HomeStreet, Inc.

Year-End and Q4 2018 Earnings Conference Call

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CORPORATE PARTICIPANTS

Mark Mason – *Chief Executive Officer*

Mark Ruh – *Chief Financial Officer*

PRESENTATION

Operator
Good day and welcome to the HomeStreet, Inc. Year-End and Fourth Quarter 2018 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 year-ended fourth quarter 2018 earnings call. Before we begin, I would like to remind you that our detailed earnings release was furnished this morning to the SEC on Form 8-K and is available on our website at ir.homestreet.com under the News and Events link. In addition, a recording and a transcript will be available at the same address following the 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 the mortgage markets, such as changes in interest rates and housing supply that affect the demand for our mortgages and that impact our net interest margin and other aspects of our financial performance; the actions, findings, or requirements of our regulators 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 present our financial results, but first I'd like to give an update on our results of operations and review our progress in executing our business strategy. Notwithstanding the impact of a challenging period in the mortgage banking cycle, I'm proud of what we accomplished in 2018. Our Commercial and Consumer Banking segment achieved record net income for the year, driven primarily by 12% increase in loans held for investment, all of which was from organic growth. This growth was broad based in all of our primary Commercial and Consumer segment business lines. Of note, commercial and industrial lending portfolio grew 16%, reflecting the substantial investments we have made in this line of business. Overall loan growth drove an increase in our net interest income during the year, despite a decline in our net interest margin. The yield curve ended the year flatter than previous quarters. December of 2018 marked both the lowest spread between the two-year treasury and the 10-year treasury and the first time the yield curve was inverted along parts of the term structure since 2007.

During the fourth quarter, our loan portfolio grew only 1%, which was less than our expectation of 2% to 4% growth. The lower growth was due to the sale of approximately $70 million of single-family loans in the quarter. For the year, loans held for investment grew 12%. This interest rate environment and increasing competition for deposits continues to pressure our net interest margin. After several quarters of short-term interest rate increases by the Federal Reserve without a similar upwards movement in long-term rates, our cost of funds has increased at a faster rate than the yield on our assets. Additionally, we experienced outflows of demand deposits by some of our commercial clients associated with the mortgage industry as seasonal servicing deposit remittances, which we replaced with higher-cost wholesale deposits and borrowings. For the year, deposits grew 6%, lower than our expectations going into the year, reflecting a more competitive deposit market.

Notwithstanding the seasonally industry-wide competitive pressure, our de novo branches, those opened five years or less, grew deposit balances by 6.8% during the quarter and 30% during the year.

During the year, we opened three new retail deposit branches, all in Washington. We also consolidated two smaller branches in Eastern Washington into nearby branches. Lastly, we announced our agreement to acquire a retail deposit branch, including approximately $123 million of both deposits and commercial loans and a commercial lending team, in San Diego County. We expect that transaction to close in March of this year. After the quarter, we opened retail deposit branches in San Jose and Santa Clara, California. These are our first deposit branches in Northern California, and these branches will both open new markets for us but also allow us to better serve existing commercial and consumer customers in Northern California.

Asset quality remained strong during the quarter, with our non-performing asset ratio ending at 17 basis points of total assets. Our early warning credit indicators continue to reflect strong fundamentals in all of our markets. We are keeping a careful eye on some of the secondary smaller markets in our footprint since these markets have historically exhibited greater price volatility compared to primary markets during the downturn. However, job creation, unemployment, commercial and residential development activity, and absorption, vacancies, cap rates, and all other leading indicators of economic activity continue to reflect strong fundamentals.

While lower commission expenses on lower loan origination volume was the primary reason for the reduction in our non-interest expense during 2018, our cost savings initiatives in 2017 and 2018 have also materially reduced these expenses. As a result of these thoughtful operational changes, base salaries, occupancy, and G&A expenses are all meaningfully lower. We reduced total headcount 16% during the year and single-family home loan centers, including satellite locations, decreased from 70 to 53. We believe that these cost-saving initiatives will position the company for improved efficiency and profitability. Additionally, while we expect our mortgage banking business profitability to improve as the mortgage cycle improves, while we wait for this part of the cycle to end we are considering additional operational and strategic changes to further improve the profitability of the mortgage business. During 2018 we sold $4.9 billion in unpaid principal balance of single-family mortgage servicing rights and modified our loss-sharing agreement with Fannie Mae related to our DUS servicing. Both of these strategies improved our regulatory capital ratios.

Also, during the year we continued to refresh our Board of Directors by appointing Mark

Patterson and Sandra Cavanaugh to the Board, adding valuable skill sets and perspective to our Board. Since joining the Board, they have both made valuable contributions toward improved governance in our strategic objectives. Don Voss, who joined the Board with our acquisition of Simplicity Bank, was named the Lead Independent Director.

Since the last proxy season, we have held productive discussions regarding corporate governance, business strategy, and our results with most of our significant shareholders. These discussions has given management and the Board meaningful insight on shareholder views on these subjects and positioned us well for the coming proxy season.

Finally, a few comments on recent events and their effect on us. Many of you may remember the devastating wildfires that impacted parts of California during the fourth quarter, with thousands of homes lost. In the fire-affected areas, we have not seen a material impact to HomeStreet borrowers, as all had adequate insurance in place. For our borrowers who were affected, many have paid off their loans in full with insurance proceeds, while a few were taking out construction loans to rebuild. Additionally, HomeStreet has less than 30 borrowers that are experiencing some financial distress due to their places of employment being affected by the fires.

We are not seeing any material uptick in single-family mortgage delinquencies, and we will continue to work with affected borrowers while monitoring the situation. Additionally, we are keeping a careful watch on the effects of the ongoing Federal Government shutdown on our business. We are receiving inquiries from furloughed federal workers about possible single-family mortgage forbearance, but to date only four borrowers have applied for this loss mitigation. The rest are using accumulated savings for the time being. We stand ready to provide assistance in the form of late fee waivers, loan modifications, and short-term loans where warranted. The most acute impact, however, is on our SBA lending business. As part of the shutdown, the SBA is not issuing loan numbers, so loans cannot be closed or funded. The secondary market for SBA loan guarantee sales are also closed, so loan sales will not recommence until after the government reopens. Other adverse effects may emerge as the shutdown persists.

And now, I'll 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. I'll first talk about our consolidated results and then provide detail on our two operating segments. Regarding our consolidated results, net income for the fourth quarter of ‘18 was $15.2 million, or $0.56 per diluted share compared to $1.8 million, or $0.44 per diluted share for the third quarter. One-time items included in net income for the fourth quarter of ‘18 were a non-core net recovery of $622,000 of restructuring and acquisition-related items net of tax and a non-core $4.9 million income tax benefit from the reevaluation of our net deferred tax liability position related to the Tax Cuts and Jobs Act legislation enacted in December of 2017 recognized in relation to the filing of our 2017 Federal tax return. Excluding the impact of these charges, core net income for the fourth quarter was $9.7 million, or $0.36 per diluted share compared to core net income of $12.3 million, or $0.45 per diluted share for the third quarter. The decrease in core net income from the prior quarter was primarily due to lower non-interest income, largely from seasonally lower net gain on loan origination and sale activities in our mortgage banking segment.

Net interest income decreased by $272,000 to $51.4 million in the fourth quarter from $51.6 million in the third quarter. This decrease in net interest income is primarily due to our slightly compressing net interest margin of 3.19%, which decreased one basis point from the third quarter's net interest margin of 3.20%. While our retail deposit base has remained relatively low, our wholesale deposit and borrowing costs have continue to increase as the Federal Reserve continues to increase short-term interest rates. During the quarter, this increase in funding cost was partially offset by higher yields on our interest earning assets. Non-interest expense, excluding the net impact of acquisition and restructuring-related items, decreased to $85.4 million in the fourth quarter of '18 from $94.1 million in the third quarter. This decrease in non-interest expense was primarily from lower commission costs on lower closed single-family mortgage loan volumes, but also due to expense reduction initiatives.

Total non-interest expense declined by $49.1 million, or 11.2% for the year ended December 31, 2018, compared to the year ended December 31, 2017. The primary driver for this reduction was lower incentives and commission expenses due to lower mortgage loan volume. However, as a result of our 2017 and 2018 expense reduction initiatives, we achieved on a core basis a $14 million, or 8.8% decrease in base salaries for the year ended December 31, 2018, compared to the year ended December 31, 2017, due to the overall reduction in our headcount. Our expense reduction initiatives also reduced general and administrative expenses on a core basis by $11.3 million, or 17% during 2018. Finally, we reduced occupancy expense on a core basis by $2.6 million, or 7.5% during 2018 due in part to reducing our total office count from 138 to 123 during the year. These expense reductions were partially offset by increases in information services expense as we continue to invest in upgrading our technology platform.

Our effective income tax benefit rate of negative 2.5% for the fourth quarter of 2018 differs from our combined federal and blended state statutory tax rate of 23.6%, primarily due to a tax benefit of $3.7 million comprised of a non-core $4.9 million benefit from the reevaluation of our net deferred tax liability position related to the Tax Cuts and Jobs Act and a core expense of $1.2 million related to the filing of our 2017 federal tax return.

I'll now discuss some key points from our Commercial and Consumer Banking segment results. Commercial and Consumer Banking segment core net income was $14.3 million in the fourth quarter, a decrease of $2.3 million from core net income of $16.6 million in the third quarter. The decrease in core net income was primarily due to the previously mentioned tax benefit related to the filing of our 2017 federal tax return. Net interest income increased $1 million from the third quarter of '18 to $48.9 million, primarily due to the growth in our loans held for investment. Our portfolio of loans held for investment in this segment increased by $47.9 million, or 1% during the fourth quarter. Growth occurred throughout the portfolio, with the exception of a decline in the single-family mortgage portfolio from the previously mentioned sale of single-family mortgage loans during the quarter.

Segment non-interest income decreased quarter-to-quarter to $10.4 million from $10.7 million. This decrease was primarily due to slightly lower profit margins from our sales of multi-family Fannie Mae DUS loans and small balance commercial real estate loans during the quarter. Segment core non-interest expense was $38.3 million, an increase of $518,000 from the third quarter of '18. This increase was primarily due to higher salaries and related costs as we added headcount ahead of the two Northern California retail deposit branches that were opened in early January of '19. Non-performing assets increased to $12.1 million, or 17 basis points of assets at December 31st compared to 15 basis points of assets at September 30th. We recorded a $500,000 provision for credit losses in the fourth quarter compared to $750,000 in the third quarter. This decrease in provision was primarily due to $559,000 of net recoveries during the fourth quarter compared to net recoveries of $122,000 during the third quarter. Deposit balances were $5.1 billion at December 31st, a decrease of $103.6 million from

September 30th.

I'll now share some key points from our Mortgage Banking segment results. The Mortgage Banking segment's core net loss in the fourth quarter was $4.5 million compared to core net loss of $4.3 million in the third quarter. Compared to last quarter, we had seasonally lower interest rate lock commitments that resulted in a decrease in gain on loan origination and sale activity and lower mortgage banking servicing income offset somewhat by lower core non-interest expense. When the single-family interest rate locks are less than closings in a given quarter, earnings are negatively affected as the majority of mortgage revenue is recognized at interest rate lock, while the majority of origination costs, including commissions, are recognized upon closing. Accordingly, the large imbalance between interest rate lock volume and closed loan volume during the third quarter normalized during the fourth quarter, resulting in a lower differential between gain on loan origination sale revenue and salaries and commission expense. Our gain on mortgage loan origination and sales composite margin was 323 basis points, a 12 basis-point increase from the third quarter, primarily due to an increase in higher profit margin refinance and FHA/VA transactions in our origination mix.

Mortgage banking segment core non-interest expense of $47.1 million decreased $9.2 million from the third quarter of ‘18, primarily due to the decrease in commissions paid as a result of lower closed mortgage loan volumes. Single family mortgage servicing income was $5.4 million in the fourth quarter, a decrease from $6.9 million in the third quarter. This decrease was primarily due to lower risk management results, partially offset by higher servicing income. The lower risk management results were primarily driven by a more volatile interest rate environment, the continued flattening of the yield curve, and increased negative convexity costs. The increase in servicing income is related to a higher average balance of loans serviced for others. Our portfolio of single family loans serviced for others increased to $20.2 billion of unpaid principal balances at December 31st compared to $19.8 billion at September 30th. The value of our mortgage servicing rights relative to the balance of loans serviced for others was 125 basis points at quarter-end, a decrease of 8 basis points compared to prior quarter-end.

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

Mark Mason
Thank you, Mark. During the past year, we've made substantial changes in our mortgage banking business to improve profitability in response to the current market conditions. As I stated earlier, we continue to consider both operational and strategic changes to improve further the profitability of this business. We are providing guidance today, assuming that we will continue with our current operations and strategy and that there are no material changes to the interest rate environment that existed on December 31, 2018. Current staffing levels, mortgage production volume as forecast by the MBA, or our regional outlook for mortgage production may impact these numbers. Actual results may vary from the guidance we are giving today, possibly in material ways if our actual strategy or future operations differ from these assumptions.

We anticipate single family mortgage loan lock and forward sale commitment volume of $1.2 billion and $1.5 billion in the first and second quarters of this year respectively. We anticipate mortgage held for sale closing volumes of $1.1 billion and $1.6 billion for the same periods. For the full year of 2019, we anticipate single family mortgage loan lock and forward sale commitments to total $5.2 billion and loan closing volume to total $5.3 billion. We expect our mortgage composite profit margin to remain in the range of between 310 and 320 basis points during the next two quarters as well as for the full year of 2019. In our Commercial and Consumer Banking segment, we expect our quarterly loan portfolio growth to average between

2% and 4% throughout this year. Reflecting the yield curve as of the end of the fourth quarter and absent changes in market rates and loan prepayment speeds, we expect our consolidated net interest margin to decrease to the range of 300 basis points to 310 basis points over the next two quarters and remaining within that range throughout this year.

During the first and second quarters of this year, we expect our total core non-interest expense to increase approximately 6% to 8%, given seasonally increasing closed single family mortgage loan expectations.

For the full year of 2019, we expect our average quarterly net change in total core non-interest expenses to increase by approximately 3%, reflecting the growth of the business overall. Total core non-interest expenses will vary quarter-to-quarter, driven by seasonality and cyclicality in both our single family and commercial real estate closed mortgage loan volume.

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

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 touchtone phone. 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
All right, thanks. Good morning.

Mark Mason
Good morning.

Jeff Rulis
First question is more on the expense side, just wanted to see if the restructuring noise, either expenses or recoveries as we saw this quarter, is that largely complete at this point? There's no tailwind into 2019, is that what you expect?

Mark Mason
Yes, with respect to the expense restructurings in the mortgage business that were announced in the--earlier in the year, and this quarter we had a fair amount of revenue noise or contra expense noise related to income taxes. We don't expect to repeat any of that going forward.

Jeff Rulis
Okay. And, then the--just on the MSR side any--I guess any thoughts on additional sales? And, then on a related, just kind of the mortgage servicing line item from a revenue basis, any expectations in ‘19?

Mark Mason
We do not have any planned sales of mortgage servicing at this time. I can't rule it out because we have, since the company has been public, on two occasions sold servicing, primarily for capital planning purposes. But, we don't have any planned at this time. Mortgage loan

servicing revenue has been challenged over the last two years in particular as the yield curve flattened. And, you can see that the company's risk management results have declined during that time. Historically, the company has had very strong servicing revenue associated not just with the growth of the servicing portfolio, but with the results of risk management, which is really hedging. And, typically the hedging income has been substantial. But, as the yield curve has flattened, the earnings on the swaps portion of that hedge, which is the lion's share, at times 75% of the hedge position, those earnings have declined substantially. And, so we expect that servicing income will be muted despite slow servicing speeds until we get a little lift in the yield curve.

Jeff Rulis
Great. And, maybe last one on the--just on the NPAs, the modest lift in what consumer and commercial. Any color on those? I assume not systemic issues, it wasn't large, but any additional detail on the increase?

Mark Mason
There's nothing noteworthy there. It's probably a little volatility given how low the numbers are.

Jeff Rulis
Fair enough. Okay, thank you.

Mark Mason
Thanks, Jeff.

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

Steve Moss
Good morning.

Mark Mason
Good morning.

Steve Moss
Wondering just go on the locked volume guidance $5.2 billion for 2019, obviously a bit lower from what it was before. Just wondering what are the drivers behind that versus expectations before?

Mark Mason
Well, recently we've seen anecdotally in our markets and specifically in the most recent data, home sales volume decline. And, while this last quarter and currently, as loan rates declined a little bit, we've seen some resurgence in refinancing, we can't expect that to continue either. And, so based upon those changes, we have lowered our expectations a little bit.

Steve Moss
Okay. And, then on the margin guide here, going to 300 to 310 in the upcoming quarters, just wondering is it primarily expect--driven by funding costs here?

Mark Mason
Yes, or just the difference in speeds, right? Funding costs rising faster than asset yields. Asset yields are still rising. And, to the extent that we see moderation in deposit betas, that would be

better, but conservatively, we thought that we needed to lower the expectation range.

Steve Moss
Okay. And, then I guess my third question, I'm not sure if I heard you correctly, Mark, but was at 2% to 4% loan growth per quarter or for the full year?

Mark Ruh
That's still per quarter. Obviously, we didn't make it last quarter, but that was in part due to a sale of single family loans, right. We would have made that range had we not elected to sell some single family mortgages out of the portfolio.

Steve Moss
All right. Thank you very much.

Mark Mason
Thanks, Steve.

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

Jackie Bohlen
Hi. Good morning, everyone.

Mark Mason
Good morning, Jackie.

Jackie Bohlen
I wanted to touch based on expenses and looking primarily to headcount and any anticipated de novo branches plans you might have in the year and understanding, of course, that there are no announced plans for the Mortgage Banking segment, but there, that possibility exists.

Mark Mason
In terms of de novo branches, we opened two in January that had been delayed for some period of time. At this time we are not planning any additional de novo branches for the foreseeable future. So, headcount increases associated with the branch network system will decline substantially from prior years, right? In terms of the mortgage business, we have had some attrition as a consequence of low volumes and as a performance-related issue. We may have additional attrition, if volume continues to decline, as the market is suggesting right now. So, that affects both, of course, the production positions, but also the operational positions depending upon total loan volume.

Jackie Bohlen
And have you been replacing any of the attrition or just absorbing it with those that you have?

Mark Mason
Well, we tried to replace attrition in production personnel with--people with higher volume in today's market conditions. That's--a day in, day out part of the business. We will attempt to replace attrition so that we keep seats filled in the offices that we have to date. If there are empty seats, the office will not be operating as efficiently as it could or should. So, we will be attempting to replace attrition of folks that are not being able to generate volume with those who do.

Jackie Bohlen
Okay. So, it sounds like then for the overall company, the headcount could come up a little bit in 2019 outside of any additional announcements?

Mark Mason
Very slightly. We haven't--we entered the year with some open positions at various places in the company. But, our expectations are that the total headcount not increase materially this year.

Jackie Bohlen
Okay. And, then given all the tax noise in the quarter, would you mind just providing us with an updated guidance for an anticipated range going forward, in terms of the tax rate?

Mark Ruh
Yes, sure. I would use our estimated from before at 20.5%. I believe that at the prior quarter we provided 21%, but I would stick with 20.5% going forward.

Jackie Bohlen
Okay. And the BNO should normalize next quarter.

Mark Ruh
That was one-time event. Yes, you wouldn't see that again. And so BNO will normalize, which does not run through the tax line number. That runs through the G&A line.

Jackie Bohlen
Yes.

Mark Ruh
That a special, yes, right. Got it.

Jackie Bohlen
Yes, definitely understood. Okay, great. Thanks, guys.

Mark Mason
Thanks, Jackie.

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

Tim O'Brien
Good morning, guys.

Mark Mason
Hi, Tim.

Tim O'Brien
A quick question for Mark Ruh. Do you happen to have the dollar amount of SBA gain on sale income for the quarter for 4Q?

Mark Ruh
For the dollar amount? I'm looking at $484,000.

Mark Mason
It's in the table.

Mark Ruh
It's in the table, that's where I looking at, yes. It's in page 12, the table for Commercial and Consumer Banking segment.

Tim O'Brien
Sorry, I missed that. I looked, but I missed it. But, thank you for that. And, then another question I have for you. With the government shutdown possibly extending, could that affect your single family mortgage business in any way, shape, or form?

Mark Mason
So far, not materially. There's a couple of government-related loan programs that have issues, like...

Tim O'Brien
Like the VA program or...

Mark Ruh
There is a USDA program and a Department of Hawaiian Home Lands program that we do through FHA that have both been shut down for the moment, but they're not a material part of the originations.

Tim O'Brien
Okay. And, same thing on the multi side, right? Not expected to impact, the shutdown is not going to impact your multi sale business.

Mark Mason
Fannie Mae continues to operate, right? So, the Fannie Mae DUS business should be unaffected, and the private business is not affected.

Tim O'Brien
Great. And, then you alluded to qualitatively some thoughts there might be some additional strategic changes that get looked at by the Board this year, Mark. Could you talk a little bit about kind of the list of what some of those changes that might be considered could be? Any of them?

Mark Mason
You know, we…

Tim O'Brien
I put you on the spot there a little bit, but…

Mark Mason
Well, only because I want to give you a quality answer, but the range of things that we look at is really wide, right? I mean, as wide as you might consider. And so, I don't want to overemphasize any particular option, because that would suggest something that we are

committed to doing, and we're not yet. But, we continue to analyze ways to improve profitability, the size of our business, the product lines within the business, expense components. This is a very tough time. And, while we have a deep and long history in the mortgage business, the status quo is not acceptable. It’s not acceptable to us, it’s not acceptable to our shareholders. And you should expect us to, after fully analyzing additional changes, make some changes that make a meaningful difference in the business.

Tim O'Brien
So, I guess looking at that, the reverse of that. Are there any critical core parts of the business that you guys--you can say right now that you remain committed to? That probably won't see any meaningful material strategic adjustments around?

Mark Mason
That's kind of a tough question to answer, because it's a very integrated business, right? And I think I'll just leave my comments where they are right now.

Tim O'Brien
You're pretty open minded, Mark.

Mark Mason
Well we have to be, right? I mean, we have a responsibility here. We have a lot of capital tied up in this business, our shareholders' capital, my capital, everybody's capital. And, we have been--while we've been active in trying to seek improved profitability, we have been patient in believing that the cycle will turn and return superior profitability, it’s taking a long time. And, while it's probably easier for us to be patient because we've been through cycles, it's less easy for people who aren't as familiar. And, so we're doing a lot of work on analyzing the business today, and that's all I’m prepared to say.

Tim O'Brien
Okay guys, thanks for the earnings call and for answering my questions. And, good luck in the New Year.

Mark Mason
Thanks, Tim.

Operator
Again, if you have a question please press star (*), then one (1) on a touchtone phone. The next question comes from Tim Coffey of FIG Partners. Please go ahead.

Tim Coffey
Thank you. Good morning, everybody.

Mark Mason
Hi, Tim.

Tim Coffey
Hi, Mark, I was wondering, can you provide little more detail on the residential mortgage loans that you sold out of the held-for-investment bucket?

Mark Mason
We took the opportunity to strip out a portion of that portfolio with an eye to, one, reducing the

size a little, but two, trying to sell some lower coupon loans while the market rates were lower to improve the yields going forward.

Tim Coffey
Okay. And, you have…

Mark Mason
I'm sorry. And, I'm in part responding to people inquiring of us whether we'd be interested in selling a portion of the portfolio.

Tim Coffey
Okay. Do you have other loans in the portfolio that kind of fit the characteristics of the loans that you sold?

Mark Mason
Well, theoretically we always do, right? I mean, if you think about originating continuously, you know.

Tim Coffey
Okay. And, then on the kind of commercial real estate loans sold in the quarter, the last couple of quarters you've sold more than you've originated. Given what we're seeing in the SBA market and the trends that you've shown in that CRE non-DUS bucket, could we see more loans being sold going forward than you originate? Of course, the portfolio you have of CRE loans anyway is growing. Is that something we could see going forward?

Mark Mason
Well, I think if you look at the full year, last year was very seasonal. In the first part of the year we originated more than we sold; second part of the year we sold more than we originated. I can't tell you exactly what the pattern is. Typically, it's in part demand-based, right? And, demand grows in the second half of the year, historically. So, that pattern of greater origination than sale in the first half and greater the sale than origination in the second half is driven in part, in large part, probably, by purchaser demand. So, I can't tell you exactly what the pattern will be, but it will not surprise me if it's the same this year.

Tim Coffey
Okay, all right. That's helpful. Thank you. And, then earlier in the Q&A, you said that you're not expecting a resurgence in refi. I'm kind of wondering what you would need to see from the market to give you that indication that refi is picking up?

Mark Mason
Well, it's picked up a little bit, right? I mean, if you look at the composition of lending and if you saw the pure December numbers and to an extent January to date, the percentage of the composition of refi versus purchase has increased. The dollar amount of that lending is still relatively weak, right, if you think about the lower levels seasonally.

I think it's important to remember that during the recession and the years following the recession, as rates fell, the industry refinanced a substantial amount of the mortgages in the United States and the average interest rate in the servicing portfolios across the United States is approximately the current rate. And, so the number of loans with a sufficient economic interest in refinancing is much smaller than in prior cycles at this time. And, so that's what I based my comments on.

Tim Coffey
Okay, okay, that's helpful. Thank you. And, then the deposit cost trends, I guess on total deposits we've seen right around say a 10 basis-point increase every quarter throughout 2018. Are you seeing that the trends are likely to be about the same or slowing?

Mark Mason
Well, everybody's portfolio is different, right, and their needs are different. We--I believe deposit costs are going to continue to increase at least in our line of sight, right? And, then, it doesn't extend too far, but that's our view here, that the pace is not going to change in the near term.

Tim Coffey
Okay. And, then just one final one. On the San Diego branch that you acquired, I mean, are going to close on in March, that's effectively kind of a small bank. Good loans, good deposits, one seasoned bankers that I know of. Can you kind of just talk about how that branch fits into the hierarchy of your Southern California footprint?

Mark Mason
Sure. This was a particularly good deal for us, because we do not currently have a commercial lending team in San Diego. We currently have four branches there, primarily consumer branches, though we have some growing commercial business there, but it's being served, or serviced out of Orange County. And, so being able to have an in-market team of well-known track record bankers is a real boost to our business. And, we're looking forward to great things for that group after they join us.

Tim Coffey
And your loan growth kind of guidance for next quarter, that was organic, right? That didn't include this branch?

Mark Mason
Loan growth for this year, that has historically--has been an organic forecast of ours, yes.

Tim Coffey
Okay. Yes, I was just double checking. All right, thank you very much. Those are my questions.

Mark Mason
Thanks, Tim.

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

Jeff Rulis
Hi, Mark. I just forgot, or I didn't quite get the numbers down on the guidance. I got the lock and closed for ’19 for the full year at 5.2 and 5.3. Could you repeat the Q1 and Q2 lock and closed?

Mark Mason
Sure. It's, locks are $1.2 billion and $1.5 billion for Q1 and Q2. And closings $1.1 billion and $1.6 billion.

Jeff Rulis
Great. That was it. Thank you.

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
Well, thank you again for patience and attendance at the call this morning. We look forward to speaking with you after our first quarter results. Thank you.

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