Call Participants

EXECUTIVES

Mark K. Mason
Executive Chairman, President & CEO

John M. Michel
Executive VP & CFO

ANALYSTS

Matthew Clark
Piper Sandler & Co., Research Division

Timothy Coffey
Janney Montgomery Scott LLC, Research Division

Woody Lay
Keefe, Bruyette, & Woods, Inc., Research Division

Brooks Dutton
Wedbush Securities

Presentation

Operator

Welcome to the Third Quarter 2024 Analyst Earnings Call for HomeStreet Bank. Presenting on today's call will be Mark K. Mason, Chairman, President and Chief Executive Officer of HomeStreet Bank; and John M. Michel, Executive Vice President and Chief Financial Officer.

I will now turn today's call over to Mr. Mark Mason. Please go ahead, sir.

Mark K. Mason
Executive Chairman, President & CEO

Hello, and thank you all for joining us for our third quarter 2024 analyst earnings call.

Before we begin, I'd like to remind you that our detailed earnings release, our investor presentation and a press release providing an update on the status of our strategic merger were filed with the SEC on Form 8-K yesterday, and are available on our website at ir.homestreet.com under the News and Events link. In addition, a recording and a transcript of this call will be available at the same address following our call.

Please note that during our call today, we will make certain predictive statements that reflect our current views, the expectations and uncertainties about the company's performance and our financial results. These are likely forward-looking statements that are made subject to the safe harbor statements included in yesterday's earnings release, our Forms 8-K, our investor deck and the risk factors disclosed in our other public filings.

Additionally, reconciliations to non-GAAP measures referred to on our call today can be found in our earnings release and investor deck.

Joining me today is our Chief Financial Officer, John Michel. John will briefly discuss our financial results, and then I'd like to give an update on our results of operations, the status of our strategic merger and our outlook going forward. We will then respond to questions from our analysts.

John?

John M. Michel
Executive VP & CFO

Thank you, Mark. Good morning, everyone, and thank you for joining us.

In the third quarter of 2024, our net loss was $7.3 million or $0.39 per share as compared to our net loss of $6.2 million or $0.33 per share in the second quarter of 2024. On a core basis, which excludes the impact of merger-related expenses, our net loss was $6 million or $0.32 per share as compared to our net loss of $4.3 million or $0.23 per share in the second quarter of 2024.

The impact of higher interest rates continues to negatively impact our levels of net interest income and noninterest income. Our net interest income in the third quarter of 2024 was $1.1 million lower than the second quarter of 2024, due to a decrease in our net interest margin from 1.37% to 1.33%, and a decrease in interest-earning assets. The decrease in our net interest margin was due to a 3 basis point decrease in the yield on interest-earning assets and a 3 basis point increase in the rates paid on interest-bearing liabilities.

Yields on interest-earning assets decreased due to lower yields on investment securities. The increase in the rates paid on our interest-bearing liabilities was due to higher deposit costs due to a greater proportion of higher cost certificates of deposits.

The income tax benefit resulted in an effective rate of 23.3% for the third quarter of 2024 as compared to an effective tax rate of 22.1% in the second quarter of 2024.

There was no provision for credit losses recognized during either the third or second quarter of 2024. This reflects the stable balance of our loan portfolio and a minimal level of identified credit issues in our loan portfolio and the lack of significant expected credit issues arising in future periods.

Going forward, we expect the ratio of our allowance for credit losses to our held-for-investment loan portfolio to remain relatively stable, and provisioning in future periods to generally reflect changes in the balance of our loans held for investment, assuming our history of minimal charge-offs continues.

Our ratios of nonperforming assets to total assets and total loans delinquent over 30 days, including nonaccrual loans, remained at low levels. As of September 30, 2024, our ratio of nonperforming assets to total assets was 0.4%, while our ratio of total loans delinquent over 30 days, including nonaccrual loans to total loans, was 69 basis points.

Noninterest income in the third quarter of 2024 decreased from the second quarter of 2024, primarily due to more income realized in the second quarter of 2024 from our investments in small business investment companies as we continue to experience low levels of single-family and commercial mortgage banking originations. The 3.5% decrease in noninterest expense in the third quarter of 2024 as compared to the second quarter of 2024 reflects the company's emphasis on reducing operating expenses where possible.

I will now turn the call over to Mark.

Mark K. Mason
Executive Chairman, President & CEO

Thanks, John.

As a result of lower noninterest income and lower net interest income, our net loss and core net loss were higher in the third quarter than the second quarter. While our net interest margin decreased slightly during the quarter, we did see it stabilize during the latter part of the quarter. With the recent decrease in short-term interest rates, we expect our funding costs to decrease in the fourth quarter and beyond, and our net interest margin to begin to increase.

In the third quarter, we reduced the rates offered on our promotional certificates of deposit, and are offering our highest rates on shorter duration CDs in anticipation of continued decreases in short-term interest rates in the future. Our noninterest expenses decreased by $1.8 million during the third quarter as we continue to focus on reducing expenses where possible.

Our full-time equivalent employees declined to 809 for the month of September versus 840 for June and 864 for December of 2023, primarily as a result of not replacing employees lost through attrition.

FirstSun and HomeStreet remains subject to their announced merger agreement of April 30, 2024, until it's amended, modified or terminated. As such, we are limited in what we can say about the merger, unless we are legally required to make disclosures about the transaction, which we did recently.

As noted in our press release, which provided an update on our strategic merger, we're disappointed that the regulators are unwilling to grant the regulatory approvals necessary for our merger to proceed.

As to the reasons that proposed merger did not get regulatory approval, I can only say that our joint press release speaks for itself. To repeat, we have been advised by our bank regulators who shared with us that there were no regulatory concerns specifically related to HomeStreet that would have prevented approval of the merger.

If we are unable to obtain regulatory approval and the merger agreement is terminated, we will immediately consider all our strategic alternatives, including operating HomeStreet on a stand-alone basis for the foreseeable future. The fact that we were informed that there were no regulatory concerns specifically related to HomeStreet that would have prevented approval of the merger leaves us free to consider all our strategic options going forward.

Assuming the termination of our merger agreement, we intend to move forward with a new strategic plan that we expect will return the company to profitability in the near term, possibly as soon as the first quarter of next year. This would include a sale of approximately $800 million in multifamily loans, the proceeds of which would be used to pay off higher cost wholesale funding.

Because we've arranged a multifamily loan sale as a part of the current merger agreement, we are very familiar with the current multifamily loan sale market, and we would expect to be able to transact the loan sale quickly. We do not believe we will need additional capital to complete this loan sale.

Assuming the termination of our merger agreement, we feel our ability to meaningfully improve results of operations in the near term and consider other strategic opportunities has improved significantly since we agreed to the proposed merger with FirstSun last January.

The recent reductions in interest rates have provided an immediate reduction in funding costs and improvement in the fair value of our company. Future reductions in interest rates, if they occur, will assist us in further improving our results of operations and the value of our company. As a result of lower interest rates, our tangible book value per share has increased due to the increased value of our available-for-sale securities portfolio.

In spite of the operating losses we have incurred through the first 9 months of this year, our tangible book value per share increased from $28.11 at December 31, 2023, to $28.13 as of September 30, 2024.

As importantly, as a result of the recent reductions in interest rates and the passage of time, as of September 30, 2024, our estimated tangible fair value per share has increased to $18.52. Due to increases in interest rates since the end of the quarter, we believe our estimated tangible fair value per share, as of today, has decreased to between $15 and $16.

During the third quarter, we started to see positive results in our deposit base as our quarter end and average balance of noninterest-bearing deposits remained stable, and our total deposits, excluding broker deposits, increased $111 million.

Our level of uninsured deposits remains low at 8% of total deposits, interest rates, bank failures and HomeStreet stock price volatility as well as the permutations of our proposed merger, our deposits have shown significant loyalty and resilience.

At quarter end, our cash and security balances of $1.4 billion or 15% of total assets, and our contingent funding availability was $5.1 billion, equal to 80% of total deposits.

Our loan portfolio remains well diversified with our highest concentration in Western states, multifamily loans, historically one of the lowest risk loan types.

Asset quality remains strong as total past due and nonaccrual loans and nonperforming assets as well as loan delinquencies remain at historically low levels at the end of the quarter.

Our portfolio has been conservatively underwritten with a very low expected loss potential. As a result, credit quality remains solid, and we currently do not see any meaningful credit challenges on the horizon.

Also, it's important to remember that our credit quality and our allowance for current loss has been subject to multiple due diligence exercises, ongoing regulatory reviews and examinations, both in the normal course and now through two merger regulatory application processes, in addition to quarterly reviews and an annual audit by our independent accountants.

At September 30, 2024, our accumulated other comprehensive income balance, a component of shareholders' equity, was a negative $69 million. While this represents a $3.64 reduction in our tangible book value per share, we know this is not a permanent impairment in the value of our equity and has no impact on our regulatory capital levels.

Given that our available liquidity, earnings and cash flow of our bank, we don't anticipate a need to sell any of these securities to meet our ongoing cash needs. So we don't anticipate realizing these temporary write-downs.

The current interest rate environment has created significant challenges for our company. In particular, the rate competition for deposits from banks, money market funds and treasury bonds has been significant. However, the recent interest rate reductions and the expectation of additional reductions in our current and forecasted results, the impact will be significant. Ultimately, we will experience an environment of stable rates, which has historically provided significantly better financial performance for our bank.

We believe we've taken significant steps to endure this period and preserve the value of our business so that we can take advantage of the coming beneficial rate cycle. And as I noted earlier, the value of our company has risen significantly recently, and is expected to continue to improve.

In summary, while we are disappointed in the failure to date in obtaining regulatory approval for our proposed merger, we are optimistic about our ability to improve our results and return significant value to our shareholders.

With that, this concludes our prepared comments today. We appreciate your attention. John and I would be happy to answer questions from our analysts at this time. Investors are welcome to reach out to John or I after the call, if they have questions that are not covered during this question-and-answer session.

Question and Answer

Operator

[Operator Instructions] Our first question comes from the line of Matthew Clark with Piper Sandler.

Matthew Clark
Piper Sandler & Co., Research Division

Good mornng, thanks for the questions. First one for me, just around the other bidders that were in your S-4, if there's no breakup fee, what's preventing you to go back to those bidders and seeking $13 to $15 a share, knowing that rates are modestly lower and the duration of your loan book is a little shorter?

Mark K. Mason
Executive Chairman, President & CEO

We have restrictions in our merger agreement from soliciting interest in the bank today. We do have the ability, if we are presented with a superior offer, to consider that in our fiduciary responsibility, but we are restricted from discussions and soliciting interest from either prior parties or others at this time. So that's the current answer to that question.

If you assume a termination of the merger agreement, we will be free to consider all strategic options, as I mentioned in my comments.

Matthew Clark
Piper Sandler & Co., Research Division

Okay. Great. And then the comment around this alternative regulatory structure that you both are considering, is that just going back to the OCC? And is there some visibility, if you were to go back, that might increase the odds of the deal getting done?

Mark K. Mason
Executive Chairman, President & CEO

I don't think we or FirstSun are prepared to discuss what the range of alternative regulatory structures might be. So I can't discuss the details of that at this time. It's obvious that any alternative regulatory structure would have to have components that to be considered, would have to have components that were meaningfully different than the two structures previously proposed to the OCC and the Federal Reserve and the Texas Department of Banking.

Matthew Clark
Piper Sandler & Co., Research Division

Okay. And then the comment in the merger update release around your regulators having no issues with HomeStreet, is that suggesting there's a combined theory concentration issue and related capital ratios? Or am I reading into that?

Mark K. Mason
Executive Chairman, President & CEO

The release speaks for itself. With respect to HomeStreet and HomeStreet's commercial real estate [indiscernible]. With respect to approval of the merger, I think you can assume that HomeStreet's commercial real estate concentration, on a stand-alone or a pro forma basis, was not an issue.

Matthew Clark
Piper Sandler & Co., Research Division

Okay. So the potential sale of $800 million in multifamily loans, I think it still keeps you above 600% at least relative to Tier 1 plus reserves down from, I think, just around 700%? And I mean, is there --

it doesn't seem like there's a need to go dramatically lower if your regulators are comfortable with the concentration, but I guess, what are your thoughts on kind of the longer-term view of the [indiscernible]?

Mark K. Mason
Executive Chairman, President & CEO

First, correction. Our current CRE concentration is roughly 600%. On a pro forma basis, post an $800 million multifamily sale, that would reduce that concentration to approximately 500%.

And obviously, we have not been required by our regulators to reduce our current concentration. It's clear that the credit quality of our commercial real estate portfolio has been pristine, conservatively underwritten. And our risk management surrounding our commercial real estate origination and loan administration is consistent with the enhanced risk management required by regulatory guidance.

Having said that, our interest, if this merger is not feasible, in selling commercial real estate loans, multifamily loans in this case, is to, as quickly as possible, return the company to what would be moderate profitability and stability so that we can consider our path forward without concerns in that regard.

Matthew Clark
Piper Sandler & Co., Research Division

Okay. And then what's the yield and duration on your $3.9 billion multifamily portfolio? And what's the current rate you can get on a new multifamily loan right now?

Mark K. Mason
Executive Chairman, President & CEO

First, the duration, I don't have the exact number, but I think it's roughly 2.5 years, give or take, a little bit. The yield, I believe, is around 4%, maybe just below 4% today. Of course, that yield is changing on a continuous basis as those loans begin to reprice.

The value of the portfolio today on a 100% basis, John?

John M. Michel
Executive VP & CFO

It's about 93 plus.

Mark K. Mason
Executive Chairman, President & CEO

93 plus?

John M. Michel
Executive VP & CFO

Yes.

Mark K. Mason
Executive Chairman, President & CEO

However, to really understand the value of that portfolio from a sales standpoint of $800 million, let's say, you have to consider which loans specifically you'll be selling.

The lowest duration loans, those loans that have already repriced or are near term repricing, have the highest market value today. That makes sense because they have the highest current or near-term yield. The lowest value then in turn are the longer duration loans, the loans with repricing dates farthest out.

We generally -- if we were to execute an $800 million sale to assist our return to profitability, we would believe we would choose the longest duration loans, which would have the lowest value but would create the greatest impact on improving profitability over the near term. Makes sense?

Matthew Clark
Piper Sandler & Co., Research Division

Yes. Yes. And then what's the rate on new multifamily you think you can get right now?

Mark K. Mason
Executive Chairman, President & CEO

Yes, it's moving around a little bit. Rates have moved up a little, but they are kind of pivoting around the midpoint of the yield curve.

Recently, 5-year hybrids in the market were yielding roughly 6%, let's say, 5.9% to 6.2% for portfolio quality loans of the type that we have.

Fannie Mae is much more competitive. Recently, loans have been done in the low 5% range and even -- maybe a month or so ago, we saw one done in the high 4% range. And you can still get full term IO from Fannie Mae on qualifying loans.

So accordingly, our Fannie Mae pipeline is larger than it's been for the last couple of years. We don't know that all those loans will close, of course, but that's kind of the state of the market right now.

Matthew Clark
Piper Sandler & Co., Research Division

Got it. And then last one for me, maybe an easier one. Do you have the spot rate on interest-bearing deposits at the end of September?

Mark K. Mason
Executive Chairman, President & CEO

We do not.

John M. Michel
Executive VP & CFO

The spot rate?

Mark K. Mason
Executive Chairman, President & CEO

Do we have the spot rate?

John M.Michel
Executive VP & CFO

I don't think we have.

Mark K. Mason
Executive Chairman, President & CEO

We don't have that information at our fingertips, and I don't know if we published it. If we can get back to you, we will.

Matthew Clark
Piper Sandler & Co., Research Division

Yes, I appreciate it. Trying to get some visibility going forward given what you've done on the pricing side.

Operator

Our next question comes from the line of Woody Lay with KBW.

Woody Lay
Keefe, Bruyette, & Woods, Inc., Research Division

Hey, thanks for taking my question. I know you're limited in what you can say regarding the regulatory process. But how should we think about the timing from here on the next step? You lay out the potential Plan B scenario, the multifamily. So just trying to get an idea of when we can get visibility on the actions ahead?

Mark K. Mason
Executive Chairman, President & CEO

That's going to depend on the feasibility of pursuing another alternative regulatory structure. And I can't comment on that today because we don't have enough information yet on how we might judge alternatives. So it's all subject to either making a decision to pursue another structure or negotiating what would be an early termination of our definitive agreement.

Currently, our agreement matures in mid-January. Given the current impossibility of [indiscernible] that we would hope that absent another viable merger alternative that we would be negotiating that termination with the folks at FirstSun. But I don't have an answer for those as we sit here today.

Woody Lay
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. That's helpful. And then maybe a follow-up point on the deposit costs. Just could you just give more general statements on how deposit pricing has trended post 50 basis point cut, and sort of your expectations for the margin in the fourth quarter?

Mark K. Mason
Executive Chairman, President & CEO

So some competitors have reduced pricing. If we think about time deposit pricing, it's come down 25 to 50 basis points, depending upon the tenor. Most competitors have moved their highest rate offerings to the shorter durations, like we have. All of us anticipate an opportunity to lower those rates going forward.

There continue to be a fairly high rate money market account offerings for a couple of reasons. One, to retain current deposits for folks. But two, most competitors, we expect to use a strategy that we've used in the past, we intend to use going forward, where we would seek to migrate time deposit customers to money market account customers to give us the ability to administrate those rates down more timely, assuming ongoing rate reductions by the Fed.

So we still see very competitive money market offerings. Of course, treasuries are still trading, I mean offering well into the 4% range. Anything associated with actual treasury bond purchases or money market funds or other fixed income funds are -- continue to be very, very competitive to the deposits.

John M. Michel
Executive VP & CFO

And Woody, just as a reminder, one of the biggest impacts we get from the drop in rates is our wholesale funding, both our borrowings and our brokered CDs. We tend to be shorter term on the brokered CDs. So our anticipation -- so the biggest impact we have on our margin immediately for these rate drops is on our wholesale funding.

Woody Lay
Keefe, Bruyette, & Woods, Inc., Research Division

Got it. And then lastly, just in the opening comments, you mentioned that the head count is down quite a bit since the start of the year. Just given the subsequent events, do you expect to backfill some of those positions going forward?

Mark K. Mason
Executive Chairman, President & CEO

We don't. We've been trying to align our head count with the level of activity in each of our business units. Some business units have not had FTE reductions of any material amount because of their level of activity. A good example is our homebuilding lending unit, our residential construction unit is going to originate something close to $700 million this year, very close to our plan. And so they have not experienced any material reduction in personnel.

Other business units, such as our mortgage banking business unit and others have had more substantial reductions. Plus, we continue to see greater back-office efficiency and some of that has come in the back office.

Operator

Our next question comes from the line of Tim Coffey with Janney.

Timothy Coffey
Janney Montgomery Scott LLC, Research Division

Mark, gentlemen, thank you for the opportunity to ask a question or two here. Mark, you said that the definitive agreement expires in January. Are you able to negotiate an extension, if you chose?

Mark K. Mason
Executive Chairman, President & CEO

Always. I mean the parties can always agree to extend, modify. Yes, as they see fit, right?

Timothy Coffey
Janney Montgomery Scott LLC, Research Division

Okay. Can you give me an idea of how far along in the process of marketing the $800 million in loans you are? Are there term sheets out?

Mark K. Mason
Executive Chairman, President & CEO

We have not marketed an $800 million pool to sell. What we have marketed and have substantially negotiated agreement to sell is a loan sale associated with the merger structure that was presented to the Federal Reserve and the Texas Department of Banking, right?

You may remember from that restructuring that we were going to sell at least $300 million of loans, and a loan pool associated with that requirement was marketed, a buyer was selected, the buyer has completed due diligence. We've substantially completed negotiating that agreement. That's the work that we've done.

But because of that, we're very familiar with the market, with buyers of size, with their pricing mechanics. And we have an agreement that's been negotiated with a significant party, with no financing contingencies.

The first thing we would probably do is see if we could negotiate what we think is a fair price and move forward with that group, given all the efficiencies that, that would entail. But we'd have to see when the time comes.

Timothy Coffey
Janney Montgomery Scott LLC, Research Division

Okay. Understood. Is the $800 million, does that include the $300 million that you've already been in discussions about? Or is that in addition to the $300 million?

Mark K. Mason
Executive Chairman, President & CEO

No, it wouldn't because we have different goals in these sales as to duration of the remaining portfolio. The pool that we have marketed as a part of our proposed merger has the shortest duration loans in it, which would garner the highest price and would leave the greatest amount of accretion, future earnings accretion in the remaining portfolio.

John M. Michel
Executive VP & CFO

Under purchase accounting.

Mark K. Mason
Executive Chairman, President & CEO

Right. Thanks, John.

If we were to sell $800 million today in order to more quickly improve the profitability of the company, we would sell the longest duration loans because that would leave us with a faster improvement in loan yields and revenue in the portfolio. Makes sense?

Timothy Coffey
Janney Montgomery Scott LLC, Research Division

I appreciate that. Yes, absolutely. Absolutely. If you do move forward on a stand-alone basis, would you also consider selling other assets, obviously not securities, but other assets like the DUS license or any kind of physical branch locations?

Mark K. Mason
Executive Chairman, President & CEO

We don't believe so. We've been down that road several times. We believe we know the value of it, which at least to this point, has been low in relation to the ongoing value of it in our company.

I can never say we wouldn't. Someone offered us $100 million as some folks suggest that they might, but never did, we would be likely to sell it, but I don't intend to again retrace all of that time wasting discussion.

Timothy Coffey
Janney Montgomery Scott LLC, Research Division

Right. Okay. Understood. And then maybe a question for John. Do you have the amount of CDs, whether it's retail or broker, maturing in the fourth quarter and the first quarter of next year?

John M. Michel
Executive VP & CFO

I don't have that handy, but I believe we do provide that in the call report. We have to put durations in there. I can't remember what the durations are, but I can check and get back to you, Tim.

Timothy Coffey
Janney Montgomery Scott LLC, Research Division

Okay. Yes, that would be great. All right.

Operator

Our next question comes from the line of David Chiaverini with Wedbush Securities.

Brooks Dutton
Wedbush Securities

This is Brooks Dutton on for David Chiaverini today. Thank you for taking my questions today. I know you haven't discussed a lot about this, but just to put a bow around it. For the $800 million of proposed loan sales, could you guys possibly discuss what type of losses could be expected on the sale of these loans? Would they be somewhere similar to $300 million you guys had previously discussed and that had a buyer lined up for?

Mark K. Mason
Executive Chairman, President & CEO

Well, again, it would be a different set of loans with longer durations. So the pricing would be somewhat lower. In our forecasting analysis work on this, we've used a range of values. Those values have gotten better since we've done that work.

But John, what do you think?

John M. Michel
Executive VP & CFO

Yes, just with interest rates, based on what it was at 9/30, we had values in between 91 and 95 kind of going through that range perspective. If interest rates are a little bit higher, it would be a little bit lower than that. But from the perspective of the timing, we would probably put a mechanism in place that would adjust the price based on yields. So that's what we did in the other. Okay.

Mark K. Mason
Executive Chairman, President & CEO

But of course, it depends on the actual loans in fairness, right? And I think John shared earlier that we think the fair value of the total portfolio is maybe roughly 93 today. These loans, being the lower value subset, would be something less than 93, not significantly less, but a little less, if that helps.

Operator

This will conclude our question-and-answer session. I will now turn the call back over to Mark Mason for closing remarks.

Mark K. Mason
Executive Chairman, President & CEO

Great. We appreciate the good attendance for this call and the great questions by analysts. Again, if any investors have questions not covered, please give us a ring, and happy to set the call to discuss those.

Have a great day. Thank you.

Operator
This concludes today's conference call. Thank you all for joining us. You may now disconnect.