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OPB - Q1 2018 Opus Bank Earnings Call

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APRIL 23, 2018 / 3:00PM, OPB - Q1 2018 Opus Bank Earnings Call

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PRESENTATION

Operator

Good morning. My name is Connie, and I will be your conference operator today. At this time, I would like to welcome everyone to the Opus Bank's first quarter earnings conference call. (Operator Instructions) Mr. Brett Villaume, you may begin your conference.

Brett Gerard Villaume - *Opus Bank - Senior VP & Director of IR*

Thank you, Connie. Good morning, and welcome to Opus Bank's investor webcast and conference call. Today, I'm joined by Stephen Gordon, Opus Bank's Chief Executive Officer and President; Brian Fitzmaurice, Senior Executive Vice President and Senior Chief Credit Officer; Kevin Thompson, Executive Vice President and Chief Financial Officer; and Will Han, Deputy CFO.

Our discussion today will cover the company's performance during the first quarter of 2018 and the information contained in the earnings press release issued earlier this morning. A slide show presentation that accompanies today's call is available on the Opus Bank investor web page at investor.opusbank.com.

Today's discussion may entail forward-looking statements, which are intended to be covered by the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. You'll find a discussion of these forward-looking statements in our recent FDIC filings and on Page 7 of this morning's release. Today's call will include a question-and-answer session following the discussion. For listeners who are participating via WebEx, should you have any questions, you may submit those using the Q&A feature located on the right-hand side of your WebEx window. The white triangle just to the left of the question mark and letters Q&A should be pointing down. Clicking on that triangle opens and closes the Q&A dialogue box.

Now I will turn the call over to Stephen Gordon, CEO and President.

Stephen H. Gordon - *Opus Bank - President, CEO & Director*

Thank you, Brett. I will now provide an overview of our results for the first quarter. And then Kevin Thompson, Chief Financial Officer; and Brian Fitzmaurice, Senior Chief Credit Officer, will go into more detail on our financial performance and credit metrics. We will address questions at the end of our prepared remarks.



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Opus' first quarter results marked a successful beginning to 2018, demonstrated by our disciplined growth and improving profitability, displaying continued momentum from 2017. For the first quarter, we reported net income of \$12.9 million or earnings per diluted share of \$0.34. Included in our net income this quarter were offsetting items, including \$1.5 million of strategic initiative and severance-related expenses, \$1.4 million of seasonally higher employer payroll taxes and a \$2.9 million recovery of professional services expense related to the settlement of a legal matter.

On a pretax, pre-provision basis, earnings increased 14% from the prior quarter to \$20.9 million and increased 13% from the first quarter of 2017. During the first quarter, we achieved \$452 million in new loan funding, which was more than double the level of new loan fundings achieved in the first quarter of last year. For the second consecutive quarter, new loan fundings exceeded loan payoffs, which measured \$271 million, including planned exits, resulting in \$56 million of net loan growth for the quarter. Planned exits were \$52 million in the first quarter as we successfully continued to reduce the balances of enterprise value loans and deemphasized lending areas. Enterprise value loans decreased by \$82 million or 20% in the first quarter, and we anticipate continuing to make progress reducing our EV portfolio throughout 2018.

We also achieved deposit growth of \$100 million during the first quarter, which was driven by growth in low or no cost commercial business demand deposits. As a result, our overall cost to deposits increased by only 2 basis points to 47 basis points, and our cost to deposits is now unchanged compared to when the Federal Reserve first began raising rates in December of 2015.

As I pointed out on our earnings conference call last quarter, we continue to anticipate that the current increasing interest rate environment will result in somewhat higher deposit costs for Opus going forward, although at a slower pace than the anticipated increase in our loan yields as we focus on growing deposit relationships in 2018.

To this point, during the quarter, we began to realize the benefit of our asset-sensitive balance sheet as our net interest margin expanded by 5 basis points to 3.20%. Furthermore, as we entered the second quarter, the weighted average rate of our new loan fundings pipeline was 34 basis points higher than at the start of the first quarter, which we anticipate will contribute to our net interest margin going forward.

Consistent with past year seasonal nature of loan production, we estimate our quarterly loan production will ramp over the course of 2018, driven by growth in our leading multifamily banking division and bolstered by the contributions from numerous commercial bankers hired throughout our footprint over the recent quarters, as we continue to invest in the growth of Opus' C&I client base and the related loan, deposit and treasury management needs.

Deposit and full relationship growth, including treasury management, is a high priority across the organization, including and especially among our Commercial and Specialty Banking teams and is expected to ramp throughout 2018. With our portfolio of enterprise value loans that are not eligible for retention continuing to shrink, we anticipate planned exits will have less of a negative impact on our quarterly net loan growth, loan yield and overall credit expenses in future quarters.

Noninterest expense decreased 5% from the prior quarter, and our efficiency ratio improved to 68% for the first quarter. The legal matters settled in the quarter had a \$750,000 per quarter professional services expense run rate that will not be incurred going forward. We remain confident in our ability to drive our efficiency ratio below 65% as we previously guided based on our expectation of continued heightened monitoring of and reductions to our operating expenses.

Our capital ratios remained strong during the first quarter, with Tier 1 leverage of 9.53% and total risk-based capital of 14.91%. Based on our earnings, strong capital levels and overall performance in the first quarter of '18, I'm proud to announce Opus' board has authorized a 10% increase in our quarterly cash dividend to \$0.11 per diluted share.

Before I conclude, I also want to take a moment to thank all of the many Opus team members responsible for our strong start to the year as we take great pride in their tireless efforts and commitment.

I will now turn the discussion over to Kevin Thompson to go into more detail on our financial performance.



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Kevin L. Thompson - *Opus Bank - Executive VP & CFO*

Thank you, Stephen. Turning to Slide 4. Average loans increased \$153 million or 3% during the first quarter while period-end balances increased \$56 million or 1%. Planned exits totaled \$52 million, and paydowns totaled \$271 million. Excluding planned exits, loan growth would have been \$108 million or approximately 9% annualized growth. We had \$452 million of new loan fundings in the first quarter. Of these, approximately 1/3 were C&I loans and the remaining were real estate-related loans, primarily driven -- primarily originated by our Income Property Banking division.

On Slide 5, we show the balance of cash and investment securities, which decreased from the prior quarter by \$238 million, primarily driven by the payoff of FHLB advances that were added at the end of the fourth quarter. Investment securities totaled \$1.1 billion, down 3% from the prior quarter, driven by principal paydowns of our Freddie Mac security. The yield on investment securities decreased 21 basis points to 1.87% as a result of elevated prepayments and a resulting higher premium amortization. The duration of our securities portfolio remains relatively short at 3.4 years.

Turning to Slide 6. Total deposits increased \$100 million in the first quarter, driven primarily by growth in core demand deposits. Our cost of deposits rose 2 basis points to 0.47% (sic) [47 bps], which is flat from where our cost of deposits was back in the fourth quarter of 2015 when the Fed began raising rates.

Opus has a diverse base of deposits from sources such as our Retail Bank, our Commercial Banking divisions, PENSCO, Escrow and Exchange, Fiduciary Banking and Municipal Banking divisions. Our loan-to-deposit ratio remained at 87% at the end of the quarter.

Turning to Slide 7. Net interest income decreased 1% during the first quarter to \$51.7 million, primarily due to lower interest income from cash and investment securities and a slightly higher cost of funds, which offset an increase in loan interest income. Planned exits, which had a weighted average rate of 7.38%, masked the true expansion of our net interest margin as well as the growth of our loan balances but decreased our potential future credit volatility. Total interest expense increased 2% in the first quarter, driven by modest increases in interest-bearing demand deposit rates. Net interest margin increased 5 basis points from the prior quarter to 3.20%, driven by higher balances of average loans and repricing and rate increases during the quarter as well as 2 fewer days in the first quarter, partially offset by a lower yield on investment securities and cash.

Proceeding to Slide 8. Noninterest income increased 5% from the prior quarter to \$13.3 million and included \$7 million of trust administration fees from PENSCO, \$1.7 million of deposit and treasury management fees, \$1.4 million of Escrow and Exchange fees and \$838,000 from our Merchant Banking division. Together, our diverse sources of noninterest income made up 20% of our total revenues, unchanged from the prior quarter.

Turning to Slide 9. Our noninterest expense decreased 5% to \$44.1 million for the first quarter. There were some important moving parts within the expenses this quarter, including \$802,000 of strategic initiative-related expenses. Also, compensation and benefits expense included \$735,000 of severance payments and \$1.4 million of seasonally higher employer payroll taxes. Offsetting these expenses was a reversal of \$2.85 million of previously incurred professional services expense related to the settlement of a legal matter during the quarter.

Excluding these items, the linked quarter decrease was primarily by lower professional services, data processing and other expenses. Our efficiency ratio decreased to 67.8% for the first quarter of 2018 compared to 71.5% for the fourth quarter of 2017.

On Slide 10, we show our regulatory capital ratios as of March 31, including Tier 1 leverage, which increased 9 basis points to 9.53%; and total risk-based capital ratio, which decreased 6 basis points to 14.91%. Tangible book value per as converted common share decreased \$0.03 to \$17.23, as the decrease in accumulated other comprehensive income offset the positive contribution of our quarterly net income to retained earnings.

As illustrated on Slide 11, our asset-sensitive balance sheet continues to be well positioned to benefit from rising interest rate environment. Looking at the table in the bottom right, you can see that 33% of our loans have reset their maturities within the next 12 months and another 25% within 1 to 3 years. Our assets have an average duration of 1.7 years compared to an average duration of our liabilities of 2.9 years. Our Asset Liability Committee continues to assess our position to determine the appropriate strategy given balance sheet movements and our interest rate outlook.

I will now turn the discussion over to Brian Fitzmaurice to go into more detail on our loan portfolio and credit metrics.



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Brian Fitzmaurice - *Opus Bank - Senior EVP & Senior Chief Credit Officer*

Thank you, Kevin. From a credit perspective, we had a productive quarter with a number of moving parts that I will expand on. First, we continued to successfully execute our strategy on reducing exposure to enterprise value loans with a reduction of \$82 million or 20%, leaving \$336 million, of which we consider 32% eligible for retention.

Secondly, we had gross charge-offs of \$14.2 million, which were offset by \$2.2 million in recoveries, resulting in \$12 million in net charge-offs. I will provide some color on the charge-off activity. 95% of the charge-offs were contained within the enterprise value and technology lending portfolios. \$10.3 million of the charge-offs were associated with 2 approximately 1-year-old nonaccrual loans with a combined recorded investment of \$26.2 million. If you recall, on previous earning calls, I have indicated that the resolution of these types of loans are generally binary, either favorable or very unfavorable. For one of the loans, we sold the note at a 12% discount to the bank's recorded investment, which I view as favorable for this type of loan. And regarding the second loan, we converted our impairment measurement methodology from discounted cash flow to fair value, also referred to as the collateral dependent value. This resulted in a 54% charge-off. We had previously established reserves for these 2 loans equal to 80% of the charge-offs. Therefore, the resolution of these loans generally fell within the outcomes we contemplated in our problem loan process.

I will now provide some observations on our nonaccrual loan portfolio, which, although increased from \$58 million to \$64 million, in my view, had some positive factors emerging from a risk management perspective. Included in the quarterly inflow were 2 entertainment loans totaling approximately \$11 million, which we are optimistic will be resolved favorably in either the second or third quarters.

Secondly, impairments calculated using the fair market value method, also referred to as the collateral-dependent method, increased from 13% to 46% of total nonaccrual loans. From my perspective, there is more precision in estimating the likely future loss content using the fair market value method versus the discounted cash flow method.

Thirdly, from an individual borrower perspective, we reduced the number of borrowers that exceeded \$10 million from 3 at the end of fiscal year-end 2017 to 1 at the end of the first quarter.

Finally, of the remaining relationships that became nonaccrual in the first quarter, excluding the aforementioned entertainment loans, none exceeded \$5 million in size, and the average unpaid principal relationship balance was \$2.1 million.

Total criticized loans decreased \$2 million during the quarter or 1% to \$247 million. There were \$10 million of upgrades out of criticized and \$51 million of loan exits, including payoffs, loan sales and normal amortization and \$58 million of downgrades. While classified loans decreased \$9 million, special mention loans increased by \$6 million during the quarter. The decrease in classified loans were driven by upgrades of \$1 million as well as payoffs, charge-offs and amortization of \$48 million, partially offset by downgrades of \$40 million. The increase in special mention loans was driven by \$40 million of downgrades, partially offset by \$8 million of upgrades, \$25 million of loan payoffs, normal amortization and migration.

Within the downgrades in the special mention was 1 \$10 million construction loan in which the project was delayed but is anticipated to be completed and paid in full.

We recorded a provision for loan losses for the first quarter of \$3.9 million. The material factors that drove the provision expense during the first quarter were net charge-offs of \$12 million, \$4.4 million of net risk weighting migration, \$3.2 million of additional reserves due to higher loss factors used to determine the loan loss reserves in accordance with our allowance methodology. These were partially offset by \$9.9 million decline in reserves due to changes in portfolio mix and loan exits and decrease in specific reserves of \$5.8 million.

As of March 31, 2018, our allowance for loan losses totaled \$67.8 million or 1.3% of total loans, a reduction of \$8 million or 17 basis points from the prior quarter. And we had \$11.9 million of specific reserves or 19% of nonaccrual loans compared to \$17.7 million or 30% of nonaccrual loans in the fourth quarter, all of which were allocated to C&I loans. Along with general reserves on C&I loans of \$35.1 million, the reserve coverage ratio was 3.8% on our total C&I portfolio at quarter end.

I'll now hand the discussion back over to Kevin.



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Kevin L. Thompson - *Opus Bank - Executive VP & CFO*

Thank you, Brian. On Slide 16, we present a summary of our outlook for the future. The outlook is based on the current economic and interest rate environment. We are targeting new loan fundings for 2018 of approximately \$2 billion, which is an increase from \$1.5 billion achieved in 2017. As we mentioned earlier, we expect an increasing percentage of new loan fundings will come from our Commercial Banking divisions as our commercial banking strategy gains momentum and new bankers ramp production. Historically, the first quarter is our slowest quarter of the year for loan fundings as production typically ramps over the course of the year, and we expect this will be the case in 2018.

We anticipate our cost-to-deposits to gradually increase in 2018 although at a lesser rate than the benefit we will realize on the asset side of our balance sheet due to our largely adjustable and variable rate loan portfolio and the short duration being realized on our loan and investment securities portfolios. We expect the pace of planned loan exits to slow during 2018, which has been a drag on our loan interest income. As a result, we expect our net interest margin to gradually increase during the year to a range of 3.20% to 3.25%. We anticipate that our continued focus on disciplined expense management will result in increased operating leverage in 2018. The resolved legal matter had a \$750,000 per quarter professional services expense run rate that will not be incurred going forward. We expect, as a result of our focus on operational excellence in both expense and revenue-generating strategies, that our efficiency ratio will gradually improve with the goal of being below 65% in 2018. We anticipate that the outstanding balances of legacy-targeted portfolios and problem loans will continue to decrease, and we remain focused on continuing to enhance our risk management infrastructure, including preparing for the implementation of CECL. We anticipate that our effective tax rate will be approximately 25% in 2018 based on our evaluation of the effect of the recently enacted tax legislation.

Finally, as stated previously, our Board of Directors approved increasing our quarterly cash dividend by 10% to \$0.11 per common share. We do not target a specific payout ratio but evaluate our dividend based on our quarterly earnings, overall profitability, our risk profile and capital levels and the outlook going forward.

I'll now hand the discussion back over to Stephen for closing remarks.

Stephen H. Gordon - *Opus Bank - President, CEO & Director*

Thank you, Kevin. While there is still work to be done to realize our true earnings potential, we are encouraged by our positive first quarter results, and we believe the foundation has been laid for continued success in 2018 and beyond through our strong risk management, disciplined- growth and operational excellence. I look forward to sharing with you our future quarterly results and speaking with you all again soon.

Thank you, again, for joining our conference call today. Operator, would you please open the call for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from the line of Jackie Bohlen from KBW.

Jacquelynne Chimera Bohlen - *Keefe, Bruyette, & Woods, Inc., Research Division - MD, Equity Research*

I'm just trying to think about professional fees a little bit and wanting to make sure I understood the moving parts there in the quarter. That \$750,000 reduction, was that included in 1Q?

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Kevin L. Thompson - *Opus Bank - Executive VP & CFO*

Yes, it was.

Jacquelynne Chimera Bohlen - *Keefe, Bruyette, & Woods, Inc., Research Division - MD, Equity Research*

Okay. So that run rate has already been established in the first quarter?

Kevin L. Thompson - *Opus Bank - Executive VP & CFO*

Oh, I -- let me correct that a little bit. The run rate will be established in the second quarter. There was an expense included in the first quarter. Is that more clear?

Jacquelynne Chimera Bohlen - *Keefe, Bruyette, & Woods, Inc., Research Division - MD, Equity Research*

Okay. Yes, yes. So to apples-to-apples, I would remove that \$750,000 cost in 2Q and then going forward?

Kevin L. Thompson - *Opus Bank - Executive VP & CFO*

Exactly, correct.

Jacquelynne Chimera Bohlen - *Keefe, Bruyette, & Woods, Inc., Research Division - MD, Equity Research*

Okay. Okay. And the \$800,000 in strategic initiatives, did those fall into professional services or are they spread throughout other categories?

Kevin L. Thompson - *Opus Bank - Executive VP & CFO*

They're partially in professional services but spread throughout other categories as well.

Jacquelynne Chimera Bohlen - *Keefe, Bruyette, & Woods, Inc., Research Division - MD, Equity Research*

Okay. Do you have -- are the majority of them in professional services or is it just kind of all over?

Kevin L. Thompson - *Opus Bank - Executive VP & CFO*

About 1/3.

Jacquelynne Chimera Bohlen - *Keefe, Bruyette, & Woods, Inc., Research Division - MD, Equity Research*

About 1/3. Okay. So with the quarter's run rate and then understanding that you had that -- the benefit from the legal settlement, so that will ramp back up with that. And then taking out the \$750,000 and then the strategic initiatives winding down, is there still more room for that line item to come down some or are we nearing a core run rate for that?



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Kevin L. Thompson - *Opus Bank - Executive VP & CFO*

We -- one of our strategic initiatives is operational excellence. And so Jackie, we are definitely focused on expense management and optimizing our operating leverage. However, on the other side of the coin, from a revenue-generating strategy, there are some investments we're looking at in our C&I business and other areas. So we really are managing to get below the 65% efficiency ratio for the year, and that is our goal.

Jacquelynne Chimera Bohlen - *Keefe, Bruyette, & Woods, Inc., Research Division - MD, Equity Research*

Okay. So revenue is a very key part of that?

Kevin L. Thompson - *Opus Bank - Executive VP & CFO*

Absolutely.

Jacquelynne Chimera Bohlen - *Keefe, Bruyette, & Woods, Inc., Research Division - MD, Equity Research*

Okay. And then just touching on loan growth, and then I'll step back. In terms of the -- there's obviously been a significant amount of rundown in the enterprise value. Will the magnitude of that start to slow or might we see another quarter or 2 as we run through those 200-some-odd loans that are eligible for retention?

Kevin L. Thompson - *Opus Bank - Executive VP & CFO*

I mean, so the runoff really could be -- even though it's not -- that we'd like to retain, they could have an event, either a sale of the company or refinance. So I think it slows but I think we probably have a couple of quarters ahead of us where it could be still elevated.

Jacquelynne Chimera Bohlen - *Keefe, Bruyette, & Woods, Inc., Research Division - MD, Equity Research*

Okay. And then, Stephen, when you talk about the ramp-up you're looking for in terms of commercial business lending, where are we at today in terms of the percent contribution versus where you'd like to be, say, a year from now?

Stephen H. Gordon - *Opus Bank - President, CEO & Director*

So overall, C&I-related loans, whether that was from traditional Commercial Banking or from our Specialty Banking divisions, contributed roughly 1/3 of our origination volume during Q1. And we'd like to see that number work its way toward, over time, more like 50%. So you can see that we've been pretty successful in hiring really solid commercial bankers. We've brought on Jim Haney as Head of Commercial Banking, and we continue focusing very much on both originating Commercial Banking loans as well as bringing on additional bankers in order to build out our footprint and execute on the strategy of expanding Commercial Banking.

Jacquelynne Chimera Bohlen - *Keefe, Bruyette, & Woods, Inc., Research Division - MD, Equity Research*

And when you think about that roughly 50-50 spread or the differential between the fundings that you're bringing on balance sheet, does that assume any shift in the Income Property Banking that you're bringing on right now, meaning that are you doing more Income Property Banking to kind of make up as you're coming into more commercial lending? Or do you expect that to stay steady and it'll just be commercial growth that drives that ratio down?



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Stephen H. Gordon - *Opus Bank - President, CEO & Director*

So we haven't changed anything in terms of our focus on multifamily and commercial real estate lending within our Commercial Real Estate Banking group. So our budgeted or forecasted numbers are anticipated to stay approximately the same type of ramp that we've experienced in previous years. And we anticipate that that's a little bit north of \$1 billion a year type of business. And then over time, we anticipate that there would be further growth on the C&I side of what we're doing. So it's not doing less of commercial real estate banking and having the percentages change, it's more or less doing the same amount of multifamily and commercial real estate lending, both permanent as well as Structured Finance, meaning bridge type of lending, but then doing more C&I lending over time.

Operator

Your next question comes from the line of Matthew Clark from Piper Jaffray.

Matthew Timothy Clark - *Piper Jaffray Companies, Research Division - Principal & Senior Research Analyst*

Could you give us what the rate on new loan fundings was this quarter? I know in the release, you said it was up 34 basis points but just wanted to know what that rate was. And then if you could talk to more recent pricing on multifamily and the traditional C&I and specialty businesses?

Stephen H. Gordon - *Opus Bank - President, CEO & Director*

Right. So I want to clarify that 34 basis points that you just referenced. That was -- when we talked about the 34 basis point increase, that's on our new loan funding pipeline when we compare where the pipeline was weighted average interest rate going into the second quarter as we entered this Q2 versus where it was at the end of the year as we entered Q1. So the rate on those loans that would be funded in future quarters is already anticipated to be higher based on where the new loan funding pipeline is at this time. That was the 34 basis points higher. Now to answer the question on what our weighted average interest rate was on new loan fundings during the quarter, Kevin?

Kevin L. Thompson - *Opus Bank - Executive VP & CFO*

During the quarter, that was 4.13%.

Matthew Timothy Clark - *Piper Jaffray Companies, Research Division - Principal & Senior Research Analyst*

Okay. And then how did that compare to the pipeline?

Stephen H. Gordon - *Opus Bank - President, CEO & Director*

That's below where the pipeline is.

Matthew Timothy Clark - *Piper Jaffray Companies, Research Division - Principal & Senior Research Analyst*

Can we get a specific rate or no?

Stephen H. Gordon - *Opus Bank - President, CEO & Director*

No.



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Matthew Timothy Clark - Piper Jaffray Companies, Research Division - Principal & Senior Research Analyst

Okay. And then just on the margin guidance...

Stephen H. Gordon - Opus Bank - President, CEO & Director

And then you also asked, I'm sorry, Matt, about multifamily loan rates today versus where they were, right? So they're in the mid- to higher 4s versus only, I want to say, only 1.5 quarters ago, they were in the -- right around 4.

Matthew Timothy Clark - Piper Jaffray Companies, Research Division - Principal & Senior Research Analyst

Okay. And then on the margin guidance of 3.20% to 3.25% by year-end, I mean, you're already at 3.20%. And given your expectation to lag deposit rates and the better rates on the pipeline, I guess, why won't we see more margin expansion than just 3.20% to 3.25% by year-end?

Kevin L. Thompson - Opus Bank - Executive VP & CFO

Yes, it's a good point. There is some upside there. However, with our portfolio, there are a lot of moving parts. We're seeing deposit costs increase across the industry. We're seeing loan growth being very anemic across the country. Now we had, excluding planned exits, a 9% annualized increase. And we're very proud of that but we are facing headwinds when it comes to loan growth. With the high paydowns in our portfolio and other factors, that is what we are anticipating at this point but there is potential upside.

Matthew Timothy Clark - Piper Jaffray Companies, Research Division - Principal & Senior Research Analyst

Okay. And then just on the EV portfolio, Brian. I guess, how much of that portfolio was criticized? And how much of it was in nonaccrual at the end of the quarter?

Brian Fitzmaurice - Opus Bank - Senior EVP & Senior Chief Credit Officer

\$97.9 million is criticized, and our nonaccrual balance is \$32.1 million.

Matthew Timothy Clark - Piper Jaffray Companies, Research Division - Principal & Senior Research Analyst

Okay. And then last one for me just on the reserves, where it is today and the specific reserves you have set aside. I guess, how do you feel about that coverage given your level of criticized nonaccruals?

Brian Fitzmaurice - Opus Bank - Senior EVP & Senior Chief Credit Officer

We obviously feel it's appropriate, and it's really a mathematical equation with very little qualitative to it. So it will move in the direction of how the quarter -- or how the asset quality performs. And we'd previously indicated, we're going to higher provisions in quarters that we have charge-offs and we had already higher charge-offs. And therefore, we had the higher component of addition.

Operator

Your next question comes from the line of Chris York from JMP Securities.



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Christopher John York - *JMP Securities LLC, Research Division - MD & Senior Research Analyst*

So continuing the line of questions that Matt just asked. You did experience some declines in your loan loss reserve ratio again. So maybe, Brian, do you expect more of your specific reserves to be released? And then secondly, what is the level of reserves that you are preserving against for loans today, recognizing that loan types have different methodologies?

Brian Fitzmaurice - *Opus Bank - Senior EVP & Senior Chief Credit Officer*

So I would expect the specific reserves, assuming it's a static population of loans, to come down either through the positive resolution of the loan or eventually, if it's not positive, one needs to recognize the charge-off. In this quarter, as we indicated, we had 80% reserved against those losses. That's because we had the 2 larger loans that were over 1 year old that were -- one dealt with, I think, in a positive thing like [Tosh] and the other, we had to write down to the collateral value. But how that works out, who knows? We could have recoveries on the remaining loan or there could be further write-down. As I said, I like the collateral value approach because it's down to the hard assets. And your second question was -- can you repeat the second one for me?

Christopher John York - *JMP Securities LLC, Research Division - MD & Senior Research Analyst*

Yes, what are you reserving on loans that you're putting on today?

Brian Fitzmaurice - *Opus Bank - Senior EVP & Senior Chief Credit Officer*

So it's going to be -- that's -- it's going to be dependent on what the situation is. So generally, if it's an EV loan and it's still an operating company, it's around, generally, 47% when we do the scenarios of -- that's kind of a directionally correct answer. Regarding whether or not how we weight the scenarios. So if the company sells or it doesn't sell, then we have further write-downs. So if it's not EV, that could be anywhere from 0 to, let's say, 35% back to a specific number but the collateral helps quite a bit in reducing the amount of specific reserves.

Stephen H. Gordon - *Opus Bank - President, CEO & Director*

Or Chris, are you asking on the new incremental loan that we originate, whether we're reserving against the different type of loan?

Christopher John York - *JMP Securities LLC, Research Division - MD & Senior Research Analyst*

Exactly.

Brian Fitzmaurice - *Opus Bank - Senior EVP & Senior Chief Credit Officer*

Oh, I'm sorry. I thought you were asking about new nonaccrual. So again, we reserve a past loan depending on the type, right? So multifamily is 35 basis points, and commercial industrial is \$146 million for the quarter. And then there's gradient to that. That's really the high and the low.

Christopher John York - *JMP Securities LLC, Research Division - MD & Senior Research Analyst*

Okay, that range is helpful. And then maybe staying on the enterprise value topic. I mean, so I calculate about \$230 million of loans not subject to retention. Generally, I'm curious, what has precluded you from selling this portfolio into what I would perceive to be a strong secondary market for this loan type?

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Brian Fitzmaurice - *Opus Bank - Senior EVP & Senior Chief Credit Officer*

We haven't taken the approach of the sale because on the -- what's not eligible for retention that these are smaller EBITDA transactions that really don't trade very favorable to the bank. And we've been pretty adept that just blocking and tackling and resolving not having to take that hit to earnings. And especially, if they're problematic, then they're going to trade it at a very low price.

Christopher John York - *JMP Securities LLC, Research Division - MD & Senior Research Analyst*

Okay, fair enough. And then you said you changed the form of valuation, and so I'm curious in what the primary form today of that collateral endowing these assets that are used in the collateral-dependent method?

Brian Fitzmaurice - *Opus Bank - Senior EVP & Senior Chief Credit Officer*

Yes. So clarify, it's loan by loan. So just in the one larger loan we were talking about, we end up -- if it's collateral-dependent, then we're valuing the asset. So it could be (inaudible). It's going to be the inventory, and it's going to be assumptions on collectibility on the accounts receivable. And if it was real estate security, it's going to be appraised on real estate.

Christopher John York - *JMP Securities LLC, Research Division - MD & Senior Research Analyst*

Okay. Last question on credit. Your debt highlighted that an entertainment company loan was added to NPAs. Was that entertainment loan related to TWC?

Brian Fitzmaurice - *Opus Bank - Senior EVP & Senior Chief Credit Officer*

Yes. So although I prefer not to talk about the clients, that name, it's in the public domain because of bankruptcy filings. And so, yes.

Christopher John York - *JMP Securities LLC, Research Division - MD & Senior Research Analyst*

Okay. Stephen or Kevin, I presume you're NIM outlook still includes 2 Fed rate increases. Is that a fair assumption?

Kevin L. Thompson - *Opus Bank - Executive VP & CFO*

Yes. So we assume one in mid-year and at year-end in our assumptions.

Christopher John York - *JMP Securities LLC, Research Division - MD & Senior Research Analyst*

Okay. And then maybe stepping back, Stephen, for you. You made some hires over the last couple of months. How would you characterize the competitive environment today in your markets for loans and then deposits? And then tangential to that, where are you seeing the best opportunities for growth?

Stephen H. Gordon - *Opus Bank - President, CEO & Director*

So it's clearly a very competitive market. Everybody has a strong appetite for both loans and deposits and the desire to create the treasury management fee income related to the relationship. The West Coast, by every means, an account is extremely over-banked. Except for that, our markets are all extremely large. We're in major metro markets, so there's plenty of opportunity for everybody to get their market share, whatever



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that market share may be. We have been accelerating the pace of hiring high-quality bankers and expanding our commercial banking concentration or focus within our footprint. And I think that's going to create opportunity going forward in terms of expanding those relationships and the loan portfolios and deposit portfolios, et cetera. If you think about the number of bankers that we've hired over the course of the last couple of quarters, they all go through their ramp-up process. And during that process, they're in the market competing against plenty other commercial bankers and everything from smaller community banks up to the Wells Fargos of the world who come down market in their business banking divisions. So the marketplace is competitive on both loans and deposits, and -- but I think we've got good bankers who are going to be able to compete effectively within those markets.

Operator

(Operator Instructions) Your next question comes from the line of Brian Zabora from Hovde.

Brian James Zabora - Hovde Group, LLC, Research Division - Director

A question on liquidity. You brought cash or interest-bearing cash balances down the quarter. How much more room do you have or where would you just like to keep it? Is there a minimum you'd like to keep?

Kevin L. Thompson - Opus Bank - Executive VP & CFO

We have, I would call it, a robust liquidity management process, where we both forecast our liquidity needs and we stress test those needs over time. And so our liquidity level is based on that forecast, and that can change over time based on future inflows and outflows of cash. And of course, we have a conservative position so that we have some contingency support in case we need it. So I would say we're very comfortable with our liquidity position going forward. It may alter a little bit based on our liquidity needs.

Brian James Zabora - Hovde Group, LLC, Research Division - Director

And then just a question on the recent hires. Generally, how long does it take for them to be fully ramped up? And in the loan pipeline where you feel like they're going to have that good run rate?

Stephen H. Gordon - Opus Bank - President, CEO & Director

So if it's a commercial banker, a C&I banker, I would assume that 5, 6 months type of ramp. And if it is an income property banker, then I would assume more like 3 to 4 months in ramping.

Brian James Zabora - Hovde Group, LLC, Research Division - Director

Okay, great. And then just lastly, I'm sorry if I missed this but kind of the EV loans that you have -- that you are eligible for retention, have you provided an updated number of that?

Stephen H. Gordon - Opus Bank - President, CEO & Director

We did. It's 32%.



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Brian James Zabora - *Hovde Group, LLC, Research Division - Director*

32%, Okay.

Operator

Your next question comes from the line of Tim O'Brien from Sandler O'Neill and Partners.

Timothy O'Brien - *Sandler O'Neill + Partners, L.P., Research Division - MD of Equity Research*

So first question. Stephen, did you make the comment cost of deposits now unchanged from when the Fed increased rates in the first quarter? Did you say something to that effect?

Stephen H. Gordon - *Opus Bank - President, CEO & Director*

What I said was that our cost to deposits is now unchanged compared to when the Fed first started raising rates in December of 2015, 1-5.

Timothy O'Brien - *Sandler O'Neill + Partners, L.P., Research Division - MD of Equity Research*

Next question on the efficiency goal or target that you have for the company, that 65% number. Is that a full year '18 number that's the goal? Or is that a quarterly number to achieve by the end of the fourth quarter or in the fourth quarter?

Kevin L. Thompson - *Opus Bank - Executive VP & CFO*

Our goal is to achieve that for 2018 for the full year.

Timothy O'Brien - *Sandler O'Neill + Partners, L.P., Research Division - MD of Equity Research*

Great. And then another question. Just on the enterprise value loan. So on a dollar basis, \$230 million in targeted payoffs out of \$336 million total, so \$106 million in retention or did I get those numbers reversed?

Kevin L. Thompson - *Opus Bank - Executive VP & CFO*

No, you have it correct.

Timothy O'Brien - *Sandler O'Neill + Partners, L.P., Research Division - MD of Equity Research*

Okay. And it looks like at the end of last year, you had \$271 million in targeted payoff loans and you had \$52 million in targeted payoff loans decline this quarter. So what's -- did you have any migration in the quarter of loans that you were targeting for retention migrate to nonretainable loans?

Stephen H. Gordon - *Opus Bank - President, CEO & Director*

So the \$271 million number was, during the quarter, total loan payoffs. So that would be -- that's not only planned exits. Planned exits were \$52 million of the \$271 million.



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Timothy O'Brien - *Sandler O'Neill + Partners, L.P., Research Division - MD of Equity Research*

So you had \$80-some-odd million in total EV loans payoff paid down this quarter. \$52 million of that was planned exits loans. We ended the quarter with \$230 million in remaining planned exit loans, and \$336 million in total enterprise value loans. Is that right?

Stephen H. Gordon - *Opus Bank - President, CEO & Director*

I believe so, yes. And just to be clear, the \$271 million number that we referenced...

Timothy O'Brien - *Sandler O'Neill + Partners, L.P., Research Division - MD of Equity Research*

Yes, last quarter.

Stephen H. Gordon - *Opus Bank - President, CEO & Director*

During Q1, right? That was total loan payoffs that included planned exits, EV loans, et cetera, plus other payoffs that we got throughout the loan portfolio. So that includes loan payoffs of multifamily loans, commercial real estate loans, et cetera, in the \$271 million total payoff number.

Timothy O'Brien - *Sandler O'Neill + Partners, L.P., Research Division - MD of Equity Research*

Do you happen to have the weighted average yield on that book of loans, planned payoff loans remaining?

Stephen H. Gordon - *Opus Bank - President, CEO & Director*

Planned exits?

Timothy O'Brien - *Sandler O'Neill + Partners, L.P., Research Division - MD of Equity Research*

Yes, planned exits. Sorry, Stephen.

Stephen H. Gordon - *Opus Bank - President, CEO & Director*

Remaining?

Timothy O'Brien - *Sandler O'Neill + Partners, L.P., Research Division - MD of Equity Research*

Yes, what's the weighted average yield on that book right now? So I mean, that's kind of a good number to be aware of just when we're looking at our margin assumptions.

Kevin L. Thompson - *Opus Bank - Executive VP & CFO*

We don't have that for the full portfolio but for the quarter end, we...



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Stephen H. Gordon - *Opus Bank - President, CEO & Director*

For planned exits.

Kevin L. Thompson - *Opus Bank - Executive VP & CFO*

For planned exits, yes. And we've try to announce that every quarter. And for the quarter, it was 7.38%.

Timothy O'Brien - *Sandler O'Neill + Partners, L.P., Research Division - MD of Equity Research*

So it's not unreasonable to think that the residual is somewhere in that elevated range. It's -- the yield on that remaining book is probably pretty solid as well?

Kevin L. Thompson - *Opus Bank - Executive VP & CFO*

It can be somewhat volatile. Last quarter, it was 6.1%. So based on estimations of cash flows, prepayments, amortization, et cetera, it can be somewhat volatile. But we announce that every quarter, and kind of the average over the quarters would be reasonable.

Stephen H. Gordon - *Opus Bank - President, CEO & Director*

The quarter before was 5.35% on planned exits. So Q3 was 5.35%, Q4 was 6.1%. This quarter was quite a high number of 7.38%.

Timothy O'Brien - *Sandler O'Neill + Partners, L.P., Research Division - MD of Equity Research*

That's great color. And then shifting gears back to what Jackie was talking about. So you had -- the line item was \$1.7 million in professional fees this quarter that you guys accrued for and under overhead expense. \$750,000 of that also was, again, this accrual for that legal situation that you were in that is going to disappear at the end of this quarter. And then 1/3 of the \$802,000 was initiative driven. So ultimately, that's going to not recur either, so that professional line item is going to settle somewhere around \$700,000 x any additions or anything else that you guys take on down the road, that's kind of the -- that's going to be the core number here going forward once the initiatives are done.

Kevin L. Thompson - *Opus Bank - Executive VP & CFO*

Everything you mentioned in the changes are correct. However, we are managing to the 65% efficiency ratio based on -- you're correct. There are initiatives on the revenue-generating side that we're looking at also on the expense side. But to support that revenue-generating engine, there may be some investments we make this year. And we will be clear of our expectations going forward of that efficiency ratio.

Timothy O'Brien - *Sandler O'Neill + Partners, L.P., Research Division - MD of Equity Research*

Is one of the initiatives CECL compliance and are you accruing already for that? I heard you had mentioned that at some point or somebody mentioned that.

Kevin L. Thompson - *Opus Bank - Executive VP & CFO*

Yes, I mentioned that. We are definitely -- we are -- we have a robust program, a subcommittee that is focused on CECL. We're working through initial understanding of our data and modeling. There will be some expenses this year that we are anticipating in that run rate and going forward, and I -- we are on a good track to be prepared for CECL.



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Timothy O'Brien - *Sandler O'Neill + Partners, L.P., Research Division - MD of Equity Research*

Okay, great. And then do you guys expect annual merit? Is there going to be an annual merit adjustment that kicks in, in the second quarter for comp? Like 3% or something? Is that a 2Q -- start in 2Q item?

Kevin L. Thompson - *Opus Bank - Executive VP & CFO*

Yes. There will be a 2Q impact to merit increases in the company.

Timothy O'Brien - *Sandler O'Neill + Partners, L.P., Research Division - MD of Equity Research*

3%? Has that been settled? Sorry.

Kevin L. Thompson - *Opus Bank - Executive VP & CFO*

It's approximately 2%.

Timothy O'Brien - *Sandler O'Neill + Partners, L.P., Research Division - MD of Equity Research*

2%, great. And then, I guess, my last question is a little bit unclear on do you -- so the number that -- the origination number that you guys posted for multi in the second quarter was \$267 million. And Stephen, you mentioned that \$1 billion goal or target of new fundings number for invest-your-own properties, is that -- did I hear that correctly? But you also mentioned kind of a ramp. So could you clarify there?

Brian Fitzmaurice - *Opus Bank - Senior EVP & Senior Chief Credit Officer*

Yes. So we have both Income Property Banking and Structured Finance inside of Commercial Real Estate Banking, and our goal with ramping for the year is a little north of \$1 billion. It's a combination of both Income Property and Structured Finance.

Timothy O'Brien - *Sandler O'Neill + Partners, L.P., Research Division - MD of Equity Research*

So some of the multi-structure -- some of the multi fundings, that \$267 million number in new fundings, that was structured? Those were structured financial or that was different? Separate?

Brian Fitzmaurice - *Opus Bank - Senior EVP & Senior Chief Credit Officer*

In the quarter?

Timothy O'Brien - *Sandler O'Neill + Partners, L.P., Research Division - MD of Equity Research*

Yes, in the quarter. I guess what I'm looking at, what I'm trying to get at is going forward, is that -- was production a little bit elevated this quarter relative to your expectations based on what you described for the full year? Is there an item in there that was additive to that, was the multi -- was the production that you're talking about that contributes to the billion-dollar growth or funding number for the year lower? Or is that going to reflect this ramp-up there as well or just a little bit of clarity on that. Does that make sense?



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Brian Fitzmaurice - *Opus Bank - Senior EVP & Senior Chief Credit Officer*

So we originated during the quarter, I would say, in aggregate across the board, higher than what we had forecasted for Q1. Does that help?

Timothy O'Brien - *Sandler O'Neill + Partners, L.P., Research Division - MD of Equity Research*

It does but you didn't -- and that -- but you also didn't change the full year number and so at this point, you're tracking higher than forecast and...

Brian Fitzmaurice - *Opus Bank - Senior EVP & Senior Chief Credit Officer*

Right. And I'm not going to go into granular detail as far as how or where that occurred across the board. I'm just -- the color I'm going to give you is that we came in higher than we internally forecasted in total aggregate new loan funding origination.

Operator

There are no further questions at this time. I'll turn the call back over to Mr. Gordon.

Stephen H. Gordon - *Opus Bank - President, CEO & Director*

Okay. Thank you. We look forward to further discussions with everybody, and we're reachable should you have any questions. Thank you.

Operator

This concludes today's conference call. You may now disconnect.

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