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OPB - Q2 2019 Opus Bank Earnings Call

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PRESENTATION

Operator

Good day, everyone, and welcome to the Opus Bank Second Quarter 2019 Earnings Conference Call. My name is Dequitria, and I will be your conference operator today. (Operator Instructions)

Speaking on today's call will be Paul Taylor, President and Chief Executive Officer; Kevin Thompson, Executive Vice President and Chief Financial Officer; Brian Fitzmaurice, Vice Chairman and Senior Chief Credit Officer.

Today's discussion will cover the company's performance during the second quarter of 2019 and information contained in the earnings press release issued earlier this morning. A slide show presentation that will -- that accompanies today's call is available on the Opus Bank investor web page at investor.opusbank.com\presentations. The call will be recorded and made available for replay after 2:00 Eastern Time on July 29, 2019, through August 29, 2019, at 11:59 p.m. Eastern Time by dialing 1 (855) 859-2056, passcode 6638938.

The discussion during the call today 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 in the earnings press release issued earlier this morning.

Today's call will include a question-and-answer session following management's prepared remarks.

Now I will turn the call over to Paul Taylor, President and CEO, for opening remarks. Sir, you may begin your conference.

Paul W. Taylor - *Opus Bank - President, CEO & Director*

Thank you, Dequitria, and good morning to everyone listening to our second quarter earnings conference call. I am Paul Taylor, President and CEO of Opus Bank.

Since this is my first earnings conference call at Opus, I would like to briefly introduce myself and provide some of my background and experience. I'll then hand the floor to Kevin Thompson, Executive Vice President and Chief Financial Officer; and Brian Fitzmaurice, Vice Chairman and Senior Chief Credit Officer, who will go into details of our financial performance and credit metrics.

To begin with, let me first say that I'm pleased to be presenting today with my colleagues, both Kevin and Brian, and I'm excited to be working with all of the Opus and PENSCO team members located in California, Washington, Oregon, Arizona and Colorado.

I joined the bank on May 1 this year as President and CEO, succeeding Paul Greig who served as interim President and CEO and will continue exclusively as Chairman of the Board. Prior to joining Opus, I was the President and CEO of Guaranty Bancorp in Denver, Colorado for approximately 8 years and also served as the company's Chief Financial Officer for several years before that. While at Guaranty, I managed the acquisition of 6 banks approximately double the size of the bank and improved the company's profitability, which had been struggling when I first took it over as CEO.

For the first quarter of 2019, Opus recorded net income of $8.7 million or $0.23 per diluted share compared to net income of $10.9 million or $0.28 per diluted share in the first quarter of 2019.

During the quarter, we incurred expenses related to strategic actions, which reduced our reported net income by approximately $4.6 million or $0.12 per diluted share. These actions included a cost reduction initiative we executed during the quarter to improve the efficiency and profitability of the bank, which also resulted in severance expense. On an adjusted basis, excluding these costs, our earnings per share came in at $0.35 for the second quarter of 2019 compared to adjusted EPS of $0.32 for the first quarter.

Our performance for the quarter was driven by strong loan growth from our multifamily lending division, solid deposit growth and positive contributions from PENSCO and our Escrow and Exchange divisions.

Additionally, our credit quality improved during the second quarter as nonperforming assets decreased 9% from the prior quarter and measured 27 basis points of total assets as of June 30.

Other important news. The bank has been managing down troubled portfolio of enterprise value loans, and the current balance of that portfolio is $65 million at the end of the quarter and is well reserved for.

While we still have a lot of work ahead of us to improve Opus' profitability, our capital ratios are healthy and can support future growth, and Opus' multifamily loan portfolio and lending operations continue to serve as a foundation of stable low-risk loans.

In a few months I've been at Opus, I visited all of our geographies and met many of our employees. Meeting them gives me confidence in the abilities of our team to achieve our strategic goals. Our markets are economically strong, and there are many levers we can pull to take advantage of opportunities of -- to grow earnings and improve shareholder return.

With that, I will now turn the discussion over to Kevin Thompson to go into our financial performance for the quarter.

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

Thank you, Paul.

Turning to Slide 4. Average loans increased $478 million from the prior quarter driven by new loan fundings of $704 million, offset by loan payoffs of $239 million. Loan growth was primarily driven by multifamily loans, which increased $354 million. We continue to opportunistically build this high-quality portfolio as we maintain a heightened focus on our retention program and as competition remain less active during the quarter. Competition has now fairly returned to the market. And with the intensified rate environment, we do not expect growth to be as strong for the remainder of the year.

Our Commercial and Specialty Banking divisions originated $92 million during the quarter, and we continue to see progress from the build-out of this important initiative that began in 2018.

Total loan yield decreased 12 basis points in the second quarter to 4.3% driven by multiple factors, including a lower interest rate environment, less interest recovered on nonaccrual loans and lower prepayment fees.

On Slide 5 we show the average balance and yield of investment securities, both of which decreased slightly in the quarter largely due to prepayment activity.

As you may recall, we reposition our securities portfolio during the fourth quarter of 2018 to increase the overall yield and extend duration slightly. This resulted in over 120 basis point increase in our securities yield and a 67% increase in interest income from securities for the first 6 months of 2019 compared to the same period in 2018.

Turning to Slide 6. Average deposits increased $225 million in the second quarter or 4% driven by growth in interest-bearing demand, money markets and time deposits. Deposit growth was broad-based from Fiduciary, Municipal, Escrow and Exchange and Commercial Banking divisions. Some seasonal deposit outflows occurred near the end of the quarter, and these balances are expected to return as they do each year.

Our cost of deposits increased 14 basis points to 1.06%, which was the primary driver of the decrease in our NIM. Higher deposit costs were seen across deposit types as we responded to continued competitive rates being offered by our peers as well as strong loan growth. Our loan-to-deposit ratio increased to 93%.

Turning to Slide 7. Net interest income decreased 0.6% during the second quarter to $50.5 million. Our loan interest income increased $4.2 million or 7%, benefiting primarily from higher average balances while interest expense rose $4.3 million or 27% driven by both higher interest paid on deposits and FHLB borrowings.

Net interest margin decreased 27 basis points from the prior quarter to 2.88%. This was driven mainly by an increase in deposit rates and balances. Interest income from higher loan balances was slightly offset by less interest recovered on nonaccrual loans and lower prepayment fees. Income from investment securities was impacted by slightly lower average balances and yield due to higher prepayments. Finally, the NIM was negatively impacted by 4 basis points due to day count in the quarter.

Proceeding to Slide 8. Noninterest income was $12 million compared to $11.1 million in the first quarter. The first quarter included an impairment charge on sublet property of approximately $0.5 million.

Our diverse sources of noninterest income, representing 19% of total revenues, provided continued stable contributions, including $6.8 million in trust administrative fees from PENSCO and $1.5 million from our Escrow and Exchange division.

Turning to Slide 9. Included in noninterest expense of $46.3 million was $4.9 million of expenses related to strategic actions, of which $4.3 million comprised severance expense. Excluding these costs and adjusting for the legal settlement in the first quarter, noninterest expense decreased 6% from the prior quarter.

The cost reduction initiative included a reduction in head count of around 5%. The initiative will enable Opus to operate more efficiently while reinvesting some of the anticipated savings to fund necessary initiatives such as infrastructure enhancements. Adjusting for strategic action-related expenses, our efficiency ratio was 63.5%.

On Slide 10, we show our capital ratios at quarter end, including tangible common equity of 8.87% and total risk-based capital of 14.77%. Tangible book value per common share increased $0.36 to $18.32 due to the contribution of net income and $7.3 million increase in other comprehensive income.

The Board has approved the payment of an $0.11 dividend per common share payable in the third quarter, which is unchanged from the prior quarter.

On Slide 11, we display some of our asset liability metrics, which includes durations and our simulation of net interest income assuming instantaneous parallel rate shifts. The anticipated duration of our assets and liabilities has decreased slightly as a result of a slight mix shift and the change in yield curve. We continue to closely assess our position as we navigate this difficult interest rate environment.

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

Brian Fitzmaurice - *Opus Bank - Vice Chairman & Senior Chief Credit Officer*

Thank you, Kevin. This morning, I will review our second quarter credit performance, which depicts our continued progress towards a normalized credit environment. This progress is highlighted by a reduction in enterprise value loans of 39% or $40.5 million, leaving a $64.5 million portfolio; a reduction in classified loans of $16.1 million or 12.9%; and a $2.2 million or 9.3% reduction in nonperforming assets. Net charge-offs totaled $4 million, special mention loans increased by $1.4 million or 5% and provisions for loan and lease losses totaled $3.3 million. We continue to expect our enterprise value loan portfolio will reduce through the rest of fiscal year 2019. During the quarter, we did not have any new special mention, substandard or nonaccrual EV loans.

The loan growth for the quarter occurred predominantly in our multifamily loan portfolio, and the new loans that were originated were underwritten using our existing prudent underwriting criteria.

As I previously mentioned, we reported a provision for loan losses of $3.3 million compared to $2.2 million provision expense last quarter. The material factors driving the provision this quarter were net charge-offs of $4 million, changes in portfolio mix and loan fundings of $3.5 million, additions to specific reserves of $1.5 million and risk-rating migration of $1.2 million. These factors were partially offset by $7.7 million of relief due to loan exits.

As of June 30, 2019, our allowance for loan losses totaled $57.7 million or 1% of total loans held for investment, a reduction of $759,000 or 7 basis points from the prior quarter. And we had $6.7 million of specific reserves or 32% of nonaccrual loans compared to $5.3 million or 23% in the first quarter of 2019.

I continue to be optimistic that our credit performance in fiscal year 2019 will be favorable to 2017 and 2018, and that we will continue to make progress in aligning our credit metrics with peer bank performance.

Please remember that notwithstanding our continued reduction in enterprise value loans, we can still incur losses in one or more of these loans.

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

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

Thank you, Brian.

On Slide 14, we present a summary of our outlook for the future. We assume a continuation of the current economic environment and 1 interest rate cut in mid-2019. The conditions in our markets remain solid despite some uncertainty in the overall economy. We expect loan growth to moderate in the second half of the year, with prepayments and competitive pressure returning to the levels we have experienced over the past few years. The overall loan growth for the year should be in the mid-teens.

We believe with the Fed Reserve potentially lowering rates, the deposit cost could moderate later in the year while still subject to competitive pressure.

We estimate our net interest margin for the full year 2019 will be approximately 2.9%, revised from the previous estimate of 3% due to the impact of the rate environment on loan and deposit pricing and the lack of repricing benefits on variable-rate loans we would experience in an increasing rate environment.

We continue to anticipate a flattening yield curve and elevated prepayments in the coming quarters.

With the pressure on net interest margin, we are very focused on disciplined expense management and revenue initiatives to increase our operating leverage. We expect our core efficiency ratio for the full year 2019 to be in the range of 64% to 65%, and we expect full year core operating expenses to be lower than those in 2018.

Regarding credit quality, we expect our credit metrics to be more aligned with peer bank performance by the end of 2019. We remain focused on maintaining a strong risk management infrastructure, including preparing for the implementation of CECL.

We anticipate that our core effective tax rate will be approximately 25% for the full year 2019.

Finally, regarding our capital position. We carefully manage our dividend payment based on our capital levels, loan growth, our risk profile and market conditions.

This concludes our prepared remarks. Operator, would you please open the line for questions?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And already in queue, we do have a question from Matthew Clark.

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

Paul, I think in your opening comments, you talked about wanting to improve profitability, achieving your strategic goals. I guess have the strategic goals of Opus changed at all since your arrival? Can you just talk through how you kind of plan to manage the balance sheet and improve profitability since you joined?

Paul W. Taylor - *Opus Bank - President, CEO & Director*

Sure, and thanks for the question. So as we look at it, I mean if you look at the balance sheet of Opus Bank today, today, Opus Bank is predominantly a multifamily lender. So as I look at that asset side, we need to diversify that. We're always going to be a multifamily bank. This is one of our core competencies, but we need to add a more robust commercial C&I portfolio onto the balance sheet, which will diversify the left side.

And going to the right side. I mean if you look at our deposits, the cost is too high. We don't have enough noninterest-bearing deposits, and we need to increase that. So we're working today on a new retail strategy in the company in order to try to generate more noninterest-bearing deposits.

Now in saying both those things, commercial loans and noninterest-bearing deposits are probably the most competitive areas in banking today. But we believe that we can make great strides at improving the commercial loan portfolio and better mixing the -- in particular, the demand deposits -- adding demand deposits.

As you look at the income statement, some of our actions we took in this last quarter, we increased almost every fee in the bank that we could. So we should start seeing that bleeding into the financials as we go forward. We've got to continue to be very vigilant on those fees and keep them increasing and staying in the market there.

Expenses, we took a lot of strides in today, trying to reduce those, control those. We've looked at facilities, we've looked at branches, we've looked at people. And probably the biggest variable we have is the net interest margin.

On Wednesday, the Fed meets and gives us their decision. Whether they're going to keep rates the same or lower them, we'll have to see. But we're very tied to the yield curve, as all banks are or most banks are, and we'll have to see where that goes in order to improve the overall condition of the income statement.

But those are really our strategic plans. I mean it's really the nuts and bolts of banking, just trying to improve what we have.

The other interesting company that I didn't fully understand the power of it is PENSCO when I first came on. PENSCO is an IRA custody business that deals in more of the alternative investments available to customers in the IRA world. And again, I think that's a pretty terrific company. And one of our strategies will be to grow that and make that a much more profitable company as we go forward.

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

Is there any appetite to slow the loan growth to some degree and take that pressure off the funding side and allow your deposit costs to maybe go down here after the Fed cuts?

Paul W. Taylor - *Opus Bank - President, CEO & Director*

Yes. Recently, we're working with raising the -- not the fees, but the interest rate on the multifamily portfolio. Obviously, we can only affect the new loans coming on. And we have to realize there's a period of time for those to take effect. But I can tell you that in the third quarter, you'll see much less growth in the loan portfolio than you saw in the first and second quarter.

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

Okay. And then just on the expenses. I think you mentioned that core expenses will be lower year-over-year. I guess my question is how much lower. And I guess it's another way of asking is there some additional cost saves coming in addition to the ones that were enacted this past quarter.

Paul W. Taylor - *Opus Bank - President, CEO & Director*

There will be. I mean we're going to reduce noninterest expense as much as we possibly can. That's going to become a daily culture in this bank as we move forward. So I think that you'll see, continuing forward, lower expenses.

Operator

Your next question comes from the line of Luke Wooten with KBW.

Luke Simeon Wooten - *Keefe, Bruyette, & Woods, Inc., Research Division - Associate*

I was wondering if you could just -- this is just kind of a clean-up. Just could you identify the amount of the severance expenses after-tax number? I know it's $4.3 million pretax. Just looking for the after-tax number.

Paul W. Taylor - *Opus Bank - President, CEO & Director*

Kevin?

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

That's a little bit of a complex question, and I'm not going to answer that directly because income taxes aren't a straight answer. So normally, you would just apply our core effective tax rate of 25% to that. There's an unusual item this quarter in that we have some higher -- a few higher-paid employees as part of the reduction in force, and they triggered the Section 162 nondeduction of some expenses. So that portion increased our tax rate by 7%. And if not for that, our tax rate would have been 25%. That's a better way to look at it.

Luke Simeon Wooten - *Keefe, Bruyette, & Woods, Inc., Research Division - Associate*

Okay. That's helpful. And then just sticking on expenses. Is the new salaries and benefits line excluding the severance impact, which comes to about $25 million? Is that a good run rate? Or do we expect more compression on that going forward?

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

I would say there's a lot of movement in that line. As banks, we defer some of our costs, the old FAS 91. And so of course, we had a good amount of production in the quarter, so that decreased that amount. We have some seasonal movements in that line as well. So on an average basis, that may be a way to look at it. But there -- we strategically look at our expenses. There may be some flux in that line and other lines as we decide how to invest some of the expenses we have over time.

Luke Simeon Wooten - *Keefe, Bruyette, & Woods, Inc., Research Division - Associate*

Okay. That's helpful. And then it looked like some of the savings from the FTEs coming down was kind of deployed into the data processing line. Is that kind of how we should see that going forward with increased investment in that -- in those initiatives?

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

That is one line. That was -- we had a lower expense in the first quarter. So the expense this quarter was more of our run rate. But to your point, that is one of the areas where we're looking at investing in customer experience, technology initiatives that may make us more efficient and help us with revenue initiatives as well.

Luke Simeon Wooten - *Keefe, Bruyette, & Woods, Inc., Research Division - Associate*

Okay. That's really helpful. And then just a quick one just kind of on the margin. Could you identify what the new loan yield is coming on for this quarter?

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

Yes. The new loan yields actually were fairly flat. First quarter and second quarter, we maintained that yield on average in the about 4.30%, 4.3%.

Luke Simeon Wooten - *Keefe, Bruyette, & Woods, Inc., Research Division - Associate*

Okay. And then just kind of talking a little bit about that with the potential for a Fed rate cut. I mean imagining majority of the production was through multifamily. Is that set to be impacted by the possibility of rate cut? Or should we kind of see that as moving less than obviously the commercial lines but also other lines of business -- the yields on those? Apologies.

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

That could be impacted. It's getting increasingly difficult to estimate that in this volatile rate environment. The multifamily -- loan rates, in general, have moved quickly in this current rate environment while the customer deposit rates have not. They've held fairly strong. Multifamily lending is very tied to the midrange of the yield curve, to that LIBOR, which has been depressed already. So you could argue some of that loan pricing impact is already priced into the market. However, as -- we may see a little more movement in that if the Fed lowers rates.

So we are currently -- in the way we're talking about our guidance, we are currently assuming that the current yield curve, this flattening yield curve continues into the future. And we are hopeful that there's some upside that there is -- if there is some easing on interest rates, that we see a more normalized rate curve that gives us some benefit to our net interest margin. We're hopeful also that deposit betas, as they did in the past 3 rate-easing cycles, move fairly quickly. However, in our guidance, we're not putting that in. We're conservatively looking in that and conservatively preparing for that in our strategy.

Operator

(Operator Instructions) And your next question comes from Tim O'Brien from Sandler O'Neill + Partners.

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

Would you guys happen to have the -- I saw the percent reduction in FTE count. Do you happen to have end of the quarter count and the start of quarter count, the hard numbers?

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

The end of the quarter was around 730 and the start of the quarter was around 760. So there's some obviously flux in not only reduction in force, but in other increases and decreases within the firm.

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

And more specifically also would you, by any chance, have commercial banker head count at the end of the quarter versus the start of the quarter?

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

Approximately 30, Tim.

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

30 at the end of the quarter. And was there any change in that head count during the quarter?

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

No. There was some flux in movement, but it was around, on average, the same amount.

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

And can you remind me who is leading that group?

Paul W. Taylor - *Opus Bank - President, CEO & Director*

Jim Haney.

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

Great. All right. And then another question I have for you is -- so the 2.90% guidance you gave reflects 1 expected rate cut, correct? Not any more than that?

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

That's correct. Just 1 we're anticipating at this point in mid-2019, 1 rate cut by the Fed. And to reiterate, we assume the same yield curve going forward, that same shape of the yield curve as it is today, and that we don't see any kind of relief on the kind of normalizing of that yield curve in our guidance.

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

Okay. Great. And then just kind of a detailed question. So the $4.3 million in strategic expenses this quarter for severance and stuff, that was captured in the $29 million compensation and benefit line, is that right? Or was it a combination of did it accrue there and in other parts of the noninterest expense total?

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

Yes. So the 4.3 -- so $4.9 million total of strategic initiatives, of which $4.3 million impacted severance expense, and yes, was in the compensation line and the other impacted more professional fees. Of course, there was a tax impact as well that we call out, kind of an unusual Section 132 item.

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

And again, that was down below -- and then you also alluded to this, that there were some -- obviously some other dynamics involved in that final $29 million, including some seasonal costs. Does that have to do with annual merit perhaps that impacted in the second quarter? Or what were you talking about there? And can you quantify that a little bit or break it out?

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

I don't have actual numbers. There's a lot of movement on these lines that complicate it. One of the big factors, though, is deferred fees, the FAS 91 when you have high loan production. But then you have the first quarter, the second quarter differential in tax, kind of seasonally high tax in the first quarter versus the second quarter and other movements. You do have bonus payments potentially impacting a special tax side in the first quarter.

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

Going forward, is there any chance that you guys are going to call out or isolate, identify deferred comp expense as a piece of the total comp and benefit just because it's been so significant in the past for Opus? Any chance of that? Or is it going to -- are you guys going to report the same?

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

I think we could consider that as helpful. We've not done that in the past, but of course, we track that closely.

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

Obviously, I'll leave it to your guys' judgment, but investors have thought it was important in the past and maybe it's something worth considering now. I'll just leave that one to you.

And then one last question, sticking with noninterest expense. So professional services costs were down $1.2 million -- or $1.1 million in the quarter. That was nice. Is that a good new kind of baseline run rate here going forward? Or have you guys turned the page on all of the professional service costs accrued at a higher level through this -- what you've been through? And are we going to see those lower here going forward?

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

I would say 2 things. I would say yes, we have turned the quarter -- corner. We are seeing fewer legal expenses and less of a need to outsource some of our processes. And so we have gone through a better spot there. However, there are some unusual -- unusually lower expenses in the second quarter. So going forward, you won't see it too much different from the first quarter. That's probably a better range. But again, that is materially less than we've spent in the past. And that is the line item, again, where we're considering some strategic initiatives to continue to invest in our future.

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

Great. And then I'm going to throw one more at you. On the -- in the fee income piece, other fee income was up a little bit. Is that $1.2 million -- that's going to remain volatile, isn't it, because you guys have some kind of volatile items that hit pretty regularly through that line, right?

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

Yes. There's less volatility than there's been in the past. As a reminder, in the first quarter, there was 1 offset. There was a lease asset impairment of about $0.5 million. And so the current quarter -- second quarter is a more of a run rate.

Now we had Merchant Banking in there in the past that caused some volatility. You won't see that volatility going forward. There's still some items, of course, like any bank would have, certain valuations. But the second quarter's run rate is a good figure to possibly use for the future.

Operator

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

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

I just have a few follow-ups. On deposit costs, is your expectation deposit cost will peak in the third quarter and then start to move lower? Just want to get a sense for how much of a 25 basis point rate cut do you plan on passing along to depositors.

Paul W. Taylor - *Opus Bank - President, CEO & Director*

That's very market-driven. But if there is a cut on Wednesday, there's some level of that 25 that we can take out. It's not all of the 25. It might be 10 to 15 basis points that we could start reducing. But we plan to be extremely proactive on that and save as many dollars as we can there.

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

Okay. And then just the loans that were transferred to held-for-sale. Are you planning to do a large securitization on the multifamily front? If so how big, timing and what the coupon is on those loans that were transferred?

Paul W. Taylor - *Opus Bank - President, CEO & Director*

We are not doing a securitization. We're selling the whole loans. And at this point in time, that's all of the loans that we've identified to sell.

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

Okay. And do they happen to be lower-yielding? Are they -- I guess my question is whether or not there's going to be some relief in the loan yield overall.

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

With our strong loan growth, we opportunistically looked at the market to see if there were opportunities, and so these are actually potentially at a gain. We're finalizing those sells as we speak. And so we looked at opportunistically selling some of our lower-yielding loans. At the same time, we have such high prepayments and low duration on these assets that it didn't make sense for us. So we feel comfortable with our current level of multifamily assets.

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

Okay. And then on the efficiency ratio guide, is that -- that 64% to 65%, is that still on an adjusted basis excluding CDI and gain on sale and all the other kind of noise?

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

That is correct, on an adjusted basis.

Operator

Your next question comes from the line of Kevin Swanson with Hovde Group.

Kevin William Swanson - *Hovde Group, LLC, Research Division - Director & VP*

Just kind of one follow-up question. Most of my other ones were answered. But on the credit side, I think prior to like early '16, you guys kind of operated a little bit below 1 on an allowance ratio. I think in the past couple of quarter, we've come down a little bit and now we kind of sit right at that level. Just curious where you see that number going. And then maybe just in general, if you could kind of comment on the credit environment that you're seeing right now.

Paul W. Taylor - *Opus Bank - President, CEO & Director*

Yes. It's going to sort of hog 1% as we go forward. And the credit environment is very strong at this point in time. We see really no deterioration in our markets.

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Brian Fitzmaurice - *Opus Bank - Vice Chairman & Senior Chief Credit Officer*

This is Brian. The allowance is obviously very mathematically driven. So we're very heavily weighted towards multifamily. So if we continue to have good progress in the reduction of our substandard assets, those would be -- positively resolving them would end up reducing the allowance a little bit because there's no reason to hold the reserves and they're quite high given our loss experience. So it could come down a little bit, the coverage.

Operator

Your next question is a follow-up from the line of Luke Wooten with KBW.

Luke Simeon Wooten - *Keefe, Bruyette, & Woods, Inc., Research Division - Associate*

Sorry. Just a couple of quick follow-ups. Just wanted to talk a little bit about the loan-to-deposit ratio. We saw a pickup in that in the quarter. I think there was a little talk about how it -- kind of trying to match the deposit growth to loan growth from the first quarter. How should we look at that ratio going forward?

Paul W. Taylor - *Opus Bank - President, CEO & Director*

I think that you'll see the ratio stay probably in the mid-90s for the foreseeable future. It may rise a little bit as we get out a little further. But again, our hopes is to grow deposits, and that would be great to reduce that ratio. But right now, it's going to stay in that similar region.

Luke Simeon Wooten - *Keefe, Bruyette, & Woods, Inc., Research Division - Associate*

Okay. That's helpful. And then just kind of on that deposit growth. I mean you guys saw solid interest-bearing demand deposit increase quarter-over-quarter. Is that through a campaign? Or are you guys -- they're just solid growth without the campaign?

Paul W. Taylor - *Opus Bank - President, CEO & Director*

Well, I think it's both. We do have a campaign going on right now in our Business Banking group and our Retail group. So that is getting some traction, but it's mostly just normal fluctuations.

Operator

And there are no further questions. I will now hand the call back over to Paul Taylor.

Paul W. Taylor - *Opus Bank - President, CEO & Director*

I want to thank everybody for joining the call. Hopefully, we have answered all of your questions. And we look forward to speaking to you in the future. If anybody has any further questions, do not hesitate to contact Kevin or myself. Thank you.

Operator

Thank you for your participation. This concludes today's conference call. You may now disconnect.