interest income decreased by $2.1 million to $47.1 million in the third quarter of 2019 from $49.2 million in the second quarter, primarily due to an increase in interest expense at higher deposit balances.

Late in the second quarter, we increased our CD balances, some with promotional interest rates to fund the transfer of servicing-related deposits in connection with the final transfer of servicings related to our first quarter sale of mortgage servicing assets. Thus, in the third quarter, we experienced a full quarter of interest expense on those higher rate CD balances.

We also experienced a decrease in interest income from a lower rate and volume of loans held for sale as we closed out the pipeline of loans associated with the sale of our standalone home loan center-based mortgage business. The rate and volume of loans held for investment also decreased during the quarter as a result of higher prepayments in response to lower long-term interest rates during the quarter.

These factors contributing to the decrease in interest income were partially offset by our continued growth core deposits, which meaningfully reduced our volume of federal home loan bank advances during the quarter. As a result of the foregoing changes, our net interest margin on a tax equivalent basis decreased 296 basis points in the third quarter from 311 basis points in the second quarter.

Loans held for investment decreased $147.8 million to $5.2 billion at the end of the third quarter from $5.3 billion at the end of the second quarter, primarily due to commercial loan sales of $233.2 million and the higher levels of prepayments previously mentioned.

Non-performing assets increased to $14.2 million, or 21 basis points of total assets at September 30th, compared to $11.7 million, or 16 basis points of assets at June 30th. The increase was primarily due to a small increase in non-performing commercial loans.

We recorded no provision for credit losses in the third quarter due to the reduction in loan balances during the quarter and continuing low levels of charge-offs fully offset by recoveries.

Deposit balances from continuing operations were $5.8 billion at September 30th, an increase of 4% from June 30th. The increase in deposits was primarily driven by our increase in CD balances previously described, as well as increases in core consumer money market and noninterest checking accounts.

Our trailing 12-month retail deposit beta for the third quarter was 61%, up from the second quarter's beta up 38%. Note that we expect our increasing deposit beta trend to reverse in the fourth quarter as we have been proactively lowering our deposit rates in September and October. Our third quarter 12-month held for investment loan beta was 41%, also up from the second quarter's beta of 31%.

Non-interest income increased $4.8 million from $19.8 million in the second quarter of 2019 to $24.6 million in the third quarter of 2019. The increase was primarily driven by an increase in volume and margin of commercial loan sales during the quarter.

Non-interest expense decreased $3.1 million to $55.7 million in the third quarter of 2019 from $58.8 million in the second quarter, primarily due to $1.7 million FDIC assessment credit, lower proxy solicitation-related costs, and lower salaries and occupancy costs related to our cost savings initiatives.

These decreases were partially offset by an increase in G&A expense due to seasonal marketing costs, along with a temporary increase in IT costs, resulting from transitioning servicing and origination systems as part of our long-term cost savings initiatives.

Our effective income tax rate of 14.6% for the third quarter of 2019 differs from our combined federal and state blended statutory tax rate of 23.6%, primarily due to the benefit we received from tax exempt interest income and its proportion to total net income.

Net income from discontinued operations was $162,000 in the third quarter of 2019, compared to a net loss of $14.5 million in the second quarter of 2019, primarily due to the absence of additional restructuring charges in the quarter and recoveries of previously recorded estimated restructuring charges and compensation-related costs of $2.3 million net of tax.

Going forward, we expect some net loss from discontinued operations in the fourth quarter, as we finalize the wind-down and transfer of discontinued standalone home loans center-based mortgage banking business and related servicing.

Thank you for your attention, and I will now turn it back over to Mark Mason.

**Mark Mason**
Thank you, Mark. Our second quarter call we laid out a plan, established by management and informed by our efficiency consultants to improve our operating efficiency and reduce our cost structure to reflect our simplified business model and lower growth expectations.

The plan identified a range of expense reduction opportunities, many of which involves substantial technology, organization, and personnel changes. These include: simplifying the organizational structure by reducing management levels and management redundancy; consolidating similar functions currently residing in multiple organizations; renegotiating where possible major contracts, primarily technology; identifying and eliminating where possible redundant or unnecessary systems and services; and adjusting staffing to recognize the significant changes in work volumes and company direction.

Our third quarter results include the implementation of the initial phases of our efficiency improvement plan. Assuming that we are able to realize the expense reductions currently planned by management and projected by our consultants and absent continuing negative impacts to our net interest margin beyond current expectations, or as a result of changes in the interest rate environment or other changes in the business environment that would negatively impact our ability to accomplish our goals, we continue to expect to achieve an efficiency ratio in the low- to mid-60% range, return on average assets exceeding 1.1%, and return on average tangible equity exceeding 11% by the end of the third quarter of 2020.

The timing of future expense reductions will vary, depending upon the nature of the expense, although a meaningful amount is expected to be realized in early 2020. We expect these expense savings to be primarily centered and continued decreases in salaries over the near-term, potential decreases in occupancy over the middle-term--medium-term--and decreases in information services over the longer-term, as contracts expire or are replaced.

Our financial targets are based only on expense savings and without any additional share purchases beyond the $25 million repurchase plan announced this week, or the possible establishment of a regular quarterly dividend in the future.

For the remainder of this year and next year, we expect ongoing runoff in our single-family loan portfolio, offset by growth in our commercial loan portfolios, resulting in a flat to slightly increasing balance of loans held for investment over these periods.

Additionally, assuming the ongoing flatness of the yield curve, we expect our net interest margin to experience additional downward pressure, as higher yielding loans are replaced by lower yielding market rate loans. Mitigating this impact somewhat is lower cost of funds from the continued growth of our consumer and business deposit balances as de novo branches continue to mature, and our commercial deposits continue to grow.

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

**QUESTIONS AND ANSWERS**

**Operator**
We will now begin the question-and-answer session. To ask a question, you may press star (*), then one (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 star (*), then two (2).

At this time, we will pause momentarily to assemble our roster. The first question comes from Jeff Rulis of D. A. Davidson. Please go ahead.

**Jeff Rulis**
Thanks. Good morning.

**Mark Mason**
Good morning, Jeff.

**Jeff Rulis**
I wanted to add a question about kind of mapping the $2.3 million in recovery of structuring comp expenses. Is that just an offset to comp? Was it in the other line? Trying to figure out where that was embedded?

**Mark Mason**
It is in the discontinued operations line, and so it is offsetting other comp and costs that were incurred in discontinued operations during the quarter.

**Jeff Rulis**
Okay. So, the 162 income was a net that – it was in that line item? It is more like…

**Mark Mason**
Exactly. Yes.

**Jeff Rulis**
Okay. Fair enough, and Mark, you mentioned kind of the balance of the year. I do not know if that–on the loan side, if that kind of carries us into early next year, but any–anything further out in terms of net growth outlook for 2020 by chance?

**Mark Mason**
Consistent with the comments I just made, we expect net growth over the period consistent with what our current strategy is, the growth is not going to be significant, but there will be growth. We have not guided a percentage at this juncture, given we are not sure about prepayment speeds, quite honestly, but we are expecting that growth.

**Jeff Rulis**
Okay, and then just circling back on the expenses, if you were to appreciate the kind of a timeline of salaries, I guess, then–I guess, occupancy and then IT, I do not–is there a way you could like a percentage or segment out? What amount of cost saves would come from each area, if that makes sense? Excess salaries 50% expected?

**Mark Mason**
Sure.

**Jeff Rulis**
Yes.

**Mark Mason**
The majority of the savings is going to come from personnel. I mean, that is–-if you just look at our cost structure, I think that the relationships in the cost structure are going to be consistent with the relationships in savings, if that helps.

**Jeff Rulis**
Okay. Got it, and then one just last one for Mark Ruh. On the tax rate, then the expectations, a lot of moving pieces, but what would you say for 2020?

**Mark Ruh**

Yes, let me give you out. For the fourth quarter, just to help you a little bit more, we are looking probably about a 14% to 17% effective tax rate. And for 2020, our view is in the 18% to 20% band for the year.

**Jeff Rulis**
Great. Thank you.

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

**Steve Moss**
Good morning, guys.

**Mark Mason**
Hi, Steve.

**Steve Moss**
Back on expenses, just want to see if you could quantify the trap costs you had this quarter and when you are talking about the IT costs and other things there. I am not sure if you mentioned, but—-or if I missed it, but I want you to start there?

**Mark Mason**
By trap costs, are you referring to the description we used a couple of quarters ago stranded costs?

**Steve Moss**
Exactly. Yes.

**Mark Mason**
We are not calculating that number these days, because once you have separated the groups, we-—and started to reduce expenses and consolidate departments and so on, it gets a little hard to track.

I mean, if you look at, I think, you should look at our expense level today versus that, which will get us to our targets, and part of that is going to be efficiency improvement, part of that is going to be simply climb back those what we previously called stranded costs.

**Steve Moss**
Okay, and then on the CD repricing and deposit repricing here in the fourth quarter, just kind of wondering, how much do you expect to see in the next—-over the next two quarters in basis points?

**Mark Mason**
In terms of total reduction in deposit cost?

**Steve Moss**
Yes.

**Mark Mason**
That is a little hard to estimate, given everything else going on. I mean, we have relatively short duration deposits, but there is some duration in them. There is one lump of nine-month CDs that

will—promotional CDs that we raised a couple of hundred million in the third quarter, that rolls in nine months, for sure. That is a discrete piece that you could track, but normal CD rollover, which you can get a view of in our 10-K, right, there is a duration table in there.

If you think about that rollover rate and CD values and money market values coming down somewhat, you-–I think, you can estimate what we are rolling in the next couple of quarters.

**Steve Moss**
Okay, and then on the repurchase announcement here, just wondering about the timing of repurchases and your capital deployment plans. Any further additional color on capital deployment longer-term?

**Mark Mason**
We are waiting for approval or non-objection from our regulators to commence the repurchase plan. I would expect it to commence in the next few weeks, because, obviously, we have application in. It will take some time to accomplish. You are familiar with the restrictions on repurchase activity. You can really buy only about 20% of the daily activity on average. So if you think about the amount we are trading currently, that will take a few months to accomplish probably.

The second part of that question, future capital utilization. Obviously, we need less capital for growth than we used to, given our strategic position today. I would expect the Board, after accomplishing this share repurchase, to consider a new authorization. The Board is expected to also discuss the possibility of initiating a regular quarterly dividend next year sometime.

**Steve Moss**
Okay, that is helpful, and then one last thing, just on the leverage ratio restriction, wondering if you have any updated thoughts there?

**Mark Mason**
That is a good question. Steve, I think what you are referring to is our informal agreement with the FDIC to maintain 9% Tier 1 at the bank level. Is that right?

**Steve Moss**
Yes.

**Mark Mason**
I think that that is an important conversation that we expect to have with our regulators probably early to mid-next year. We want to make sure that we have a solid view of recurring earnings and that we get our earnings into the range of our peers. So that we can have a productive conversation on that point.

**Steve Moss**
All right. Thank you very much.

**Mark Mason**
Thanks, Steve. Good questions.

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

**Timothy O'Brien**
Good morning. Thanks, guys, for taking my questions. First question that I have, and tell me if you already answered this. Did you have-–I am assuming there was no revenue from discontinued operations generated in the third quarter? Is that correct?

**Mark Mason**
There was some revenue, in that we were closing the pipeline of their loans, and there was some interest income in the-–because of the warehouse, the loans held for sale, right? But it will impact….

**Timothy O'Brien**
Is there any…. Mark Ruh, is there any chance you could kind of give me a ballpark of what that revenue number might come in around?

**Mark Mason**
I will answer that for Mark. If-–we have not disclosed the detail, but will it be in the Q?

**Mark Ruh**
Well, we do not disclose any of the detail of discontinued operations at all.

**Mark Mason**
Even in the 10-Q.

**Mark Ruh**
But as we mentioned in the script that may be essentially in a wind-down discontinued operation center in the quarter. So, there should be no revenue–I mean no revenue [unintelligible]

**Mark Mason**
There should be no future revenue.

**Mark Ruh**
There will be no future revenue in the fourth quarter. Now, there will be expense though, however, certainly, as we wind it down, but there will really be no material revenue.

**Timothy O'Brien**
No material revenue going forward. I guess, there is a – I am going in a direction with my questions that is leading someplace else and that was kind of incidental, but what I am trying to get at is, ex any revenue that you had plus the $2.3 million recovery. And then looking at what the net from discontinued operations was, that gives us a sense of what the costs were. And my question is, was: what was that cost number from discontinued operations, ex the recovery in any associated revenue? What was that ballpark number? Was it a few million bucks?

**Mark Ruh**
Well, I will say this. Look, we have not disclosed the detail, one, because we do not think it is material, right? It does not speak to future earnings. It is a cleanup operation. The revenue was not significant. Most of the activity was expense offset by the recoveries.

**Timothy O'Brien**
Great. Okay, that is helpful, and obviously, that cost number from discontinued operations is going to most likely be lower in the fourth quarter than it was in the third quarter. That is a good assumption too, correct?

**Mark Mason**
General-–generally correct. It is-–it should be lower, but it is not going to be nonexistent.

**Timothy O'Brien**
Understood.

**Mark Mason**
And until we get the rest of the way through the quarter and see what the final cleanup of a couple of items are, we cannot be sure, and that is why we are being a little vague. I am sorry.

**Timothy O'Brien**
No, that is okay, Mark, and then another question is on the-–in the top line, $32.8 million this quarter. Can you provide, what piece of that was variable rate tied to gain on sale or kind of give me a ballpark of what that number was?

**Mark Mason**
If we were going to disclose all those numbers, we provide a schedule. So, I do not think we should do it piecemeal.

**Timothy O'Brien**
Yes. I am just trying to get at what kind of the fixed rate comp number was in the third quarter kind of as a baseline, core comp, fixed rate comp here and the work off of that is ultimately my intent and it is just…?

**Mark Mason**
I get it. Tim, I do get it. I understand your challenge and the forecast indeed. But again, if we do it this quarter, then we feel obligation to do it next quarter, and then we will have to start creating schedules and that is kind of…

**Timothy O'Brien**
So, if I promise you, I would not ask again?

**Mark Mason**
Yes, we will talk there. I will just say, no, but I appreciate your challenge.

**Timothy O'Brien**
It is okay. Yes, I thought I'd try. Yes, I'll step back now. Thank you.

**Mark Mason**
Thank you.

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

**Jackie Bohlen**
Hi, everyone. Good morning.

**Mark Mason**
Hi, Jackie.

**Jackie Bohlen**
I wanted to see-–hi, Mark--where you stand in terms of the identification of anticipated cost savings. Are you close to identifying most of everything, or is there still more that the consultants are working on?

**Mark Mason**
That that is a fascinating question. There are different levels of identification. Let me start with that, right? We have had an identification of the areas of cost savings of the type of cost since the middle of the second quarter, essentially, right? Now taking those areas of cost savings, translating them to plans, which may involve consolidation of activities. consolidation and elimination of multiple software systems, things like that, now you go down to a level okay. Now we need an executable plan for that consolidation, and we need to identify individuals who will be staying versus leaving in terms of positions and individual people.

So, we have identified all of the areas. Some of the areas-–and we have a calendar on which we and our consultants are working each piece. And I would say, we are about halfway or more through the pieces in terms of plans and specific identification. All the pieces are not equal though.

So, as you would expect, we are attacking the largest opportunities first. And so I would say that we are-–it is hard to put a number on this--substantially more than halfway through the specific identification process, and that is why we continue, but 100% through the process of identifying where the savings will come from. And I hope that does not sound too vague, but it is quite a process of organizational change, technology change and the like, and because of where we are at, we still feel comfortable saying we believe we are going to achieve our targets. And you know the unfortunate part of that is, most of the realization of that change is going to occur in future periods, right?

We are going to see some more progress in the fourth quarter, mostly personnel reduction and then a substantial more in the first quarter, again, mostly personnel, but some technology and in occupancy, and then the remainder over the – remainder of the year next year.

There is also meaningful savings on the technology side, that will occur after 2020. And that is unfortunate. In that, we would like to get all the savings we can right away, but we have some longer-term technology contracts. The great example is our core system, right, with FIS, which do not mature until 2022, which are very challenging to renegotiate when someone has contractual revenues already in their plan, right?

So, that is kind of the progression from here, and we feel good about where we were at, and then that is the feeling I want you all to take away from this call. It is still a lot of work and the economic environment provides some uncertainty still. I hope that helps.

**Jackie Bohlen**

It does. So essentially, you fully identified the areas you want to pull costs out of, you are roughly around 50%, little more in terms of figuring out how you are going to execute some of those savings and what micro areas those might come from. And then so, you still need to continue to figure out where you are going to be able to pull those costs from and then set up an execution schedule for that? Am I understanding correctly?

**Mark Mason**
I think that is right. I mean, the fact that we may not have a fully detailed plan for certain areas. It does not mean we have not looked at them and do not know where the things are going to come from, we do, but getting down to execution dates, personal things like that on some of the lesser areas, not done. Again, all the areas are not the same magnitude. That is the other important things.

**Jackie Bohlen**
Yes. Understood, and I would guess, you are executing on the easier items first, and then the more challenging items, which have come over time?

**Mark Mason**
Not necessarily true.

**Jackie Bohlen**
Okay.

**Mark Mason**
We want most significant magnitude first.

**Jackie Bohlen**
Okay.

**Mark Mason**
If there are things that are easy to do and apparent today, we are asking the leaders in those areas to work on them immediately, but they are not going to have help from senior management or consultants yet, right? So we are expecting our people to be doing whatever work they can independent of our process and that happened in one of the areas that is most easily identifiable is in attrition, and when we have attrition in areas, and I am talking substantially in non-revenue areas, we are asking our managers to first ask themselves if the process or work being done by that position can be absorbed within the remaining group, and I am so happy with the work that our folks are doing. They are really stretching and being creative to do that, right, to absorb into existing resources, the work that some attrition position might create.

Now, that is not going to be true in every position. We will not starve our people for appropriate resources. We will not change our risk management profile, but our business is changing a lot, and in some areas, attrition can be turned into savings.

**Jackie Bohlen**
Okay, all right, and then just one more for me on a completely separate topic. I-–you mentioned that the single-family portfolio will run down, and I know we have discussed this before. Do you have kind of a general target in mind for where that portfolio would trend down to as a percentage of total loans?

**Mark Mason**
That is a fair question. I think that-–it over…

**Jackie Bohlen**
I am just trying to think about the magnitude of decline at all.

**Mark Mason**
I can check this. But I would say, my sense of the numbers we are looking at could be about a 20% decline in balances over the next, say, 18 months, and those are-–that is very rough, and I might have to correct it. But I think that that order of magnitude could occur, and then Gerhard can follow up with you.

**Jackie Bohlen**
Okay. I mean, I understand where we…

**Mark Mason**
Good, but it is just that we do not know if rates are going to continue to decline, right? I mean, the…

**Jackie Bohlen**
Yes.

**Mark Mason**
The environment is so uncertain.

**Jackie Bohlen**
Yes. No, that's definitely understood that we are operating in a fluid environment. Okay, great. Thank you for taking my questions.

**Mark Mason**
Thanks, Jackie.

**Operator**
Again, if you have a question, please press star (*), then one (1).

The next question comes from Tim Coffey of Janney. Please go ahead.

**Tim Coffey**
Thanks, Ruh and Mark.

**Mark Mason**
Hi, Tim.

**Tim Coffey**
With the drop in rates, I got to imagine there has been an increase in refi activity within your branches. I am wondering, do you anticipate the volume of the refi activity to kind of lift your sold volume off the $300 million that we saw in the third quarter?

**Mark Mason**
Third quarter volume, remember, is impacted by closing the pipeline, the home loan centers, but-–and it is elevated somewhat by extra refinancing. On a level state, we are expecting that

business to originate about $1 billion a year, and that is excluding the joint venture with WMS that we have, which will soon be up.

So we are running probably 20% higher than a non-refi period would suggest, but that extra refi volume, we expect to continue somewhat in the fourth quarter subject to seasonality, and into the first part of next year, but again that forecast is just subject to a lot of uncertainty with rates.

**Tim Coffey**
Sure, sure. I understand. Do you anticipate that additional volume to have any- create any additional volatility within your expenses?

**Mark Mason**
Well, sure, I have got commission revenue, of course. I mean, commission, yes.

**Tim Coffey**
Okay, okay, and then the commercial loan sales in the quarter of $270 million. Is that a good run rate that you are looking at?

**Mark Mason**
It can be a little seasonal. Fourth quarter is typically pretty strong, and we are expecting that again this year. If you look at last year's fourth quarter, the commercial loan sales were actually a little less than third quarter this year. So, third quarter was surprisingly good. I would expect a reasonably strong fourth quarter. Will it be as large as the third quarter kind of remains to be seen.

**Tim Coffey**
Okay, and then was anything in the margins on the gain on sale of either the loans, commercial or single-family residential that you should keep an eye on?

**Mark Mason**
The margins on the single-family loans will improve dramatically after we sell our interest in WMS, because think about the corresponding margin on purchase loans being about half, the margin on retail originated loans. Of course the volume will decline, but the margins will increase. Also, the business we have today, the retail mortgage business is substantially better controlled and at the margin more profitable than the very large business we had.

We are much more stingy in price exceptions, and the absolute volume is not as important to us as profit margins and expense control, as you would expect, and so the consistency of our margins going forward on the retained business should be substantially better than they have been.

**Tim Coffey**
Okay.

**Mark Mason**
I mean, the pure margin, the pure composite margin this last quarter on our retail-originated business, the continuing business, was well above 300 basis points, somewhere in the nature of 320. And it has not been that good for quite a while before that.

**Tim Coffey**

Yes, and I know you entered into an agreement to sell the ownership interest in WMS. Do you have any idea when it is going to close?

**Mark Mason**
We hope this quarter. It should close this quarter.

**Tim Coffey**
Okay, and just follow up on the earlier question about CD maturity schedule. It does not sound you have anything material repricing in the next two quarters, or was it just more of a kind of look at the schedule in Qs and Ks to really get better answer?

**Mark Mason**
Yes, I think it is the regular rollover.

**Tim Coffey**
Okay.

**Mark Mason**
The one promotional piece that I mentioned is not going to roll for another couple of quarters, right, the $200 million that we promotional CDs we raised to fund the servicing transfer in the third quarter, that is going to take a while, but the regular rollover is going to continue.

**Tim Coffey**
Okay. Okay, so you are just calling out the nine-month promotional?

**Mark Mason**
Yes. That is all I called out, right.

**Tim Coffey**
Okay. All right. Those are all my questions. Thanks a lot.

**Mark Mason**
Thanks, Tim.

**Operator**
And we have a follow-up from Jeff Rulis of D. A. Davidson. Please go ahead.

**Jeff Rulis**
Thanks. Just a couple of others. On the-–in the credit side, it looks like you had some deterioration in the commercial non-performers. Could you itemize either--was that by geography or just any color on the increase in non-accruals? Thanks.

**Mark Mason**
There is not much distinction there. There are a few smaller credits that went to non-accrual. We do not expect any material losses. We have good collateral coverage, and some of these will hopefully be upgraded sometime soon as well.

**Jeff Rulis**
Were there any geographic specifics to that?

**Mark Mason**
Not really. I mean, our concentrations are in Puget Sound in Southern California, and there is a little of both.

**Jeff Rulis**
And then Mark on the-–you said earlier the efficiency goal is low- to mid-60%. The previous call, you had low-60%. Just curious as to the shift is that an updated revenue projection, or is that less cost savings as you wrap your hands around the things you have got in place?

**Mark Mason**
Well, the last time we mentioned it, it was probably low to mid and we described it as low, right? If it is not 60%, right, it is somewhere between 60% and 65%, right? I think right now, we just provide a little uncertainty because of the interest rate environment on the impact on revenue.

**Jeff Rulis**
Okay. All right. Thank you.

**Mark Mason**
Thank you, Jeff.

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

**CONCLUSION**

**Mark Mason**
Thank you, again, for your participation and attention today. We look forward to speaking to you again next quarter.

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