S&P Global
Market Intelligence

Hawaiian Electric Industries, Inc.

NYSE:HE

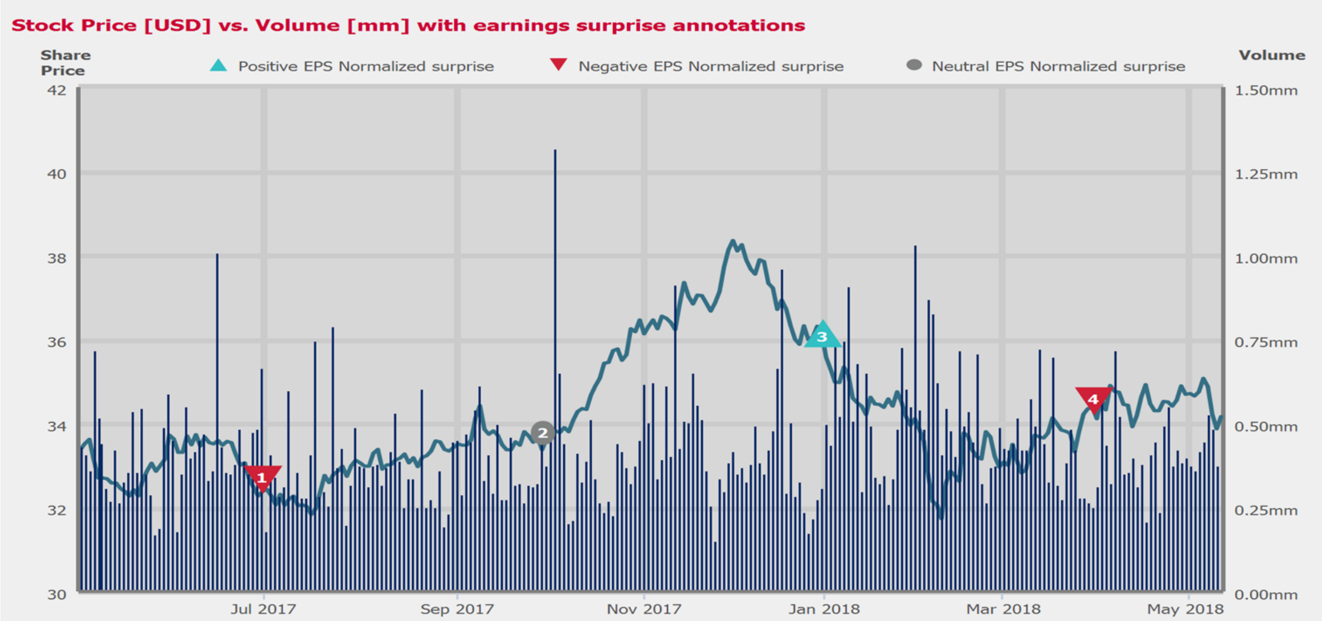
FQ2 2018 Earnings Call Transcripts

Friday, August 03, 2018 8:00 PM GMT

S&P Global Market Intelligence Estimates

	-FQ2 2018-			-FQ3 2018-	-FY 2018-	-FY 2019-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.42	0.42	▲0.00	0.64	1.90	2.05
Revenue (mm)	616.37	685.28	▲11.18	731.97	2569.77	2609.04

Currency: USD
Consensus as of Jul-20-2018 9:13 PM GMT



- EPS NORMALIZED -	CONSENSUS	ACTUAL	SURPRISE
FQ2 2017	0.39	0.36	▼(7.69 %)
FQ3 2017	0.55	0.55	●0.00 %
FQ4 2017	0.41	0.43	▲4.88 %
FQ1 2018	0.38	0.37	▼(2.63 %)

Table of Contents

Call Participants

EXECUTIVES

Alan M. Oshima
President, CEO & Director of Hawaiian Electric Company Inc.

Constance Hee Lau
President, CEO & Director

Gregory C. Hazelton
CFO, Executive VP & Treasurer

Julie Smolinski
investor relations contact

Richard F. Wacker
President, CEO & Director of American Savings Bank FSB

Tayne S. Y. Sekimura
Chief Financial Officer and Senior Vice President

ANALYSTS

Andrew Levi

Jacquelynne Chimera Bohlen
Keefe, Bruyette, & Woods, Inc., Research Division

Julien Patrick Dumoulin-Smith
BofA Merrill Lynch, Research Division

Paul Patterson
Glenrock Associates LLC

Presentation

Operator

Good day, and welcome to the Quarter 2 2018 Hawaiian Electric Industries Earnings Conference Call. [Operator Instructions] Please note this event is being recorded.

And I would now like to turn the conference over to Julie Smolinski, Manager of Investor Relations. Please go ahead.

Julie Smolinski
investor relations contact

Thank you, and welcome to Hawaiian Electric Industries Second Quarter 2018 Earnings Conference Call.

Joining me today are Connie Lau, HEI's President and Chief Executive Officer and Chairman of the Board of Hawaiian Electric Company and American Savings Bank; Greg Hazelton, HEI Executive Vice President and Chief Financial Officer; Alan Oshima, Hawaiian Electric Company's President and Chief Executive Officer; and Rich Wacker, American Savings Bank President and Chief Executive Officer; as well as other members of senior management.

Connie will provide an overview, followed by Greg, who will update you on Hawaii's economy, our results for the second quarter and our outlook for the remainder of the year. Then we will conclude with questions and answers.

During today's call, we will be using non-GAAP financial measures to describe our operating performance. Our press release and webcast presentation are posted on HEI's Investor Relations website and contain reconciliations of these measures to the equivalent GAAP measures. Forward-looking statements will also be made on today's call. Factors that could cause actual result to differ materially from expectations can be found in our webcast slides or filings with the SEC and on the HEI website.

I'll now ask our CEO, Connie Lau, to begin with an overview.

Constance Hee Lau
President, CEO & Director

Thanks, Julie, and aloha to everyone.

In the second quarter, we continued to make significant progress on our strategies across the enterprise and delivered solid results in line with our full year expectations, with consolidated net income of $46 million and consolidated earnings per share of $0.42. Our utilities made major strides on their strategies in the quarter, paving the way for more renewable and more choices for customers while enhancing system resilience and reliability.

Regulatory progress continued at a rapid pace, with our commission issuing several key decisions that helped keep the momentum toward achieving our state's renewable goals.

American continues to perform well, achieving its second consecutive quarter of record net income as it remains focused on making banking easier for customers and deepening relationships with them. We are reaffirming our 2018 earnings guidance, and Greg will go over that in more detail later.

At our utilities, milestones were reached and our transition is back to a triannual rate case cycle, with final commission decisions in June in our Hawaiian Electric Oahu 2017 test year rate case and our Hawaii Electric Light 2016 test year rate case and the filing of a settlement for our Maui Electric 2018 test year rate case. An interim decision from Maui is expected this month.

As part of state policy to reduce fossil fuels and increase renewable energy, the Hawaiian Electric rate case decision included a symmetrical fossil fuel risk-sharing component for utility generation. Variations above or below a benchmark are shared 98% for the customer and 2% to the utility. And the utility's annual upside or downside is capped at $2.5 million. We're working through the details of that mechanism now.

At the same time, the commission expanded the heat rate deadband in recognition that greater operating flexibility strengthens our ability to integrate more renewable sources. We continue to pave the way for more clean energy, and in June, applied to implement the first phase of our grid modernization strategy to enable more renewable generation and more customer options. We are pleased to be receiving national attention for those efforts, with our utilities named Investor-owned Utility of the Year by Smart Electric Power Alliance and featured in a Verizon ad, highlighting our use of their smart sensors to integrate more rooftop solar.

We were also excited to bring our state-of-the-art Schofield Generating Station online in June under budget. The flexible efficient facility runs on biofuels and conventional fuels, improves Oahu's grid resilience and reliability as we add more solar and wind resources. With the commission's decision in June, Schofield also became the first project approved for recovery under the MPIR, or Major Project Interim Recovery mechanism.

In addition, our community-based renewable energy program is off to a strong start after commission approval last month, with applications from organizations seeking to build communities solar facilities already exceeding program capacity on Oahu and Hawaii Island.

Through the performance-based regulation, or PBR docket, we are working together with our commission, the Consumer Advocate and other stakeholders to build additional performance considerations into our existing regulatory framework to further align it with the state's renewable energy policy. We believe this docket will lead to a gradual evolution of our existing framework rather than a wholesale change and that the commission has designed a thoughtful collaborative process that recognizes the importance of avoiding unintended consequences. We see PBR as an opportunity for our company as incentives may be developed to provide revenue opportunities for investment in services without completely changing cost to service regulation. We also view the docket as an opportunity for all stakeholders to align on what is needed to achieve our collective goal of 100% renewable energy, including a financially stable utility and a safe, reliable and resilient grid.

To that end, the first technical workshop amongst stakeholders was held late last month with good discussion on goals and desired outcomes for PBR.

Turning to the bank. As I mentioned, American achieved its second consecutive quarter of record quarterly net income, reflecting a healthy Hawaii economy and good operating execution, while the bank continues to benefit from lower tax rates due to tax reform. American continues to maintain its low-risk profile, strong balance sheet and excellent funding base. Along with making banking easy for customers and building deeper relationships with them, American's new Honolulu campus remains a key focus for the bank. The campus is well on its way to completion and is expected to result in greater efficiencies for both the bank and its customers.

At Pacific Current, our first 2 projects are proceeding well, with our solar plus storage project for the University of Hawaii in the construction phase and our Hamakua Energy project, supplying needed power for Hawaii Island, while the third-party-owned geothermal plant is out of service due to lava activity.

Cash flow from Hamakua Energy continues to fund Pacific Current's start-up costs as we prudently build the organization. Going forward, we see significant opportunity for nonregulated investment to help Hawaii achieve its nation-leading goals in clean energy, renewable ground transportation and carbon neutrality. And we believe Pacific Current is well positioned to participate in that opportunity.

Finally, our companies continue to assist customers who have been affected by the ongoing lava activity in the Puna district on Hawaii Island. While several hundred families have lost their homes and others have had to evacuate, the estimated impact on our consolidated enterprise [indiscernible].

I'll now ask Greg to cover the Hawaii economy, our second quarter financial results and the 2018 outlook.

Gregory C. Hazelton

CFO, Executive VP & Treasurer

Thanks, Connie.

The overall health of Hawaii's economy remains sound as the expansion continues, with ongoing strength in tourism and real estate and a labor force near full employment. At 2.1% in June, Hawaiian unemployment remains at record lows and below the national rate. The tourism expansion that began in 2010 has continued, with the industry building upon its 2017 record results in visitor arrivals and spending. The outlook remains positive, on pace for another record setting year as we approach 10 million visitors, and airlines continued to increase their seats to Hawaii.

Hawaii real estate also remains strong. Year-to-date June on Oahu, sale prices continued to rise due to high demand. While single-family sales volume declined modestly compared to the first half of 2017, condo sales volumes rose. Overall, the Hawaiian economy continues performing well, and the outlook remains positive.

Turning to our financial results. As shown on Slide 6, second quarter earnings increased to $0.42 per share compared to $0.36 per share in the second quarter of 2017. We realized earnings improvement at both the utility and bank, offset in part by higher holding company losses, which were expected due to lower tax benefit on expenses from a reduced federal tax rate and increased borrowing costs. Pacific Current, which is included in the holding company in the other segment, has contributed positively to net income and cash flow year-to-date and has modestly offset some of the holding company losses.

Turning to Slide 7. HEI's consolidated GAAP ROE for the last 12 months was 8.6%, with contributions of 7.2% from utility and 12.3% from the bank. Excluding the onetime impacts of tax reform recorded in the fourth quarter of 2017, HEI's core consolidated ROE for the last 12 months strengthened to 9.2% versus 8.9% for 2017.

Our utility LTM ROE for June 2018 reflects the ongoing transition back to a triannual rate case cycle after no base rate increases for 6 years. This includes 10 months of new rates at Hawaiian Electric Light and 4.5 months of new rates at Hawaiian Electric, our largest utility. We are expecting an interim decision in the Maui electric rate case this month and will also benefit from the recently approved Schofield MPIR recovery. Recovery for Schofield is limited to the simple average rate base in 2018, the first year of our operation, with recovery of substantially all of the plant investment beginning in 2019.

Regarding other major projects. The enterprise resource -- the Enterprise System Project, or ERP, is scheduled to come online in the fourth quarter and under the $78 million cap. And portions of the expenses associated with the ERP are already incorporated into recent rate cases. The balance of their ERP investment will be included in upcoming rate cases.

Our Joint Base Pearl Harbor-Hickam PV project is now scheduled to come online in Q2 2019, with interim recovery through the MPIR beginning next year. Thus, our 2019 ROE should reflect a full year of new rates at all 3 utilities, a full recovery of substantially all of our Schofield investment and partial recoveries on our ERP and Joint Base Pearl Harbor-Hickam PV investments.

Our bank ROE for the last 12 months grew, driven by -- primarily by tax reform, continued low-cost funding and strengthening yields on earning assets.

On Slide 8, utility earnings were $31.2 million in the second quarter of 2018 compared to $25.6 million in the second quarter of 2017. The most significant income drivers were as follows: $8 million higher RAM revenues in 2018, primarily due to lower RAM revenues in the second quarter of 2017 because of the return in 2017 to recording Oahu RAM revenues for accounting purposes on a lagged basis beginning June 1 instead of on a January calendar year basis due to the expiration of a 2013 settlement agreement; and $7 million of rate relief from the now final Hawaiian Electric 2017 and Hawaii Electric Light 2016 test year rate cases.

These amounts were partially offset by $6 million higher O&M expenses compared to 2017, primarily due to the reset of pension costs as part of the rate case interim decisions; lava response costs; and higher vegetation management costs, partially offset by higher overhauls in the prior year's quarter; $2 million higher depreciation expense as a result of increased investment from integration of more renewable energy; improved customer reliability and greater system efficiency; and $2 million lower net income, representing the difference between the tax reform-related reduction in revenue requirements based on test year projections; and our actual second quarter tax reform-related savings.

Turning to the bank on Slide 9. In the second quarter of 2018, American achieved its second consecutive quarter of record quarterly net income, reaching $20.6 million or $3.8 million higher than the second quarter of 2017 and $1.6 million higher in the first or linked quarter of 2018. Compared to the linked quarter, the increase was primarily driven by higher net interest income, which is mainly due to deposit growth that funded the loan portfolio along with a lower provision for loan losses. Compared to the second quarter of 2017, the $3.8 million higher net income was primarily driven by higher net interest income and lower tax expense from the lower federal tax rate, partially offset by lower noninterest income.

On Slide 10, American's solid profitability continued in the second quarter with increased return on assets and continued strong net interest margin. We achieved a return on assets of 120 basis points for the quarter, exceeding our first quarter 2018 return on assets of 112 basis points and our 110 basis point threshold for the year. Net interest margin was 3.6% for the quarter and year-to-date, consistent with the linked quarter and within our guidance range of 3.7% to 3.8%.

On Slide 11, American's net interest margin reflects higher yields on interest-earning assets and continued low-cost deposit growth that funded earning asset growth in loan and investment portfolios. Our interest-earning asset yield of 3.99% increased 1 basis point over the linked quarter.

Our funding costs have remained low in a rising interest rate environment as we continue to benefit from our disciplined approach and our focus on relationship banking. Cost of funds were 24 basis points in the second quarter, just 1 basis point above the linked quarter and well over our peers.

On Slide 12, net interest income grew by approximately 2% compared to the linked quarter, also driven by continued low-cost deposit growth and higher yields on interest-earning assets discussed on the last slide. Total loans as of June 30, 2018, increased by $104 million or 4.4% annualized from December 31, driven mainly by a $91 million increase in commercial real estate loans. We expect to meet our target of low- to mid-single-digit earning asset growth for the year. As of June 30, 2018, deposits increased by $226 million or 7.7% annualized from December 31, including approximately $100 million in repurchase agreements that were transferred into deposit accounts. Excluding such transfers, deposit growth was 4.4 -- 4.2% annualized.

On Slide 13, credit quality remains sound due to prudent risk management and the healthy Hawaii economic environment. Our residential portfolio remains very clean. Consumer unsecured credit quality is in line with expectations, and the commercial and commercial real estate portfolios are stable with improving trends. Provision for loan losses reflected increased reserves for loan growth and additional loan loss reserves for the consumer and residential loan portfolios, partially offset by the release of reserves due to improved credit quality in other portfolios.

Allowance for loan losses of $53 million was 1.11% of outstanding loans at the quarter end, a reduction from 1.14% in the linked quarter and 1.19% in the prior year. Our net charge-off ratio increased to 32 basis points for the second quarter compared to 28 basis points in the linked quarter, primarily driven by our higher-margin unsecured consumer credit portfolio, which remains a profitable area of growth. Nonaccrual loans as a percent of total loans receivable held for investment was 0.57% compared to 0.53% at the end of the linked quarter.

American's asset and funding mix remains attractive relative to peers. 100% of our loan portfolio was funded with low-cost core deposits versus the aggregate of our peer banks at 88%. In the second quarter, total deposits increased by $37 million. Our average cost of funds was 41 basis points lower than the peer median. American also paid $11 million in dividends to HEI in the second quarter while remaining well capitalized at June 30 with a leverage ratio of 8.6% and tangible common equity to tangible assets ratio of 7.6% and total risk-based capital ratio of 13.9%.

As we look ahead to the remainder of the year, we are revising our utility CapEx forecast for 2018 to $400 million from $450 million due to a combination of cost savings and some schedule delays. An estimated $18 million of the decrease is attributable to our Joint Base Pearl Harbor-Hickam PV project representing lower project costs of $10 million as well as our expectation that the project will now be completed in 2019 rather than 2018. An estimated $16 million is due to delays in certain other major projects, including $5 million related to permitting for the Waiau hydro project, $5 million relating to land easements for the Maui substation project as well as lower cost for Schofield as the project was completed under budget. The remainder is due to baseline work delays due to lava flows on the Hawaii Island, technical issues requiring additional planning and other schedule revisions. As a result of these changes to our CapEx forecast, we now expect 2018 rate base growth of 7% to 9% versus 8% to 10% previously forecast.

Turning to our financing outlook on Slide 16. The $50 million decrease in utility CapEx plan resulted in a corresponding decrease of approximately $30 million in HEI's expected 2018 investment in the utility now estimated at $100 million. In addition the lower utility CapEx reduced the utilities' debt requirements by $20 million, resulting in $130 million forecasted for the year, of which $100 million was placed with investors in May.

At the consolidated level, we anticipate no new equity required in 2018 while we manage 2 metrics and a profile consistent with investment-grade ratings.

Turning to Slide 17. We are reaffirming HEI's 2018 earnings guidance in the range of $1.80 to $2 per share. We are working to offset some headwinds, including onetime costs year-to-date, with partial recovery of our Schofield capital investment in our first year of operation under the MPIR mechanism and our lower CapEx outlook for the year. We have revised the utility assumptions for 2018 O&M increase over 2017 to 4%, which is the original 2% plus onetime items year-to-date for smart grid costs incurred before approval of our revised grid modernization strategy and onetime rent expense adjustment for existing substation land, unbudgeted emergency repair work on -- in Oahu transmission line and an increased scope of Maui overhauls.

As discussed earlier, we revised our 2018 CapEx outlook to $400 million, which impacts AFUDC. In 2019, we should benefit from the full year of reset rates across all 3 utilities and a full year of recovery on substantially all of our Schofield investment.

Finally, we do not expect Pacific Current to contribute meaningfully to 2018 earnings, given start-up costs for the year as we build out the platform and team.

Connie will now make closing remarks.

Constance Hee Lau
President, CEO & Director

Thanks, Greg.

In summary, we continue to focus on our enterprise-wide mission of being a catalyst for a better Hawaii. Our utilities advance their work to modernize our grid to facilitate more renewable resources and provide more customer options. The commission decisions issued in the quarter help us move forward and maintain momentum towards our state's renewable goals. Our utilities continue to focus on providing more customer value and on their role in creating resilient, sustainable communities through technology, smart use of resources and partnership building.

At the bank, we continue our work to make banking easier, deepen customer relationships, strengthen efficiencies and enhance asset quality while growing the asset portfolio. And we very much look forward to the new campus opening later this year.

At Pacific Current, our first 2 projects are proceeding well, and we are prudently investing in the build-out of the organization. Overall, our business model continues to provide the financial resources to invest in the strategic growth of our companies and our state's sustainable future whilst supporting our dividend, which our board maintained at $0.31 per share this quarter, continuing our history of uninterrupted dividends since 1901. The dividend yield continues to be attractive at 3.5% as of yesterday's market

close. As always, our companies will continue to focus on providing long-term value for our customer, communities, employees and shareholders.
And now, we look forward to hearing your questions.

Question and Answer

Operator

[Operator Instructions] The first question comes from Julien Dumoulin-Smith of Bank of America.

Julien Patrick Dumoulin-Smith
BofA Merrill Lynch, Research Division

So a couple of questions for you, if I can. First, just going back to some of the commentaries here on the capital spending for the year and more broadly, just what happened in terms of just the trend here for the balance of the year? And should we be worried at all just with respect to implications on forward years at all?

Gregory C. Hazelton
CFO, Executive VP & Treasurer

We don't think it -- that there's any implication for the forward years, and we've maintained our guidance range in the $400 million to $500 million moving forward. The delay in the West Loch PV project has contributed to it some. We did bring Schofield in under budget some. And as is typical, there tends to be some schedule delays, permitting some technical issues, which allow us to fully deploy -- which allowed -- didn't allow us to fully deploy the capital. We also had some work interruptions as we experienced the lava flows on Hawaii Island that had delayed some work as well. So again, I wouldn't extrapolate from that to future years or future periods. In fact, 2019, we'll see some continued investment in the PV project at West loch as well.

Julien Patrick Dumoulin-Smith
BofA Merrill Lynch, Research Division

You preempt sort of the next question. And how should we think about the volcano impacts from the -- an impact year-to-date as well as prospectively for the balance of the year? Maybe describe it in terms of O&M or ROE impact. And does that normalize out in subsequent year? And then similarly, I suppose, what kind of capital investment might be required here as you think about it?

Gregory C. Hazelton
CFO, Executive VP & Treasurer

Capital investment -- the capital investment was related to the lava flows, Julien.

Julien Patrick Dumoulin-Smith
BofA Merrill Lynch, Research Division

Yes -- or yes, just into the future periods, how do you think about, shall we say, reinvestment needs created from the lava flows?

Constance Hee Lau
President, CEO & Director

So Julien, let me break in here. The lava activity is really concentrated on the big island of Hawaii, which is only about maybe 1% or 2% of that entire island, so it is not a huge impact on our consolidated facilities. So that was the reason why, in my remarks, we said that the -- we're not expecting that the impact is going to be material across our entire enterprise, including the bank side, after the 2014 lava flow in that -- relatively the same area. The bank actually stopped making mortgages in that area. So the exposure for both companies is relatively small. Also, on the utility side, some of those areas now the residents have had to -- have been mandatorily evacuated. And people are not yet -- not moving back into those areas, and so we will likely not rebuild those portions of the system. We're looking at some other ways to serve customers that might have been cut off because those were overrun by lava through other means to provide the electricity to those areas. But pretty minor impact and then we also do have insurance coverages for things like the one substation that was impacted.

Julien Patrick Dumoulin-Smith
BofA Merrill Lynch, Research Division

Understood. Okay. Just wanted to sure. And then lastly, can you talk a little bit more on the PBR side of things? Obviously, you covered this a little bit in the remarks. Can you talk about the various mechanisms here and how you see that impacting your earned ROE trends? I suppose there could be some both puts and takes here. But can you talk to some of the higher-level ones discussed?

Constance Hee Lau
President, CEO & Director

Yes. We actually put a slide in the appendix. Let me see if...

Gregory C. Hazelton
CFO, Executive VP & Treasurer

Slide 37.

Constance Hee Lau
President, CEO & Director

Slide 37, and that probably gives you a really good overview of all the performance incentive mechanisms that have been put in place thus far. Starting on the left side of that slide, you can see the reliability one for SAIDI and SAIFI. That totaled about $6.6 million, I think, probably closer to $6.7 million when we actually add them together. And then customer service is both a penalty and incentive, so it goes both ways. And that's roughly $1.3 million there. And then, as I mentioned in the prepared remarks, on the 98%, 2% fuel cost sharing mechanism that was just put in for Oahu, that is capped at $2.5 million, up or down. And then on the resource acquisition side, where we never had been able to earn anything other than just recovering our cost for entering into third-party PPAs with renewable developers, we now have the $3.5 million potential upside for bringing contracts in under targeted cost levels and then a small one for the first phase of demand response. So the commission is beginning to put in these mechanisms, but as you can see from the amounts involved, they're doing it very cautiously and thoughtfully. And that will be the subject for the next 2 years as we go through the PBR docket. First phase is now underway, really evaluating the current regulatory structure to see what parts of it are actually working fine to move us in the direction of achieving state policy and others where there may need to be some tweaking of that. And then Phase 2 will actually be that process to engage all stakeholders and redesign some of the mechanisms.

Julien Patrick Dumoulin-Smith
BofA Merrill Lynch, Research Division

Excellent. Understood. And to be clear about the implementation time line, obviously, this would be phased in. It would seem, right? Or this 2020 would be the timely start. Would you expect that there might be year 1 impacts in terms of having these measures in place? Or to the extent which of these are performance based, I mean, would they sort of accrue over time, right, i.e., you have some period at which you're benchmarked against some metrics and then only the subsequent would you have an impact?

Constance Hee Lau
President, CEO & Director

Yes and it differs by mechanism that...

Alan M. Oshima
President, CEO & Director of Hawaiian Electric Company Inc.

I think you ought to be careful, Julien. What you're looking on the slide are current PBR mechanisms. This is Alan. I'm sorry. The docket really extends for 2 years. So we don't know what's going to emerge, so I really recommend that you follow the docket and really read the PUC's opening on the docket itself and the press release they issued, which really cautions against this is not a quote. This is a gradual process and no unintended consequences to the financial integrity of the utility. So what you see on the slide are current mechanisms. We're also discussing, perhaps, as we upgrade renewables, to make it faster, on, say, the Big Island that's impacted by lava, whether we get an additional mechanism for bringing on more renewables faster. So it's a work in progress. We don't know what's going to come out at the end of the 2 year, but the current -- the first sessions with all stakeholders, I think, everyone loved feeling it was very productive, and there's a basis now to move forward for really informed discussions.

Constance Hee Lau
President, CEO & Director

And Julien, as you can tell, the -- each mechanism is very tailored to a specific circumstance. So as Alan pointed out, the ones on reliability and customer service, we've actually had for a while, and so you have seen the impacts of that already in our results. And the fuel cost sharing one, of course, is just brand new. And resource acquisition relates to the ongoing renewable RFP, and that would be spread over 2 years. One would be -- we get potentially half of that when the contracts are signed and potentially the other half after the project goes into operation so very much tailored to every particular circumstance. And that's part of the intent of the process, is that it is done very thoughtfully.

Operator

The next question comes from Paul Patterson of Glenrock Associates.

Paul Patterson
Glenrock Associates LLC

So like to follow up on the PBR for a second. So -- and I heard your discussion there. What I'm wondering is -- and I apologize if I missed this. There was just a little bit of a quick interruption. But when I look at the stats -- when I look at the filings, et cetera, right now it seems kind of sort of very preliminary, right? When do you think we're going to get a sense as to where they're actually headed in terms of the incentives and penalties and what have you? What's the next date to sort of look out for, I guess, in terms of what we might see in terms of where the commission is actually headed on this?

Alan M. Oshima
President, CEO & Director of Hawaiian Electric Company Inc.

Well, they just started the process. So first -- this is, Paul, Alan. They just started the first group session. That's going to be followed by some filings and additional group sessions. So Tayne can give you maybe a little bit more on that.

Tayne S. Y. Sekimura
Chief Financial Officer and Senior Vice President

This is Tayne. Just to give you some flavor the first technical workshop that we did have, prior to the -- that workshop, the commission staff did issue a report on discussing some broad high-level potential peaks or goals and outcomes. And the -- and actually, during the workshop, I mean, there was a lot of guidance given there. And the next session, which will be held, the technical workshop will be at the end of September, where we'll go through the existing regulatory mechanisms already in place. So there'll be a discussion there. And then following that will be a third session to actually talk specifically about metrics. So the way in which the PUC crafted these sessions was to start with very high-level goals and outcomes, look at what we have and then get into the metrics, so as Alan pointed out, a very measured and rational way of looking at the PBR structure.

Paul Patterson
Glenrock Associates LLC

Okay. So the third session is when, I'm sorry?

Tayne S. Y. Sekimura
Chief Financial Officer and Senior Vice President

The third session is on the metrics, and that'll happen -- let's see.

Paul Patterson
Glenrock Associates LLC

I can find that later. I probably have it. I just was wondering if you had it off your head. The -- okay. So there's going to be workshop and they're going to discuss it. But I guess, is there going to be any testimony filed in terms of where parties are in terms of what they're expecting? Or is that some time to be determined after the third session?

Tayne S. Y. Sekimura
Chief Financial Officer and Senior Vice President

After the first session, there is going to be position papers filed by the parties on August 24 on positions on goals and outcomes. So that would be the next step.

Paul Patterson
Glenrock Associates LLC

Okay. That was very high level -- but that was very high level, right? I mean, that...

Tayne S. Y. Sekimura
Chief Financial Officer and Senior Vice President

Thant's correct.

Paul Patterson
Glenrock Associates LLC

Right. So I mean, so we -- but it sounds like it's going to be closer to the end of the year that we're actually going to see people sort of staking out where things -- where they want things to be or hope to have things to be, will be, what, closer to December or something? Do you follow what I'm saying? The substance is very high level, but I mean, I can't really gather much from it.

Alan M. Oshima
President, CEO & Director of Hawaiian Electric Company Inc.

Paul, we don't know the exact dates the commission might drive people to that. And I also caution that there are a number of parties that are involved in this and so what certain parties may take maybe at the fringes, and the commission is going to really look into the totality of getting a PBR decision in 2 years. So I wouldn't rush to judgment even on the initial filings because it's still a process.

Paul Patterson
Glenrock Associates LLC

Okay. So you guys are basically cautiously optimistic, but very cautious is what I'm gathering, I guess, just because of the amount of work that has to be done. Is that an accurate way to put it -- to describe it or...

Alan M. Oshima
President, CEO & Director of Hawaiian Electric Company Inc.

Let me describe our position. We've always been in favor of a rational performance-based ratemaking. We were the first to propose it back in the 1990s. It's not until recently where you have a landscape upon which we can be measured. And so I think the timing is fine. I really do appreciate the commission's approach to this, to approach it gradually with a lot of input. For example, I don't think many of the people in the docket really knew that we already have some PBR involved in our ratemaking structure. So it's really levelizing the knowledge base, working off the same foundation as we move forward to align everybody in this thing.

Paul Patterson
Glenrock Associates LLC

Okay. But you guys also seem to be still concerned about unintended consequences. And anything you want to flesh out there at all or...

Alan M. Oshima
President, CEO & Director of Hawaiian Electric Company Inc.

Well, it's not only we are concerned about unintended consequences. A lot of the stakeholders are. And so for example, preserving the financial integrity of our utilities when we have so many third-party IPPs that rely on our balance sheet as we're the sole off-taker from their projects to get reasonable cost of financing for those projects really requires, really, a stable financial customer. And so I think as we go through PBR, all these things will be more fully vetted so that people have a fuller understanding of our role and third-party roles on how do we get customer costs to a reasonable level based upon what is incurred in this very, very fast moving 100% renewable project.

Constance Hee Lau
President, CEO & Director

And Paul, I think the good thing is that there is a good solid process that the PUC has put in place so that many voices will come to the table. And as you know, oftentimes, voices, including the utilities, come from one perspective or a few perspectives, and you really need to get all of them on the table for a balanced decision to be made by a regulatory body like our PUC. So there are 9 interveners that have been allowed into the docket and 1 participant, so that's a good thing that there will be a whole range of voices that can be heard.

Paul Patterson
Glenrock Associates LLC

Okay, great. And then just on -- and I apologize if I missed this. The O&M, you now expect to be 4% higher in 2017 versus, I think, previously it was 2%. And now it includes a onetime item, and I apologize for missing this. What was the onetime item? And how much was it?

Gregory C. Hazelton
CFO, Executive VP & Treasurer

We had a couple of items. We have a write-off of a smart grid investment with the approval of our grid -- that was done prior to the approval of our grid modernization strategy about $1.8 million. And then we had a $1 million of lease cost -- legacy lease cost that was essentially a catch-up earlier this year that hadn't been paid previously, so about $2.8 million.

Operator

Our next question comes from Jackie Bohlen of KBW.

Jacquelynne Chimera Bohlen
Keefe, Bruyette, & Woods, Inc., Research Division

Just wanted to dig into the provisions first. With the unchanged guidance of $14 million to $18 million and the expense itself tracking a little over $6 million today, Rich, I wondered if you could just reconcile the low tracking versus what you expect to end up at the end of the year?

Richard F. Wacker
President, CEO & Director of American Savings Bank FSB

It's -- we improved a little bit this quarter with the annual updates of financials from a lot of our customers, and that gave us a little bit lower requirements in this quarter, so that's fairly unique. That doesn't happen every quarter. And so it's really just [lean]. If you look at the sort of the normal run rate that we've been having and [indiscernible] one commercial loan, as we've said for us in a long time, is kind of lumpy, and it's leaving some room for the prospect of the unexpected commercial -- large commercial loan. So I think we're comfortable with the guidance range, and I think you had some special considerations this quarter that are what made it a little bit lower than the normal run rate.

Jacquelynne Chimera Bohlen
Keefe, Bruyette, & Woods, Inc., Research Division

Okay, that makes sense. And then in terms of the commercial portfolio, we've had 2 quarters of expansion now. And I know a lot of the shared national credits, the rundown on that has stopped. So are we at a point where that portfolio will continue to grow barring any outsized payoff?

Richard F. Wacker
President, CEO & Director of American Savings Bank FSB

Right. That's our hope. So as -- we talked a lot last year about sort of restructuring book and bringing down the leverage loan levels, and most of that was, as you mentioned, in the shared national book. So yes, we've got -- we -- by the end of the year, we did what we thought we needed to do, and our goal was to be back on a growth track and have it track our overall portfolio growth targets in that mid-single-digit range.

Jacquelynne Chimera Bohlen
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. And then switching gears over to the net interest margin, which has held up very well despite rising costs that I know we've been seeing. Looking at the loan side first, how much is mix shift driving the increase in loan yields versus just the rise in interest rates?

Richard F. Wacker
President, CEO & Director of American Savings Bank FSB

Right. There's a combination. It's both factors. If I look at this quarter -- give me a second. I'll find this. We look at this quarter, it's fairly balanced between pricing and volume in terms of the growth compared to the prior year.

Jacquelynne Chimera Bohlen
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. And are you seeing in certain portfolios what's coming on the books, coming on at a higher rate than where the portfolio yield is at?

Richard F. Wacker
President, CEO & Director of American Savings Bank FSB

Yes. So this quarter, it was a little bit stronger than last quarter, where production is higher than portfolio rate in every line except our home equity line, which really has those introductory rates on it. So it was a good quarter for that.

Jacquelynne Chimera Bohlen
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. And I would assume where the introductory rates aren't happening, those HELOCs are repricing nicely.

Richard F. Wacker
President, CEO & Director of American Savings Bank FSB

Yes.

Jacquelynne Chimera Bohlen
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. And then just one last one for me on the other side of the balance sheet in terms of deposits. You've done a tremendous job of keeping those costs low. Are you seeing any pressure so far in this quarter? And I guess, what are your expectations as the Fed continues to raise rates?

Richard F. Wacker

President, CEO & Director of American Savings Bank FSB

Yes. I think we expect continued pressure, but our goal is through the efforts that Connie mentioned [indiscernible] banking and what we're doing there to continue to outperform on that and keep lower betas than what some of our other peers might be seeing. That's our goal. But there is pressure. There's more pressure on commercial, especially the larger customers. I think that's clearly where we're seeing more pressure. But overall, we're happy with what we've been able to do, and we hope to kind of be able to keep that going.

Jacquelynne Chimera Bohlen
Keefe, Bruyette, & Woods, Inc., Research Division

Okay. And public funds remain a pretty low source of funds for you.

Richard F. Wacker
President, CEO & Director of American Savings Bank FSB

3% of total deposits.

Operator

Our next question comes from Andrew Levi of ExodusPoint.

Andrew Levi

Just a couple questions and actually, I always have the bank questions [indiscernible] a lot. That was [helpful].

Alan M. Oshima
President, CEO & Director of Hawaiian Electric Company Inc.

We do, too.

Constance Hee Lau
President, CEO & Director

Jackie's good.

Andrew Levi

She is good and I actually enjoy talking to her as well, so very helpful when I do. So back to the utility, just on the PBR mechanisms and all that, I guess, the ones that you have in place right now, have you been easily achieving those mechanisms, the goals?

Constance Hee Lau
President, CEO & Director

Well, for the most part, if you look at them, they're really -- because it started with the reliability ones, those don't have an upside. Those are penalties. So we certainly have been keeping the reliability up and performing to those standards.

Andrew Levi

Okay. And then, I guess, what's being proposed? If I heard correct, it's going to be a 2-year process. Is that what you guys were saying?

Constance Hee Lau
President, CEO & Director

Yes, roughly on the renewable resource performance incentives, that relates to the renewable resource request for proposal that we have out, and it relates to when the contract is actually into and when the project comes online so roughly a 2-year process.

Andrew Levi

Okay. So we really have no idea whether these standards will be easily met or they'll be hard to [take] or whatever it may be.

Alan M. Oshima
President, CEO & Director of Hawaiian Electric Company Inc.

On that, we have the process in place. So while we can't forecast the outcome, we're reasonably optimistic as we will have a good outcome so -- but it's still in process.

Andrew Levi

I got it. I understand.

Gregory C. Hazelton
CFO, Executive VP & Treasurer

That's only upside [indiscernible].

Andrew Levi

Right, right, right, I understand. And then just kind of where we are as we enter August just range wise, how would you categorize for both the bank and utility? Are we kind of in the middle of the range, higher end of the range, low end of the range for each?

Gregory C. Hazelton
CFO, Executive VP & Treasurer

Well, as you can tell, I'd say, on a year-to-date basis, we've performed well, and obviously, the bank continues to improve and provide strong performance. We've had some challenges at the utility because of some onetime costs, but we're still low within the range. We are taking action to offset some of those costs to continue to support our performance. So I -- at this point, I'm not prepared to guide to a point on the range. We're still -- we still got a lot to go in the balance of the year, but I think we're positioned well to perform well within our range.

Andrew Levi

Okay. And then the last question, maybe it's too early to kind of talk about it. But just for financing for '19, will we need equity in '19 or probably not?

Gregory C. Hazelton
CFO, Executive VP & Treasurer

Well, I will provide updated guidance on 2019 once we finished our year-end process and as we report year-end results. As you know, under the Tax Reform Act, that has caused us to fund more of our investments through equity and debt through from a financing perspective. So that's caused us to look at and possibly need equity sooner than otherwise anticipated but -- than where we were previously. And then nonetheless, we'll come out with that guidance when we do 2019. Should we need modest amounts of equity at any point in the range, we also have our efficient dividend reinvestment program that very efficiently meets those -- a fair amount of any equity needs going forward in a very efficient process and throughout the -- throughout each calendar year. We are not taking, just to be clear, any -- our DRIP program is not doing any primary issuances at this point.

Operator

This concludes our question-and-answer session. I would like to turn the conference back over to Julie Smolinski for any closing remarks.

Julie Smolinski
investor relations contact

Thank you, everyone, for joining us today, and we hope you have a wonderful weekend.

Gregory C. Hazelton
CFO, Executive VP & Treasurer

Thank you.

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