HomeStreet, Inc.

Q2 2019 Earnings Conference Call

Tuesday, July 23, 2019, 1:00 P.M. Eastern

CORPORATE PARTICIPANTS

Mark Mason – *Chairman and Chief Executive Officer*

Mark Ruh –*Chief Financial Officer*

PRESENTATION

Operator
Good day and welcome to the HomeStreet, Inc. Second Quarter 2019 Earnings Call. All participants will be in listen-only mode, should you need assistance, please signal a conference specialist by pressing start (*), then zero (0) on your telephone keypad. 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, Chairman and CEO. Please go ahead.

Mark Mason
Hello and thank you for joining us for our second 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 isn't 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 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.

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

The second quarter of 2019 marked a significant milestone in achieving our long-term strategic goals. We completed the sale of substantially all of our standalone home loan centers and transferred most of our related personnel to HomeBridge Financial Services. The remaining offices that were not sold were closed during the quarter. As a result, our employee count decreased from 1937 at the end of the first quarter to 1221 at the end of the second quarter.

Much of this activity took place in June, so our consolidated results of operations included an almost entire quarter of historical mortgage banking activities.

As part of our decision to reduce our exposure to mortgage banking, in July, we entered into a non-ballot binding letter of interest to sell our ownership interest in WMS Series, LLC. The successful completion of this transaction will further reduce the single-family mortgage banking volume we generate going forward. For perspective, during the second quarter, we originated $166 million of held for sale loan volume and $5.3 million of held for investment loan volume from WMS.

At the beginning of the second quarter, we announced our board had authorized a $75 million share repurchase program. As of the end of the quarter, we repurchased 963,600 shares in the open market at an average price per share of $29.40. Subsequent to quarter end, upon receiving Federal Reserve Bank non objection, we purchased Blue Lion Capital's 1.7 million shares, representing 100% of Blue Lion Capital and its affiliate ownership position at a price per share of $31.16, which price represented the five-day volume weighted average price prior to the date of our 2019 annual meeting.

We are pleased to reach this amicable resolution with Blue Lion Capital, which will allow us to focus completely on the business going forward. Asset quality remains strong and improved during the quarter with non-performing assets declining to 16 basis points of total assets at the end of the second quarter from 23 basis points at the end of the first 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.

Total deposits on our continuing operations increased 8% during the quarter and deposits on our de novo branches, those opened within the last five years, increased 25% during the same period. During the quarter, we announced the consolidation of our Lake Oswego, Oregon retail deposit branch into our Lake Grove Oregon branch, which will take place in September of this year. We are dedicated to making this a seamless transition for our customers.

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

Mark Ruh
Thank you, Mark. Good morning, everyone and thank you again for joining us. In the first quarter, we announced that we would sell our home loan center-based mortgage banking business and retain our substantially smaller bank's location-based mortgage banking business. As a result, the historical results of our mortgage banking segments were reclassified as discontinued operations.

Beginning in April 2019 and going forward, the assets, liabilities, revenues, and expenses of the retained bank's location-based mortgage banking business are included in continuing operations. I will be highlighting the impact from these changes in the presentation of our financial results during the quarter.

And now, regarding our second quarter financial results, our consolidated net loss, which includes the results of both continuing and discontinued operations, for the second quarter of 19 was $5.6 million, or $0.22 per diluted share, compared to a net loss of $1.7 million, or $0.06 per diluted share for the first quarter of '19. The share repurchase from Blue Lion Capital and affiliates on July 11, caused us to reclassify $52.7 million of our equity to temporary equity as of quarter end. This reclassification caused us to hold temporary equity for the last 10 days of the second quarter, resulting in a slightly dilutive effect to both income from continuing operations and loss per common share of approximately $0.01.

One-time items include the net income for the second quarter of ‘19 were comprised of $9.6 million restructuring charges from the exit or disposal of our home loan center-based mortgage banking business, and $33,000 of acquisition-related recoveries, net of tax. This compared to one-time items in the first quarter of $9.6 million of similar restructuring expenses, net of tax, and $290,000 of acquisition-related expenses, net of tax.

Net income was adversely impacted during the quarter by the timing of the sale of our home loan center-based mortgage business. We recognized a full quarter of expenses on closed loan volume, but only a partial quarter of revenue on interest rate lock volume. When single family interest rate lock volume is lower than closed loan volume in a given quarter, net income is reduced because the majority of mortgage revenue is recognized at interest rate lock, while most of the origination costs, including commissions, are recognized upon closing. This imbalance reduced net income during the quarter by approximately $3 million.

This adverse effect will continue during the third quarter of ‘19, as we expect to recognize limited revenue on interest rate lock and forward commitment volume but will continue to close the remaining loans from the pipeline that was sold. Net income from continuing operations for the second quarter of ‘19 was $8.9 million, compared to net income from continuing operations for the first quarter of ‘19 of $5.1 million. Of this increase, $3.2 million is due to the inclusion, beginning in April, of the revenues and expenses from the retained bank location-based mortgage banking business previously included in discontinued operations. Excluding this impact, the increase was primarily due to a decrease in the provision for credit losses and an increase in non-interest income from increases in gain on sale of investment securities, and prepayment fees received on the payoff of commercial loans.

Net interest income increased by $1.6 million to $49.2 million in the second quarter of ‘19 from $47.6 million in the first quarter. Of the increase, $1.2 million was due to the inclusion, beginning in April, of net interest income from the retained bank location-based mortgage banking business previously included in discontinued operations. The remainder was due to higher average balances in loans held for investment during the quarter. Our net interest margin on a tax equivalent basis remained at 311 basis points in the second quarter compared to the prior quarter. Compared to the first quarter of ‘19, the benefit of growth in non-interest-bearing deposit was offset by higher interest-bearing deposit costs.

Loans held for investment decreased $59 million, or 1%, to $5.3 billion at the end of the second quarter from $5.4 billion at the end of the first quarter. Sales of commercial real estate and single-family mortgage loans during the quarter offset net increases in the portfolio from new lending. Non-performing assets decreased to $11.7 million, or 16 basis points of total assets at June 30 compared to $16.7 million or 23 basis points of assets at March 31. The decrease from March 31 was primarily due to the payoff of a $4.7 million SBA 504 construction loan that had been previously downgraded to nonaccrual during the first quarter.

We recorded no provision for credit losses in the second quarter compared to a $1.5 million provision in the first quarter. This decrease in provision versus the prior quarter was primarily due to the reduction in loan balances and a slight recovery on loan losses during the quarter.

Deposit balances, excluding those related to discontinued operations were $5.6 billion at June 30, an increase of 8% from March 31st. The increase in deposits was primarily driven by an increase in consumer time deposits.

We raised generally less than nine months CD deposit in anticipation of a decrease in servicing related deposits associated with the final transfers of mortgage servicing rights this month and in August. Subsequently, we reduced our rates on these deposit products. We also had strong growth in non-interest-bearing business deposits. Our trailing 12-month deposit beta for the second quarter was 38%, up slightly from the first quarter's deposit beta of 31%. Our second quarter 12 month held for investment loan beta was 31%.

Non-interest income increased $11.7 million from $8.1 million in the first quarter of '19 to $19.8 million in the second quarter of '19. $10.4 million of this increase was due to the inclusion, beginning in April, of non-interest income from the retained bank location mortgage banking business previously included in discontinued operations. The remainder was due to an increase on the gain on sale of investment securities during the quarter and an increase in prepayment penalties received on the path of commercial loans.

Non-interest expense increased $11 million to $58.8 million in the second quarter of '19 from $47.8 million in the first quarter. $7.6 million of this increase was due to the inclusion, beginning in April, of expenses from the retained bank location-based mortgage banking business previously included in discontinued operations. The remainder of the increase during the quarter was due primarily to proxy solicitation and other annual meeting costs, offset by $672,000 of legal expense reimbursements, recognized in the first quarter of '19.

Our effective income tax rate of 14% for the second quarter of 2019 differs from our combined federal and blended state 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 loss from discontinued operations was $14.5 million in the second quarter of '19, compared to a net loss of $6.8 million in the first quarter of '19. The increase in net loss from discontinued operations was due to the adverse impact of the imbalance between the volume of interest rate locks and volume of closed loans that was previously discussed.

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

Mark Mason
Thank you, Mark. Now that we have completed most of the asset sale portion of our mortgage banking restructuring plan, we have turned our focus to improving our operating efficiency and reducing our cost structure to reflect our simplified business model and lowered growth expectations. In addition to the expense reductions to date and plan by management, Dan Davis and CBC for Profits, our cost efficiency consultants, had identified a range of additional expense reduction opportunities, 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 within the company, renegotiating where possible major contracts, primarily technology, identifying and eliminating where possible all redundant or unnecessary systems and services, and adjusting staffing to recognize the significant changes in work volumes and company direction.

Despite the challenges of the yield curve, and assuming our strong credit culture maintains our low level of problem assets, and assuming we realize the expense reductions currently planned by management and projected by our consultants, we expect to achieve an efficiency ratio in the low 60% range, return on average assets exceeding 1.1%, and return on average tangible equity exceeding 11% within the next four quarters, with additional improvement after that time.

The timing of these expense reductions will vary depending upon the nature of the expense, although a meaningful amount is expected to be realized in early 2020. These return targets are based only on expense savings without additional share repurchases, or the possible establishment of a regular quarterly dividend. Additionally, revenue enhancements, such as improvement in our cost of funds and fee income, would improve these return targets. Going forward, as we implement the expense reductions identified by our consultants, we will be better able to forecast the timing of their expected impact on our financial results.

In future quarters, we will be providing detailed numbers on expense reductions to date, and more specific timing of efficiency ratio, return on average assets and return on average tangible equity targets in the future. As a consequence of this change in business strategy, we are also updating our growth expectations for the near term. For the remainder of this year and next year, we will be replacing runoff in our single- family loan portfolio with growth in our commercial loan portfolios, resulting in no net growth in loans held for investment over these terms. Additionally, assuming no change in the current yield curve, we expect a net interest margin consistent with our just concluded second quarter.

This concludes our prepared comments. We appreciate your attention today and Mark and I will 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. If at any time, your question has been addressed and you would like 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 Luke Wooten of KBW. Please go ahead.

Luke Wooten
I just wanted to start off with just some questions on what you just touched upon on the strategic initiative and just kind of wanted to see in terms of some of the technology renegotiations and systems consolidations, they relate a lot or heavily to the kind of information services lines and if you could just touch on that a little bit more for the forward guidance.

Mark Mason
Sure, it touches several categories of expenses. Of course, the technology line item, which is comprised not just of inside IT personnel and costs, but more substantially the cost of software systems that provide the backbone of our operating systems. And we have a lot of systems here, we have some very specialized loan products, and a fairly wide menu of products. And we have identified a certain amount of duplication of services among those products. We are analyzing those areas of potential duplication and consolidation, in conjunction with the need to

renegotiate many of our contracts as a result of substantially reduced volumes, subsequent to our sale of the majority of our mortgage banking activities.

Luke Wooten
Okay that is helpful. Thanks, and then just switching over to, what you were just touching on the loan growth, you said that offsetting the commercial contraction, that loan growth can be relatively flat through the end of the year, is that how I should interpret it**?**

Mark Mason
Offsetting the runoff in the single-family mortgage portion of our portfolio, right, understanding mortgage origination volume is going to decline pretty dramatically, those balances, particularly in this interest rate environment, are going to decline more quickly than in the past substantially. But we expect to offset that runoff with greater levels or greater composition of various commercial loans.

Luke Wooten
Okay, that is helpful and then I will just touch one more on the margin, just trying to get a sense of, if we do get a rate cut here in the next, well, it looks like in the next couple of days, but just through the end of the year, how much of your commercial loan is floating to prime or LIBOR and given that cut, how do you see those yields trending?

Mark Mason
A meaningful amount of our portfolio is adjustable. In rough numbers, I believe about a third of it is monthly adjusting, roughly and the remainder of the adjustable portion of the portfolio is of a hybrid nature, right, short term structure and then floating.

Luke Wooten
Okay. And then just given a cut, how do you see the yields on that? I mean, I imagine, do you have any kind of guidance for the impact to the NIM or is it kind of just to be assumed that through the end of the year, if there is a cut or two, this would be down modestly?

Mark Mason
You know we are pretty balanced. And when we look at the potential for a cut at the short term of the curve, that is going to have offsetting impact in our funding costs today, given our level of home loan advances and a falling deposit beta.

Operator
Our next question comes from Jeff Rulis of D.A. Davidson. Please go ahead.

Jeff Rulis
A question on the income statement and trying to get into an okay approach to rightsizing what things look like post Q2. Is it a good place to start, maybe fair to back out the 10.4 and 7.6 in fee income and expenses from the discontinued ops. Understand, going forward and then understanding efforts made to build that fee income and reduced cost. Is that a fair start point?

Mark Ruh
No, actually the reverse. The change in the quarter was reclassifying that portion of mortgage origination and servicing that will be continuing out of discontinued operations in the prior quarter into continued operations. And so, you should expect to, going forward, see those higher levels of revenue and expense.

Jeff Rulis
Okay. And then on the stranded costs, I think you identified 8.3 previously. What of those have been captured as of the 2Q run rate and I suppose what is left?

Mark Ruh
Yes. And I apologize for not calling that out. But if you look on page 25 of our earnings release under the non-GAAP financial measures, at the end of the first page, it shows second to last line on that page, the stranded cost numbers for the quarters, historical and most recent, and the $8.3 million has declined to $6.2 million in the second quarter and still falling, of course.

Jeff Rulis
And are the exit and disposal cost, is that complete, i.e., no further charges anticipated in future quarters.

Mark Ruh
In terms of restructuring type charges, that is substantially correct. We may have some miscellaneous items that come through, however, we will still have some operating loss in discontinued operations in the third quarter, as we finish closing the pipeline of lock loans that existed when we transferred the offices and personnel. Those loans are being closed with the assistance of that personnel that will be transferred under a transition services agreement with HomeBridge. And while the economics of that agreement, we think are favorable for the company, we are not anticipating net income, probably some smaller net loss in discontinued operations.

Jeff Rulis
Okay, and additional balance sheet adjustments post second quarter, you spoke about 133 million in deposits set to transfer to the mortgage buyer and then, you had an elevated loans held for sale, could you talk about just structured deposits and loans that are planned to go away?

Mark Ruh
So, right, including the expected reduction in deposits, loans held for sale should fall ultimately to less than $100 million. Two things driving that. One, of course, the completion of the closing of the discontinued pipeline and then ultimate sale of those loans, but also the sale of our interest in Windermere mortgage services, which provides currently $70 million, $75 million a month in originations to us, maybe larger last month. So, all of those will create a decline, ultimately in loans held for sale over the next 6-to-9 months. The largest part of that being in the third quarter.

The deposit number that we previously discussed, and of course, this temporary equity number that is existing temporarily at the end of this quarter.

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

Steve Moss
I want to start on the mortgage banking side, assuming the sale of WMS here? I guess it's kind of fair to think about originations on an annual basis probably in something like the $750 million to $1 billion range annually.

Mark Ruh

That is fair. It is seasonal still, right.

Steve Moss
Right. Okay. And then just in terms of, as you are thinking about expenses here, about how long do you think it will take to implement the bulk of the consultants and your own plans, recommendations? Should we think of that over the next six months or is it really longer over a 12-month plus period?

Mark Mason
Well, I just stated in my comments that we are expecting to realize the lion's share of this over the next four quarters with a meaningful amount in early 2020. Right now, it is a little hazy, right. I mean, we are just investigating the potentials and beginning planning. And so it is a little hard to be more specific, but we feel good enough to make, to provide this guidance. And unfortunately, right now, it is kind of as good as we can provide. But beyond the first half or the first three quarters of next year, there is still more to come, right.

Additionally, if you think about limiting loan growth, but continuing deposit growth, we are planning on improvement in our cost of funds as well, but these numbers do not include any of that.

Steve Moss
Right. And then, I guess, on the CD special that you guys ran, just kind of wondering, where was that? And where are your CD rates today versus perhaps the current cost of funds that we [unintelligible]?

Mark Mason
Well, they are down substantially. We had a hole to fill, right, a very temporary one to plan for, with the transfer servicing deposits. And relative to advances and with liquidity considerations, we felt the right thing for us to do was to float a certain amount of short-term CDs and raise that money quickly past life premium. But the rates on those products are down very substantially. Yes, 40 basis points. Right.

Steve Moss
Okay that is helpful. And then, I guess as the balance sheet here is more or less stable, how should we think about, you talked about commercial loan growth? How should we think about that underlying mix between C&I, CRE, and construction?

Mark Mason
If you look at past volumes, I would expect a consistent relationship generally, though, our C&I lending has been increasing quarter-over-quarter, if you look at the trend over the last five quarters or so. Residential construction lending has declined somewhat, consistent with a slowdown in that market. And so, I think you will see that construction volume decline somewhat. Commercial real estate, general commercial real estate lending, we expect to be very strong, perhaps grow slightly during this period. We will not be holding all that on our balance sheet though. While originations have grown, sales are growing as well. And we effectively use that product type to balance our balance sheet needs these days. And we continue to work on growing our C&I business, as I previously stated.

Steve Moss

Okay. And I guess more of like a, little more, I guess, housekeeping items, if you will, it looks like you guys disclose proxy expenses and some severance and looks like that came through continuing operations. I was wondering if you could quantify those items?

Mark Mason
We have not specifically. But the delta between the items that we have described, primarily not exclusively, relates to those items. We did have severance in continuing operations, because as we have been discussing, we have been paring down corporate services and personnel. And, in total, those numbers have been meaningful and salaries and related costs for the quarter, about $1 million of that delta, if that helps.

Steve Moss
Okay, that is helpful, and I think that is everything from me at the moment. Thank you very much guys.

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

Tim O'Brien
Thanks. First question I have for you guys. Can you talk a little bit about capital management plans and needs here going forward, obviously, with slower loan growth planned? That is a factor in this, but, and also where you see capital ratios, key capital ratios kind of settling out with the share buyback pending and stuff?

Mark Mason
Sure, all of our current buyback activities have been concluded, right. We first suspended and will soon terminate the $75 million board authorized repurchase plan, given we filled that and a little more with the repurchase of the Blue Lion shares. We, by strategy, quickly authorized after the end of the first quarter, and the completion of our servicing sales, our $75 million buyback with the intention of completing the home loan center sales and then after second quarter, assuming the completion of the sales, re-evaluating our capital needs going forward, and it is our expectation that the board will authorize additional future share repurchases, and ultimately, a regular quarterly dividend. We are very early in the stabilization of the company. If you think about what we just went through in the first and second quarters, and what we will be going through for the next several quarters in efficiency improvement, I do not expect that we will wait too long before the board authorizes additional adjustments to our capital. But I don't want to front run their decisioning. But I expect that that will happen.

Tim O'Brien
And then sticking my turn on with another expense question. So, on that page, it looked like about $6.2 million or thereabouts, on page 25, for shared cost reduction. So, $2 million reduction if I'm reading it, right.

Mark Mason
Yes.

Tim O'Brien
And then the work that Mr. Davis has done and the consultants and stuff, are the cost savings that they have--those opportunities been identified and quantified? And are they separate from these shared costs, targeted share cost reductions?

Mark Mason
I would not say they are necessarily separate, in that the classes of potential savings, cross many aspects of the company, which would include corporate services.

Tim O'Brien
And then, I guess a different way to look at where you guys ended up, finishing the second quarter from an expense standpoint, and kind of on a go forward basis. Do you have a sense of ballpark range of where total non-interest expense might foot, ex-one timers and extraneous costs and things like that, the core number here in the third quarter? Is that going to be north/south of $60 million do you think?

Mark Ruh
Well, this last quarter's total expense was $58 million. So, I do not expect it will be higher than that number. Right. If you think about the things that went on at the company, including continuing reductions in personnel, and the fact that the second quarter is really a peak quarter for mortgage loan originations, even in our ongoing business, that we would expect the number generally not to exceed that number. I will warn you, we could have non-recurring write offs, restructuring, severance, and we will, right, related to some of these cost savings initiatives. I am speaking to core numbers.

Tim O'Brien
In that second quarter number, the $59 million core number, that did include retention of the mortgage business of those--that personnel and stuff, their compensation is reflected in that number in the second quarter, that $59 million, correct?

Mark Ruh
That is correct.

Tim O'Brien
And can you quantify what the savings are from that severance here going forward?

Mark Ruh
In continuing operations, I think I just mentioned that we had about $1 million of personnel-related...

Unidentified Speaker
This was the restructuring charge of $1 million.

Mark Ruh
Right, but that is what he is saying.

Unidentified Speaker
But these are not for annualized run rates going forward.

Mark Ruh
But I do not think I can give guidance on forward similar numbers yet.

Tim O'Brien
Alight. Fair enough. I will step back. Thank you.

Mark Ruh
Alright Tim, appreciated.

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

Tim Coffey
Thank you, good morning gentlemen. As we look at kind of the forward run rate for the gain on sale line, with the composition, would you anticipate the composition will look a lot like it has the last two quarters where mortgage banking is a sizable portion of that component, followed up by commercial real estate?

Mark Mason
I think that is going to be true in terms of the size of the numbers. The efficiency of those two operations is dramatically different. Right? If you think about the relationship between the revenues and expenses, right, our efficiency ratio in commercial real estate is in the mid-to-high 30% range, right. But single-family retail mortgage is running in probably mid-70 range, right?

So, remember, and remember, there is seasonality still in mortgage revenue, second quarter being relatively high point for the year. So the relationship or the composition of that non-interest income will change during the year, perhaps meaningfully. Additionally, commercial real estate loan sales and in turn gain is historically higher in the second half of the year than the first half of the year, in particular, Fannie Mae DUS loans sales are typically higher in the second half of the year. And so you can see a material change in the composition of that revenue line through the year.

Tim Coffey
Okay. What about the absolute dollars falling to that line?

Mark Mason
Not sure I understand the question.

Tim Coffey
Will we expect the gain on sale line item to come down?

Mark Mason
I would expect it to be seasonal with respect to each of the operations. And I think it is a little unclear at this point how much will be offset versus a decline.

Tim Coffey
And then, kind of flipping over to the mix of earning assets, if the loans, the commentary on the loan portfolio going forward, will combine with your expectations to grow deposits? Would you anticipate that securities would become a bigger part of that earning asset mix or do you think it can stay kind of in this low-teens on an average basis?

Mark Mason
We carry a securities for liquidity and collateral purposes. And so, they will vary. Generally, around 15% of assets, roughly less if we can, right, but you should generally see that balances vary in relation to the size of the balance sheet around those numbers, say 13% to 15%, roughly.

Tim Coffey
And then with the exit from a substantial portion of the mortgage business, would it be correct to start thinking that your average borrowings will start to decline?

Mark Mason
Yes, as the balance sheet stabilizes. We do expect deposit to continue to grow. If you assume that our loan portfolio stabilizes around this number for the near term, and deposits continue to grow, those will create a reduced need for home loan advances and other borrowings. And so you should see the composition of funding change.

Tim Coffey
Okay, great, thank you those were my questions.

Operator
Again, if you have a question, please press star (*), then one (1). Our next question comes from Jeff Rulis of D.A. Davidson. Please go ahead.

Jeff Rulis
Just a couple of housekeeping follow-ups, maybe for Mark Ruh. The expected tax rate going forward, do you have an estimate on that?

Mark Ruh
Yes. It looks like it is going to be closer to what we report as a combined federal and statutory tax rate. So, it was a little bit low this quarter. But as we have larger income basically, the portion that we attribute to tax free securities will be less. So it is going to climb higher. And we typically have seen in the past it is around 20% to 21%. I mean, when we started having quarters where we start earning again, on a net basis, you are going to see it, you are going to see converge towards that, towards that combined federal and state tax statutory rate. But again, we have worked typically, we were running 20, 21 is what you will see. This was an odd quarter because net income is so low.

Jeff Rulis
Right, okay. And then, just to peg on the Q3 average diluted share count, just some moving pieces there. We could do the math on what is coming out. But do you have a number? There is some averaging in there?

Mark Ruh
Yes, I do not have--that really small effect that we talked about that happened in the second quarter, if there may be a very, very immaterial effect due to that in the first 11 days of the third quarter, but it will be tiny. I mean, you guys really will not even see it. I mean, I think as far as the diluted share count, you can expect that the only shares we are going to be bringing on is due to shares that would be issued due to employee grants, which is generally a pretty small number. But you do have to remember that we are losing the 1.7 million shares that were repurchased to Blue Lion. So those will drop off after the first 11 days of July. And then so our diluted share count will change due to that.

Jeff Rulis
As well as the open market purchases, repurchases.

Mark Ruh
Well, those are, you see those already, those are done. Yes. Those are done, so they are in.

Mark Mason
They are finished.

Mark Ruh
Yes. We finished that up in June, we are done with that.

Jeff Rulis
There was no tale of buyback in July.

Mark Ruh
No. All done in June.

Jeff Rulis
Great. And then maybe last one Mark Mason, just to confirm, those financial numbers you rolled out as 60% efficiency ratio or low range, ROA 1%, ROTCE 11%, your expectation is to get to those numbers by this time next year. So, when reporting, is that--am I reading that right?

Mark Mason
Yes, it was actually in excess of 1.1% on assets, in excess of 11% return on tangible common, just to be specific. Our expectation is that we would be able to get to that run rate a year from now, right, meaning in the third quarter.

Jeff Rulis
Okay, third quarter of 2020 is your expectation on those estimates? Okay.

Mark Mason
Right. So, it is sort of a lag when you accomplish the cut or you take the action, right?

Jeff Rulis
I did not catch that last bit.

Mark Mason
There is a lag between taking the action, right, and getting the benefit in the P&L. Right. So, all these things happening to get the sort of annualized benefit of all those things. That is what we are currently targeting.

Operator
Our next question comes from Jordan Hymowitz of Philadelphia Financial. Please go ahead.

Jordan Hymowitz
Thank you for my questions. If you are saying your loan portfolio stabilizes here, and securities are about 15%, would you say your total assets are bottom around 6.5, 6.7 billion? Is that a good number?

Mark Mason
They are going to decline slightly, 6.5, I believe is low. I think that, a higher number is more reasonable. We should be quite similar to where we are now.

Jordan Hymowitz
So, let us just say that you have 200 million of available for sale and a little less securities, let us just say it is 6.7 billion, which maybe it is higher. And you said 1.1% on assets. That is 73 million without any additional buybacks, you know, that is about a 280 in EPS number. Is that math right?

Mark Mason
The math is the math, right.

Jordan Hymowitz
Okay. And there is a possibility for it to…

Mark Mason
Not to be snotty. I am sorry, not to be snotty. That is just, you are right. That is the math. If we get the share count right.

Jordan Hymowitz
So, there is a possibility for additional buybacks, a possibility, correct?

Mark Mason
Yes.

Jordan Hymowitz
And would you say it is a fair statement that now that you have got rid of the mortgage business and you are probably in the hottest market in the country, you would be more of a desirable candidate to sell or to be bought rather?

Mark Mason
I would assume that is true.

Jordan Hymowitz
Thank you very much. Have a great day.

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
We appreciate all the great questions and your patience on the call today. Look forward to talking to you at the end of the next quarter. Thank you.

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