

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

HomeStreet, Inc.  
Form 10-Q  
November 07, 2013

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

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FORM 10-Q

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

For the quarterly period ended: September 30, 2013  
Commission file number: 001-35424

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HOMESTREET, INC.  
(Exact name of registrant as specified in its charter)

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|                                                      |                                   |
|------------------------------------------------------|-----------------------------------|
| 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 | <input type="checkbox"/> | Accelerated Filer         | <input checked="" type="checkbox"/> |
| Non-accelerated Filer   | <input type="checkbox"/> | Smaller Reporting Company | <input type="checkbox"/>            |

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 October 31, 2013 was 14,425,224.

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PART I – FINANCIAL INFORMATION

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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 and other direct and indirect subsidiaries of HomeStreet, Inc.

PART I – FINANCIAL INFORMATION  
ITEM 1. FINANCIAL STATEMENTS

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

| (in thousands, except share data)                                                                                   | September 30,<br>2013 | December 31,<br>2012 |
|---------------------------------------------------------------------------------------------------------------------|-----------------------|----------------------|
| <b>ASSETS</b>                                                                                                       |                       |                      |
| Cash and cash equivalents (including interest-bearing instruments of \$21,747 and \$12,414)                         | \$37,906              | \$25,285             |
| Investment securities available for sale                                                                            | 573,591               | 416,329              |
| Loans held for sale (includes \$385,110 and \$607,578 carried at fair value)                                        | 385,110               | 620,799              |
| Loans held for investment (net of allowance for loan losses of \$24,694 and \$27,561)                               | 1,510,169             | 1,308,974            |
| Mortgage servicing rights (includes \$136,897 and \$87,396 carried at fair value)                                   | 146,300               | 95,493               |
| Other real estate owned                                                                                             | 12,266                | 23,941               |
| Federal Home Loan Bank stock, at cost                                                                               | 35,370                | 36,367               |
| Premises and equipment, net                                                                                         | 24,684                | 15,232               |
| Accounts receivable and other assets                                                                                | 128,927               | 88,810               |
| Total assets                                                                                                        | \$2,854,323           | \$2,631,230          |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>                                                                         |                       |                      |
| <b>Liabilities:</b>                                                                                                 |                       |                      |
| Deposits                                                                                                            | \$2,098,076           | \$1,976,835          |
| Federal Home Loan Bank advances                                                                                     | 338,690               | 259,090              |
| Accounts payable and other liabilities                                                                              | 87,492                | 69,686               |
| Long-term debt                                                                                                      | 61,857                | 61,857               |
| Total liabilities                                                                                                   | 2,586,115             | 2,367,468            |
| <b>Shareholders' equity:</b>                                                                                        |                       |                      |
| 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, 14,422,354 shares and 14,382,638 shares | 511                   | 511                  |
| Additional paid-in capital                                                                                          | 91,415                | 90,189               |
| Retained earnings                                                                                                   | 185,379               | 163,872              |
| Accumulated other comprehensive income (loss)                                                                       | (9,097)               | ) 9,190              |
| Total shareholders' equity                                                                                          | 268,208               | 263,762              |
| Total liabilities and shareholders' equity                                                                          | \$2,854,323           | \$2,631,230          |

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

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

|                                                                                                                                                                                                                                                                                                                                    | Three Months Ended<br>September 30, |          | Nine Months Ended<br>September 30, |          |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------|----------|------------------------------------|----------|
| (in thousands, except share data)                                                                                                                                                                                                                                                                                                  | 2013                                | 2012     | 2013                               | 2012     |
| Interest income:                                                                                                                                                                                                                                                                                                                   |                                     |          |                                    |          |
| Loans                                                                                                                                                                                                                                                                                                                              | \$19,425                            | \$18,512 | \$54,920                           | \$52,344 |
| Investment securities available for sale                                                                                                                                                                                                                                                                                           | 3,895                               | 2,517    | 9,552                              | 7,205    |
| Other                                                                                                                                                                                                                                                                                                                              | 28                                  | 24       | 82                                 | 216      |
|                                                                                                                                                                                                                                                                                                                                    | 23,348                              | 21,053   | 64,554                             | 59,765   |
| Interest expense:                                                                                                                                                                                                                                                                                                                  |                                     |          |                                    |          |
| Deposits                                                                                                                                                                                                                                                                                                                           | 2,222                               | 3,908    | 8,078                              | 12,985   |
| Federal Home Loan Bank advances                                                                                                                                                                                                                                                                                                    | 434                                 | 297      | 1,113                              | 1,506    |
| Securities sold under agreements to repurchase                                                                                                                                                                                                                                                                                     | —                                   | 19       | 11                                 | 69       |
| Long-term debt                                                                                                                                                                                                                                                                                                                     | 274                                 | 305      | 2,274                              | 1,041    |
| Other                                                                                                                                                                                                                                                                                                                              | 6                                   | 4        | 16                                 | 13       |
|                                                                                                                                                                                                                                                                                                                                    | 2,936                               | 4,533    | 11,492                             | 15,614   |
| Net interest income                                                                                                                                                                                                                                                                                                                | 20,412                              | 16,520   | 53,062                             | 44,151   |
| (Reversal of) provision for credit losses                                                                                                                                                                                                                                                                                          | (1,500)                             | ) 5,500  | 900                                | 7,500    |
| Net interest income after provision for credit losses                                                                                                                                                                                                                                                                              | 21,912                              | 11,020   | 52,162                             | 36,651   |
| Noninterest income:                                                                                                                                                                                                                                                                                                                |                                     |          |                                    |          |
| Net gain on mortgage loan origination and sale activities                                                                                                                                                                                                                                                                          | 33,491                              | 65,336   | 139,870                            | 141,683  |
| Mortgage servicing income                                                                                                                                                                                                                                                                                                          | 4,011                               | 506      | 9,265                              | 15,470   |
| (Loss) income from Windermere Mortgage Services Series LLC                                                                                                                                                                                                                                                                         | (550)                               | ) 1,188  | 1,063                              | 3,748    |
| Loss on debt extinguishment                                                                                                                                                                                                                                                                                                        | —                                   | —        | —                                  | (939)    |
| Depositor and other retail banking fees                                                                                                                                                                                                                                                                                            | 791                                 | 756      | 2,273                              | 2,262    |
| Insurance commissions                                                                                                                                                                                                                                                                                                              | 242                                 | 192      | 612                                | 551      |
| (Loss) gain on sale of investment securities available for sale (includes unrealized gains (losses) reclassified from accumulated other comprehensive income of \$(184) and \$397 for the three months ended September 30, 2013 and 2012, and \$6 and \$1,349 for the nine months ended September 30, 2013 and 2012, respectively) | (184)                               | ) 397    | 6                                  | 1,349    |
| Other                                                                                                                                                                                                                                                                                                                              | 373                                 | 716      | 1,584                              | 1,965    |
|                                                                                                                                                                                                                                                                                                                                    | 38,174                              | 69,091   | 154,673                            | 166,089  |
| Noninterest expense:                                                                                                                                                                                                                                                                                                               |                                     |          |                                    |          |
| Salaries and related costs                                                                                                                                                                                                                                                                                                         | 39,689                              | 31,573   | 113,330                            | 81,148   |
| General and administrative                                                                                                                                                                                                                                                                                                         | 9,234                               | 7,148    | 30,434                             | 19,304   |
| Legal                                                                                                                                                                                                                                                                                                                              | 844                                 | 312      | 2,054                              | 1,471    |
| Consulting                                                                                                                                                                                                                                                                                                                         | 884                                 | 1,069    | 2,343                              | 1,746    |
| Federal Deposit Insurance Corporation assessments                                                                                                                                                                                                                                                                                  | 227                                 | 794      | 937                                | 2,751    |
| Occupancy                                                                                                                                                                                                                                                                                                                          | 3,484                               | 2,279    | 9,667                              | 6,160    |
| Information services                                                                                                                                                                                                                                                                                                               | 3,552                               | 2,411    | 10,122                             | 6,128    |
| Net cost of operation and sale of other real estate owned                                                                                                                                                                                                                                                                          | 202                                 | 348      | 1,740                              | 8,917    |
|                                                                                                                                                                                                                                                                                                                                    | 58,116                              | 45,934   | 170,627                            | 127,625  |
| Income before income taxes                                                                                                                                                                                                                                                                                                         | 1,970                               | 34,177   | 36,208                             | 75,115   |

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|                                                                                                                                                                                                                              |            |            |            |            |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------|------------|------------|------------|
| Income tax expense (includes reclassification adjustments of \$(64) and \$139 for the three months ended September 30, 2013 and 2012, and \$2 and \$472 for the nine months ended September 30, 2013 and 2012, respectively) |            |            |            |            |
|                                                                                                                                                                                                                              | 308        | 12,186     | 11,538     | 14,487     |
| NET INCOME                                                                                                                                                                                                                   | \$1,662    | \$21,991   | \$24,670   | \$60,628   |
| Basic income per share                                                                                                                                                                                                       | \$0.12     | \$1.53     | \$1.72     | \$4.68     |
| Diluted income per share                                                                                                                                                                                                     | \$0.11     | \$1.50     | \$1.67     | \$4.52     |
| Basic weighted average number of shares outstanding                                                                                                                                                                          | 14,388,559 | 14,335,950 | 14,374,943 | 12,960,212 |
| Diluted weighted average number of shares outstanding                                                                                                                                                                        | 14,790,671 | 14,699,032 | 14,793,427 | 13,414,475 |
| See accompanying notes to interim consolidated financial statements (unaudited).                                                                                                                                             |            |            |            |            |

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

| (in thousands)                                                                                                                                                                                                                                                               | Three Months Ended<br>September 30, |          | Nine Months Ended<br>September 30, |          |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------|----------|------------------------------------|----------|
|                                                                                                                                                                                                                                                                              | 2013                                | 2012     | 2013                               | 2012     |
| Net income                                                                                                                                                                                                                                                                   | \$1,662                             | \$21,991 | \$24,670                           | \$60,628 |
| Other comprehensive income (loss), net of tax:                                                                                                                                                                                                                               |                                     |          |                                    |          |
| Unrealized (loss) gain on securities:                                                                                                                                                                                                                                        |                                     |          |                                    |          |
| Unrealized holding (loss) gain arising during the period<br>(net of tax (benefit) expense of \$(362) and \$1,564 for the<br>three months ended September 30, 2013 and 2012 and \$(9,845) and \$3,135 for the nine months ended<br>September 30, 2013 and 2012, respectively) | (673                                | ) 3,525  | (18,283                            | ) 6,107  |
| Reclassification adjustment included in net income (net<br>of tax (benefit) expense of \$(64) and \$139 for the three<br>months ended September 30, 2013 and 2012, and \$2 and 120<br>\$472 for the nine months ended September 30, 2013 and<br>2012, respectively)          |                                     | (258     | ) (4                               | ) (877   |
| Other comprehensive income (loss)                                                                                                                                                                                                                                            | (553                                | ) 3,267  | (18,287                            | ) 5,230  |
| Comprehensive income                                                                                                                                                                                                                                                         | \$1,109                             | \$25,258 | \$6,383                            | \$65,858 |

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<br>of shares | Common<br>stock | Additional<br>paid-in<br>capital | Retained<br>earnings | Accumulated<br>other<br>comprehensive<br>income (loss) | Total     |
|-----------------------------------|---------------------|-----------------|----------------------------------|----------------------|--------------------------------------------------------|-----------|
| Balance, January 1, 2012          | 5,403,498           | \$511           | \$31                             | \$81,746             | \$ 4,119                                               | \$86,407  |
| Net income                        | —                   | —               | —                                | 60,628               | —                                                      | 60,628    |
| Share-based compensation          | —                   | —               | 2,415                            | —                    | —                                                      | 2,415     |
| Common stock issued               | 8,951,474           | —               | 86,818                           | —                    | —                                                      | 86,818    |
| Other comprehensive income        | —                   | —               | —                                | —                    | 5,230                                                  | 5,230     |
| Balance, September 30, 2012       | 14,354,972          | \$511           | \$89,264                         | \$142,374            | \$ 9,349                                               | \$241,498 |
| Balance, January 1, 2013          | 14,382,638          | \$511           | \$90,189                         | \$163,872            | \$ 9,190                                               | \$263,762 |
| Net income                        | —                   | —               | —                                | 24,670               | —                                                      | 24,670    |
| Dividends declared                | —                   | —               | —                                | (3,163 )             | —                                                      | (3,163 )  |
| Share-based compensation          | —                   | —               | 1,098                            | —                    | —                                                      | 1,098     |
| Common stock issued               | 39,716              | —               | 128                              | —                    | —                                                      | 128       |
| Other comprehensive loss          | —                   | —               | —                                | —                    | (18,287 )                                              | (18,287 ) |
| Balance, September 30, 2013       | 14,422,354          | \$511           | \$91,415                         | \$185,379            | \$ (9,097 )                                            | \$268,208 |

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

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

|                                                                                           | Nine Months Ended September 30, |              |
|-------------------------------------------------------------------------------------------|---------------------------------|--------------|
| (in thousands)                                                                            | 2013                            | 2012         |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>                                              |                                 |              |
| Net income                                                                                | \$24,670                        | \$60,628     |
| Adjustments to reconcile net income to net cash used in operating activities:             |                                 |              |
| Amortization/accretion of discount/premium on loans held for investment, net of additions | 56                              | (919 )       |
| Amortization/accretion of discount/premium on investment securities                       | 5,629                           | 3,877        |
| Amortization of intangibles                                                               | 22                              | 77           |
| Amortization of mortgage servicing rights                                                 | 1,347                           | 1,551        |
| Provision for credit losses                                                               | 900                             | 7,500        |
| Provision for losses on other real estate owned                                           | 547                             | 10,955       |
| Depreciation on premises and equipment                                                    | 3,231                           | 1,864        |
| Fair value adjustment of loans held for sale                                              | 15,602                          | (26,975 )    |
| Fair value adjustment of foreclosed loans transferred to other real estate owned          | (218 )                          | (489 )       |
| Origination of mortgage servicing rights                                                  | (53,627 )                       | (33,606 )    |
| Change in fair value of mortgage servicing rights                                         | 1,493                           | 27,889       |
| Net gain on sale of investment securities                                                 | (6 )                            | (1,349 )     |
| Net gain on sale of other real estate owned                                               | (526 )                          | (2,764 )     |
| Net deferred income tax expense (benefit)                                                 | 18,650                          | (11,494 )    |
| Share-based compensation expense                                                          | 932                             | 2,415        |
| Origination of loans held for sale                                                        | (4,151,302 )                    | (3,433,925 ) |
| Proceeds from sale of loans held for sale                                                 | 4,425,792                       | 3,075,401    |
| Cash used by changes in operating assets and liabilities:                                 |                                 |              |
| Increase in accounts receivable and other assets                                          | (36,680 )                       | (55,462 )    |
| Increase in accounts payable and other liabilities                                        | 1,704                           | 38,691       |
| Net cash provided by (used in) operating activities                                       | 258,216                         | (336,135 )   |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>                                              |                                 |              |
| Purchase of investment securities                                                         | (286,741 )                      | (260,566 )   |
| Proceeds from sale of investment securities                                               | 54,166                          | 159,174      |
| Principal repayments and maturities of investment securities                              | 41,556                          | 28,150       |
| Proceeds from sale of other real estate owned                                             | 17,396                          | 47,392       |
| Mortgage servicing rights purchased from others                                           | (20 )                           | (65 )        |
| Capital expenditures related to other real estate owned                                   | (22 )                           | (4,643 )     |
| Origination of loans held for investment and principal repayments, net                    | (261,379 )                      | (62 )        |
| Property and equipment purchased                                                          | (12,683 )                       | (8,355 )     |
| Net cash used in investing activities                                                     | (447,727 )                      | (38,975 )    |

| (in thousands)                                                                  | Nine Months Ended September 30, |                   |
|---------------------------------------------------------------------------------|---------------------------------|-------------------|
|                                                                                 | 2013                            | 2012              |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>                                    |                                 |                   |
| Increase (decrease) in deposits, net                                            | \$ 121,241                      | \$(27,941 )       |
| Proceeds from Federal Home Loan Bank advances                                   | 4,477,102                       | 4,975,490         |
| Repayment of Federal Home Loan Bank advances                                    | (4,397,502 )                    | (4,901,811 )      |
| Proceeds from securities sold under agreements to repurchase                    | 159,790                         | 393,500           |
| Repayment of securities sold under agreements to repurchase                     | (159,790 )                      | (393,500 )        |
| Proceeds from Federal Home Loan Bank stock repurchase                           | 997                             | 330               |
| Proceeds from stock issuance, net                                               | 128                             | 87,791            |
| Excess tax benefits related to the exercise of stock options                    | 166                             | —                 |
| Net cash provided by financing activities                                       | 202,132                         | 133,859           |
| <b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>                     | <b>12,621</b>                   | <b>(241,251 )</b> |
| <b>CASH AND CASH EQUIVALENTS:</b>                                               |                                 |                   |
| Beginning of year                                                               | 25,285                          | 263,302           |
| End of period                                                                   | \$37,906                        | \$22,051          |
| <b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:</b>                       |                                 |                   |
| Cash paid during the period for:                                                |                                 |                   |
| Interest                                                                        | \$24,969                        | \$16,642          |
| Federal and state income taxes                                                  | 6,796                           | 11,746            |
| Non-cash activities:                                                            |                                 |                   |
| Loans held for investment foreclosed and transferred to other real estate owned | 10,831                          | 37,305            |
| Loans transferred from held for investment to held for sale                     | 54,403                          | 9,966             |
| Ginnie Mae loans recorded with the right to repurchase, net                     | \$3,775                         | \$3,330           |

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 Pacific Northwest, California and 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, Union Street Holdings LLC and Lacey Gateway LLC. HomeStreet Bank was formed in 1986 and is a state-chartered savings 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. 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. Although these estimates contemplate current conditions and how they are expected to change in the future, it is reasonably possible that actual conditions could be worse than anticipated in those estimates, which could materially affect the Company’s results of operations and financial condition. Management has made significant estimates in several areas, and actual results could differ materially from those estimates. Certain amounts in the financial statements from prior periods have been reclassified to conform to the current financial statement presentation.

The information furnished in these unaudited interim financial statements reflects 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 the Company’s Annual Report on Form 10-K for the year ended December 31, 2012, filed with the Securities and Exchange Commission (“2012 Annual Report on Form 10-K”).

Shares outstanding and per share information presented in this Form 10-Q have been adjusted to reflect the 2-for-1 forward stock splits effective on November 5, 2012 and on March 6, 2012.

NOTE 2—SIGNIFICANT RISKS AND UNCERTAINTIES:

Regulatory Agreements

Homestreet, Inc. received notification from the Federal Reserve Bank of San Francisco that the Cease and Desist Order, dated May 18, 2009 issued by the Office of Thrift Supervision, had been terminated effective March 26, 2013.

On December 27, 2012, the Bank had been notified by the Federal Deposit Insurance Corporation (“FDIC”) and the Washington State Department of Financial Institutions (“WDFI”) that the Bank had taken appropriate corrective actions to address the memorandum of understanding (“MOU”) in place since March 26, 2012, and consequently the Bank’s MOU was terminated effective December 27, 2012. The Bank is no longer considered a “troubled institution” and is considered “well-capitalized” within the meaning of the FDIC’s prompt corrective action rules.



## NOTE 3—INVESTMENT SECURITIES AVAILABLE FOR SALE:

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

| (in thousands)                       | At September 30, 2013 |                        |                         |              |
|--------------------------------------|-----------------------|------------------------|-------------------------|--------------|
|                                      | Amortized cost        | Gross unrealized gains | Gross unrealized losses | Fair value   |
| Mortgage-backed securities:          |                       |                        |                         |              |
| Residential                          | \$ 147,396            | \$ 221                 | \$(3,354)               | ) \$ 144,263 |
| Commercial                           | 13,478                | 242                    | —                       | ) 13,720     |
| Municipal bonds                      | 152,481               | 672                    | (5,712)                 | ) 147,441    |
| Collateralized mortgage obligations: |                       |                        |                         |              |
| Residential                          | 153,460               | 1,473                  | (1,467)                 | ) 153,466    |
| Commercial                           | 17,457                | —                      | (466)                   | ) 16,991     |
| Corporate debt securities            | 75,888                | 1                      | (5,926)                 | ) 69,963     |
| U.S. Treasury securities             | 27,744                | 3                      | —                       | ) 27,747     |
|                                      | \$ 587,904            | \$ 2,612               | \$(16,925)              | ) \$ 573,591 |

| (in thousands)                       | At December 31, 2012 |                        |                         |              |
|--------------------------------------|----------------------|------------------------|-------------------------|--------------|
|                                      | Amortized cost       | Gross unrealized gains | Gross unrealized losses | Fair value   |
| Mortgage-backed securities:          |                      |                        |                         |              |
| Residential                          | \$ 62,847            | \$ 223                 | \$(217)                 | ) \$ 62,853  |
| Commercial                           | 13,720               | 660                    | —                       | ) 14,380     |
| Municipal bonds                      | 123,695              | 5,574                  | (94)                    | ) 129,175    |
| Collateralized mortgage obligations: |                      |                        |                         |              |
| Residential                          | 163,981              | 6,333                  | (115)                   | ) 170,199    |
| Commercial                           | 8,983                | 60                     | —                       | ) 9,043      |
| U.S. Treasury securities             | 30,670               | 11                     | (2)                     | ) 30,679     |
|                                      | \$ 403,896           | \$ 12,861              | \$(428)                 | ) \$ 416,329 |

Mortgage-backed securities ("MBS") and collateralized mortgage obligations ("CMO") represent securities issued by government sponsored entities ("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 September 30, 2013 and December 31, 2012, 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 September 30, 2013 and December 31, 2012, substantially all securities held had ratings available by external ratings agencies.

Investment securities 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 September 30, 2013   |             |                         |            |                         |             |
|----------------------------------------|-------------------------|-------------|-------------------------|------------|-------------------------|-------------|
|                                        | Less than 12 months     |             | 12 months or more       |            | Total                   |             |
|                                        | Gross unrealized losses | Fair value  | Gross unrealized losses | Fair value | Gross unrealized losses | Fair value  |
| Residential mortgage-backed securities | \$(3,133                | ) \$121,234 | \$(221                  | ) \$7,361  | \$(3,354                | ) \$128,595 |
| Municipal bonds                        | (5,712                  | ) 97,091    | —                       | —          | (5,712                  | ) 97,091    |
| Collateralized mortgage obligations:   |                         |             |                         |            |                         |             |
| Residential                            | (1,169                  | ) 50,895    | (298                    | ) 10,678   | (1,467                  | ) 61,573    |
| Commercial                             | (466                    | ) 16,991    | —                       | —          | (466                    | ) 16,991    |
| Corporate debt securities              | (5,926                  | ) 69,826    | —                       | —          | (5,926                  | ) 69,826    |
|                                        | \$(16,406               | ) \$356,037 | \$(519                  | ) \$18,039 | \$(16,925               | ) \$374,076 |
|                                        |                         |             |                         |            |                         |             |
| (in thousands)                         | At December 31, 2012    |             |                         |            |                         |             |
|                                        | 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                            | \$(217                  | ) \$18,121  | \$—                     | \$—        | \$(217                  | ) \$18,121  |
| Municipal bonds                        | (94                     | ) 4,212     | —                       | —          | (94                     | ) 4,212     |
| Collateralized mortgage obligations:   |                         |             |                         |            |                         |             |
| Residential                            | (115                    | ) 13,883    | —                       | —          | (115                    | ) 13,883    |
| U.S. Treasury securities               | —                       | —           | (2                      | ) 10,238   | (2                      | ) 10,238    |
|                                        | \$(426                  | ) \$36,216  | \$(2                    | ) \$10,238 | \$(428                  | ) \$46,454  |

The Company has evaluated securities 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 company- or industry-specific credit event. As of September 30, 2013 and December 31, 2012, the present value of the cash flows expected to be collected on all of the Company debt securities was greater than amortized cost of those securities. In addition, as of September 30, 2013 and December 31, 2012, 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 Company did not hold any equity securities as of September 30, 2013 and December 31, 2012.



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.

| At September 30, 2013                |                 |                        |                                   |                        |                                    |                        |                 |                        |            |                        |            |                        |
|--------------------------------------|-----------------|------------------------|-----------------------------------|------------------------|------------------------------------|------------------------|-----------------|------------------------|------------|------------------------|------------|------------------------|
| (in thousands)                       | 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 | Fair Value | Weighted Average Yield |
| Mortgage-backed securities:          |                 |                        |                                   |                        |                                    |                        |                 |                        |            |                        |            |                        |
| Residential                          | \$—             | — %                    | \$—                               | — %                    | \$11,310                           | 1.82 %                 | \$132,953       | 2.18 %                 | \$144,263  | 2.15 %                 |            |                        |
| Commercial                           | —               | —                      | —                                 | —                      | —                                  | —                      | 13,720          | 4.49                   | 13,720     | 4.49                   |            |                        |
| Municipal bonds                      | —               | —                      | —                                 | —                      | 19,890                             | 3.51                   | 127,551         | 4.41                   | 147,441    | 4.29                   |            |                        |
| Collateralized mortgage obligations: |                 |                        |                                   |                        |                                    |                        |                 |                        |            |                        |            |                        |
| Residential                          | —               | —                      | —                                 | —                      | 13,643                             | 2.17                   | 139,823         | 2.65                   | 153,466    | 2.61                   |            |                        |
| Commercial                           | —               | —                      | —                                 | —                      | 5,311                              | 1.85                   | 11,680          | 1.40                   | 16,991     | 1.54                   |            |                        |
| Corporate debt securities            | —               | —                      | —                                 | —                      | 33,238                             | 3.31                   | 36,725          | 3.75                   | 69,963     | 3.54                   |            |                        |
| U.S. Treasury securities             | 26,746          | 0.24                   | 1,001                             | 0.18                   | —                                  | —                      | —               | —                      | 27,747     | 0.23                   |            |                        |
| Total available for sale             | \$26,746        | 0.24 %                 | \$1,001                           | 0.18 %                 | \$83,392                           | 2.88 %                 | \$462,452       | 3.11 %                 | \$573,591  | 2.94 %                 |            |                        |

| At December 31, 2012                 |                 |                        |                                   |                        |                                    |                        |                 |                        |            |                        |            |                        |
|--------------------------------------|-----------------|------------------------|-----------------------------------|------------------------|------------------------------------|------------------------|-----------------|------------------------|------------|------------------------|------------|------------------------|
| (in thousands)                       | 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 | Fair Value | Weighted Average Yield |
| Mortgage-backed securities:          |                 |                        |                                   |                        |                                    |                        |                 |                        |            |                        |            |                        |
| Residential                          | \$—             | — %                    | \$—                               | — %                    | \$—                                | — %                    | \$62,853        | 2.81 %                 | \$62,853   | 2.81 %                 |            |                        |
| Commercial                           | —               | —                      | —                                 | —                      | —                                  | —                      | 14,380          | 4.03                   | 14,380     | 4.03                   |            |                        |
| Municipal bonds                      | —               | —                      | —                                 | —                      | 15,673                             | 3.64                   | 113,502         | 4.66                   | 129,175    | 4.53                   |            |                        |
| Collateralized mortgage obligations: |                 |                        |                                   |                        |                                    |                        |                 |                        |            |                        |            |                        |
| Residential                          | —               | —                      | —                                 | —                      | —                                  | —                      | 170,199         | 2.64                   | 170,199    | 2.64                   |            |                        |
| Commercial                           | —               | —                      | —                                 | —                      | —                                  | —                      | 9,043           | 2.06                   | 9,043      | 2.06                   |            |                        |

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|                          |          |      |   |     |   |   |          |      |        |           |      |   |           |      |   |
|--------------------------|----------|------|---|-----|---|---|----------|------|--------|-----------|------|---|-----------|------|---|
| U.S. Treasury securities | 30,679   | 0.23 | — | —   | — | — | —        | —    | 30,679 | 0.23      |      |   |           |      |   |
| Total available for sale | \$30,679 | 0.23 | % | \$— | — | % | \$15,673 | 3.64 | %      | \$369,977 | 3.33 | % | \$416,329 | 3.11 | % |

Sales of investment securities available for sale were as follows.

| (in thousands) | Three Months Ended September 30, |          | Nine Months Ended September 30, |           |
|----------------|----------------------------------|----------|---------------------------------|-----------|
|                | 2013                             | 2012     | 2013                            | 2012      |
| Proceeds       | \$1,972                          | \$39,635 | \$52,566                        | \$159,174 |
| Gross gains    | —                                | 434      | 322                             | 1,780     |
| Gross losses   | (184                             | ) (37    | ) (316                          | ) (431    |

There were \$57.6 million in investment securities pledged to secure advances from the Federal Home Loan Bank of Seattle ("FHLB") at September 30, 2013 and \$51.9 million in investment securities pledged to secure advances from the FHLB at December 31, 2012. At September 30, 2013 and December 31, 2012 there were \$27.1 million and \$18.6 million, respectively, of securities pledged to secure derivatives in a liability position.

Tax-exempt interest income on securities available for sale of \$1.5 million and \$1.3 million for the three months ended September 30, 2013 and 2012, respectively, and \$4.2 million and \$3.0 million for the nine months ended September 30, 2013 and 2012, 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 to the Company's 2012 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 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<br>September 30,<br>2013 | At<br>December 31,<br>2012 |
|-------------------------------|-----------------------------|----------------------------|
| Consumer loans                |                             |                            |
| Single family                 | \$818,992                   | \$673,865                  |
| Home equity                   | 129,785                     | 136,746                    |
|                               | 948,777                     | 810,611                    |
| Commercial loans              |                             |                            |
| Commercial real estate        | 400,150                     | 361,879                    |
| Multifamily                   | 42,187                      | 17,012                     |
| Construction/land development | 79,435                      | 71,033                     |
| Commercial business           | 67,547                      | 79,576                     |
|                               | 589,319                     | 529,500                    |

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|                                      |             |             |
|--------------------------------------|-------------|-------------|
|                                      | 1,538,096   | 1,340,111   |
| Net deferred loan fees and discounts | (3,233      | ) (3,576 )  |
|                                      | 1,534,863   | 1,336,535   |
| Allowance for loan losses            | (24,694     | ) (27,561 ) |
|                                      | \$1,510,169 | \$1,308,974 |

Loans in the amount of \$675.2 million and \$469.8 million at September 30, 2013 and December 31, 2012, respectively, were pledged to secure borrowings from the FHLB as part of our liquidity management strategy. The FHLB does not have the right to sell or re-pledge these loans.

Loans held for investment are primarily secured by real estate located in the states of Washington, Oregon, Idaho and Hawaii. Loan concentrations may exist when there are amounts loaned to borrowers engaged in similar activities or similar types of loans extended to a diverse group of borrowers that would cause them to be similarly impacted by economic or other conditions. At September 30, 2013 we had concentrations representing 10% or more of the total portfolio by state and property type for the loan classes of single family and commercial real estate within the state of Washington, which represented 42.8% and 20.8% respectively. At December 31, 2012 we had concentrations representing 10% or more of the total portfolio by state and property type for the loan classes of single family and commercial real estate within the state of Washington, which represented 40.4% and 22.5% of the total portfolio, respectively. These loans were mostly located within the Puget Sound area, particularly within King County.

### 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 September 30, 2013. 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 the 2012 Annual Report on Form 10-K.

Activity in the allowance for credit losses was as follows.

| (in thousands)                              | Three Months Ended September 30, |           | Nine Months Ended September 30, |            |
|---------------------------------------------|----------------------------------|-----------|---------------------------------|------------|
|                                             | 2013                             | 2012      | 2013                            | 2012       |
| Allowance for credit losses (roll-forward): |                                  |           |                                 |            |
| Beginning balance                           | \$27,858                         | \$27,125  | \$27,751                        | \$42,800   |
| (Reversal of) provision for credit losses   | (1,500)                          | ) 5,500   | 900                             | 7,500      |
| (Charge-offs), net of recoveries            | (1,464)                          | ) (4,998) | ) (3,757)                       | ) (22,673) |
| Ending balance                              | \$24,894                         | \$27,627  | \$24,894                        | \$27,627   |
| Components:                                 |                                  |           |                                 |            |
| Allowance for loan losses                   | \$24,694                         | \$27,461  | \$24,694                        | \$27,461   |
| Allowance for unfunded commitments          | 200                              | 166       | 200                             | 166        |
| Allowance for credit losses                 | \$24,894                         | \$27,627  | \$24,894                        | \$27,627   |

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

| (in thousands) | Three Months Ended September 30, 2013 |             |            | (Reversal of) Provision | Ending balance |
|----------------|---------------------------------------|-------------|------------|-------------------------|----------------|
|                | Beginning balance                     | Charge-offs | Recoveries |                         |                |
| Consumer loans |                                       |             |            |                         |                |
| Single family  | \$13,810                              | \$ (606)    | ) \$179    | \$ (1,251)              | ) \$12,132     |
| Home equity    | 4,879                                 | (377)       | ) 273      | (139)                   | ) 4,636        |
|                | 18,689                                | (983)       | ) 452      | (1,390)                 | ) 16,768       |

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|                                   |          |          |         |          |            |
|-----------------------------------|----------|----------|---------|----------|------------|
| Commercial loans                  |          |          |         |          |            |
| Commercial real estate            | 5,723    | (1,306   | ) —     | 51       | 4,468      |
| Multifamily                       | 690      | —        | —       | 80       | 770        |
| Construction/land development     | 1,185    | —        | 348     | (141     | ) 1,392    |
| Commercial business               | 1,571    | —        | 25      | (100     | ) 1,496    |
|                                   | 9,169    | (1,306   | ) 373   | (110     | ) 8,126    |
| Total allowance for credit losses | \$27,858 | \$(2,289 | ) \$825 | \$(1,500 | ) \$24,894 |

| (in thousands)                    | Three Months Ended September 30, 2012 |             |            | (Reversal of) Provision | Ending balance |
|-----------------------------------|---------------------------------------|-------------|------------|-------------------------|----------------|
|                                   | Beginning balance                     | Charge-offs | Recoveries |                         |                |
| Consumer loans                    |                                       |             |            |                         |                |
| Single family                     | \$12,865                              | \$(1,363)   | ) \$22     | \$2,028                 | \$13,552       |
| Home equity                       | 4,851                                 | (1,078)     | ) 121      | 1,139                   | 5,033          |
|                                   | 17,716                                | (2,441)     | ) 143      | 3,167                   | 18,585         |
| Commercial loans                  |                                       |             |            |                         |                |
| Commercial real estate            | 4,343                                 | (1,757)     | ) 130      | 1,020                   | 3,736          |
| Multifamily                       | 923                                   | —           | —          | (151)                   | ) 772          |
| Construction/land development     | 3,022                                 | (1,823)     | ) 193      | 1,472                   | 2,864          |
| Commercial business               | 1,121                                 | (74)        | ) 631      | (8)                     | ) 1,670        |
|                                   | 9,409                                 | (3,654)     | ) 954      | 2,333                   | 9,042          |
| Total allowance for credit losses | \$27,125                              | \$(6,095)   | ) \$1,097  | \$5,500                 | \$27,627       |

| (in thousands)                    | Nine Months Ended September 30, 2013 |             |            | (Reversal of) Provision | Ending balance |
|-----------------------------------|--------------------------------------|-------------|------------|-------------------------|----------------|
|                                   | Beginning balance                    | Charge-offs | Recoveries |                         |                |
| Consumer loans                    |                                      |             |            |                         |                |
| Single family                     | \$13,388                             | \$(2,468)   | ) \$425    | \$787                   | \$12,132       |
| Home equity                       | 4,648                                | (1,515)     | ) 526      | 977                     | 4,636          |
|                                   | 18,036                               | (3,983)     | ) 951      | 1,764                   | 16,768         |
| Commercial loans                  |                                      |             |            |                         |                |
| Commercial real estate            | 5,312                                | (1,449)     | ) —        | 605                     | 4,468          |
| Multifamily                       | 622                                  | —           | —          | 148                     | 770            |
| Construction/land development     | 1,580                                | (148)       | ) 699      | (739)                   | ) 1,392        |
| Commercial business               | 2,201                                | —           | 173        | (878)                   | ) 1,496        |
|                                   | 9,715                                | (1,597)     | ) 872      | (864)                   | ) 8,126        |
| Total allowance for credit losses | \$27,751                             | \$(5,580)   | ) \$1,823  | \$900                   | \$24,894       |

| (in thousands)                    | Nine Months Ended September 30, 2012 |             |            | (Reversal of) Provision | Ending balance |
|-----------------------------------|--------------------------------------|-------------|------------|-------------------------|----------------|
|                                   | Beginning balance                    | Charge-offs | Recoveries |                         |                |
| Consumer loans                    |                                      |             |            |                         |                |
| Single family                     | \$10,671                             | \$(3,889)   | ) \$455    | \$6,315                 | \$13,552       |
| Home equity                       | 4,623                                | (3,577)     | ) 398      | 3,589                   | 5,033          |
|                                   | 15,294                               | (7,466)     | ) 853      | 9,904                   | 18,585         |
| Commercial loans                  |                                      |             |            |                         |                |
| Commercial real estate            | 4,321                                | (3,474)     | ) 258      | 2,631                   | 3,736          |
| Multifamily                       | 335                                  | —           | —          | 437                     | 772            |
| Construction/land development     | 21,237                               | (13,858)    | ) 835      | (5,350)                 | ) 2,864        |
| Commercial business               | 1,613                                | (538)       | ) 717      | (122)                   | ) 1,670        |
|                                   | 27,506                               | (17,870)    | ) 1,810    | (2,404)                 | ) 9,042        |
| Total allowance for credit losses | \$42,800                             | \$(25,336)  | ) \$2,663  | \$7,500                 | \$27,627       |





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

| (in thousands)                   | At September 30, 2013                                     |                                                           | Total    | Loans:<br>collectively<br>evaluated for<br>impairment | Loans:<br>individually<br>evaluated for<br>impairment | Total       |
|----------------------------------|-----------------------------------------------------------|-----------------------------------------------------------|----------|-------------------------------------------------------|-------------------------------------------------------|-------------|
|                                  | Allowance:<br>collectively<br>evaluated for<br>impairment | Allowance:<br>individually<br>evaluated for<br>impairment |          |                                                       |                                                       |             |
| Consumer loans                   |                                                           |                                                           |          |                                                       |                                                       |             |
| Single family                    | \$10,676                                                  | \$1,456                                                   | \$12,132 | \$745,211                                             | \$73,781                                              | \$818,992   |
| Home equity                      | 4,585                                                     | 51                                                        | 4,636    | 127,226                                               | 2,559                                                 | 129,785     |
|                                  | 15,261                                                    | 1,507                                                     | 16,768   | 872,437                                               | 76,340                                                | 948,777     |
| Commercial loans                 |                                                           |                                                           |          |                                                       |                                                       |             |
| Commercial real estate           | 4,468                                                     | —                                                         | 4,468    | 372,905                                               | 27,245                                                | 400,150     |
| Multifamily                      | 315                                                       | 455                                                       | 770      | 38,997                                                | 3,190                                                 | 42,187      |
| Construction/land<br>development | 1,081                                                     | 311                                                       | 1,392    | 72,768                                                | 6,667                                                 | 79,435      |
| Commercial business              | 811                                                       | 685                                                       | 1,496    | 66,022                                                | 1,525                                                 | 67,547      |
|                                  | 6,675                                                     | 1,451                                                     | 8,126    | 550,692                                               | 38,627                                                | 589,319     |
| Total                            | \$21,936                                                  | \$2,958                                                   | \$24,894 | \$1,423,129                                           | \$114,967                                             | \$1,538,096 |
|                                  |                                                           |                                                           |          |                                                       |                                                       |             |
| (in thousands)                   | At December 31, 2012                                      |                                                           | Total    | Loans:<br>collectively<br>evaluated for<br>impairment | Loans:<br>individually<br>evaluated for<br>impairment | Total       |
|                                  | Allowance:<br>collectively<br>evaluated for<br>impairment | Allowance:<br>individually<br>evaluated for<br>impairment |          |                                                       |                                                       |             |
| Consumer loans                   |                                                           |                                                           |          |                                                       |                                                       |             |
| Single family                    | \$11,212                                                  | \$2,176                                                   | \$13,388 | \$599,538                                             | \$74,327                                              | \$673,865   |
| Home equity                      | 4,611                                                     | 37                                                        | 4,648    | 133,026                                               | 3,720                                                 | 136,746     |
|                                  | 15,823                                                    | 2,213                                                     | 18,036   | 732,564                                               | 78,047                                                | 810,611     |
| Commercial loans                 |                                                           |                                                           |          |                                                       |                                                       |             |
| Commercial real estate           | 3,682                                                     | 1,630                                                     | 5,312    | 334,406                                               | 27,473                                                | 361,879     |
| Multifamily                      | 106                                                       | 516                                                       | 622      | 13,791                                                | 3,221                                                 | 17,012      |
| Construction/land<br>development | 1,092                                                     | 488                                                       | 1,580    | 58,129                                                | 12,904                                                | 71,033      |
| Commercial business              | 680                                                       | 1,521                                                     | 2,201    | 77,256                                                | 2,320                                                 | 79,576      |
|                                  | 5,560                                                     | 4,155                                                     | 9,715    | 483,582                                               | 45,918                                                | 529,500     |
| Total                            | \$21,383                                                  | \$6,368                                                   | \$27,751 | \$1,216,146                                           | \$123,965                                             | \$1,340,111 |

Interest payments on impaired loans, applied against loan principal or recognized as interest income, of \$1.2 million and \$1.3 million were recorded for cash payments received during the three months ended September 30, 2013 and 2012, respectively, and \$3.5 million and \$4.3 million was recorded for cash payments received during the nine months ended September 30, 2013 and 2012, respectively.

## Impaired Loans

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

|                                     | At September 30, 2013              |                                         |                   |
|-------------------------------------|------------------------------------|-----------------------------------------|-------------------|
| (in thousands)                      | Recorded investment <sup>(1)</sup> | Unpaid principal balance <sup>(2)</sup> | Related allowance |
| With no related allowance recorded: |                                    |                                         |                   |
| Consumer loans                      |                                    |                                         |                   |
| Single family                       | \$38,138                           | \$41,130                                | \$—               |
| Home equity                         | 1,802                              | 1,868                                   | —                 |
|                                     | 39,940                             | 42,998                                  | —                 |
| Commercial loans                    |                                    |                                         |                   |
| Commercial real estate              | 27,245                             | 29,247                                  | —                 |
| Multifamily                         | 508                                | 508                                     | —                 |
| Construction/land development       | 6,356                              | 16,061                                  | —                 |
| Commercial business                 | 120                                | 137                                     | —                 |
|                                     | 34,229                             | 45,953                                  | —                 |
|                                     | \$74,169                           | \$88,951                                | \$—               |
| With an allowance recorded:         |                                    |                                         |                   |
| Consumer loans                      |                                    |                                         |                   |
| Single family                       | \$35,643                           | \$35,701                                | \$1,456           |
| Home equity                         | 757                                | 757                                     | 51                |
|                                     | 36,400                             | 36,458                                  | 1,507             |
| Commercial loans                    |                                    |                                         |                   |
| Multifamily                         | 2,682                              | 2,860                                   | 455               |
| Construction/land development       | 311                                | 311                                     | 311               |
| Commercial business                 | 1,405                              | 1,534                                   | 685               |
|                                     | 4,398                              | 4,705                                   | 1,451             |
|                                     | \$40,798                           | \$41,163                                | \$2,958           |
| Total:                              |                                    |                                         |                   |
| Consumer loans                      |                                    |                                         |                   |
| Single family                       | \$73,781                           | \$76,831                                | \$1,456           |
| Home equity                         | 2,559                              | 2,625                                   | 51                |
|                                     | 76,340                             | 79,456                                  | 1,507             |
| Commercial loans                    |                                    |                                         |                   |
| Commercial real estate              | 27,245                             | 29,247                                  | —                 |
| Multifamily                         | 3,190                              | 3,368                                   | 455               |
| Construction/land development       | 6,667                              | 16,372                                  | 311               |
| Commercial business                 | 1,525                              | 1,671                                   | 685               |
|                                     | 38,627                             | 50,658                                  | 1,451             |
| Total impaired loans                | \$114,967                          | \$130,114                               | \$2,958           |

|                                     | At December 31, 2012               |                                         |                   |
|-------------------------------------|------------------------------------|-----------------------------------------|-------------------|
| (in thousands)                      | Recorded investment <sup>(1)</sup> | Unpaid principal balance <sup>(2)</sup> | Related allowance |
| With no related allowance recorded: |                                    |                                         |                   |
| Consumer loans                      |                                    |                                         |                   |
| Single family                       | \$28,202                           | \$29,946                                | \$—               |
| Home equity                         | 2,728                              | 3,211                                   | —                 |
|                                     | 30,930                             | 33,157                                  | —                 |
| Commercial loans                    |                                    |                                         |                   |
| Commercial real estate              | 10,933                             | 12,445                                  | —                 |
| Multifamily                         | 508                                | 508                                     | —                 |
| Construction/land development       | 11,097                             | 20,990                                  | —                 |
| Commercial business                 | 147                                | 162                                     | —                 |
|                                     | 22,685                             | 34,105                                  | —                 |
|                                     | \$53,615                           | \$67,262                                | \$—               |
| With an allowance recorded:         |                                    |                                         |                   |
| Consumer loans                      |                                    |                                         |                   |
| Single family                       | \$46,125                           | \$47,553                                | \$2,176           |
| Home equity                         | 992                                | 1,142                                   | 37                |
|                                     | 47,117                             | 48,695                                  | 2,213             |
| Commercial loans                    |                                    |                                         |                   |
| Commercial real estate              | 16,540                             | 16,540                                  | 1,630             |
| Multifamily                         | 2,713                              | 2,891                                   | 516               |
| Construction/land development       | 1,807                              | 1,807                                   | 488               |
| Commercial business                 | 2,173                              | 2,287                                   | 1,521             |
|                                     | 23,233                             | 23,525                                  | 4,155             |
|                                     | \$70,350                           | \$72,220                                | \$6,368           |
| Total:                              |                                    |                                         |                   |
| Consumer loans                      |                                    |                                         |                   |
| Single family                       | \$74,327                           | \$77,499                                | \$2,176           |
| Home equity                         | 3,720                              | 4,353                                   | 37                |
|                                     | 78,047                             | 81,852                                  | 2,213             |
| Commercial loans                    |                                    |                                         |                   |
| Commercial real estate              | 27,473                             | 28,985                                  | 1,630             |
| Multifamily                         | 3,221                              | 3,399                                   | 516               |
| Construction/land development       | 12,904                             | 22,797                                  | 488               |
| Commercial business                 | 2,320                              | 2,449                                   | 1,521             |
|                                     | 45,918                             | 57,630                                  | 4,155             |
| Total impaired loans                | \$123,965                          | \$139,482                               | \$6,368           |

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

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

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

| (in thousands)                | Three Months Ended September |           | Nine Months Ended September |           |
|-------------------------------|------------------------------|-----------|-----------------------------|-----------|
|                               | 30,<br>2013                  | 2012      | 30,<br>2013                 | 2012      |
| Consumer loans                |                              |           |                             |           |
| Single family                 | \$79,527                     | \$69,419  | \$77,841                    | \$66,967  |
| Home equity                   | 3,095                        | 2,860     | 3,345                       | 2,788     |
|                               | 82,622                       | 72,279    | 81,186                      | 69,755    |
| Commercial loans              |                              |           |                             |           |
| Commercial real estate        | 27,456                       | 31,765    | 27,775                      | 33,439    |
| Multifamily                   | 3,194                        | 5,779     | 3,205                       | 6,512     |
| Construction/land development | 7,218                        | 19,197    | 9,450                       | 43,656    |
| Commercial business           | 1,696                        | 1,792     | 1,922                       | 1,379     |
|                               | 39,564                       | 58,533    | 42,352                      | 84,986    |
|                               | \$122,186                    | \$130,812 | \$123,538                   | \$154,741 |

## 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 following tables present designated loan grades by loan portfolio segment and loan class.

| (in thousands)                | At September 30, 2013 |           | Special mention | Substandard | Total       |
|-------------------------------|-----------------------|-----------|-----------------|-------------|-------------|
|                               | Pass                  | Watch     |                 |             |             |
| Consumer loans                |                       |           |                 |             |             |
| Single family                 | \$729,682             | \$48,950  | \$15,587        | \$24,773    | \$818,992   |
| Home equity                   | 127,100               | 50        | 265             | 2,370       | 129,785     |
|                               | 856,782               | 49,000    | 15,852          | 27,143      | 948,777     |
| Commercial loans              |                       |           |                 |             |             |
| Commercial real estate        | 263,828               | 86,418    | 41,424          | 8,480       | 400,150     |
| Multifamily                   | 37,447                | 1,550     | 3,190           | —           | 42,187      |
| Construction/land development | 65,655                | 7,215     | 2,920           | 3,645       | 79,435      |
| Commercial business           | 54,340                | 7,083     | 3,304           | 2,820       | 67,547      |
|                               | 421,270               | 102,266   | 50,838          | 14,945      | 589,319     |
|                               | \$1,278,052           | \$151,266 | \$66,690        | \$42,088    | \$1,538,096 |

| (in thousands)                | At December 31, 2012 |           | Special mention | Substandard | Total       |
|-------------------------------|----------------------|-----------|-----------------|-------------|-------------|
|                               | Pass                 | Watch     |                 |             |             |
| Consumer loans                |                      |           |                 |             |             |
| Single family                 | \$565,312            | \$55,768  | \$27,599        | \$25,186    | \$673,865   |
| Home equity                   | 131,246              | 1,337     | 1,193           | 2,970       | 136,746     |
|                               | 696,558              | 57,105    | 28,792          | 28,156      | 810,611     |
| Commercial loans              |                      |           |                 |             |             |
| Commercial real estate        | 217,370              | 102,353   | 17,931          | 24,225      | 361,879     |
| Multifamily                   | 12,222               | 1,569     | 3,221           | —           | 17,012      |
| Construction/land development | 21,540               | 7,243     | 35,368          | 6,882       | 71,033      |
| Commercial business           | 68,134               | 7,914     | 462             | 3,066       | 79,576      |
|                               | 319,266              | 119,079   | 56,982          | 34,173      | 529,500     |
|                               | \$1,015,824          | \$176,184 | \$85,774        | \$62,329    | \$1,340,111 |

The Company considers 'adversely classified assets' to include loans graded as Substandard, Doubtful, and Loss as well as other real estate owned ("OREO"). As of September 30, 2013 and December 31, 2012, none of the Company's loans were rated Doubtful or Loss. For a detailed discussion on credit quality indicators used by management, see Note 5, Loans and Credit Quality within the 2012 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 Federal Housing Authority ("FHA") or guaranteed by the Department of Veterans' Affairs ("VA") are generally maintained on accrual status even if 90 days or more past due.



The following tables present aging analyses of past due loans by loan portfolio segment and loan class.

| At September 30, 2013            |                        |                        |                                |                   |              |                |                                                                     |
|----------------------------------|------------------------|------------------------|--------------------------------|-------------------|--------------|----------------|---------------------------------------------------------------------|
| (in thousands)                   | 30-59 days<br>past due | 60-89 days<br>past due | 90 days or<br>more<br>past due | Total past<br>due | Current      | Total<br>loans | 90 days or<br>more past<br>due and<br>still accruing <sup>(1)</sup> |
| Consumer loans                   |                        |                        |                                |                   |              |                |                                                                     |
| Single family                    | \$ 10,359              | \$ 5,170               | \$ 56,410                      | \$ 71,939         | \$ 747,053   | \$ 818,992     | \$ 43,762                                                           |
| Home equity                      | 554                    | 100                    | 2,295                          | 2,949             | 126,836      | 129,785        | —                                                                   |
|                                  | 10,913                 | 5,270                  | 58,705                         | 74,888            | 873,889      | 948,777        | 43,762                                                              |
| Commercial loans                 |                        |                        |                                |                   |              |                |                                                                     |
| Commercial real estate           | —                      | —                      | 6,861                          | 6,861             | 393,289      | 400,150        | —                                                                   |
| Multifamily                      | —                      | —                      | —                              | —                 | 42,187       | 42,187         | —                                                                   |
| Construction/land<br>development | —                      | —                      | 3,544                          | 3,544             | 75,891       | 79,435         | —                                                                   |
| Commercial business              | —                      | —                      | 1,405                          | 1,405             | 66,142       | 67,547         | —                                                                   |
|                                  | —                      | —                      | 11,810                         | 11,810            | 577,509      | 589,319        | —                                                                   |
|                                  | \$ 10,913              | \$ 5,270               | \$ 70,515                      | \$ 86,698         | \$ 1,451,398 | \$ 1,538,096   | \$ 43,762                                                           |
| At December 31, 2012             |                        |                        |                                |                   |              |                |                                                                     |
| (in thousands)                   | 30-59 days<br>past due | 60-89 days<br>past due | 90 days or<br>more<br>past due | Total past<br>due | Current      | Total<br>loans | 90 days or<br>more past<br>due and<br>still accruing <sup>(1)</sup> |
| Consumer loans                   |                        |                        |                                |                   |              |                |                                                                     |
| Single family                    | \$ 11,916              | \$ 4,732               | \$ 53,962                      | \$ 70,610         | \$ 603,255   | \$ 673,865     | \$ 40,658                                                           |
| Home equity                      | 787                    | 242                    | 2,970                          | 3,999             | 132,747      | 136,746        | —                                                                   |
|                                  | 12,703                 | 4,974                  | 56,932                         | 74,609            | 736,002      | 810,611        | 40,658                                                              |
| Commercial loans                 |                        |                        |                                |                   |              |                |                                                                     |
| Commercial real estate           | —                      | —                      | 6,403                          | 6,403             | 355,476      | 361,879        | —                                                                   |
| Multifamily                      | —                      | —                      | —                              | —                 | 17,012       | 17,012         | —                                                                   |
| Construction/land<br>development | —                      | —                      | 5,042                          | 5,042             | 65,991       | 71,033         | —                                                                   |
| Commercial business              | —                      | —                      | 2,173                          | 2,173             | 77,403       | 79,576         | —                                                                   |
|                                  | —                      | —                      | 13,618                         | 13,618            | 515,882      | 529,500        | —                                                                   |
|                                  | \$ 12,703              | \$ 4,974               | \$ 70,550                      | \$ 88,227         | \$ 1,251,884 | \$ 1,340,111   | \$ 40,658                                                           |

(1) 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 accrual and nonaccrual loan balances by loan portfolio segment and loan class.

| (in thousands)                | At September 30, 2013 |            | Total       |
|-------------------------------|-----------------------|------------|-------------|
|                               | Accrual               | Nonaccrual |             |
| Consumer loans                |                       |            |             |
| Single family                 | \$806,344             | \$12,648   | \$818,992   |
| Home equity                   | 127,490               | 2,295      | 129,785     |
|                               | 933,834               | 14,943     | 948,777     |
| Commercial loans              |                       |            |             |
| Commercial real estate        | 393,289               | 6,861      | 400,150     |
| Multifamily                   | 42,187                | —          | 42,187      |
| Construction/land development | 75,891                | 3,544      | 79,435      |
| Commercial business           | 66,142                | 1,405      | 67,547      |
|                               | 577,509               | 11,810     | 589,319     |
|                               | \$1,511,343           | \$26,753   | \$1,538,096 |
|                               |                       |            |             |
| (in thousands)                | At December 31, 2012  |            | Total       |
|                               | Accrual               | Nonaccrual |             |
| Consumer loans                |                       |            |             |
| Single family                 | \$660,561             | \$13,304   | \$673,865   |
| Home equity                   | 133,776               | 2,970      | 136,746     |
|                               | 794,337               | 16,274     | 810,611     |
| Commercial loans              |                       |            |             |
| Commercial real estate        | 355,476               | 6,403      | 361,879     |
| Multifamily                   | 17,012                | —          | 17,012      |
| Construction/land development | 65,991                | 5,042      | 71,033      |
| Commercial business           | 77,403                | 2,173      | 79,576      |
|                               | 515,882               | 13,618     | 529,500     |
|                               | \$1,310,219           | \$29,892   | \$1,340,111 |

The Company had 194 loan relationships classified as troubled debt restructurings (“TDRs”) totaling \$109.4 million at September 30, 2013 with related unfunded commitments of \$41 thousand. The Company had 162 loan relationships classified as TDRs totaling \$110.8 million at December 31, 2012 with related unfunded commitments of \$25 thousand. The increase in the number of TDR loan relationships at September 30, 2013 from December 31, 2012 is primarily due to an increase in the number of single family loan TDRs, partially offset by a decline in the number of commercial construction/land development loan TDRs. TDR loans within the loans held for investment portfolio and the related reserves are included in the impaired loan tables above.



# Troubled Debt Restructurings

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

| At Three Months Ended September 30, 2013 |                         |                              |                     |                     |
|------------------------------------------|-------------------------|------------------------------|---------------------|---------------------|
| (dollars in thousands)                   | Concession type         | Number of loan relationships | Recorded investment | Related charge-offs |
| Consumer loans                           |                         |                              |                     |                     |
| Single family                            |                         |                              |                     |                     |
|                                          | Interest rate reduction | 27                           | \$5,538             | \$—                 |
| Home equity                              |                         |                              |                     |                     |
|                                          | Interest rate reduction | 2                            | 132                 | —                   |
| Total consumer                           |                         |                              |                     |                     |
|                                          | Interest rate reduction | 29                           | \$5,670             | \$—                 |
| Total loans                              |                         |                              |                     |                     |
|                                          | Interest rate reduction | 29                           | \$5,670             | \$—                 |
| At Three Months Ended September 30, 2012 |                         |                              |                     |                     |
| (dollars in thousands)                   | Concession type         | Number of loan relationships | Recorded investment | Related charge-offs |
| Consumer loans                           |                         |                              |                     |                     |
| Single family                            |                         |                              |                     |                     |
|                                          | Interest rate reduction | 4                            | \$960               | \$—                 |
| Home equity                              |                         |                              |                     |                     |
|                                          | Interest rate reduction | 1                            | 48                  | —                   |
| Total consumer                           |                         |                              |                     |                     |
|                                          | Interest rate reduction | 5                            | \$1,008             | \$—                 |
| Commercial loans                         |                         |                              |                     |                     |
| Commercial real estate                   |                         |                              |                     |                     |
|                                          | Interest rate reduction | 1                            | \$5,012             | \$—                 |
| Total loans                              |                         |                              |                     |                     |
|                                          | Interest rate reduction | 6                            | \$6,020             | \$—                 |
| At Nine Months Ended September 30, 2013  |                         |                              |                     |                     |
| (dollars in thousands)                   | Concession type         | Number of loan relationships | Recorded investment | Related charge-offs |
| Consumer loans                           |                         |                              |                     |                     |
| Single family                            |                         |                              |                     |                     |
|                                          | Interest rate reduction | 51                           | \$11,300            | \$—                 |
| Home equity                              |                         |                              |                     |                     |
|                                          | Interest rate reduction | 5                            | 301                 | —                   |
| Total consumer                           |                         |                              |                     |                     |
|                                          | Interest rate reduction | 56                           | \$11,601            | \$—                 |
| Total loans                              |                         |                              |                     |                     |
|                                          | Interest rate reduction | 56                           | \$11,601            | \$—                 |



| At Nine Months Ended September 30, 2012 |                         |                              |                     |                     |
|-----------------------------------------|-------------------------|------------------------------|---------------------|---------------------|
| (dollars in thousands)                  | Concession type         | Number of loan relationships | Recorded investment | Related charge-offs |
| Consumer loans                          |                         |                              |                     |                     |
| Single family                           |                         |                              |                     |                     |
|                                         | Interest rate reduction | 28                           | \$9,092             | \$ 58               |
|                                         | Payment restructure     | 1                            | 273                 | —                   |
|                                         |                         | 29                           | \$9,365             | \$ 58               |
| Home equity                             |                         |                              |                     |                     |
|                                         | Interest rate reduction | 6                            | \$492               | \$—                 |
| Total consumer                          |                         |                              |                     |                     |
|                                         | Interest rate reduction | 34                           | \$9,584             | \$ 58               |
|                                         | Payment restructure     | 1                            | 273                 | —                   |
|                                         |                         | 35                           | \$9,857             | \$ 58               |
| Commercial loans                        |                         |                              |                     |                     |
| Commercial real estate                  |                         |                              |                     |                     |
|                                         | Interest rate reduction | 2                            | \$5,779             | \$—                 |
| Total loans                             |                         |                              |                     |                     |
|                                         | Interest rate reduction | 36                           | \$15,363            | \$ 58               |
|                                         | Payment restructure     | 1                            | 273                 | —                   |
|                                         |                         | 37                           | \$15,636            | \$ 58               |

The following table presents loans that were modified as TDRs within the previous 12 months and subsequently re-defaulted during the three and nine months ended September 30, 2013 and 2012, 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 September 30, |                                                |                     |                                                |                     |
|----------------------------------|------------------------------------------------|---------------------|------------------------------------------------|---------------------|
| (dollars in thousands)           | Number of loan relationships that re-defaulted | Recorded investment | 2013                                           | 2012                |
|                                  |                                                |                     | Number of loan relationships that re-defaulted | Recorded investment |
| Consumer loans                   |                                                |                     |                                                |                     |
| Single family                    | 7                                              | \$1,017             | 18                                             | \$4,290             |
| Home equity                      | —                                              | —                   | —                                              | —                   |
|                                  | 7                                              | 1,017               | 18                                             | 4,290               |
| Commercial loans                 |                                                |                     |                                                |                     |
| Commercial real estate           | —                                              | —                   | 1                                              | 7,716               |
| Construction/land development    | —                                              | —                   | —                                              | —                   |
| Commercial business              | —                                              | —                   | 1                                              | 21                  |
|                                  | —                                              | —                   | 2                                              | 7,737               |
|                                  | 7                                              | \$1,017             | 20                                             | \$12,027            |



| (dollars in thousands)        | Nine Months Ended September 30,<br>2013                    |                        | 2012                                                       |                        |
|-------------------------------|------------------------------------------------------------|------------------------|------------------------------------------------------------|------------------------|
|                               | Number of<br>loan<br>relationships<br>that<br>re-defaulted | Recorded<br>investment | Number of<br>loan<br>relationships<br>that<br>re-defaulted | Recorded<br>investment |
| Consumer loans                |                                                            |                        |                                                            |                        |
| Single family                 | 14                                                         | \$2,573                | 41                                                         | \$9,551                |
| Home equity                   | 1                                                          | 22                     | 1                                                          | 34                     |
|                               | 15                                                         | 2,595                  | 42                                                         | 9,585                  |
| Commercial loans              |                                                            |                        |                                                            |                        |
| Commercial real estate        | 1                                                          | 770                    | 1                                                          | 7,716                  |
| Construction/land development | —                                                          | —                      | —                                                          | —                      |
| Commercial business           | —                                                          | —                      | 3                                                          | 410                    |
|                               | 1                                                          | 770                    | 4                                                          | 8,126                  |
|                               | 16                                                         | \$3,365                | 46                                                         | \$17,711               |

#### NOTE 5—DEPOSITS:

Deposit balances, including stated rates, were as follows.

| (in thousands)                                                                                                         | At<br>September 30,<br>2013 | At<br>December 31,<br>2012 |
|------------------------------------------------------------------------------------------------------------------------|-----------------------------|----------------------------|
| Noninterest-bearing accounts                                                                                           | \$351,274                   | \$358,831                  |
| NOW accounts 0.00% to 0.75% at September 30, 2013 and December 31, 2012                                                | 272,029                     | 174,699                    |
| Statement savings accounts, due on demand 0.20% to 1.00% at September 30, 2013 and 0.20% to 0.85% at December 31, 2012 | 135,428                     | 103,932                    |
| Money market accounts, due on demand 0.00% to 1.50% at September 30, 2013 and December 31, 2012                        | 879,122                     | 683,906                    |
| Certificates of deposit 0.10% to 3.92% at September 30, 2013 and 0.10% to 4.70% at December 31, 2012                   | 460,223                     | 655,467                    |
|                                                                                                                        | \$2,098,076                 | \$1,976,835                |

There were no public funds included in deposits as of September 30, 2013 and December 31, 2012.

Interest expense on deposits was as follows.

| (in thousands)             | Three Months Ended<br>September 30, |       | Nine Months Ended September<br>30, |       |
|----------------------------|-------------------------------------|-------|------------------------------------|-------|
|                            | 2013                                | 2012  | 2013                               | 2012  |
| NOW accounts               | \$265                               | \$129 | \$656                              | \$368 |
| Statement savings accounts | 140                                 | 113   | 358                                | 289   |
| Money market accounts      | 1,060                               | 858   | 2,890                              | 2,394 |

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|                         |         |         |         |          |
|-------------------------|---------|---------|---------|----------|
| Certificates of deposit | 757     | 2,808   | 4,174   | 9,934    |
|                         | \$2,222 | \$3,908 | \$8,078 | \$12,985 |

The weighted-average interest rates on certificates of deposit at September 30, 2013 and December 31, 2012 were 0.63% and 1.59%, respectively.

Certificates of deposit outstanding as of September 30, 2013, mature as follows.

| (in thousands)      | At<br>September 30,<br>2013 |
|---------------------|-----------------------------|
| Within one year     | \$377,372                   |
| One to two years    | 31,189                      |
| Two to three years  | 36,728                      |
| Three to four years | 9,157                       |
| Four to five years  | 5,777                       |
|                     | \$460,223                   |

The aggregate amount of time deposits in denominations of \$100 thousand or more at September 30, 2013 and December 31, 2012 was \$143.7 million and \$300.4 million, respectively. The aggregate amount of time deposits in denominations of more than \$250 thousand at September 30, 2013 and December 31, 2012 was \$15.0 million and \$45.3 million, respectively. There were \$158.0 million in brokered deposits as of September 30, 2013 and none at December 31, 2012.

#### NOTE 6—DERIVATIVES AND HEDGING ACTIVITIES:

In order 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 mortgage servicing rights ("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 cash flow or foreign currency hedge instruments at September 30, 2013 or December 31, 2012. Derivatives are reported at their respective fair values in the accounts receivable and 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 accounts receivable and 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 Available for Sale of this Form 10-Q for further information on securities collateral pledged. As of September 30, 2013 and December 31, 2012, 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 the 2012 Annual Report on Form 10-K.



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

| (in thousands)                                                   | At September 30, 2013 |                        |             |
|------------------------------------------------------------------|-----------------------|------------------------|-------------|
|                                                                  | Notional amount       | Fair value derivatives |             |
|                                                                  |                       | Asset                  | Liability   |
| Forward sale commitments                                         | \$677,538             | \$2,357                | \$(10,871 ) |
| Interest rate swaptions                                          | 305,000               | 136                    | —           |
| Interest rate lock commitments                                   | 388,977               | 13,753                 | (76 )       |
| Interest rate swaps                                              | 500,997               | 4,611                  | (13,176 )   |
| Total derivatives before netting                                 | \$1,872,512           | 20,857                 | (24,123 )   |
| Netting adjustments                                              |                       | (5,635 )               | 5,635       |
| Carrying value on consolidated statements of financial condition |                       | \$15,222               | \$(18,488 ) |

  

| (in thousands)                                                   | At December 31, 2012 |                        |             |
|------------------------------------------------------------------|----------------------|------------------------|-------------|
|                                                                  | Notional amount      | Fair value derivatives |             |
|                                                                  |                      | Asset                  | Liability   |
| Forward sale commitments                                         | \$1,258,152          | \$621                  | \$(2,743 )  |
| Interest rate lock commitments                                   | 734,762              | 22,548                 | (20 )       |
| Interest rate swaps                                              | 361,892              | 538                    | (9,358 )    |
| Total derivatives before netting                                 | \$2,354,806          | 23,707                 | (12,121 )   |
| Netting adjustments                                              |                      | (1,052 )               | 1,052       |
| Carrying value on consolidated statements of financial condition |                      | \$22,655               | \$(11,069 ) |

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

| (in thousands)                                                             | At September 30, 2013 |                     |                |                                     |                    |            |
|----------------------------------------------------------------------------|-----------------------|---------------------|----------------|-------------------------------------|--------------------|------------|
|                                                                            | Gross fair value      | Netting adjustments | Carrying value | Cash collateral paid <sup>(1)</sup> | Securities pledged | Net amount |
| Derivative assets:                                                         |                       |                     |                |                                     |                    |            |
| Forward sale commitments                                                   | \$2,357               | \$ (992 )           | \$1,365        | \$—                                 | \$—                | \$1,365    |
| Interest rate swaps / swaptions                                            | 4,747                 | (4,643 )            | 104            | —                                   | —                  | 104        |
| Total derivatives subject to legally enforceable master netting agreements | 7,104                 | (5,635 )            | 1,469          | —                                   | —                  | 1,469      |
| Interest rate lock commitments                                             | 13,753                | —                   | 13,753         | —                                   | —                  | 13,753     |
| Total derivative assets                                                    | \$20,857              | \$ (5,635 )         | \$15,222       | \$—                                 | \$—                | \$15,222   |
| Derivative liabilities:                                                    |                       |                     |                |                                     |                    |            |
| Forward sale commitments                                                   | \$(10,871 )           | \$ 992              | \$(9,879 )     | \$8,273                             | \$1,467            | \$(139 )   |
| Interest rate swaps                                                        | (13,176 )             | 4,643               | (8,533 )       | 7,928                               | 605                | —          |
| Total derivatives subject to legally enforceable master netting agreements | (24,047 )             | 5,635               | (18,412 )      | 16,201                              | 2,072              | (139 )     |
| Interest rate lock commitments                                             | (76 )                 | —                   | (76 )          | —                                   | —                  | (76 )      |
| Total derivative liabilities                                               | \$(24,123 )           | \$ 5,635            | \$(18,488 )    | \$16,201                            | \$2,072            | \$(215 )   |



|                                                                            | At December 31, 2012 |                     |                |                          |            |
|----------------------------------------------------------------------------|----------------------|---------------------|----------------|--------------------------|------------|
| (in thousands)                                                             | Gross fair value     | Netting adjustments | Carrying value | Cash collateral paid (1) | Net amount |
| Derivative assets:                                                         |                      |                     |                |                          |            |
| Forward sale commitments                                                   | \$621                | \$(621              | ) \$—          | \$—                      | \$—        |
| Interest rate swaps                                                        | 538                  | (431                | ) 107          | —                        | 107        |
| Total derivatives subject to legally enforceable master netting agreements | 1,159                | (1,052              | ) 107          | —                        | 107        |
| Interest rate lock commitments                                             | 22,548               | —                   | 22,548         | —                        | 22,548     |
| Total derivative assets                                                    | \$23,707             | \$(1,052            | ) \$22,655     | \$—                      | \$22,655   |
| Derivative liabilities:                                                    |                      |                     |                |                          |            |
| Forward sale commitments                                                   | \$(2,743             | ) \$621             | \$(2,122       | ) \$1,953                | \$(169     |
| Interest rate swaps                                                        | (9,358               | ) 431               | (8,927         | ) 8,927                  | —          |
| Total derivatives subject to legally enforceable master netting agreements | (12,101              | ) 1,052             | (11,049        | ) 10,880                 | (169       |
| Interest rate lock commitments                                             | (20                  | ) —                 | (20            | ) —                      | (20        |
| Total derivative liabilities                                               | \$(12,121            | ) \$1,052           | \$(11,069      | ) \$10,880               | \$(189     |

Excludes cash collateral of \$27.6 million and \$18.0 million at September 30, 2013 and December 31, 2012, which predominantly consists of collateral transferred by the Company at the initiation of derivative transactions and held (1) by the counterparty as security. These amounts were not netted against the derivative payables, because, at an individual counterparty level, the collateral exceeded the fair value exposure at September 30, 2013 and December 31, 2012.

The ineffective portion of net gain (loss) on derivatives in fair value hedging relationships, recognized in other noninterest income on the consolidated statements of operations, for loans held for investment were \$10 thousand and \$16 thousand for the three months ended September 30, 2013 and 2012, respectively and \$116 thousand and \$64 thousand for the nine months ended September 30, 2013 and 2012, respectively.

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

| (in thousands)                                                | Three Months Ended September 30, |         | Nine Months Ended September 30, |          |
|---------------------------------------------------------------|----------------------------------|---------|---------------------------------|----------|
|                                                               | 2013                             | 2012    | 2013                            | 2012     |
| Recognized in noninterest income:                             |                                  |         |                                 |          |
| Net gain on mortgage loan origination and sale activities (1) | \$(37,017 )                      | \$891   | \$(17,368 )                     | \$11,456 |
| Mortgage servicing income (2)                                 | 3,631                            | 4,861   | (12,392 )                       | 24,600   |
|                                                               | \$(33,386 )                      | \$5,752 | \$(29,760 )                     | \$36,056 |

(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 mortgage servicing rights MSRs.



## NOTE 7—MORTGAGE BANKING OPERATIONS:

Loans held for sale consisted of the following.

| (in thousands) | At<br>September 30,<br>2013 | At<br>December 31,<br>2012 |
|----------------|-----------------------------|----------------------------|
| Single family  | \$385,110                   | \$607,578                  |
| Multifamily    | —                           | 13,221                     |
|                | \$385,110                   | \$620,799                  |

Loans sold consisted of the following.

| (in thousands) | Three Months Ended September<br>30,<br>2013 |             | Nine Months Ended September<br>30,<br>2013 |             |
|----------------|---------------------------------------------|-------------|--------------------------------------------|-------------|
|                | 2012                                        |             | 2012                                       |             |
| Single family  | \$1,326,888                                 | \$1,238,879 | \$3,916,918                                | \$2,735,893 |
| Multifamily    | 21,998                                      | 26,515      | 87,971                                     | 85,116      |
|                | \$1,348,886                                 | \$1,265,394 | \$4,004,889                                | \$2,821,009 |

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 September<br>30,<br>2013 |          | Nine Months Ended September<br>30,<br>2013 |           |
|-----------------------------------------------------------------|---------------------------------------------|----------|--------------------------------------------|-----------|
|                                                                 | 2012                                        |          | 2012                                       |           |
| Single family:                                                  |                                             |          |                                            |           |
| Servicing value and secondary marketing gains <sup>(1)</sup>    | \$23,076                                    | \$56,142 | \$110,760                                  | \$120,471 |
| Provision for repurchase losses <sup>(2)</sup>                  | —                                           | (526)    | —                                          | (2,846)   |
| Net gain from secondary marketing activities                    | 23,076                                      | 55,616   | 110,760                                    | 117,625   |
| Loan origination and funding fees                               | 8,302                                       | 8,680    | 24,363                                     | 20,817    |
| Total single family                                             | 31,378                                      | 64,296   | 135,123                                    | 138,442   |
| Multifamily                                                     | 2,113                                       | 1,040    | 4,747                                      | 3,241     |
| Total net gain on mortgage loan origination and sale activities | \$33,491                                    | \$65,336 | \$139,870                                  | \$141,683 |

Comprised of gains and losses on interest rate lock commitments (which considers the value of servicing), single (1) family loans held for sale, forward sale commitments used to economically hedge secondary market activities, and the estimated fair value of the repurchase or indemnity obligation recognized on new loan sales.

(2) Represents changes in estimated probable future repurchase losses on previously sold loans.

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<br>September 30,<br>2013 | At<br>December 31,<br>2012 |
|---------------------------------|-----------------------------|----------------------------|
| Single family                   |                             |                            |
| U.S. government and agency      | \$10,950,086                | \$8,508,458                |
| Other                           | 336,158                     | 362,230                    |
|                                 | 11,286,244                  | 8,870,688                  |
| Commercial                      |                             |                            |
| Multifamily                     | 722,767                     | 727,118                    |
| Other                           | 50,629                      | 53,235                     |
|                                 | 773,396                     | 780,353                    |
| Total loans serviced for others | \$12,059,640                | \$9,651,041                |

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 8, Commitments, Guarantees and Contingencies. The following is a summary of changes in the Company's liability for estimated mortgage repurchase losses.

| (in thousands)                 | Three Months Ended September<br>30, |         | Nine Months Ended September<br>30, |         |
|--------------------------------|-------------------------------------|---------|------------------------------------|---------|
|                                | 2013                                | 2012    | 2013                               | 2012    |
| Beginning balance              | \$1,810                             | \$2,119 | \$1,955                            | \$471   |
| Additions <sup>(1)</sup>       | 505                                 | 1,018   | 1,513                              | 3,624   |
| Realized losses <sup>(2)</sup> | (717)                               | (1,202) | (1,870)                            | (2,160) |
| Balance, end of period         | \$1,598                             | \$1,935 | \$1,598                            | \$1,935 |

(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.

Advances are made to Ginnie Mae mortgage pools for delinquent loan payments. We also fund foreclosure costs and we repurchase loans from Ginnie Mae mortgage pools prior to recovery of guaranteed amounts. Ginnie Mae advances of \$7.5 million and \$5.9 million were recorded in accounts receivable and other assets as of September 30, 2013 and December 31, 2012, 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 September 30, 2013 and December 31, 2012, delinquent or defaulted mortgage loans currently in Ginnie Mae pools that the Company has recognized on its consolidated statements of financial condition totaled

\$11.8 million and \$8.0 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<br>September 30, |          | Nine Months Ended<br>September 30, |           |
|-----------------------------------------------------------------------------------------|-------------------------------------|----------|------------------------------------|-----------|
|                                                                                         | 2013                                | 2012     | 2013                               | 2012      |
| Servicing income, net:                                                                  |                                     |          |                                    |           |
| Servicing fees and other                                                                | \$8,934                             | \$7,168  | \$24,497                           | \$20,310  |
| Changes in fair value of single family MSR's due to modeled amortization <sup>(1)</sup> | (5,221                              | ) (5,360 | ) (16,896                          | ) (14,382 |
| Amortization of multifamily MSR's                                                       | (433                                | ) (598   | ) (1,347                           | ) (1,551  |
|                                                                                         | 3,280                               | 1,210    | 6,254                              | 4,377     |
| Risk management, single family MSR's:                                                   |                                     |          |                                    |           |
| Changes in fair value due to changes in model inputs and/or assumptions <sup>(2)</sup>  | (2,900                              | ) (5,565 | ) 15,403                           | (13,507   |
| Net gain (loss) from derivatives economically hedging MSR                               | 3,631                               | 4,861    | (12,392                            | ) 24,600  |
|                                                                                         | 731                                 | (704     | ) 3,011                            | 11,093    |
| Mortgage servicing income                                                               | \$4,011                             | \$506    | \$9,265                            | \$15,470  |

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

(2) Principally reflects changes in model assumptions, including prepayment speed assumptions, which are primarily affected by changes in mortgage interest rates.

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's is determined based on the price that would be received to sell the MSR's 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's 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's were as follows.

| (rates per annum) <sup>(1)</sup>                | Three Months Ended September<br>30, |         | Nine Months Ended September<br>30, |         |
|-------------------------------------------------|-------------------------------------|---------|------------------------------------|---------|
|                                                 | 2013                                | 2012    | 2013                               | 2012    |
| Constant prepayment rate ("CPR") <sup>(2)</sup> | 8.39                                | % 11.62 | % 8.87                             | % 11.11 |
| Discount rate                                   | 10.21                               | % 10.24 | % 10.25                            | % 10.29 |

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

(2) Represents the expected lifetime average.





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<br>September 30,<br>2013 |   |
|---------------------------------------------------|-----------------------------|---|
| Fair value of single family MSR                   | \$136,897                   |   |
| Expected weighted-average life (in years)         | 6.91                        |   |
| Constant prepayment rate <sup>(1)</sup>           | 11.63                       | % |
| Impact on 10% adverse change                      | \$(6,893                    | ) |
| Impact on 25% adverse change                      | \$(14,523                   | ) |
| Discount rate                                     | 10.50                       | % |
| Impact on fair value of 100 basis points increase | \$(5,314                    | ) |
| Impact on fair value of 200 basis points increase | \$(10,232                   | ) |

(1) Represents the expected lifetime average.

These sensitivities are hypothetical and should be used with caution. As the table above demonstrates, the Company's methodology for estimating the fair value of MSRs 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 MSRs 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 MSRs measured at fair value are as follows.

| (in thousands)                                                                         | Three Months Ended September<br>30,<br>2013 |          | Nine Months Ended September<br>30,<br>2013 |           |
|----------------------------------------------------------------------------------------|---------------------------------------------|----------|--------------------------------------------|-----------|
|                                                                                        | 2013                                        | 2012     | 2013                                       | 2012      |
| Beginning balance                                                                      | \$128,146                                   | \$70,585 | \$87,396                                   | \$70,169  |
| Additions and amortization:                                                            |                                             |          |                                            |           |
| Originations                                                                           | 16,862                                      | 14,121   | 50,974                                     | 31,442    |
| Purchases                                                                              | 10                                          | 6        | 19                                         | 65        |
| Changes due to modeled amortization <sup>(1)</sup>                                     | (5,221                                      | ) (5,360 | ) (16,896                                  | ) (14,382 |
| Net additions and amortization                                                         | 11,651                                      | 8,767    | 34,097                                     | 17,125    |
| Changes in fair value due to changes in model inputs and/or assumptions <sup>(2)</sup> | (2,900                                      | ) (5,565 | ) 15,404                                   | (13,507   |
| Ending balance                                                                         | \$136,897                                   | \$73,787 | \$136,897                                  | \$73,787  |

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

(2)

Primarily reflects changes in model assumptions, including prepayment speed assumptions, which are primarily affected by changes in mortgage interest rates.

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

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

| (in thousands)    | Three Months Ended<br>September 30, |         | Nine Months Ended September<br>30, |          |
|-------------------|-------------------------------------|---------|------------------------------------|----------|
|                   | 2013                                | 2012    | 2013                               | 2012     |
| Beginning balance | \$9,239                             | \$7,655 | \$8,097                            | \$7,112  |
| Origination       | 597                                 | 668     | 2,652                              | 2,164    |
| Amortization      | (433                                | ) (598  | ) (1,346                           | ) (1,551 |
| Ending balance    | \$9,403                             | \$7,725 | \$9,403                            | \$7,725  |

At September 30, 2013, the expected weighted-average life of the Company's multifamily MSRs was 9.09 years. Projected amortization expense for the gross carrying value of multifamily MSRs is estimated as follows.

| (in thousands)                    | At<br>September 30,<br>2013 |
|-----------------------------------|-----------------------------|
| Remainder of 2013                 | \$417                       |
| 2014                              | 1,566                       |
| 2015                              | 1,402                       |
| 2016                              | 1,287                       |
| 2017                              | 1,162                       |
| 2018 and thereafter               | 3,569                       |
| Carrying value of multifamily MSR | \$9,403                     |

## NOTE 8—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 amounts of unused commitments do not necessarily represent future credit exposure or cash requirements in that commitments may expire without being drawn upon.

In the ordinary course of business, the Company makes unfunded loan commitments as part of its residential mortgage lending activities generally in the form of a written confirmation from the Company to the seller of a property that we will advance the specified funds enabling the buyer to complete the purchase of the property. Unfunded loan commitments totaled \$445.8 million (\$380.3 million fixed-rate and \$65.5 million adjustable-rate commitments) at September 30, 2013 and \$768.9 million (\$746.8 million fixed-rate and \$22.1 million adjustable-rate commitments) at December 31, 2012.

In the ordinary course of business, the Company extends secured and unsecured open-end loans to meet the financing needs of its customers. Commitments related to unused home equity and commercial real estate lines of credit and business banking funding lines totaled \$112.2 million and \$91.1 million at September 30, 2013 and December 31, 2012, respectively. Undistributed construction loan commitments, where the Company has an obligation to advance funds for construction progress payments, were \$97.2 million and \$34.5 million at September 30, 2013 and December 31, 2012, 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 \$200 thousand and \$190 thousand at September 30, 2013 and December 31, 2012, respectively.

### Guarantees

In the ordinary course of business, the Company sells loans through the Fannie Mae Multifamily Delegated Underwriting and Servicing Program (“DUS®”) 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 equally 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 and are no longer on the Company's consolidated statements of financial condition, a liability is recorded for this loss sharing arrangement under the accounting guidance for guarantees. As of September 30, 2013 and December 31, 2012, the total unpaid principal balance of loans sold under this program was \$722.8 million and \$727.1 million, respectively. The Company's reserve liability related to this arrangement totaled \$2.0 million and \$3.3 million at September 30, 2013 and December 31, 2012, respectively. There were no actual losses incurred under this arrangement during the three and nine months ended September 30, 2013 and 2012.

### Mortgage repurchase liability

In the ordinary course of business, the Company sells residential mortgage loans to GSEs that include the mortgage loans in GSE-guaranteed mortgage securitizations. In addition, the Company pools FHA-insured and VA-guaranteed mortgage loans that are used to back Ginnie Mae-guaranteed 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 any credit loss on the repurchased mortgage loans after accounting for any mortgage insurance that it 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 Ginnie Mae, FHA or VA. As an originator of FHA-insured or VA-guaranteed loans, the Company is responsible for obtaining the insurance with FHA or the guarantee with the VA. If loans are later found not to meet the requirements of FHA or VA, through required internal quality control reviews or through agency audits, the Company may be required to indemnify FHA or VA against losses. The loans remain in Ginnie Mae pools unless and until they are repurchased by the Company. In general, once a FHA or VA loan becomes 90 days past due, the Company repurchases the FHA or VA loan to minimize the cost of interest advances on the loan. If the loan is cured through

<sup>1</sup> DUS® is a registered trademark of Fannie Mae

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 that were subject to the terms and conditions of these representations and warranties totaled \$11.34 billion and \$8.92 billion as of September 30, 2013 and December 31, 2012, respectively. At September 30, 2013 and December 31, 2012, the Company had recorded a mortgage repurchase liability, included in accounts payable and other liabilities on the consolidated statements of financial condition, of \$1.6 million and \$2.0 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 September 30, 2013, we reviewed our legal claims and determined that there were no claims that are considered to be probable or reasonably possible of resulting in a loss. As a result, the Company did not have any amounts reserved for legal claims as of September 30, 2013.

#### NOTE 9—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 the 2012 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 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 MSR's. Additionally, at least annually ALCO 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 results 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 certain 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.

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. Observable market prices of identical or similar securities are used where available.                                                                                                                                                                                                                                                                                            | Estimated fair value classified as Level 1.                                                                                                                                                 |
| 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"> <li>• Expected prepayment speeds</li> <li>• Estimated credit losses</li> <li>• Market liquidity adjustments</li> </ul>                                                                                                                                                                                              | Level 2 recurring fair value measurement                                                                                                                                                    |
| Loans held for sale                                             | Fair value is based on observable market data, including:                                                                                                                                                                                                                                                                                                                                                                                                                                 |                                                                                                                                                                                             |
| Single-family loans                                             | <ul style="list-style-type: none"> <li>• Quoted market prices, where available</li> <li>• Dealer quotes for similar loans</li> <li>• Forward sale commitments</li> </ul> <p>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.</p> | Level 2 recurring fair value measurement                                                                                                                                                    |
| Multifamily loans                                               |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           | Carried at lower of amortized cost or fair value.                                                                                                                                           |
| Loans held for investment                                       |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           | Estimated fair value classified as Level 2.                                                                                                                                                 |
| Loans held for investment, excluding collateral dependent loans | <p>Fair value is based on discounted cash flows, which considers the following inputs:</p> <ul style="list-style-type: none"> <li>• Current lending rates for new loans</li> <li>• Expected prepayment speeds</li> <li>• Estimated credit losses</li> <li>• Market liquidity adjustments</li> </ul>                                                                                                                                                                                       | <p>For the carrying value of loans see Note 1–Summary of Significant Accounting Policies within the 2012 Annual Report on Form 10-K.</p> <p>Estimated fair value classified as Level 3.</p> |

Loans held for investment,  
collateral dependent

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:

- 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
- 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

Carried at lower of amortized cost or fair value of collateral, less the estimated cost to sell.

Classified as a Level 3 nonrecurring fair value measurement in periods where carrying value is adjusted to reflect the fair value of collateral.

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| Asset/Liability class                  | Valuation methodology, inputs and assumptions                                                                                                                                                                                        | Classification                                                                                                                      |
|----------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------|
| Mortgage servicing rights              |                                                                                                                                                                                                                                      |                                                                                                                                     |
| Single family MSRs                     | 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 7, Mortgage Banking Operations. | Level 3 recurring fair value measurement                                                                                            |
| Multifamily MSRs                       | Fair value is based on discounted estimated future servicing fees and other revenue, less estimated costs to service the loans.                                                                                                      | Carried at lower of amortized cost or fair value<br><br>Estimated fair value classified as Level 3.                                 |
| Derivatives                            |                                                                                                                                                                                                                                      |                                                                                                                                     |
| Interest rate swaps                    | Fair value is based on quoted prices for identical or similar instruments, when available.                                                                                                                                           |                                                                                                                                     |
| Interest rate swaptions                | 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:                                                         | Level 2 recurring fair value measurement                                                                                            |
| Forward sale commitments               | <ul style="list-style-type: none"> <li>• Forward interest rates</li> <li>• Interest rate volatilities</li> </ul> The fair value considers several factors including:                                                                 |                                                                                                                                     |
| Interest rate lock commitments         | <ul style="list-style-type: none"> <li>• Fair value of the underlying loan based on quoted prices in the secondary market, when available.</li> <li>• Value of servicing</li> <li>• Fall-out factor</li> </ul>                       | Level 3 recurring fair value measurement effective December 31, 2012.                                                               |
| Other real estate owned ("OREO")       | Fair value is based on appraised value of collateral. 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.<br>Carried at par value. |
| Federal Home Loan Bank stock           | Carrying value approximates fair value as FHLB stock can only be purchased or redeemed 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.<br>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.                                                                                         |

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|                                 |                                                                                                                                                                              |                                                                                |
|---------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------|
| 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.                       | Carried at historical cost.<br><br>Estimated fair value classified as Level 2. |
| 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. | Carried at historical cost.<br><br>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<br>September 30,<br>2013 | Level 1 | Level 2   | Level 3   |
|------------------------------------------|----------------------------------------|---------|-----------|-----------|
| Assets:                                  |                                        |         |           |           |
| Investment securities available for sale |                                        |         |           |           |
| Mortgage backed securities:              |                                        |         |           |           |
| Residential                              | \$144,263                              | \$—     | \$144,263 | \$—       |
| Commercial                               | 13,720                                 | —       | 13,720    | —         |
| Municipal bonds                          | 147,441                                | —       | 147,441   | —         |
| Collateralized mortgage obligations:     |                                        |         |           |           |
| Residential                              | 153,466                                | —       | 153,466   | —         |
| Commercial                               | 16,991                                 | —       | 16,991    | —         |
| Corporate debt securities                | 69,963                                 | —       | 69,963    | —         |
| U.S. Treasury securities                 | 27,747                                 | —       | 27,747    | —         |
| Single family mortgage servicing rights  | 136,897                                | —       | —         | 136,897   |
| Single family loans held for sale        | 385,110                                | —       | 385,110   | —         |
| Derivatives                              |                                        |         |           |           |
| Forward sale commitments                 | 2,357                                  | —       | 2,357     | —         |
| Interest rate swaptions                  | 136                                    | —       | 136       | —         |
| Interest rate lock commitments           | 13,753                                 | —       | —         | 13,753    |
| Interest rate swaps                      | 4,611                                  | —       | 4,611     | —         |
| Total assets                             | \$1,116,455                            | \$—     | \$965,805 | \$150,650 |
| Liabilities:                             |                                        |         |           |           |
| Derivatives                              |                                        |         |           |           |
| Forward sale commitments                 | \$10,871                               | \$—     | \$10,871  | \$—       |
| Interest rate lock commitments           | 76                                     | —       | —         | 76        |
| Interest rate swaps                      | 13,176                                 | —       | 13,176    | —         |
| Total liabilities                        | \$24,123                               | \$—     | \$24,047  | \$76      |

| (in thousands)                           | Fair Value at<br>December 31,<br>2012 | Level 1 | Level 2     | Level 3   |
|------------------------------------------|---------------------------------------|---------|-------------|-----------|
| Assets:                                  |                                       |         |             |           |
| Investment securities available for sale |                                       |         |             |           |
| Mortgage backed securities:              |                                       |         |             |           |
| Residential                              | \$62,853                              | \$—     | \$62,853    | \$—       |
| Commercial                               | 14,380                                | —       | 14,380      | —         |
| Municipal bonds                          | 129,175                               | —       | 129,175     | —         |
| Collateralized mortgage obligations:     |                                       |         |             |           |
| Residential                              | 170,199                               | —       | 170,199     | —         |
| Commercial                               | 9,043                                 | —       | 9,043       | —         |
| U.S. Treasury securities                 | 30,679                                | —       | 30,679      | —         |
| Single family mortgage servicing rights  | 87,396                                | —       | —           | 87,396    |
| Single family loans held for sale        | 607,578                               | —       | 607,578     | —         |
| Derivatives                              |                                       |         |             |           |
| Forward sale commitments                 | 621                                   | —       | 621         | —         |
| Interest rate lock commitments           | 22,548                                | —       | —           | 22,548    |
| Interest rate swaps                      | 538                                   | —       | 538         | —         |
| Total assets                             | \$1,135,010                           | \$—     | \$1,025,066 | \$109,944 |
| Liabilities:                             |                                       |         |             |           |
| Derivatives                              |                                       |         |             |           |
| Forward sale commitments                 | \$2,743                               | \$—     | \$2,743     | \$—       |
| Interest rate lock commitments           | 20                                    | —       | —           | 20        |
| Interest rate swaps                      | 9,358                                 | —       | 9,358       | —         |
| Total liabilities                        | \$12,121                              | \$—     | \$12,101    | \$20      |

There were no transfers between levels of the fair value hierarchy during the three and nine months ended September 30, 2013 and 2012.

#### Level 3 Recurring Fair Value Measurements

The Company's level 3 recurring fair value measurements consist of single family mortgage servicing rights and, as of December 31, 2012, interest rate lock commitments, which are accounted for as derivatives. For information regarding fair value changes and activity for single family MSRs during the three and nine months ended September 30, 2013 and 2012, see Note 7, Mortgage Banking Operations.

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

| (in thousands)                                 | Three Months<br>Ended<br>September 30, | Nine Months<br>Ended<br>September 30, |
|------------------------------------------------|----------------------------------------|---------------------------------------|
| Beginning balance, net                         | \$406                                  | \$22,528                              |
| Total realized/unrealized gains <sup>(1)</sup> | 28,538                                 | 102,231                               |
| Settlements                                    | (15,267)                               | (111,082)                             |
| Ending balance, net                            | \$13,677                               | \$13,677                              |

(1)

All realized and unrealized gains and losses are recognized in earnings as net gain from mortgage loan origination and sale activities on the consolidated statement of operations. For the three and nine months ended September 30, 2013 there were net unrealized (losses) gains of \$13.3 million and \$13.7 million, respectively, recognized on interest rate lock commitments still outstanding at September 30, 2013.

In the first quarter of 2013, the Company refined the valuation methodology used for interest rate lock commitments to reflect assumptions that the Company believes a market participant would consider under current market conditions. This change in

accounting estimate resulted in an increase in fair value of \$4.3 million to the Company's interest rate lock commitments outstanding at March 31, 2013.

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

| (dollars in thousands)              | At September 30, 2013 |                     | Significant Unobservable Input | Low   | High   | Weighted Average |
|-------------------------------------|-----------------------|---------------------|--------------------------------|-------|--------|------------------|
|                                     | Fair Value            | Valuation Technique |                                |       |        |                  |
| Interest rate lock commitments, net | \$13,677              | Income approach     | Fall out factor                | 0.5%  | 100.0% | 16.4%            |
|                                     |                       |                     | Value of servicing             | 0.36% | 2.14%  | 0.98%            |
| (dollars in thousands)              | At December 31, 2012  |                     | Significant Unobservable Input | Low   | High   | Weighted Average |
|                                     | Fair Value            | Valuation Technique |                                |       |        |                  |
| Interest rate lock commitments, net | \$22,528              | Income Approach     | Fall out factor                | 0.4%  | 59.3%  | 16.8%            |
|                                     |                       |                     | Value of servicing             | 0.50% | 2.18%  | 1.04%            |

The fair value of interest rate lock commitments decreases in value upon an increase in the fall-out factor and increases in value upon an increase in the value of servicing. Changes in the fall-out factor and value of servicing do not increase or decrease based on movements in the other significant unobservable input.

#### 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, less the estimated cost to sell. The following tables present assets that were recorded at fair value during the three and nine months ended September 30, 2013 and 2012 and still held at the end of the respective reporting period.

| (in thousands)                           | Three Months Ended September 30, 2013           |         |         |          | Total Gains (Losses) |
|------------------------------------------|-------------------------------------------------|---------|---------|----------|----------------------|
|                                          | Fair Value of Assets Held at September 30, 2013 | Level 1 | Level 2 | Level 3  |                      |
| Loans held for investment <sup>(1)</sup> | \$37,853                                        | \$—     | \$—     | \$37,853 | \$(760 )             |
| Other real estate owned <sup>(2)</sup>   | 1,847                                           | —       | —       | 1,847    | (174 )               |
| Total                                    | \$39,700                                        | \$—     | \$—     | \$39,700 | \$(934 )             |
| (in thousands)                           | Three Months Ended September 30, 2012           |         |         |          | Total Losses         |
|                                          | Fair Value of Assets Held at September 30, 2012 | Level 1 | Level 2 | Level 3  |                      |



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|                                          |          |     |     |          |           |   |
|------------------------------------------|----------|-----|-----|----------|-----------|---|
| Loans held for investment <sup>(1)</sup> | \$34,699 | \$— | \$— | \$34,699 | \$(1,817) | ) |
| Other real estate owned <sup>(2)</sup>   | 5,738    | —   | —   | 5,738    | (2,464)   | ) |
| Total                                    | \$40,437 | \$— | \$— | \$40,437 | \$(4,281) | ) |

| (in thousands)                           | Nine Months Ended September 30, 2013            |         |         |          |                      |
|------------------------------------------|-------------------------------------------------|---------|---------|----------|----------------------|
|                                          | Fair Value of Assets Held at September 30, 2013 | Level 1 | Level 2 | Level 3  | Total Gains (Losses) |
| Loans held for investment <sup>(1)</sup> | \$37,853                                        | \$—     | \$—     | \$37,853 | \$(1,510 )           |
| Other real estate owned <sup>(2)</sup>   | 10,398                                          | —       | —       | 10,398   | (2,589 )             |
| Total                                    | \$48,251                                        | \$—     | \$—     | \$48,251 | \$(4,099 )           |

| (in thousands)                           | Nine Months Ended September 30, 2012            |         |         |          |              |
|------------------------------------------|-------------------------------------------------|---------|---------|----------|--------------|
|                                          | Fair Value of Assets Held at September 30, 2012 | Level 1 | Level 2 | Level 3  | Total Losses |
| Loans held for investment <sup>(1)</sup> | \$35,659                                        | \$—     | \$—     | \$35,659 | \$(5,324 )   |
| Other real estate owned <sup>(2)</sup>   | 11,035                                          | —       | —       | 11,035   | (5,554 )     |
| Total                                    | \$46,694                                        | \$—     | \$—     | \$46,694 | \$(10,878 )  |

(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.

The following table presents significant Level 3 unobservable inputs used to measure fair value on a nonrecurring basis during the nine months ended September 30, 2013 and the three and nine months ended September 30, 2012 for assets still held at the end of the period. For the three months ended September 30, 2013 there were no significant unobservable inputs used to measure fair value on a nonrecurring basis.

| (dollars in thousands)    | Fair Value of Assets Held at September 30, 2013 <sup>(1)</sup> | Valuation Technique | Significant Unobservable Input             | Nine Months Ended September 30, 2013  |   |      |   |                  |   |
|---------------------------|----------------------------------------------------------------|---------------------|--------------------------------------------|---------------------------------------|---|------|---|------------------|---|
|                           |                                                                |                     |                                            | Low                                   |   | High |   | Weighted Average |   |
| Loans held for investment | \$14,605                                                       | Market approach     | Comparable sale adjustments <sup>(2)</sup> | 0                                     | % | 45   | % | 20               | % |
|                           | 14,605                                                         | Income approach     | Capitalization rate                        | 6.4                                   | % | 10.8 | % | 8.2              | % |
|                           |                                                                |                     | Discount rate                              | 8.2                                   | % | 9.5  | % | 8.9              | % |
| Other real estate owned   | \$5,814                                                        | Market approach     | Comparable sale adjustments <sup>(2)</sup> | 0                                     | % | 50   | % | 25               | % |
| (dollars in thousands)    | Fair Value of Assets Held at September 30, 2012 <sup>(1)</sup> | Valuation Technique | Significant Unobservable Input             | Three Months Ended September 30, 2012 |   |      |   |                  |   |
|                           |                                                                |                     |                                            | Low                                   |   | High |   | Weighted Average |   |
| Loans held for investment | \$34,699                                                       | Market approach     |                                            | 3                                     | % | 45   | % | 24               | % |

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|                         |         |                 |                                                                      |     |   |     |   |     |   |
|-------------------------|---------|-----------------|----------------------------------------------------------------------|-----|---|-----|---|-----|---|
|                         | 10,462  | Income approach | Comparable sale<br>adjustments <sup>(2)</sup><br>Capitalization rate | 5.0 | % | 9.0 | % | 7.0 | % |
| Other real estate owned | \$5,738 | Market approach | Comparable sale<br>adjustments <sup>(2)</sup>                        | 1   | % | 13  | % | 7   | % |

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| (dollars in thousands)    | Fair Value<br>of Assets<br>Held at<br>September<br>30, 2012 <sup>(1)</sup> | Valuation<br>Technique | Significant Unobservable<br>Input             | Nine Months Ended<br>September 30,<br>2012 |        |                     |   |  |
|---------------------------|----------------------------------------------------------------------------|------------------------|-----------------------------------------------|--------------------------------------------|--------|---------------------|---|--|
|                           |                                                                            |                        |                                               | Low                                        | High   | Weighted<br>Average |   |  |
| Loans held for investment | \$35,659                                                                   | Market approach        | Comparable sale<br>adjustments <sup>(2)</sup> | 1                                          | % 45   | % 23                | % |  |
|                           |                                                                            |                        | Other discounts <sup>(3)</sup>                | 28                                         | % 74   | % 51                | % |  |
|                           | 10,975                                                                     | Income approach        | Capitalization rate                           | 6.0                                        | % 11.0 | % 8.5               | % |  |
| Other real estate owned   | \$11,035                                                                   | Market approach        | Comparable sale<br>adjustments <sup>(2)</sup> | 0                                          | % 70   | % 35                | % |  |
|                           |                                                                            |                        | Other discounts <sup>(3)</sup>                | 4                                          | % 64   | % 34                | % |  |

Assets that are valued using more than one valuation technique are presented within multiple categories for each (1) valuation technique used. Excludes unobservable inputs that we consider, both individually and in the aggregate, to have been insignificant relative to our overall nonrecurring Level 3 measurements recorded during the period.

(2) Represents the range of net adjustments reflecting differences between a comparable sale and the property being appraised, expressed as an absolute value.

Includes bulk sale discounts applied to the aggregate retail value of tract development properties, accelerated marketing period discounts and time-hold or other discounts applied to derive the “as is” market value of certain (3) properties requiring a holding period before reaching a state of feasibility or completion (e.g., “upon completion” or “upon stabilization” value) and management discounts based on the Company's experience with actual liquidation values.

The Company's property appraisals are primarily based on the market approach and income approach methodologies, which consider recent sales of comparable properties, including their income generating characteristics, and then make adjustments to reflect the general assumptions that a market participant would make when analyzing the property for purchase. These adjustments may increase or decrease an appraised value and can vary significantly depending on the location, physical characteristics and income producing potential of each individual property. Additionally, 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 comparable sale adjustments. Given these variations, comparable sale adjustments are generally not a reliable indicator for how fair value will increase or decrease from period to period. Under certain circumstances, management discounts are applied based on specific characteristics of an individual property and the Company's experience with actual liquidation values.

In addition to the instruments disclosed in the table above, certain nonrecurring fair value measurements of residential properties were 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.

## 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 September 30, 2013 |             |          |             |           |
|-----------------------------------------|-----------------------|-------------|----------|-------------|-----------|
| (in thousands)                          | Carrying Value        | Fair Value  | Level 1  | Level 2     | Level 3   |
| Assets:                                 |                       |             |          |             |           |
| Cash and cash equivalents               | \$37,906              | \$37,906    | \$37,906 | \$—         | \$—       |
| Loans held for investment               | 1,510,169             | 1,525,432   | —        | —           | 1,525,432 |
| Mortgage servicing rights – multifamily | 9,403                 | 10,899      | —        | —           | 10,899    |
| Federal Home Loan Bank stock            | 35,370                | 35,370      | —        | 35,370      | —         |
| Liabilities:                            |                       |             |          |             |           |
| Deposits                                | \$2,098,076           | \$1,982,714 | \$—      | \$1,982,714 | \$—       |
| Federal Home Loan Bank advances         | 338,690               | 341,555     | —        | 341,555     | —         |
| Long-term debt                          | 61,857                | 60,239      | —        | 60,239      | —         |
|                                         |                       |             |          |             |           |
|                                         | At December 31, 2012  |             |          |             |           |
| (in thousands)                          | Carrying Value        | Fair Value  | Level 1  | Level 2     | Level 3   |
| Assets:                                 |                       |             |          |             |           |
| Cash and cash equivalents               | \$25,285              | \$25,285    | \$25,285 | \$—         | \$—       |
| Loans held for investment               | 1,308,974             | 1,340,882   | —        | —           | 1,340,882 |
| Loans held for sale – multifamily       | 13,221                | 14,810      | —        | 14,810      | —         |
| Mortgage servicing rights – multifamily | 8,097                 | 9,497       | —        | —           | 9,497     |
| Federal Home Loan Bank stock            | 36,367                | 36,367      | —        | 36,367      | —         |
| Liabilities:                            |                       |             |          |             |           |
| Deposits                                | \$1,976,835           | \$1,979,925 | \$—      | \$1,979,925 | \$—       |
| Federal Home Loan Bank advances         | 259,090               | 263,209     | —        | 263,209     | —         |
| Long-term debt                          | 61,857                | 60,241      | —        | 60,241      | —         |

Excluded from the fair value tables above are certain off-balance sheet loan commitments such as unused home equity lines of credit, business banking line funds and undisbursed construction funds. A reasonable estimate of the fair value of these instruments is the carrying value of deferred fees plus the related allowance for credit losses, which amounted to \$440 thousand and \$216 thousand at September 30, 2013 and December 31, 2012, respectively.

## NOTE 10—EARNINGS PER SHARE:

The following table summarizes the calculation of earnings per share for the three and nine months ended September 30, 2013 and 2012.

| (in thousands, except share and per share data)                        | For the Three Months Ended<br>September 30, |            | For the Nine Months Ended<br>September 30, |            |
|------------------------------------------------------------------------|---------------------------------------------|------------|--------------------------------------------|------------|
|                                                                        | 2013                                        | 2012       | 2013                                       | 2012       |
| Net income                                                             | \$1,662                                     | \$21,991   | \$24,670                                   | \$60,628   |
| Weighted average shares:                                               |                                             |            |                                            |            |
| Basic weighted-average number of common shares outstanding             | 14,388,559                                  | 14,335,950 | 14,374,943                                 | 12,960,212 |
| Dilutive effect of outstanding common stock equivalents <sup>(1)</sup> | 402,112                                     | 363,082    | 418,484                                    | 454,263    |
| Diluted weighted-average number of common stock outstanding            | 14,790,671                                  | 14,699,032 | 14,793,427                                 | 13,414,475 |
| Earnings per share:                                                    |                                             |            |                                            |            |
| Basic earnings per share                                               | \$0.12                                      | \$1.53     | \$1.72                                     | \$4.68     |
| Diluted earnings per share                                             | \$0.11                                      | \$1.50     | \$1.67                                     | \$4.52     |

Excluded from the computation of diluted earnings per share (due to their antidilutive effect) for the three and nine months ended September 30, 2013 and 2012 were certain stock options and unvested restricted stock issued to key (1)senior 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 112,765 and 50,978 at September 30, 2013 and 2012, respectively.

## NOTE 11—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.

As a result of a change in the manner in which management evaluates strategic decisions, commencing with the second quarter of 2013, the Company realigned its business segments and organized them into two lines of business: Commercial and Consumer Banking segment and Mortgage Banking segment. In conjunction with this realignment, the Company modified its internal reporting to provide discrete financial information to management for these two business segments. The information that follows has been revised to reflect the current business segments.

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 and business portfolio loans; non-deposit investment products; insurance products and cash management services. We originate residential and commercial 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 commercial real estate loans including multifamily lending 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 and purchases single family residential mortgage loans for sale in the secondary markets. We purchase loans from Windermere Mortgage Services Series LLC through a correspondent arrangement with that company. 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. A small percentage of our loans are brokered or sold on a servicing-released basis to correspondent lenders. We manage the loan funding and the interest rate risk associated with the secondary market loan sales and the retained servicing rights within this business segment.

Financial highlights by operating segment were as follows.

| (in thousands)                            | Three Months Ended September 30, 2013 |                                          |             |
|-------------------------------------------|---------------------------------------|------------------------------------------|-------------|
|                                           | Mortgage<br>Banking                   | Commercial<br>and<br>Consumer<br>Banking | Total       |
| Condensed income statement:               |                                       |                                          |             |
| Net interest income <sup>(1)</sup>        | \$4,493                               | \$15,919                                 | \$20,412    |
| (Reversal of) provision for credit losses | —                                     | (1,500)                                  | (1,500)     |
| Noninterest income                        | 36,945                                | 1,229                                    | 38,174      |
| Noninterest expense                       | 44,539                                | 13,577                                   | 58,116      |
| Income (loss) before income taxes         | (3,101)                               | 5,071                                    | 1,970       |
| Income tax expense (benefit)              | (911)                                 | 1,219                                    | 308         |
| Net income (loss)                         | \$(2,190)                             | \$3,852                                  | \$1,662     |
| Average assets                            | \$656,697                             | \$2,129,597                              | \$2,786,294 |

| (in thousands)                     | Three Months Ended September 30, 2012 |                                          |             |
|------------------------------------|---------------------------------------|------------------------------------------|-------------|
|                                    | Mortgage<br>Banking                   | Commercial<br>and<br>Consumer<br>Banking | Total       |
| Condensed income statement:        |                                       |                                          |             |
| Net interest income <sup>(1)</sup> | \$4,424                               | \$12,096                                 | \$16,520    |
| Provision for credit losses        | —                                     | 5,500                                    | 5,500       |
| Noninterest income                 | 66,617                                | 2,474                                    | 69,091      |
| Noninterest expense                | 32,632                                | 13,302                                   | 45,934      |
| Income (loss) before income taxes  | 38,409                                | (4,232)                                  | 34,177      |
| Income tax expense (benefit)       | 14,090                                | (1,904)                                  | 12,186      |
| Net income (loss)                  | \$24,319                              | \$(2,328)                                | \$21,991    |
| Average assets                     | \$670,715                             | \$1,772,975                              | \$2,443,690 |

| (in thousands)                     | Nine Months Ended September 30, 2013 |                                          |          |
|------------------------------------|--------------------------------------|------------------------------------------|----------|
|                                    | Mortgage<br>Banking                  | Commercial<br>and<br>Consumer<br>Banking | Total    |
| Condensed income statement:        |                                      |                                          |          |
| Net interest income <sup>(1)</sup> | \$12,375                             | \$40,687                                 | \$53,062 |
| Provision for credit losses        | —                                    | 900                                      | 900      |
| Noninterest income                 | 149,517                              | 5,156                                    | 154,673  |
| Noninterest expense                | 127,879                              | 42,748                                   | 170,627  |
| Income before income taxes         | 34,013                               | 2,195                                    | 36,208   |
| Income tax expense (benefit)       | 11,663                               | (125)                                    | 11,538   |
| Net income                         | \$22,350                             | \$2,320                                  | \$24,670 |



|                |           |             |             |
|----------------|-----------|-------------|-------------|
| Average assets | \$641,336 | \$1,996,713 | \$2,638,049 |
|----------------|-----------|-------------|-------------|

| (in thousands)                     | Nine Months Ended September 30, 2012 |                                          |             |
|------------------------------------|--------------------------------------|------------------------------------------|-------------|
|                                    | Mortgage<br>Banking                  | Commercial<br>and<br>Consumer<br>Banking | Total       |
| Condensed income statement:        |                                      |                                          |             |
| Net interest income <sup>(1)</sup> | \$9,697                              | \$34,454                                 | \$44,151    |
| Provision for credit losses        | —                                    | 7,500                                    | 7,500       |
| Noninterest income                 | 158,832                              | 7,257                                    | 166,089     |
| Noninterest expense                | 80,777                               | 46,848                                   | 127,625     |
| Income (loss) before income taxes  | 87,752                               | (12,637 )                                | 75,115      |
| Income tax expense (benefit)       | 16,935                               | (2,448 )                                 | 14,487      |
| Net income (loss)                  | \$70,817                             | \$(10,189 )                              | \$60,628    |
| Average assets                     | \$506,098                            | \$1,870,076                              | \$2,376,174 |

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, (1) 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 12—SUBSEQUENT EVENTS:

On November 1, 2013, the Company completed its acquisition of Fortune Bank and YNB Financial Services Corp. (“YNB”), the parent of Yakima National Bank. The Company acquired all of the voting equity interests of Fortune Bank and YNB. Immediately following completion of the acquisitions, YNB was merged into HomeStreet, Inc. Additionally, Fortune Bank and Yakima National Bank were merged into HomeStreet Bank. The combined organization had approximately \$3.10 billion in assets on a pro forma basis as of September 30, 2013. The primary objective for the acquisitions is to grow the Company’s Commercial and Consumer Banking business. Additionally, the acquisition of Yakima National Bank expands the Company's geographic footprint, which is consistent with our ongoing growth strategy. The operating results of the Company for the three months ended September 30, 2013 do not include the operating results of Fortune Bank and YNB as the acquisition did not close until November 1, 2013. It is not practical to present financial information related to the acquisitions at this time because the fair value measurement of assets acquired and liabilities assumed has not been finalized. On October 24, 2013, the Company announced that its board of directors approved a common stock dividend of \$0.11 per share, payable on November 25, 2013 to shareholders of record as of November 4, 2013.

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

### FORWARD-LOOKING STATEMENTS

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. 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 or acquisitions; 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. Some of the factors that may cause us to fall short of expectations or to deviate from our intended courses of action include:

- the qualifying disclosures and other factors referenced in this Form 10-Q including, but not limited to, those listed under Item 1A "Risk Factors" and "Management's Discussion and Analysis of Financial Condition and Results of Operations;"
- our ability to manage the credit risks of our lending activities, including potential increases in loan delinquencies, nonperforming assets and write offs, decreased collateral values, inadequate loan reserve amounts and the effectiveness of our hedging strategies;
- our ability to grow our geographic footprint and our various lines of business, and to manage that growth effectively, including our effectiveness in managing the associated costs and in generating the expected revenues and strategic benefits;
- our ability to complete our pending acquisitions and effectively integrate those into our operations;
- general economic conditions, either nationally or in our market area, including increases in mortgage interest rates, declines in housing refinance activities, employment trends, business contraction, consumer confidence, real estate values and other recessionary pressures;
- the impact of and our ability to anticipate and respond effectively to changes in the levels of general interest rates, mortgage interest rates, deposit interest rates, our net interest margin and funding sources;
- compliance with regulatory requirements, including laws and regulations such as those related to the Dodd-Frank Act and new rules being promulgated under that Act as well as restrictions that may be imposed by our federal and state regulatory authorities, including the extent to which regulatory initiatives may affect our capital, liquidity and

earnings;

the effect on our mortgage origination and resale operations of changes in mortgage markets generally, including the uncertain impact on the market for non-qualified mortgage loans resulting from regulations taking effect in January 2014, as well as in monetary policies and economic trends and initiatives as those events affect our mortgage origination and servicing operations;

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compliance with requirements of investors and/or government-owned or sponsored entities, including Fannie Mae, Freddie Mac, Ginnie Mae, the Federal Housing Administration (the “FHA”) the Department of Housing and Urban Development (“HUD”) and the Department of Veterans' Affairs (the “VA”); costs associated with the integration of new personnel from growth through acquisitions and hiring initiatives, including increased salary costs, as well as time and attention from our management team that is needed to successfully complete such acquisitions; our ability to control costs while meeting operational needs and retaining key members of our senior management team and other key managers and business producers; and competition.

We do not intend to update any of the forward-looking statements after the date of this report, whether to conform these statements to actual results or changes in our expectations or otherwise. Readers are cautioned not to place undue reliance on these forward-looking statements.

You may review a copy of this quarterly report on Form 10-Q, 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.

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Summary Financial Data

|                                                  | At or for the Quarter Ended |               |               |               |                | At or for the Nine Months Ended |                |
|--------------------------------------------------|-----------------------------|---------------|---------------|---------------|----------------|---------------------------------|----------------|
| (dollars in thousands, except share data)        | Sept. 30, 2013              | Jun. 30, 2013 | Mar. 31, 2013 | Dec. 31, 2012 | Sept. 30, 2012 | Sept. 30, 2013                  | Sept. 30, 2012 |
| Income statement data (for the period ended):    |                             |               |               |               |                |                                 |                |
| Net interest income                              | \$20,412                    | \$17,415      | \$15,235      | \$16,591      | \$16,520       | \$53,062                        | \$44,151       |
| (Reversal of) provision for credit losses        | (1,500)                     | ) 400         | 2,000         | 4,000         | 5,500          | 900                             | 7,500          |
| Noninterest income                               | 38,174                      | 57,556        | 58,943        | 71,932        | 69,091         | 154,673                         | 166,089        |
| Noninterest expense                              | 58,116                      | 56,712        | 55,799        | 55,966        | 45,934         | 170,627                         | 127,625        |
| Net income before taxes                          | 1,970                       | 17,859        | 16,379        | 28,557        | 34,177         | 36,208                          | 75,115         |
| Income tax expense                               | 308                         | 5,791         | 5,439         | 7,060         | 12,186         | 11,538                          | 14,487         |
| Net income                                       | \$1,662                     | \$12,068      | \$10,940      | \$21,497      | \$21,991       | \$24,670                        | \$60,628       |
| Basic earnings per common share <sup>(1)</sup>   | \$0.12                      | \$0.84        | \$0.76        | \$1.50        | \$1.53         | \$1.72                          | \$4.68         |
| Diluted earnings per common share <sup>(1)</sup> | \$0.11                      | \$0.82        | \$0.74        | \$1.46        | \$1.50         | \$1.67                          | \$4.52         |
| Common shares outstanding <sup>(1)</sup>         | 14,422,354                  | 14,406,676    | 14,400,206    | 14,382,638    | 14,354,972     | 14,422,354                      | 14,354,972     |
| Weighted average common shares:                  |                             |               |               |               |                |                                 |                |
| Basic                                            | 14,388,559                  | 14,376,580    | 14,359,691    | 14,371,120    | 14,335,950     | 14,374,943                      | 12,960,212     |
| Diluted                                          | 14,790,671                  | 14,785,481    | 14,804,129    | 14,714,166    | 14,699,032     | 14,793,427                      | 13,414,475     |
| Shareholders' equity per share                   | \$18.60                     | \$18.62       | \$18.78       | \$18.34       | \$16.82        | \$18.60                         | 16.82          |
| Financial position (at period end):              |                             |               |               |               |                |                                 |                |
| Cash and cash equivalents                        | \$37,906                    | \$21,645      | \$18,709      | \$25,285      | \$22,051       | \$37,906                        | \$22,051       |
| Investment securities available for sale         | 573,591                     | 538,164       | 415,238       | 416,329       | 414,050        | 573,591                         | 414,050        |
| Loans held for sale                              | 385,110                     | 471,191       | 430,857       | 620,799       | 535,908        | 385,110                         | 535,908        |
| Loans held for investment, net                   | 1,510,169                   | 1,416,439     | 1,358,982     | 1,308,974     | 1,268,703      | 1,510,169                       | 1,268,703      |
| Mortgage servicing rights                        | 146,300                     | 137,385       | 111,828       | 95,493        | 81,512         | 146,300                         | 81,512         |
| Other real estate owned                          | 12,266                      | 11,949        | 21,664        | 23,941        | 17,003         | 12,266                          | 17,003         |
| Total assets                                     | 2,854,323                   | 2,776,124     | 2,508,251     | 2,631,230     | 2,511,269      | 2,854,323                       | 2,511,269      |
| Deposits                                         | 2,098,076                   | 1,963,123     | 1,934,704     | 1,976,835     | 1,981,814      | 2,098,076                       | 1,981,814      |
| FHLB advances                                    | 338,690                     | 409,490       | 183,590       | 259,090       | 131,597        | 338,690                         | 131,597        |
| Shareholders' equity                             | 268,208                     | 268,321       | 270,405       | 263,762       | 241,499        | 268,208                         | 241,499        |
| Financial position (averages):                   |                             |               |               |               |                |                                 |                |
| Investment securities available for sale         | \$556,862                   | \$512,475     | \$422,761     | \$418,261     | \$411,916      | \$497,857                       | \$408,320      |
| Loans held for investment                        | 1,475,011                   | 1,397,219     | 1,346,100     | 1,297,615     | 1,270,652      | 1,406,582                       | 1,304,526      |
|                                                  | 2,474,397                   | 2,321,195     | 2,244,563     | 2,244,727     | 2,187,059      | 2,347,560                       | 2,140,383      |

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|                                    |           |           |           |           |           |           |           |
|------------------------------------|-----------|-----------|-----------|-----------|-----------|-----------|-----------|
| Total interest-earning assets      |           |           |           |           |           |           |           |
| Total interest-bearing deposits    | 1,488,076 | 1,527,732 | 1,543,645 | 1,609,075 | 1,625,437 | 1,519,615 | 1,656,874 |
| FHLB advances                      | 374,682   | 307,296   | 147,097   | 122,516   | 112,839   | 277,192   | 83,523    |
| Repurchase agreements              | —         | 10,913    | —         | 558       | 18,478    | 3,638     | 23,597    |
| Total interest-bearing liabilities | 2,045,155 | 1,917,098 | 1,752,599 | 1,794,006 | 1,818,611 | 1,906,023 | 1,825,851 |
| Shareholders' equity               | 271,286   | 280,783   | 274,355   | 262,163   | 231,361   | 275,463   | 193,308   |

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Summary Financial Data (continued)

|                                                              | At or for the Quarter Ended |   |               |   |               |                  |               |   | At or for the Nine Months Ended |   |                |                  |                |   |
|--------------------------------------------------------------|-----------------------------|---|---------------|---|---------------|------------------|---------------|---|---------------------------------|---|----------------|------------------|----------------|---|
| (dollars in thousands, except share data)                    | Sept. 30, 2013              |   | Jun. 30, 2013 |   | Mar. 31, 2013 |                  | Dec. 31, 2012 |   | Sept. 30, 2012                  |   | Sept. 30, 2013 |                  | Sept. 30, 2012 |   |
| Financial performance:                                       |                             |   |               |   |               |                  |               |   |                                 |   |                |                  |                |   |
| Return on average common shareholders' equity <sup>(2)</sup> | 2.45                        | % | 17.19         | % | 15.95         | %                | 32.80         | % | 38.02                           | % | 11.94          | %                | 41.82          | % |
| Return on average assets                                     | 0.24                        | % | 1.86          | % | 1.75          | %                | 3.46          | % | 3.60                            | % | 1.25           | %                | 3.40           | % |
| Net interest margin <sup>(3)</sup>                           | 3.41                        | % | 3.10          | % | 2.81          | % <sup>(4)</sup> | 3.06          | % | 3.12                            | % | 3.12           | % <sup>(4)</sup> | 2.83           | % |
| Efficiency ratio <sup>(5)</sup>                              | 99.20                       | % | 75.65         | % | 75.22         | %                | 63.22         | % | 53.65                           | % | 82.14          | %                | 60.70          | % |
| Asset quality:                                               |                             |   |               |   |               |                  |               |   |                                 |   |                |                  |                |   |
| Allowance for credit losses                                  | \$24,894                    |   | \$27,858      |   | \$28,594      |                  | \$27,751      |   | \$27,627                        |   | \$24,894       |                  | \$27,627       |   |
| Allowance for loan losses/total loans                        | 1.61                        | % | 1.92          | % | 2.05          | %                | 2.06          | % | 2.12                            | % | 1.61           | %                | 2.12           | % |
| Allowance for loan losses/nonaccrual loans                   | 92.30                       | % | 93.11         | % | 88.40         | %                | 92.20         | % | 71.80                           | % | 92.30          | %                | 71.80          | % |
| Total nonaccrual loans <sup>(6)</sup>                        | \$26,753                    |   | \$29,701      |   | \$32,133      |                  | \$29,892      |   | \$38,247                        |   | \$26,753       |                  | \$38,247       |   |
| Nonaccrual loans/total loans                                 | 1.74                        | % | 2.06          | % | 2.32          | %                | 2.24          | % | 2.95                            | % | 1.74           | %                | 2.95           | % |
| Other real estate owned                                      | \$12,266                    |   | \$11,949      |   | \$21,664      |                  | \$23,941      |   | \$17,003                        |   | \$12,266       |                  | \$17,003       |   |
| Total nonperforming assets                                   | \$39,019                    |   | \$41,650      |   | \$53,797      |                  | \$53,833      |   | \$55,250                        |   | \$39,019       |                  | \$55,250       |   |
| Nonperforming assets/total assets                            | 1.37                        | % | 1.50          | % | 2.14          | %                | 2.05          | % | 2.20                            | % | 1.37           | %                | 2.20           | % |
| Net charge-offs                                              | \$1,464                     |   | \$1,136       |   | \$1,157       |                  | \$3,876       |   | \$4,998                         |   | \$3,757        |                  | \$22,673       |   |
| Regulatory capital ratios for the Bank:                      |                             |   |               |   |               |                  |               |   |                                 |   |                |                  |                |   |
| Tier 1 leverage capital (to average assets)                  | 10.85                       | % | 11.89         | % | 11.97         | %                | 11.78         | % | 10.86                           | % | 10.85          | %                | 10.86          | % |
| Tier 1 risk-based capital (to risk-weighted assets)          | 17.19                       | % | 17.89         | % | 19.21         | %                | 18.05         | % | 16.76                           | % | 17.19          | %                | 16.76          | % |
| Total risk-based capital (to risk-weighted assets)           | 18.44                       | % | 19.15         | % | 20.47         | %                | 19.31         | % | 18.01                           | % | 18.44          | %                | 18.01          | % |
| Other data:                                                  |                             |   |               |   |               |                  |               |   |                                 |   |                |                  |                |   |
| Full-time equivalent employees (ending)                      | 1,426                       |   | 1,309         |   | 1,218         |                  | 1,099         |   | 998                             |   | 1,426          |                  | 998            |   |



- (1) Share and per share data shown after giving effect to the 2-for-1 forward stock splits effective March 6, 2012 and November 5, 2012.
- (2) Net earnings available to common shareholders divided by average common shareholders' equity.
- (3) Net interest income divided by total average interest-earning assets on a tax equivalent basis.  
Net interest margin for the first quarter of 2013 included \$1.4 million in interest expense related to the correction of the cumulative effect of an error in prior years, resulting from the under accrual of interest due on the Trust
- (4) Preferred Securities ("TruPS") for which the Company had deferred the payment of interest. Excluding the impact of the prior period interest expense correction, the net interest margin was 3.06% for the quarter ended March 31, 2013 and 3.21% for the nine months ended September 30, 2013.
- (5) Noninterest expense divided by total revenue (net interest income and noninterest income).
- (6) Generally, loans are placed on nonaccrual status when they are 90 or more days past due.

| (in thousands)                                                       | At or for the Quarter Ended |                  |                  |                  |                   | At or for the Nine Months Ended |                   |
|----------------------------------------------------------------------|-----------------------------|------------------|------------------|------------------|-------------------|---------------------------------|-------------------|
|                                                                      | Sept. 30,<br>2013           | Jun. 30,<br>2013 | Mar. 31,<br>2013 | Dec. 31,<br>2012 | Sept. 30,<br>2012 | Sept. 30,<br>2013               | Sept. 30,<br>2012 |
| <b>SUPPLEMENTAL DATA:</b>                                            |                             |                  |                  |                  |                   |                                 |                   |
| Loans serviced for others                                            |                             |                  |                  |                  |                   |                                 |                   |
| Single family                                                        | \$11,286,244                | \$10,404,613     | \$9,701,396      | \$8,870,688      | \$8,109,669       | \$11,286,244                    | \$8,109,669       |
| Multifamily                                                          | 722,767                     | 720,368          | 737,007          | 727,118          | 760,820           | 722,767                         | 760,820           |
| Other                                                                | 50,629                      | 51,058           | 52,825           | 53,235           | 53,617            | 50,629                          | 53,617            |
| Total loans serviced for others                                      | \$12,059,640                | \$11,176,039     | \$10,491,228     | \$9,651,041      | \$8,924,106       | \$12,059,640                    | \$8,924,106       |
| Loan production volumes:                                             |                             |                  |                  |                  |                   |                                 |                   |
| Single family mortgage closed loans <sup>(1) (2)</sup>               | \$1,187,061                 | \$1,307,286      | \$1,192,156      | \$1,518,971      | \$1,368,238       | \$3,686,503                     | \$3,149,196       |
| Single family mortgage interest rate lock commitments <sup>(2)</sup> | 786,147                     | 1,423,290        | 1,035,822        | 1,254,954        | 1,313,182         | 3,245,259                       | 3,531,713         |
| Single family mortgage loans sold <sup>(2)</sup>                     | 1,326,888                   | 1,229,686        | 1,360,344        | 1,434,947        | 1,238,879         | 3,916,918                       | 2,735,893         |
| Multifamily mortgage originations                                    | 10,734                      | 14,790           | 49,119           | 40,244           | 20,209            | 74,643                          | 71,830            |
| Multifamily mortgage loans sold                                      | 21,998                      | 15,386           | 50,587           | 33,689           | 26,515            | 87,971                          | 85,116            |

(1) Represents single family mortgage closed loan volume designated for sale during each respective period.

(2) Includes loans originated by Windermere Mortgage Series Services LLC ("WMS") and purchased by HomeStreet Bank.

This report contains forward-looking statements. For a discussion about such statements, including the risks and uncertainties inherent therein, see “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 2012 Annual Report on Form 10-K.

### Management's Overview of Third Quarter 2013 Financial Performance

We are a diversified financial services company founded in 1921 and headquartered in Seattle, Washington, serving customers primarily in the Pacific Northwest, California and Hawaii. HomeStreet, Inc. (the "Company") is principally engaged in real estate lending, including mortgage banking activities, and commercial and consumer banking. Our primary subsidiaries are HomeStreet Bank (the "Bank") and HomeStreet Capital Corporation. The Bank is a Washington state-chartered savings bank that provides residential and commercial loans, deposit products and services, non-deposit investment products, private banking and cash management services. Our primary loan products include single family residential mortgages, loans secured by commercial real estate, loans for residential and commercial real estate construction, and commercial business loans. HomeStreet Capital Corporation, a Washington corporation, originates, sells and services multifamily mortgage loans under the Fannie Mae Delegated Underwriting and Servicing Program (“DUS”<sup>®</sup>)<sup>1</sup> in conjunction with HomeStreet Bank. Doing business as HomeStreet Insurance, we provide insurance products and services for consumers and businesses. We also offer single family home loans through our partial ownership in an affiliated business arrangement known as Windermere Mortgage Services Series LLC (“WMS LLC”).

We generate revenue by earning “net interest income” and “noninterest income.” Net interest income is primarily the difference between our interest income earned on loans and investment securities less the interest we pay on deposits and other borrowings. We earn noninterest income from the origination, sale and servicing of loans and from fees earned on deposit services and investment and insurance sales.

At September 30, 2013, we had total assets of \$2.85 billion, net loans held for investment of \$1.51 billion, deposits of \$2.1 billion and shareholders' equity of \$268.2 million.

On August 15, 2013, the Company paid a common stock dividend of \$0.11 per share to shareholders.

On October 25, 2013, the Company announced that its board of directors approved a common stock dividend of \$0.11 per share, payable on November 25, 2013 to shareholders of record as of November 4, 2013.

On November 1, 2013, the Company completed its acquisition of Fortune Bank and YNB Financial Services Corp. (“YNB”), the parent of Yakima National Bank. Immediately following completion of the acquisitions, YNB was merged into HomeStreet, Inc. Additionally, Fortune Bank and Yakima National Bank were merged into HomeStreet Bank. The combined organization had approximately \$3.10 billion in assets on a pro forma basis as of September 30, 2013. The acquisition of the two banks, along with the pending acquisition of two retail deposit branches from AmericanWest Bank, increases the Company's total assets by approximately \$290 million and the total number of HomeStreet Bank retail deposit branches to 30.

Results for the third quarter of 2013 compared to third quarter of 2012 reflect the growth of our mortgage banking business and investments to expand our commercial and consumer business. Since September 2012, we have increased our lending capacity by adding loan officers and operations personnel in single family lending, commercial real estate lending, and commercial business lending. We opened 17 mortgage lending offices, a new commercial lending office and three new de novo bank branches. In addition, we expanded our range of services by adding a new private banking department.

During the quarter, we experienced changes in the mortgage market associated with elevated mortgage interest rates. Significant decreases in mortgage refinancing activity were only partially offset by a slow-growing purchase mortgage market. We expect to grow our purchase mortgage and overall market share as total mortgage market originations decline and the mortgage origination market continues to transition away from one dominated by mortgage refinancing, largely due to an increase in interest rates that has made refinancing less attractive in recent months. We continue to focus on the purchase mortgage market by developing additional targeted shared marketing relationships with builders, real estate agents and other real estate professionals and hiring loan officers who have proven track records in generating home purchase mortgage loans.

<sup>1</sup> DUS® is a registered trademark of Fannie Mae 53

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## Consolidated Financial Performance

|                                                     | At or for the Three Months Ended September 30, |          |                              |    | At or for the Nine Months Ended September 30, |           |                              |    |
|-----------------------------------------------------|------------------------------------------------|----------|------------------------------|----|-----------------------------------------------|-----------|------------------------------|----|
| (in thousands, except per share data and ratios)    | 2013                                           | 2012     | Percent Change 2013 vs. 2012 |    | 2013                                          | 2012      | Percent Change 2013 vs. 2012 |    |
| Selected statement of operations data               |                                                |          |                              |    |                                               |           |                              |    |
| Total net revenue                                   | \$58,586                                       | \$85,611 | (32                          | )% | \$207,735                                     | \$210,240 | (1                           | )% |
| Total noninterest expense                           | 58,116                                         | 45,934   | 27                           |    | 170,627                                       | 127,625   | 34                           |    |
| (Reversal of) provision for credit losses           | (1,500                                         | ) 5,500  | NM                           |    | 900                                           | 7,500     | (88                          | )  |
| Income tax expense                                  | 308                                            | 12,186   | (97                          | )  | 11,538                                        | 14,487    | (20                          | )  |
| Net income                                          | \$1,662                                        | \$21,991 | (92                          | )  | \$24,670                                      | \$60,628  | (59                          | )  |
| Financial performance                               |                                                |          |                              |    |                                               |           |                              |    |
| Diluted earnings per common share                   | \$0.11                                         | \$1.50   | (93                          | )% | \$1.67                                        | \$4.52    | (63                          | )% |
| Return on average common shareholders' equity       | 2.45                                           | % 38.02  | % NM                         |    | 11.94                                         | % 41.82   | % NM                         |    |
| Return on average assets                            | 0.24                                           | % 3.60   | % NM                         |    | 1.25                                          | % 3.40    | % NM                         |    |
| Net interest margin                                 | 3.41                                           | % 3.12   | % NM                         |    | 3.12                                          | % 2.83    | % NM                         |    |
| Capital ratios (Bank only)                          |                                                |          |                              |    |                                               |           |                              |    |
| Tier 1 leverage capital (to average assets)         | 10.85                                          | % 10.86  | % NM                         |    | 10.85                                         | % 10.86   | % NM                         |    |
| Tier 1 risk-based capital (to risk-weighted assets) | 17.19                                          | % 16.76  | % NM                         |    | 17.19                                         | % 16.76   | % NM                         |    |
| Total risk-based capital (to risk-weighted assets)  | 18.44                                          | % 18.01  | % NM                         |    | 18.44                                         | % 18.01   | % NM                         |    |
| NM = Not meaningful                                 |                                                |          |                              |    |                                               |           |                              |    |

For the third quarter of 2013, net income was \$1.7 million, or \$0.11 per diluted share, compared with \$22.0 million, or \$1.50 per diluted share a year ago. Return on equity for the third quarter of 2013 (on an annualized basis) was 2.45%, compared to 38.02% for the same period last year, while return on average assets for the third quarter of 2013 (on an annualized basis) was 0.24%, compared to 3.60% for the same period a year ago.

## Commercial and Consumer Banking Segment Results

Commercial and Consumer Banking segment net income increased to \$3.9 million in the third quarter of 2013 from a net loss of \$2.3 million in the third quarter of 2012, due to a reversal to the provision for credit losses and an increase in net interest income, which reflects improvements in our loan credit quality and in our deposit product and pricing strategy. The continued improvement in the composition of deposits was primarily the result of our successful efforts to attract transaction and savings deposit balances through effective brand marketing and the growth of our retail deposit branch network.

Improved credit quality of the Company's loan portfolio resulted in a \$1.5 million reversal to the provision for credit losses in the third quarter of 2013. Provision of \$5.5 million was recorded in the third quarter of 2012. Net charge-offs

were \$1.5 million in the third quarter of 2013 compared to \$5.0 million in the third quarter of 2012. Overall, the allowance for loan losses (which excludes the allowance for unfunded commitments) was 1.61% of loans held for investment at September 30, 2013 compared to 2.12% at September 30, 2012, reflecting the improved credit quality of the Company's loan portfolio. Nonperforming assets of \$39.0 million, or 1.37% of total assets at September 30, 2013 were down significantly from September 30, 2012 when nonperforming assets were \$55.3 million, or 2.20% of total assets.

Commercial and Consumer Banking segment noninterest expense increased 2.1% to \$13.6 million from the third quarter of 2012, primarily related to increased salaries and related costs, reflecting the continued growth of our commercial real estate and commercial business lending units and the expansion of our branch banking network.

## Mortgage Banking Segment Results

Mortgage Banking segment recorded a net loss of \$2.2 million in the third quarter of 2013 compared to net income of \$24.3 million in the third quarter of 2012. The decrease in net income was primarily driven by substantially lower mortgage interest rate lock commitment volumes and lower gain on sale margins. Commitment volume declined due to the rise in mortgage interest rates that caused a significant decrease in refinancing activity that was only partially offset by a slow-growing purchase mortgage market. At the same time, the mortgage market became substantially more competitive as lenders tried to secure a reliable flow of production through reduced prices. Closed loan volume was, however, substantially higher than the volume of new interest rate lock commitments. This imbalance in the quarter negatively affected earnings, as a majority of our mortgage revenue is recognized at the date of interest rate lock, while a majority of our origination costs, including commissions, are recognized upon funding the loan.

Mortgage Banking noninterest expense increased 36.5% to \$44.5 million from the third quarter of 2012. The \$11.9 million increase in noninterest expense primarily related to the addition of mortgage originators and mortgage fulfillment personnel as we grow our single family mortgage lending network.

## Income Tax Expense

Our consolidated income tax expense was \$308 thousand in the third quarter of 2013 compared to \$12.2 million in the third quarter of 2012. Our estimated annual effective income tax rate was 31.9% as compared to an annual effective tax rate of 20.8% for 2012. The lower effective income tax rate in 2012 compared to 2013 primarily reflected the benefit of a full reversal of deferred tax asset valuation allowances during 2012.

## Regulatory Matters

The Bank continued to remain well-capitalized, with a Tier 1 leverage capital ratio of 10.85% and total risk-based capital ratio of 18.44% at September 30, 2013.

## Critical Accounting Policies and Estimates

Our significant accounting policies are fundamental to understanding our results of operations and financial condition because they require that we use estimates and assumptions that may affect the value of our assets or liabilities and financial results. Three of these policies are critical because they require management to make difficult, subjective and complex judgments about matters that are inherently uncertain and because it is likely that materially different amounts would be reported under different conditions or using different assumptions. These policies govern:

• Allowance for Loan Losses

• Fair Value of Financial Instruments, Single Family MSRs and other real estate owned ("OREO")

• Income Taxes

These policies and estimates are described in further detail in Part II, Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations and Note 1, Summary of Significant Accounting Policies within the 2012 Annual Report on Form 10-K.

## Results of Operations

## Average Balances and Rates

Average balances, together with the total dollar amounts of interest income and expense, on a tax equivalent basis related to such balances and the weighted average rates, were as follows.

|                                                | Three Months Ended September 30,<br>2013 |          |                       |   | 2012               |          |                       |   |
|------------------------------------------------|------------------------------------------|----------|-----------------------|---|--------------------|----------|-----------------------|---|
| (in thousands)                                 | Average<br>Balance                       | Interest | Average<br>Yield/Cost |   | Average<br>Balance | Interest | Average<br>Yield/Cost |   |
| Assets:                                        |                                          |          |                       |   |                    |          |                       |   |
| Interest-earning assets: <sup>(1)</sup>        |                                          |          |                       |   |                    |          |                       |   |
| Cash & cash equivalents                        | \$37,671                                 | \$17     | 0.24                  | % | \$50,056           | \$24     | 0.15                  | % |
| Investment securities                          | 556,862                                  | 4,452    | 3.20                  | % | 411,916            | 3,013    | 2.93                  | % |
| Loans held for sale                            | 404,853                                  | 4,004    | 3.96                  | % | 454,435            | 4,083    | 3.59                  | % |
| Loans held for investment                      | 1,475,011                                | 15,453   | 4.18                  | % | 1,270,652          | 14,464   | 4.54                  | % |
| Total interest-earning assets                  | 2,474,397                                | 23,926   | 3.88                  | % | 2,187,059          | 21,584   | 3.94                  | % |
| Noninterest-earning assets <sup>(2)</sup>      | 311,897                                  |          |                       |   | 256,631            |          |                       |   |
| Total assets                                   | \$2,786,294                              |          |                       |   | \$2,443,690        |          |                       |   |
| Liabilities and shareholders' equity:          |                                          |          |                       |   |                    |          |                       |   |
| Deposits:                                      |                                          |          |                       |   |                    |          |                       |   |
| Interest-bearing demand accounts               | \$254,277                                | 265      | 0.41                  | % | \$155,947          | 128      | 0.33                  | % |
| Savings accounts                               | 123,444                                  | 140      | 0.45                  | % | 98,711             | 114      | 0.46                  | % |
| Money market accounts                          | 848,300                                  | 1,060    | 0.50                  | % | 655,123            | 857      | 0.52                  | % |
| Certificate accounts                           | 262,055                                  | 663      | 0.92                  | % | 715,656            | 2,809    | 1.56                  | % |
| Total interest-bearing deposits                | 1,488,076                                | 2,128    | 0.57                  | % | 1,625,437          | 3,908    | 0.96                  | % |
| FHLB advances                                  | 374,682                                  | 434      | 0.46                  | % | 112,839            | 297      | 1.19                  | % |
| Securities sold under agreements to repurchase | —                                        | —        | —                     | % | 18,478             | 19       | 0.14                  | % |
| Long-term debt                                 | 61,231                                   | 274      | 1.75                  | % | 61,857             | 305      | 1.97                  | % |
| Other borrowings                               | 121,166                                  | 99       | 0.31                  | % | —                  | 4        | —                     | % |
| Total interest-bearing liabilities             | 2,045,155                                | 2,935    | 0.57                  | % | 1,818,611          | 4,533    | 0.99                  | % |
| Noninterest-bearing liabilities                | 469,853                                  |          |                       |   | 393,718            |          |                       |   |
| Total liabilities                              | 2,515,008                                |          |                       |   | 2,212,329          |          |                       |   |
| Shareholders' equity                           | 271,286                                  |          |                       |   | 231,361            |          |                       |   |
| Total liabilities and shareholders' equity     | \$2,786,294                              |          |                       |   | \$2,443,690        |          |                       |   |
| Net interest income <sup>(3)</sup>             |                                          | \$20,991 |                       |   |                    | \$17,051 |                       |   |
| Net interest spread                            |                                          |          | 3.31                  | % |                    |          | 2.95                  | % |
| Impact of noninterest-bearing sources          |                                          |          | 0.10                  | % |                    |          | 0.17                  | % |
| Net interest margin                            |                                          |          | 3.41                  | % |                    |          | 3.12                  | % |

(1) The average balances of nonaccrual assets and related income, if any, are included in their respective categories.

(2) Includes loan balances that have been foreclosed and are now reclassified to OREO.



Includes taxable-equivalent adjustments primarily related to tax-exempt income on certain loans and securities of (3) \$579 thousand and \$531 thousand for the quarters ended September 30, 2013 and September 30, 2012, respectively. The estimated federal statutory tax rate was 35% for the periods presented.

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| (in thousands)                                 | Nine Months Ended September 30,<br>2013 |          |                       |                  | 2012               |          |                       |   |
|------------------------------------------------|-----------------------------------------|----------|-----------------------|------------------|--------------------|----------|-----------------------|---|
|                                                | Average<br>Balance                      | Interest | Average<br>Yield/Cost |                  | Average<br>Balance | Interest | Average<br>Yield/Cost |   |
| Assets:                                        |                                         |          |                       |                  |                    |          |                       |   |
| Interest-earning assets: <sup>(1)</sup>        |                                         |          |                       |                  |                    |          |                       |   |
| Cash & cash equivalents                        | \$27,488                                | \$46     | 0.26                  | %                | \$116,789          | \$208    | 0.24                  | % |
| Investment securities                          | 497,857                                 | 11,175   | 2.99                  | %                | 408,320            | 8,358    | 2.73                  | % |
| Loans held for sale                            | 415,633                                 | 11,218   | 3.60                  | %                | 310,748            | 8,544    | 3.67                  | % |
| Loans held for investment                      | 1,406,582                               | 43,795   | 4.13                  | %                | 1,304,526          | 43,906   | 4.49                  | % |
| Total interest-earning assets                  | 2,347,560                               | 66,234   | 3.75                  | %                | 2,140,383          | 61,016   | 3.80                  | % |
| Noninterest-earning assets <sup>(2)</sup>      | 280,668                                 |          |                       |                  | 235,791            |          |                       |   |
| Total assets                                   | \$2,628,228                             |          |                       |                  | \$2,376,174        |          |                       |   |
| Liabilities and shareholders' equity:          |                                         |          |                       |                  |                    |          |                       |   |
| Deposits:                                      |                                         |          |                       |                  |                    |          |                       |   |
| Interest-bearing demand accounts               | \$224,942                               | 656      | 0.39                  | %                | \$148,288          | 368      | 0.33                  | % |
| Savings accounts                               | 114,023                                 | 358      | 0.42                  | %                | 85,376             | 290      | 0.45                  | % |
| Money market accounts                          | 776,267                                 | 2,890    | 0.50                  | %                | 592,195            | 2,390    | 0.54                  | % |
| Certificate accounts                           | 404,383                                 | 4,080    | 1.24                  | %                | 831,015            | 9,937    | 1.60                  | % |
| Total interest-bearing deposits                | 1,519,615                               | 7,984    | 0.69                  | %                | 1,656,874          | 12,985   | 1.05                  | % |
| FHLB advances                                  | 277,192                                 | 1,113    | 0.53                  | %                | 83,523             | 1,506    | 2.40                  | % |
| Securities sold under agreements to repurchase | 3,638                                   | 11       | 0.40                  | %                | 23,597             | 69       | 0.39                  | % |
| Long-term debt                                 | 61,646                                  | 2,274    | <sup>(3)</sup> 4.86   | % <sup>(3)</sup> | 61,857             | 1,041    | 2.24                  | % |
| Other borrowings                               | 43,932                                  | 109      | 0.31                  | %                | —                  | 12       | —                     | % |
| Total interest-bearing liabilities             | 1,906,023                               | 11,491   | 0.79                  | %                | 1,825,851          | 15,613   | 1.14                  | % |
| Noninterest-bearing liabilities                | 446,742                                 |          |                       |                  | 357,015            |          |                       |   |
| Total liabilities                              | 2,352,765                               |          |                       |                  | 2,182,866          |          |                       |   |
| Shareholders' equity                           | 275,463                                 |          |                       |                  | 193,308            |          |                       |   |
| Total liabilities and shareholders' equity     | \$2,628,228                             |          |                       |                  | \$2,376,174        |          |                       |   |
| Net interest income <sup>(4)</sup>             |                                         | \$54,743 |                       |                  |                    | \$45,403 |                       |   |
| Net interest spread                            |                                         |          | 2.96                  | %                |                    |          | 2.66                  | % |
| Impact of noninterest-bearing sources          |                                         |          | 0.16                  | %                |                    |          | 0.17                  | % |

|                     |      |                  |      |   |
|---------------------|------|------------------|------|---|
| Net interest margin | 3.12 | % <sup>(3)</sup> | 2.83 | % |
|---------------------|------|------------------|------|---|

(1) The average balances of nonaccrual assets and related income, if any, are included in their respective categories.

(2) Includes loan balances that have been foreclosed and are now reclassified to OREO.

(3) Interest expense for the nine months ended September 30, 2013 included \$1.4 million recorded in the first quarter of 2013 related to the correction of the cumulative effect of an error in prior years, resulting from the under accrual of interest due on our Trust Preferred Securities for which the Company had deferred payment of interest.

Excluding the impact of the prior period interest expense correction, the net interest margin was 3.21%.

(4) Includes taxable-equivalent adjustments primarily related to tax-exempt income on certain loans and securities of \$1.7 million and \$1.3 million for the nine months ended September 30, 2013 and September 30, 2012, respectively. The estimated federal statutory tax rate was 35% for the periods presented.

## Interest on Nonaccrual Loans

We do not include interest collected on nonaccrual loans in interest income. When we place a loan on nonaccrual status, we reverse the accrued unpaid interest receivable against interest income and amortization of any net deferred fees is suspended. Additionally, if a nonaccrual loan is placed back on accrual status or paid off, the accumulated interest collected on the loan is recognized at the time the loan is removed from nonaccrual status. The net increase/(decrease) to interest income due to adjustments made for nonaccrual loans, including the effect of additional interest income that would have been recorded during the period if the loans had been accruing, was \$(232) thousand and \$95 thousand for the three months ended September 30, 2013 and 2012, respectively, and \$(557) thousand and \$(1.0) million for the nine months ended September 30, 2013 and 2012, respectively.

## Net Interest Income

Our earnings depend significantly on net interest income, which is the difference between income earned on our interest-earning assets, primarily loans and investment securities, and interest paid on interest-bearing liabilities. Our interest-bearing liabilities consist primarily of deposits and borrowed funds, including our outstanding Trust Preferred Securities ("TruPS") and advances from the Federal Home Loan Bank of Seattle ("FHLB").

Net interest income on a tax equivalent basis was \$21.0 million for the third quarter of 2013, an increase of \$3.9 million, or 23.1%, from \$17.1 million for the third quarter of 2012. For the first nine months of 2013, net interest income was \$54.7 million, an increase of \$9.3 million, or 20.6%, from \$45.4 million in the same period last year. During the third quarter of 2013, total interest income increased \$2.3 million from the third quarter of 2012, while total interest expense declined \$1.6 million from the third quarter of 2012. The net interest margin for the third quarter of 2013 improved to 3.41% from 3.12% in the third quarter of 2012, and improved to 3.12% for the nine months ended September 30, 2013 from 2.83% for the same period last year. Improvement in the margin from the third quarter of 2012 resulted from a 42 basis point decline in our average interest-bearing cost of funds, due in large part to the re-pricing of maturing time deposits. This improvement was partially offset by a 6 basis point decline in our yield on interest-earning assets, largely due to increased balances of single family adjustable-rate mortgage loans.

Total average interest-earning assets increased from the three and nine months ended September 30, 2012 primarily as a result of growth in the investment securities portfolio and new portfolio loan originations, being partially offset by a decrease in loans held for sale. The increase in average balances of portfolio loans reflects our year-over-year growth in loan production volume from all of our commercial and consumer business lines. Total average interest-bearing deposit balances increased from the prior periods mostly as a result of an increase in transaction and savings deposits, partially offset by a decline in higher-cost retail certificates of deposits.

Total interest income on a tax equivalent basis of \$23.9 million in the third quarter of 2013 increased \$2.3 million, or 10.9%, from \$21.6 million in the third quarter of 2012, primarily driven by higher average balances of portfolio loans and investment securities. The increase in interest income was also the result of higher yields on higher average balances of investment securities, the balances of which increased \$144.9 million, or 35.2%, in the third quarter of 2013 from the third quarter of 2012.

These increases were partially offset by increased balances of lower-yielding single family adjustable-rate mortgage loans. Yields on portfolio loans decreased 36 basis points compared to the third quarter of 2012. For the first nine months of 2013, interest income was \$66.2 million, an increase of \$5.2 million, or 8.6%, from \$61.0 million in the same period last year resulting from higher average balances of loans held for sale and held for investment and a higher average balance and yield on investment securities.

Total interest expense of \$2.9 million in the third quarter of 2013 decreased \$1.6 million, or 35.3%, from \$4.5 million in the third quarter of 2012. This decrease was primarily due to a \$453.6 million, or 63.4%, decline in the average balance of higher-yielding certificates of deposit, partially offset by a \$98.3 million, or 63.1%, increase in the average balance of lower-cost transaction and savings deposits. Also contributing to the decrease in interest expense in the

third quarter of 2013 compared to the third quarter of 2012 was the restructuring of FHLB advances, prepaying certain long-term advances and using short-term FHLB advances to meet short-term mortgage origination and sales funding needs, which contributed to a 73 basis point decline in interest cost on FHLB advances. For the first nine months of 2013, interest expense was \$11.5 million, a decrease of \$4.1 million, or 26.4%, from \$15.6 million in the same period last year, primarily driven by a decline in the average balance of higher-cost certificates of deposit, partially offset by an increase in the average balance of transaction and savings deposits.

## Provision for Credit Losses

Improved credit quality of the Company's loan portfolio resulted in a \$1.5 million reversal to the provision for credit losses in the third quarter of 2013, compared to a provision for credit losses of \$5.5 million recorded in the third quarter of 2012. For the first nine months of 2013, loan loss provision was \$900 thousand compared to \$7.5 million in the same period last year. Nonperforming assets ("NPAs") were \$39.0 million at September 30, 2013 compared to \$53.8 million at December 31, 2012. Nonaccrual loans of \$26.8 million at September 30, 2013 decreased \$3.1 million, or 10.5%, from \$29.9 million at December 31, 2012.

Net charge-offs of \$1.5 million in the third quarter of 2013 were down \$3.5 million from net charge-offs of \$5.0 million in the third quarter of 2012. For the first nine months of 2013, net charge-offs were \$3.8 million compared to \$22.7 million in the same period last year. The decrease in net charge-offs in 2013 as compared to the same periods of 2012 was primarily due to lower charge-offs on residential and commercial construction loans during 2013. For a more detailed discussion on our allowance for loan losses and related provision for loan losses, see Credit Risk Management within Management's Discussion and Analysis in this Form 10-Q.

## Noninterest Income

Noninterest income was \$38.2 million in the third quarter of 2013, a decrease of \$30.9 million, or 44.7%, from \$69.1 million in the third quarter of 2012. For the first nine months of 2013, noninterest income was \$154.7 million, a decrease of \$11.4 million, or 6.9%, from \$166.1 million in the same period last year. Our noninterest income is heavily dependent upon our single family mortgage banking activities, which are comprised of mortgage origination and sale activities and mortgage servicing activities. The level of our mortgage banking activity fluctuates and is influenced by mortgage interest rates, the economy, employment and housing supply and affordability, among other factors. The decrease in noninterest income in the third quarter of 2013 as compared to the third quarter of 2012 was the result of lower mortgage loan origination and sale revenue, primarily the result of a 40.1% decrease in interest rate lock commitments, mostly related to substantially lower refinancing activities. Our single family mortgage interest rate lock commitments decreased 40.1% to \$786.1 million in the third quarter of 2013 compared to \$1.31 billion in the third quarter of 2012.

Noninterest income consisted of the following.

| (in thousands)                                                           | Three Months Ended |                    | Dollar Change | Percent Change | Nine Months Ended  |                    | Dollar Change | Percent Change |
|--------------------------------------------------------------------------|--------------------|--------------------|---------------|----------------|--------------------|--------------------|---------------|----------------|
|                                                                          | September 30, 2013 | September 30, 2012 |               |                | September 30, 2013 | September 30, 2012 |               |                |
| Noninterest income                                                       |                    |                    |               |                |                    |                    |               |                |
| Net gain on mortgage loan origination and sale activities <sup>(1)</sup> | \$33,491           | \$65,336           | \$(31,845)    | (49)%          | \$139,870          | \$141,683          | \$(1,813)     | (1)%           |
| Mortgage servicing income                                                | 4,011              | 506                | 3,505         | 693            | 9,265              | 15,470             | (6,205)       | (40)%          |
| (Loss) income from Windermere Mortgage Services Series LLC               | (550)              | 1,188              | (1,738)       | NM             | 1,063              | 3,748              | (2,685)       | (72)%          |
| Loss on debt extinguishment                                              | —                  | —                  | —             | NM             | —                  | (939)              | 939           | NM             |
| Depositor and other retail banking fees                                  | 791                | 756                | 35            | 5              | 2,273              | 2,262              | 11            | —              |

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|                                              |          |          |            |        |           |           |            |        |
|----------------------------------------------|----------|----------|------------|--------|-----------|-----------|------------|--------|
| Insurance commissions                        | 242      | 192      | 50         | 26     | 612       | 551       | 61         | 11     |
| (Loss) gain on securities available for sale | (184 )   | 397      | (581 )     | NM     | 6         | 1,349     | (1,343 )   | (100 ) |
| Other                                        | 373      | 716      | (343 )     | (48 )  | 1,584     | 1,965     | (381 )     | (19 )  |
| Total noninterest income                     | \$38,174 | \$69,091 | \$(30,917) | (45 )% | \$154,673 | \$166,089 | \$(11,416) | (7 )%  |

NM = not meaningful

(1) Single family and multifamily mortgage banking activities.

The significant components of our noninterest income are described in greater detail, as follows.

Net gain on mortgage loan origination and sale activities consisted of the following.

| (in thousands)                                               | Three Months Ended |                    | Dollar Change | Percent Change | Nine Months Ended  |                    | Dollar Change | Percent Change |
|--------------------------------------------------------------|--------------------|--------------------|---------------|----------------|--------------------|--------------------|---------------|----------------|
|                                                              | September 30, 2013 | September 30, 2012 |               |                | September 30, 2013 | September 30, 2012 |               |                |
| Single family:                                               |                    |                    |               |                |                    |                    |               |                |
| Servicing value and secondary marketing gains <sup>(1)</sup> | \$23,076           | \$56,142           | \$(33,066)    | (59 )%         | \$110,760          | \$120,471          | \$(9,711 )    | (8 )%          |
| Provision for repurchase losses <sup>(2)</sup>               | —                  | (526 )             | 526           | (100 )         | —                  | (2,846 )           | 2,846         | (100 )         |
| Net gain from secondary marketing activities                 | 23,076             | 55,616             | (32,540 )     | (59 )          | 110,760            | 117,625            | (6,865 )      | (6 )           |
| Loan origination and funding fees                            | 8,302              | 8,680              | (378 )        | (4 )           | 24,363             | 20,817             | 3,546         | 17             |
| Total single family                                          | 31,378             | 64,296             | (32,918 )     | (51 )          | 135,123            | 138,442            | (3,319 )      | (2 )           |
| Multifamily                                                  | 2,113              | 1,040              | 1,073         | 103            | 4,747              | 3,241              | 1,506         | 46             |
| Net gain on mortgage loan origination and sale activities    | \$33,491           | \$65,336           | \$(31,845)    | (49 )%         | \$139,870          | \$141,683          | \$(1,813 )    | (1 )%          |

Comprised of gains and losses on interest rate lock commitments (which considers the value of servicing), single (1) family loans held for sale, forward sale commitments used to economically hedge secondary market activities, and the estimated fair value of the repurchase or indemnity obligation recognized on new loan sales.

(2) Represents changes in estimated probable future repurchase losses on previously sold loans.

Net gain on mortgage loan origination and sale activities was \$33.5 million for the third quarter of 2013, a decrease of \$31.8 million, or 48.7%, from \$65.3 million for the third quarter of 2012, primarily driven by lower mortgage loan origination and sale revenue, mostly due to an increase in mortgage interest rates that has led to substantially lower interest rate lock volume and lower profit margins.

For the first nine months of 2013, net gain on mortgage loan origination and sale activities was \$139.9 million, a decrease of \$1.8 million, or 1.3%, from \$141.7 million in the same period last year. Significant decreases in mortgage refinance activities were partially offset by a slow growing mortgage purchase market and the expansion of our mortgage lending operations as we added approximately 80 mortgage production personnel during the first nine months of 2013.

Single family production volumes related to loans designated for sale consisted of the following.

| (in thousands)                                 | Three Months Ended |                    | Dollar Change | Percent Change | Nine Months Ended  |                    | Dollar Change | Percent Change |
|------------------------------------------------|--------------------|--------------------|---------------|----------------|--------------------|--------------------|---------------|----------------|
|                                                | September 30, 2013 | September 30, 2012 |               |                | September 30, 2013 | September 30, 2012 |               |                |
| Production volumes:                            |                    |                    |               |                |                    |                    |               |                |
| Single family                                  |                    |                    |               |                |                    |                    |               |                |
| mortgage closed loan volume <sup>(1) (2)</sup> | \$1,187,061        | \$1,368,238        | \$(181,177)   | (13 )%         | \$3,686,503        | \$3,149,196        | \$537,307     | 17 %           |
|                                                | 786,147            | 1,313,182          | (527,035 )    | (40 )          | 3,245,259          | 3,531,713          | (286,454 )    | (8 )           |



Single family  
mortgage interest rate  
lock commitments <sup>(2)</sup>

(1) Represents single family mortgage originations designated for sale during each respective period.

(2) Includes loans originated by Windermere Mortgage Series Services LLC ("WMS") and purchased by HomeStreet Bank.

During the third quarter of 2013, single family closed loan production decreased 13.2% and single family interest rate lock commitments decreased 40.1% as compared to the third quarter of 2012. For the first nine months of 2013, single family closed loan production increased 17.1% and single family interest rate lock commitments decreased 8.1% as compared to the same period last year. Our production mix continued to shift to the purchase mortgage market during the third quarter of 2013, as interest rate lock commitments were comprised of 80% purchase and 20% refinance mortgage transactions.

The Company records a liability for estimated mortgage repurchase losses, which has the effect of reducing net gain on mortgage loan origination and sale activities. The following table presents the effect of changes in the Company's mortgage repurchase liability within the respective line items of net gain on mortgage loan origination and sale activities.

| (in thousands)                                               | Three Months Ended<br>September 30, |             | Nine Months Ended September<br>30, |             |
|--------------------------------------------------------------|-------------------------------------|-------------|------------------------------------|-------------|
|                                                              | 2013                                | 2012        | 2013                               | 2012        |
| Effect of changes to the mortgage repurchase liability:      |                                     |             |                                    |             |
| Servicing value and secondary marketing gains <sup>(1)</sup> | \$ (505                             | ) \$ (492   | ) \$ (1,513                        | ) \$ (776   |
| Provision for repurchase losses <sup>(2)</sup>               | —                                   | (526        | ) —                                | (2,848      |
|                                                              | \$ (505                             | ) \$ (1,018 | ) \$ (1,513                        | ) \$ (3,624 |

(1) Represents the estimated fair value of the repurchase or indemnity obligation recognized as a reduction of proceeds on new loan sales.

(2) Represents changes in estimated probable future repurchase losses on previously sold loans.

For further information on the Company's mortgage repurchase liability, see Note 8, Commitments, Guarantees and Contingencies in this Form 10-Q.

Mortgage servicing income consisted of the following.

| (in thousands)                                                                                          | Three Months Ended<br>September 30, |          | Dollar<br>Change | Percent<br>Change | Nine Months Ended<br>September 30, |          | Dollar<br>Change | Percent<br>Change |        |    |
|---------------------------------------------------------------------------------------------------------|-------------------------------------|----------|------------------|-------------------|------------------------------------|----------|------------------|-------------------|--------|----|
|                                                                                                         | 2013                                | 2012     |                  |                   | 2013                               | 2012     |                  |                   |        |    |
| Servicing income, net:                                                                                  |                                     |          |                  |                   |                                    |          |                  |                   |        |    |
| Servicing fees and other                                                                                | \$8,934                             | \$7,168  | \$1,766          | 25                | %                                  | \$24,497 | \$20,310         | \$4,187           | 21     | %  |
| Changes in fair value of<br>MSRs due to modeled<br>amortization <sup>(1)</sup>                          | (5,221                              | ) (5,360 | ) 139            | (3                | )                                  | (16,896  | ) (14,382        | ) (2,514          | ) 17   |    |
| Amortization                                                                                            | (433                                | ) (598   | ) 165            | (28               | )                                  | (1,347   | ) (1,551         | ) 204             | (13    | )  |
|                                                                                                         | 3,280                               | 1,210    | 2,070            | 171               | %                                  | 6,254    | 4,377            | 1,877             | 43     | %  |
| Risk management:                                                                                        |                                     |          |                  |                   |                                    |          |                  |                   |        |    |
| Changes in fair value of<br>MSRs due to changes in<br>model inputs and/or<br>assumptions <sup>(2)</sup> | (2,900                              | ) (5,565 | ) \$2,665        | (48               | )%                                 | 15,403   | (13,507          | ) \$28,910        | (214   | )% |
| Net gain from derivatives<br>economically hedging<br>MSRs                                               | 3,631                               | 4,861    | (1,230           | ) (25             | )                                  | (12,392  | ) 24,600         | (36,992           | ) (150 | )  |
|                                                                                                         | 731                                 | (704     | ) 1,435          | NM                |                                    | 3,011    | 11,093           | (8,082            | ) (73  | )  |
| Mortgage servicing<br>income                                                                            | \$4,011                             | \$506    | \$3,505          | 693               | %                                  | \$9,265  | \$15,470         | \$(6,205          | ) (40  | )% |
| NM = not meaningful                                                                                     |                                     |          |                  |                   |                                    |          |                  |                   |        |    |

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

(2)

Primarily reflects changes in model assumptions, including prepayment speed assumptions, which are primarily affected by changes in mortgage interest rates.

For the third quarter of 2013, mortgage servicing income was \$4.0 million, an increase of \$3.5 million from \$506 thousand in the third quarter of 2012, primarily driven by increased servicing fees collected in the quarter on the Company's single family mortgage servicing and improved mortgage servicing rights ("MSR") risk management results.

For the first nine months of 2013, mortgage servicing income was \$9.3 million, a decrease of \$6.2 million from \$15.5 million in the first nine months of 2012. This decrease was primarily due to MSR risk management results, which represents changes in the fair value of single family MSRs due to changes in model inputs and assumptions net of the gain/(loss) from derivatives economically hedging MSRs. The fair value of MSRs is sensitive to changes in interest rates, primarily due to the effect on prepayment speeds. MSRs typically decrease in value when interest rates decline because declining interest rates tend to increase mortgage prepayment speeds and therefore reduce the expected life of the net servicing cash flows of the MSR asset. Certain other changes in MSR fair value relate to factors other than interest rate changes and are generally not within the scope

of the Company's MSR economic hedging strategy. These factors may include but are not limited to the impact of changes to the housing price index, the level of home sales activity, changes to mortgage spreads, valuation discount rates, costs to service and policy changes by U.S. government agencies.

The net performance of the MSR risk management activities for the third quarter of 2013 was a gain of \$731 thousand compared to a loss of \$704 thousand in the third quarter of 2012. For the first nine months of 2013, the net performance of the MSR risk management activities was a gain of \$3.0 million compared to a gain of \$11.1 million for the same period last year. The lower gain in 2013 largely reflects lower sensitivity to interest rates for the Company's MSRs, which enabled the Company to reduce the notional amount of derivative instruments used to economically hedge MSRs. The lower notional amount of derivative instruments, along with a flatter yield curve, resulted in lower net gains from MSR risk management, which negatively impacted mortgage servicing income. In addition, MSR risk management results for 2013 reflect the impact on the fair value of MSRs due to changes in model inputs and assumptions related to factors other than interest rate changes. Such factors included changes to the FHA streamlined refinance program and higher expected home values, both of which generally lead to higher projected prepayment speeds, and a decline in income from MSR risk management activities in 2013.

Mortgage servicing fees collected in the third quarter of 2013 were \$8.9 million, an increase of \$1.8 million, or 24.6%, from \$7.2 million in the third quarter of 2012. Our loans serviced for others portfolio increased to \$12.06 billion at September 30, 2013 from \$9.65 billion at December 31, 2012 and \$8.92 billion at September 30, 2012.

(Loss) income from Windermere Mortgage Services Series LLC in the third quarter of 2013 was a loss of \$550 thousand compared to income of \$1.2 million in the third quarter of 2012. The decrease in 2013 was primarily due to decreased interest rate lock commitments and closed loan volume, which were \$110.7 million and \$192.9 million, respectively, for the three months ended September 30, 2013 compared to \$224.1 million and \$268.4 million, respectively, for the same period in 2012.

Depositor and other retail banking fees for the three and nine months ended September 30, 2013 were relatively consistent with 2012 results. The following table presents the composition of depositor and other retail banking fees for the periods indicated.

| (in thousands)                                | Three Months Ended September 30, |       | Dollar Change | Percent Change | Nine Months Ended September 30, |         | Dollar Change | Percent Change |      |
|-----------------------------------------------|----------------------------------|-------|---------------|----------------|---------------------------------|---------|---------------|----------------|------|
|                                               | 2013                             | 2012  |               |                | 2013                            | 2012    |               |                |      |
| Fees:                                         |                                  |       |               |                |                                 |         |               |                |      |
| Monthly maintenance and deposit-related fees  | \$387                            | \$387 | \$—           | —              | %                               | \$1,106 | \$1,157       | \$(51)         | (4)% |
| Debit Card/ATM fees                           | 381                              | 340   | 41            | 12             |                                 | 1,104   | 1,030         | 74             | 7    |
| Other fees                                    | 23                               | 29    | (6)           | (21)           | )                               | 63      | 75            | (12)           | (16) |
| Total depositor and other retail banking fees | \$791                            | \$756 | \$35          | 5              | %                               | \$2,273 | \$2,262       | \$11           | —    |

#### Noninterest Expense

Noninterest expense was \$58.1 million in the third quarter of 2013, an increase of \$12.2 million, or 26.5%, from \$45.9 million in the third quarter of 2012. For the first nine months of 2013, noninterest expense was \$170.6 million, an increase of \$43.0 million, or 33.7%, from \$127.6 million for the same period last year. The increase in noninterest expense was primarily the result of increased salary and related costs and general and administrative expenses

resulting from the growth in personnel as we continue to expand our mortgage banking and commercial and consumer businesses.

Noninterest expense consisted of the following.

| (in thousands)                                            | Three Months Ended |                    | Dollar Change | Percent Change | Nine Months Ended  |                    | Dollar Change | Percent Change |
|-----------------------------------------------------------|--------------------|--------------------|---------------|----------------|--------------------|--------------------|---------------|----------------|
|                                                           | September 30, 2013 | September 30, 2012 |               |                | September 30, 2013 | September 30, 2012 |               |                |
| Noninterest expense                                       |                    |                    |               |                |                    |                    |               |                |
| Salaries and related costs                                | \$39,689           | \$31,573           | \$8,116       | 26 %           | \$113,330          | \$81,148           | \$32,182      | 40 %           |
| General and administrative                                | 9,234              | 7,148              | 2,086         | 29             | 30,434             | 19,304             | 11,130        | 58             |
| Legal                                                     | 844                | 312                | 532           | 171            | 2,054              | 1,471              | 583           | 40             |
| Consulting                                                | 884                | 1,069              | (185)         | (17)           | 2,343              | 1,746              | 597           | 34             |
| Federal Deposit Insurance Corporation assessments         | 227                | 794                | (567)         | (71)           | 937                | 2,751              | (1,814)       | (66)           |
| Occupancy                                                 | 3,484              | 2,279              | 1,205         | 53             | 9,667              | 6,160              | 3,507         | 57             |
| Information services                                      | 3,552              | 2,411              | 1,141         | 47             | 10,122             | 6,128              | 3,994         | 65             |
| Net cost of operation and sale of other real estate owned | 202                | 348                | (146)         | (42)           | 1,740              | 8,917              | (7,177)       | (80)           |
| Total noninterest expense                                 | \$58,116           | \$45,934           | \$12,182      | 27 %           | \$170,627          | \$127,625          | \$43,002      | 34 %           |

The significant components of our noninterest expense are described in greater detail, as follows.

Salaries and related costs were \$39.7 million in the third quarter of 2013, an increase of \$8.1 million, or 25.7%, from \$31.6 million in the third quarter of 2012. For the first nine months of 2013, salaries and related costs were \$113.3 million, an increase of \$32.2 million, or 39.7%, from \$81.1 million for the same period last year. The increase primarily resulted from a \$7.2 million and \$30.9 million increase in salaries and related costs, including commissions, for the third quarter and first nine months of 2013, respectively, due to the overall growth in our mortgage lending and commercial and consumer business lines. At September 30, 2013, we had increased our full-time equivalent employees by 42.9% from September 30, 2012.

General and administrative expense was \$9.2 million in the third quarter of 2013, an increase of \$2.1 million, or 29.2%, from \$7.1 million in the third quarter of 2012. For the first nine months of 2013, general and administrative expenses were \$30.4 million, an increase of \$11.1 million, or 57.7%, from \$19.3 million for the same period last year. These expenses include general office and equipment expense, marketing, taxes and insurance. The increase in general and administrative expense was primarily due to Company growth and increased marketing expenses.

#### Income Tax Expense

Income tax expense was \$308 thousand in the third quarter of 2013 compared to \$12.2 million in the third quarter of 2012. Our estimated annual effective income tax rate was 31.9% as compared to an annual effective tax rate of 20.8% for 2012. The lower effective income tax rate in 2012 primarily reflected the benefit of a full reversal of deferred tax asset valuation allowances during 2012.

#### Review of Financial Condition – Comparison of September 30, 2013 to December 31, 2012

Total assets were \$2.85 billion at September 30, 2013 and \$2.63 billion at December 31, 2012. The increase in total assets was primarily due to a \$157.3 million increase in investment securities and a \$201.2 million increase in portfolio loans, partially offset by a \$235.7 million decrease in loans held for sale.

Cash and cash equivalents was \$37.9 million at September 30, 2013 compared to \$25.3 million at December 31, 2012, an increase of \$12.6 million, or 49.9%.

Investment securities available for sale were \$573.6 million at September 30, 2013 compared to \$416.3 million at December 31, 2012, an increase of \$157.3 million, or 37.8%. The higher balance of our investment securities portfolio reflects management's decision in the second quarter of 2013 to increase this component of the overall asset mix and to add corporate debt securities to the Company's portfolio. With the Company's improved credit position and excess capital, the investment in corporate debt securities provides diversification in the portfolio with minimal additional credit risk.

The following table details the composition of our our investment securities available for sale by dollar amount and as a percentage of the total securities portfolio.

| (in thousands)                                 | At September 30, 2013 |         | At December 31, 2012 |         |   |
|------------------------------------------------|-----------------------|---------|----------------------|---------|---|
|                                                | Fair Value            | Percent | Fair Value           | Percent |   |
| Investment securities available for sale:      |                       |         |                      |         |   |
| Mortgage-backed securities:                    |                       |         |                      |         |   |
| Residential                                    | \$144,263             | 25.2    | % \$62,853           | 15.1    | % |
| Commercial                                     | 13,720                | 2.4     | 14,380               | 3.5     |   |
| Municipal bonds                                | 147,441               | 25.7    | 129,175              | 31.0    |   |
| Collateralized mortgage obligations:           |                       |         |                      |         |   |
| Residential                                    | 153,466               | 26.8    | 170,199              | 40.9    |   |
| Commercial                                     | 16,991                | 3.0     | 9,043                | 2.2     |   |
| Corporate debt securities                      | 69,963                | 12.2    | —                    | —       |   |
| U.S. Treasury securities                       | 27,747                | 4.8     | 30,679               | 7.4     |   |
| Total investment securities available for sale | \$573,591             | 100.0   | % \$416,329          | 100.0   | % |

Loans held for sale were \$385.1 million at September 30, 2013 compared to \$620.8 million at December 31, 2012, a decrease of \$235.7 million, or 38.0%. Loans held for sale include single family and multifamily residential loans, typically sold within 30 days of closing the loan. The decrease in loans held for sale was primarily the result of rising mortgage interest rates and declining refinancing loan volume, coupled with low housing inventories that have constrained the purchase mortgage market.

Loans held for investment, net were \$1.51 billion at September 30, 2013 compared to \$1.31 billion at December 31, 2012, an increase of \$201.2 million, or 15.4%. Our single family loan portfolio increased \$145.1 million from December 31, 2012, primarily as a result of increased originations of mortgages that exceed conventional conforming loan limits. Our commercial real estate and multifamily loan balances increased a combined \$63.4 million from December 31, 2012 as we continued to grow our commercial real estate lending business. These increases were partially offset by a \$12.0 million decrease in commercial business loans, as unscheduled payoffs were greater than loan originations during the first nine months of 2013.

The following table details the composition of our loans held for investment portfolio by dollar amount and as a percentage of our total loan portfolio.

| (in thousands)                        | At September 30, 2013 |         | At December 31, 2012 |         |   |
|---------------------------------------|-----------------------|---------|----------------------|---------|---|
|                                       | Amount                | Percent | Amount               | Percent |   |
| Consumer loans                        |                       |         |                      |         |   |
| Single family                         | \$818,992             | 53.2    | % \$673,865          | 50.3    | % |
| Home equity                           | 129,785               | 8.4     | 136,746              | 10.2    |   |
|                                       | 948,777               | 61.6    | 810,611              | 60.5    |   |
| Commercial loans                      |                       |         |                      |         |   |
| Commercial real estate <sup>(1)</sup> | 400,150               | 26.0    | 361,879              | 27.0    |   |
| Multifamily                           | 42,187                | 2.7     | 17,012               | 1.3     |   |
| Construction/land development         | 79,435                | 5.2     | 71,033               | 5.3     |   |
| Commercial business                   | 67,547                | 4.5     | 79,576               | 5.9     |   |
|                                       | 589,319               | 38.4    | 529,500              | 39.5    |   |
|                                       | 1,538,096             | 100.0   | % 1,340,111          | 100.0   | % |
| Net deferred loan fees and costs      | (3,233                | )       | (3,576               | )       |   |
|                                       | 1,534,863             |         | 1,336,535            |         |   |
| Allowance for loan losses             | (24,694               | )       | (27,561              | )       |   |



\$1,510,169

\$1,308,974

- (1) September 30, 2013 and December 31, 2012 balances comprised of \$95.3 million and \$94.9 million of owner occupied loans, respectively, and \$304.9 million and \$267.0 million of non-owner occupied loans, respectively.

Accounts receivable and other assets was \$128.9 million at September 30, 2013 compared to \$88.8 million at December 31, 2012, an increase of \$40.1 million, or 45.2%. This increase was primarily due to a \$10.6 million investment in an affordable

housing project and an increase in cash provided to counterparties as collateral for derivative positions used to hedge our mortgage servicing rights and mortgage banking activities. A receivable is recorded for the amount of cash delivered as collateral.

Deposits were \$2.10 billion at September 30, 2013 compared to \$1.98 billion at December 31, 2012, an increase of \$121.2 million or 6.1%. This increase was due to higher balances of transaction and savings deposits, which were \$1.42 billion at September 30, 2013, an increase of \$375.2 million, or 35.9%, from \$1.05 billion at December 31, 2012. Largely offsetting the increases in transaction and savings deposits was the managed reduction of certificates of deposit balances, which were \$460.2 million at September 30, 2013, a decrease of \$195.2 million, or 30%, from \$655.5 million at December 31, 2012. This improvement in the composition of deposits was primarily the result of our successful efforts to attract transaction and savings deposit balances through effective brand marketing.

The following table details the composition of our deposits by dollar amount and as a percentage of our total deposits.

| (in thousands)                                          | At September 30, 2013 |         | At December 31, 2012 |         |   |
|---------------------------------------------------------|-----------------------|---------|----------------------|---------|---|
|                                                         | Amount                | Percent | Amount               | Percent |   |
| Deposits by Product:                                    |                       |         |                      |         |   |
| Noninterest-bearing accounts - checking and savings     | \$134,725             | 6       | % \$83,563           | 4       | % |
| Interest-bearing transaction and savings deposits:      |                       |         |                      |         |   |
| NOW accounts                                            | 272,029               | 13      | 174,699              | 9       |   |
| Statement savings accounts due on demand                | 135,428               | 7       | 103,932              | 5       |   |
| Money market accounts due on demand                     | 879,122               | 42      | 683,906              | 35      |   |
| Total interest-bearing transaction and savings deposits | 1,286,579             | 62      | 962,537              | 49      |   |
| Total transaction and savings deposits                  | 1,421,304             | 68      | 1,046,100            | 53      |   |
| Certificates of deposit                                 | 460,223               | 22      | 655,467              | 33      |   |
| Noninterest-bearing accounts - other                    | 216,549               | 10      | 275,268              | 14      |   |
| Total deposits                                          | \$2,098,076           | 100     | % \$1,976,835        | 100     | % |

Federal Home Loan Bank advances were \$338.7 million at September 30, 2013 compared to \$259.1 million at December 31, 2012, an increase of \$79.6 million, or 30.7%. The increase was the result of higher overall asset balances, as the Company uses these borrowings to fund our mortgage banking and securities investment activities.

Accounts payable and other liabilities were \$87.5 million at September 30, 2013 compared to \$69.7 million at December 31, 2012, an increase of \$17.8 million, or 25.6%. This increase was primarily due to the change in the fair value of derivatives used for MSR risk management, partially offset by the first quarter 2013 payment of \$13.5 million in net deferred interest payable due on its outstanding TruPS.

#### Shareholders' Equity

Shareholders' equity was \$268.2 million at September 30, 2013 compared with \$263.8 million at December 31, 2012. This increase included net income of \$24.7 million, partially offset by a comprehensive loss of \$18.3 million recognized during the nine months ended September 30, 2013. The comprehensive loss represents unrealized losses in the valuation of our investment securities portfolio at September 30, 2013 as a result of the increase in interest rates experienced in the latter part of the second quarter of 2013.

On August 29, 2013, the Company paid a common stock dividend of \$0.11 per share payable to shareholders of record as of August 5, 2013.

As a result of the above, shareholders' equity, on a per share basis, increased to \$18.60 per share at September 30, 2013, up from \$18.34 per share at December 31, 2012.

## Return on Equity and Assets

The following table presents certain information regarding our returns on average equity and average total assets. Return on equity ratios for the periods shown may not be comparable due to the impact and timing of the Company's initial public offering of common stock completed in February 2012 and changes in the annual effective income tax rate between periods. During 2012, the Company benefited from the full reversal of its deferred tax asset valuation allowances.

|                                       | At or for the Three Months<br>Ended September 30, |         | At or for the Nine Months<br>Ended September 30, |         |   |
|---------------------------------------|---------------------------------------------------|---------|--------------------------------------------------|---------|---|
|                                       | 2013                                              | 2012    | 2013                                             | 2012    |   |
| Return on assets <sup>(1)</sup>       | 0.24                                              | % 3.60  | % 1.25                                           | % 3.40  | % |
| Return on equity <sup>(2)</sup>       | 2.45                                              | % 38.02 | % 11.94                                          | % 41.82 | % |
| Equity to assets ratio <sup>(3)</sup> | 9.74                                              | % 9.47  | % 10.48                                          | % 8.14  | % |

(1) Net income divided by average total assets (annualized).

(2) Net income divided by average equity (annualized).

(3) Average equity divided by average total assets.

## 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.

As a result of a change in the manner in which management evaluates strategic decisions, commencing with the second quarter of 2013, the Company realigned its business segments and organized them into two lines of business: Commercial and Consumer Banking and Mortgage Banking. In conjunction with this realignment, the Company modified its internal reporting to provide discrete financial information to management for these two business segments. The information that follows has been revised to reflect the current business segments.

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

## Commercial and Consumer Banking Segment

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 and business portfolio loans; investment products; insurance products and cash management services. We originate residential and commercial 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 commercial real estate loans including multifamily lending through our Fannie Mae DUS business, whereby loans are sold to or securitized by Fannie Mae, while the Company generally retains the servicing rights. As of September 30, 2013, our bank branch network consists of 23 branches, primarily in the Pacific Northwest and Hawaii. At September 30, 2013 and December 31, 2012, our transaction and savings deposits totaled \$1.42 billion and \$1.05 billion and our loan portfolio totaled \$1.51 billion and \$1.31 billion, respectively. This segment is also responsible for the management of the Company's portfolio of investment securities.



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Commercial and Consumer Banking segment results are detailed below.

| (in thousands)                                                      | Three Months Ended<br>September 30, |              | Dollar<br>Change | Percent<br>Change | Nine Months Ended<br>September 30, |              | Dollar<br>Change | Percent<br>Change |
|---------------------------------------------------------------------|-------------------------------------|--------------|------------------|-------------------|------------------------------------|--------------|------------------|-------------------|
|                                                                     | 2013                                | 2012         |                  |                   | 2013                               | 2012         |                  |                   |
| Net interest income                                                 | \$ 15,919                           | \$ 12,096    | \$ 3,823         | 32 %              | \$ 40,687                          | \$ 34,454    | \$ 6,233         | 18 %              |
| (Reversal of) provision for credit losses                           | (1,500 )                            | 5,500        | (7,000 )         | NM                | 900                                | 7,500        | (6,600 )         | (88 )             |
| Noninterest income                                                  | 1,229                               | 2,474        | (1,245 )         | (50 )             | 5,156                              | 7,257        | (2,101 )         | (29 )             |
| Noninterest expense                                                 | 13,577                              | 13,302       | 275              | 2                 | 42,748                             | 46,848       | (4,100 )         | (9 )              |
| Income (loss) before income taxes                                   | 5,071                               | (4,232 )     | 9,303            | NM                | 2,195                              | (12,637 )    | 14,832           | NM                |
| Income tax expense (benefit)                                        | 1,219                               | (1,904 )     | 3,123            | NM                | (125 )                             | (2,448 )     | 2,323            | (95 )             |
| Net income (loss)                                                   | \$ 3,852                            | \$(2,328 )   | \$ 6,180         | NM                | \$ 2,320                           | \$(10,189 )  | \$ 12,509        | NM                |
| Average assets                                                      | \$ 2,129,597                        | \$ 1,772,975 | \$ 356,622       | 20 %              | \$ 1,996,713                       | \$ 1,870,076 | \$ 126,637       | 7 %               |
| Pre-tax pre-provision profit (loss) <sup>(1)</sup>                  | 3,571                               | 1,268        | 2,303            | 182               | 3,095                              | (5,137 )     | 8,232            | NM                |
| Efficiency ratio <sup>(2)</sup>                                     | 79.18 %                             | 91.30 %      | NM               | NM                | 93.25 %                            | 112.32 %     | NM               | NM                |
| Full-time equivalent employees (ending)                             | 504                                 | 377          | NM               | 34                | 504                                | 377          | NM               | 34                |
| Multifamily net gain on mortgage loan origination and sale activity | \$ 2,113                            | \$ 1,040     | 1,073            | 103               | \$ 4,747                           | \$ 3,241     | 1,506            | 46                |
| Production volumes:                                                 |                                     |              |                  |                   |                                    |              |                  |                   |
| Multifamily mortgage originations                                   | 10,734                              | 20,209       | (9,475 )         | (47 )             | 74,643                             | 71,830       | 2,813            | 4                 |
| Multifamily mortgage loans sold                                     | 21,998                              | 26,515       | (4,517 )         | (17 )             | 87,971                             | 85,116       | 2,855            | 3                 |
| NM = not meaningful                                                 |                                     |              |                  |                   |                                    |              |                  |                   |

Pre-tax pre-provision profit is total net revenue (net interest income and noninterest income) less noninterest (1)expense. The Company believes that this financial measure is useful in assessing the ability of a lending institution to generate income in excess of its provision for credit losses.  
(2)Noninterest expense divided by total net revenue (net interest income and noninterest income).

Commercial and Consumer Banking net income was \$3.9 million for the third quarter of 2013, improved by \$6.2 million from a net loss of \$2.3 million for the third quarter of 2012. For the first nine months of 2013, Commercial and Consumer Banking had net income of \$2.3 million, improved by \$12.5 million from a net loss of \$10.2 million for the first nine months of 2012. Improved credit quality of the Company's loan portfolio resulted in a \$1.5 million reversal to the provision for credit losses in the third quarter of 2013, compared to a provision of \$5.5 million in the third quarter of 2012. Additionally, the increase in net income in 2013 was the result of an increase in net interest income, which reflects improvements in our deposit product and pricing strategy. That strategy resulted in our reducing higher-cost deposits and converting customers with maturing certificates of deposit to transaction and savings deposits.

Commercial and Consumer Banking segment servicing income consisted of the following.

| (in thousands)                       | Three Months Ended<br>September 30, |         | Dollar<br>Change | Percent<br>Change | Nine Months Ended<br>September 30, |         | Dollar<br>Change | Percent<br>Change |
|--------------------------------------|-------------------------------------|---------|------------------|-------------------|------------------------------------|---------|------------------|-------------------|
|                                      | 2013                                | 2012    |                  |                   | 2013                               | 2012    |                  |                   |
| Servicing income, net:               |                                     |         |                  |                   |                                    |         |                  |                   |
| Servicing fees and other             | \$789                               | \$1,017 | \$(228)          | (22)%             | \$2,341                            | \$2,569 | \$(228)          | (9)%              |
| Amortization of multifamily MSR's    | (433)                               | (598)   | 165              | (28)              | (1,347)                            | (1,551) | 204              | (13)              |
| Commercial mortgage servicing income | \$356                               | \$419   | \$(63)           | (15)%             | \$994                              | \$1,018 | \$(24)           | (2)%              |

Commercial and Consumer Banking segment loans serviced for others consisted of the following.

| (in thousands)                             | At September<br>30,<br>2013 | At December<br>31,<br>2012 |
|--------------------------------------------|-----------------------------|----------------------------|
| Commercial                                 |                             |                            |
| Multifamily                                | \$722,767                   | \$727,118                  |
| Other                                      | 50,629                      | 53,235                     |
| Total commercial loans serviced for others | \$773,396                   | \$780,353                  |

Commercial and Consumer Banking segment noninterest expense of \$13.6 million increased \$275 thousand, or 2.1%, from \$13.3 million in the third quarter of 2012, primarily due to increased salaries and related costs, reflecting the growth of our commercial real estate and commercial business lending units and the expansion of our branch banking network.

### Mortgage Banking Segment

Mortgage Banking originates and purchases single family residential mortgage loans for sale in the secondary markets. We purchase loans from Windermere Mortgage Services Series LLC through a correspondent arrangement between HomeStreet Bank and that company. 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. A small percentage of our loans are brokered or sold on a servicing-released basis to correspondent lenders. We manage the loan funding and the interest rate risk associated with the secondary market loan sales and the retained servicing rights within this business segment.



Mortgage Banking segment results are detailed below.

| (in thousands)                                                       | Three Months Ended<br>September 30, |           | Dollar<br>Change | Percent<br>Change |   | Nine Months Ended<br>September 30, |           | Dollar<br>Change | Percent<br>Change |   |
|----------------------------------------------------------------------|-------------------------------------|-----------|------------------|-------------------|---|------------------------------------|-----------|------------------|-------------------|---|
|                                                                      | 2013                                | 2012      |                  |                   |   | 2013                               | 2012      |                  |                   |   |
| Net interest income                                                  | \$4,493                             | \$4,424   | \$69             | 2                 | % | \$12,375                           | \$9,697   | \$2,678          | 28                | % |
| Noninterest income                                                   | 36,945                              | 66,617    | (29,672 )        | (45 )             |   | 149,517                            | 158,832   | (9,315 )         | (6 )              |   |
| Noninterest expense                                                  | 44,539                              | 32,632    | 11,907           | 36                |   | 127,879                            | 80,777    | 47,102           | 58                |   |
| (Loss) income before income taxes                                    | (3,101 )                            | 38,409    | (41,510 )        | NM                |   | 34,013                             | 87,752    | (53,739 )        | (61 )             |   |
| Income tax (benefit) expense                                         | (911 )                              | 14,090    | (15,001 )        | NM                |   | 11,663                             | 16,935    | (5,272 )         | (31 )             |   |
| Net (loss) income                                                    | \$(2,190 )                          | \$24,319  | \$(26,509 )      | NM                |   | \$22,350                           | \$70,817  | \$(48,467 )      | (68 )             |   |
| Average assets                                                       | \$656,697                           | \$670,715 | \$(14,018 )      | (2 )              | % | \$641,336                          | \$506,098 | \$135,238        | 27                | % |
| Efficiency ratio <sup>(1)</sup>                                      | 107.48 %                            | 45.93 %   | NM               | NM                |   | 78.99 %                            | 47.93 %   | NM               | NM                |   |
| Full-time equivalent employees (ending)                              | 922                                 | 621       | NM               | 48                |   | 922                                | 621       | NM               | 48                |   |
| Production volumes for sale to the secondary market:                 |                                     |           |                  |                   |   |                                    |           |                  |                   |   |
| Single family mortgage closed                                        | 1,187,061                           | 1,368,238 | (181,177 )       | (13 )             |   | 3,686,503                          | 3,149,196 | 537,307          | 17                |   |
| loan volume <sup>(2)(3)</sup>                                        |                                     |           |                  |                   |   |                                    |           |                  |                   |   |
| Single family mortgage interest rate lock commitments <sup>(2)</sup> | 786,147                             | 1,313,182 | (527,035 )       | (40 )             |   | 3,245,259                          | 3,531,713 | (286,454 )       | (8 )              |   |
| Single family mortgage loans sold <sup>(2)</sup>                     | 1,326,888                           | 1,238,879 | 88,009           | 7                 |   | 3,916,918                          | 2,735,893 | 1,181,025        | 43                |   |

(1) Noninterest expense divided by total net revenue (net interest income and noninterest income).

(2) Includes loans originated by Windermere Mortgage Series Services LLC ("WMS") and purchased by HomeStreet Bank.

(3) Represents single family mortgage production volume designated for sale to the secondary market during each respective period.

Mortgage Banking net loss was \$2.2 million for the third quarter of 2013, a decrease of \$26.5 million from net income of \$24.3 million for the third quarter of 2012. For the first nine months of 2013, Mortgage Banking net income was

\$22.4 million, a decrease of \$48.5 million, or 68.4%, from net income of \$70.8 million for the first nine months of 2012. The decrease in Mortgage Banking net income for the third quarter of 2013 was driven primarily by higher mortgage interest rates that led to a sharp decrease in interest rate lock commitment volume, as a substantial amount of the gain on loan origination and sale activities is recognized at the time of interest rate lock, as well as the imbalance between the volume of interest rate lock commitments and closed loans. In periods where the volume of closed loans significantly exceeds the volume of interest rate lock commitments, noninterest expense will be higher relative to noninterest income because variable costs, notably commissions and incentives, are recognized at the time of closing the loan. In the third quarter of 2013, single family mortgage closed loans of \$1.19 billion were 51.0% greater than interest rate lock commitments of \$786.1 million.

Mortgage Banking net gain on sale to the secondary market is detailed in the following table.

| (in thousands)                                                                                  | Three Months Ended<br>September 30, |          | Nine Months Ended<br>September 30, |           |
|-------------------------------------------------------------------------------------------------|-------------------------------------|----------|------------------------------------|-----------|
|                                                                                                 | 2013                                | 2012     | 2013                               | 2012      |
| Net gain on mortgage loan origination and sale activities: <sup>(1)</sup>                       |                                     |          |                                    |           |
| Single family:                                                                                  |                                     |          |                                    |           |
| Servicing value and secondary marketing gains <sup>(2)</sup>                                    | \$23,076                            | \$56,142 | \$110,760                          | \$120,471 |
| Provision for repurchase losses <sup>(3)</sup>                                                  | —                                   | (526)    | —                                  | (2,846)   |
| Net gain from secondary marketing activities                                                    | 23,076                              | 55,616   | 110,760                            | 117,625   |
| Loan origination and funding fees                                                               | 8,302                               | 8,680    | 24,363                             | 20,817    |
| Total mortgage banking net gain on mortgage loan origination and sale activities <sup>(1)</sup> | \$31,378                            | \$64,296 | \$135,123                          | \$138,442 |
| Composite Margin (in basis points):                                                             |                                     |          |                                    |           |
| Servicing value and secondary marketing gains / interest rate lock commitments <sup>(4)</sup>   | 294                                 | 424      | 328                                | 333       |
| Loan origination and funding fees / retail mortgage originations <sup>(5)</sup>                 | 81                                  | 77       | 77                                 | 83        |
| Composite Margin                                                                                | 375                                 | 501      | 405                                | 416       |

(1) Excludes inter-segment activities.

Comprised of gains and losses on interest rate lock commitments (which considers the value of servicing), single

(2) family loans held for sale, forward sale commitments used to economically hedge secondary market activities, and the estimated fair value of the repurchase or indemnity obligation recognized on new loan sales.

(3) Represents changes in estimated probable future repurchase losses on previously sold loans.

Servicing value and secondary marketing gains have been aggregated and are stated as a percentage of interest rate lock commitments. In previous quarters, the value of originated mortgage servicing rights was presented as a separate component of the composite margin and stated as a percentage of mortgage loans sold. Prior periods have been revised to conform to the current presentation.

(4) Loan origination and funding fees is stated as a percentage of mortgage originations from the retail channel and excludes mortgage loans purchased from WMS.

Net gain on mortgage loan origination and sale activities was \$31.4 million for the third quarter of 2013, a decrease of \$32.9 million, or 51.2%, from \$64.3 million in the third quarter of 2012. This decrease is primarily the result of the 40.1% decrease in interest rate lock commitments, which was heavily driven by an increase in mortgage interest rates that led to a decrease in refinance mortgage volume and the shift to a purchase mortgage-dominated market.

Due to differences in the timing of revenue recognition between components of the gain on loan origination and sale activities, the Company analyzes the profitability of these activities using a 'Composite Margin,' which is comprised of the ratios of the components to their respective populations of interest rate lock commitments and closed loans. The Composite Margin for the third quarter of 2013 was 375 basis points, down from 501 basis points in the third quarter of 2012. The decrease from the prior year is primarily the result of increased price competition resulting from lower industry application volume and the shift to a purchase mortgage-dominated market. In addition, due to the impact of changes in the FHA mortgage insurance program, we experienced a reduction in FHA-insured mortgage loan originations that historically have had higher profit margins on their origination and sale.

Mortgage Banking servicing income consisted of the following.

| (in thousands)                                                                                          | Three Months Ended<br>September 30, |          | Dollar<br>Change | Percent<br>Change | Nine Months Ended<br>September 30, |           | Dollar<br>Change | Percent<br>Change |
|---------------------------------------------------------------------------------------------------------|-------------------------------------|----------|------------------|-------------------|------------------------------------|-----------|------------------|-------------------|
|                                                                                                         | 2013                                | 2012     |                  |                   | 2013                               | 2012      |                  |                   |
| Servicing income, net:                                                                                  |                                     |          |                  |                   |                                    |           |                  |                   |
| Servicing fees and other                                                                                | \$8,145                             | \$6,151  | \$1,994          | 32 %              | \$22,156                           | \$17,741  | \$4,415          | 25 %              |
| Changes in fair value of<br>MSRs due to modeled<br>amortization <sup>(1)</sup>                          | (5,221 )                            | (5,360 ) | 139              | (3 )              | (16,896 )                          | (14,382 ) | (2,514 )         | 17                |
|                                                                                                         | 2,924                               | 791      | 2,133            | 270 %             | 5,260                              | 3,359     | (1,226 )         | (36 )%            |
| Risk management:                                                                                        |                                     |          |                  |                   |                                    |           |                  |                   |
| Changes in fair value of<br>MSRs due to changes in<br>model inputs and/or<br>assumptions <sup>(2)</sup> | (2,900 )                            | (5,565 ) | \$2,665          | (48 )%            | 15,403                             | (13,507 ) | \$28,910         | (214 )%           |
| Net gain from derivatives<br>economically hedging<br>MSRs                                               | 3,631                               | 4,861    | (1,230 )         | (25 )             | (12,392 )                          | 24,600    | (36,992 )        | (150 )            |
|                                                                                                         | 731                                 | (704 )   | 1,435            | NM                | 3,011                              | 11,093    | (9,658 )         | (87 )             |
| Mortgage servicing<br>income                                                                            | \$3,655                             | \$87     | \$3,568          | NM                | \$8,271                            | \$14,452  | \$(10,884 )      | (75 )%            |
| NM = not meaningful                                                                                     |                                     |          |                  |                   |                                    |           |                  |                   |

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

(2) Principally reflects changes in model assumptions, including prepayment speed assumptions, which are primarily affected by changes in mortgage interest rates.

Single family mortgage servicing income of \$3.7 million in the third quarter of 2013 increased \$3.6 million from the third quarter of 2012. This increase was primarily due to increased servicing fees collected in the quarter on the Company's single family mortgage servicing and improved mortgage servicing rights ("MSR") risk management results. Risk management results represent changes in the fair value of single family MSRs due to changes in model inputs and assumptions net of the gain/(loss) from derivatives economically hedging MSRs.

Single family mortgage servicing income of \$8.3 million for the first nine months of 2013 decreased \$10.9 million from the first nine months of 2012, primarily due to risk management activities.

Single family mortgage servicing fees collected in the third quarter of 2013 increased \$2.0 million, or 32.4%, from the third quarter of 2012 resulting from growth in the portfolio of single family loans serviced for others. The portfolio of single family loans serviced for others increased to \$11.29 billion at quarter end compared to \$8.87 billion at December 31, 2012 and \$8.11 billion at September 30, 2012.

Single family loans serviced for others consisted of the following.

| (in thousands)                              | At September<br>30,<br>2013 | At December<br>31,<br>2012 |
|---------------------------------------------|-----------------------------|----------------------------|
| Single family<br>U.S. government and agency | \$10,950,086                | \$8,508,458                |

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|                                               |               |              |
|-----------------------------------------------|---------------|--------------|
| Other                                         | 336,158       | 362,230      |
| Total single family loans serviced for others | \$ 11,286,244 | \$ 8,870,688 |

Mortgage Banking noninterest expense of \$44.5 million increased \$11.9 million, or 36.5%, from \$32.6 million in the third quarter of 2012. This increase was primarily attributable to increased salaries and related costs due to our continued growth in loan production personnel and our expansion in new markets.

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Mortgage Banking net loss of \$2.2 million for the third quarter of 2013 was driven primarily by the sharp decrease in interest rate lock commitment volume, as a substantial amount of the gain on loan origination and sale activities is recognized at the time of rate lock, as well as the imbalance between the volume of interest rate lock commitments and closed loans. In periods where the volume of closed loans significantly exceeds the volume of interest rate lock commitments, noninterest expense will be higher relative to noninterest income because variable costs, notably commissions and incentives, are recognized at the time of closing the loan. In the third quarter of 2013, single family mortgage closed loans of \$1.19 billion were 51.0% greater than interest rate lock commitments of \$786.1 million.

#### Off-Balance Sheet Arrangements

In the normal course of business, we are a party to financial instruments with off-balance sheet risk. These financial instruments (which include but are not limited to commitments to originate loans and commitments to purchase loans) include potential credit risk in excess of the amount recognized in the accompanying consolidated financial statements. These transactions are designed to (1) meet the financial needs of our customers, (2) manage our credit, market or liquidity risks, (3) diversify our funding sources and/or (4) optimize capital.

For more information on off-balance sheet arrangements, including derivative counterparty credit risk, see the Off-Balance Sheet Arrangements and Commitments, Guarantees and Contingencies discussions within Part II, Item 7 Management's Discussion and Analysis in our 2012 Annual Report on Form 10-K, as well as Note 13, Commitments, Guarantees and Contingencies within the 2012 Annual Report on Form 10-K and Note 8, Commitments, Guarantees and Contingencies in this Form 10-Q.

#### Enterprise Risk Management

All financial institutions manage and control a variety of business and financial risks that can significantly affect their financial performance. Among these risks are credit risk; market risk, which includes interest rate risk and price risk; liquidity risk; and operational risk. We are also subject to risks associated with compliance/legal, strategic and reputational matters.

For more information on how we manage these business, financial and other risks, see the Enterprise Risk Management discussion within Part II, Item 7 Management's Discussion and Analysis in our 2012 Annual Report on Form 10-K.

#### Credit Risk Management

The following discussion highlights developments since December 31, 2012 and should be read in conjunction with the Credit Risk Management discussion within Part II, Item 7 Management's Discussion and Analysis in our 2012 Annual Report on Form 10-K.

#### Asset Quality and Nonperforming Assets

Nonperforming assets ("NPAs") were \$39.0 million and \$53.8 million at September 30, 2013 and December 31, 2012, respectively. NPAs at September 30, 2013 represented 1.37% of total assets compared to 2.05% of total assets at December 31, 2012. Nonaccrual loans of \$26.8 million, or 1.74% of total loans at September 30, 2013, decreased \$3.1 million, or 10.5% from \$29.9 million, or 2.24% of total loans at December 31, 2012. OREO balances of \$12.3 million at September 30, 2013 declined \$11.7 million, or 48.8%, from \$23.9 million at December 31, 2012. Net charge-offs during the three and nine months ended September 30, 2013 were \$1.5 million and \$3.8 million, respectively, compared with \$5.0 million and \$22.7 million during the three and nine months ended September 30, 2012, respectively.

At September 30, 2013, our loans held for investment portfolio, excluding the allowance for loan losses, was \$1.53 billion, an increase of \$198.3 million from December 31, 2012, while the allowance for loan losses decreased to \$24.7 million, or 1.61% of loans held for investment, compared to \$27.6 million, or 2.06% of loans held for investment at December 31, 2012, reflecting the improved credit quality of the Company's loan portfolio.

Improved credit quality of the Company's loan portfolio resulted in a \$1.5 million reversal to the provision for credit losses in the third quarter of 2013, compared to a provision of \$5.5 million in the third quarter of 2012. Our provision for credit losses for the nine months ended September 30, 2013 was \$900 thousand. For the three and nine months ended September 30, 2012, our provision for credit losses was \$5.5 million and \$7.5 million, respectively. Net charge-offs in the quarter totaled \$1.5 million, down from \$5.0 million of net charge-offs in the third quarter of 2012. Of the \$1.5 million in net charge-offs during the quarter, \$967 thousand had been specifically reserved as of June 30, 2013.

The following tables present the recorded investment, unpaid principal balance and related allowance for impaired loans, broken down by those with and those without a specific reserve.

| (in thousands)                           | At September 30, 2013 |                          |                   |
|------------------------------------------|-----------------------|--------------------------|-------------------|
|                                          | Recorded Investment   | Unpaid Principal Balance | Related Allowance |
| Impaired loans:                          |                       |                          |                   |
| Loans with no related allowance recorded | \$74,169              | \$88,951                 | \$—               |
| Loans with an allowance recorded         | 40,798                | 41,163                   | 2,958             |
| Total                                    | \$114,967             | \$130,114                | \$2,958           |

| (in thousands)                           | At December 31, 2012 |                          |                   |
|------------------------------------------|----------------------|--------------------------|-------------------|
|                                          | Recorded Investment  | Unpaid Principal Balance | Related Allowance |
| Impaired loans:                          |                      |                          |                   |
| Loans with no related allowance recorded | \$53,615             | \$67,262                 | \$—               |
| Loans with an allowance recorded         | 70,350               | 72,220                   | 6,368             |
| Total                                    | \$123,965            | \$139,482                | \$6,368           |

The Company had 190 impaired loans totaling \$115.0 million at September 30, 2013 and 167 impaired loans totaling \$124.0 million at December 31, 2012. The average recorded investment in these loans for the three and nine months ended September 30, 2013 was \$122.2 million and \$123.5 million compared with \$130.8 million and \$154.7 million for the three and nine months ended September 30, 2012. Impaired loans of \$40.8 million at September 30, 2013 had a valuation allowance of \$3.0 million. At December 31, 2012, impaired loans of \$70.4 million had a valuation allowance of \$6.4 million.

The allowance for credit losses represents management's estimate of the incurred credit losses inherent within our loan portfolio. For further discussion related to credit policies and estimates see Critical Accounting Policies and Estimates — Allowance for Loan Losses within Part II, Item 7 Management's Discussion and Analysis in our 2012 Annual Report on Form 10-K.

The following table presents the allowance for credit losses, including reserves for unfunded commitments, by loan class.

| (in thousands) | At September 30, 2013 |                                         |                                     | At December 31, 2012 |                                         |                                     |   |
|----------------|-----------------------|-----------------------------------------|-------------------------------------|----------------------|-----------------------------------------|-------------------------------------|---|
|                | Amount                | Percent of Allowance to Total Allowance | Loan Category as a % of Total Loans | Amount               | Percent of Allowance to Total Allowance | Loan Category as a % of Total Loans |   |
| Consumer loans |                       |                                         |                                     |                      |                                         |                                     |   |
| Single family  | \$12,132              | 48.7                                    | % 53.2                              | % \$13,388           | 48.2                                    | % 50.3                              | % |
| Home equity    | 4,636                 | 18.6                                    | % 8.4                               | % 4,648              | 16.7                                    | % 10.2                              | % |
|                | 16,768                | 67.3                                    | % 61.6                              | % 18,036             | 64.9                                    | % 60.5                              | % |



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|                                   |          |       |         |            |       |         |   |  |
|-----------------------------------|----------|-------|---------|------------|-------|---------|---|--|
| Commercial loans                  |          |       |         |            |       |         |   |  |
| Commercial real estate            | 4,468    | 17.9  | % 26.0  | % 5,312    | 19.1  | % 27.0  | % |  |
| Multifamily                       | 770      | 3.1   | % 2.7   | % 622      | 2.2   | % 1.3   | % |  |
| Construction/land development     | 1,392    | 5.6   | % 5.2   | % 1,580    | 5.7   | % 5.3   | % |  |
| Commercial business               | 1,496    | 6.1   | % 4.5   | % 2,201    | 8.1   | % 5.9   | % |  |
|                                   | 8,126    | 32.7  | % 38.4  | % 9,715    | 35.1  | % 39.5  | % |  |
| Total allowance for credit losses | \$24,894 | 100.0 | % 100.0 | % \$27,751 | 100.0 | % 100.0 | % |  |

The following table presents activity in our allowance for credit losses, which includes reserves for unfunded commitments.

| (in thousands)                          | Three Months Ended September 30, |           | Nine Months Ended September 30, |            |
|-----------------------------------------|----------------------------------|-----------|---------------------------------|------------|
|                                         | 2013                             | 2012      | 2013                            | 2012       |
| Allowance at the beginning of period    | \$27,858                         | \$27,125  | \$27,751                        | \$42,800   |
| (Reversal of) provision for loan losses | (1,500)                          | ) 5,500   | 900                             | 7,500      |
| Recoveries:                             |                                  |           |                                 |            |
| Consumer                                |                                  |           |                                 |            |
| Single family                           | 179                              | 22        | 425                             | 455        |
| Home equity                             | 273                              | 121       | 526                             | 398        |
|                                         | 452                              | 143       | 951                             | 853        |
| Commercial                              |                                  |           |                                 |            |
| Commercial real estate                  | —                                | 130       | —                               | 258        |
| Construction/land development           | 348                              | 193       | 699                             | 835        |
| Commercial business                     | 25                               | 631       | 173                             | 717        |
|                                         | 373                              | 954       | 872                             | 1,810      |
| Total recoveries                        | 825                              | 1,097     | 1,823                           | 2,663      |
| Charge-offs:                            |                                  |           |                                 |            |
| Consumer                                |                                  |           |                                 |            |
| Single family                           | (606)                            | ) (1,363) | ) (2,468)                       | ) (3,889)  |
| Home equity                             | (377)                            | ) (1,078) | ) (1,515)                       | ) (3,577)  |
|                                         | (983)                            | ) (2,441) | ) (3,983)                       | ) (7,466)  |
| Commercial                              |                                  |           |                                 |            |
| Commercial real estate                  | (1,306)                          | ) (1,757) | ) (1,449)                       | ) (3,474)  |
| Construction/land development           | —                                | (1,823)   | ) (148)                         | ) (13,858) |
| Commercial business                     | —                                | (74)      | ) —                             | (538)      |
|                                         | (1,306)                          | ) (3,654) | ) (1,597)                       | ) (17,870) |
| Total charge-offs                       | (2,289)                          | ) (6,095) | ) (5,580)                       | ) (25,336) |
| (Charge-offs), net of recoveries        | (1,464)                          | ) (4,998) | ) (3,757)                       | ) (22,673) |
| Balance at end of period                | \$24,894                         | \$27,627  | \$24,894                        | \$27,627   |

The following table presents the composition of TDRs by accrual and nonaccrual status.

| (in thousands)                | At September 30, 2013 |            | Total     |
|-------------------------------|-----------------------|------------|-----------|
|                               | Accrual               | Nonaccrual |           |
| Consumer                      |                       |            |           |
| Single family <sup>(1)</sup>  | \$71,686              | \$4,819    | \$76,505  |
| Home equity                   | 2,426                 | 132        | 2,558     |
|                               | 74,112                | 4,951      | 79,063    |
| Commercial                    |                       |            |           |
| Commercial real estate        | 20,385                | —          | 20,385    |
| Multifamily                   | 3,190                 | —          | 3,190     |
| Construction/land development | 3,122                 | 3,544      | 6,666     |
| Commercial business           | 120                   | —          | 120       |
|                               | 26,817                | 3,544      | 30,361    |
|                               | \$100,929             | \$8,495    | \$109,424 |
|                               |                       |            |           |
| (in thousands)                | At December 31, 2012  |            | Total     |
|                               | Accrual               | Nonaccrual |           |
| Consumer                      |                       |            |           |
| Single family <sup>(1)</sup>  | \$67,483              | \$3,931    | \$71,414  |
| Home equity                   | 2,288                 | 465        | 2,753     |
|                               | 69,771                | 4,396      | 74,167    |
| Commercial                    |                       |            |           |
| Commercial real estate        | 21,071                | 770        | 21,841    |
| Multifamily                   | 3,221                 | —          | 3,221     |
| Construction/land development | 6,365                 | 5,042      | 11,407    |
| Commercial business           | 147                   | —          | 147       |
|                               | 30,804                | 5,812      | 36,616    |
|                               | \$100,575             | \$10,208   | \$110,783 |

(1) Includes loan balances insured by the FHA or guaranteed by the VA of \$17.6 million and \$13.1 million, at September 30, 2013 and December 31, 2012, respectively.

The following tables present information about TDRs by loan portfolio segment and loan class.

At September 30, 2013

| (dollars in thousands)        | Concession type          | Number of loan relationships | Recorded investment | Related cumulative charge-offs |
|-------------------------------|--------------------------|------------------------------|---------------------|--------------------------------|
| Consumer loans                |                          |                              |                     |                                |
| Single family <sup>(1)</sup>  |                          |                              |                     |                                |
|                               | Interest rate reduction  | 151                          | \$75,155            | \$ 3,504                       |
|                               | Payment restructure      | 8                            | 1,350               | —                              |
|                               |                          | 159                          | \$76,505            | \$ 3,504                       |
| Home equity                   |                          |                              |                     |                                |
|                               | Interest rate reduction  | 20                           | \$2,384             | \$ 25                          |
|                               | Payment restructure      | 5                            | 174                 | —                              |
|                               |                          | 25                           | \$2,558             | \$ 25                          |
| Total consumer                |                          |                              |                     |                                |
|                               | Interest rate reduction  | 171                          | \$77,539            | \$ 3,529                       |
|                               | Payment restructure      | 13                           | 1,524               | —                              |
|                               |                          | 184                          | \$79,063            | \$ 3,529                       |
| Commercial loans              |                          |                              |                     |                                |
| Commercial real estate        |                          |                              |                     |                                |
|                               | Interest rate reduction  | 2                            | \$5,779             | \$ 1,884                       |
|                               | Forgiveness of principal | 1                            | 14,606              | 1,000                          |
|                               |                          | 3                            | \$20,385            | \$ 2,884                       |
| Multifamily                   |                          |                              |                     |                                |
|                               | Interest rate reduction  | 2                            | \$3,190             | \$ —                           |
|                               |                          | 2                            | \$3,190             | \$ —                           |
| Construction/land development |                          |                              |                     |                                |
|                               | Interest rate reduction  | 3                            | \$6,254             | \$ 7,063                       |
|                               | Forgiveness of principal | 1                            | 412                 | 49                             |
|                               |                          | 4                            | \$6,666             | \$ 7,112                       |
| Commercial business           |                          |                              |                     |                                |
|                               | Payment restructure      | 1                            | 120                 | 68                             |
|                               |                          | 1                            | \$120               | \$ 68                          |
| Total commercial              |                          |                              |                     |                                |
|                               | Interest rate reduction  | 7                            | \$15,223            | \$ 8,947                       |
|                               | Payment restructure      | 1                            | 120                 | 68                             |
|                               | Forgiveness of principal | 2                            | 15,018              | 1,049                          |
|                               |                          | 10                           | \$30,361            | \$ 10,064                      |
| Total loans                   |                          |                              |                     |                                |
|                               | Interest rate reduction  | 178                          | \$92,762            | \$ 12,476                      |
|                               | Payment restructure      | 14                           | 1,644               | 68                             |
|                               | Forgiveness of principal | 2                            | 15,018              | 1,049                          |
|                               |                          | 194                          | \$109,424           | \$ 13,593                      |

(1) Includes loan balances insured by the FHA or guaranteed by the VA of \$17.6 million at September 30, 2013.

| (dollars in thousands)        | At December 31, 2012     |                              |                     |                                |
|-------------------------------|--------------------------|------------------------------|---------------------|--------------------------------|
|                               | Concession type          | Number of loan relationships | Recorded investment | Related cumulative charge-offs |
| Consumer loans                |                          |                              |                     |                                |
| Single family <sup>(1)</sup>  |                          |                              |                     |                                |
|                               | Interest rate reduction  | 118                          | \$70,042            | \$ 3,647                       |
|                               | Payment restructure      | 8                            | 1,372               | —                              |
|                               |                          | 126                          | \$71,414            | \$ 3,647                       |
| Home equity                   |                          |                              |                     |                                |
|                               | Interest rate reduction  | 19                           | \$2,577             | \$ 176                         |
|                               | Payment restructure      | 5                            | 176                 | —                              |
|                               |                          | 24                           | \$2,753             | \$ 176                         |
| Total consumer                |                          |                              |                     |                                |
|                               | Interest rate reduction  | 137                          | \$72,619            | \$ 3,823                       |
|                               | Payment restructure      | 13                           | 1,548               | —                              |
|                               |                          | 150                          | \$74,167            | \$ 3,823                       |
| Commercial loans              |                          |                              |                     |                                |
| Commercial real estate        |                          |                              |                     |                                |
|                               | Interest rate reduction  | 2                            | \$6,071             | \$ 1,884                       |
|                               | Payment restructure      | 1                            | 15,770              | —                              |
|                               |                          | 3                            | \$21,841            | \$ 1,884                       |
| Multifamily                   |                          |                              |                     |                                |
|                               | Interest rate reduction  | 2                            | \$3,221             | \$ —                           |
|                               |                          | 2                            | \$3,221             | \$ —                           |
| Construction/land development |                          |                              |                     |                                |
|                               | Interest rate reduction  | 4                            | \$10,753            | \$ 7,065                       |
|                               | Forgiveness of principal | 2                            | 654                 | 43                             |
|                               |                          | 6                            | \$11,407            | \$ 7,108                       |
| Commercial business           |                          |                              |                     |                                |
|                               | Payment restructure      | 1                            | \$147               | \$ 68                          |
|                               |                          | 1                            | \$147               | \$ 68                          |
| Total commercial              |                          |                              |                     |                                |
|                               | Interest rate reduction  | 8                            | \$20,045            | \$ 8,949                       |
|                               | Payment restructure      | 2                            | 15,917              | 68                             |
|                               | Forgiveness of principal | 2                            | 654                 | 43                             |
|                               |                          | 12                           | \$36,616            | \$ 9,060                       |
| Total loans                   |                          |                              |                     |                                |
|                               | Interest rate reduction  | 145                          | \$92,664            | \$ 12,772                      |
|                               | Payment restructure      | 15                           | 17,465              | 68                             |
|                               | Forgiveness of principal | 2                            | 654                 | 43                             |
|                               |                          | 162                          | \$110,783           | \$ 12,883                      |

(1) Includes loan balances insured by the FHA or guaranteed by the VA of \$13.1 million at December 31, 2012.

Delinquent loans and other real estate owned by loan type consisted of the following.

| (in thousands)                   | At September 30, 2013  |                        | 90 Days or<br>More Past<br>Due and Not<br>Accruing | 90 Days or<br>More Past<br>Due and Still<br>Accruing <sup>(1)</sup> | Total<br>Past Due<br>Loans | Other<br>Real Estate<br>Owned |
|----------------------------------|------------------------|------------------------|----------------------------------------------------|---------------------------------------------------------------------|----------------------------|-------------------------------|
|                                  | 30-59 Days<br>Past Due | 60-89 Days<br>Past Due |                                                    |                                                                     |                            |                               |
| Consumer loans                   |                        |                        |                                                    |                                                                     |                            |                               |
| Single family                    | \$10,359               | \$5,170                | \$12,648                                           | \$43,762                                                            | \$71,939                   | \$5,494                       |
| Home equity                      | 554                    | 100                    | 2,295                                              | —                                                                   | 2,949                      | —                             |
|                                  | 10,913                 | 5,270                  | 14,943                                             | 43,762                                                              | 74,888                     | 5,494                         |
| Commercial loans                 |                        |                        |                                                    |                                                                     |                            |                               |
| Commercial real estate           | —                      | —                      | 6,861                                              | —                                                                   | 6,861                      | —                             |
| Construction/land<br>development | —                      | —                      | 3,544                                              | —                                                                   | 3,544                      | 5,815                         |
| Commercial business              | —                      | —                      | 1,405                                              | —                                                                   | 1,405                      | 957                           |
|                                  | —                      | —                      | 11,810                                             | —                                                                   | 11,810                     | 6,772                         |
| Total                            | \$10,913               | \$5,270                | \$26,753                                           | \$43,762                                                            | \$86,698                   | \$12,266                      |
| At December 31, 2012             |                        |                        |                                                    |                                                                     |                            |                               |
| (in thousands)                   | At December 31, 2012   |                        | 90 Days or<br>More Past<br>Due and Not<br>Accruing | 90 Days or<br>More Past<br>Due and Still<br>Accruing <sup>(1)</sup> | Total<br>Past Due<br>Loans | Other<br>Real Estate<br>Owned |
|                                  | 30-59 Days<br>Past Due | 60-89 Days<br>Past Due |                                                    |                                                                     |                            |                               |
| Consumer loans                   |                        |                        |                                                    |                                                                     |                            |                               |
| Single family                    | \$11,916               | \$4,732                | \$13,304                                           | \$40,658                                                            | \$70,610                   | \$4,071                       |
| Home equity                      | 787                    | 242                    | 2,970                                              | —                                                                   | 3,999                      | —                             |
|                                  | 12,703                 | 4,974                  | 16,274                                             | 40,658                                                              | 74,609                     | 4,071                         |
| Commercial loans                 |                        |                        |                                                    |                                                                     |                            |                               |
| Commercial real estate           | —                      | —                      | 6,403                                              | —                                                                   | 6,403                      | 10,283                        |
| Construction/land<br>development | —                      | —                      | 5,042                                              | —                                                                   | 5,042                      | 9,587                         |
| Commercial business              | —                      | —                      | 2,173                                              | —                                                                   | 2,173                      | —                             |
|                                  | —                      | —                      | 13,618                                             | —                                                                   | 13,618                     | 19,870                        |
| Total                            | \$12,703               | \$4,974                | \$29,892                                           | \$40,658                                                            | \$88,227                   | \$23,941                      |

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

### Liquidity and Capital Management

Liquidity management is primarily intended to ensure we are able to maintain cash flows adequate to fund operations and meet our obligations, including demands of depositors, funding loan commitments, draws on lines of credit and paying any creditors, on a timely and cost-effective basis in various market conditions. Our liquidity profile is influenced by changes in market conditions, the composition of the balance sheet and risk tolerance levels.

HomeStreet, Inc. and HomeStreet Bank have established liquidity guidelines and operating practices that involve the assessment of the sources and uses of cash as well as collateral maintained at the Federal Reserve Bank and FHLB.

The overall liquidity position is projected on a short-term and long-term basis to manage liquidity risk. Furthermore, the projected liquidity position is analyzed and reviewed using stress scenarios on a semi-annual basis to identify potential adverse impacts to off-balance sheet capacity and to ensure operational preparedness.

HomeStreet, Inc. and the Bank have different funding needs and sources of liquidity and separate regulatory capital requirements.

## HomeStreet, Inc.

The main source of liquidity for the Company is proceeds from dividends from the Bank and HomeStreet Capital Corporation. In the past, we have raised longer-term funds through the issuance of senior debt and TruPS. Historically, the main cash outflows were distributions to shareholders, interest and principal payments to creditors and operating expenses. The Company's ability to pay dividends to shareholders depends substantially on dividends received from the Bank.

## HomeStreet Bank

The Bank's primary short-term sources of funds include deposits, advances from the FHLB, repayments and prepayments of loans, proceeds from the sale of loans and investment securities and interest from our loans and investment securities. We have also raised short-term funds through the sale of securities under agreements to repurchase. While scheduled principal repayments on loans are a relatively predictable source of funds, deposit inflows and outflows and loan prepayments are greatly influenced by interest rates, economic conditions and competition. The primary liquidity ratio is defined as net cash, short-term investments and other marketable assets as a percent of net deposits and short-term borrowings. At September 30, 2013, our primary liquidity ratio was 36.8% compared to 43.9% at December 31, 2012.

At September 30, 2013 and December 31, 2012, the Bank had available borrowing capacity of \$91.4 million and \$55.7 million from the FHLB, and \$382.8 million and \$124.3 million from the Federal Reserve Bank of San Francisco, respectively.

Our lending agreement with the FHLB permits it to refuse to make advances during periods in which an "event of default" (as defined in that agreement) exists. An event of default occurs when the FHLB gives notice to the Bank of an intention to take any of a list of permissible actions following the occurrence of specified events or conditions affecting the Bank. The Bank is not aware of any potential event of default at the present time.

## Cash Management

For the nine months ended September 30, 2013, cash and cash equivalents increased \$12.6 million, compared to a decrease of \$241.3 million for the nine months ended September 30, 2012. The following discussion highlights the major activities and transactions that affected our cash flows during these periods.

### Cash flows from operating activities

The Company's operating assets and liabilities are used to support our lending activities, including the origination and sale of mortgage loans. For the nine months ended September 30, 2013, net cash of \$258.2 million was provided by operating activities, as proceeds from the sale of loans held for sale were largely offset by cash used to fund the production of loans held for sale. We believe that cash flows from operations, available cash balances and our ability to generate cash through short-term debt are sufficient to fund our operating liquidity needs. For the nine months ended September 30, 2012, net cash of \$336.1 million was used in operating activities, primarily to fund the production of loans held for sale.

### Cash flows from investing activities

The Company's investing activities primarily include available-for-sale securities and loans originated and held for investment. For the nine months ended September 30, 2013, net cash of \$447.7 million was used in investing



activities, as the Company increased the balances of its investment securities portfolio and its loans held for investment portfolio. For the nine months ended September 30, 2012, net cash of \$39.0 million was used in investing activities, as we used the proceeds from our stock issuance to purchase available-for-sale securities. Net purchases in our investment securities portfolio were \$232.6 million during that period, reflecting management's decision during the quarter to increase this component of the overall asset mix.

#### Cash flows from financing activities

The Company's financing activities are primarily related to customer deposits and net proceeds from the FHLB. For the nine months ended September 30, 2013, net cash of \$202.1 million was provided by financing activities. We had net proceeds of \$79.6 million of FHLB advances as the Company grew its investment securities portfolio by \$157.3 million and its loans held for investment portfolio by \$201.2 million, both of which require additional wholesale funding. The decline of customer deposits due to the maturity of certificates of deposit was partially offset by increased transaction and savings deposits. For the nine months ended September 30, 2012, net cash of \$133.9 million was provided by financing activities as the Company had

net proceeds of \$87.8 million from the issuance of common stock, mostly through our initial public offering, which we used to purchase available-for-sale investment securities.

### Capital Management

Federally insured depository institutions, such as the Bank, are required to maintain a minimum level of regulatory capital. The FDIC regulations recognize two types, or tiers, of capital: “core capital,” or Tier 1 capital, and “supplementary capital,” or Tier 2 capital. The FDIC currently measures a bank’s capital using (1) Tier 1 leverage ratio, (2) Tier 1 risk-based capital ratio and (3) Total risk-based capital ratio. In order to qualify as “well capitalized,” a bank must have a Tier 1 leverage ratio of at least 5.0%, a Tier 1 risk-based capital ratio of at least 6.0% and a Total risk-based capital ratio of at least 10.0%. In order to be deemed “adequately capitalized,” a bank generally must have a Tier 1 leverage ratio of at least 4.0%, a Tier 1 risk-based capital ratio of at least 4.0% and a Total risk-based capital ratio of at least 8.0%. The FDIC retains the right to require a depository institution to maintain a higher capital level based on its particular risk profile.

At September 30, 2013 the Bank was “well capitalized” under the FDIC regulatory requirements.

The following tables present the Bank’s capital amounts and ratios.

#### At September 30, 2013

| (in thousands)                                      | Actual    |       | For Minimum Capital Adequacy Purposes |       | To Be Categorized As “Well Capitalized” Under Prompt Corrective Action Provisions |       |  |   |
|-----------------------------------------------------|-----------|-------|---------------------------------------|-------|-----------------------------------------------------------------------------------|-------|--|---|
|                                                     | Amount    | Ratio | Amount                                | Ratio | Amount                                                                            | Ratio |  |   |
| Tier 1 leverage capital (to average assets)         | \$302,959 | 10.85 | % \$111,691                           | 4.0   | % \$139,614                                                                       | 5.0   |  | % |
| Tier 1 risk-based capital (to risk-weighted assets) | 302,959   | 17.19 | % 70,505                              | 4.0   | % 105,757                                                                         | 6.0   |  | % |
| Total risk-based capital (to risk-weighted assets)  | 325,027   | 18.44 | % 141,010                             | 8.0   | % 176,262                                                                         | 10.0  |  | % |

#### At December 31, 2012

| (in thousands)                                      | Actual    |       | For Minimum Capital Adequacy Purposes |       | To Be Categorized As “Well Capitalized” Under Prompt Corrective Action Provisions |       |  |   |
|-----------------------------------------------------|-----------|-------|---------------------------------------|-------|-----------------------------------------------------------------------------------|-------|--|---|
|                                                     | Amount    | Ratio | Amount                                | Ratio | Amount                                                                            | Ratio |  |   |
| Tier 1 leverage capital (to average assets)         | \$286,963 | 11.78 | % \$97,466                            | 4.0   | % \$121,833                                                                       | 5.0   |  | % |
| Tier 1 risk-based capital (to risk-weighted assets) | 286,963   | 18.05 | % 63,596                              | 4.0   | % 95,394                                                                          | 6.0   |  | % |
| Total risk-based capital (to risk-weighted assets)  | 306,934   | 19.31 | % 127,192                             | 8.0   | % 158,991                                                                         | 10.0  |  | % |

### Basel III

In July 2013, federal banking regulators (including the FDIC and the FRB) adopted new capital rules (the “Rules”). The Rules apply to both depository institutions (such as the Bank) and their holding companies (such as the Company). The Rules reflect, in part, certain standards initially adopted by the Basel Committee on Banking Supervision in December 2010 (which standards are commonly referred to as “Basel III”) as well as requirements contemplated by the Dodd-Frank Act.

Under the Rules, both the Company and the Bank will be required to meet certain minimum capital requirements. The Rules implement a new capital ratio of common equity Tier 1 capital to risk-based assets. Common equity Tier 1 capital generally consists of retained earnings and common stock instruments (subject to certain adjustments), as well as accumulated other comprehensive income (“AOCI”) except to the extent that the Company and the Bank exercise a one-time irrevocable option to exclude certain components of AOCI. Both the Company and the Bank expect to elect this one-time option to exclude certain components of AOCI. Both the Company and the Bank are required to have a common equity Tier 1 capital ratio of 4.5%. In addition, both the Company and the Bank are required to have a Tier 1 leverage ratio of 4.0%, a Tier 1 risk-based ratio of 6.0%

and a total risk-based ratio of 8.0%. Both the Company and the Bank are required to establish a “conservation buffer”, consisting of common equity Tier 1 capital, equal to 2.5%. An institution that does not meet the conservation buffer will be subject to restrictions on certain activities including payment of dividends, stock repurchases and discretionary bonuses to executive officers.

The prompt corrective action rules, which apply to the Bank but not the Company, are modified to include a common equity Tier 1 risk-based ratio and to increase certain other capital requirements for the various thresholds. For example, the requirements for the Bank to be considered well-capitalized under the Rules are a 5.0% Tier 1 leverage ratio, a 6.5% common equity Tier 1 risk-based ratio, an 8.0% Tier 1 risk-based capital ratio and a 10.0% total risk-based capital ratio. To be adequately capitalized, those ratios are 4.0%, 4.5%, 6.0% and 8.0%, respectively.

The Rules modify the manner in which certain capital elements are determined, including but not limited to, requiring certain deductions related to mortgage servicing rights and deferred tax assets. When the federal banking regulators initially proposed new capital rules in 2012, the rules would have phased out trust preferred securities as a component of Tier 1 capital. As finally adopted, however, the Rules permit holding companies with less than \$15 billion in total assets as of December 31, 2009 (which includes the Company) to continue to include trust preferred securities issued prior to May 19, 2010 in Tier 1 capital, generally up to 25% of other Tier 1 capital.

The Rules make changes in the methods of calculating certain risk-based assets, which in turn affects the calculation of risk-based ratios. Higher or more sensitive risk weights are assigned to various categories of assets, among which are commercial real estate, credit facilities that finance the acquisition, development or construction of real property, certain exposures or credit that are 90 days past due or are nonaccrual, foreign exposures, certain corporate exposures, securitization exposures, equity exposures and in certain cases mortgage servicing rights and deferred tax assets.

The Company and the Bank are generally required to begin compliance with the Rules on January 1, 2015. The conservation buffer will be phased in beginning in 2016 and will take full effect on January 1, 2019. Certain calculations under the Rules will also have phase-in periods. We believe that the current capital levels of the Company and the Bank are in compliance with the standards under the Rules including the conservation buffer.

#### Accounting Developments

See the Consolidated Financial Statements—Note 1, Summary of Significant Accounting Policies for a discussion of Accounting Developments.

### ITEM 3 QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

#### Market Risk Management

For a discussion of the quantitative and qualitative disclosures about market risk, see Part II, Item 7A Quantitative and Qualitative Disclosures About Market Risk, Market Risk Management in our 2012 Annual Report on Form 10-K.

### ITEM 4 CONTROLS AND PROCEDURES

#### Disclosure Controls and Procedures

The Company carried out an evaluation, with the participation of our management, and under the supervision of our Chief Executive Officer and Chief Accounting Officer, of the effectiveness of our disclosure controls and procedures (as defined under Rule 13a-15(e) and Rule 15d-15(e) under the Exchange Act) as of the end of the period covered by this report. Based upon that evaluation, our Chief Executive Officer and Chief Accounting Officer concluded that our disclosure controls and procedures were effective as of September 30, 2013.

#### Internal Control Over Financial Reporting

There were no changes to our internal control over financial reporting that occurred during the quarter ended September 30, 2013 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## PART II – OTHER INFORMATION

### ITEM 1 LEGAL PROCEEDINGS

Because the nature of our business involves the collection of numerous accounts, the validity of liens and compliance with various state and federal lending laws, we are subject to various legal proceedings in the ordinary course of our business related to foreclosures, bankruptcies, condemnation and quiet title actions and alleged statutory and regulatory violations. We are also subject to legal proceedings in the ordinary course of business related to employment matters. We do not expect that these proceedings, taken as a whole, will have a material adverse effect on our business, financial position or our results of operations. There are currently no matters that, in the opinion of management, would have a material adverse effect on our consolidated financial position, results of operation or liquidity, or for which there would be a reasonable possibility of such a material adverse effect based on information known at this time.

### ITEM 1A RISK FACTORS

An investment in the Company is speculative and involves a high degree of risk. The risks described below represent some of the material risks you should carefully consider before making an investment decision. If any of these risks occur, our business, capital, liquidity, financial condition and results of operations could be materially and adversely affected, in which case the price of our common stock could decline significantly and you could lose all or a part of your investment. The risk factors described below are not the only risks that may affect us. Additional risks and uncertainties not presently known to us, or that we currently deem immaterial, may also become important factors that materially and adversely affect our business, capital, liquidity, financial condition and results of operations. You should carefully consider the following risk factors, together with the other information contained in this Report and other documents we file with the SEC, before making an investment decision about the Company.

Fluctuations in interest rates could adversely affect the value of our assets and reduce our net interest income and noninterest income thereby adversely affecting our earnings and profitability.

Interest rates may be affected by many factors beyond our control, including general and economic conditions and the monetary and fiscal policies of various governmental and regulatory authorities. Changes in interest rates may reduce our mortgage revenues, which would negatively impact our noninterest income and to a lesser extent our net interest income, and may impact demand for our residential loan products and the revenue realized on the sale of loans. Our earnings are also dependent on the difference between the interest earned on loans and investments and the interest paid on deposits and borrowings. Changes in market interest rates impact the rates earned on loans and investment securities and the rates paid on deposits and borrowings and may negatively impact our ability to attract deposits, make loans and achieve satisfactory interest rate spreads, which could adversely affect our financial condition or results of operations. In addition, changes to market interest rates may impact the level of loans, deposits and investments and the credit quality of existing loans.

Our securities portfolio includes securities that are insured or guaranteed by U.S. government agencies or government-sponsored enterprises and other securities that are sensitive to interest rate fluctuations. The unrealized gains or losses in our available-for-sale portfolio are reported as a separate component of shareholders' equity until realized upon sale. As a result, future interest rate fluctuations may impact shareholders' equity, causing material fluctuations from quarter to quarter. Failure to hold our securities until maturity or until market conditions are favorable for a sale could adversely affect our financial condition.

A significant portion of our noninterest income is derived from originating residential mortgage loans and selling them into the secondary market. That business has benefited from a long period of historically low interest rates. To the extent interest rates rise, particularly if they rise substantially, we may experience a reduction in mortgage

financing and refinancing of new home purchases. These factors have and may in the future further negatively affect our mortgage loan origination volume and adversely affect our noninterest income.

Our mortgage servicing rights carry interest rate risk because the total amount of servicing fees earned, as well as changes in fair-market value, fluctuate based on expected loan prepayments (affecting the expected average life of a portfolio of residential mortgage servicing rights). The rate of prepayment of residential mortgage loans may be influenced by changing national and regional economic trends, such as recessions or depressed real estate markets, as well as the difference between interest rates on existing residential mortgage loans relative to prevailing residential mortgage rates. Changes in prepayment rates are therefore difficult for us to predict. An increase in the general level of interest rates may adversely affect the ability of some borrowers to pay the interest and principal of their obligations. During periods of declining interest rates, many residential borrowers

refinance their mortgage loans. The loan administration fee income related to the residential mortgage loan servicing rights corresponding to a mortgage loan decreases as mortgage loans are prepaid. Consequently, the fair value of portfolios of residential mortgage loan servicing rights tend to decrease during periods of declining interest rates, because greater prepayments can be expected and, as a result, the amount of loan administration income received also decreases.

A change in federal monetary policy could adversely impact our mortgage banking revenues.

The Federal Reserve System or Federal Reserve is responsible for regulating the supply of money in the United States, and as a result its monetary policies strongly influence our costs of funds for lending and investing as well as the rate of return we are able to earn on those loans and investments, both of which impact our net interest income and net interest margin. The Federal Reserve Board's interest rate policies can also materially affect the value of financial instruments we hold, including debt securities and mortgage servicing rights, or MSRs. These monetary policies can also negatively impact our borrowers, which in turn may increase the risk that they will be unable to pay their loans according to the terms or at all. We have no control over the monetary policies of the Federal Reserve Board and cannot predict when changes are expected or what the magnitude of such changes may be.

As a result of the Federal Reserve Board's concerns regarding continued slow economic growth, the Federal Reserve Board's Open Market Committee expanded its standing monetary policy, known as "quantitative easing," in September 2012 to provide for a purchases by the Federal Reserve of up to \$40 billion per month of mortgage-backed securities in the secondary market and up to \$45 billion per month of longer-term United States Treasury securities. This program, which is intended to bolster the U.S. economy by retaining relatively low interest rates to promote increased spending, was adopted in 2008 and originally provided for the repurchase of only treasury securities. The inclusion of mortgage-backed securities was intended to have the effect of maintaining historically low mortgage interest rates. Because a substantial portion of our revenues and our net income historically have been, and in the foreseeable future are expected to be, derived from gain on the origination and sale of mortgage loans and on the continuing servicing of those loans, the Federal Reserve Board's policy may have had, and for so long as the program continues, may continue to have, the effect of supporting higher revenues than might otherwise be available. Contrarily, a reduction in or termination of this policy, absent a significant rebound in employment and real wages, would likely reduce mortgage originations throughout the United States, including ours. Recent speculation regarding potential changes in this policy has led to volatility in the financial markets and may have been a factor in increasing mortgage interest rates, reducing the overall demand in the market for mortgage loan origination. An actual reduction or termination of the quantitative easing program would likely further raise interest rates, which could reduce our mortgage origination revenues and in turn have a material adverse impact upon our business.

We may incur significant losses as a result of ineffective hedging of interest rate risk related to our loans sold with a reservation of servicing rights.

Both the value our single family mortgage servicing rights, or MSRs, and the value of our single family loans held for sale changes with fluctuations in interest rates, among other things, reflecting the changing expectations of mortgage prepayment activity. To mitigate potential losses of fair value of single family loans held for sale and MSRs related to changes in interest rates, we actively hedge this risk with financial derivative instruments. Hedging is a complex process, requiring sophisticated models, experienced and skilled personnel and continual monitoring. Changes in the value of our hedging instruments may not correlate with changes in the value of our single family loans held for sale and MSRs, and we could incur a net valuation loss as a result of our hedging activities. Following the expansion of our single family mortgage operations in early 2012 through the addition of a significant number of single family mortgage origination personnel, the volume of our single family loans held for sale and MSRs has increased. The increase in volume in turn increases our exposure to the risks associated with the impact of interest rate fluctuations on single family loans held for sale and MSRs.



A substantial portion of our revenue is derived from residential mortgage lending which is a market sector that has significant volatility and is facing significant regulatory changes which take effect in January 2014.

A substantial portion of our consolidated net revenues (net interest income plus noninterest income) are derived from originating and selling residential mortgages. Residential mortgage lending in general has experienced substantial volatility in recent periods. Moreover, a significant increase in interest rates, which we experienced in the second quarter of 2013, may materially and adversely affect our future loan origination volume, margins, and the value of the collateral securing our outstanding loans, may increase rates of borrower default, and may otherwise adversely affect our business.

Difficult market conditions have adversely affected and may continue to have an adverse effect on our business.

During the period from early 2008 through most of 2011, the United States economy in general, and the financial institutions sector in particular, experienced a severe downturn owing to a number of factors that affected virtually every aspect of our business. While these conditions have moderated, uncertainty continues to affect our business, and thus raises risk as to our ability to maintain profitability at current levels.

In particular, we may face risks related to market conditions that may negatively impact our business opportunities and plans, such as:

- uncertainty related to increased regulation and aggressive governmental enforcement in the financial sector generally and the mortgage banking business specifically, including increased costs of compliance;
- the models we use to assess the creditworthiness of our customers may prove less reliable than we had anticipated in predicting future behaviors which may impair our ability to make good underwriting decisions;
- challenges in accurately estimating the ability of our borrowers to repay their loans if our forecasts of economic conditions and other economic predictions are not accurate;
- increases in FDIC insurance premiums due to depletion of that agency's insurance funds;
- restrictions in our ability to engage in routine funding transactions due to the commercial soundness of other financial institutions and government sponsored entities ("GSEs"); and
- uncertainty regarding future political developments and fiscal policy.

If recovery from the economic recession slows or if we experience another recessionary dip, our ability to access capital and our business, financial condition and results of operations may be adversely impacted.

We have been rapidly increasing the growth of our mortgage banking business through hiring of additional loan officers and support personnel, and the costs associated with that growth may not keep pace with the anticipated increase in our revenues.

Beginning in February of 2012, we have hired a substantial number of mortgage loan personnel, including large groups of employees previously affiliated with MetLife Home Loans. In addition to increasing our exposure to a more volatile segment of our business, the rapid expansion of our single family mortgage loan operations through hiring a large number of additional employees in our traditional markets and in additional Western states involves significant expense and exposes us to potential additional risks, including:

- Expenses related to hiring and training a large number of new employees;
- Higher compensation costs relative to production in the initial months of new employment;
- Increased compliance costs;
- Costs associated with opening new offices that may be needed to provide for the new employees;
- New state laws and regulations to which we have not been previously subject;
- Diversion of management's attention from the daily operations of other aspects of the business;
- The potential of litigation related from prior employers related to the portability of their employees;
- The potential loss of other key employees.

We cannot give assurance that these costs and other risks will be fully offset or mitigated by increased revenue generated by the expansion in this business line in the near future, or at all.

Efforts to integrate future acquisitions could consume significant resources.

In addition to our recently announced acquisitions of Fortune Bank, Yakima National Bank and agreements to acquire two retail branches of AmericanWest Bank, which are expected to close in the fourth quarter of 2013, we may seek out other acquisitions in the near future as we look for ways to continue to grow our business and our market share. These acquisitions and pending acquisitions and any other future acquisition we may undertake involve numerous risks related to the integration of the acquired assets or entity into HomeStreet or HomeStreet Bank, including risks

that arise after the transaction is completed. These risks include:

- difficulties in integrating the operations, technologies, and personnel of the acquired companies;
- difficulties in implementing internal controls over financial reporting;
- diversion of management's attention from normal daily operations of the business;
- inability to maintain the key business relationships and the reputations of acquired businesses;

entry into markets in which we have limited or no prior experience and in which competitors have stronger market positions;  
responsibility for the liabilities of acquired businesses;  
inability to maintain our internal standards, controls, procedures and policies at the acquired companies or businesses; and  
potential loss of key employees of the acquired companies.  
Difficulties in integrating any or all of these acquisitions may increase our costs and adversely impact our financial condition and results of operations.  
We cannot assure you that we will remain profitable.

We have sustained significant losses in the past and cannot guarantee that we will remain profitable or be able to maintain the level of profit we are currently experiencing. Many factors determine whether or not we will be profitable in a given quarter, and our ability to remain profitable is threatened by a myriad of issues, including:  
Increased costs from growth through acquisition of new loan officers, originators and servicing personnel as well as the acquisition of other entities such as Fortune and Yakima National Bank could exceed the income growth anticipated from these opportunities, especially in the short term as these new hires and new acquisitions are integrated into our business;  
Changes in the interest rate environment may limit our ability to make loans, decrease our net interest income and noninterest income, reduce demand for loans, increase the cost of deposits and otherwise negatively impact our financial situation;  
Volatility in mortgage markets, which is driven by factors outside of our control such as interest rate changes, housing inventory and general economic conditions, may negatively impact our ability to originate loans and change the fair value of our existing loans;  
Changes in governmental sponsored entities and their ability to buy our loans in the secondary market may have significant changes in our ability to recognize income on sale of our loans to third parties;  
Competition in the mortgage market industry may drive down the interest rates we are able to offer while at the same time changes in the cost structures and fees of governmental sponsored entities to whom we sell many of these loans may compress our margins and reduce our net income and profitability; and  
Our hedging strategies to offset risks related to interest rate changes may not prove to be successful and may result in unanticipated losses for the Company.  
These and other factors may limit our ability to generate revenue in excess of our costs in any given quarter, which in turn may result in a lower rate of profitability or even substantial losses for the Company.  
HomeStreet, Inc. primarily relies on dividends from the Bank and payment of dividends by the Bank may be limited by applicable laws and regulations.

HomeStreet, Inc. is a separate legal entity from the Bank, and although we do receive some dividends from HomeStreet Capital Corporation, the primary source of our funds from which we service our debt, pay dividends to our shareholders and otherwise satisfy our obligations is dividends from the Bank. The availability of dividends from the Bank is limited by various statutes and regulations, as well as by our policy of retaining a significant portion of our earnings to support the Bank's operations. If the Bank cannot pay dividends to us, we may be limited in our ability to service our debts, fund the Company's operations and pay dividends to the Company's shareholders.

The significant concentration of real estate secured loans in our portfolio has had and may continue to have a negative impact on our asset quality and profitability.

Substantially all of our loans are secured by real property. Our real estate secured lending is generally sensitive to national, regional and local economic conditions, making loss levels difficult to predict. Declines in real estate sales and prices, significant increases in interest rates, and a degeneration in prevailing economic conditions may result in higher than expected loan delinquencies, foreclosures, problem loans, OREO, net charge-offs and provisions for credit

and OREO losses. Although real estate prices have recently increased in markets in which we operate, if market values were to decline again, the collateral for our loans may provide less security and our ability to recover the principal, interest and costs due on defaulted loans by selling the underlying real estate will be diminished, leaving us more likely to suffer additional losses on defaulted loans. Such declines may have a greater effect on our earnings and capital than on the earnings and capital of financial institutions whose loan portfolios are more geographically diversified.

Worsening conditions in the real estate market and higher than normal delinquency and default rates on loans could cause other adverse consequences for us, including:

- the reduction of cash flows and capital resources, as we are required to make cash advances to meet contractual obligations to investors, process foreclosures, and maintain, repair and market foreclosed properties;
- declining mortgage servicing fee revenues;
- increasing loan servicing costs;
- declining fair value on our mortgage servicing rights; and
- declining fair values and liquidity of securities held in our investment portfolio that are collateralized by mortgage obligations.

Our allowance for loan losses may prove inadequate or we may be negatively affected by credit risk exposures. Future additions to our allowance for loan losses will reduce our earnings.

Our business depends on the creditworthiness of our customers. As with most financial institutions, we maintain an allowance for loan losses to provide for defaults and nonperformance, which represents management's best estimate of probable incurred losses inherent in the loan portfolio. Management's estimate is the result of our continuing evaluation of specific credit risks and loan loss experience, current loan portfolio quality, present economic, political and regulatory conditions, industry concentrations and other factors that may indicate future loan losses. The determination of the appropriate level of the allowance for loan losses inherently involves a high degree of subjectivity and judgment and requires us to make estimates of current credit risks and future trends, all of which may undergo material changes. Generally, our nonperforming loans and OREO reflect operating difficulties of individual borrowers and weaknesses in the economies of the markets we serve. This allowance may not be adequate to cover actual losses, and future provisions for losses could materially and adversely affect our financial condition, results of operations and cash flows.

In addition, we are currently pursuing a strategy of growth through acquisition, including the acquisitions of Fortune Bank, Yakima National Bank and the pending acquisitions of two branches of AmericanWest Bank. Upon the closing of those acquisitions, we have added and will be adding loans held by the acquired company or branch to our books. Although we review loan quality as part of our diligence in considering any acquisition, the addition of such loans may increase our credit risk exposure, requiring an increase in our allowance for loan losses or we may experience adverse effects to our financial condition, results of operations and cash flows stemming from losses on those additional loans.

If we breach any of the representations or warranties we make to a purchaser when we sell mortgage loans, we may be liable to the purchaser for unpaid principal and interest on the loan.

When we sell mortgage loans in the ordinary course of business, we are required to make certain representations and warranties to the purchaser about the mortgage loans and the manner in which they were originated. Our loan sale agreements require us to repurchase mortgage loans if we have breached any of these representations or warranties, in which case we may be required to repurchase such loan and record a loss upon repurchase and/or bear any subsequent loss on the loan. We may not have any remedies available to us against a third party for such losses, or the remedies available to us may not be as broad as the remedies available to the purchaser of the mortgage loan against us. In addition, if there are remedies against a third party available to us, we face further risk that such third party may not have the financial capacity to perform remedies that otherwise may be available to us. Therefore, if a purchaser enforces remedies against us, we may not be able to recover our losses from a third party and may be required to bear the full amount of the related loss. If repurchase and indemnity demands increase, our liquidity, results of operations and financial condition will be adversely affected.

If we breach any representations and warranties or fail to follow guidelines when originating a FHA/HUD-insured loan or a VA-guaranteed loan, we may lose the insurance or guarantee on the loan and suffer losses and/or pay penalties.

We originate and purchase, sell and thereafter service single family loans that are insured by FHA/HUD or guaranteed by the VA. We certify to the FHA/HUD and the VA that the loans meet their requirements and guidelines. The FHA/HUD and VA audit loans that are insured or guaranteed under their programs, including audits of our processes and procedures as well as individual loan documentation. Violations of guidelines can result in monetary penalties or require us to provide indemnifications against loss or loans declared ineligible for their programs. In the past, monetary penalties and losses from indemnifications have not created material losses to the Bank. As a result of the housing crisis, the FHA/HUD has stepped up enforcement initiatives. In addition to regular FHA/HUD audits, HUD's Inspector General has become active in enforcing FHA regulations with respect to individual loans and has partnered with the Department of Justice ("DOJ") in filing lawsuits against lenders for systemic violations. The penalties resulting from such lawsuits can be much more severe, since systemic violations

can be applied to groups of loans and penalties may be subject to treble damages. The DOJ has used the Federal False Claims Act in prosecuting these lawsuits. Because of our significant origination of FHA/HUD insured and VA guaranteed loans, if the DOJ were to find potential violations by the Bank, we could be subject to material monetary penalties and/or losses, and may even be subject to lawsuits alleging systemic violations which could result in treble damages.

Changes in fee structures by third party loan purchasers and mortgage insurers may decrease the margin we can recognize on conforming home loans and may adversely impact our results of operations.

Recently, certain third party loan purchasers have revised their fee structures and increased the costs of doing business with them. For example, certain purchasers of conforming loans, including Fannie Mae and Freddie Mac, raised costs for guarantor fees and other required fees and payments. Additionally, the FHA raised costs for premiums and extended the period for which private mortgage insurance is required on a loan purchased by them. These changes increased the cost of selling conforming loans to third party loan purchasers which in turn decreases our margin and negatively impacts our profitability. Additional changes in the future from third party loan purchasers may have a negative impact on our ability to originate loans to be sold because of the increased costs of such loans and may decrease our profitability with respect to loans held for sale. In addition, any significant adverse change in the level of activity in the secondary market or the underwriting criteria of these third party loan purchasers could negatively impact our results of business, operations and cash flows.

We may face risk of loss if we purchase loans from a seller that fails to satisfy its indemnification obligations.

We generally receive representations and warranties from the originators and sellers from whom we purchase loans and servicing rights such that if a loan defaults and there has been a breach of such representations and warranties, we may be able to pursue a remedy against the seller of the loan for the unpaid principal and interest on the defaulted loan. However, if the originator and/or seller breach such representations and warranties and does not have the financial capacity to pay the related damages, we may be subject to the risk of loss for such loan as the originator or seller may not be able to pay such damages or repurchase loans when called upon by us to do so. Currently, we only purchase loans from Windermere Mortgage Services Series LLC, an affiliated business arrangement with certain Windermere real estate brokerage franchise owners.

The proposed restructuring or elimination of Fannie Mae and Freddie Mac could negatively affect our business.

We originate and purchase, sell and thereafter service single family and multifamily mortgages under the Fannie Mae, and to a lesser extent the Freddie Mac single family purchase programs and the Fannie Mae multifamily DUS program. Since the nationwide downturn in residential mortgage lending that began in 2007 and the placement of Fannie Mae and Freddie Mac into conservatorship, Congress and various executive branch agencies have offered a wide range of proposals aimed at restructuring these agencies.

In August 2012, the Treasury Department entered into amendments to its senior preferred stock purchase agreements with each of Fannie Mae and Freddie Mac that require those agencies to reduce the amount of mortgage assets they hold, setting a cap of \$650 billion for December 31, 2012 and requiring a decrease of at least 15% per year for each year thereafter, to a minimum of \$250 billion, as a step toward winding down those agencies. Most recently, the House Financial Services Committee recommended legislation that would wind down Fannie Mae and Freddie Mac with the expectation that a private market would emerge to purchase, bundle and resell conforming loans into the secondary market in their stead, subject to oversight and regulation from the federal government.

Whether or not such a private market would emerge is unknown. We cannot predict whether or not this or any other proposed legislation will pass, when or if a dismantling of Fannie Mae and Freddie Mac may occur, what the future of the mortgage market might be as a following a dismantling of Fannie Mae and Freddie Mac, or how such legislation or any alternative legislation that may be proposed might impact our business. Moreover, we cannot predict what



regulation may apply to private third party loan purchasers following a move away from government sponsored entities as the largest entities that purchase, bundle and securitize loans, although the Dodd-Frank Act already imposes a requirement that private securitizers of mortgage and other asset backed securities retain, subject to certain exemptions, not less than five percent of the credit risk of the mortgages or other assets backing the securities.

While there is no clarity on what will ultimately happen to Fannie Mae and Freddie Mac, any dismantling of those entities, or any other legislation that calls for the restructuring of Fannie those entities in such a way that restricts their loan purchase programs, may have a material adverse effect on our ability to originate loans and sell those loans to third party purchasers, which in turn would have a material adverse effect on our business and results of operations. Moreover, we have recorded on our balance sheet an intangible asset (mortgage servicing rights, or MSRs) relating to our right to service single and multifamily loans sold to Fannie Mae and Freddie Mac. That MSR asset was valued at \$146.3 million at September 30, 2013

and \$95.5 million at December 31, 2012. Changes in Fannie Mae's and Freddie Mac's policies and operations that adversely affect our single family residential loan and DUS mortgage servicing assets may require us to record impairment charges to the value of these assets, and significant impairment charges could be material and adversely affect our business.

Through our wholly owned subsidiary HomeStreet Capital Corporation, we participate as a lender in the DUS program. Fannie Mae delegates responsibility for originating, underwriting and servicing mortgages, and we assume a limited portion of the risk of loss during the remaining term on each commercial mortgage loan that we sell to Fannie Mae.

We are subject to extensive regulation that has restricted and could further restrict our activities, including capital distributions, and impose financial requirements or limitations on the conduct of our business.

Our operations are subject to extensive regulation by federal, state and local governmental authorities, including the FDIC, the Washington Department of Financial Institutions and the Federal Reserve, and are subject to various laws and judicial and administrative decisions imposing requirements and restrictions on part or all of our operations. Because our business is highly regulated, the laws, rules and regulations to which we are subject are evolving and change frequently. Changes to those laws, rules and regulations are also sometimes retroactively applied. Furthermore, the on-site examination cycle for an institution in our circumstances is frequent and extensive. Examination findings by the regulatory agencies may result in adverse consequences to the Company or the Bank. Regulatory authorities have extensive discretion in their supervisory and enforcement activities, including the authority to restrict our operations, adversely reclassify our assets, determine the level of deposit premiums assessed and require us to increase our allowance for loan losses.

The Dodd-Frank Act is expected to increase our costs of operations, increase our regulatory and legal risks and may have a material negative effect on us.

The Dodd-Frank Act significantly changes the laws as they apply to financial institutions and revises and expands the rulemaking, supervisory and enforcement authority of federal banking regulators. It is also expected to have a material impact on our relationships with current and future customers.

Some of these changes are effective immediately, though many are being phased in gradually. In addition, the statute in many instances calls for regulatory rulemaking to implement its provisions, not all of which have been completed, so the precise contours of the law and its effects on us cannot yet be fully understood. The provisions of the Dodd-Frank Act and the subsequent exercise by regulators of their revised and expanded powers thereunder could materially and negatively impact the profitability of our business, the value of assets we hold or the collateral available for our loans, require changes to business practices or force us to discontinue businesses and expose us to additional costs, taxes, liabilities, enforcement actions and reputational risk. See "Regulation and Supervision" in Part I - Item 1 of our Annual Report on Form 10-K for the year ended December 31, 2012.

We will be subject to more stringent capital requirements.

On July 2, 2013, the U.S. federal banking regulators (including the Federal Reserve and FDIC) jointly announced the adoption of new rules relating to capital standards requirements, including requirements contemplated by the Dodd-Frank Act as well as certain standards initially adopted by the Basel Committee on Banking Supervision, which standards are commonly referred to as Basel III. A substantial portion of these rules will apply to both the Company and the Bank beginning in January 2015. As part of these new rules, both the Company and the Bank will be required to have a common equity Tier 1 capital ratio of 4.5%, have a Tier 1 leverage ratio of 4.0%, a Tier 1 risk-based ratio of 6.0% and a total risk-based ratio of 8.0%. In addition, both the Company and the Bank will be required to establish a

“conservation buffer”, consisting of common equity Tier 1 capital, equal to 2.5%, which in effect brings the common equity Tier 1 capital ratio requirement to 7% to preclude regulatory restrictions on specified operations. In this regard, any institution that does not meet the conservation buffer will be subject to restrictions on certain activities including payment of dividends, stock repurchases and discretionary bonuses to executive officers. Additional prompt corrective action rules will apply to the Bank, including higher ratio requirements for the Bank to be considered well-capitalized. The new rules also modify the manner for determining when certain capital elements are included in the ration calculations. Maintaining higher capital levels may result in lower profits for the Company as we will not be able to grow our lending as quickly as we might otherwise be able to do if we were to maintain lower capital levels.

We have in the past and may again in the future be subject to certain specific regulatory constraints on the activities of the Bank and the Company, which could result in us not being as profitable as banks that are not subject to such conditions.

Between 2009 and 2013, both the Bank and the Company operated under specific regulatory restrictions on their operations. These restrictions were intended to preserve and strengthen the Bank's capital adequacy and improve its asset quality, among other things,

and limited our ability to pay cash dividends or to renew or incur debt. The Bank operated under a cease and desist order from May 8, 2009 until March 26, 2012, when that order was replaced with a memorandum of understanding (“MOU”). On December 27, 2012, the FDIC determined that the MOU was no longer necessary and, as a result, terminated the MOU. Additionally, the Company, which was subject to a cease and desist order since May 8, 2009, had such order terminated effective March 26, 2013. However, we cannot offer assurances that we can avoid the adverse conditions that caused us to fall below desirable performance levels, and if that were to happen, we may again become subject to more stringent regulatory orders and other regulatory enforcement actions.

New federal and state legislation, case law or regulatory action may negatively impact our business.

Enacted legislation, including the Dodd-Frank Act, as well as future federal and state legislation, case law and regulations could require us to revise our operations and change certain business practices, impose additional costs, reduce our revenue and earnings and otherwise adversely impact our business, financial condition and results of operations. For instance,

Recent legislation and court decisions with precedential value could allow judges to modify the terms of residential mortgages in bankruptcy proceedings and could hinder our ability to foreclose promptly on defaulted mortgage loans or expand assignee liability for certain violations in the mortgage loan origination process, any or all of which could adversely affect our business or result in our being held responsible for violations in the mortgage loan origination process.

Congress and various regulatory authorities have proposed programs that would require a reduction in principal balances of “underwater” residential mortgages, which if implemented would tend to reduce loan servicing income and which might adversely affect the carrying values of portfolio loans.

Recent court cases in Oregon and Washington have challenged whether Mortgage Electronic Registration Systems, Inc. (“MERS”) meets the statutory definition of deed of trust beneficiary under applicable state laws. Based on decisions handed down by courts in Oregon, we and other servicers of MERS related loans have elected to foreclose through judicial procedures in Oregon, resulting in increased foreclosure costs, longer foreclosure timelines and additional delays. If the Oregon case law is upheld on appeal, and/or if the Washington courts issue a similar decision in the cases pending before them, our foreclosure costs and foreclosure timelines may continue to increase, which in turn, could increase our single family loan delinquencies and adversely affect our cost of doing business and results of operations

We cannot offer assurances as to which, if any, of these initiatives may be adopted or, if adopted, to what extent they would affect our business. Any such initiatives may limit our ability to take actions that may be essential to preserve the value of the mortgage loans we service or hold for investment. Any restriction on our ability to foreclose on a loan, any requirement that we forego a portion of the amount otherwise due on a loan or any requirement that we modify any original loan terms may require us to advance principal, interest, tax and insurance payments, which would negatively impact our business, financial condition, liquidity and results of operations. Given the relatively high percentage of our business that derives from originating residential mortgages, any such actions are likely to have a significant impact on our business, and the effects we experience will likely be disproportionately high in comparison to financial institutions whose residential mortgage lending is more attenuated.

In addition, while these legislative and regulatory proposals generally have focused primarily, if not exclusively, on residential mortgage origination, other laws and regulations may be enacted that affect the manner in which we do business and the products and services that we provide, restrict our ability to growth through acquisition, restrict our ability to compete in our current business or expand into any new business, and impose additional fees, assessments or taxes on us or increase our regulatory oversight. For example, our consumer business, including our mortgage, credit card, and other consumer lending and non-lending businesses, may be adversely affected by the policies enacted by the Consumer Financial Protection Bureau (CFPB) which has broad rulemaking authority over consumer financial

products and services. The full impact of CFPB's activities on our business is still unknown, however, we anticipate that CFPB actions may increase our compliance costs and require changes in our business practices as a result of new regulations and requirements and could limit the products and services we are able to provide to customers. We are unable to predict whether U.S. federal, state or local authorities, or other pertinent bodies, will enact legislation, laws, rules, regulations, handbooks, guidelines or similar provisions that will affect our business or require changes in our practices in the future, and any such changes could adversely affect our cost of doing business and profitability. See "Regulation and Supervision - Regulation and Supervision" in Part I- Item 1 of our Annual Report on Form 10-K for the year ended December 31, 2012.

An important information technology systems provider was previously identified as having internal control deficiencies, and the persistence or recurrence of such issues could give rise to significant risks to the Bank and the Company.

In the first quarter of 2012 and again in the second quarter of 2013, we were notified that the provider of one of the Bank's critical information technology and transaction processing systems was identified as posing a significant risk to banking operations for that vendor's clients. That vendor encountered a significant cyber-attack and related computer fraud, and there have been indications that in the absence of a prompt remediation of known and unknown deficiencies, that vendor's systems may create enhanced risk for users.

The Bank does not use this system that was the subject of the cyber-attack; however, the Bank uses this vendor for a wide variety of important functions, and given their progress in remediating these issues, and subject to the vendor's continued progress, we have plans to increase our reliance on this vendor and its products and services. Our Board of Directors, as well as the Bank's Board of Directors, were briefed on this development and are provided quarterly updates on the vendor's remediation efforts. Although the vendor believed all of the outstanding actions had been completed by March 31, 2013, a subsequent assessment found those remediation activities had not been wholly effective. If these concerns are not addressed effectively, the Bank could experience a number of potentially materially adverse consequences, including:

- greater than normal exposure to compliance problems, which could lead to adverse regulatory actions, including potential enforcement actions;
- the need to replace one or more of our information systems providers, which could lead to increased costs, disruptions in our relationships with one or more customers, management distractions, and other difficulties;
- potential claims by customers, including class action claims, resulting from actual or alleged compromises of consumer or business financial information;
- difficulties in maintaining an adequate system of internal controls and procedures and internal control over financial reporting;
- the loss of confidence of one or more of our customers, or reputational harm associated with the use of these systems, particularly if our customers experience actual difficulties, losses or attacks; and
- a dispute with this vendor over the adequacy of the products and services for which we contracted, potentially including increases in legal fees and other litigation costs.

A failure in or breach of our security systems or infrastructure, or those of our third party vendors and other service providers, resulting from cyber-attacks, could disrupt our businesses, result in the disclosure or misuse of confidential or proprietary information, damage our reputation, increase our costs and cause losses.

Information security risks for financial institutions have generally increased in recent years in part because of the proliferation of new technologies, the use of the Internet and telecommunications technologies to conduct financial transactions, and the increased sophistication and activities of organized crime, hackers, terrorists, activists, and other external parties. Those parties also may attempt to fraudulently induce employees, customers, or other users of our systems to disclose confidential information in order to gain access to our data or that of our customers. Our operations rely on the secure processing, transmission and storage of confidential information in our computer systems and networks, either managed directly by us or through our data processing vendors. In addition, to access our products and services, our customers may use personal smartphones, tablet PC's, and other mobile devices that are beyond our control systems. Although we believe we have robust information security procedures and controls, our technologies, systems, networks, and our customers' devices may become the target of cyber-attacks or information security breaches that could result in the unauthorized release, gathering, monitoring, misuse, loss or destruction of Company or our customers' confidential, proprietary and other information, or otherwise disrupt the Company's or its customers' or other third parties' business operations.

Third parties with which we do business or that facilitate our business activities, including exchanges, clearing houses, financial intermediaries or vendors that provide services or security solutions for our operations, could also be sources of operational and information security risk to us, including from breakdowns or failures of their own systems or capacity constraints.

To date we have not experienced any material losses relating to cyber-attacks or other information security breaches, but there can be no assurance that we will not suffer such attacks and losses in the future. Our risk and exposure to these matters remains heightened because of, among other things, the evolving nature of these threats, our plans to continue to implement our Internet banking and mobile banking channel, our expanding operations and the outsourcing of a significant portion of our business operations. As a result, cyber-security and the continued development and enhancement of our controls, processes and practices designed to protect customer information, our systems, computers, software, data and networks from attack, damage

or unauthorized access remain a priority for the Company. As cyber threats continue to evolve, we may be required to expend significant additional resources to insure, to continue to modify or enhance our protective measures or to investigate and remediate important information security vulnerabilities.

Disruptions or failures in the physical infrastructure or operating systems that support our businesses and customers, or cyber-attacks or security breaches of the networks, systems or devices that our customers use to access our products and services could result in customer attrition, financial losses, the inability of our customers to transact business with us, violations of applicable privacy and other laws, regulatory fines, penalties or intervention, reputational damage, reimbursement or other compensation costs, and/or additional compliance costs, any of which could materially and adversely affect our results of operations or financial condition.

The network and computer systems on which we depend could fail or experience security breaches.

Our computer systems could be vulnerable to unforeseen problems. Because we conduct a part of our business over the Internet and outsource several critical functions to third parties, operations will depend on our ability, as well as the ability of third-party service providers, to protect computer systems and network infrastructure against damage from fire, power loss, telecommunications failure, physical break-ins or similar catastrophic events. Any damage or failure that causes interruptions in operations could have a material adverse effect on our business, financial condition and results of operations.

In addition, a significant barrier to online financial transactions is the secure transmission of confidential information over public networks. Our Internet banking system relies on encryption and authentication technology to provide the security and authentication necessary to effect secure transmission of confidential information. Advances in computer capabilities, new discoveries in the field of cryptography or other developments could result in a compromise or breach of the algorithms our third-party service providers use to protect customer transaction data. If any such compromise of security were to occur, it could have a material adverse effect on our business, financial condition and results of operations.

Our real estate lending also exposes us to environmental liabilities.

In the course of our business, it is necessary to foreclose and take title to real estate, which could subject us to environmental liabilities with respect to these properties. Hazardous substances or waste, contaminants, pollutants or sources thereof may be discovered on properties during our ownership or after a sale to a third party. We could be held liable to a governmental entity or to third parties for property damage, personal injury, investigation and clean-up costs incurred by these parties in connection with environmental contamination, or may be required to investigate or clean up hazardous or toxic substances or chemical releases at such properties. The costs associated with investigation or remediation activities could be substantial and could substantially exceed the value of the real property. In addition, as the owner or former owner of a contaminated site, we may be subject to common law claims by third parties based on damages and costs resulting from environmental contamination emanating from the property. We may be unable to recover costs from any third party. These occurrences may materially reduce the value of the affected property, and we may find it difficult or impossible to use or sell the property prior to or following any environmental remediation. If we ever become subject to significant environmental liabilities, our business, financial condition and results of operations could be materially and adversely affected.

We may be required to recognize impairment with respect to investment securities, including the FHLB stock we hold.

Our securities portfolio currently includes securities with unrecognized losses. We may continue to observe declines in the fair market value of these securities. We evaluate the securities portfolio for any other than temporary



impairment each reporting period. In addition, as a condition of membership in the FHLB, we are required to purchase and hold a certain amount of FHLB stock. Our stock purchase requirement is based, in part, upon the outstanding principal balance of advances from the FHLB. Our FHLB stock is carried at cost and is subject to recoverability testing under applicable accounting standards. Future negative changes to the financial condition of the FHLB may require us to recognize an impairment charge with respect to such holdings. The FHLB is currently subject to a Consent Order issued by its primary regulator, the Federal Housing Finance Agency.

The strength and stability of other financial institutions may adversely affect our business.

Our counterparty risk exposure is affected by the actions and creditworthiness of other financial institutions with which we do business. Negative impacts to our counterparty financial institutions could affect our ability to engage in routine funding transactions. Financial services institutions are interrelated as a result of trading, clearing, counterparty or other relationships. Many of these types of transactions can expose us to credit risk in the event of default by a direct or indirect counterparty or client.

If other financial institutions in our markets dispose of real estate collateral at below-market or distressed prices, such actions may increase our losses and have a material adverse effect on our financial condition and results of operations.

Our accounting policies and methods are fundamental to how we report our financial condition and results of operations, and we use estimates in determining the fair value of certain of our assets, which estimates may prove to be imprecise and result in significant changes in valuation.

A portion of our assets are carried on the balance sheet at fair value, including investment securities available for sale, mortgage servicing rights related to single family loans and single family loans held for sale. Generally, for assets that are reported at fair value, we use quoted market prices or internal valuation models that utilize observable market data inputs to estimate their fair value. In certain cases, observable market prices and data may not be readily available or their availability may be diminished due to market conditions. We use financial models to value certain of these assets. These models are complex and use asset-specific collateral data and market inputs for interest rates. Although we have processes and procedures in place governing internal valuation models and their testing and calibration, such assumptions are complex as we must make judgments about the effect of matters that are inherently uncertain. Different assumptions could result in significant changes in valuation, which in turn could affect earnings or result in significant changes in the dollar amount of assets reported on the balance sheet.

Our operations could be interrupted if our third-party service and technology providers experience difficulty, terminate their services or fail to comply with banking regulations.

We depend, and will continue to depend, to a significant extent, on a number of relationships with third-party service and technology providers. Specifically, we receive core systems processing, essential web hosting and other Internet systems and deposit and other processing services from third-party service providers. If these third-party service providers experience difficulties or terminate their services and we are unable to replace them with other service providers, our operations could be interrupted and our operating expenses may be materially increased. If an interruption were to continue for a significant period of time, our business financial condition and results of operations could be materially adversely affected.

We continually encounter technological change, and we may have fewer resources than many of our competitors to continue to invest in technological improvements.

The financial services industry is undergoing rapid technological changes with frequent introductions of new technology-driven products and services. The effective use of technology increases efficiency and enables financial institutions to better serve customers and to reduce costs. Our future success will depend, in part, upon our ability to address the needs of our clients by using technology to provide products and services that will satisfy client demands for convenience, as well as to create additional efficiencies in our operations. Many national vendors provide turn-key services to community banks, such as internet banking and remote deposit capture that allow smaller banks to compete with institutions that have substantially greater resources to invest in technological improvements. We may not be able, however, to effectively implement new technology-driven products and services or be successful in marketing these products and services to our customers.

In addition, because of the demand for technology-driven products, banks are increasingly contracting with third party vendors to provide data processing and core banking functions. The use of technology-related products, services, delivery channels and processes exposes a bank to various risks, particularly transaction, strategic, reputation and compliance risks. There can be no assurance that we will be able to successfully manage the risks associated with our increased dependency on technology.

Federal, state and local consumer lending laws may restrict our ability to originate or increase our risk of liability with respect to certain mortgage loans and could increase our cost of doing business.

Federal, state and local laws have been adopted that are intended to eliminate certain lending practices considered “predatory” or “unfair and deceptive practices.” These laws prohibit practices such as steering borrowers away from more affordable products, selling unnecessary insurance to borrowers, repeatedly refinancing loans, and making loans without a reasonable expectation that the borrowers will be able to repay the loans irrespective of the value of the underlying property. It is our policy not to make predatory loans or engage in deceptive practices, but these laws create the potential for liability with respect to our lending, servicing, loan investment and deposit taking activities. They increase our cost of doing business, and ultimately may prevent us from making certain loans and cause us to reduce the average percentage rate or the points and fees on loans that we do make.

Some provisions of our articles of incorporation and bylaws and certain provisions of Washington law may deter takeover attempts, which may limit the opportunity of our shareholders to sell their shares at a favorable price.

Some provisions of our articles of incorporation and bylaws may have the effect of deterring or delaying attempts by our shareholders to remove or replace management, to commence proxy contests, or to effect changes in control. These provisions include:

- a classified board of directors so that only approximately one third of our board of directors is elected each year;
- elimination of cumulative voting in the election of directors;
- procedures for advance notification of shareholder nominations and proposals;
- the ability of our board of directors to amend our bylaws without shareholder approval; and
- the ability of our board of directors to issue shares of preferred stock without shareholder approval upon the terms and conditions and with the rights, privileges and preferences as the board of directors may determine.

In addition, as a Washington corporation, we are subject to Washington law which imposes restrictions on some transactions between a corporation and certain significant shareholders. These provisions, alone or together, could have the effect of deterring or delaying changes in incumbent management, proxy contests or changes in control.

ITEM 2 UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Not applicable.

ITEM 3 DEFAULTS UPON SENIOR SECURITIES

Not applicable.

ITEM 4 MINE SAFETY DISCLOSURE

Not applicable.

ITEM 5 OTHER INFORMATION

Not applicable.

## ITEM 6 EXHIBITS

## EXHIBIT INDEX

| Exhibit Number | Description                                                                                                                                                                                               |
|----------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 31.1           | Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. <sup>(1)</sup>                                                                                        |
| 31.2           | Certification of Chief Accounting Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. <sup>(1)</sup>                                                                                       |
| 32             | Certification of Periodic Financial Report by Principal Executive Officer and Principal Accounting Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and 18 U.S.C. § 1350. <sup>(2)</sup> |
| 101.INS        | XBRL Instance Document <sup>(3)(4)</sup>                                                                                                                                                                  |
| 101.SCH        | XBRL Taxonomy Extension Schema Document <sup>(3)</sup>                                                                                                                                                    |
| 101.CAL        | XBRL Taxonomy Extension Calculation Linkbase Document <sup>(3)</sup>                                                                                                                                      |
| 101.DEF        | XBRL Taxonomy Extension Label Linkbase Document <sup>(3)</sup>                                                                                                                                            |
| 101.LAB        | XBRL Taxonomy Extension Presentation Linkbase Document <sup>(3)</sup>                                                                                                                                     |
| 101.PRE        | XBRL Taxonomy Extension Definitions Linkbase Document <sup>(3)</sup>                                                                                                                                      |

(1) Filed herewith.

This exhibit shall not be deemed “filed” for purposes of Section 18 of the Securities Exchange Act of 1934, or (2) otherwise subject to the liability of that Section. Such exhibit shall not be deemed incorporated into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934.

As provided in Rule 406T of Regulation S-T, this information shall not be deemed “filed” for purposes of Section 11 (3) and 12 of the Securities Act of 1933 and Section 18 of the Securities Exchange Act of 1934 or otherwise subject to liability under those sections.

Pursuant to Rule 405 of Regulation S-T, includes the following financial information included in the Firm’s Quarterly Report on Form 10-Q for the quarter ended September 30, 2013, formatted in XBRL (eXtensible Business Reporting Language) interactive data files: (i) the Consolidated Statements of Operations for the three and nine months ended September 30, 2013 and 2012, (ii) the Consolidated Statements of Financial Condition as (4) of September 30, 2013, and December 31, 2012, (iii) the Consolidated Statements of Stockholders’ Equity and Comprehensive Income for the three and nine months ended September 30, 2013 and 2012, (iv) the Consolidated Statements of Cash Flows for the nine months ended September 30, 2013 and 2012, and (v) the Notes to Consolidated Financial Statements.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Seattle, State of Washington, on November 7, 2013.

HomeStreet, Inc.

By: /s/ Mark K. Mason  
Mark K. Mason  
President and Chief Executive Officer

HomeStreet, Inc.

By: /s/ Cory D. Stewart  
Cory D. Stewart  
Executive Vice President and  
Chief Accounting Officer