HomeStreet, Inc.
Form 10-Q
November 05, 2015
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended: September 30, 2015
Commission file number: 001-35424

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

Washington	91-0186600
(State or other jurisdiction of incorporation)	(IRS Employer Identification No.)

601 Union Street, Suite 2000
Seattle, Washington 98101
(Address of principal executive offices)
(Zip Code)
(206) 623-3050
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes o No x
The number of outstanding shares of the registrant's common stock as of November 2, 2015 was 22,076,533.6.

PART I – FINANCIAL INFORMATION

ITEM 1 FINANCIAL STATEMENTS

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, 2015	December 31, 2014
ASSETS		
Cash and cash equivalents (including interest-earning instruments of $11,363 and $10,271)	$ 37,303	$ 30,502
Investment securities (includes $570,082 and $427,326 carried at fair value)	602,018	455,332
Loans held for sale (includes $860,800 and $610,350 carried at fair value)	882,319	621,235
Loans held for investment (net of allowance for loan losses of $26,922 and $22,021; includes $23,755 and $0 carried at fair value)	3,012,943	2,099,129
Mortgage servicing rights (includes $132,701 and $112,439 carried at fair value)	146,080	123,324
Other real estate owned	8,273	9,448
Federal Home Loan Bank stock, at cost	44,652	33,915
Premises and equipment, net	60,544	45,251
Goodwill	11,945	11,945
Other assets	169,576	105,009
Total assets	$ 4,975,653	$ 3,535,090
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities:		
Deposits	$ 3,307,693	$ 2,445,430
Federal Home Loan Bank advances	1,025,745	597,590
Federal funds purchased and securities sold under agreements to repurchase	—	50,000
Accounts payable and other liabilities	119,900	77,975
Long-term debt	61,857	61,857
Total liabilities	4,515,195	3,232,852
Commitments and contingencies (Note 8)		
Shareholders' equity:		
Preferred stock, no par value, authorized 10,000 shares, issued and outstanding, 0 shares and 0 shares	—	—
Common stock, no par value, authorized 160,000,000, issued and outstanding, 22,061,702 shares and 14,856,611 shares	511	511
Additional paid-in capital	222,047	96,615
Retained earnings	236,207	203,566
Accumulated other comprehensive income	1,693	1,546
Total shareholders' equity	460,458	302,238
Total liabilities and shareholders' equity	$ 4,975,653	$ 3,535,090

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

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

(in thousands, except share data)	Three Months Ended September 30, 2015	Three Months Ended September 30, 2014	Nine Months Ended September 30, 2015	Nine Months Ended September 30, 2014
Interest income:				
Loans	$41,012	$25,763	$111,603	$71,865
Investment securities	2,754	2,565	8,426	8,199
Other	224	150	647	449
	43,990	28,478	120,676	80,513
Interest expense:				
Deposits	3,069	2,364	8,656	7,080
Federal Home Loan Bank advances	958	509	2,476	1,366
Federal funds purchased and securities sold under agreements to repurchase	—	6	8	7
Long-term debt	278	271	815	851
Other	51	20	123	42
	4,356	3,170	12,078	9,346
Net interest income	39,634	25,308	108,598	71,167
Provision (reversal of provision) for credit losses	700	—	4,200	(1,500)
Net interest income after provision for credit losses	38,934	25,308	104,398	72,667
Noninterest income:				
Net gain on mortgage loan origination and sale activities	57,885	37,642	189,746	104,946
Mortgage servicing income	4,768	6,155	10,896	24,284
Income (loss) from WMS Series LLC	380	(122)	1,428	(69)
Gain (loss) on debt extinguishment	—	2	—	(573)
Depositor and other retail banking fees	1,701	944	4,239	2,676
Insurance agency commissions	477	256	1,183	892
Gain on sale of investment securities available for sale (includes unrealized gain reclassified from accumulated other comprehensive income of $1,002 and $480 for the three months ended September 30, 2015 and 2014, and $1,002 and $1,173 for the nine months ended September 30, 2015 and 2014, respectively)	1,002	480	1,002	1,173
Bargain purchase gain	796	—	7,345	—
Other	459	456	(11)	841
	67,468	45,813	215,828	134,170
Noninterest expense:				
Salaries and related costs	60,991	42,604	180,238	118,681
General and administrative	14,869	10,326	42,532	31,593
Legal	868	630	1,912	1,571
Consulting	166	628	6,544	2,182
Federal Deposit Insurance Corporation assessments	504	682	1,890	1,874
Occupancy	6,077	4,935	18,024	14,042
Information services	8,159	4,220	21,993	13,597
Net cost (income) from operation and sale of other real estate owned	392	133	710	(320)

	92,026	64,158	273,843	183,220
Income before income taxes	14,376	6,963	46,383	23,617
Income tax expense (includes reclassification adjustments of $351 and $168 for the three months ended September 30, 2015 and 2014, and $351 and $411 for the nine months ended September 30, 2015 and 2014, respectively)	4,415	1,988	13,742	6,979
NET INCOME	$9,961	$4,975	$32,641	$16,638
Basic income per share	$0.45	$0.34	$1.60	$1.12
Diluted income per share	$0.45	$0.33	$1.58	$1.11
Dividends paid on common stock per share	$—	$—	$—	$0.11
Basic weighted average number of shares outstanding	22,035,317	14,805,780	20,407,386	14,797,019
Diluted weighted average number of shares outstanding	22,291,810	14,968,238	20,646,540	14,957,034

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in thousands)	2015	2014	2015	2014
Net income	$9,961	$4,975	$32,641	$16,638
Other comprehensive income, net of tax:				
Unrealized gain on investment securities available for sale:				
Unrealized holding gain arising during the period (net of tax expense of $1,576 and $501 for the three months ended September 30, 2015 and 2014 and $430 and $6,579 for the nine months ended September 30, 2015 and 2014, respectively)	2,926	930	798	12,218
Reclassification adjustment included in net income (net of tax expense of $351 and $168 for the three months ended September 30, 2015 and 2014, and $351 and $411 for the nine months ended September 30, 2015 and 2014, respectively)	(651)	(312)	(651)	(762)
Other comprehensive income	2,275	618	147	11,456
Comprehensive income	$12,236	$5,593	$32,788	$28,094

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

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

(in thousands, except share data)	Number of shares	Common stock	Additional paid-in capital	Retained earnings	Accumulated other comprehensive income (loss)	Total
Balance, January 1, 2014	14,799,991	$511	$94,474	$182,935	$ (11,994)	$265,926
Net income	—	—	—	16,638	—	16,638
Dividends ($0.11 per share)	—	—	—	(1,628)	—	(1,628)
Share-based compensation expense	—	—	1,867	—	—	1,867
Common stock issued	52,980	—	309	—	—	309
Other comprehensive income	—	—	—	—	11,456	11,456
Balance, September 30, 2014	14,852,971	$511	$96,650	$197,945	$ (538)	$294,568
Balance, January 1, 2015	14,856,611	$511	$96,615	$203,566	$ 1,546	$302,238
Net income	—	—	—	32,641	—	32,641
Share-based compensation expense	—	—	986	—	—	986
Common stock issued	7,205,091	—	124,446	—	—	124,446
Other comprehensive income	—	—	—	—	147	147
Balance, September 30, 2015	22,061,702	$511	$222,047	$236,207	$ 1,693	$460,458

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)	2015	2014
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$32,641	$16,638
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation, amortization and accretion	10,700	13,293
Provision (reversal of provision) for credit losses	4,200	(1,500)
Fair value adjustment of loans held for sale	(3,797)	(11,320)
Fair value adjustment of loans held for investment	1,797	—
Origination of mortgage servicing rights	(58,158)	(32,726)
Change in fair value of mortgage servicing rights	34,949	26,075
Net gain on sale of investment securities	(1,002)	(1,173)
Net gain on sale of loans originated as held for investment	—	(4,586)
Net fair value adjustment, gain on sale and provision for losses on other real estate owned	290	(641)
Loss on early retirement of long-term debt	—	573
Loss on disposal of fixed assets	89	—
Net deferred income tax expense (benefit)	11,491	(13,502)
Share-based compensation expense	783	1,100
Bargain purchase gain	(7,345)	—
Origination of loans held for sale	(5,599,978)	(2,840,050)
Proceeds from sale of loans originated as held for sale	5,349,444	2,459,748
Cash used by changes in operating assets and liabilities:		
(Increase) decrease in accounts receivable and other assets	(32,025)	25,486
Increase in accounts payable and other liabilities	22,550	9,959
Net cash (used in) operating activities	(233,371)	(352,626)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of investment securities	(177,535)	(45,179)
Proceeds from sale of investment securities	28,080	75,599
Principal repayments and maturities of investment securities	25,835	32,040
Proceeds from sale of other real estate owned	4,953	6,019
Proceeds from sale of loans originated as held for investment	—	271,409
Proceeds from sale of mortgage servicing rights	3,825	39,004
Mortgage servicing rights purchased from others	(9)	(8)
Origination of loans held for investment and principal repayments, net	(260,404)	(389,196)
Purchase of property and equipment	(16,961)	(13,904)
Net cash acquired from Simplicity acquisition	112,196	—
Net cash used in investing activities	(280,020)	(24,216)

(in thousands)	Nine Months Ended September 30, 2015	2014
CASH FLOWS FROM FINANCING ACTIVITIES:		
Increase in deposits, net	$212,710	$214,637
Proceeds from Federal Home Loan Bank advances	7,332,200	4,619,927
Repayment of Federal Home Loan Bank advances	(6,969,700)	(4,467,927)
Federal funds purchased and proceeds from securities sold under agreements to repurchase	73,004	58,308
Repayment of securities sold under agreements to repurchase	(123,004)	(44,083)
Proceeds from Federal Home Loan Bank stock repurchase	90,565	1,017
Purchase of Federal Home Loan Bank stock	(95,783)	—
Repayment of long-term debt	—	(3,527)
Dividends paid	—	(1,628)
Proceeds from stock issuance, net	177	130
Excess tax benefit related to the exercise of stock options	23	767
Net cash provided by financing activities	520,192	377,621
NET INCREASE IN CASH AND CASH EQUIVALENTS	6,801	779
CASH AND CASH EQUIVALENTS:		
Beginning of year	30,502	33,908
End of period	$37,303	$34,687
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid during the period for:		
Interest paid	$12,021	$10,785
Federal and state income taxes paid, net of (refunds)	16,533	(10,642)
Non-cash activities:		
Loans held for investment foreclosed and transferred to other real estate owned	4,095	3,647
Loans transferred from held for investment to held for sale	32,421	310,455
Loans transferred from held for sale to held for investment	25,668	17,095
Ginnie Mae loans recognized with the right to repurchase, net	3,345	649
Simplicity acquisition:		
Assets acquired, excluding cash acquired	738,279	—
Liabilities assumed	718,916	—
Bargain purchase gain	7,345	—
Common stock issued	$124,214	$—

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 and Union Street Holdings 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. These estimates that require application of management's most difficult, subjective or complex judgments often result in the need to make estimates about the effect of matters that are inherently uncertain and may change in future periods. Not all of these significant accounting policies require management to make difficult, subjective or complex judgments or estimates. Management has made significant estimates in several areas, including the fair value of assets acquired and liabilities assumed in business combinations (Note 2, Business Combinations), allowance for credit losses (Note 4, Loans and Credit Quality), valuation of residential mortgage servicing rights and loans held for sale (Note 7, Mortgage Banking Operations), loans held for investment (Note 4, Loans and Credit Quality), investment securities (Note 3, Investment Securities) and derivatives (Note 6, Derivatives and Hedging Activities). Certain amounts in the financial statements from prior periods have been reclassified to conform to the current financial statement presentation.

These unaudited interim financial statements reflect all adjustments that are, in the opinion of management, necessary for a fair statement of the results for the periods presented. These adjustments are of a normal recurring nature, unless otherwise disclosed in this Form 10-Q. The results of operations in the interim financial statements do not necessarily indicate the results that may be expected for the full year. The interim financial information should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2014, filed with the Securities and Exchange Commission (“2014 Annual Report on Form 10-K”).

Recent Accounting Developments

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

On April 7, 2015, the FASB issued ASU 2015-03, Simplifying the Presentation of Debt Issuance Costs. The ASU was issued to simplify the presentation of debt issuance costs. This guidance requires that debt issuance costs related to a recognized debt liability be presented on the statement of financial condition as a direct deduction from the carrying amount of that debt liability, consistent with the presentation of debt discounts. This guidance becomes effective for the Company for the interim and annual periods beginning after December 15, 2015, and early adoption is permitted for financial statements that have not been previously issued. The guidance is required to be applied on a retrospective basis to each individual period presented on the statement of financial condition. The adoption of this guidance will result in a reclassification of debt issuance costs from other assets to consolidated obligations on the statement of financial condition. The Company is in the process of evaluating the effect of this guidance on the financial statements but the impact is not expected to be material.

On April 15, 2015, the FASB issued ASU 2015-05, Customer’s Accounting for Fees Paid in Cloud Computing Arrangement. The ASU was issued to clarify a customer's accounting for fees paid in a cloud computing arrangement. The amendments provide guidance to customers in determining whether a cloud computing arrangement includes a software license that should be accounted for as internal-use software. If the arrangement does not contain a software license, it would be accounted for as a service contract. This guidance becomes effective for the Company for the interim and annual periods beginning after December 15, 2015, early adoption is permitted. The Company can elect to adopt the amendments either (1) prospectively to all arrangements entered into or materially modified after the effective date or (2) retrospectively. The Company is in the process of evaluating this guidance and its effect on the financial statements but the impact is not expected to be material.

In February 2015, the FASB issued ASU 2015-02, Consolidation. The ASU provides an additional requirement for a limited partnership or similar entity to qualify as a voting interest entity, amending the criteria for consolidating such an entity and eliminating the deferral provided under previous guidance for investment companies. In addition, the new guidance amends the criteria for evaluating fees paid to a decision maker or service provider as a variable interest and amends the criteria for evaluating the effect of fee arrangements and related parties on a VIE primary beneficiary determination. This guidance is effective for interim and annual reporting periods beginning after December 15, 2015. The Company is currently evaluating this guidance to determine the impact on its consolidated financial statements.

In January 2014, the FASB issued ASU 2014-04, Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon foreclosure. The ASU clarifies that an in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, the amendments require interim and annual disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. The amendments are effective for annual and interim reporting periods beginning on or after December 15, 2014 and can be applied with a modified retrospective transition method or prospectively. The prospective adoption of ASU 2014-04 did not have a material impact on the Company's consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606). This ASU clarifies the principles for recognizing revenue from contracts with customers. The new accounting guidance, which does not apply to financial instruments, is effective on a retrospective basis beginning on January 1, 2017. The adoption of ASU 2014-09 is not expected to have a material impact on the Company's consolidated financial statements.

In June 2014, the FASB issued ASU 2014-11, Transfers and Servicing (Topic 860): Repurchase-to Maturity Transactions, Repurchase Financings, and Disclosures. The ASU applies to all entities that enter into repurchase-to-maturity transactions or repurchase financings. The amendments in this ASU require that repurchase-to-maturity transactions be accounted for as secured borrowings consistent with the accounting for other repurchase agreements. In addition, the amendments require separate accounting for a transfer of a financial asset executed contemporaneously with a repurchase agreement with the same counterparty (a repurchase financing), which will result in secured borrowing accounting for the repurchase agreement. The amendments require an entity to disclose information about transfers accounted for as sales in transactions that are economically similar to repurchase agreements, in which the transferor retains substantially all of the exposure to the economic return on the transferred financial asset throughout the term of the transaction. In addition the amendments require disclosure of the types of collateral pledged in repurchase agreements, securities lending transactions, and repurchase-to-maturity transactions and the tenor of those transactions. The amendments in this ASU are effective for public business entities for the first interim or annual period beginning after December 15, 2014. The application of this guidance required enhanced disclosures of the Company's repurchase agreements, but had no impact on the Company's consolidated financial statements.

In August 2014, the FASB issued ASU 2014-14, Classification of Certain Government-Guaranteed Mortgage Loans upon Foreclosure. The ASU clarifies the classification of certain foreclosed mortgage loans held by creditors that are either fully or partially guaranteed under government programs. The ASU requires that a mortgage loan be derecognized and that a separate other receivable be recognized upon foreclosure if the following conditions are met: (1) the loan has a government guarantee that is not separable from the loan before foreclosure; (2) at the time of foreclosure, the creditor has the intent to convey the real estate property to the guarantor and make a claim on the guarantee, and the creditor has the ability to recover under that claim; (3) at the time of foreclosure, any amount of the claim that is determined on the basis of the fair value of the real estate is fixed. The separate other receivable should be measured based on the amount of the loan balance expected to be recovered from the guarantor. The amendments are effective for annual and interim reporting periods beginning on or after December 15, 2014 and can be applied with a modified retrospective transition method or prospectively. The prospective adoption of this ASU did not have a material impact on the Company's consolidated financial statements.

NOTE 2–BUSINESS COMBINATIONS:

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

At the closing, there were 7,180,005 shares of Simplicity common stock, par value $0.01, outstanding, all of which were cancelled and exchanged for an equal number of shares of HomeStreet common stock, no par value, issued to Simplicity’s stockholders. In connection with the merger, all outstanding options to purchase Simplicity common stock were cancelled in exchange for a cash payment equal to the difference between a calculated price of HomeStreet common stock and the exercise price of the option, provided, however, that any options that were out-of-the-money at the time of closing were cancelled for no consideration. The calculated price of $17.53 was determined by averaging the closing price of HomeStreet common stock for the 10 trading days prior to but not including the 5th business day before the closing date. The aggregate consideration paid by us in the Simplicity acquisition was approximately $471 thousand in cash and 7,180,005 shares of HomeStreet common stock with a fair value of approximately $124.2 million as of the acquisition date. We used current liquidity sources to fund the cash consideration.

The acquisition was accounted for under the acquisition method of accounting pursuant to ASC 805, Business Combinations. The assets and liabilities, both tangible and intangible, were recorded at their estimated fair values as of acquisition date. The Company made significant estimates and exercised significant judgment in estimating the fair values and accounting for such acquired assets and assumed liabilities. The valuation of acquired loans, mortgage servicing rights, premises and equipment, core deposit intangibles, deferred taxes, deposits, Federal Home Loan Bank advances and any contingent liabilities that arise as a result of the transaction are considered preliminary and such fair value estimates are subject to adjustment for up to one year after the acquisition date or when additional information relative to the closing date fair values becomes available and such information is considered final, whichever is earlier.

A summary of the consideration paid, the assets acquired and liabilities assumed in the merger are presented below:

(in thousands)	March 1, 2015	
Fair value consideration paid to Simplicity shareholders:		
Cash paid (79,399 stock options, consideration based on intrinsic value at a calculated price of $17.53)		$471
Fair value of common shares issued (7,180,005 shares at $17.30 per share)		124,214
Total purchase price		$124,685
Fair value of assets acquired:		
Cash and cash equivalents	112,667	
Investment securities	26,845	
Acquired loans	664,148	
Mortgage servicing rights	980	
Federal Home Loan Bank stock	5,520	
Premises and equipment	2,966	
Bank-owned life insurance	14,501	
Core deposit intangibles	7,450	
Accounts receivable and other assets	15,869	
Total assets acquired	850,946	
Fair value of liabilities assumed:		
Deposits	651,202	
Federal Home Loan Bank advances	65,855	
Accounts payable and accrued expenses	1,859	
Total liabilities assumed	718,916	
Net assets acquired		$132,030
Preliminary bargain purchase (gain)		$(7,345)

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

The operations of Simplicity are included in the Company's operating results as of the acquisition date of March 1, 2015 through the period ended September 30, 2015. Acquisition-related costs were expensed as incurred in noninterest expense as merger and integration costs.

The following table provides a breakout of merger-related expense for the nine months ended September 30, 2015 and for the year ended December 31, 2014:

(in thousands)	Nine Months Ended September 30, 2015	Year Ended December 31, 2014
Noninterest expense		
Salaries and related costs	$7,669	$23
General and administrative	1,256	179
Legal	530	245
Consulting	5,539	388
Occupancy	335	4
Information services	481	50
Total noninterest expense	$15,810	$889

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

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

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

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

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

Unaudited Pro Forma Results of Operations

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
(in thousands, except share data)	2015	2014	2015	2014
Net interest income	$39,603	$33,182	$113,190	$95,140
Provision (reversal of provision) for credit losses	700	(350)	4,200	(2,250)
Total noninterest income	66,676	47,207	209,239	145,702
Total noninterest expense	91,557	71,014	266,243	218,437
Net income	$9,756	$6,471	$35,355	$20,430
Basic income per share	$0.44	$0.30	$1.60	$0.94
Diluted income per share	$0.44	$0.30	$1.59	$0.93
Basic weighted average number of shares outstanding	22,035,317	21,551,126	22,034,201	21,749,352
Diluted weighted average number of shares outstanding	22,291,810	21,735,713	22,207,764	21,934,050

NOTE 3–INVESTMENT SECURITIES:

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

	At September 30, 2015			
(in thousands)	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Mortgage-backed securities:				
Residential	$91,562	$216	$(774)	$91,004
Commercial	23,824	331	(90)	24,065
Municipal bonds	184,160	3,350	(427)	187,083
Collateralized mortgage obligations:				
Residential	88,459	119	(789)	87,789

Commercial	55,849	468	(71)	56,246
Corporate debt securities	84,304	307	(1,729)	82,882
U.S. Treasury securities	40,991	22	—	41,013
	$569,149	$4,813	$(3,880)	$570,082

(in thousands)	At December 31, 2014 Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Mortgage-backed securities:				
Residential	$107,624	$509	$(853)	$107,280
Commercial	13,030	641	—	13,671
Municipal bonds	119,744	2,847	(257)	122,334
Collateralized mortgage obligations:				
Residential	44,254	161	(1,249)	43,166
Commercial	20,775	—	(289)	20,486
Corporate debt securities	80,214	296	(1,110)	79,400
U.S. Treasury securities	40,976	13	—	40,989
	$426,617	$4,467	$(3,758)	$427,326

Mortgage-backed securities ("MBS") and collateralized mortgage obligations ("CMO") represent securities issued by government sponsored enterprises ("GSEs"). Each of the MBS and CMO securities in our investment portfolio are guaranteed by Fannie Mae, Ginnie Mae or Freddie Mac. Municipal bonds are comprised of general obligation bonds (i.e., backed by the general credit of the issuer) and revenue bonds (i.e., backed by revenues from the specific project being financed) issued by various municipal corporations. As of September 30, 2015 and December 31, 2014, 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, 2015 and December 31, 2014, substantially all securities held had ratings available by external ratings agencies.

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

	At September 30, 2015					
	Less than 12 months		12 months or more		Total	
(in thousands)	Gross unrealized losses	Fair value	Gross unrealized losses	Fair value	Gross unrealized losses	Fair value
Mortgage-backed securities:						
Residential	$(344)	$28,158	$(430)	$21,833	$(774)	$49,991
Commercial	(90)	16,431	—	—	(90)	16,431
Municipal bonds	(281)	41,334	(147)	5,815	(428)	47,149
Collateralized mortgage obligations:						
Residential	(191					