

HomeStreet, Inc.
Form 10-Q
August 04, 2016
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended: June 30, 2016

Commission file number: 001-35424

HOMESTREET, INC.

(Exact name of registrant as specified in its charter)

Washington	91-0186600
(State or other jurisdiction of incorporation)	(IRS Employer Identification No.)
601 Union Street, Suite 2000	
Seattle, Washington 98101	
(Address of principal executive offices)	
(Zip Code)	
(206) 623-3050	
(Registrant's telephone number, including area code)	

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act:

Large Accelerated Filer ☐ Accelerated Filer ☒

Non-accelerated Filer ☐ Smaller Reporting Company ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ☐ No ☒

The number of outstanding shares of the registrant's common stock as of August 2, 2016 was 24,826,304.6.

Table of Contents

PART I – FINANCIAL INFORMATION

ITEM 1 FINANCIAL STATEMENTS

<u>Consolidated Statements of Financial Condition (Unaudited) at June 30, 2016 and December 31, 2015</u>	<u>4</u>
<u>Interim Consolidated Statements of Operations (Unaudited) for the Three and Six Months Ended June 30, 2016 and 2015</u>	<u>5</u>
<u>Interim Consolidated Statements of Comprehensive Income (Unaudited) for the Three and Six Months Ended June 30, 2016 and 2015</u>	<u>6</u>
<u>Interim Consolidated Statements of Shareholders' Equity (Unaudited) for the Six Months Ended June 30, 2016 and 2015</u>	<u>7</u>
<u>Interim Consolidated Statements of Cash Flows (Unaudited) for the Six Months Ended June 30, 2016 and 2015</u>	<u>8</u>
<u>Notes to Interim Consolidated Financial Statements (Unaudited)</u>	
<u>Note 1 – Summary of Significant Accounting Policies</u>	<u>10</u>
<u>Note 2 – Business Combinations</u>	<u>12</u>
<u>Note 3 – Investment Securities</u>	<u>15</u>
<u>Note 4 – Loans and Credit Quality</u>	<u>19</u>
<u>Note 5 – Deposits</u>	<u>34</u>
<u>Note 6 – Long-Term Debt</u>	<u>35</u>
<u>Note 7 – Derivatives and Hedging Activities</u>	<u>36</u>
<u>Note 8 – Mortgage Banking Operations</u>	<u>38</u>
<u>Note 9 – Commitments, Guarantees and Contingencies</u>	<u>43</u>
<u>Note 10 – Fair Value Measurement</u>	<u>44</u>
<u>Note 11 – Earnings Per Share</u>	<u>54</u>
<u>Note 12 – Business Segments</u>	<u>55</u>
<u>Note 13 – Accumulated Other Comprehensive Income</u>	<u>57</u>
<u>Note 14 – Subsequent Events</u>	<u>57</u>

ITEM 2

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

<u>Forward-Looking Statements</u>	<u>58</u>
<u>Summary Financial Data</u>	<u>59</u>
<u>Management's Overview of Financial Performance</u>	<u>62</u>
<u>Critical Accounting Policies and Estimates</u>	<u>64</u>
<u>Results of Operations</u>	<u>65</u>
<u>Review of Financial Condition</u>	<u>72</u>
<u>Business Segments</u>	<u>75</u>
<u>Off-Balance Sheet Arrangements</u>	<u>80</u>
<u>Enterprise Risk Management</u>	<u>80</u>
<u>Credit Risk Management</u>	<u>81</u>
<u>Liquidity and Capital Management</u>	<u>86</u>
<u>Accounting Developments</u>	<u>89</u>

Table of Contents

ITEM 3	<u>QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>	<u>90</u>
ITEM 4	<u>CONTROLS AND PROCEDURES</u>	<u>93</u>
<u>PART II – OTHER INFORMATION</u>		
ITEM 1	<u>LEGAL PROCEEDINGS</u>	<u>93</u>
ITEM 1A	<u>RISK FACTORS</u>	<u>94</u>
ITEM 6	<u>EXHIBITS</u>	<u>111</u>
	<u>SIGNATURES</u>	<u>112</u>

Unless we state otherwise or the content otherwise requires, references in this Form 10-Q to “HomeStreet,” “we,” “our,” “us” or the “Company” refer collectively to HomeStreet, Inc., a Washington corporation, HomeStreet Bank (“Bank”), HomeStreet Capital Corporation (“HomeStreet Capital”) and other direct and indirect subsidiaries of HomeStreet, Inc.

PART I
ITEM 1.
FINANCIAL
STATEMENTS

HOMESTREET, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
(Unaudited)

(in thousands, except share data)	June 30, 2016	December 31, 2015
ASSETS		
Cash and cash equivalents (including interest-earning instruments of \$2,557 and \$2,079)	\$45,229	\$32,684
Investment securities (includes \$890,356 and \$541,151 carried at fair value)	928,364	572,164
Loans held for sale (includes \$716,913 and \$632,273 carried at fair value)	772,780	650,163
Loans held for investment (net of allowance for loan losses of \$32,656 and \$29,278; includes \$22,362 and \$21,544 carried at fair value)	3,698,959	3,192,720
Mortgage servicing rights (includes \$130,900 and \$156,604 carried at fair value)	147,266	171,255
Other real estate owned	10,698	7,531
Federal Home Loan Bank stock, at cost	40,414	44,342
Premises and equipment, net	67,884	63,738
Goodwill	19,846	11,521
Other assets	209,738	148,377
Total assets	\$5,941,178	\$4,894,495
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities:		
Deposits	\$4,239,155	\$3,231,953
Federal Home Loan Bank advances	878,987	1,018,159
Accounts payable and other liabilities	138,307	117,251
Long-term debt	125,126	61,857
Total liabilities	5,381,575	4,429,220
Commitments and contingencies (Note 9)		
Shareholders' equity:		
Preferred stock, no par value, authorized 10,000 shares, issued and outstanding, 0 shares and 0 shares	—	—
Common stock, no par value, authorized 160,000,000, issued and outstanding, 24,821,349 shares and 22,076,534 shares	511	511
Additional paid-in capital	276,303	222,328
Retained earnings	273,041	244,885
Accumulated other comprehensive income (loss)	9,748	(2,449)
Total shareholders' equity	559,603	465,275
Total liabilities and shareholders' equity	\$5,941,178	\$4,894,495

See accompanying notes to interim consolidated financial statements (unaudited).

HOMESTREET, INC. AND SUBSIDIARIES
INTERIM CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
(in thousands, except share data)	2016	2015	2016	2015
Interest income:				
Loans	\$47,262	\$ 38,944	\$89,996	\$ 70,591
Investment securities	4,002	3,278	7,055	5,672
Other	27	218	294	423
	51,291	42,440	97,345	76,686
Interest expense:				
Deposits	4,449	3,005	8,018	5,587
Federal Home Loan Bank advances	1,462	906	2,881	1,518
Federal funds purchased and securities sold under agreements to repurchase	—	3	—	8
Long-term debt	823	272	1,134	537
Other	75	24	139	72
	6,809	4,210	12,172	7,722
Net interest income	44,482	38,230	85,173	68,964
Provision for credit losses	1,100	500	2,500	3,500
Net interest income after provision for credit losses	43,382	37,730	82,673	65,464
Noninterest income:				
Net gain on mortgage loan origination and sale activities	85,630	69,974	146,893	131,861
Mortgage servicing income	13,182	1,831	21,311	6,128
Income from WMS Series LLC	1,164	484	1,300	1,048
Depositor and other retail banking fees	1,652	1,399	3,247	2,538
Insurance agency commissions	370	291	764	706
Gain on sale of investment securities available for sale	62	—	97	—
Bargain purchase gain (adjustment)	—	(79)	—	6,549
Other	416	(913)	572	(470)
	102,476	72,987	174,184	148,360
Noninterest expense:				
Salaries and related costs	75,167	61,654	142,451	119,247
General and administrative	16,739	13,955	32,261	26,780
Amortization of core deposit intangibles	525	547	1,057	883
Legal	605	577	1,048	1,044
Consulting	1,177	813	2,849	6,378
Federal Deposit Insurance Corporation assessments	784	861	1,500	1,386
Occupancy	7,513	6,107	14,668	11,947
Information services	8,447	7,714	15,981	13,834
Net cost from operation and sale of other real estate owned	74	107	569	318
	111,031	92,335	212,384	181,817
Income before income taxes	34,827	18,382	44,473	32,007
Income tax expense	13,078	6,006	16,317	9,327
NET INCOME	\$21,749	\$ 12,376	\$28,156	\$ 22,680
Basic income per share	\$0.88	\$ 0.56	\$1.16	\$ 1.16
Diluted income per share	\$0.87	\$ 0.56	\$1.15	\$ 1.14

Edgar Filing: HomeStreet, Inc. - Form 10-Q

Basic weighted average number of shares outstanding	24,708,372	2,028,539	24,192,441	19,593,421
Diluted weighted average number of shares outstanding	24,911,912	2,292,734	24,394,648	19,823,905

See accompanying notes to interim consolidated financial statements (unaudited).

HOMESTREET, INC. AND SUBSIDIARIES
INTERIM CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)

(in thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Net income	\$21,749	\$12,376	\$28,156	\$22,680
Other comprehensive income (loss), net of tax:				
Unrealized gain (loss) on investment securities available for sale:				
Unrealized holding gain (loss) arising during the period, net of tax expense (benefit) of \$3,030 and \$(2,313) for the three months ended June 30, 2016 and 2015, \$6,602 and \$(1,146) for the six months ended June 30, 2016 and 2015, respectively	5,627	(4,295)	12,260	(2,128)
Reclassification adjustment for net gains included in net income, net of tax expense of \$22 and \$0 for the three months ended June 30, 2016 and 2015, and \$34 and \$0 for the six months ended June 30, 2016 and 2015, respectively	(40)	—	(63)	—
Other comprehensive income (loss)	5,587	(4,295)	12,197	(2,128)
Comprehensive income	\$27,336	\$8,081	\$40,353	\$20,552

See accompanying notes to interim consolidated financial statements (unaudited).

HOMESTREET, INC. AND SUBSIDIARIES
INTERIM CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
(Unaudited)

(in thousands, except share data)	Number of shares	Common stock	Additional paid-in capital	Retained earnings	Accumulated other comprehensive income (loss)	Total
Balance, January 1, 2015	14,856,611	\$ 511	\$ 96,615	\$ 203,566	\$ 1,546	\$ 302,238
Net income	—	—	—	22,680	—	22,680
Share-based compensation expense	—	—	598	—	—	598
Common stock issued	7,208,638	—	124,338	—	—	124,338
Other comprehensive loss	—	—	—	—	(2,128)	(2,128)
Balance, June 30, 2015	22,065,249	\$ 511	\$ 221,551	\$ 226,246	\$ (582)	\$ 447,726
Balance, January 1, 2016	22,076,534	\$ 511	\$ 222,328	\$ 244,885	\$ (2,449)	\$ 465,275
Net income	—	—	—	28,156	—	28,156
Share-based compensation expense	—	—	827	—	—	827
Common stock issued	2,744,815	—	53,148	—	—	53,148
Other comprehensive income	—	—	—	—	12,197	12,197
Balance, June 30, 2016	24,821,349	\$ 511	\$ 276,303	\$ 273,041	\$ 9,748	\$ 559,603

See accompanying notes to interim consolidated financial statements (unaudited).

HOMESTREET, INC. AND SUBSIDIARIES
INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Six Months Ended June 30,	
(in thousands)	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$28,156	\$22,680
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation, amortization and accretion	8,565	7,156
Provision for credit losses	2,500	3,500
Net fair value adjustment and gain on sale of loans held for sale	(131,102)	2,265
Fair value adjustment of loans held for investment	1,272	1,679
Origination of mortgage servicing rights	(34,580)	(36,932)
Change in fair value of mortgage servicing rights	57,284	7,075
Net gain on sale of investment securities	(97)	—
Net gain on sale of loans originated as held for investment	(793)	—
Net fair value adjustment, gain on sale and provision for losses on other real estate owned	646	(54)
Loss on disposal of fixed assets	513	28
Net deferred income tax (benefit) expense	(7,951)	4,292
Share-based compensation expense	827	630
Bargain purchase gain	—	(6,549)
Origination of loans held for sale	(3,930,954)	(3,628,598)
Proceeds from sale of loans originated as held for sale	3,931,729	3,265,616
Changes in operating assets and liabilities:		
Increase in other assets	(51,974)	(24,903)
Increase in accounts payable and other liabilities	17,077	24,706
Net cash used in operating activities	(108,882)	(357,409)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of investment securities	(356,975)	(49,972)
Proceeds from sale of investment securities	11,467	—
Principal repayments and maturities of investment securities	37,099	16,290
Proceeds from sale of other real estate owned	164	2,142
Proceeds from sale of loans originated as held for investment	39,022	—
Proceeds from sale of mortgage servicing rights	—	3,825
Mortgage servicing rights purchased from others	—	(6)
Capital expenditures related to other real estate owned	(32)	—
Origination of loans held for investment and principal repayments, net	(414,089)	(134,003)
Proceeds from sale of property and equipment	1,148	—
Purchase of property and equipment	(12,151)	(11,676)
Net cash acquired from acquisitions	17,495	112,196
Net cash used in investing activities	(676,852)	(61,204)

(in thousands)	Six Months Ended June 30,	
	2016	2015
CASH FLOWS FROM FINANCING ACTIVITIES:		
Increase in deposits, net	\$880,701	\$226,021
Proceeds from Federal Home Loan Bank advances	7,621,460	3,934,500
Repayment of Federal Home Loan Bank advances	(7,774,960)	(3,675,000)
Federal funds purchased and proceeds from securities sold under agreements to repurchase	—	73,004
Repayment of securities sold under agreements to repurchase	—	(123,004)
Proceeds from Federal Home Loan Bank stock repurchase	123,038	27,685
Purchase of Federal Home Loan Bank stock	(117,879)	(28,993)
Proceeds from debt issuance, net	63,255	—
Proceeds from stock issuance, net	2,664	127
Excess tax benefit related to the exercise of stock options	—	(32)
Net cash provided by financing activities	798,279	434,308
NET INCREASE IN CASH AND CASH EQUIVALENTS	12,545	15,695
CASH AND CASH EQUIVALENTS:		
Beginning of year	32,684	30,502
End of period	\$45,229	\$46,197
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid during the period for:		
Interest paid	\$14,905	\$7,677
Federal and state income taxes paid (refunds), net	(1,464)	16,281
Non-cash activities:		
Loans held for investment foreclosed and transferred to other real estate owned	1,168	4,095
Loans transferred from held for investment to held for sale	37,648	15,899
Loans transferred from held for sale to held for investment	7,129	25,668
(Reduction in) Ginnie Mae loans recognized with the right to repurchase, net	(2,725)	594
Simplicity acquisition:		
Assets acquired, excluding cash acquired	—	737,483
Liabilities assumed	—	718,916
Bargain purchase gain	—	6,549
Common stock issued	—	124,214
Orange County Business Bank acquisition:		
Assets acquired, excluding cash acquired	165,822	—
Liabilities assumed	141,267	—
Goodwill	8,325	—
Common stock issued	\$50,373	\$—

See accompanying notes to interim consolidated financial statements (unaudited).

HomeStreet, Inc. and Subsidiaries
Notes to Interim Consolidated Financial Statements (Unaudited)

NOTE 1—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

HomeStreet, Inc. and its wholly owned subsidiaries (the “Company”) is a diversified financial services company serving customers primarily in the western United States, including Hawaii. The Company is principally engaged in real estate lending, including mortgage banking activities, and commercial and consumer banking. The consolidated financial statements include the accounts of HomeStreet, Inc. and its wholly owned subsidiaries, HomeStreet Capital Corporation and HomeStreet Bank (the “Bank”), and the Bank’s subsidiaries, HomeStreet/WMS, Inc., HomeStreet Reinsurance, Ltd., Continental Escrow Company, HS Properties, Inc. and Union Street Holdings LLC. HomeStreet Bank was formed in 1986 and is a state-chartered commercial bank.

The Company’s accounting and financial reporting policies conform to accounting principles generally accepted in the United States of America (U.S. GAAP). Inter-company balances and transactions have been eliminated in consolidation. Equity investments through which we are able to exercise significant influence over but do not control the investee and are not the primary beneficiary of the investee’s activities are accounted for using the equity method. In preparing the consolidated financial statements, the Company is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the financial statements and revenues and expenses during the reporting periods and related disclosures. These estimates that require application of management’s most difficult, subjective or complex judgments often result in the need to make estimates about the effect of matters that are inherently uncertain and may change in future periods. Management has made significant estimates in several areas, including the fair value of assets acquired and liabilities assumed in business combinations (Note 2, Business Combinations), allowance for credit losses (Note 4, Loans and Credit Quality), valuation of residential mortgage servicing rights and loans held for sale (Note 8, Mortgage Banking Operations), valuation of certain loans held for investment (Note 4, Loans and Credit Quality), valuation of investment securities (Note 3, Investment Securities), and valuation of derivatives (Note 7, Derivatives and Hedging Activities). Certain amounts in the financial statements from prior periods have been reclassified to conform to the current financial statement presentation.

These unaudited interim financial statements reflect all adjustments that are, in the opinion of management, necessary for a fair statement of the results for the periods presented. These adjustments are of a normal recurring nature, unless otherwise disclosed in this Form 10-Q. The results of operations in the interim financial statements do not necessarily indicate the results that may be expected for the full year. The interim financial information should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2015, filed with the Securities and Exchange Commission (“2015 Annual Report on Form 10-K”).

Recent Accounting Developments

On June 16, 2016, the FASB issued Accounting Standards Update (“ASU”) 2016-13, Financial Instruments-Credit Losses (Topic 326). The amendments in this ASU were issued to provide financial statement users with more decision-useful information about the current expected credit losses (CECL) on financial instruments that are not accounted for at fair value through net income, including loans held for investment, held-to-maturity debt securities, trade and other receivables, net investment in leases and other commitments to extend credit held by a reporting entity at each reporting date. The amendments to this ASU require that financial assets measured at amortized cost be presented at the net amount expected to be collected, through an allowance for credit losses that is deducted from the amortized cost basis. The amendments in this ASU eliminate the probable initial recognition in current GAAP and reflect an entity’s current estimate of all expected credit losses. The measurement of expected credit losses is based upon historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the financial assets.

For purchased financial assets with a more-than-insignificant amount of credit deterioration since origination (“PCD assets”) that are measured at amortized cost, the initial allowance for credit losses is added to the purchase price rather than being reported as a credit loss expense. Subsequent changes in the allowance for credit losses on PCD assets are recognized through the statement of income as a credit loss expense.

Credit losses relating to available-for-sale debt securities will be recorded through an allowance for credit losses rather than as a direct write-down to the security.

The amendments to this ASU are effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. The amendments in this ASU should be applied on a modified-retrospective transition approach that would require a cumulative-effect adjustment to the opening retained earnings in the statement of financial condition as of the date of

adoption. A prospective transition approach is required for debt securities for which an other-than-temporary impairment had been recognized before the effective date. The Company is currently evaluating the impact of this ASU and the Company expects this ASU to have a material impact on the Company's consolidated financial statements.

On March 30, 2016, the FASB issued ASU 2016-09, Stock Compensation (Topic 718), Improvements to Employee Share-Based Payment Accounting. The FASB issued this ASU as part of its initiative to reduce complexity in accounting standards. This new accounting standard simplifies several areas of accounting for share-based payment transactions, including tax provision, classification in the cash-flow statement, forfeitures, and statutory tax withholding requirements. The amendments in this ASU are effective for annual periods beginning after December 15, 2016, including interim periods within those annual periods. Early application was permitted upon issuance of the ASU. The Company determined to early adopt the provisions of ASU 2016-09 during the second quarter of 2016 and determined the new standard did not have a material impact on the Company's Consolidated Financial Statements.

On February 25 2016, the FASB issued ASU 2016-02, Leases (Topic 842). The amendments in this ASU require lessees to recognize a lease liability, which is a lessee's obligation to make lease payments arising from a lease, and a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. This ASU simplifies the accounting for sale and leaseback transactions. The amendments in this ASU are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early application was permitted upon issuance of the ASU. Lessees (for capital and operating leases) and lessors (for sales-type, direct financing, and operating leases) must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The modified retrospective approach would not require any transition accounting for leases that expired before the earliest comparative period presented. Lessees and lessors may not apply a full retrospective transition approach. The Company is currently evaluating the provisions of this guidance to determine the potential impact the new standard will have on the Company's consolidated financial statements.

On September 25, 2015, the FASB issued ASU 2015-16, Simplifying the Accounting for Measurement-Period Adjustments. The ASU was issued to simplify the accounting for measurement period adjustments for business combinations. The amendments in the ASU require that the acquirer recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amount is determined. The acquirer is required to also record, in the same period's financial statements, the effect on earnings of changes in depreciation, amortization, or other income effects, if any, as a result of the change to the provisional amounts, calculated as if the accounting had been completed at the acquisition date. In addition, an entity is required to present separately on the face of the income statement or disclose in the notes to the financial statements the portion of the amount recorded in current-period earnings by line item that would have been recorded in previous reporting periods if the adjustment to the provisional amounts had been recognized as of the acquisition date. For public business entities, the amendments in this ASU were effective for fiscal years beginning after December 15, 2015, including interim periods within those fiscal years. The Company adopted this guidance during the first quarter of 2016 and applied it prospectively to adjustments to provisional amounts.

On April 7, 2015, the FASB issued ASU 2015-03, Simplifying the Presentation of Debt Issuance Costs. The ASU was issued to simplify the presentation of debt issuance costs. This guidance requires that debt issuance costs related to a recognized debt liability be presented on the statement of financial condition as a direct deduction from the carrying amount of that debt liability, consistent with the presentation of debt discounts. This guidance became effective for the Company for the interim and annual periods beginning after December 15, 2015, and early adoption was permitted for financial statements that had not been previously issued. The guidance is required to be applied on a retrospective basis to each individual period presented on the statement of financial condition. The Company adopted this guidance during the first quarter of 2016 and determined there was no material impact on the Company's consolidated financial statements.

On April 15, 2015, the FASB issued ASU 2015-05, Customer's Accounting for Fees Paid in Cloud Computing Arrangement. The ASU was issued to clarify a customer's accounting for fees paid in a cloud computing arrangement. The amendments provide guidance to customers in determining whether a cloud computing arrangement includes a software license that should be accounted for as internal-use software. If the arrangement does not contain a software license, it would be accounted for as a service contract. This guidance became effective for the Company for the interim and annual periods beginning after December 15, 2015; early adoption was permitted. The Company could elect to adopt the amendments either (1) prospectively to all arrangements entered into or materially modified after the effective date or (2) retrospectively. The Company adopted this guidance during the first quarter of 2016 and determined there was no material impact on the Company's consolidated financial statements.

In February 2015, the FASB issued ASU 2015-02, Consolidation. The ASU provides an additional requirement for a limited partnership or similar entity to qualify as a voting interest entity, amending the criteria for consolidating such an entity and eliminating the deferral provided under previous guidance for investment companies. In addition, the new guidance amends the criteria for evaluating fees paid to a decision maker or service provider as a variable interest and amends the criteria for evaluating the effect of fee arrangements and related parties on a variable interest entity ("VIE") primary beneficiary determination. This guidance was effective for interim and annual reporting periods beginning after December 15, 2015. The Company adopted this guidance during the first quarter of 2016 and determined there was no material impact on the Company's consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606). This ASU clarifies the principles for recognizing revenue from contracts with customers. On August 12, 2015, the FASB issued ASU 2015-14 to defer the effective date of ASU 2014-09. Public business entities, certain not-for-profit entities, and certain employee benefit plans should apply the guidance in ASU 2014-09 to annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. Earlier application is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. On March 17, 2016, the FASB issued Accounting Standards Update 2016-08 to clarify the implementation guidance on principal versus agent considerations. The adoption of this guidance is not expected to have a material impact on the Company's consolidated financial statements.

NOTE 2—BUSINESS COMBINATIONS:

Recent Acquisition Activity

On February 1, 2016, the Company completed its acquisition of Orange County Business Bank ("OCBB") located in Irvine, California through the merger of OCBB with and into HomeStreet Bank with HomeStreet Bank as the surviving subsidiary. The purchase price of this acquisition was \$55.9 million. OCBB shareholders as of the effective time received merger consideration equal to 0.5206 shares of HomeStreet common stock, and \$1.1641 in cash upon the surrender of their OCBB shares, which resulted in the issuance of 2,459,408 shares of HomeStreet common stock. The provisional application of the acquisition method of accounting resulted in goodwill of \$8.3 million. The primary objective for this acquisition is to grow our Commercial and Consumer Banking segment. Along with two de novo branches opened in California during the quarter, adding Orange County Business Bank's branch brings HomeStreet's Southern California retail deposit branch network to ten locations.

On December 11, 2015, the Company acquired a former AmericanWest Bank retail deposit branch and certain related assets located in Dayton, Washington. This acquisition increases HomeStreet's network of branches in eastern Washington to a total of five retail deposit branches. The Company purchased the branch from Banner Bank, which had recently acquired AmericanWest Bank. The purchase resulted in a bargain purchase gain of \$381 thousand.

Simplicity Acquisition

On March 1, 2015, the Company completed its acquisition of Simplicity Bancorp, Inc., a Maryland corporation ("Simplicity") and Simplicity's wholly owned subsidiary, Simplicity Bank. Simplicity's principal business activities prior to the merger were attracting retail deposits from the general public, originating or purchasing loans, primarily loans secured by first mortgages on owner-occupied, one-to-four family residences and multifamily residences located in Southern California and, to a lesser extent, commercial real estate, automobile and other consumer loans; and the origination and sale of fixed-rate, conforming, one-to-four family residential real estate loans in the secondary market, usually with servicing retained. The primary objective for this acquisition was to grow our Commercial and Consumer Banking segment by expanding the business of the former Simplicity branches by offering additional banking and lending products to former Simplicity customers as well as new customers. The acquisition was accomplished by the merger of Simplicity with and into HomeStreet, Inc. with HomeStreet, Inc. as the surviving corporation, followed by

the merger of Simplicity Bank with and into HomeStreet Bank with HomeStreet Bank as the surviving subsidiary. The results of operations of Simplicity are included in the consolidated results of operations from the date of acquisition.

At the closing, there were 7,180,005 shares of Simplicity common stock, par value \$0.01, outstanding, all of which were cancelled and exchanged for an equal number of shares of HomeStreet common stock, no par value, issued to Simplicity's stockholders. In connection with the merger, all outstanding options to purchase Simplicity common stock were cancelled in exchange for a cash payment equal to the difference between a calculated price of HomeStreet common stock and the exercise price of the option, provided, however, that any options that were out-of-the-money at the time of closing were cancelled for no consideration. The calculated price of \$17.53 was determined by averaging the closing price of HomeStreet common stock for

the 10 trading days prior to but not including the 5th business day before the closing date. The aggregate consideration paid by us in the Simplicity acquisition was approximately \$471 thousand in cash and 7,180,005 shares of HomeStreet common stock with a fair value of approximately \$124.2 million as of the acquisition date. We used current liquidity sources to fund the cash consideration.

The acquisition was accounted for under the acquisition method of accounting pursuant to ASC 805, Business Combinations. The assets and liabilities, both tangible and intangible, were recorded at their estimated fair values as of acquisition date. The Company made significant estimates and exercised significant judgment in estimating the fair values and accounting for such acquired assets and assumed liabilities.

A summary of the consideration paid, the assets acquired and liabilities assumed in the merger are presented below:
(in thousands) March 1, 2015

Fair value consideration paid to Simplicity shareholders:

Cash paid (79,399 stock options, consideration based on intrinsic value at a calculated price of \$17.53)	\$471
Fair value of common shares issued (7,180,005 shares at \$17.30 per share)	124,214
Total purchase price	\$124,685
Fair value of assets acquired:	
Cash and cash equivalents	112,667
Investment securities	26,845
Acquired loans	664,148
Mortgage servicing rights	980
Federal Home Loan Bank stock	5,520
Premises and equipment	2,966
Bank-owned life insurance	14,501
Core deposit intangibles	7,450
Accounts receivable and other assets	15,869
Total assets acquired	850,946
Fair value of liabilities assumed:	
Deposits	651,202
Federal Home Loan Bank advances	65,855
Accounts payable and accrued expenses	1,859
Total liabilities assumed	718,916
Net assets acquired	\$132,030
Bargain purchase (gain)	\$(7,345)

The application of the acquisition method of accounting resulted in a bargain purchase gain of \$7.3 million which was reported as a component of noninterest income on our consolidated statements of operations. A substantial portion of the assets acquired from Simplicity were mortgage-related assets, which generally decrease in value as interest rates rise and increase in value as interest rates fall. The bargain purchase gain was driven largely by a substantial decline in long-term interest rates between the period shortly after our announcement of the Simplicity acquisition and its closing, which resulted in an increase in the fair value of the acquired mortgage assets and the overall net fair value of assets acquired. In addition, the Company believes it was able to acquire Simplicity for less than the fair value of its net assets due to Simplicity's stock trading below its book value for an extended period of time prior to the announcement of the acquisition. The Company negotiated a purchase price per share for Simplicity that was above the prevailing stock price thereby representing a premium to the shareholders. The stock consideration transferred was based on a 1:1 stock conversion ratio. The price of the Company's shares declined between the time the deal was announced and when it closed which also attributed to the bargain purchase gain. The acquisition of Simplicity by the

Company was approved by Simplicity's shareholders. For tax purposes, the bargain purchase gain is a non-taxable event.

The operations of Simplicity are included in the Company's operating results as of the acquisition date of March 1, 2015. Acquisition-related costs were expensed as incurred in noninterest expense as merger and integration costs.

The following table provides a breakout of merger-related expense for the six months ended June 30, 2015:

	Six Months Ended June 30, 2015
(in thousands)	

Noninterest expense	
Salaries and related costs	\$7,676
General and administrative	1,249
Legal	351
Consulting	5,751
Occupancy	383
Information services	(37)
Total noninterest expense	\$15,373

The \$664.1 million estimated fair value of loans acquired from Simplicity was determined by utilizing a discounted cash flow methodology considering credit and interest rate risk. Cash flows were determined by estimating future credit losses and the rate of prepayments. Projected monthly cash flows were then discounted to present value based on the Company's weighted average cost of capital. The discount for acquired loans from Simplicity was \$16.6 million as of the acquisition date.

A core deposit intangible ("CDI") of \$7.5 million was recognized related to the core deposits acquired from Simplicity. A discounted cash flow method was used to estimate the fair value of the certificates of deposit. The CDI is amortized over its estimated useful life of approximately ten years using an accelerated method and will be reviewed for impairment quarterly.

The fair value of savings and transaction deposit accounts was assumed to approximate the carrying value as these accounts have no stated maturity and are payable on demand. A discounted cash flow method was used to estimate the fair value of the certificates of deposit. A premium, which will be amortized over the contractual life of the deposits, of \$4.0 million was recorded for certificates of deposit.

The fair value of Federal Home Loan Bank advances was estimated using a discounted cash flow method. A premium, which will be amortized over the contractual life of the advances, of \$855 thousand was recorded for the Federal Home Loan Bank advances.

The Company determined that meeting the disclosure requirements related to the amounts of revenues and earnings of the acquiree included in the consolidated statements of operations since the acquisition date is impracticable. The financial activity and operating results of the acquiree were commingled with the Company's financial activity and operating results as of the acquisition date.

Unaudited Pro Forma Results of Operations

The following table presents our unaudited pro forma results of operations for the periods presented as if the Simplicity acquisition had been completed on January 1, 2014. The unaudited pro forma results of operations include the historical accounts of Simplicity and pro forma adjustments as may be required, including the amortization of intangibles with definite lives and the amortization or accretion of any premiums or discounts arising from fair value adjustments for assets acquired and liabilities assumed. The unaudited pro forma information is intended for informational purposes only and is not necessarily indicative of our future operating results or operating results that would have occurred had the Simplicity acquisition been completed at the beginning of 2014. No assumptions have been applied to the pro forma results of operations regarding possible revenue enhancements, expense efficiencies or asset dispositions.

(in thousands, except share data)	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Net interest income	\$44,482	\$ 38,370	\$85,173	\$ 73,587
Provision for credit losses	1,100	500	2,500	3,500
Total noninterest income	102,476	73,070	174,184	142,563
Total noninterest expense	111,031	89,095	212,384	174,686
Net income	\$21,749	\$ 14,384	\$28,156	\$ 25,599
Basic income per share	\$0.88	\$ 0.65	\$1.16	\$ 1.16
Diluted income per share	\$0.87	\$ 0.65	\$1.15	\$ 1.15
Basic weighted average number of shares outstanding	24,708,372	22,028,539	24,192,442	22,033,644
Diluted weighted average number of shares outstanding	24,911,912	22,292,734	24,394,642	22,165,741

NOTE 3—INVESTMENT SECURITIES:

The following table sets forth certain information regarding the amortized cost and fair values of our investment securities available for sale.

(in thousands)	At June 30, 2016			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Mortgage-backed securities:				
Residential	\$138,277	\$ 1,109	\$ (312)	\$139,074
Commercial	24,271	436	—	24,707
Municipal bonds	326,717	9,120	(36)	335,801
Collateralized mortgage obligations:				
Residential	161,963	1,850	(407)	163,406
Commercial	114,475	1,713	(89)	116,099
Corporate debt securities	83,611	2,059	(421)	85,249
U.S. Treasury securities	26,019	1	—	26,020
	\$875,333	\$ 16,288	\$ (1,265)	\$890,356

(in thousands)	At December 31, 2015			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Mortgage-backed securities:				
Residential	\$69,342	\$ 19	\$ (1,260)	\$68,101
Commercial	18,142	14	(305)	17,851
Municipal bonds	168,722	3,460	(313)	171,869
Collateralized mortgage obligations:				
Residential	86,167	32	(1,702)	84,497
Commercial	80,190	43	(1,100)	79,133
Corporate debt securities	81,280	125	(2,669)	78,736
U.S. Treasury securities	41,047	—	(83)	40,964
	\$544,890	\$ 3,693	\$ (7,432)	\$541,151

Mortgage-backed securities ("MBS") and collateralized mortgage obligations ("CMO") represent securities issued by government sponsored enterprises ("GSEs"). Each of the MBS and CMO securities in our investment portfolio are guaranteed by Fannie Mae, Ginnie Mae or Freddie Mac. Municipal bonds are comprised of general obligation bonds (i.e., backed by the general credit of the issuer) and revenue bonds (i.e., backed by revenues from the specific project being financed) issued by various municipal corporations. As of June 30, 2016 and December 31, 2015, all securities held, including municipal bonds and corporate debt securities, were rated investment grade based upon external ratings where available and, where not available, based upon internal ratings which correspond to ratings as defined by Standard and Poor's Rating Services ("S&P") or Moody's Investors Services ("Moody's"). As of June 30, 2016 and December 31, 2015, substantially all securities held had ratings available by external ratings agencies.

Investment securities available for sale that were in an unrealized loss position are presented in the following tables based on the length of time the individual securities have been in an unrealized loss position.

(in thousands)	At June 30, 2016					
	Less than 12 months		12 months or more		Total	
	Gross unrealized losses	Fair value	Gross unrealized losses	Fair value	Gross unrealized losses	Fair value
Mortgage-backed securities:						
Residential	\$(31)	\$2,047	\$(281)	\$17,584	\$(312)	\$19,631
Municipal bonds	(29)	9,814	(7)	2,218	(36)	12,032
Collateralized mortgage obligations:						
Residential	(107)	18,875	(300)	10,331	(407)	29,206
Commercial	(40)	14,351	(49)	3,997	(89)	18,348
Corporate debt securities	—	—	(421)	11,119	(421)	11,119
U.S. Treasury securities	—	25,020	—	—	—	25,020
	\$(207)	\$70,107	\$(1,058)	\$45,249	\$(1,265)	\$115,356

Edgar Filing: HomeStreet, Inc. - Form 10-Q

(in thousands)	At December 31, 2015					
	Less than 12 months		12 months or more		Total	
	Gross unrealized losses	Fair value	Gross unrealized losses	Fair value	Gross unrealized losses	Fair value
Mortgage-backed securities:						
Residential	\$(572)	\$36,477	\$(688)	\$21,119	\$(1,260)	\$57,596
Commercial	(305)	16,072	—	—	(305)	16,072
Municipal bonds	(211)	21,302	(101)	5,839	(312)	27,141
Collateralized mortgage obligations:						
Residential	(673)	50,490	(1,029)	26,028	(1,702)	76,518
Commercial	(986)	60,812	(115)	4,348	(1,101)	65,160
Corporate debt securities	(1,142)	36,953	(1,527)	27,405	(2,669)	64,358
U.S. Treasury securities	(83)	40,964	—	—	(83)	40,964
	\$(3,972)	\$263,070	\$(3,460)	\$84,739	\$(7,432)	\$347,809

The Company has evaluated securities available for sale that are in an unrealized loss position and has determined that the decline in value is temporary and is related to the change in market interest rates since purchase. The decline in value is not related to any issuer- or industry-specific credit event. The Company has not identified any expected credit losses on its debt securities as of June 30, 2016 and December 31, 2015. In addition, as of June 30, 2016 and December 31, 2015, the Company had not made a decision to sell any of its debt securities held, nor did the Company consider it more likely than not that it would be required to sell such securities before recovery of their amortized cost basis.

The following tables present the fair value of investment securities available for sale by contractual maturity along with the associated contractual yield for the periods indicated below. Contractual maturities for mortgage-backed securities and collateralized mortgage obligations as presented exclude the effect of expected prepayments. Expected maturities will differ from contractual maturities because borrowers may have the right to prepay obligations before the underlying mortgages mature. The weighted-average yield is computed using the contractual coupon of each security weighted based on the fair value of each security and does not include adjustments to a tax equivalent basis.

(dollars in thousands)	At June 30, 2016									
	Within one year		After one year through five years		After five years through ten years		After ten years		Total	
	Fair Value	Weighted Average Yield	Fair Value	Weighted Average Yield	Fair Value	Weighted Average Yield	Fair Value	Weighted Average Yield	Fair Value	Weighted Average Yield
Mortgage-backed securities:										
Residential	\$—	— %	\$2	0.33 %	\$2,645	1.57 %	\$136,427	1.76 %	\$139,074	1.76 %
Commercial	—	—	22,885	2.15	1,822	3.01	—	—	24,707	2.21
Municipal bonds	2,232	3.55	10,337	3.06	54,895	2.51	268,337	3.80	335,801	3.57
Collateralized mortgage obligations:										
Residential	—	—	—	—	3,037	1.30	160,369	1.78	163,406	1.78
Commercial	—	—	22,537	2.11	53,505	2.48	40,057	1.99	116,099	2.24

Edgar Filing: HomeStreet, Inc. - Form 10-Q

Corporate debt securities	—	—	17,464	2.96	30,884	3.33	36,901	4.15	85,249	3.61
U.S. Treasury securities	25,020	0.36	1,000	0.64	—	—	—	—	26,020	0.37
Total available for sale	\$27,252	0.62 %	\$74,225	2.43 %	\$146,788	2.64 %	\$642,091	2.76 %	\$890,356	2.65 %

Edgar Filing: HomeStreet, Inc. - Form 10-Q

(dollars in thousands)	At December 31, 2015									
	Within one year		After one year through five years		After five years through ten years		After ten years		Total	
	Fair Value	Weighted Average Yield	Fair Value	Weighted Average Yield	Fair Value	Weighted Average Yield	Fair Value	Weighted Average Yield	Fair Value	Weighted Average Yield
Mortgage-backed securities:										
Residential	\$—	— %	\$4	0.39 %	\$3,176	1.63 %	\$64,921	1.88 %	\$68,101	1.87 %
Commercial	—	—	—	—	17,851	2.20	—	—	17,851	2.20
Municipal bonds	510	2.09	8,828	3.33	31,806	3.16	130,725	3.99	171,869	3.79
Collateralized mortgage obligations:										
Residential	—	—	—	—	153	0.92	84,344	1.74	84,497	1.74
Commercial	—	—	5,354	1.87	56,506	2.29	17,273	1.87	79,133	2.17
Corporate debt securities	—	—	10,413	2.70	38,291	3.20	30,032	3.64	78,736	3.31
U.S. Treasury securities	39,971	0.39	993	0.63	—	—	—	—	40,964	0.40
Total available for sale	\$40,481	0.41 %	\$25,592	2.65 %	\$147,783	2.69 %	\$327,295	2.83 %	\$541,151	2.60 %

Sales of investment securities available for sale were as follows.

	Three Months Ended June 30,		Six Months Ended June 30,	
(in thousands)	2016	2015	2016	2015
Proceeds	\$1,706	\$—	\$11,467	\$—
Gross gains	62	—	97	—
Gross losses	\$—	\$—	\$—	\$—

The following table summarizes the carrying value of securities pledged as collateral to secure public deposits, borrowings and other purposes as permitted or required by law:

(in thousands)	At June 30, 2016
Federal Home Loan Bank to secure borrowings	\$122,085
Washington and California State to secure public deposits	31,218
Securities pledged to secure derivatives in a liability position	24,585
Other securities pledged	4,985
Total securities pledged as collateral	\$182,873

The Company assesses the creditworthiness of the counterparties that hold the pledged collateral and has determined that these arrangements have little risk. There were no securities pledged under repurchase agreements at June 30, 2016 and December 31, 2015.

Tax-exempt interest income on securities available for sale totaling \$1.5 million and \$852 thousand for the three months ended June 30, 2016 and 2015, respectively, and \$2.4 million and \$1.6 million for the six months ended June 30, 2016 and 2015, respectively, was recorded in the Company's consolidated statements of operations.

NOTE 4—LOANS AND CREDIT QUALITY:

For a detailed discussion of loans and credit quality, including accounting policies and the methodology used to estimate the allowance for credit losses, see Note 1, Summary of Significant Accounting Policies, and Note 5, Loans and Credit Quality, within our 2015 Annual Report on Form 10-K.

The Company's portfolio of loans held for investment is divided into two portfolio segments, consumer loans and commercial loans, which are the same segments used to determine the allowance for loan losses. Within each portfolio segment, the Company monitors and assesses credit risk based on the risk characteristics of each of the following loan classes: single family and home equity and other loans within the consumer loan portfolio segment and commercial real estate, multifamily, construction/land development and commercial business loans within the commercial loan portfolio segment.

Loans held for investment consist of the following:

(in thousands)	At June 30, 2016	At December 31, 2015
Consumer loans		
Single family ⁽¹⁾	\$ 1,218,216	\$ 1,203,180
Home equity and other	309,204	256,373
	1,527,420	1,459,553
Commercial loans		
Commercial real estate	762,170	600,703
Multifamily	562,728	426,557
Construction/land development	639,441	583,160
Commercial business	239,077	154,262
	2,203,416	1,764,682
	3,730,836	3,224,235
Net deferred loan fees and costs	779	(2,237)
	3,731,615	3,221,998
Allowance for loan losses	(32,656)	(29,278)
	\$ 3,698,959	\$ 3,192,720

Includes \$22.4 million and \$21.5 million at June 30, 2016 and December 31, 2015, respectively, of loans where a (1) fair value option election was made at the time of origination and, therefore, are carried at fair value with changes recognized in the consolidated statements of operations.

Loans in the amount of \$1.72 billion and \$1.73 billion at June 30, 2016 and December 31, 2015, respectively, were pledged to secure borrowings from the FHLB as part of our liquidity management strategy. Additionally, loans totaling \$522.8 million and \$572.0 million at June 30, 2016 and December 31, 2015, respectively, were pledged to secure borrowings from the Federal Reserve Bank. The FHLB and Federal Reserve Bank do not have the right to sell or re-pledge these loans.

Credit Risk Concentrations

Concentrations of credit risk arise when a number of customers are engaged in similar business activities or activities in the same geographic region, or when they have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic conditions.

Loans held for investment are primarily secured by real estate located in the Pacific Northwest, California and Hawaii. At June 30, 2016, we had concentrations representing 10% or more of the total portfolio by state and property type for the loan classes of single family, commercial real estate and construction/land development within the state of Washington, which represented 15.4%, 14.1% and 10.0% of the total portfolio, respectively. Additionally, we had a concentration representing 10% or more by state and property type for the single family loan class within the state of California, which represented 12.0% of the total portfolio. At December 31, 2015 we had concentrations representing 10% or more of the total portfolio by state and property type for the loan classes of single family, commercial real estate and construction/land development within the state of Washington, which represented 18.0%, 14.7% and 11.3% of the total portfolio, respectively. Additionally, we had a concentration representing 10% or more by state and property type for the single family loan class within the state of California, which represented 13.6% of the total portfolio.

Credit Quality

Management considers the level of allowance for loan losses to be appropriate to cover credit losses inherent within the loans held for investment portfolio as of June 30, 2016. In addition to the allowance for loan losses, the Company maintains a separate allowance for losses related to unfunded loan commitments, and this amount is included in accounts payable and other liabilities on the consolidated statements of financial condition. Collectively, these allowances are referred to as the allowance for credit losses.

For further information on the policies that govern the determination of the allowance for loan losses levels, see Note 1, Summary of Significant Accounting Policies, within our 2015 Annual Report on Form 10-K.

Activity in the allowance for credit losses was as follows.

(in thousands)	Three Months		Six Months	
	Ended June 30,		Ended June 30,	
	2016	2015	2016	2015
Allowance for credit losses (roll-forward):				
Beginning balance	\$32,423	\$25,628	\$30,659	\$22,524
Provision for credit losses	1,100	500	2,500	3,500
Recoveries, net of charge-offs	478	320	842	424
Ending balance	\$34,001	\$26,448	\$34,001	\$26,448
Components:				
Allowance for loan losses	\$32,656	\$25,777	\$32,656	\$25,777
Allowance for unfunded commitments	1,345	671	1,345	671
Allowance for credit losses	\$34,001	\$26,448	\$34,001	\$26,448

Edgar Filing: HomeStreet, Inc. - Form 10-Q

Activity in the allowance for credit losses by loan portfolio and loan class was as follows.

Three Months Ended June 30, 2016					
(in thousands)	Beginning balance	Charge-offs	Recoveries	(Reversal of) Provision	Ending balance
Consumer loans					
Single family	\$9,026	\$ —	\$ 2	\$ (734)	\$8,294
Home equity and other	4,852	(204)	87	665	5,400
	13,878	(204)	89	(69)	13,694
Commercial loans					
Commercial real estate	5,175	—	—	870	6,045
Multifamily	1,832	—	—	216	2,048
Construction/land development	9,286	—	573	(490)	9,369
Commercial business	2,252	—	20	573	2,845
	18,545	—	593	1,169	20,307
Total allowance for credit losses	\$32,423	\$ (204)	\$ 682	\$ 1,100	\$34,001

Three Months Ended June 30, 2015					
(in thousands)	Beginning balance	Charge-offs	Recoveries	(Reversal of) Provision	Ending balance
Consumer loans					
Single family	\$9,959	\$ —	\$ 181	\$ (1,143)	\$8,997
Home equity and other	3,331	(119)	57	613	3,882
	13,290	(119)	238	(530)	12,879
Commercial loans					
Commercial real estate	4,551	—	37	458	5,046
Multifamily	661	—	—	119	780
Construction/land development	5,003	—	85	855	5,943
Commercial business	2,123	(9)	88	(402)	1,800
	12,338	(9)	210	1,030	13,569
Total allowance for credit losses	\$25,628	\$ (128)	\$ 448	\$ 500	\$26,448

Six Months Ended June 30, 2016					
(in thousands)	Beginning balance	Charge-offs	Recoveries	(Reversal of) Provision	Ending balance
Consumer loans					
Single family	\$8,942	\$ (32)	\$ 86	\$ (702)	\$8,294
Home equity and other	4,620	(298)	338	740	5,400
	13,562	(330)	424	38	13,694
Commercial loans					
Commercial real estate	4,847	—	—	1,198	6,045
Multifamily	1,194	—	—	854	2,048
Construction/land development	9,271	(42)	783	(643)	9,369
Commercial business	1,785	(26)	33	1,053	2,845

Edgar Filing: HomeStreet, Inc. - Form 10-Q

	17,097	(68)	816	2,462	20,307
Total allowance for credit losses	\$30,659	\$ (398)	\$ 1,240	\$ 2,500	\$34,001

21

Edgar Filing: HomeStreet, Inc. - Form 10-Q

Six Months Ended June 30, 2015

(in thousands)	Beginning balance	Charge-offs	Recoveries	(Reversal of) Provision	Ending balance
Consumer loans					
Single family	\$9,447	\$ —	\$ 246	\$ (696)	\$8,997
Home equity and other	3,322	(201)	141	620	3,882
	12,769	(201)	387	(76)	12,879
Commercial loans					
Commercial real estate	3,846	(16)	37	1,179	5,046
Multifamily	673	—	—	107	780
Construction/land development	3,818	—	99	2,026	5,943
Commercial business	1,418	(9)	127	264	1,800
	9,755	(25)	263	3,576	13,569
Total allowance for credit losses	\$22,524	\$ (226)	\$ 650	\$ 3,500	\$26,448

The following table disaggregates our allowance for credit losses and recorded investment in loans by impairment methodology.

(in thousands)	At June 30, 2016					
	Allowance: collectively evaluated for impairment	Allowance: individually evaluated for impairment	Total	Loans: collectively evaluated for impairment	Loans: individually evaluated for impairment	Total
Consumer loans						
Single family	\$8,078	\$ 216	\$8,294	\$1,112,375	\$ 83,479	\$1,195,854
Home equity and other	5,334	66	5,400	307,808	1,396	309,204
	13,412	282	13,694	1,420,183	84,875	1,505,058
Commercial loans						
Commercial real estate	6,045	—	6,045	759,055	3,115	762,170
Multifamily	2,048	—	2,048	562,107	621	562,728
Construction/land development	9,369	—	9,369	637,108	2,333	639,441
Commercial business	2,536	309	2,845	236,408	2,669	239,077
	19,998	309	20,307	2,194,678	8,738	2,203,416
Total loans evaluated for impairment	33,410	591	34,001	3,614,861	93,613	3,708,474
Loans held for investment carried at fair value						22,362 (1)
Total loans held for investment	\$33,410	\$ 591	\$34,001	\$3,614,861	\$ 93,613	\$3,730,836

(1) Comprised of single family loans where a fair value option election was made at the time of origination and, therefore, are carried at fair value with changes recognized in the consolidated statements of operations.

(in thousands)	At December 31, 2015					
	Allowance: collectively evaluated for impairment	Allowance: individually evaluated for impairment	Total	Loans: collectively evaluated for impairment	Loans: individually evaluated for impairment	Total
Consumer loans						
Single family	\$8,723	\$ 219	\$8,942	\$1,101,891	\$ 79,745	\$1,181,636
Home equity and other	4,545	75	4,620	254,762	1,611	256,373
	13,268	294	13,562	1,356,653	81,356	1,438,009
Commercial loans						
Commercial real estate	4,847	—	4,847	597,571	3,132	600,703
Multifamily	1,194	—	1,194	423,424	3,133	426,557
Construction/land development	9,271	—	9,271	579,446	3,714	583,160
Commercial business	1,512	273	1,785	151,924	2,338	154,262
	16,824	273	17,097	1,752,365	12,317	1,764,682
Total loans evaluated for impairment	30,092	567	30,659	3,109,018	93,673	3,202,691
Loans held for investment carried at fair value						21,544 (1)
Total loans held for investment	\$30,092	\$ 567	\$30,659	\$3,109,018	\$ 93,673	\$3,224,235

(1) Comprised of single family loans where a fair value option election was made at the time of origination and, therefore, are carried at fair value with changes recognized in the consolidated statements of operations.

Impaired Loans

The following tables present impaired loans by loan portfolio segment and loan class.

(in thousands)	At June 30, 2016		
	Unpaid		
	Recorded principal investment	Unpaid principal balance	Related allowance
	(1)	(2)	
With no related allowance recorded:			
Consumer loans			
Single family	\$81,768	\$83,909	\$ —
Home equity and other	761	839	—
	82,529	84,748	—
Commercial loans			
Commercial real estate	3,115	3,672	—
Multifamily	621	745	—
Construction/land development	2,333	3,259	—
Commercial business	1,171	2,061	—
	7,240	9,737	—
	\$89,769	\$94,485	\$ —
With an allowance recorded:			
Consumer loans			
Single family	\$1,711	\$1,824	\$ 216
Home equity and other	635	635	66
	2,346	2,459	282
Commercial loans			
Commercial business	1,498	1,564	309
	1,498	1,564	309
	\$3,844	\$4,023	\$ 591
Total:			
Consumer loans			
Single family ⁽³⁾	\$83,479	\$85,733	\$ 216
Home equity and other	1,396	1,474	66
	84,875	87,207	282
Commercial loans			
Commercial real estate	3,115	3,672	—
Multifamily	621	745	—
Construction/land development	2,333	3,259	—
Commercial business	2,669	3,625	309
	8,738	11,301	309
Total impaired loans	\$93,613	\$98,508	\$ 591

(1) Includes partial charge-offs and nonaccrual interest paid and purchase discounts and premiums.

(2) Unpaid principal balance does not include partial charge-offs, purchase discounts and premiums or nonaccrual interest paid. Related allowance is calculated on net book balances not unpaid principal balances.

(3) Includes \$79.9 million in single family performing TDRs.

At December 31, 2015

(in thousands)	Unpaid Recorded principal investment balance	Related allowance
----------------	--	----------------------

With no related allowance recorded:

Consumer loans

Single family	\$78,240	\$80,486	\$ —
Home equity and other	955	1,033	—
	79,195	81,519	—

Commercial loans

Commercial real estate	3,132	3,421	—
Multifamily	3,133	3,429	—
Construction/land development	3,714	4,214	—
Commercial business	1,373	1,475	—
	11,352	12,539	—
	\$90,547	\$94,058	\$ —

With an allowance recorded:

Consumer loans

Single family	\$1,505	\$1,618	\$ 219
Home equity and other	656	656	75
	2,161	2,274	294

Commercial loans

Commercial business	965	1,019	273
	965	1,019	273
	\$3,126	\$3,293	\$ 567

Total:

Consumer loans

Single family ⁽³⁾	\$79,745	\$82,104	\$ 219
Home equity and other	1,611	1,689	75
	81,356	83,793	294

Commercial loans

Commercial real estate	3,132	3,421	—
Multifamily	3,133	3,429	—
Construction/land development	3,714	4,214	—
Commercial business	2,338	2,494	273
	12,317	13,558	273

Total impaired loans	\$93,673	\$97,351	\$ 567
----------------------	----------	----------	--------

(1) Includes partial charge-offs and nonaccrual interest paid.

(2) Unpaid principal balance does not include partial charge-offs, purchase discounts and premiums or nonaccrual interest paid. Related allowance is calculated on net book balances not unpaid principal balances.

(3) Includes \$74.7 million in single family performing TDRs.

The following table provides the average recorded investment in impaired loans by portfolio segment and class.

(in thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Consumer loans				
Single family	\$81,754	\$78,720	\$81,612	\$78,440
Home equity and other	1,412	2,250	1,504	2,387
	83,166	80,970	83,116	80,827
Commercial loans				
Commercial real estate	3,125	23,469	3,124	24,572
Multifamily	1,864	4,270	1,878	3,873
Construction/land development	2,458	5,047	3,023	5,180
Commercial business	2,802	4,832	2,503	4,347
	10,249	37,618	10,528	37,972
	\$93,415	\$118,588	\$93,644	\$118,799

Credit Quality Indicators

Management regularly reviews loans in the portfolio to assess credit quality indicators and to determine appropriate loan classification and grading in accordance with applicable bank regulations. The Company's risk rating methodology assigns risk ratings ranging from 1 to 10, where a higher rating represents higher risk. The Company differentiates its lending portfolios into homogeneous loans and non-homogeneous loans.

The 10 risk rating categories can be generally described by the following groupings for non-homogeneous loans:

Pass. We have five pass risk ratings which represent a level of credit quality that ranges from no well-defined deficiency or weakness to some noted weakness, however the risk of default on any loan classified as pass is expected to be remote. The five pass risk ratings are described below:

Minimal Risk. A minimal risk loan, risk rated 1-Exceptional, is to a borrower of the highest quality. The borrower has an unquestioned ability to produce consistent profits and service all obligations and can absorb severe market disturbances with little or no difficulty.

Low Risk. A low risk loan, risk rated 2-Superior, is similar in characteristics to a minimal risk loan. Balance sheet and operations are slightly more prone to fluctuations within the business cycle; however, debt capacity and debt service coverage remains strong. The borrower will have a strong demonstrated ability to produce profits and absorb market disturbances.

Modest Risk. A modest risk loan, risk rated 3-Excellent, is a desirable loan with excellent sources of repayment and no currently identifiable risk associated with collection. The borrower exhibits a very strong capacity to repay the loan in accordance with the repayment agreement. The borrower may be susceptible to economic cycles, but will have cash reserves to weather these cycles.

Average Risk. An average risk loan, risk rated 4-Good, is an attractive loan with sound sources of repayment and no material collection or repayment weakness evident. The borrower has an acceptable capacity to pay in accordance with the agreement. The borrower is susceptible to economic cycles and more efficient competition, but should have modest reserves sufficient to survive all but the most severe downturns or major setbacks.

Acceptable Risk. An acceptable risk loan, risk rated 5-Acceptable, is a loan with lower than average, but still acceptable credit risk. These borrowers may have higher leverage, less certain but viable repayment sources, have limited financial reserves and may possess weaknesses that can be adequately mitigated through collateral, structural or credit enhancement. The borrower is susceptible to economic cycles and is less resilient to negative market forces or financial events. Reserves may be insufficient to survive a modest downturn.

Watch. A watch loan, risk rated 6-Watch, is still pass-rated, but represents the lowest level of acceptable risk due to an emerging risk element or declining performance trend. Watch ratings are expected to be temporary, with issues resolved or manifested to the extent that a higher or lower rating would be appropriate. The borrower should have a plausible plan, with reasonable certainty of success, to correct the problems in a short period of time. Borrowers rated watch are characterized by elements of uncertainty, such as:

- The borrower may be experiencing declining operating trends, strained cash flows or less-than anticipated performance. Cash flow should still be adequate to cover debt service, and the negative trends should be identified as being of a short-term or temporary nature.

- The borrower may have experienced a minor, unexpected covenant violation.

- Companies who may be experiencing tight working capital or have a cash cushion deficiency.

- A loan may also be a watch if financial information is late, there is a documentation deficiency, the borrower has experienced unexpected management turnover, or if they face industry issues that, when combined with performance factors create uncertainty in their future ability to perform.

- Delinquent payments, increasing and material overdraft activity, request for bulge and/or out- of-formula advances may be an indicator of inadequate working capital and may suggest a lower rating.

- Failure of the intended repayment source to materialize as expected, or renewal of a loan (other than cash/marketable security secured or lines of credit) without reduction are possible indicators of a watch or worse risk rating.

Special Mention. A special mention loan, risk rated 7-Special Mention, has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the loans or the institutions credit position at some future date. They contain unfavorable characteristics and are generally undesirable. Loans in this category are currently protected but are potentially weak and constitute an undue and unwarranted credit risk, but not to the point of a substandard classification. A special mention loan has potential weaknesses, which if not checked or corrected, weaken the loan or inadequately protect the Company's position at some future date. Such weaknesses include:

- Performance is poor or significantly less than expected. There may be a temporary debt-servicing deficiency or inadequate working capital as evidenced by a cash cushion deficiency, but not to the extent that repayment is compromised. Material violation of financial covenants is common.

- Loans with unresolved material issues that significantly cloud the debt service outlook, even though a debt servicing deficiency does not currently exist.

- Modest underperformance or deviation from plan for real estate loans where absorption of rental/sales units is necessary to properly service the debt as structured. Depth of support for interest carry provided by owner/guarantors may mitigate and provide for improved rating.

- This rating may be assigned when a loan officer is unable to supervise the credit properly, an inadequate loan agreement, an inability to control collateral, failure to obtain proper documentation, or any other deviation from prudent lending practices.

- Unlike a substandard credit, there should be a reasonable expectation that these temporary issues will be corrected within the normal course of business, rather than liquidation of assets, and in a reasonable period of time.

Substandard. A substandard loan, risk rated 8-Substandard, is inadequately protected by the current sound worth and paying capacity of the borrower or of the collateral pledged, if any. Loans so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the loan. They are characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected. Loss potential, while existing in the aggregate amount of substandard loans, does not have to exist in individual loans classified substandard. Loans are classified as substandard when they have unsatisfactory characteristics causing unacceptable levels of risk. A substandard loan normally has one or more well-defined weaknesses that could jeopardize repayment of the loan. The likely need to liquidate assets to correct the problem, rather than repayment from successful operations is the key distinction between special mention and substandard. The following are examples of well-defined weaknesses:

- Cash flow deficiencies or trends are of a magnitude to jeopardize current and future payments with no immediate relief. A loss is not presently expected, however the outlook is sufficiently uncertain to preclude ruling out the

possibility.

¶The borrower has been unable to adjust to prolonged and unfavorable industry or economic trends.

Material underperformance or deviation from plan for real estate loans where absorption of rental/sales units is necessary to properly service the debt and risk is not mitigated by willingness and capacity of owner/guarantor to support interest payments.

• Management character or honesty has become suspect. This includes instances where the borrower has become uncooperative.

Due to unprofitable or unsuccessful business operations, some form of restructuring of the business, including liquidation of assets, has become the primary source of loan repayment. Cash flow has deteriorated, or been diverted, to the point that sale of collateral is now the Company's primary source of repayment (unless this was the original source of repayment). If the collateral is under the Company's control and is cash or other liquid, highly marketable securities and properly margined, then a more appropriate rating might be special mention or watch.

• The borrower is involved in bankruptcy proceedings where collateral liquidation values are expected to fully protect the Company against loss.

• There is material, uncorrectable faulty documentation or materially suspect financial information.

Doubtful. Loans classified as doubtful, risk rated 9-Doubtful, have all the weaknesses inherent in one classified substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable and improbable. The possibility of loss is extremely high, but because of certain important and reasonably specific pending factors, which may work towards strengthening of the loan, classification as a loss (and immediate charge-off) is deferred until more exact status may be determined. Pending factors include proposed merger, acquisition, liquidation procedures, capital injection, and perfection of liens on additional collateral and refinancing plans. In certain circumstances, a doubtful rating will be temporary, while the Company is awaiting an updated collateral valuation. In these cases, once the collateral is valued and appropriate margin applied, the remaining un-collateralized portion will be charged-off. The remaining balance, properly margined, may then be upgraded to substandard, however must remain on non-accrual.

Loss. Loans classified as loss, risk rated 10-Loss, are considered un-collectible and of such little value that the continuance as an active Company asset is not warranted. This rating does not mean that the loan has no recovery or salvage value, but rather that the loan should be charged-off now, even though partial or full recovery may be possible in the future.

Impaired. Loans are classified as impaired when, based on current information and events, it is probable that the Company will be unable to collect the scheduled payments of principal and interest when due, in accordance with the terms of the original loan agreement, without unreasonable delay. This generally includes all loans classified as nonaccrual and troubled debt restructurings. Impaired loans are risk rated for internal and regulatory rating purposes, but presented separately for clarification.

Homogeneous loans maintain their original risk rating until they are greater than 30 days past due, and risk rating reclassification is based primarily on the past due status of the loan. The risk rating categories can be generally described by the following groupings for commercial and commercial real estate homogeneous loans:

Watch. A homogeneous watch loan, risk rated 6, is 30-59 days past due from the required payment date at month-end.

Special Mention. A homogeneous special mention loan, risk rated 7, is 60-89 days past due from the required payment date at month-end.

Substandard. A homogeneous substandard loan, risk rated 8, is 90-179 days past due from the required payment date at month-end.

Loss. A homogeneous loss loan, risk rated 10, is 180 days and more past due from the required payment date. These loans are generally charged-off in the month in which the 180 day time period elapses.

The risk rating categories can be generally described by the following groupings for residential and home equity and other homogeneous loans:

Watch. A homogeneous retail watch loan, risk rated 6, is 60-89 days past due from the required payment date at month-end.

Edgar Filing: HomeStreet, Inc. - Form 10-Q

Substandard. A homogeneous retail substandard loan, risk rated 8, is 90-179 days past due from the required payment date at month-end.

Loss. A homogeneous retail loss loan, risk rated 10, becomes past due 180 cumulative days from the contractual due date. These loans are generally charged-off in the month in which the 180 day period elapses.

Residential and home equity loans modified in a troubled debt restructure are not considered homogeneous. The risk rating classification for such loans are based on the non-homogeneous definitions noted above.

The following tables summarize designated loan grades by loan portfolio segment and loan class.

(in thousands)	At June 30, 2016				
	Pass	Watch	Special mention	Substandard	Total
Consumer loans					
Single family	\$ 1,185,120 ⁽¹⁾	\$ 4,098	\$ 16,317	\$ 12,681	\$ 1,218,216
Home equity and other	306,934	100	507	1,663	309,204
	1,492,054	4,198	16,824	14,344	1,527,420
Commercial loans					
Commercial real estate	696,170	58,959	3,147	3,894	762,170
Multifamily	544,157	17,122	903	546	562,728
Construction/land development	618,551	8,908	10,510	1,472	639,441
Commercial business	192,857	37,053	3,111	6,056	239,077
	2,051,735	122,042	17,671	11,968	2,203,416
	\$ 3,543,789	\$ 126,240	\$ 34,495	\$ 26,312	\$ 3,730,836

⁽¹⁾ Includes \$22.4 million of loans where a fair value option election was made at the time of origination and, therefore, are carried at fair value with changes recognized in the consolidated statements of operations.

(in thousands)	At December 31, 2015				
	Pass	Watch	Special mention	Substandard	Total
Consumer loans					
Single family	\$ 1,165,990 ⁽¹⁾	\$ 7,933	\$ 16,439	\$ 12,818	\$ 1,203,180
Home equity and other	253,912	381	478	1,602	256,373
	1,419,902	8,314	16,917	14,420	1,459,553
Commercial loans					
Commercial real estate	535,903	55,058	7,067	2,675	600,703
Multifamily	403,604	20,738	1,657	558	426,557
Construction/land development	552,819	25,520	4,407	414	583,160
Commercial business	120,969	30,300	1,731	1,262	154,262
	1,613,295	131,616	14,862	4,909	1,764,682
	\$ 3,033,197	\$ 139,930	\$ 31,779	\$ 19,329	\$ 3,224,235

⁽¹⁾ Includes \$21.5 million of loans where a fair value option election was made at the time of origination and, therefore, are carried at fair value with changes recognized in the consolidated statements of operations.

As of June 30, 2016 and December 31, 2015, none of the Company's loans were rated Doubtful or Loss. For a detailed discussion on credit quality, see Note 5, Loans and Credit Quality, within our 2015 Annual Report on Form 10-K.

Nonaccrual and Past Due Loans

Loans are placed on nonaccrual status when the full and timely collection of principal and interest is doubtful, generally when the loan becomes 90 days or more past due for principal or interest payment or if part of the principal balance has been charged off. Loans whose repayments are insured by the FHA or guaranteed by the VA are generally maintained on accrual status even if 90 days or more past due.

The following table presents an aging analysis of past due loans by loan portfolio segment and loan class.

(in thousands)	At June 30, 2016			Total past due	Current	Total loans	90 days or more past due and accruing
	30-59 days past due	60-89 days past due	90 days or more past due				
Consumer loans							
Single family	\$7,283	\$ 4,522	\$39,326	\$51,131	\$1,167,085 ⁽¹⁾	\$1,218,216	\$ 30,787 ⁽²⁾
Home equity and other	463	100	1,663	2,226	306,978	309,204	—
	7,746	4,622	40,989	53,357	1,474,063	1,527,420	30,787
Commercial loans							
Commercial real estate	—	—	3,100	3,100	759,070	762,170	—
Multifamily	356	—	113	469	562,259	562,728	—
Construction/land development	—	—	1,003	1,003	638,438	639,441	—
Commercial business	—	—	1,327	1,327	237,750	239,077	—
	356	—	5,543	5,899	2,197,517	2,203,416	—
	\$8,102	\$ 4,622	\$46,532	\$59,256	\$3,671,580	\$3,730,836	\$ 30,787
At December 31, 2015							
(in thousands)	At December 31, 2015			Total past due	Current	Total loans	90 days or more past due and accruing
	30-59 days past due	60-89 days past due	90 days or more past due				
Consumer loans							
Single family	\$7,098	\$ 3,537	\$48,714	\$59,349	\$1,143,831 ⁽¹⁾	\$1,203,180	\$ 36,595 ⁽²⁾
Home equity and other	1,095	398	1,576	3,069	253,304	256,373	—
	8,193	3,935	50,290	62,418	1,397,135	1,459,553	36,595
Commercial loans							
Commercial real estate	233	—	2,341	2,574	598,129	600,703	—
Multifamily	—	—	119	119	426,438	426,557	—
Construction/land development	77	—	339	416	582,744	583,160	—
Commercial business	—	—	692	692	153,570	154,262	17
	310	—	3,491	3,801	1,760,881	1,764,682	17
	\$8,503	\$ 3,935	\$53,781	\$66,219	\$3,158,016	\$3,224,235	\$ 36,612

Includes \$22.4 million and \$21.5 million of loans at June 30, 2016 and December 31, 2015, respectively, where a (1) fair value option election was made at the time of origination and, therefore, are carried at fair value with changes recognized in the consolidated statements of operations.

(2) FHA-insured and VA-guaranteed single family loans that are 90 days or more past due are maintained on accrual status if they are determined to have little to no risk of loss.

The following tables present performing and nonperforming loan balances by loan portfolio segment and loan class.

(in thousands)	At June 30, 2016		
	Accrual	Nonaccrual	Total
Consumer loans			
Single family	\$ 1,209,677 ⁽¹⁾	\$ 8,539	\$ 1,218,216
Home equity and other	307,541	1,663	309,204
	1,517,218	10,202	1,527,420
Commercial loans			
Commercial real estate	759,070	3,100	762,170
Multifamily	562,615	113	562,728
Construction/land development	638,438	1,003	639,441
Commercial business	237,750	1,327	239,077
	2,197,873	5,543	2,203,416
	\$ 3,715,091	\$ 15,745	\$ 3,730,836

(in thousands)	At December 31, 2015		
	Accrual	Nonaccrual	Total
Consumer loans			
Single family	\$ 1,191,061 ⁽¹⁾	\$ 12,119	\$ 1,203,180
Home equity and other	254,797	1,576	256,373
	1,445,858	13,695	1,459,553
Commercial loans			
Commercial real estate	598,362	2,341	600,703
Multifamily	426,438	119	426,557
Construction/land development	582,821	339	583,160
Commercial business	153,588	674	154,262
	1,761,209	3,473	1,764,682
	\$ 3,207,067	\$ 17,168	\$ 3,224,235

Includes \$22.4 million and \$21.5 million of loans at June 30, 2016 and December 31, 2015, where a fair value (1) option election was made at the time of origination and, therefore, are carried at fair value with changes recognized in the consolidated statements of operations.

The following tables present information about TDR activity during the periods presented.

Three Months Ended June 30, 2016

(dollars in thousands)	Concession type	Number of loan modifications	Recorded investment	Related charge-offs
Consumer loans				
Single family				
	Interest rate reduction	13	\$ 2,369	\$ —
	Payment restructure	19	3,747	—
Home equity and other				
	Interest rate reduction	1	13	—
Total consumer				
	Interest rate reduction	14	2,382	—
	Payment restructure	19	3,747	—
		33	6,129	—
Total loans				
	Interest rate reduction	14	2,382	—
	Payment restructure	19	3,747	—
		33	\$ 6,129	\$ —

Three Months Ended June 30, 2015

(dollars in thousands)	Concession type	Number of loan modifications	Recorded investment	Related charge-offs
Consumer loans				
Single family				
	Interest rate reduction	17	\$ 4,402	\$ —
Total consumer				
	Interest rate reduction	17	4,402	—
		17	4,402	—
Commercial loans				
Commercial business				
	Interest rate reduction	2	482	—
Total commercial				
	Interest rate reduction	2	482	—
		2	482	—
Total loans				
	Interest rate reduction	19	4,884	—
		19	\$ 4,884	\$ —

Edgar Filing: HomeStreet, Inc. - Form 10-Q

Six Months Ended June 30, 2016

(dollars in thousands)	Concession type	Number of loan modifications	Recorded investment	Related charge-offs
Consumer loans				
Single family				
	Interest rate reduction	18	\$ 3,389	\$ —
	Payment restructure	34	6,918	—
Home equity and other				
	Interest rate reduction	1	13	—
Total consumer				
	Interest rate reduction	19	3,402	—
	Payment restructure	34	6,918	—
		53	10,320	—
Total loans				
	Interest rate reduction	19	3,402	—
	Payment restructure	34	6,918	—
		53	\$ 10,320	\$ —

Six Months Ended June 30, 2015

(dollars in thousands)	Concession type	Number of loan modifications	Recorded investment	Related charge-offs
Consumer loans				
Single family				
	Interest rate reduction	28	\$ 6,792	\$ —
Home equity and other				
	Interest rate reduction	1	37	—
Total consumer				
	Interest rate reduction	29	6,829	—
Commercial loans				
Commercial business				
	Interest rate reduction	2	482	—
Total commercial				
	Interest rate reduction	2	482	—
		2	482	—
Total loans				
	Interest rate reduction	31	7,311	—
		31	\$ 7,311	\$ —

The following tables present loans that were modified as TDRs within the previous 12 months and subsequently re-defaulted during the three and six months ended June 30, 2016 and 2015, respectively. A TDR loan is considered re-defaulted when it becomes doubtful that the objectives of the modifications will be met, generally when a consumer loan TDR becomes 60 days or more past due on principal or interest payments or when a commercial loan TDR becomes 90 days or more past due on principal or interest payments.

Three Months Ended June 30,
2016 2015
Number Number
of of
loan Recorded loan Recorded
relationships relationships
that that
re-defaulted re-defaulted

Consumer loans

Single family 8 \$ 2,367 1 \$ 220
Home equity and other 1 93 — —
9 \$ 2,460 1 \$ 220

Six Months Ended June 30,
2016 2015
Number Number
of of
loan Recorded loan Recorded
relationships relationships
that that
re-defaulted re-defaulted

Consumer loans

Single family 9 \$ 2,638 7 \$ 1,718
Home equity and other 1 93 — —
10 \$ 2,731 7 \$ 1,718

NOTE 5—DEPOSITS:

Deposit balances, including stated rates, were as follows.

(in thousands)	At June 30, 2016	At December 31, 2015
Noninterest-bearing accounts	\$915,123	\$ 643,028
NOW accounts, 0.00% to 1.00% at June 30, 2016 and December 31, 2015	518,132	408,477
Statement savings accounts, due on demand, 0.00% to 1.13% at June 30, 2016 and 0.00% to 1.00% at December 31, 2015	300,070	292,092
Money market accounts, due on demand, 0.00% to 1.50% at June 30, 2016 and 0.00% to 1.45% at December 31, 2015	1,366,581	1,155,464
Certificates of deposit, 0.15% to 3.80% at June 30, 2016 and 0.05% to 3.80% at December 31, 2015	1,139,249	732,892
	\$4,239,155	\$ 3,231,953

Interest expense on deposits was as follows.

(in thousands)	Three Months		Six Months	
	Ended June 30,		Ended June 30,	
	2016	2015	2016	2015
NOW accounts	\$489	\$466	\$981	\$788
Statement savings accounts	255	266	509	521
Money market accounts	1,606	1,244	2,973	2,383
Certificates of deposit	2,099	1,029	3,555	1,895
	\$4,449	\$3,005	\$8,018	\$5,587

The weighted-average interest rates on certificates of deposit at June 30, 2016 and December 31, 2015 were 0.93% and 0.96% respectively.

Certificates of deposit outstanding mature as follows.

(in thousands)	At June 30, 2016
Within one year	\$748,938
One to two years	300,518
Two to three years	49,745
Three to four years	24,625
Four to five years	15,423
	\$1,139,249

The aggregate amount of time deposits in denominations of \$100 thousand or more at June 30, 2016 and December 31, 2015 was \$503.2 million and \$290.1 million, respectively. The aggregate amount of time deposits in denominations of more than \$250 thousand at June 30, 2016 and December 31, 2015 was \$77.2 million and \$81.7 million, respectively. There were \$310.4 million and \$120.3 million of brokered deposits at June 30, 2016 and December 31, 2015, respectively.

NOTE 6—LONG-TERM DEBT:

On May 26, 2016, the Company closed on a \$65.0 million in aggregate principal amount of its 6.50% Senior Notes due 2026 (the “Senior Notes”) at an offering price of 100% plus accrued interest. The Senior Notes were sold and issued in a private offering.

The Company raised capital by issuing trust preferred securities during the period from 2005 through 2007 resulting in a debt balance of \$61.9 million that remains outstanding at June 30, 2016. In connection with the issuance of trust preferred securities, HomeStreet, Inc. issued to HomeStreet Statutory Trust Junior Subordinated Deferrable Interest Debentures. The sole assets of the HomeStreet Statutory Trust are the Subordinated Debt Securities I, II, III, and IV.

The Subordinated Debt Securities are as follows:

(in thousands)	HomeStreet Statutory I	II	III	IV
Date issued	June 2005	September 2005	February 2006	March 2007
Amount	\$5,155	\$20,619	\$20,619	\$15,464
Interest rate	3 MO LIBOR + 1.70%	3 MO LIBOR + 1.50%	3 MO LIBOR + 1.37%	3 MO LIBOR + 1.68%
Maturity date	June 2035	December 2035	March 2036	June 2037
Call option ⁽¹⁾	5 years	5 years	5 years	5 years

(1) Call options are exercisable at par.

NOTE 7—DERIVATIVES AND HEDGING ACTIVITIES:

To reduce the risk of significant interest rate fluctuations on the value of certain assets and liabilities, such as certain mortgage loans held for sale or MSRs, the Company utilizes derivatives, such as forward sale commitments, futures, option contracts, interest rate swaps and swaptions as risk management instruments in its hedging strategy. Derivative transactions are measured in terms of notional amount, which is not recorded in the consolidated statements of financial condition. The notional amount is generally not exchanged and is used as the basis for interest and other contractual payments.

We held no derivatives designated as a fair value, cash flow or foreign currency hedge instrument at June 30, 2016 or December 31, 2015. Derivatives are reported at their respective fair values in the other assets or accounts payable and other liabilities line items on the consolidated statements of financial condition, with changes in fair value reflected in current period earnings.

As permitted under U.S. GAAP, the Company nets derivative assets and liabilities when a legally enforceable master netting agreement exists between the Company and the derivative counterparty, which are documented under industry standard master agreements and credit support annexes. The Company's master netting agreements provide that following an uncured payment default or other event of default the non-defaulting party may promptly terminate all transactions between the parties and determine a net amount due to be paid to, or by, the defaulting party. An event of default may also occur under a credit support annex if a party fails to make a collateral delivery (which remains uncured following applicable notice and grace periods). The Company's right of offset requires that master netting agreements are legally enforceable and that the exercise of rights by the non-defaulting party under these agreements will not be stayed, or avoided under applicable law upon an event of default including bankruptcy, insolvency or similar proceeding.

The collateral used under the Company's master netting agreements is typically cash, but securities may be used under agreements with certain counterparties. Receivables related to cash collateral that has been paid to counterparties is included in other assets on the Company's consolidated statements of financial condition. Any securities pledged to counterparties as collateral remain on the consolidated statement of financial condition. Refer to Note 3, Investment Securities, for further information on securities collateral pledged. At June 30, 2016 and December 31, 2015, the Company did not hold any collateral received from counterparties under derivative transactions.

For further information on the policies that govern derivative and hedging activities, see Note 1, Summary of Significant Accounting Policies, and Note 11, Derivatives and Hedging Activities, within our 2015 Annual Report on Form 10-K.

Edgar Filing: HomeStreet, Inc. - Form 10-Q

The notional amounts and fair values for derivatives consist of the following.

(in thousands)	Notional amount	Fair value derivatives	
		Asset	Liability
Forward sale commitments	\$2,874,721	\$12,408	\$(16,090)
Interest rate swaptions	268,000	134	—
Interest rate lock and purchase loan commitments	1,113,631	39,995	(4)
Interest rate swaps	2,012,950	58,322	(20,625)
Total derivatives before netting	\$6,269,302	110,859	(36,719)
Netting adjustment/Cash collateral ⁽¹⁾		(9,780)	34,738
Carrying value on consolidated statements of financial condition		\$101,079	\$(1,981)

(in thousands)	Notional amount	Fair value derivatives	
		Asset	Liability
Forward sale commitments	\$1,069,102	\$1,885	\$(1,496)
Interest rate lock and purchase loan commitments	594,360	17,719	(8)
Interest rate swaps	1,109,350	8,670	(4,007)
Total derivatives before netting	\$2,772,812	28,274	(5,511)
Netting adjustment/Cash collateral ⁽¹⁾		8,971	5,411
Carrying value on consolidated statements of financial condition		\$37,245	\$(100)

Includes cash collateral of \$25.0 million and \$14.4 million at June 30, 2016 and December 31, 2015 respectively, (1) as part of netting adjustments which primarily consists of collateral transferred by the Company at the initiation of derivative transactions and held by the counterparty as security.

The following tables present gross and net information about derivative instruments.

At June 30, 2016					
(in thousands)	Gross fair value	Netting adjustments/ Cash collateral ⁽¹⁾	Carrying value	Securities not offset in consolidated balance sheet (disclosure-only netting)	Net amount
Derivative assets	\$110,859	\$ (9,780)	\$101,079	\$ —	\$101,079
Derivative liabilities	\$(36,719)	\$ 34,738	\$(1,981)	\$ 913	\$(1,068)

At December 31, 2015					
(in thousands)	Gross fair value	Netting adjustments/ Cash collateral ⁽¹⁾	Carrying value	Securities not offset in consolidated balance sheet (disclosure-only netting)	Net amount

netting)

Derivative assets	\$28,274	\$ 8,971	\$37,245	\$	—	\$37,245
-------------------	----------	----------	----------	----	---	----------

Derivative liabilities	\$(5,511)	\$ 5,411	\$(100)	\$	5	\$(95)
------------------------	------------	----------	----------	----	---	---------

Includes cash collateral of \$25.0 million and \$14.4 million at June 30, 2016 and December 31, 2015 respectively, (1) as part of the netting adjustments which primarily consists of collateral transferred by the Company at the initiation of derivative transactions and held by the counterparty as security.

The following table presents the net gain (loss) recognized on derivatives, including economic hedge derivatives, within the respective line items in the statement of operations for the periods indicated.

(in thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Recognized in noninterest income:				
Net gain on mortgage loan origination and sale activities ⁽¹⁾	\$761	\$14,248	\$(331)	\$22,251
Mortgage servicing income ⁽²⁾	22,241	(17,221)	53,948	(4,987)
Other ⁽³⁾	(390)	—	(1,352)	—
	\$22,612	\$(2,973)	\$52,265	\$17,264

(1) Comprised of interest rate lock commitments ("IRLCs") and forward contracts used as an economic hedge of IRLCs and single family mortgage loans held for sale.

(2) Comprised of interest rate swaps, interest rate swaptions and forward contracts used as an economic hedge of single family MSRs.

(3) Comprised of interest rate swaps, interest rate swaptions and forward contracts used as an economic hedge of fair value option loans held for investment.

NOTE 8—MORTGAGE BANKING OPERATIONS:

Loans held for sale consisted of the following.

(in thousands)	At June 30, 2016	At December 31, 2015
Single family	\$716,913	\$ 632,273
Multifamily DUS [®] ⁽¹⁾	39,174	11,076
Other ⁽²⁾	16,693	6,814
Total loans held for sale	\$772,780	\$ 650,163

(1) Fannie Mae Multifamily Delegated Underwriting and Servicing Program ("DUS[®]") is a registered trademark of Fannie Mae.

(2) Includes multifamily loans originated from sources other than DUS.

Loans sold consisted of the following.

(in thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Single family	\$2,173,392	\$1,894,387	\$3,644,975	\$3,211,346
Multifamily DUS	109,394	72,459	157,364	98,632
Other ⁽¹⁾	31,813	—	31,813	—
Total loans sold	\$2,314,599	\$1,966,846	\$3,834,152	\$3,309,978

(1) Includes multifamily loans originated from sources other than DUS.

Net gain on mortgage loan origination and sale activities, including the effects of derivative risk management instruments, consisted of the following.

(in thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Single family:				
Servicing value and secondary market gains ⁽¹⁾	\$73,685	\$61,884	\$127,812	\$118,173
Loan origination and funding fees	7,355	5,635	12,683	10,090
Total single family	81,040	67,519	140,495	128,263
Multifamily DUS	3,655	2,314	5,184	3,253
Other ⁽²⁾	935	141	1,214	345
Total net gain on mortgage loan origination and sale activities	\$85,630	\$69,974	\$146,893	\$131,861

Comprised of gains and losses on interest rate lock and purchase loan commitments (which considers the value of (1)servicing), single family loans held for sale, forward sale commitments used to economically hedge secondary market activities, and changes in the Company's repurchase liability for loans that have been sold.

(2)Includes multifamily loans originated from sources other than DUS.

The Company's portfolio of loans serviced for others is primarily comprised of loans held in U.S. government and agency MBS issued by Fannie Mae, Freddie Mac and Ginnie Mae. Loans serviced for others are not included in the consolidated statements of financial condition as they are not assets of the Company.

The composition of loans serviced for others is presented below at the unpaid principal balance.

(in thousands)	At June 30,	At
	2016	December 31, 2015
Single family		
U.S. government and agency	\$16,433,411	\$14,628,596
Other	640,109	719,215
	17,073,520	15,347,811
Commercial		
Multifamily DUS	1,023,505	924,367
Other	62,466	79,513
	1,085,971	1,003,880
Total loans serviced for others	\$18,159,491	\$16,351,691

The Company has made representations and warranties that the loans sold meet certain requirements. The Company may be required to repurchase mortgage loans or indemnify loan purchasers due to defects in the origination process of the loan, such as documentation errors, underwriting errors and judgments, appraisal errors, early payment defaults and fraud. For further information on the Company's mortgage repurchase liability, see Note 9, Commitments, Guarantees and Contingencies, of this Form 10-Q.

The following is a summary of changes in the Company's liability for estimated mortgage repurchase losses.

(in thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Balance, beginning of period	\$2,725	\$2,111	\$2,922	\$1,956
Additions ⁽¹⁾	885	682	912	1,169
Realized losses ⁽²⁾	(231)	(313)	(455)	(645)
Balance, end of period	\$3,379	\$2,480	\$3,379	\$2,480

(1) Includes additions for new loan sales and changes in estimated probable future repurchase losses on previously sold loans.

(2) Includes principal losses and accrued interest on repurchased loans, "make-whole" settlements, settlements with claimants and certain related expense.

The Company has agreements with investors to advance scheduled principal and interest amounts on delinquent loans. Advances are also made to fund the foreclosure and collection costs of delinquent loans prior to the recovery of reimbursable amounts from investors or borrowers. Advances of \$5.7 million and \$9.6 million were recorded in other assets as of June 30, 2016 and December 31, 2015, respectively.

When the Company has the unilateral right to repurchase Ginnie Mae pool loans it has previously sold (generally loans that are more than 90 days past due), the Company then records the loan on its consolidated statement of financial condition. At June 30, 2016 and December 31, 2015, delinquent or defaulted mortgage loans currently in Ginnie Mae pools that the Company has recognized on its consolidated statements of financial condition totaled \$26.3 million and \$29.0 million, respectively, with a corresponding amount recorded within accounts payable and other liabilities on the consolidated statements of financial condition. The recognition of previously sold loans does not impact the accounting for the previously recognized MSRs.

Revenue from mortgage servicing, including the effects of derivative risk management instruments, consisted of the following.

(in thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Servicing income, net:				
Servicing fees and other	\$13,402	\$10,057	\$25,932	\$19,120
Changes in fair value of single family MSRs due to modeled amortization ⁽¹⁾	(7,758)	(9,012)	(15,015)	(18,247)
Amortization of multifamily MSRs	(648)	(476)	(1,285)	(930)
	4,996	569	9,632	(57)
Risk management, single family MSRs:				
Changes in fair value of MSRs due to changes in market inputs and/or model updates ⁽²⁾	(14,055)	18,483	(42,269)	11,172
Net gain from derivatives economically hedging MSR	22,241	(17,221)	53,948	(4,987)
	8,186	1,262	11,679	6,185
Mortgage servicing income	\$13,182	\$1,831	\$21,311	\$6,128

(1) Represents changes due to collection/realization of expected cash flows and curtailments.

(2)

Principally reflects changes in market inputs, which include current market interest rates and prepayment model updates, both of which affect future prepayment speed and cash flow projections.

All MSR's are initially measured and recorded at fair value at the time loans are sold. Single family MSR's are subsequently carried at fair value with changes in fair value reflected in earnings in the periods in which the changes occur, while multifamily MSR's are subsequently carried at the lower of amortized cost or fair value.

The fair value of MSR is determined based on the price that would be received to sell the MSR in an orderly transaction between market participants at the measurement date. The Company determines fair value using a valuation model that calculates the net present value of estimated future cash flows. Estimates of future cash flows include contractual servicing fees, ancillary income and costs of servicing, the timing of which are impacted by assumptions, primarily expected prepayment speeds and discount rates, which relate to the underlying performance of the loans.

The initial fair value measurement of MSR is adjusted up or down depending on whether the underlying loan pool interest rate is at a premium, discount or par. Key economic assumptions used in measuring the initial fair value of capitalized single family MSR were as follows.

	Three Months Ended June 30,		Six Months Ended June 30,	
(rates per annum) ⁽¹⁾	2016	2015	2016	2015
Constant prepayment rate ("CPR") ⁽²⁾	15.62 %	13.31 %	16.30 %	14.56 %
Discount rate ⁽³⁾	10.57 %	10.06 %	10.44 %	10.28 %

(1) Weighted average rates for sales during the period for sales of loans with similar characteristics.

(2) Represents the expected lifetime average.

(3) Discount rate is a rate based on market observations.

Key economic assumptions and the sensitivity of the current fair value for single family MSR to immediate adverse changes in those assumptions were as follows.

(dollars in thousands)	At June 30, 2016
Fair value of single family MSR	\$ 130,900
Expected weighted-average life (in years)	3.84
Constant prepayment rate ⁽¹⁾	21.74 %
Impact on 25 basis points adverse change	\$(18,106)
Impact on 50 basis points adverse change	\$(34,321)
Discount rate	10.50 %
Impact on fair value of 100 basis points increase	\$(3,432)
Impact on fair value of 200 basis points increase	\$(6,680)

(1) Represents the expected lifetime average.

These sensitivities are hypothetical and subject to key assumptions of the underlying valuation model. As the table above demonstrates, the Company's methodology for estimating the fair value of MSR is highly sensitive to changes in key assumptions. For example, actual prepayment experience may differ and any difference may have a material effect on MSR fair value. Changes in fair value resulting from changes in assumptions generally cannot be extrapolated because the relationship of the change in assumption to the change in fair value may not be linear. Also, in this table, the effect of a variation in a particular assumption on the fair value of the MSR is calculated without changing any other assumption; in reality, changes in one factor may be associated with changes in another (for example, decreases in market interest rates may provide an incentive to refinance; however, this may also indicate a slowing economy and an increase in the unemployment rate, which reduces the number of borrowers who qualify for refinancing), which may magnify or counteract the sensitivities. Thus, any measurement of MSR fair value is limited by the conditions existing and assumptions made as of a particular point in time. Those assumptions may not be appropriate if they are applied to a different point in time.

The changes in single family MSR's measured at fair value are as follows.

(in thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Beginning balance	\$ 133,449	\$ 110,709	\$ 156,604	\$ 112,439
Additions and amortization:				
Originations	19,264	20,405	31,580	35,218
Purchases	—	3	—	6
Changes due to modeled amortization ⁽¹⁾	(7,758)	(9,012)	(15,015)	(18,247)
Net additions and amortization	11,506	11,396	16,565	16,977
Changes in fair value of MSR's due to changes in market inputs and/or model updates ⁽²⁾	(14,055)	18,483	(42,269)	11,172
Ending balance	\$ 130,900	\$ 140,588	\$ 130,900	\$ 140,588

(1) Represents changes due to collection/realization of expected cash flows and curtailments.

(2) Principally reflects changes in market inputs, which include current market interest rates and prepayment model updates, both of which affect future prepayment speed and cash flow projections.

MSR's resulting from the sale of multifamily loans are recorded at fair value and subsequently carried at the lower of amortized cost or fair value. Multifamily MSR's are amortized in proportion to, and over, the estimated period the net servicing income will be collected.

The changes in multifamily MSR's measured at the lower of amortized cost or fair value were as follows.

(in thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Beginning balance	\$ 15,402	\$ 11,013	\$ 14,651	\$ 10,885
Origination	1,612	2,112	3,000	2,694
Amortization	(648)	(476)	(1,285)	(930)
Ending balance	\$ 16,366	\$ 12,649	\$ 16,366	\$ 12,649

At June 30, 2016, the expected weighted-average life of the Company's multifamily MSR's was 9.98 years. Projected amortization expense for the gross carrying value of multifamily MSR's is estimated as follows.

(in thousands)	At June 30, 2016
Remainder of 2016	\$ 1,228
2017	2,355
2018	2,200
2019	2,093
2020	1,971
2021 and thereafter	6,519
Carrying value of multifamily MSR	\$ 16,366

NOTE 9—COMMITMENTS, GUARANTEES AND CONTINGENCIES:

Commitments

Commitments to extend credit are agreements to lend to customers in accordance with predetermined contractual provisions. These commitments may be for specific periods or contain termination clauses and may require the payment of a fee by the borrower. The total amount of unused commitments do not necessarily represent future credit exposure or cash requirements in that commitments may expire without being drawn upon.

The Company makes certain unfunded loan commitments as part of its lending activities that have not been recognized in the Company's financial statements. These include commitments to extend credit made as part of the Company's lending activities on loans the Company intends to hold in its loans held for investment portfolio. The aggregate amount of these unrecognized unfunded loan commitments existing at June 30, 2016 and December 31, 2015 was \$110.9 million and \$52.9 million, respectively.

In the ordinary course of business, the Company extends secured and unsecured open-end loans to meet the financing needs of its customers. Undistributed construction loan commitments, where the Company has an obligation to advance funds for construction progress payments, were \$488.8 million and \$456.4 million at June 30, 2016 and December 31, 2015, respectively. Unused home equity and commercial banking funding lines totaled \$251.2 million and \$216.5 million at June 30, 2016 and December 31, 2015, respectively. The Company has recorded an allowance for credit losses on loan commitments, included in accounts payable and other liabilities on the consolidated statements of financial condition, of \$1.3 million and \$1.4 million at June 30, 2016 and December 31, 2015, respectively.

Guarantees

In the ordinary course of business, the Company sells loans through the Fannie Mae Multifamily Delegated Underwriting and Servicing Program ("DUS®")¹ that are subject to a credit loss sharing arrangement. The Company services the loans for Fannie Mae and shares in the risk of loss with Fannie Mae under the terms of the DUS contracts. Under the program, the DUS lender is contractually responsible for the first 5% of losses and then shares in the remainder of losses with Fannie Mae with a maximum lender loss of 20% of the original principal balance of each DUS loan. For loans that have been sold through this program, a liability is recorded for this loss sharing arrangement under the accounting guidance for guarantees. As of June 30, 2016 and December 31, 2015, the total unpaid principal balance of loans sold under this program was \$1.02 billion and \$924.4 million, respectively. The Company's reserve liability related to this arrangement totaled \$1.9 million and \$3.0 million at June 30, 2016 and December 31, 2015, respectively. There were no actual losses incurred under this arrangement during the three and six months ended June 30, 2016 and 2015.

Mortgage repurchase liability

In the ordinary course of business, the Company sells residential mortgage loans to GSEs and other entities. In addition, the Company pools FHA-insured and VA-guaranteed mortgage loans into Ginnie Mae, Fannie Mae and Freddie Mac guaranteed mortgage-backed securities. The Company has made representations and warranties that the loans sold meet certain requirements. The Company may be required to repurchase mortgage loans or indemnify loan purchasers due to defects in the origination process of the loan, such as documentation errors, underwriting errors and judgments, early payment defaults and fraud.

These obligations expose the Company to mark-to-market and credit losses on the repurchased mortgage loans after accounting for any mortgage insurance that we may receive. Generally, the maximum amount of future payments the Company would be required to make for breaches of these representations and warranties would be equal to the

unpaid principal balance of such loans that are deemed to have defects that were sold to purchasers plus, in certain circumstances, accrued and unpaid interest on such loans and certain expenses.

The Company does not typically receive repurchase requests from the FHA or VA. As an originator of FHA-insured or VA-guaranteed loans, the Company is responsible for obtaining the insurance with the FHA or the guarantee with the VA. If loans are later found not to meet the requirements of the FHA or VA, through required internal quality control reviews or through agency audits, the Company may be required to indemnify the FHA or VA against losses. The loans remain in Ginnie Mae pools unless and until they are repurchased by the Company. In general, once an FHA or VA loan becomes 90 days past due, the Company repurchases the FHA or VA residential mortgage loan to minimize the cost of interest advances on the loan. If the loan is cured through borrower efforts or through loss mitigation activities, the loan may be resold into a Ginnie Mae pool. The Company's liability for mortgage loan repurchase losses incorporates probable losses associated with such indemnification.

The total unpaid principal balance of loans sold on a servicing-retained basis that were subject to the terms and conditions of these representations and warranties totaled \$17.14 billion and \$15.43 billion as of June 30, 2016 and December 31, 2015, respectively. At June 30, 2016 and December 31, 2015, the Company had recorded a mortgage repurchase liability for loans sold on a servicing-retained and servicing-released basis, included in accounts payable and other liabilities on the consolidated statements of financial condition, of \$3.4 million and \$2.9 million, respectively.

Contingencies

In the normal course of business, the Company may have various legal claims and other similar contingent matters outstanding for which a loss may be realized. For these claims, the Company establishes a liability for contingent losses when it is probable that a loss has been incurred and the amount of loss can be reasonably estimated. For claims determined to be reasonably possible but not probable of resulting in a loss, there may be a range of possible losses in excess of the established liability. At June 30, 2016, we reviewed our legal claims and determined that there were no material claims that were considered to be probable or reasonably possible of resulting in a loss. As a result, the Company did not have any material amounts reserved for legal claims as of June 30, 2016.

NOTE 10—FAIR VALUE MEASUREMENT:

For a further discussion of fair value measurements, including information regarding the Company's valuation methodologies and the fair value hierarchy, see Note 17, Fair Value Measurement within our 2015 Annual Report on Form 10-K.

Valuation Processes

The Company has various processes and controls in place to ensure that fair value measurements are reasonably estimated. The Finance Committee of the Board provides oversight and approves the Company's Asset/Liability Management Policy ("ALMP"). The Company's ALMP governs, among other things, the application and control of the valuation models used to measure fair value. On a quarterly basis, the Company's Asset/Liability Management Committee ("ALCO") and the Finance Committee of the Board review significant modeling variables used to measure the fair value of the Company's financial instruments, including the significant inputs used in the valuation of single family MSRs. Additionally, ALCO periodically obtains an independent review of the MSR valuation process and procedures, including a review of the model architecture and the valuation assumptions. The Company obtains an MSR valuation from an independent valuation firm monthly to assist with the validation of the fair value estimate and the reasonableness of the assumptions used in measuring fair value.

The Company's real estate valuations are overseen by the Company's appraisal department, which is independent of the Company's lending and credit administration functions. The appraisal department maintains the Company's appraisal policy and recommends changes to the policy subject to approval by the Company's Loan Committee and the Credit Committee of the Board. The Company's appraisals are prepared by independent third-party appraisers and the Company's internal appraisers. Single family appraisals are generally reviewed by the Company's single family loan underwriters. Single family appraisals with unusual, higher risk or complex characteristics, as well as commercial real estate appraisals, are reviewed by the Company's appraisal department.

We obtain pricing from third party service providers for determining the fair value of a substantial portion of our investment securities available for sale. We have processes in place to evaluate such third party pricing services to ensure information obtained and valuation techniques used are appropriate. For fair value measurements obtained from third party services, we monitor and review the results to ensure the values are reasonable and in line with market experience for similar classes of securities. While the inputs used by the pricing vendor in determining fair value are not provided, and therefore unavailable for our review, we do perform certain procedures to validate the

values received, including comparisons to other sources of valuation (if available), comparisons to other independent market data and a variance analysis of prices by Company personnel that are not responsible for the performance of the investment securities.

Estimation of Fair Value

Fair value is based on quoted market prices, when available. In cases where a quoted price for an asset or liability is not available, the Company uses valuation models to estimate fair value. These models incorporate inputs such as forward yield curves, loan prepayment assumptions, expected loss assumptions, market volatilities, and pricing spreads utilizing market-based inputs where readily available. The Company believes its valuation methods are appropriate and consistent with those that would be used by other market participants. However, imprecision in estimating unobservable inputs and other factors may result in these fair value measurements not reflecting the amount realized in an actual sale or transfer of the asset or liability in a current market exchange.

Edgar Filing: HomeStreet, Inc. - Form 10-Q

The following table summarizes the fair value measurement methodologies, including significant inputs and assumptions, and classification of the Company's assets and liabilities.

Asset/Liability class	Valuation methodology, inputs and assumptions	Classification
Cash and cash equivalents	Carrying value is a reasonable estimate of fair value based on the short-term nature of the instruments.	Estimated fair value classified as Level 1.
Investment securities	Observable market prices of identical or similar securities are used where available.	
Investment securities available for sale	<p>If market prices are not readily available, value is based on discounted cash flows using the following significant inputs:</p> <ul style="list-style-type: none"> Expected prepayment speeds Estimated credit losses Market liquidity adjustments <p>Observable market prices of identical or similar securities are used where available.</p>	Level 2 recurring fair value measurement
Investment securities held to maturity	<p>If market prices are not readily available, value is based on discounted cash flows using the following significant inputs:</p> <ul style="list-style-type: none"> Expected prepayment speeds Estimated credit losses Market liquidity adjustments 	<p>Carried at amortized cost.</p> <p>Estimated fair value classified as Level 2.</p>
Loans held for sale	Fair value is based on observable market data, including:	
Single family loans, excluding loans transferred from held for investment	<ul style="list-style-type: none"> Quoted market prices, where available Dealer quotes for similar loans Forward sale commitments <p>When not derived from observable market inputs, fair value is based on discounted cash flows, which considers the following inputs:</p> <ul style="list-style-type: none"> Current lending rates for new loans Expected prepayment speeds Estimated credit losses Market liquidity adjustments 	<p>Level 2 recurring fair value measurement</p> <p>Estimated fair value classified as Level 3.</p>
Loans originated as held for investment and transferred to held for sale	<p>Fair value is based on discounted cash flows, which considers the following inputs:</p> <ul style="list-style-type: none"> Current lending rates for new loans 	<p>Carried at lower of amortized cost or fair value.</p> <p>Estimated fair value</p>

- Expected prepayment speeds classified as Level 3.
- Estimated credit losses
- Market liquidity adjustments

Multifamily loans (DUS)	The sale price is set at the time the loan commitment is made, and as such subsequent changes in market conditions have a very limited effect, if any, on the value of these loans carried on the consolidated statements of financial condition, which are typically sold within 30 days of origination.	Carried at lower of amortized cost or fair value.
		Estimated fair value classified as Level 2.

Edgar Filing: HomeStreet, Inc. - Form 10-Q

Asset/Liability class	Valuation methodology, inputs and assumptions	Classification
Loans held for investment	Fair value is based on discounted cash flows, which considers the following inputs:	For the carrying value of loans see Note 1—Summary of Significant Accounting Policies of the 2015 Annual Report on Form 10-K.
Loans held for investment, excluding collateral dependent loans and loans transferred from held for sale	<ul style="list-style-type: none"> • Current lending rates for new loans • Expected prepayment speeds • Estimated credit losses • Market liquidity adjustments <p>Fair value is based on appraised value of collateral, which considers sales comparison and income approach methodologies. Adjustments are made for various factors, which may include:</p> <ul style="list-style-type: none"> • Adjustments for variations in specific property qualities such as location, physical dissimilarities, market conditions at the time of sale, income producing characteristics and other factors 	Estimated fair value classified as Level 3.
Loans held for investment, collateral dependent	<ul style="list-style-type: none"> • Adjustments to obtain “upon completion” and “upon stabilization” values (e.g., property hold discounts where the highest and best use would require development of a property over time) • Bulk discounts applied for sales costs, holding costs and profit for tract development and certain other properties <p>Fair value is based on discounted cash flows, which considers the following inputs:</p>	Carried at lower of amortized cost or fair value of collateral, less the estimated cost to sell.
Loans held for investment transferred from loans held for sale	<ul style="list-style-type: none"> • Current lending rates for new loans • Expected prepayment speeds • Estimated credit losses • Market liquidity adjustments 	Classified as a Level 3 nonrecurring fair value measurement in periods where carrying value is adjusted to reflect the fair value of collateral.
Mortgage servicing rights	For information on how the Company measures the fair value of its single family MSRs, including key economic assumptions and the sensitivity of fair value to changes in those assumptions, see Note 8, Mortgage Banking Operations.	Level 3 recurring fair value measurement
Single family MSRs	Fair value is based on discounted estimated future servicing fees and other revenue, less estimated costs to service the loans.	Level 3 recurring fair value measurement
Multifamily MSRs		Carried at lower of amortized cost or fair value
Derivatives		Estimated fair value classified as Level 3.
Interest rate swaps		

Edgar Filing: HomeStreet, Inc. - Form 10-Q

Interest rate swaptions Forward sale commitments	Fair value is based on quoted prices for identical or similar instruments, when available.	Level 2 recurring fair value measurement
---	--	--

When quoted prices are not available, fair value is based on internally developed modeling techniques, which require the use of multiple observable market inputs including:

- Forward interest rates

- Interest rate volatilities

The fair value considers several factors including:

Interest rate lock and
purchase loan commitments

- Fair value of the underlying loan based on quoted prices in the secondary market, when available.

Level 3 recurring fair value measurement

- Value of servicing

- Fall-out factor

Asset/Liability class	Valuation methodology, inputs and assumptions	Classification
Other real estate owned ("OREO")	Fair value is based on appraised value of collateral, less the estimated cost to sell. See discussion of "loans held for investment, collateral dependent" above for further information on appraisals.	Carried at lower of amortized cost or fair value of collateral (Level 3), less the estimated cost to sell.
Federal Home Loan Bank stock	Carrying value approximates fair value as FHLB stock can only be purchased or redeemed at par value.	Carried at par value. Estimated fair value classified as Level 2.
Deposits		Carried at historical cost.
Demand deposits	Fair value is estimated as the amount payable on demand at the reporting date.	Estimated fair value classified as Level 2. Carried at historical cost.
Fixed-maturity certificates of deposit	Fair value is estimated using discounted cash flows based on market rates currently offered for deposits of similar remaining time to maturity.	Estimated fair value classified as Level 2. Carried at historical cost.
Federal Home Loan Bank advances	Fair value is estimated using discounted cash flows based on rates currently available for advances with similar terms and remaining time to maturity.	Estimated fair value classified as Level 2. Carried at historical cost.
Long-term debt	Fair value is estimated using discounted cash flows based on current lending rates for similar long-term debt instruments with similar terms and remaining time to maturity.	Estimated fair value classified as Level 2.

The following table presents the levels of the fair value hierarchy for the Company's assets and liabilities measured at fair value on a recurring basis.

(in thousands)	Fair Value at June 30, 2016			
	Level 1	Level 2	Level 3	
Assets:				
Investment securities available for sale				
Mortgage backed securities:				
Residential	\$ 139,074	\$ —	\$ —	\$ —
Commercial	24,707	—	24,707	—
Municipal bonds	335,801	—	335,801	—
Collateralized mortgage obligations:				
Residential	163,406	—	163,406	—
Commercial	116,099	—	116,099	—
Corporate debt securities	85,249	—	85,249	—
U.S. Treasury securities	26,020	—	26,020	—
Single family mortgage servicing rights	130,900	—	—	130,900
Single family loans held for sale	716,913	—	673,171	43,742
Single family loans held for investment	22,362	—	—	22,362
Derivatives				
Forward sale commitments	12,408	—	12,408	—
Interest rate swaptions	134	—	134	—
Interest rate lock and purchase loan commitments	39,995	—	—	39,995
Interest rate swaps	58,322	—	58,322	—
Total assets	\$1,871,390	\$ —	\$ —	\$236,999
Liabilities:				
Derivatives				
Forward sale commitments	\$ 16,090	\$ —	\$ —	\$ —
Interest rate lock and purchase loan commitments	4	—	—	4
Interest rate swaps	20,625	—	20,625	—
Total liabilities	\$36,719	\$ —	\$ —	\$4

(in thousands)	Fair Value at December 31, 2015	Level 1	Level 2	Level 3
Assets:				
Investment securities available for sale				
Mortgage backed securities:				
Residential	\$68,101	\$	—\$68,101	\$—
Commercial	17,851	—	17,851	—
Municipal bonds	171,869	—	171,869	—
Collateralized mortgage obligations:				
Residential	84,497	—	84,497	—
Commercial	79,133	—	79,133	—
Corporate debt securities	78,736	—	78,736	—
U.S. Treasury securities	40,964	—	40,964	—
Single family mortgage servicing rights	156,604	—	—	156,604
Single family loans held for sale	632,273	—	582,951	49,322
Single family loans held for investment	21,544	—	—	21,544
Derivatives				
Forward sale commitments	1,884	—	1,884	—
Interest rate swaptions	—	—	—	—
Interest rate lock and purchase loan commitments	17,719	—	—	17,719
Interest rate swaps	8,670	—	8,670	—
Total assets	\$1,379,845	\$	—\$1,134,656	\$245,189
Liabilities:				
Derivatives				
Forward sale commitments	\$1,496	\$	—\$1,496	\$—
Interest rate lock and purchase loan commitments	8	—	—	8
Interest rate swaps	4,007	—	4,007	—
Total liabilities	\$5,511	\$	—\$5,503	\$8

There were no transfers between levels of the fair value hierarchy during the three and six months ended June 30, 2016 and 2015.

Level 3 Recurring Fair Value Measurements

The Company's level 3 recurring fair value measurements consist of single family mortgage servicing rights, single family loans held for investment where fair value option was elected, certain single family loans held for sale, and interest rate lock and purchase loan commitments, which are accounted for as derivatives. For information regarding fair value changes and activity for single family MSRs during the three and six months ended June 30, 2016 and 2015, see Note 8, Mortgage Banking Operations of this Form 10-Q.

The Company transferred certain loans from held for sale to held for investment. These loans were originated as held for sale loans where the Company had elected fair value option. The Company determined these loans to be level 3 recurring assets as the valuation technique included a significant unobservable input. The total amount of held for investment loans where fair value option election was made was \$22.4 million at June 30, 2016.

Edgar Filing: HomeStreet, Inc. - Form 10-Q

The following information presents significant Level 3 unobservable inputs used to measure fair value of single family loans held for investment where fair value option was elected.

(dollars in thousands)	At June 30, 2016		Significant Unobservable Input	Low	High	Weighted Average
	Fair Value	Valuation Technique				
Loans held for investment, fair value option	\$22,362	Income approach	Implied spread to benchmark interest rate curve	4.21%	6.03%	4.72%
(dollars in thousands)	At December 31, 2015		Significant Unobservable Input	Low	High	Weighted Average
	Fair Value	Valuation Technique				
Loans held for investment, fair value option	\$21,544	Income approach	Implied spread to benchmark interest rate curve	3.26%	4.35%	4.01%

The following information presents significant Level 3 unobservable inputs used to measure fair value of certain single family loans held for sale where fair value option was elected.

(dollars in thousands)	At June 30, 2016		Significant Unobservable Input	Low	High	Weighted Average
	Fair Value	Valuation Technique				
Loans held for sale, fair value option	\$43,742	Income approach	Implied spread to benchmark interest rate curve	4.01%	5.64%	4.32%
			Market price movement from comparable bond	—%	0.68%	0.39%
(dollars in thousands)	At December 31, 2015		Significant Unobservable Input	Low	High	Weighted Average
	Fair Value	Valuation Technique				
Loans held for sale, fair value option	\$49,322	Income approach	Implied spread to benchmark interest rate curve	2.68%	7.62%	3.91%
			Market price movement from comparable bond	(0.43)%	(0.06)%	(0.27)%

The following table presents fair value changes and activity for Level 3 interest rate lock and purchase loan commitments.

(in thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Beginning balance, net	\$28,482	\$26,019	\$17,711	\$11,933
Total realized/unrealized gains ⁽¹⁾	58,767	32,160	103,295	88,146
Settlements	(47,258)	(34,692)	(81,015)	(76,592)
Ending balance, net	\$39,991	\$23,487	\$39,991	\$23,487

All realized and unrealized gains and losses are recognized in earnings as net gain from mortgage loan origination and sale activities on the consolidated statements of operations. There were net unrealized gains of \$40.0 million (1) for the three and six months ended June 30, 2016 and \$23.5 million for the three and six months ended June 30, 2015, respectively, recognized on interest rate lock and purchase loan commitments outstanding at June 30, 2016 and 2015, respectively.

Edgar Filing: HomeStreet, Inc. - Form 10-Q

The following information presents significant Level 3 unobservable inputs used to measure fair value of interest rate lock and purchase loan commitments.

(dollars in thousands)	At June 30, 2016		Significant Unobservable Input	Low	High	Weighted Average
	Fair Value	Valuation Technique				
Interest rate lock and purchase loan commitments, net	\$39,991	Income approach	Fall out factor	0.73%	66.31%	13.41%
			Value of servicing	0.57%	1.79%	1.00%

(dollars in thousands)	At December 31, 2015		Significant Unobservable Input	Low	High	Weighted Average
	Fair Value	Valuation Technique				
Interest rate lock and purchase loan commitments, net	\$17,711	Income approach	Fall out factor	0.60%	61.16%	15.80%
			Value of servicing	0.53%	1.71%	0.80%

Nonrecurring Fair Value Measurements

Certain assets held by the Company are not included in the tables above, but are measured at fair value on a nonrecurring basis. These assets include certain loans held for investment and other real estate owned that are carried at the lower of cost or fair value of the underlying collateral, less the estimated cost to sell. The estimated fair values of real estate collateral are generally based on internal evaluations and appraisals of such collateral, which use the market approach and income approach methodologies. All impaired loans are subject to an internal evaluation completed quarterly by management as part of the allowance process.

The fair value of commercial properties are generally based on third-party appraisals that consider recent sales of comparable properties, including their income-generating characteristics, adjusted (generally based on unobservable inputs) to reflect the general assumptions that a market participant would make when analyzing the property for purchase. The Company uses a fair value of collateral technique to apply adjustments to the appraisal value of certain commercial loans held for investment that are collateralized by real estate. During the three and six months ended June 30, 2016 and 2015, the Company recorded no adjustments to the appraisal values of certain commercial loans held for investment that are collateralized by real estate.

The Company uses a fair value of collateral technique to apply adjustments to the stated value of certain commercial loans held for investment that are not collateralized by real estate. During the three and six months ended June 30, 2016, the Company applied a stated value adjustment of 63.4%. During the three months ended June 30, 2015, the Company applied a range of stated value adjustments of 42.4% to 51.4%, with a weighted average of 48.2%. During the six months ended June 30, 2015, the Company applied a range of stated value adjustments of 25.0% to 51.4%, with a weighted average of 36.8%. During the three and six months ended June 30, 2016 and 2015, the Company did not apply any adjustment to the appraisal value of OREO.

Residential properties are generally based on unadjusted third-party appraisals. Factors considered in determining the fair value include geographic sales trends, the value of comparable surrounding properties as well as the condition of the property.

These adjustments include management assumptions that are based on the type of collateral dependent loan and may increase or decrease an appraised value. Management adjustments vary significantly depending on the location, physical characteristics and income producing potential of each individual property. The quality and volume of market information available at the time of the appraisal can vary from period-to-period and cause significant changes to the nature and magnitude of the unobservable inputs used. Given these variations, changes in these unobservable inputs are generally not a reliable indicator for how fair value will increase or decrease from period to period.

Edgar Filing: HomeStreet, Inc. - Form 10-Q

The following tables present assets that had changes in their recorded fair value during the three and six months ended June 30, 2016 and 2015 and what we still held at the end of the respective reporting period.

(in thousands)	At or for the Three Months Ended June 30, 2016				
	Fair Value of Assets Held at June 30, 2016				Total Gains (Losses)
	Level 1	Level 2	Level 3		

Loans held for investment ⁽¹⁾	\$2,581	\$ —	—\$	—\$2,581	\$ 20
Other real estate owned ⁽²⁾	5,485	—	—	5,485	—
Total	\$8,066	\$ —	—\$	—\$8,066	\$ 20

(in thousands)	At or for the Three Months Ended June 30, 2015				
	Fair Value of Assets Held at June 30, 2015				Total Gains (Losses)
	Level 1	Level 2	Level 3		

Loans held for investment ⁽¹⁾	\$8,955	\$ —	—\$	—\$8,955	\$ 170
Other real estate owned ⁽²⁾	—	—	—	—	—
Total	\$8,955	\$ —	—\$	—\$8,955	\$ 170

(in thousands)	At or for the Six Months Ended June 30, 2016				
	Fair Value of Assets Held at June 30, 2016				Total Gains (Losses)
	Level 1	Level 2	Level 3		

Loans held for investment ⁽¹⁾	\$2,581	\$ —	—\$	—\$2,581	\$ (14)
Other real estate owned ⁽²⁾	5,485	—	—	5,485	(391)
Total	\$8,066	\$ —	—\$	—\$8,066	\$ (405)

(in thousands)	At or for the Six Months Ended June 30, 2015			
	Level 1	Level 2	Level 3	

Edgar Filing: HomeStreet, Inc. - Form 10-Q

	Fair Value of Assets Held at June 30, 2015			Total Gains (Losses)
Loans held for investment ⁽¹⁾	\$8,955	\$	—\$	—\$8,955
Other real estate owned ⁽²⁾	—	—	—	—
Total	\$8,955	\$	—\$	—\$8,955
				\$ 184

(1) Represents the carrying value of loans for which adjustments are based on the fair value of the collateral.

(2) Represents other real estate owned where an updated fair value of collateral is used to adjust the carrying amount subsequent to the initial classification as other real estate owned.

Fair Value of Financial Instruments

The following presents the carrying value, estimated fair value and the levels of the fair value hierarchy for the Company's financial instruments other than assets and liabilities measured at fair value on a recurring basis.

	At June 30, 2016				
(in thousands)	Carrying Value	Fair Value	Level 1	Level 2	Level 3
Assets:					
Cash and cash equivalents	\$45,229	\$45,229	\$45,229	\$—	\$ —
Investment securities held to maturity	38,008	39,386	—	39,386	—
Loans held for investment	3,676,597	3,790,687	—	—	3,790,687
Loans held for sale – transferred from held for investment	9,858	9,858	—	—	9,858
Loans held for sale – multifamily	39,174	39,174	—	39,174	—
Mortgage servicing rights – multifamily	16,366	18,190	—	—	18,190
Federal Home Loan Bank stock	40,414	40,414	—	40,414	—
Liabilities:					
Deposits	\$4,239,155	\$4,224,768	\$—	\$4,224,768	\$ —
Federal Home Loan Bank advances	878,987	883,016	—	883,016	—
Long-term debt	125,126	128,603	—	128,603	—
At December 31, 2015					
(in thousands)	Carrying Value	Fair Value	Level 1	Level 2	Level 3
Assets:					
Cash and cash equivalents	\$32,684	\$32,684	\$32,684	\$—	\$ —
Investment securities held to maturity	31,013	31,387	—	31,387	—
Loans held for investment	3,171,176	3,255,740	—	—	3,255,740
Loans held for sale – transferred from held for investment	6,814	6,814	—	—	6,814
Loans held for sale – multifamily	11,076	11,076	—	11,076	—
Mortgage servicing rights – multifamily	14,651	16,412	—	—	16,412
Federal Home Loan Bank stock	44,342	44,342	—	44,342	—
Liabilities:					
Deposits	\$3,231,953	\$3,229,670	\$—	\$3,229,670	\$ —
Federal Home Loan Bank advances	1,018,159	1,021,344	—	1,021,344	—
Long-term debt	61,857	60,239	—	60,239	—

NOTE 11—EARNINGS PER SHARE:

The following table summarizes the calculation of earnings per share.

(in thousands, except share and per share data)	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Net income	\$21,749	\$ 12,376	\$28,156	\$ 22,680
Weighted average shares:				
Basic weighted-average number of common shares outstanding	24,708,372	22,028,539	24,192,441	19,593,421
Dilutive effect of outstanding common stock equivalents ⁽¹⁾	203,544	264,195	202,207	230,484
Diluted weighted-average number of common stock outstanding	24,911,916	22,292,734	24,394,648	19,823,905
Earnings per share:				
Basic earnings per share	\$0.88	\$ 0.56	\$1.16	\$ 1.16
Diluted earnings per share	\$0.87	\$ 0.56	\$1.15	\$ 1.14

Excluded from the computation of diluted earnings per share (due to their antidilutive effect) for the three and six months ended June 30, 2016 and 2015 were certain stock options and unvested restricted stock issued to key senior (1) management personnel and directors of the Company. The aggregate number of common stock equivalents related to such options and unvested restricted shares, which could potentially be dilutive in future periods, was zero and 927 at June 30, 2016 and 2015, respectively.

NOTE 12–BUSINESS SEGMENTS:

The Company's business segments are determined based on the products and services provided, as well as the nature of the related business activities, and they reflect the manner in which financial information is currently evaluated by management. The Company organizes the segments into two lines of business: Commercial and Consumer Banking segment and Mortgage Banking segment.

A description of the Company's business segments and the products and services that they provide is as follows.

Commercial and Consumer Banking provides diversified financial products and services to our commercial and consumer customers through bank branches and through ATMs, online, mobile and telephone banking. These products and services include deposit products; residential, consumer, business and agricultural portfolio loans; non-deposit investment products; insurance products and cash management services. We originate construction loans, bridge loans and permanent loans for our portfolio primarily on single family residences, and on office, retail, industrial and multifamily property types. We originate multifamily real estate loans through our Fannie Mae DUS business, whereby loans are sold to or securitized by Fannie Mae, while the Company generally retains the servicing rights. This segment is also responsible for the management of the Company's portfolio of investment securities.

Mortgage Banking originates single family residential mortgage loans for sale in the secondary markets. The majority of our mortgage loans are sold to or securitized by Fannie Mae, Freddie Mac or Ginnie Mae, while we retain the right to service these loans. We have become a rated originator and servicer of jumbo loans, allowing us to sell these loans to other securitizers. Additionally, we purchase loans from WMS Series LLC through a correspondent arrangement with that company. We also sell loans on a servicing-released and servicing-retained basis to securitizers and correspondent lenders. A small percentage of our loans are brokered to other lenders or sold on a servicing-released basis to correspondent lenders. On occasion, we may sell a portion of our MSR portfolio. We manage the loan funding and the interest rate risk associated with the secondary market loan sales and the retained single family mortgage servicing rights within this business segment.

Financial highlights by operating segment were as follows.

(in thousands)	Three Months Ended June 30, 2016		
	Mortgage Banking	Commercial and Consumer Banking	Total
Condensed income statement:			
Net interest income ⁽¹⁾	\$6,089	\$38,393	\$44,482
Provision for credit losses	—	1,100	1,100
Noninterest income	94,295	8,181	102,476
Noninterest expense	76,928	34,103	111,031
Income before income taxes	23,456	11,371	34,827
Income tax expense	8,786	4,292	13,078
Net income	\$14,670	\$7,079	\$21,749
Total assets	\$966,586	\$4,974,592	\$5,941,178

Three Months Ended June 30, 2015

(in thousands)	Commercial		
	Mortgage Banking	and Consumer Banking	Total
Condensed income statement:			
Net interest income ⁽¹⁾	\$7,585	\$30,645	\$38,230
Provision for credit losses	—	500	500
Noninterest income	69,363	3,624	72,987
Noninterest expense	63,055	29,280	92,335
Income before income taxes	13,893	4,489	18,382
Income tax expense	4,371	1,635	6,006
Net income	\$9,522	\$2,854	\$12,376
Total assets	\$1,175,075	\$3,691,173	\$4,866,248

Six Months Ended June 30, 2016

(in thousands)	Commercial		
	Mortgage Banking	and Consumer Banking	Total
Condensed income statement:			
Net interest income ⁽¹⁾	\$11,134	\$74,039	\$85,173
Provision for credit losses	—	2,500	2,500
Noninterest income	161,360	12,824	174,184
Noninterest expense	141,651	70,733	212,384
Income before income taxes	30,843	13,630	44,473
Income tax expense	11,308	5,009	16,317
Net income	\$19,535	\$8,621	\$28,156
Total assets	\$966,586	\$4,974,592	\$5,941,178

Six Months Ended June 30, 2015

(in thousands)	Commercial		
	Mortgage Banking	and Consumer Banking	Total
Condensed income statement:			
Net interest income ⁽¹⁾	\$13,212	\$55,752	\$68,964
Provision for credit losses	—	3,500	3,500
Noninterest income	134,655	13,705	148,360
Noninterest expense	116,871	64,946	181,817
Income before income taxes	30,996	1,011	32,007
Income tax expense (benefit)	11,156	(1,829)	9,327
Net income	\$19,840	\$2,840	\$22,680
Total assets	\$1,175,075	\$3,691,173	\$4,866,248

(1) Net interest income is the difference between interest earned on assets and the cost of liabilities to fund those assets. Interest earned includes actual interest earned on segment assets and, if the segment has excess liabilities,

interest credits for providing funding to the other segment. The cost of liabilities includes interest expense on segment liabilities and, if the segment does not have enough liabilities to fund its assets, a funding charge based on the cost of excess liabilities from another segment.

NOTE 13—ACCUMULATED OTHER COMPREHENSIVE INCOME:

The following table shows changes in accumulated other comprehensive income (loss) from unrealized gain (loss) on available-for-sale securities, net of tax.

(in thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Beginning balance	\$4,161	\$3,713	\$(2,449)	\$1,546
Other comprehensive income (loss) before reclassifications	5,627	(4,295)	12,260	(2,128)
Amounts reclassified from accumulated other comprehensive income (loss)	(40)	—	(63)	—
Net current-period other comprehensive income (loss)	5,587	(4,295)	12,197	(2,128)
Ending balance	\$9,748	\$(582)	\$9,748	\$(582)

The following table shows the affected line items in the consolidated statements of operations from reclassifications of unrealized gain (loss) on available-for-sale securities from accumulated other comprehensive income (loss).

Affected Line Item in the Consolidated Statements of Operations	Amount Reclassified from Accumulated Other Comprehensive Income			
	Three Months Ended June 30,		Six Months Ended June 30,	
(in thousands)	2016	2015	2016	2015
Gain on sale of investment securities available for sale	\$ 62	\$ —	\$ 97	\$ —
Income tax expense	22	—	34	—
Total, net of tax	\$ 40	\$ —	\$ 63	\$ —

NOTE 14—SUBSEQUENT EVENTS:

The Company has evaluated subsequent events through the time of filing this Quarterly Report on Form 10-Q and has concluded that there are no significant events that occurred subsequent to the balance sheet date but prior to the filing of this report that would have a material impact on the consolidated financial statements.

ITEM 2 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FORWARD-LOOKING STATEMENTS

Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with the Consolidated Financial Statements and Notes presented elsewhere in this report and in HomeStreet, Inc.'s 2015 Annual Report on Form 10-K.

This Form 10-Q and the documents incorporated by reference contain, in addition to historical information, "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act") and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). These statements relate to our future plans, objectives, expectations, intentions and financial performance, and assumptions that underlie these statements. When used in this Form 10-Q, terms such as "anticipates," "believes," "continue," "could," "estimates," "expects," "intends," "may," "plans," "potential," "predicts," "should," or "will" or the negative of those terms or comparable terms are intended to identify such forward-looking statements. These statements involve known and unknown risks, uncertainties and other factors that may cause industry trends or actual results, level of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by these statements. Our actual results may differ significantly from the results discussed in such forward-looking statements, and we may take actions that differ from our current plans and expectations. All statements other than statements of historical fact are "forward-looking statements" for the purposes of these provisions, including:

- any projections of revenues, estimated operating expenses or other financial items;
- any statements of the plans and objectives of management for future operations or programs;
- any statements regarding future operations, plans, or regulatory or shareholder approvals;
- any statements concerning proposed new products or services;
- any statements regarding pending or future mergers, acquisitions or other transactions; and
- any statement regarding future economic conditions or performance, and any statement of assumption underlying any of the foregoing.

These and other forward looking statements are, among other things, attempts to predict the future and, as such, may not come to pass. A wide variety of events, circumstances and conditions may cause us to fall short of management's expectations as expressed herein, or to deviate from the plans and intentions we have described in this report.

Unless required by law, we do not intend to update any of the forward-looking statements after the date of this Form 10-Q to conform these statements to actual results or changes in our expectations. Readers are cautioned not to place undue reliance on these forward-looking statements, which apply only as of the date of this Form 10-Q.

Except as otherwise noted, references to "we," "our," "us" or "the Company" refer to HomeStreet, Inc. and its subsidiaries that are consolidated for financial reporting purposes.

You may review a copy of this Form 10-Q quarterly report, including exhibits and any schedule filed therewith, and obtain copies of such materials at prescribed rates, at the Securities and Exchange Commission's Public Reference Room at, 100 F Street, NE, Washington, D.C. 20549. You may obtain information on the operation of the Public Reference Room by calling the Securities and Exchange Commission at 1-800-SEC-0330. The Securities and Exchange Commission maintains a website (<http://www.sec.gov>) that contains reports, proxy and information statements and other information regarding registrants, such as HomeStreet, Inc., that file electronically with the Securities and Exchange Commission. Copies of our Securities Exchange Act reports also are available from our investor relations website, <http://ir.homestreet.com>. Except as otherwise expressly noted in that section of our investor relations website, information contained in or linked from our websites is not incorporated into and does not constitute

a part of this report.

58

Summary Financial Data

	At or for the Three Months Ended					At or for the Six Months Ended	
(dollars in thousands, except share data)	Jun. 30, 2016	Mar. 31, 2016	Dec. 31, 2015	Sept. 30, 2015	Jun. 30, 2015	Jun. 30, 2016	Jun. 30, 2015
Income statement data (for the period ended):							
Net interest income	\$44,482	\$ 40,691	\$ 39,740	\$ 39,634	\$ 38,230	\$85,173	\$68,964
Provision for credit losses	1,100	1,400	1,900	700	500	2,500	3,500
Noninterest income	102,476	71,708	65,409	67,468	72,987	174,184	148,360
Noninterest expense	111,031	101,353	92,725	92,026	92,335	212,384	181,817
Income before income taxes	34,827	9,646	10,524	14,376	18,382	44,473	32,007
Income tax expense	13,078	3,239	1,846	4,415	6,006	16,317	9,327
Net income	\$21,749	\$ 6,407	\$ 8,678	\$ 9,961	\$ 12,376	\$28,156	\$22,680
Basic income per share	\$0.88	\$ 0.27	\$ 0.39	\$ 0.45	\$ 0.56	\$1.16	\$1.16
Diluted income per share	\$0.87	\$ 0.27	\$ 0.39	\$ 0.45	\$ 0.56	\$1.15	\$1.14
Common shares outstanding	24,821,349	24,550,219	22,076,534	22,061,702	22,065,249	24,821,349	