NAUGLE THOMAS E
Form 4
March 02, 2011

FORM 4

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

STATEMENT OF CHANGES IN BENEFICIAL OWNERSHIP OF SECURITIES

Filed pursuant to Section 16(a) of the Securities Exchange Act of 1934, Section 17(a) of the Public Utility Holding Company Act of 1935 or Section 30(h) of the Investment Company Act of 1940

Check this box if no longer subject to Section 16. Form 4 or Form 5 obligations may continue. *See* Instruction 1(b).

OMB APPROVAL	
OMB Number:	3235-0287
Expires:	January 31, 2005
Estimated average burden hours per response...	0.5

(Print or Type Responses)

1. Name and Address of Reporting Person *
NAUGLE THOMAS E

(Last) (First) (Middle)

25 CORPORATE DRIVE

(Street)

BURLINGTON, MA 01803

(City) (State) (Zip)

2. Issuer Name **and** Ticker or Trading Symbol
CIRCOR INTERNATIONAL INC [CIR]

3. Date of Earliest Transaction (Month/Day/Year)
02/28/2011

4. If Amendment, Date Original Filed(Month/Day/Year)

5. Relationship of Reporting Person(s) to Issuer

(Check all applicable)

__X__ Director _____ 10% Owner
_____ Officer (give title below) _____ Other (specify below)

6. Individual or Joint/Group Filing(Check Applicable Line)
_X_ Form filed by One Reporting Person
___ Form filed by More than One Reporting Person

Table I - Non-Derivative Securities Acquired, Disposed of, or Beneficially Owned

1.Title of Security (Instr. 3)	2. Transaction Date (Month/Day/Year)	2A. Deemed Execution Date, if any (Month/Day/Year)	3. Transaction Code (Instr. 8)		4. Securities Acquired (A) or Disposed of (D) (Instr. 3, 4 and 5)			5. Amount of Securities Beneficially Owned Following Reported Transaction(s) (Instr. 3 and 4)	6. Ownership Form: Direct (D) or Indirect (I) (Instr. 4)	7. Nature of Indirect Beneficial Ownership (Instr. 4)
			Code	V	Amount	(A) or (D)	Price			

Reminder: Report on a separate line for each class of securities beneficially owned directly or indirectly.

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SEC 1474 (9-02)

Table II - Derivative Securities Acquired, Disposed of, or Beneficially Owned
(*e.g.*, puts, calls, warrants, options, convertible securities)

1. Title of Derivative Security	2. Conversion or Exercise	3. Transaction Date (Month/Day/Year)	3A. Deemed Execution Date, if any	4. Transaction Code	5. Number of Derivative Securities	6. Date Exercisable and Expiration Date (Month/Day/Year)	7. Title and Amount Underlying Securitie (Instr. 3 and 4)

(Instr. 3)	Price of Derivative Security		(Month/Day/Year)	(Instr. 8)		Acquired (A) or Disposed of (D) (Instr. 3, 4, and 5)					
				Code	V	(A)	(D)	Date Exercisable	Expiration Date	Title	Amour or Numbe of Shares
Management Stock Purchase	(1)	02/28/2011		A		1,531		02/28/2014	02/28/2021	Common Stock	1,53
Restricted Stock Units	(2)	02/28/2011		A		1,284		03/28/2012	02/28/2021	Common Stock	1,284

Reporting Owners

Reporting Owner Name / Address	Relationships			
	Director	10% Owner	Officer	Other
NAUGLE THOMAS E 25 CORPORATE DRIVE BURLINGTON, MA 01803	X			

Signatures

By: /s/ Alan J. Glass, attorney-in-fact	03/02/2011
**Signature of Reporting Person	Date

Explanation of Responses:

* If the form is filed by more than one reporting person, *see* Instruction 4(b)(v).

** Intentional misstatements or omissions of facts constitute Federal Criminal Violations. *See* 18 U.S.C. 1001 and 15 U.S.C. 78ff(a).

(1) This Restricted Stock Units (RSUs) grant is issued pursuant to a provision of the issuer Management Stock Purchase Plan (MSPP) whereby certain directors may make an advance election to receive RSUs in lieu of a specified percentage or dollar amount of that directors? annual retainer.? The RSUs are issued in whole units at a 33% discount from fair market value of the issuer?s common stock generally on the date the underlying retainer is determined and generally vest 3 years from the date of the grant, at which time the RSUs convert into shares of common stock on a one-for-one basis unless the director previously elected a longer deferral period.? The Reporting Person has elected in advance to receive RSUs in lieu of his entire annual director retainer fee $40,000 for 2011.

(2) The grant of Restricted Stock Units (RSUs), reported herein, entitles the Reporting Person to receive shares of the issuer common stock in equal installments of one-third of the original RSU grant on either (i) the annual vesting of the grant or (ii) upon the conclusion of such longer deferral period as the Reporting Person may elect in advance.? In either occurrence, (i) or (ii), the RSUs automatically convert into shares of common stock on a one-for-one basis at no conversion cost to the Reporting Person.

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3.40
%

2.99
%
Impact of noninterest-bearing sources

0.08
%

0.11
%
Net interest margin

3.48
%

3.10
%

(1) The average balances of nonaccrual assets and related income, if any, are included in their respective categories.
(2) Includes former loan balances that have been foreclosed and are now reclassified to OREO.
(3) Includes taxable-equivalent adjustments primarily related to tax-exempt income on certain loans and securities of $503 thousand and $580 thousand for the three months ended June 30, 2014 and June 30, 2013, respectively. The estimated federal statutory tax rate was 35% for the periods presented.

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(in thousands)	Six Months Ended June 30, 2014 Average Balance	Interest	Average Yield/Cost		2013 Average Balance	Interest	Average Yield/Cost	
Assets:								
Interest-earning assets: [1]								
Cash and cash equivalents	$32,400	$32	0.20	%	$22,312	$30	0.26	%
Investment securities	462,338	6,864	2.99	%	467,865	6,723	2.87	%
Loans held for sale	395,953	7,470	3.77	%	421,112	7,214	3.43	%
Loans held for investment	1,798,384	38,687	4.30	%	1,371,801	28,341	4.14	%
Total interest-earning assets	2,689,075	53,053	3.98	%	2,283,090	42,308	3.71	%
Noninterest-earning assets [2]	353,433				264,795			
Total assets	$3,042,508				$2,547,885			
Liabilities and shareholders' equity:								
Deposits:								
Interest-bearing demand accounts	$261,401	356	0.27	%	$210,032	391	0.38	%
Savings accounts	162,854	419	0.52	%	109,234	218	0.40	%
Money market accounts	952,770	2,101	0.44	%	739,652	1,830	0.50	%
Certificate accounts	513,551	1,842	0.72	%	476,726	3,417	1.45	%
Total interest-bearing deposits	1,890,576	4,718	0.50	%	1,535,644	5,856	0.77	%
Federal Home Loan Bank advances	337,125	867	0.52	%	227,639	680	0.60	%
Securities sold under agreements to repurchase	568	1	0.36	%	5,487	11	0.40	%
Long-term debt	62,780	581	1.87	%	61,857	1,999	6.43	% [3]
Other borrowings	—	—	—	%	4,675	10	0.42	%
Total interest-bearing liabilities	2,291,049	6,167	0.54	%	1,835,302	8,556	0.94	%
Noninterest-bearing liabilities	472,946				434,995			
Total liabilities	2,763,995				2,270,297			
Shareholders' equity	278,513				277,588			
Total liabilities and shareholders' equity	$3,042,508				$2,547,885			
Net interest income [4]		$46,886				$33,752		
Net interest spread			3.44	%			2.77	%
Impact of noninterest-bearing sources			0.05	%			0.19	%
Net interest margin			3.49	%			2.96	% [3]

(1) The average balances of nonaccrual assets and related income, if any, are included in their respective categories.
(2) Includes former loan balances that have been foreclosed and are now reclassified to OREO.
(3) Interest expense for the first quarter of 2013 included $1.4 million related to the correction of the cumulative effect of an immaterial error in prior years, resulting from the under accrual of interest due on the 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 3.08% for the six months ended June 30, 2013.
(4) Includes taxable-equivalent adjustments primarily related to tax-exempt income on certain loans and securities of $1.0 million and $1.1 million for the six months ended June 30, 2014 and June 30, 2013, 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 interest is received on nonaccrual loans, the interest collected on the loan is recognized as an adjustment to the

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cost basis of the loan. The net 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 $157 thousand and $174 thousand for the three months ended June 30, 2014 and 2013, respectively, and $257 thousand and $325 thousand for the six months ended June 30, 2014 and 2013, respectively.

Net Income

Net income was $9.4 million for the three months ended June 30, 2014, a decrease of $2.7 million, or 22.4%, from net income of $12.1 million for the three months ended June 30, 2013. For the first six months of 2014, net income was $11.7 million, a decrease of $11.3 million, or 49.3%, from $23.0 million for the first six months of 2013. The decline in net income mainly resulted from a decrease in noninterest income compared to the same periods in 2013, primarily due to a significantly lower gain on mortgage loan origination and sale activities driven by lower single family interest rate lock commitments.

For the three months ended June 30, 2014, noninterest income decreased $3.9 million, or 6.8%, compared to the same period in 2013. Noninterest expense increased $6.3 million, or 11.0%, compared to the same period last year due to increased salary, occupancy, information technology and similar costs we incurred as we continue to expand our mortgage banking and commercial and consumer businesses. The decreases to net income was partially offset by a $5.7 million, or 32.9%, increase in net interest income in the three months ended June 30, 2014 mainly due to higher yields on higher average balances of loans held for investment. Included in net income for the second quarter of 2014 were a $4.7 million pre-tax net increase in mortgage servicing income resulting from the sale of MSRs and a $3.9 million pre-tax gain on single family mortgage origination and sale activities from the sale of loans that were originally held for investment.

Net Interest Income

Our profitability depends 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 and advances from the Federal Home Loan Bank ("FHLB").

Net interest income on a tax equivalent basis was $23.7 million for the second quarter of 2014, an increase of $5.7 million, or 31.4%, from $18.0 million for the second quarter of 2013. For the first six months of 2014, net interest income was $46.9 million, an increase of $13.1 million, or 38.9%, from $33.8 million for the first six months of 2013. During the second quarter of 2014, total interest income increased $5.7 million from the second quarter of 2013, while total interest expense was relatively unchanged from the second quarter of 2013. The net interest margin for the second quarter of 2014 improved to 3.48% from 3.10% in the second quarter of 2013, and improved to 3.49% for the six months ended June 30, 2014 from 2.96% for the same period last year. Included in interest income for the six months ended June 30, 2014 is $618 thousand in interest collected on three nonaccrual loans that were paid off during the period. Included in interest expense for the six months ended June 30, 2013 was $1.4 million related to the correction of the cumulative effect of an immaterial error in prior years, resulting from the under accrual of interest due on the 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 3.08%. The net interest margin increase from the second quarter of 2013 resulted from a 30 basis point increase in yields on average interest-earning assets, mostly due to higher yields on higher average balances of portfolio loans, as well as an 11 basis point decline in the cost of funds.

Total average interest-earning assets increased from the three and six months ended June 30, 2013, primarily as a result of growth in average loans held for investment, both from originations and from fourth quarter 2013 acquisitions. Total average interest-bearing deposit balances increased from the prior periods primarily due to

acquisition-related and organic growth in transaction and savings deposits.
Total interest income on a tax equivalent basis of $26.7 million in the second quarter of 2014 increased $5.7 million, or 26.9%, from $21.0 million in the second quarter of 2013, primarily driven by higher average balances of loans. Average balances of total loans increased $457.9 million, or 25.6%, from the second quarter of 2013. For the first six months of 2014, interest income was $53.1 million, an increase of $10.7 million, or 25.4%, from $42.3 million in the same period last year resulting from higher average balances of loans held for investment.

Total interest expense of $3.1 million was relatively unchanged compared to interest expense in the second quarter of 2013. Higher average balances of interest-bearing deposits in the second quarter of 2014 were primarily offset by a 12 basis point reduction in cost of interest-bearing deposits. For the first six months of 2014, interest expense was $6.2 million, a decrease of $2.4 million, or 27.9%, from $8.6 million in the six months ended June 30, 2013, reflecting a lower cost of funds on interest-bearing deposits. Included in interest expense for the six months ended June 30, 2013 was expense of $1.4 million recorded in

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the first quarter of 2013 related to the correction of the cumulative effect of an immaterial error in prior years, resulting from the under accrual of interest due on the TruPS for which the Company had deferred the payment of interest.

Provision for Credit Losses

Due to a significant decrease in classified loan balances and lower charge-offs, we recorded no provision in the second quarter of 2014, which followed a release of $1.5 million of reserves in the first quarter of 2014, compared to a provision of $400 thousand in the second quarter of 2013 and $2.4 million during the six months ended June 30, 2013. Nonaccrual loans declined to $21.2 million at June 30, 2014, a decrease of $4.5 million, or 17.5%, from $25.7 million at December 31, 2013. Nonaccrual loans as a percentage of total loans was 1.16% at June 30, 2014 compared to 1.36% at December 31, 2013.

Net charge-offs of $149 thousand in the second quarter of 2014 were down $987 thousand from net charge-offs of $1.1 million in the second quarter of 2013. For the first six months of 2014, net charge-offs were $421 thousand compared to $2.3 million in the same period last year. The decrease in net charge-offs in the three and six months ended June 30, 2014 compared to the same periods of 2013 was primarily due to lower charge-offs on single family and home equity loans. 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 of this Form 10-Q.

Noninterest Income

Noninterest income was $53.7 million in the second quarter of 2014, a decrease of $3.9 million, or 6.8%, from $57.6 million in the second quarter of 2013. For the first six months of 2014, noninterest income was $88.4 million, a decrease of $28.1 million, or 24.2%, from $116.5 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 as well as 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 second quarter of 2014 compared to the second quarter of 2013 was primarily the result of lower net gain on mortgage loan origination and sale activities. This was due mostly to the significant reduction in mortgage refinance volumes driven by higher mortgage interest rates, partially offset by higher purchase mortgage volume from the expansion of our mortgage lending operations and an $8.0 million increase in mortgage servicing income. Our single family mortgage interest rate lock commitments of $1.20 billion in the second quarter of 2014 decreased 15.6% compared to $1.42 billion in the second quarter of 2013. Included in noninterest income for the second quarter of 2014 were a $4.7 million pre-tax net increase in mortgage servicing income resulting from the sale of MSRs and a $3.9 million pre-tax gain on single family mortgage origination and sale activities from the sale of loans that were originally held for investment.

Noninterest income consisted of the following.

(in thousands)	Three Months Ended June 30, 2014	2013	Dollar Change	Percent Change	Six Months Ended June 30, 2014	2013	Dollar Change	Percent Change
Noninterest income								
Net gain on mortgage loan origination and sale activities [(1)]	$41,794	$52,424	$(10,630)	(20)%	$67,304	$106,379	$(39,075)	(37)%
	10,184	2,183	8,001	367	18,129	5,255	12,874	245

Mortgage servicing income								
Income from WMS Series LLC	246	993	(747)	(75)	53	1,613	(1,560)	(97)
Loss on debt extinguishment	11	—	11	NM	(575)	—	(575)	NM
Depositor and other retail banking fees	917	761	156	20	1,732	1,482	250	17
Insurance agency commissions	232	190	42	22	636	370	266	72
Gain (loss) on securities available for sale	(20)	238	NM	NM	693	190	503	265
Other	286	767	(481)	(63)	385	1,210	(825)	NM
Total noninterest income	$53,650	$57,556	$(3,648)	(6)%	$88,357	$116,499	$(28,142)	(24)%

NM = not meaningful

(1) Single family and multifamily mortgage banking activities.

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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 June 30, 2014	2013	Dollar Change	Percent Change	Six Months Ended June 30, 2014	2013	Dollar Change	Percent Change
Single family:								
Servicing value and secondary market gains[1]	$30,233	$43,448	$(13,215)	(30)%	$49,792	$87,683	$(37,891)	(43)%
Loan origination and funding fees	6,781	8,267	(1,486)	(18)	11,542	16,062	(4,520)	(28)
Total single family	37,014	51,715	(14,701)	(28)	61,334	103,745	(42,411)	(41)
Multifamily	693	709	(16)	(2)	1,089	2,634	(1,545)	(59)
Other	4,087	—	4,087	NM	4,881	—	4,881	NM
Net gain on mortgage loan origination and sale activities	$41,794	$52,424	$(10,630)	(20)%	$67,304	$106,379	$(39,075)	(37)%

NM = not meaningful

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

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

(in thousands)	Three Months Ended June 30, 2014	2013	Dollar Change	Percent Change	Six Months Ended June 30, 2014	2013	Dollar Change	Percent Change
Single family mortgage closed loan volume [1] [2]	$1,100,704	$1,307,286	$(206,582)	(16)%	$1,774,987	$2,499,442	$(724,455)	(29)%
Single family mortgage interest rate lock commitments [2]	1,201,665	1,423,290	(221,625)	(16)	2,004,973	2,459,112	(454,139)	(18)

(1) Represents single family mortgage originations designated for sale during each respective period.
(2) Includes loans originated by WMS Series LLC and purchased by HomeStreet Bank.

During the second quarter of 2014, single family closed loan production decreased 15.8% and single family interest rate lock commitments decreased 15.6% compared to the second quarter of 2013. For the first six months of 2014, single family closed loan production decreased 29.0% and single family interest rate lock commitments decreased 18.5% compared to the same period last year. These decreases were mainly the result of higher mortgage interest rates beginning in the second quarter of 2013 that led to a reduction in refinance mortgage activity since then.

Net gain on mortgage loan origination and sale activities was $41.8 million for the second quarter of 2014, a decrease of $10.6 million, or 20.3%, from $52.4 million for the second quarter of 2013. This decrease predominantly reflected substantially lower mortgage interest rate lock commitment volumes and lower secondary market margins. Commitment volumes declined mainly due to the rise in mortgage interest rates beginning in the second quarter of

2013, causing a significant decrease in refinancing activity that was only partially offset by a slightly stronger purchase mortgage market. This impact was partially mitigated by the expansion of our mortgage lending operations as the number of loan officers grew by approximately 31.5% over the past twelve months. Included in net gain on mortgage loan origination and sale activities for the second quarter of 2014 was a $3.9 million pre-tax gain on single family mortgage origination and sale activities from the sale of loans that were originally held for investment.

For the first six months of 2014, net gain on mortgage loan origination and sale activities was $67.3 million, a decrease of $39.1 million, or 36.7%, from $106.4 million in the same period last year. Significant decreases in mortgage refinance activities were partially offset by a slow growing purchase market and the expansion of our mortgage lending operations.

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Included in net gain on mortgage loan origination and sale activities for the first six months of 2014 was a $4.6 million pre-tax gain on single family mortgage origination and sale activities from the sale of loans that were originally held for investment.

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. For further information on the Company's mortgage repurchase liability, see Note 7, Commitments, Guarantees and Contingencies in this Form 10-Q.

	Three Months Ended June 30,		Six Months Ended June 30,	
(in thousands)	2014	2013	2014	2013
Effect of changes to the mortgage repurchase liability recorded in net gain on mortgage loan origination and sale activities:				
New loan sales [1]	$(313)	$(472)	$(552)	$(1,008)
	$(313)	$(472)	$(552)	$(1,008)

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

Mortgage servicing income consisted of the following.

	Three Months Ended June 30,		Dollar Change	Percent Change	Six Months Ended June 30,		Dollar Change	Percent Change
(in thousands)	2014	2013			2014	2013		
Servicing income, net:								
Servicing fees and other	$10,112	$7,955	$2,157	27 %	$19,961	$15,562	$4,399	28 %
Changes in fair value of MSRs due to modeled amortization [1]	(7,109)	(6,964)	(145)	2	(13,077)	(12,639)	(438)	3
Amortization	(434)	(423)	(11)	3	(858)	(913)	55	(6)
	2,569	568	2,001	352	6,026	2,010	4,016	200
Risk management:								
Changes in fair value of MSRs due to changes in model inputs and/or assumptions [2]	(3,326) [3]	15,120	(18,446)	NM	(8,735) [3]	19,268	(28,003)	NM
Net gain (loss) from derivatives economically hedging MSRs	10,941	(13,505)	24,446	NM	20,838	(16,023)	36,861	NM
	7,615	1,615	6,000	372	12,103	3,245	8,858	273
Mortgage servicing income	$10,184	$2,183	$8,001	367 %	$18,129	$5,255	$12,874	245 %

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.

(3) Includes pre-tax income of $4.7 million, net of brokerage fees and prepayment reserves, resulting from the sale of single family MSRs during the three months ended June 30, 2014.

For the second quarter of 2014, mortgage servicing income was $10.2 million, an increase of $8.0 million, or 367%, from $2.2 million in the second quarter of 2013, primarily due to the June 30, 2014 sale of the rights to service $2.96 billion of single family mortgage loans serviced for Fannie Mae. The sale resulted in a $4.7 million, net of transaction costs, pre-tax increase in mortgage servicing income during the quarter.

Also contributing to the increase in mortgage servicing income is improved risk management results. MSR 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. 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

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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 our MSR risk management activities for the second quarter of 2014 was a gain of $7.6 million compared to a gain of $1.6 million in the second quarter of 2013. The higher hedging gain in 2014 largely reflected higher sensitivity to interest rates for the Company's MSRs, which led the Company to increase the notional amount of derivative instruments used to economically hedge MSRs. The higher notional amount of derivative instruments, along with a steeper yield curve, resulted in higher net gains from MSR risk management, which positively impacted mortgage servicing income. In addition, MSR risk management results for 2014 reflected the impact on the fair value of MSRs of changes in model inputs and assumptions related to historically low prepayment speeds experienced during the second quarter of 2014 resulting in lower projected prepayment speeds. Included in the gain for the second quarter of 2014 was a net $4.7 million in pre-tax income resulting from the sale of MSRs.

Mortgage servicing fees collected in the second quarter of 2014 were $10.1 million, an increase of $2.2 million, or 27.1%, from $8.0 million in the second quarter of 2013. Our loans serviced for others portfolio was $10.70 billion at June 30, 2014 compared to $12.61 billion at December 31, 2013 and $11.18 billion at June 30, 2013. The lower balance at quarter end was the result of the June 30, 2014 sale of the rights to service $2.96 billion of single family mortgage loans. Mortgage servicing fees collected in future periods will be negatively impacted in the short term because the balance of the loans serviced for others portfolio was reduced as a consequence of this sale.

Income from WMS Series LLC in the second quarter of 2014 was $246 thousand compared to $993 thousand in the second quarter of 2013. The decrease in 2014 was primarily due to a 35.2% decrease in interest rate lock commitments and a 40.1% decrease in closed loan volume, which were $134.4 million and $130.7 million, respectively, for the three months ended June 30, 2014 compared to $207.4 million and $218.2 million, respectively, for the same period in 2013.

Depositor and other retail banking fees for the three and six months ended June 30, 2014 increased from the three and six months ended June 30, 2013, primarily driven by an increase in the number of transaction accounts as we grow our retail deposit branch network. The following table presents the composition of depositor and other retail banking fees for the periods indicated.

(in thousands)	Three Months Ended June 30, 2014	Three Months Ended June 30, 2013	Dollar Change	Percent Change	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013	Dollar Change	Percent Change
Fees:								
Monthly maintenance and deposit-related fees	$428	$366	$62	17 %	$818	$719	$99	14 %
Debit Card/ATM fees	471	373	98	26	886	723	163	23
Other fees	18	22	(4)	(18)	28	40	(12)	(30)
Total depositor and other retail banking fees	$917	$761	$156	20 %	$1,732	$1,482	$250	17 %

Noninterest Expense

Noninterest expense was $63.0 million in the second quarter of 2014, an increase of $6.3 million, or 11.0%, from $56.7 million in the second quarter of 2013. For the first six months of 2014, noninterest expense was $119.1 million, an increase of $6.6 million, or 5.8%, from $112.5 million for the same period last year. The increase in noninterest expense in the second quarter of 2014 was primarily the result of a $2.0 million increase in salaries and related cost, a $1.3 million increase in occupancy, and a $1.3 million increase in information services. The increase in noninterest expense for the three and six months of 2014 compared to prior year was primarily a result of the integration of our acquisitions and an 18.1% growth in personnel in connection with our continued expansion of our mortgage banking and commercial and consumer businesses. These additions to personnel were partially offset by attrition and position eliminations in mortgage production, mortgage operations, and in commercial lending and administration. Position eliminations beginning in the fourth quarter of 2013 were in response to a slowdown in mortgage activity as well as the integration of our acquisitions and were intended to improve efficiency and performance. The increases in noninterest expense were partially offset by a decrease in mortgage origination commissions and sales management incentives.

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Noninterest expense consisted of the following.

(in thousands)	Three Months Ended June 30, 2014	2013	Dollar Change	Percent Change	Six Months Ended June 30, 2014	2013	Dollar Change	Percent Change
Noninterest expense								
Salaries and related costs	$40,606	$38,579	$2,027	5 %	$76,077	$73,641	$2,436	3 %
General and administrative	11,145	10,270	875	9	21,267	21,200	67	—
Legal	542	599	(57)	(10)	941	1,210	(269)	(22)
Consulting	603	763	(160)	(21)	1,554	1,459	95	7
Federal Deposit Insurance Corporation assessments	572	143	429	300	1,192	710	482	68
Occupancy	4,675	3,381	1,294	38	9,107	6,183	2,924	47
Information services	4,862	3,574	1,288	36	9,377	6,570	2,807	43
Net cost of operation and sale of other real estate owned	(34)	(597)	563	(94)	(453)	1,538	(1,991)	(129)
Total noninterest expense	$62,971	$56,712	$6,259	11 %	$119,062	$112,511	$6,551	6 %

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

Salaries and related costs were $40.6 million in the second quarter of 2014, an increase of $2.0 million, or 5.3%, from $38.6 million in the second quarter of 2013. For the first six months of 2014, salaries and related costs were $76.1 million, an increase of $2.4 million, or 3.3%, from $73.6 million for the same period last year. These increases primarily resulted from an 18.1% increase in full-time equivalent employees at June 30, 2014 compared to June 30, 2013, largely offset by reduced mortgage origination commissions and incentives resulting from lower mortgage closed loan volume.

General and administrative expense was $11.1 million in the second quarter of 2014, an increase of $875 thousand, or 8.5%, from $10.3 million in the second quarter of 2013. For the first six months of 2014, general and administrative expenses were $21.3 million, an increase of $67 thousand, or 0.3%, from $21.2 million for the same period last year. These expenses include general office and equipment expense, marketing, taxes and insurance.

Income Tax Expense

The Company's income tax expense was $4.5 million in the second quarter of 2014 compared to $5.8 million in the second quarter of 2013. For the first six months of 2014, income tax expense was $5.0 million compared to $11.2 million for the same period last year. Our effective income tax rate was 32.3% and 30.0% for the three and six months ended June 30, 2014, respectively, as compared to an annual effective tax rate of 31.6% for 2013. Our effective income tax rate in the three and six months ended June 30, 2014 differed from the Federal statutory tax rate of 35% due to state income taxes on income in Oregon, Hawaii, California and Idaho and tax-exempt interest income. Included in income tax expense for the first six months of 2014 is $406 thousand of discrete tax items related to prior periods that were recorded in the first quarter of 2014.

Review of Financial Condition – Comparison of June 30, 2014 to December 31, 2013

Total assets were $3.24 billion at June 30, 2014 and $3.07 billion at December 31, 2013. The increase in total assets was primarily due to a $269.5 million increase in loans held for sale, partially offset by a $58.9 million decrease in

loans held for investment and a $43.9 million decrease in investment securities. The change in loan balances was the result of the transfer of $310.5 million of single family mortgage loans out of the held for investment portfolio and into loans held for sale in March of this year and the subsequent sale of $266.8 million of these loans. The Company transferred $17.1 million of single family loans out of loans held for sale and into the portfolio at June 30, 2014.

Cash and cash equivalents was $75.0 million at June 30, 2014 compared to $33.9 million at December 31, 2013, an increase of $41.1 million, or 121.2%.

Investment securities were $455.0 million at June 30, 2014 compared to $498.8 million at December 31, 2013, a decrease of $43.9 million, or 8.8%, primarily due to sales of securities.

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We primarily hold investment securities for liquidity purposes, while also creating a relatively stable source of interest income. We designated substantially all securities as available for sale. We held securities having a carrying value of $18.0 million at June 30, 2014, which were designated as held to maturity.

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

	At June 30, 2014			At December 31, 2013		
(in thousands)	Fair Value	Percent		Fair Value	Percent	
Investment securities available for sale:						
Mortgage-backed securities:						
Residential	$110,266	25.2	%	$133,910	27.8	%
Commercial	13,674	3.1		13,433	2.8	
Municipal bonds	125,813	28.8		130,850	27.2	
Collateralized mortgage obligations:						
Residential	56,767	13.0		90,327	18.8	
Commercial	16,021	3.7		16,845	3.5	
Corporate debt securities	72,420	16.6		68,866	14.3	
U.S. Treasury securities	42,010	9.6		27,452	5.7	
Total investment securities available for sale	$436,971	100.0	%	$481,683	100.0	%

Loans held for sale were $549.4 million at June 30, 2014 compared to $279.9 million at December 31, 2013, an increase of $269.5 million, or 96.3%. Loans held for sale include single family and multifamily residential loans, typically sold within 30 days of closing the loan. The increase in the loans held for sale balance is primarily due to increased single family mortgage closed loan volume as well as the transfer of $310.5 million of single family mortgage loans out of the loans held for investment portfolio and into loans held for sale in March of this year. During the first six months of 2014, the Company sold $266.8 million of these loans. The Company transferred $17.1 million of single family loans out of loans held for sale and into the loans held for investment portfolio at June 30, 2014.

Loans held for investment, net were $1.81 billion at June 30, 2014 compared to $1.87 billion at December 31, 2013, a decrease of $58.9 million, or 3.1%. Our single family loan portfolio decreased $155.7 million from December 31, 2013, as the Company transferred $310.5 million of single family mortgage loans out of the portfolio and into loans held for sale in March of this year. Our construction loans, including commercial construction and residential construction, increased $88.8 million from December 31, 2013, primarily from new originations in our commercial real estate and residential construction lending business.

Mortgage servicing rights were $118.0 million at June 30, 2014 compared to $162.5 million at December 31, 2013, a decrease of $44.5 million, or 27%. The decline in the size of our servicing portfolio was the result of a strategic decision to sell a portion of our single family MSRs to increase capital in preparation for compliance with the new Basel III regulatory capital standards. During the quarter, the Company sold the rights to service $2.96 billion of single family mortgage loans serviced for Fannie Mae, representing 24.3% of HomeStreet’s total single family mortgage loans serviced for others portfolio as of June 30, 2014. The Company anticipates transferring the servicing of these loans to the purchaser by October 1, 2014, and will continue to service these mortgages as a subservicer for the purchaser until such time. These loans are excluded from the Company's MSR portfolio at June 30, 2014.

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.

	At June 30, 2014			At December 31, 2013		
(in thousands)	Amount	Percent		Amount	Percent	
Consumer loans						
Single family	$749,204	40.7	%	$904,913	47.7	%
Home equity	136,181	7.4		135,650	7.1	
	885,385	48.1		1,040,563	54.8	
Commercial loans						
Commercial real estate [(1)]	476,411	25.9		477,642	25.1	
Multifamily	72,327	3.9		79,216	4.2	
Construction/land development	219,282	11.9		130,465	6.9	
Commercial business	185,177	10.2		171,054	9.0	
	953,197	51.9		858,377	45.2	
	1,838,582	100.0	%	1,898,940	100.0	%
Net deferred loan fees and costs	(3,761	)		(3,219	)	
	1,834,821			1,895,721		
Allowance for loan losses	(21,926	)		(23,908	)	
	$1,812,895			$1,871,813		

(1) June 30, 2014 and December 31, 2013 balances comprised of $143.8 million and $156.7 million of owner occupied loans, respectively, and $332.6 million and $320.9 million of non-owner occupied loans, respectively.

Deposits were $2.42 billion at June 30, 2014 compared to $2.21 billion at December 31, 2013, an increase of $206.9 million, or 9.4%. This increase was due to higher balances of transaction and savings deposits, which were $1.72 billion at June 30, 2014, an increase of $186.2 million, or 12.1%, from $1.54 billion at December 31, 2013, reflecting the organic growth and expansion of our branch banking network. Certificates of deposit balances were $457.5 million at June 30, 2014, a decrease of $56.9 million, or 11.1%, from $514.4 million at December 31, 2013.

Deposit balances by dollar amount and as a percentage of our total deposits were as follows for the periods indicated:

(in thousands)	At June 30, 2014			At December 31, 2013		
	Amount	Percent		Amount	Percent	
Noninterest-bearing accounts - checking and savings	$235,844	9.8	%	$199,943	9.0	%
Interest-bearing transaction and savings deposits:						
NOW accounts	324,604	13.4		262,138	11.9	
Statement savings accounts due on demand	166,851	6.9		156,181	7.1	
Money market accounts due on demand	996,473	41.2		919,322	41.6	
Total interest-bearing transaction and savings deposits	1,487,928	61.5		1,337,641	60.6	
Total transaction and savings deposits	1,723,772	71.3		1,537,584	69.6	
Certificates of deposit	457,529	18.9		514,400	23.3	
Noninterest-bearing accounts - other	236,411	9.8		158,837	7.1	
Total deposits	$2,417,712	100.0	%	$2,210,821	100.0	%

Federal Home Loan Bank advances were $384.1 million at June 30, 2014 compared to $446.6 million at December 31, 2013, a decrease of $62.5 million, or 14.0%. The Company uses these borrowings to primarily fund our mortgage banking and securities investment activities.

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Long-term debt was $61.9 million at June 30, 2014 compared to $64.8 million at December 31, 2013, a decrease of $3.0 million, or 4.6%. During the first quarter of 2014, we redeemed $3.0 million of TruPS that were acquired as part of the acquisition of YNB in 2013.

Shareholders’ Equity

Shareholders' equity was $288.2 million at June 30, 2014 compared to $265.9 million at December 31, 2013. This increase included net income of $11.7 million and other comprehensive income of $10.8 million recognized during the six months ended June 30, 2014, partially offset by dividend payments of $1.6 million during the first quarter of 2014. Other comprehensive income represents unrealized gains in the valuation of our investment securities portfolio at June 30, 2014.

Shareholders’ equity, on a per share basis, was $19.41 per share at June 30, 2014, compared to $17.97 per share at December 31, 2013.

Return on Equity and Assets

The following table presents certain information regarding our returns on average equity and average total assets.

	At or for the Three Months Ended June 30,		At or for the Six Months Ended June 30,	
	2014	2013	2014	2013
Return on assets [(1)]	1.22 %	1.86 %	0.77 %	1.81 %
Return on equity [(2)]	13.17 %	17.19 %	8.38 %	16.58 %
Equity to assets ratio [(3)]	9.29 %	10.80 %	9.15 %	10.89 %

(1) Net income (annualized) divided by average total assets.
(2) Net earnings (loss) available to common shareholders (annualized) divided by average common shareholders’ equity.
(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.

This process is dynamic and is based on management's current view of the Company's operations and is not necessarily comparable with similar information for other financial institutions. We define our business segments by product type and customer segment. If the management structure or the allocation process changes, allocations, transfers and assignments may change. The information that follows has been revised to reflect the manner in which financial information is currently evaluated by management.

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; non-deposit

investment products; insurance products and cash management services. We originate construction loans, bridge loans and permanent loans for our portfolio primarily on single family residences, and on office, retail, industrial and multifamily property types. We originate multifamily real estate loans through our Fannie Mae DUS business, whereby loans are sold to or securitized by Fannie Mae, while the Company generally retains the servicing rights. As of June 30, 2014, our bank branch network consists of 31 branches in the Pacific Northwest and Hawaii. At June 30, 2014 and December 31, 2013, our transaction and savings deposits totaled $1.72 billion and $1.54 billion, respectively, and our loan portfolio totaled $1.81 billion and $1.87 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 June 30, 2014	2013	Change	Percent Change	Six Months Ended June 30, 2014	2013	Change	Percent Change
Net interest income	$19,403	$13,790	$5,613	41 %	$39,636	$24,917	$14,719	59 %
Provision for credit losses	—	400	(400)	(100)	(1,500)	2,400	(3,900)	NM
Noninterest income	6,614	2,776	3,838	138	9,572	6,112	3,460	57
Noninterest expense	20,434	13,905	6,529	47	39,727	29,764	9,963	33
Income (loss) before income tax expense (benefit)	5,583	2,261	3,322	147	10,981	(1,135)	12,116	NM
Income tax expense (benefit)	1,830	281	1,549	551	3,112	(816)	3,928	NM
Net income (loss)	$3,753	$1,980	$1,773	90 %	$7,869	$(319)	$8,188	NM
Average assets	$2,478,073	$2,018,573	$459,500	23 %	$2,534,399	$1,954,068	$580,331	30 %
Efficiency ratio (1)	78.54 %	83.94 %			80.73 %	95.92 %		
Full-time equivalent employees (ending)	599	476	123	26	599	476	123	26
Multifamily net gain on mortgage loan origination and sale activity	$693	$709	$(16)	(2)	$1,089	$2,634	$(1,545)	(59)
Production volumes:								
Multifamily mortgage originations	23,105	14,790	8,315	56	34,448	63,909	(29,461)	(46)
Multifamily mortgage loans sold	$15,902	$15,386	$516	3 %	$22,165	$65,973	$(43,808)	(66)%

NM = not meaningful

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

Commercial and Consumer Banking net income was $3.8 million for the second quarter of 2014, improved by $1.8 million from net income of $2.0 million for the second quarter of 2013. For the first six months of 2014, Commercial and Consumer Banking net income was $7.9 million, improved by $8.2 million, from a net loss of $319 thousand for the first six months of 2013. The increase in net income in the second quarter of 2014 was primarily the result of a $5.6 million increase in net interest income, resulting from higher average balances of interest-earning assets related to our fourth quarter 2013 acquisitions, as well as higher yields on loans held for investment. Included in net income for the second quarter of 2014 was a $3.9 million pre-tax gain on single family mortgage origination and sale activities from the sale of loans that were originally held for investment.
Due to a significant decrease in classified loan balances and lower charge-offs, we recorded no provision for credit losses in the second quarter of 2014, which followed a release of $1.5 million of reserves in the first quarter of 2014, compared to a provision of $400 thousand in the second quarter of 2013 and $2.4 million during the six months ended June 30, 2013.

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

(in thousands)	Three Months Ended June 30, 2014	Three Months Ended June 30, 2013	Dollar Change	Percent Change	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013	Dollar Change	Percent Change
Servicing income, net:								
Servicing fees and other	$1,017	$739	$278	38 %	$1,907	$1,551	$356	23 %
Amortization of multifamily MSRs	(434)	(423)	(11)	3	(858)	(913)	55	(6)
Commercial mortgage servicing income	$583	$316	$267	84 %	$1,049	$638	$411	64 %

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

(in thousands)	At June 30, 2014	At December 31, 2013
Commercial		
Multifamily	$704,997	$720,429
Other	97,996	95,673
Total commercial loans serviced for others	$802,993	$816,102

Commercial and Consumer Banking segment noninterest expense of $20.4 million increased $6.5 million, or 47.0%, from $13.9 million in the second quarter of 2013, 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, including growth through acquisitions.

Mortgage Banking Segment

Mortgage Banking originates single family residential mortgage loans for sale in the secondary markets. We have become a rated originator and servicer of non-conforming jumbo loans, allowing us to sell these loans to other securitizers. We also purchase loans from WMS 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. On occasion, we may sell a portion of our MSR portfolio. A small percentage of our loans are brokered to other lenders 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 single family mortgage servicing rights within this business segment.

Mortgage Banking segment results are detailed below.

(in thousands)	Three Months Ended June 30, 2014	2013	Change	Percent Change	Six Months Ended June 30, 2014	2013	Change	Percent Change
Net interest income	$3,744	$3,625	$119	3 %	$6,223	$7,733	$(1,510)	(20)%
Noninterest income	47,036	54,780	(7,744)	(14)	78,785	110,387	(31,602)	(29)
Noninterest expense	42,537	42,807	(270)	(1)	79,335	82,747	(3,412)	(4)
Income before income tax expense	8,243	15,598	(7,355)	(47)	5,673	35,373	(29,700)	(84)
Income tax expense	2,634	5,510	(2,876)	(52)	1,879	12,046	(10,167)	(84)
Net income	$5,609	$10,088	$(4,479)	(44)%	$3,794	$23,327	$(19,533)	(84)%
Average assets	$584,256	$581,361	$2,895	— %	$508,109	$593,817	$(85,708)	(14)%
Efficiency ratio (1)	83.77 %	73.29 %			93.33 %	70.05 %		
Full-time equivalent employees (ending)	947	833	114	14	947	833	114	14
Production volumes for sale to the secondary market:								
Single family mortgage closed loan volume (2)(3)	$1,100,704	$1,307,286	$(206,582)	(16)	$1,774,987	$2,499,442	$(724,455)	(29)
Single family mortgage interest rate lock commitments(2)	1,201,665	1,423,290	(221,625)	(16)	2,004,973	2,459,112	(454,139)	(18)
Single family mortgage loans sold(2)	$906,342	$1,229,686	$(323,344)	(26)%	$1,526,255	$2,590,030	$(1,063,775)	(41)%

(1) Noninterest expense divided by total net revenue (net interest income and noninterest income).
(2) Includes loans originated by WMS Series LLC 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 income was $5.6 million for the second quarter of 2014, a decrease of $4.5 million or 44.4% from net income of $10.1 million for the second quarter of 2013. For the first six months of 2014, Mortgage Banking net income was $3.8 million, a decrease of $19.5 million, or 83.7%, from net income of $23.3 million for the first six months of 2013. The decrease in Mortgage Banking net income for the second quarter of 2014 was driven primarily

by higher mortgage interest rates that led to a sharp decrease in interest rate lock commitment volume primarily due to higher mortgage interest rates which began in the latter part of the second quarter of 2013.

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

(in thousands)	Three Months Ended June 30, 2014	2013	Six Months Ended June 30, 2014	2013
Net gain on mortgage loan origination and sale activities:[1]				
Single family:				
Servicing value and secondary market gains[2]	$30,233	$43,448	$49,792	$87,683
Loan origination and funding fees	6,781	8,267	11,542	16,062
Total mortgage banking net gain on mortgage loan origination and sale activities[1]	$37,014	$51,715	$61,334	$103,745

(1) Excludes inter-segment activities.

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

Net gain on mortgage loan origination and sale activities was $37.0 million for the second quarter of 2014, a decrease of $14.7 million, or 28.4%, from $51.7 million in the second quarter of 2013. This decrease is primarily the result of a 15.6% decrease in interest rate lock commitments, which was mainly driven by an increase in mortgage interest rates which began in the latter part of the second quarter of 2013, which led to a decrease in refinance mortgage volume, and a shift to a purchase mortgage-dominated market.

Mortgage Banking servicing income consisted of the following.

(in thousands)	Three Months Ended June 30, 2014	2013	Dollar Change	Percent Change	Six Months Ended June 30, 2014	2013	Dollar Change	Percent Change
Servicing income, net:								
Servicing fees and other	$9,095	$7,216	$1,879	26 %	$18,054	$14,011	$4,043	29 %
Changes in fair value of MSRs due to modeled amortization [1]	(7,109)	(6,964)	(145)	2	(13,077)	(12,639)	(438)	3
	1,986	252	1,734	688	4,977	1,372	3,605	263
Risk management:								
Changes in fair value of MSRs due to changes in model inputs and/or assumptions [2]	(3,326)[3]	15,120	$(18,446)	(122)	(8,735)[3]	19,268	$(28,003)	(145)
Net gain from derivatives economically hedging MSRs	10,941	(13,505)	24,446	(181)	20,838	(16,023)	36,861	(230)
	7,615	1,615	6,000	372	12,103	3,245	8,858	273
Mortgage Banking servicing income	$9,601	$1,867	$7,734	414 %	$17,080	$4,617	$12,463	270 %

(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.

(3) Includes pre-tax income of $4.7 million, net of brokerage fees and prepayment reserves, resulting from the sale of single family MSRs during the three months ended June 30, 2014.

Single family mortgage servicing income of $9.6 million in the second quarter of 2014 increased $7.7 million, or 414%, from $1.9 million in the second quarter of 2013. Included in servicing income for the second quarter of 2014 is $4.7 million of pre-tax income recognized from the sale of single family MSRs. The increase compared to the second quarter of 2013 was also due to improved risk management results and increased servicing fees collected. 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.

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For the first six months of 2014, single family mortgage servicing income of $17.1 million increased $12.5 million, or 269.9%, from $4.6 million for the first six months of 2013, primarily as a result of improved risk management results. Single family mortgage servicing fees collected in the second quarter of 2014 increased $1.9 million, or 26.0%, from the second quarter of 2013 resulting primarily from growth in the portfolio of single family loans serviced for others. As a result of the June 30, 2014 sale of single family MSRs, the portfolio of single family loans serviced for others decreased to $9.9 billion at June 30, 2014 compared to $10.4 billion at June 30, 2013. Mortgage servicing fees collected in future periods will be negatively impacted in the short term because the balance of the loans serviced for others portfolio was reduced as a consequence of this sale.

Single family loans serviced for others consisted of the following.

(in thousands)	At June 30, 2014	At December 31, 2013
Single family		
U.S. government and agency	$9,308,096	$11,467,853
Other	586,978	327,768
Total single family loans serviced for others	$9,895,074	$11,795,621

Mortgage Banking noninterest expense of $42.5 million in the second quarter of 2014 decreased $270 thousand, or 0.6%, from $42.8 million in the second quarter of 2013, primarily due to lower commission and incentive expense as closed loan volumes declined 15.8% from the second quarter of 2013. This decrease was partially offset by higher expenses related to increased salary and related costs and general and administrative expenses resulting from our expansion into new markets.

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 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 2013 Annual Report on Form 10-K, as well as Note 14, Commitments, Guarantees and Contingencies in our 2013 Annual Report on Form 10-K and Note 7, 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 2013 Annual Report on Form 10-K.

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Credit Risk Management

The following discussion highlights developments since December 31, 2013 and should be read in conjunction with the Credit Risk Management discussion within Part II, Item 7 Management's Discussion and Analysis in our 2013 Annual Report on Form 10-K.

Asset Quality and Nonperforming Assets

Nonperforming assets ("NPAs") were $32.3 million, or 1.00% of total assets at June 30, 2014, compared to $38.6 million, or 1.26% of total assets at December 31, 2013. Nonaccrual loans of $21.2 million, or 1.16% of total loans at June 30, 2014, decreased $4.5 million, or 17.5%, from $25.7 million, or 1.36% of total loans at December 31, 2013. OREO balances of $11.1 million at June 30, 2014 decreased $1.8 million, or 14.2%, from $12.9 million at December 31, 2013. Net charge-offs during the three and six months ended June 30, 2014 were $149 thousand and $421 thousand, respectively, compared with $1.1 million and $2.3 million during the three and six months ended June 30, 2013, respectively.

At June 30, 2014, our loans held for investment portfolio, excluding the allowance for loan losses, was $1.83 billion, a decrease of $60.9 million from December 31, 2013. The allowance for loan losses decreased to $21.9 million, or 1.19% of loans held for investment, compared to $23.9 million, or 1.26% of loans held for investment at December 31, 2013.
Due to a significant decrease in classified loan balances and lower charge-offs, the Company recorded no provision for credit losses in the second quarter of 2014 compared to a provision of $400 thousand in the second quarter of 2013. For the six months ended June 30, 2014, we had a release of reserves of $1.5 million, compared to a provision for credit losses of $2.4 million for the six months ended 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.

	At June 30, 2014			
(in thousands)	Recorded Investment		Unpaid Principal Balance	Related Allowance
Impaired loans:				
Loans with no related allowance recorded	$73,616		$89,210	$—
Loans with an allowance recorded	43,396		44,172	2,528
Total	$117,012	(1)	$133,382	$2,528

	At December 31, 2013			
(in thousands)	Recorded Investment		Unpaid Principal Balance	Related Allowance
Impaired loans:				
Loans with no related allowance recorded	$81,301		$112,795	$—
Loans with an allowance recorded	38,568		38,959	2,571
Total	$119,869	(1)	$151,754	$2,571

(1) Includes $67.8 million and $70.3 million in single family performing troubled debt restructurings ("TDRs") at June 30, 2014 and December 31, 2013, respectively.

The Company had 227 impaired loans totaling $117.0 million at June 30, 2014 and 216 impaired loans totaling $119.9 million at December 31, 2013. The average recorded investment in these loans for the three and six months ended June 30, 2014 was $117.4 million and $118.2 million, respectively, compared with $127.6 million and $126.4 million for the three and six months ended June 30, 2013, respectively. Impaired loans of $43.4 million and $38.6 million had a valuation allowance of $2.5 million and $2.6 million at June 30, 2014 and December 31, 2013, respectively.

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 —

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Allowance for Loan Losses within Part II, Item 7 Management's Discussion and Analysis in our 2013 Annual Report on Form 10-K.

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

	At June 30, 2014			At December 31, 2013		
(in thousands)	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	$9,111	41.1 %	40.7 %	$11,990	49.8 %	47.7 %
Home equity	3,517	15.9	7.4	3,987	16.6	7.1
	12,628	57.0	48.1	15,977	66.4	54.8
Commercial loans						
Commercial real estate	4,063	18.3	25.9	4,012	16.7	25.2
Multifamily	887	4.0	3.9	942	3.9	4.2
Construction/land development	2,418	10.9	11.9	1,414	5.9	6.9
Commercial business	2,172	9.8	10.2	1,744	7.1	8.9
	9,540	43.0	51.9	8,112	33.6	45.2
Total allowance for credit losses	$22,168	100.0 %	100.0 %	$24,089	100.0 %	100.0 %

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

(in thousands)	Three Months Ended June 30, 2014	Three Months Ended June 30, 2013	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013
Allowance at the beginning of period	$22,317	$28,594	$24,089	$27,751
Provision for loan losses	—	400	(1,500)	2,400
Recoveries:				
Consumer				
Single family	25	171	41	246
Home equity	236	156	326	253
	261	327	367	499
Commercial				
Commercial real estate	100	—	156	—
Construction/land development	46	281	62	351
Commercial business	63	36	147	148
	209	317	365	499
Total recoveries	470	644	732	998
Charge-offs:				
Consumer				
Single family	(172)	(1,141)	(283)	(1,862)
Home equity	(136)	(299)	(559)	(1,138)
	(308)	(1,440)	(842)	(3,000)
Commercial				
Commercial real estate	(23)	(340)	(23)	(143)
Construction/land development	—	—	—	(148)
Commercial business	(288)	—	(288)	—
	(311)	(340)	(311)	(291)
Total charge-offs	(619)	(1,780)	(1,153)	(3,291)
(Charge-offs), net of recoveries	(149)	(1,136)	(421)	(2,293)
Balance at end of period	$22,168	$27,858	$22,168	$27,858

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

(in thousands)	At June 30, 2014 Accrual	Nonaccrual	Total
Consumer			
Single family [1]	$69,779	$1,461	$71,240
Home equity	2,394	—	2,394
	72,173	1,461	73,634
Commercial			
Commercial real estate	21,401	2,735	24,136
Multifamily	3,125	—	3,125
Construction/land development	5,843	—	5,843
Commercial business	302	9	311
	30,671	2,744	33,415
	$102,844	$4,205	$107,049

(in thousands)	At December 31, 2013 Accrual	Nonaccrual	Total
Consumer			
Single family [1]	$70,304	$4,017	$74,321
Home equity	2,558	86	2,644
	72,862	4,103	76,965
Commercial			
Commercial real estate	19,620	628	20,248
Multifamily	3,163	—	3,163
Construction/land development	6,148	—	6,148
Commercial business	112	—	112
	29,043	628	29,671
	$101,905	$4,731	$106,636

(1) Includes loan balances insured by the FHA or guaranteed by the VA of $19.0 million and $17.8 million, at June 30, 2014 and December 31, 2013, respectively.

The Company had 210 loan relationships classified as troubled debt restructurings (“TDRs”) totaling $107.0 million at June 30, 2014 with related unfunded commitments of $52 thousand. The Company had 204 loan relationships classified as TDRs totaling $106.6 million at December 31, 2013 with related unfunded commitments of $47 thousand. TDR loans within the loans held for investment portfolio and the related reserves are included in the impaired loan tables above.

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

(in thousands)	At June 30, 2014 30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due and Not Accruing	90 Days or More Past Due and Still Accruing		Total Past Due Loans	Other Real Estate Owned
Consumer loans							
Single family	$10,967	$3,943	$6,988	$32,032	(1)	$53,930	$3,205
Home equity	209	368	1,166	—		1,743	—
	11,176	4,311	8,154	32,032		55,673	3,205
Commercial loans							
Commercial real estate	—	—	9,871	—		9,871	2,040
Construction/land development	—	72	—	—		72	5,838
Commercial business	759	837	3,172	—		4,768	—
	759	909	13,043	—		14,711	7,878
Total	$11,935	$5,220	$21,197	$32,032		$70,384	$11,083

(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.

(in thousands)	At December 31, 2013 30-59 Days Past Due	60-89 Days Past Due	90 Days or More Past Due and Not Accruing	90 Days or More Past Due and Still Accruing[(1)]		Total Past Due Loans	Other Real Estate Owned
Consumer loans							
Single family	$6,466	$4,901	$8,861	$46,811	(1)	$67,039	$5,246
Home equity	375	75	1,846	—		2,296	—
	6,841	4,976	10,707	46,811		69,335	5,246
Commercial loans							
Commercial real estate	—	—	12,257	—		12,257	1,688
Construction/land development	—	—	—	—		—	5,977
Commercial business	—	—	2,743	—		2,743	—
	—	—	15,000	—		15,000	7,665
Total	$6,841	$4,976	$25,707	$46,811		$84,335	$12,911

(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 Resources

Liquidity risk management is primarily intended to ensure we are able to maintain cash flows adequate to fund operations and meet our obligations, including demands from depositors, 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., HomeStreet Capital ("HSC") and the Bank
have established liquidity guidelines and operating plans that detail the sources and uses of cash and liquidity.

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

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HomeStreet, Inc.

The main source of liquidity for HomeStreet, Inc. is proceeds from dividends from the Bank and HomeStreet Capital. 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. HomeStreet, Inc.'s ability to pay dividends to shareholders depends substantially on dividends received from the Bank.

HomeStreet Capital

HomeStreet Capital generates positive cash flow from its servicing fee income on the DUS portfolio, net of its costs to service the portfolio. Offsetting this are HomeStreet Capital's costs to purchase the servicing rights on new production from the Bank. Liquidity management and reporting requirements for DUS lenders such as HomeStreet Capital are set by Fannie Mae. HomeStreet Capital's liquidity management therefore consists of meeting Fannie Mae requirements and its own operational needs.

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 June 30, 2014, our primary liquidity ratio was 35.2% compared to 26.9% at December 31, 2013.

At June 30, 2014 and December 31, 2013, the Bank had available borrowing capacity of $166.4 million and $228.5 million from the FHLB, and $393.5 million and $332.7 million from the Federal Reserve Bank of San Francisco, respectively.

Cash Flows

For the six months ended June 30, 2014, cash and cash equivalents increased $41.1 million, compared to a decrease of $3.6 million for the six months ended June 30, 2013. 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 six months ended June 30, 2014, net cash of $236.2 million was used in operating activities, as cash used to fund loans held for sale production exceeded proceeds from the sale of loans. 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 six months ended June 30, 2013, net cash of $115.1 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.

Cash flows from investing activities

The Company's investing activities primarily include available-for-sale securities and loans originated as held for investment. For the six months ended June 30, 2014, net cash of $122.0 million was provided by investing activities, resulting from the sale of loans originated as held for investment and the sale of investment securities, primarily offset by the funding of portfolio loans. The Company elected to sell single-family mortgage loans to provide additional liquidity to support the commercial loan portfolio growth and to reduce the concentration of single-family mortgage loans in the portfolio. For the six months ended June 30, 2013, net cash of $256.3 million was used in investing activities, as the Company increased the balances of its investment securities portfolio and its loans held for investment portfolio.

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Cash flows from financing activities

The Company's financing activities are primarily related to customer deposits and net proceeds from the FHLB. For the six months ended June 30, 2014, net cash of $155.4 million was provided by financing activities, primarily driven by a $206.9 million growth in deposits, partially offset by net repayments of FHLB advances of $62.5 million. For the six months ended June 30, 2013, net cash of $137.6 million was provided by financing activities. We had net proceeds of $150.4 million of FHLB advances as the Company grew its investment securities portfolio by $121.8 million and its loans held for investment portfolio by $107.5 million, both of which require additional wholesale funding.

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 June 30, 2014, the Bank's capital ratios continued to meet the regulatory capital category of “well capitalized” as defined by the FDIC’s prompt corrective action rules.

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

	At June 30, 2014								
	Actual			For Minimum Capital Adequacy Purposes			To Be Categorized As “Well Capitalized” Under Prompt Corrective Action Provisions		
(in thousands)	Amount	Ratio		Amount	Ratio		Amount	Ratio	
Tier 1 leverage capital (to average assets)	$307,110	10.17	%	$120,739	4.0	%	$150,924	5.0	%
Tier 1 risk-based capital (to risk-weighted assets)	307,110	13.84	%	88,760	4.0	%	133,140	6.0	%
Total risk-based capital (to risk-weighted assets)	$329,277	14.84	%	$177,520	8.0	%	$221,900	10.0	%

	At December 31, 2013								
	Actual			For Minimum Capital Adequacy Purposes			To Be Categorized As “Well Capitalized” Under Prompt Corrective Action Provisions		
(in thousands)	Amount	Ratio		Amount	Ratio		Amount	Ratio	
Tier 1 leverage capital (to average assets)	$291,673	9.96	%	$117,182	4.0	%	$146,478	5.0	%
	291,673	14.12	%	81,708	4.0	%	122,562	6.0	%

Tier 1 risk-based capital (to risk-weighted assets)						
Total risk-based capital (to risk-weighted assets)	$315,762	15.28 %	$163,415	8.0 %	$204,269	10.0 %

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New Capital Regulations

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 at least 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 at least 6.0% and a total risk-based ratio of at least 8.0%. In addition to the preceding requirements, both the Company and the Bank are required to establish a “conservation buffer”, consisting of common equity Tier 1 capital, which is at least 2.5% above each of the preceding common equity Tier 1 capital ratios, the Tier 1 risk-based ratio and the total risk based ratio. 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. As a result, the Company will not be required to exclude our outstanding trust preferred securities from our Tier 1 capital calculations.

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 as of the effective date, and we have taken additional steps, including the sale of MSRs in the quarter ended June 30, 2014, to increase our capital to prepare for compliance with these new standards.

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

The following discussion highlights developments since December 31, 2013 and should be read in conjunction with the Market Risk Management discussion within Part II, Item 7A Quantitative and Qualitative Disclosures About Market Risk in our 2013 Annual Report on Form 10-K. Since December 31, 2013, there have been no material changes in the types of risk management instruments we use or in our hedging strategies.

During the six months ending June 30, 2014, the Company undertook certain actions in order to adjust the interest rate risk sensitivity of its balance sheet. Specifically, the Company reduced the interest rate sensitivity of its available-for-sale investment securities and held-for-investment loan portfolios and extended the maturity of a portion of its FHLB borrowings. As a result of these combined actions, the estimated sensitivity of net interest income is positively correlated with changes in interest rates, meaning an increase (decrease) in interest rates would result in an increase (decrease) in net interest income.

Market risk is defined as the sensitivity of income, fair value measurements and capital to changes in interest rates, foreign currency exchange rates, commodity prices and other relevant market rates or prices. The primary market risks that we are exposed to are price and interest rate risks. Price risk is defined as the risk to current or anticipated earnings or capital arising from changes in the value of either assets or liabilities that are entered into as part of distributing or managing risk. Interest rate risk is defined as risk to current or anticipated earnings or capital arising from movements in interest rates.

For the Company, price and interest rate risks arise from the financial instruments and positions we hold. This includes loans, mortgage servicing rights, investment securities, deposits, borrowings, long-term debt and derivative financial instruments. Due to the nature of our operations, we are not subject to foreign currency exchange or commodity price risk. Our real estate loan portfolio is subject to risks associated with the local economies of our various markets and, in particular, the regional economy of the Pacific Northwest and, to a growing extent, California.

Our price and interest rate risks are managed by the Bank’s Asset/Liability Management Committee ("ALCO"), a management committee that identifies and manages the sensitivity of earnings or capital to changing interest rates to achieve our overall financial objectives. ALCO is a management-level committee whose members include the Chief Investment Officer, acting as the chair, the Chief Executive Officer and other members of management. The committee meets monthly and is responsible for:

- understanding the nature and level of the Company's interest rate risk and interest rate sensitivity;
- assessing how that risk fits within our overall business strategies;
- ensuring an appropriate level of rigor and sophistication in the risk management process for the overall level of risk;
- complying with and reviewing the asset/liability management policy;
- formulating and implementing strategies to improve balance sheet mix and earnings.

The Finance Committee of the Bank's Board provides oversight of the asset/liability management process, reviews the results of interest rate risk analysis and approves relevant policies.

The spread between the yield on interest-earning assets and the cost of interest-bearing liabilities and the relative dollar amounts of these assets and liabilities are the principal items affecting net interest income. Changes in net interest spread (interest rate risk) are influenced to a significant degree by the repricing characteristics of assets and liabilities (timing risk), the relationship between various rates (basis risk), customer options (option risk) and changes in the shape of the yield curve (time-sensitive risk). We manage the available-for-sale investment securities portfolio while maintaining a balance between risk and return. The Company's funding strategy is to grow core deposits while

we efficiently supplement using wholesale borrowings.

We estimate the sensitivity of our net interest income to changes in market interest rates using an interest rate simulation model that includes assumptions related to the level of balance sheet growth, deposit repricing characteristics and the rate of prepayments for multiple interest rate change scenarios. Interest rate sensitivity depends on certain repricing characteristics in our interest-earnings assets and interest-bearing liabilities, including the maturity structure of assets and liabilities and their repricing characteristics during the periods of changes in market interest rates. Effective interest rate risk management seeks to ensure both assets and liabilities respond to changes in interest rates within an acceptable timeframe, minimizing the impact of interest rate changes on net interest income and capital. Interest rate sensitivity is measured as the difference between the

volume of assets and liabilities, at a point in time, that are subject to repricing at various time horizons, known as interest rate sensitivity gaps.

The following table presents sensitivity gaps for these different intervals.

	June 30, 2014							
(dollars in thousands)	3 Mos. or Less	More Than 3 Mos. to 6 Mos.	More Than 6 Mos. to 12 Mos.	More Than 12 Mos. to 3 Yrs.	More Than 3 Yrs. to 5 Yrs.	More Than 5 Yrs.	Non-Rate-Sensitive	Total
Interest-earning assets:								
Cash & cash equivalents	$74,991	$—	$—	$—	$—	$—	$—	$74,991
FHLB Stock	—	—	—	—	—	34,618	—	34,618
Investment securities[1]	10,835	6,828	11,253	85,071	40,094	300,885	—	454,966
Mortgage loans held for sale	549,440	—	—	—	—	—	—	549,440
Loans held for investment[1]	542,832	116,243	206,364	414,976	299,567	254,839	—	1,834,82
Total interest-earning assets	1,178,098	123,071	217,617	500,047	339,661	590,342	—	2,948,83
Non-interest-earning assets	—	—	—	—	—	—	286,840	286,840
Total assets	$1,178,098	$123,071	$217,617	$500,047	$339,661	$590,342	$286,840	$3,235,6
Interest-bearing liabilities:								
NOW accounts [2]	$324,604	$—	$—	$—	$—	$—	$—	$324,60
Statement savings accounts[2]	166,851	—	—	—	—	—	—	166,851
Money market accounts[2]	996,473	—	—	—	—	—	—	996,473
Certificates of deposit	183,434	80,799	55,190	124,439	13,667	—	—	457,529
FHLB advances	288,500	30,000	—	50,000	—	15,590	—	384,090
Securities sold under agreements to repurchase	14,681	—	—	—	—	—	—	14,681
Long-term debt [3]	61,857	—	—	—	—	—	—	61,857
Total interest-bearing liabilities	2,036,400	110,799	55,190	174,439	13,667	15,590	—	2,406,08
Non-interest bearing liabilities	—	—	—	—	—	—	541,342	541,342
Equity	—	—	—	—	—	—	288,249	288,249
Total liabilities and shareholders' equity	$2,036,400	$110,799	$55,190	$174,439	$13,667	$15,590	$829,591	$3,235,6

Interest sensitivity gap	$(858,302)	$12,272	$162,427	$325,608	$325,994	$574,752
Cumulative interest sensitivity gap	$(858,302)	$(846,030)	$(683,603)	$(357,995)	$(32,001)	$542,751
Cumulative interest sensitivity gap as a percentage of total assets	(26.5)%	(26.1)%	(21.1)%	(11.1)%	(1.0)%	16.8%
Cumulative interest-earning assets as a percentage of cumulative interest-bearing liabilities	57.9%	60.6%	69.0%	84.9%	98.7%	122.6%

(1) Based on contractual maturities, repricing dates and forecasted principal payments assuming normal amortization and, where applicable, prepayments.
(2) Assumes 100% of interest-bearing non-maturity deposits are subject to repricing in three months or less.
(3) Based on contractual maturity.

As of June 30, 2014, the Bank was asset sensitive overall, but liability sensitive in the "three months or less" period. The positive gap in the interest rate sensitivity analysis indicates that our net interest income would rise in the long term if market interest rates increase and generally fall in the long term if market interest rates decline.

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Changes in the mix of interest-earning assets or interest-bearing liabilities can either increase or decrease the net interest margin, without affecting interest rate sensitivity. In addition, the interest rate spread between an earning asset and its funding liability can vary significantly, while the timing of repricing for both the asset and the liability remains the same, thereby impacting net interest income. This characteristic is referred to as basis risk. Varying interest rate environments can create unexpected changes in prepayment levels of assets and liabilities that are not reflected in the interest rate sensitivity analysis. These prepayments may have a significant impact on our net interest margin. Because of these factors, an interest sensitivity gap analysis may not provide an accurate assessment of our actual exposure to changes in interest rates.

The estimated impact on our net interest income over a time horizon of one year and the change in net portfolio value as of June 30, 2014 and December 31, 2013 are provided in the table below. For the scenarios shown, the interest rate simulation assumes an instantaneous and sustained shift in market interest rates and no change in the composition or size of the balance sheet.

	June 30, 2014		December 31, 2013	
Change in Interest Rates	Percentage Change			
(basis points)	Net Interest Income [1]	Net Portfolio Value [2]	Net Interest Income [1]	Net Portfolio Value [2]
+200	1.0 %	(11.6)%	(4.4)%	(21.2)%
+100	0.5	(4.0)	(1.6)	(10.9)
-100	(3.3)	(3.9)	(1.9)	7.8
-200	(7.1)%	(6.1)%	(3.0)%	6.7 %

(1) This percentage change represents the impact to net interest income and servicing income for a one-year period, assuming there is no change in the structure of the balance sheet.

(2) This percentage change represents the impact to the net present value of equity, assuming there is no change in the structure of the balance sheet.

At June 30, 2014, we believe our net interest income sensitivity did not exhibit a strong bias to either an increase in interest rates or a decline in interest rates. During the six months ended June 30, 2014, the Company has reduced the interest rate sensitivity of its assets and increased the interest rate sensitivity of its liabilities. It is expected that, as interest rates change, net interest income will be positively correlated with rate movements, i.e. an increase (decrease) in interest rates would result in an increase (decrease) in net interest income. Some of the assumptions made in the simulation model may not materialize and unanticipated events and circumstances will occur. In addition, the simulation model does not take into account any future actions that we could undertake to mitigate an adverse impact due to changes in interest rates from those expected, in the actual level of market interest rates or competitive influences on our deposits.

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 June 30, 2014.

Internal Control Over Financial Reporting

There were no changes to our internal control over financial reporting that occurred during the quarter ended June 30, 2014 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 loss based on information known at this time.

ITEM 1A RISK FACTORS

This Quarterly Report on Form 10-Q contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of certain factors, including the risks faced by us described below and elsewhere in this report.

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. Increases in interest rates in early 2014 reduced our mortgage revenues in large part by drastically reducing the market for refinancings, which has negatively impacted our noninterest income and, to a lesser extent, our net interest income, as well as 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.

In addition, 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. Future interest rate fluctuations may impact the value of these securities and as a result, 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 continue to rise, particularly if they rise substantially, we may experience a further reduction in mortgage financing of new home purchases and refinancing. These factors have negatively affected our mortgage loan origination volume and our noninterest income in the past and may do so again in the future.

Current economic conditions continue to pose significant challenges for us and could adversely affect our financial condition and results of operations.

Despite recent improvements in the economy and increases in interest rates, we are continuing to operate in an uncertain economic environment, including sluggish national and global conditions, accompanied by high unemployment and very low interest rates. Financial institutions continue to be affected by changing conditions in the real estate and financial markets, along with an arduous and changing regulatory climate. Recent improvements in the housing market may not continue, and a return to a recessionary economy could result in financial stress on our borrowers that may result in volatility in home prices, increased foreclosures and significant write-downs of asset values, all of which would adversely affect our financial condition and results of operations.

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

- Market developments may affect consumer confidence levels and may cause adverse changes in payment patterns, resulting in increased delinquencies and default rates on loans and other credit facilities;
- Regulatory scrutiny of the industry could increase, leading to harsh regulation of our industry that could lead to a higher cost of compliance, limit our ability to pursue business opportunities and increase our exposure to the judicial system and the plaintiff's bar;
- 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;
- If our forecasts of economic conditions and other economic predictions are not accurate, we may face challenges in accurately estimating the ability of our borrowers to repay their loans;
- Further erosion in the fiscal condition of the U.S. Treasury may lead to new taxes limiting the ability of the Company to pursue growth and return profits to shareholders; and
- Future political developments and fiscal policy decisions may create uncertainty in the marketplace.

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.

The proposed restructuring or replacement of Fannie Mae and Freddie Mac and changes in existing government-sponsored and federal mortgage programs could adversely 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. The Obama administration has called for scaling back the role of the U.S. government in, and promoting the return of private capital to, the mortgage markets and the reduction of the role of Fannie Mae and Freddie Mac in the mortgage markets by, among other things, reducing conforming loan limits, increasing guarantee fees and requiring larger down payments by borrowers with the ultimate goal of winding down Fannie Mae and Freddie Mac.

One of the leading proposals being debated in Congress would eliminate Fannie Mae and Freddie Mac and replace them with a government-regulated cooperative authorized to issue mortgage-backed securities with a governmental guarantee. Other proposals have suggested privatizing Fannie Mae and Freddie Mac. We cannot predict how or when Congress will act in response to these or other proposals. However, any restructuring or replacement of Fannie Mae and Freddie Mac that restricts the current loan purchase programs of those entities may 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 $118.0 million at June 30, 2014. Changes in the policies and operations of Fannie Mae and Freddie Mac or any replacement for or successor to those entities 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.

In addition, our ability to generate income through mortgage sales to institutional investors depends in part on programs sponsored by Fannie Mae, Freddie Mac and Ginnie Mae, which facilitate the issuance of mortgage-backed securities in the secondary market. Any discontinuation of, or significant reduction in, the operation of those programs could have a material adverse effect on our loan origination and mortgage sales as well as our results of operations. Also, any significant adverse change in the level of activity in the secondary market or the underwriting criteria of these entities could negatively impact our results of business, operations and cash flows.

We may need to increase our capital to be prepared to comply with more stringent capital requirements under Basel III beginning on January 1, 2015.

In July 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 Section 171 of 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

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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 means in effect that in order to prevent certain regulatory restrictions, the common equity Tier 1 capital ratio requirement will be 7.0%, the Tier 1 risk-based ratio requirement will be 8.5% and the total risk-based ratio requirement will be 10.5%. 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. The requirement for a conservation buffer will be phased in beginning in 2016 and will take full effect on January 1, 2019.

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 ratio calculations. Under current capital standards, the effects of accumulated other comprehensive income items included in capital are excluded for the purposes of determining regulatory capital ratios. Under Basel III, the effects of certain accumulated other comprehensive items are not excluded; however, banking organizations that are not required to use advanced approaches, including the Company and the Bank, may make a one-time permanent election to continue to exclude these items. The Company and Bank expect to make this election in order to avoid significant variations in the level of capital depending upon the impact of interest rate fluctuations on the fair value of the Company's securities portfolio.

In addition, deductions include, for example, the requirement that mortgage servicing rights, certain deferred tax assets not dependent upon future taxable income and significant investments in non-consolidated financial entities be deducted from the new common equity Tier 1 capital to the extent that any one such category exceeds 10% of new common equity Tier 1 capital, or all such categories in the aggregate exceed 15% of new common equity Tier 1 capital. 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. See “Regulation and Supervision of Home Street Bank - Capital and Prompt Corrective Action Requirements - New Capital Regulations” in Item 1 of our Form 10-K for the year ended December 31, 2013 previously filed with the SEC.

The sale of approximately 24% of our MSR portfolio in the second quarter of 2014 was consummated in part to facilitate balance sheet and capital management in preparation for Basel III. The application of more stringent capital requirements could, among other things, result in lower returns on invested capital and result in regulatory actions if we were to be unable to comply with such requirements.

We are subject to extensive regulation that may restrict our activities, including declaring cash dividends or capital distributions, and imposes 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. Examination findings by the regulatory agencies may result in adverse consequences to the Company or the Bank. We have, in the past, been subject to specific regulatory orders that constrained our business and required us to take measures that investors may have deemed undesirable, and we may again in the future be subject to such orders if banking regulators were to determine that our operations require such restrictions. 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 and may have a material negative effect on us.

The Dodd-Frank Act significantly changed the laws as they apply to financial institutions and revised and expanded 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 were effective immediately, though many are being phased in gradually. In addition, the statute in many instances calls for regulatory rulemaking to implement its provisions. While some provisions are now being implemented, such
as the Basel III capital standards which take effect beginning on January 1, 2015, not all of the regulations called for by
Dodd-Frank have been completed or are in effect, 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

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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. For example, the Dodd-Frank Act 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. See “Regulation and Supervision” in Item 1 of our Form 10-K for the year ended December 31, 2013 previously filed with the SEC.

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. . While the Oregon Supreme Court has ruled on the appeal of several lower-court MERS cases, enough ambiguity exists in the ruling that we and other servicers of MERS-related loans have elected to foreclose primarily through judicial procedures in Oregon, resulting in increased foreclosure costs, longer foreclosure timelines and additional delays. If state courts in Washington or other states where we do significant business issue similar decisions 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, servicing costs, and adversely affect our cost of doing business and results of operations.

These or other judicial decisions or legislative actions, if upheld or implemented, 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 and courts decisions generally have focused primarily, if not exclusively, on residential mortgage origination and servicing, 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 grow 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.

New CFPB regulations which took effect in January 2014 may negatively impact our residential mortgage loan business and compliance risk.

Our consumer business, including our mortgage, credit card, and other consumer lending and non-lending businesses, may be adversely affected by the policies enacted or regulations adopted by the Consumer Financial Protection Bureau (CFPB) which has broad rulemaking authority over consumer financial products and services. In January 2014 new federal regulations promulgated by the CFPB took effect which impact how we originate and service residential mortgage loans. The new regulations, among other things, require mortgage lenders to assess and document a borrower's ability to repay their mortgage loan. The regulations provide borrowers the ability to challenge foreclosures and sue for damages based on allegations that the lender failed to meet the standard for determining the borrower's ability to repay their loan. While the regulations include presumptions in favor of the lender based on certain loan underwriting criteria, it is uncertain how these presumptions will be construed and applied by courts in the event of litigation. The ultimate impact of these new regulations on the lender's enforcement of its loan documents in the event of a loan default, and the cost and expense of doing so, is uncertain, but may be

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significant. In addition, the secondary market demand for loans that do not fall within the presumptively safest category of a “qualified mortgage” as defined by the CFPB is uncertain.

The new regulations also require changes to certain loan servicing procedures and practices. The new servicing rules will, among other things, result in increased foreclosure costs and longer foreclosure timelines in the event of loan default, and failure to comply with the new servicing rules may result in additional litigation and compliance risk.

The CFPB recently proposed additional rules under the Home Mortgage Disclosure Act (“HMDA”) that are intended to improve information reported about the residential mortgage market and increase disclosure about consumer access to mortgage credit. As drafted, the proposed updates to the HMDA increase the types of dwelling-secured loans that would be subject to the disclosure requirements of the rule and expands the categories of information that financial institutions such as the Bank would be required to report with respect to such loans and such borrowers, including potentially sensitive customer information. If implemented, these changes would increase our compliance costs due to the need for additional resources to meet the enhanced disclosure requirements, including additional personnel and training costs as well as informational systems to allow the Bank to properly capture and report the additional mandated information. In addition, because of the anticipated volume of new data that would be required to be reported under the updated rules, the Bank would face an increased risk of errors in the information. More importantly, because of the sensitive nature of some of the additional customer information to be included in such reports, the Bank would face a higher potential for a security breach resulting in the disclosure of sensitive customer information in the event the HMDA reporting files were obtained by an unauthorized party.

While the full impact of CFPB's activities on our business is still unknown, we anticipate that the proposed rule change under the HMDA and other CFPB actions that may follow 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 Item 1 of our Form 10-K for the year ended December 31, 2013 previously filed with the SEC.

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.

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. New capital rules will also impose more stringent capital requirements to maintain “well capitalized” status which may additionally impact the Bank’s ability to pay dividends to the Company. See “Regulation of Home Street Bank - Capital and Prompt Corrective Action Requirements - New Capital Rules” in Item 1 of our Form 10-K for the year ended December 31, 2013 previously filed with the SEC. 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. While the Company has made special dividend distributions to its public shareholders in recent quarters, the Company has not adopted a dividend policy and the board of directors determined that it is in the best interests of the shareholders not to declare a dividend to be paid in the second

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and third quarters of 2014. As such, our dividends are not regular and are subject to restriction due to cash flow limitations, capital requirements, capital needs of the business or other factors.

We cannot assure you that we will remain profitable.

We have sustained significant losses in the past and our profitability has declined in recent quarters. We 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, and our ability to remain profitable is threatened by a myriad of issues, including:

- Further increases in interest rates may continue to 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 and servicing rights;
- Changes in regulations that impact the Company or the Bank and may limit our ability to offer certain products or services or may increase our costs of compliance;
- Increased costs from growth through acquisition could exceed the income growth anticipated from these opportunities, especially in the short term as these acquisitions are integrated into our business;
- Changes in government-sponsored enterprises and their ability to insure or to buy our loans in the secondary market may result in 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 on our mortgages, which will negatively impact our net interest income;
- Changes in the cost structures and fees of government-sponsored enterprises 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, which in turn may result in a lower rate of profitability or even substantial losses for the Company.

We have been pursuing an aggressive growth strategy within both our single family mortgage banking and Commercial Bank business segments through hiring of additional 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 loan and support personnel in both our traditional markets and in additional Western states and we expect to continue to grow our business through opportunistic hiring of additional loan origination and servicing personnel. In addition to increasing our exposure to a more volatile single family mortgage banking segment of our business by increasing the number of originators of such loans, the aggressive growth strategy for both the single family Mortgage Banking segment and the Commercial and Consumer Banking segment of our business 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 our investment in new employees who are terminated or seek to leave the Company prior to being profitable to us;
- The potential loss of other key employees.

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

Future acquisitions could consume significant resources, present significant challenges in integration and may not be successful.

In the fourth quarter of 2013 we completed our acquisitions of Fortune Bank, Yakima National Bank and the two retail branches of AmericanWest Bank. While we consider those acquisitions to be substantially integrated, 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. Any future acquisition we may undertake may involve numerous risks related to the investigation and consideration of the potential
acquisition, the costs of undertaking such a transaction and, if we are successful in closing such transaction, the risks inherent in 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:

- Diversion of management's attention from normal daily operations of the business;
- Costs incurred in the process of vetting potential acquisition candidates which may not be recouped by the Company;
- Difficulties in integrating the operations, technologies, and personnel of the acquired companies;
- Difficulties in implementing internal controls over financial reporting;
- 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;
- Potential 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 pursuing or integrating any new acquisitions may increase our costs and adversely impact our financial condition and results of operations. Further, even if we successfully address these factors and are successful in closing the transaction and integrating the systems together, we may nonetheless experience customer losses, or we may fail to grow the acquired businesses as we intend.

Federal, state and local consumer protection laws may restrict our ability to offer and/ or increase our risk of liability with respect to certain products and services and could increase our cost of doing business.

Federal, state and local laws have been adopted that are intended to eliminate certain practices considered “predatory” or “unfair and deceptive”.” These laws prohibit practices such as steering borrowers away from more affordable products, failing to disclose key features, limitations, or costs related to products and services, selling unnecessary insurance to borrowers, repeatedly refinancing loans, imposing excessive fees for overdrafts, 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 and regulations create the potential for liability with respect to our lending, servicing, loan investment and deposit taking activities. As we offer products and services to customers in additional states, we may become subject to additional state and local laws designed to protect consumers. The additional laws and regulations may increase our cost of doing business, and ultimately may prevent us from making certain loans, offering certain products, and may cause us to reduce the average percentage rate or the points and fees on loans and other products and services that we do provide.

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 are stable in the markets in which we operate, if market values decline, 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

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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 because we recognize these revenues only upon collection;
- 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, as a result of our acquisitions of Fortune Bank, Yakima National Bank and two branches of AmericanWest Bank in the second half of 2013, we have added the loans previously held by the acquired companies or related to the acquired branches to our books. Any future acquisitions we may make will have a similar result. Although we review loan quality as part of our due 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.

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.

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 PCs, and other mobile devices that are beyond our control systems. Although we believe we have robust information security procedures and controls, we are heavily reliant on our third party vendors, and our vendors' or our own
our technologies, systems, networks and our customers' devices may become the target of cyber-attacks, computer viruses, malicious code, unauthorized access, hackers 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. In addition, some of our primary third party service providers may be subject to enhanced regulatory scrutiny due to regulatory findings during examinations of such service provider(s) conducted by federal regulators. While we have and will subject such vendor(s) to higher scrutiny and monitor any corrective measures that the vendor(s) are or would undertake, we are not able to fully mitigate any risk which could result from a breach or other operational failure caused by this, or any other vendor's breach.

To date we are not aware of 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, cybersecurity 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, however, our measures may be insufficient to prevent physical .and electronic break-ins, denial of service and other cyber-attacks or security breaches.

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, additional regulatory scrutiny, reputational damage, litigation, 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 may compromise our ability to perform critical functions in a timely manner and could have a material adverse effect on our business, financial condition and results of operations as well

as our reputation and customer or vendor relationships.

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.

The failure to protect our customers' confidential information and privacy could adversely affect our business.
We are subject to state and federal privacy regulations and confidentiality obligations that, among other things restrict the use and dissemination of, and access to, the information that we produce, store or maintain in the course of our business. We also

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have contractual obligations to protect certain confidential information we obtain from our existing vendors and customers. These obligations generally include protecting such confidential information in the same manner and to the same extent as we protect our own confidential information, and in some instances may impose indemnity obligations on us relating to unlawful or unauthorized disclosure of any such information.

The actions we may take in order to promote compliance with these obligations vary by business segment and may change over time, but may include, among other things:

- training and educating our employees and independent contractors regarding our obligations relating to confidential information;
- monitoring changes in state or federal privacy and compliance requirements;
- drafting and enforcing appropriate contractual provisions into any contract that raises proprietary and confidentiality issues;
- maintaining secure storage facilities and protocols for tangible records;
- physically and technologically securing access to electronic information; and
- in the event of a security breach, providing credit monitoring or other services to affected customers.

If we do not properly comply with privacy regulations and protect confidential information, we could experience adverse consequences, including regulatory sanctions, penalties or fines, increase compliance costs, litigation and damage to our reputation, which in turn could result in decreased revenues and loss of customers, all of which would have a material adverse effect on our business, financial condition and results of operations.

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, or if any parties to whom our third party service providers have subcontracted services, 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.

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.

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

The 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 be unable to pay their loans 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, in 2008 implemented its standing monetary policy known as “quantitative easing,” a program involving the purchase of mortgage backed securities and United States Treasury securities, the volume of which has been aligned with specific economic targets or measures intended to bolster the U.S. economy. As the Federal Reserve Board, through the Federal Open Market Committee (the “Committee”), monitors economic performance, the volume of the quantitative easing program continues to be incrementally reduced. The Committee has stated that if incoming information broadly supports the Committee's expectation of ongoing improvement in labor market conditions and inflation moving back toward its longer-run objective, the Committee will likely reduce the pace of asset purchases in further measured steps at future meetings. However, asset purchases are not on a preset course, and the Committee's decisions about their pace will remain contingent on the Committee's outlook for the labor market and inflation as well as its assessment of the likely efficacy and costs of such purchases.

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 monetary policies 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. Continued reduction or termination of the quantitative easing program may likely further raise interest rates, which could reduce our mortgage origination revenues and in turn have a material adverse impact upon our business.

A substantial portion of our revenue is derived from residential mortgage lending which is a market sector that experiences significant volatility.

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. An increase in interest rates in the second quarter of 2013 resulted in a significant adverse impact on our business and financial results due primarily to a related decrease in volume of loan originations, especially refinancings. Any future additional increase in interest rates may further 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. Additionally, in recent periods we have experienced very low levels of homes available for sale in many of the markets in which we operate. The lack of housing inventory has had a downward impact on the volume of mortgage loans that we originate. Further, it has resulted in elevated costs, as a significant amount of loan processing and underwriting that we perform are to qualifying borrowers for mortgage loan transactions that never materialize. The lack of inventory of homes for sale may continue to have an adverse impact on mortgage loan volumes into the foreseeable future.

We may incur losses due to changes in prepayment rates.

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.

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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.

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

Certain third party loan purchasers revised their fee structures in the third quarter of 2013 and increased the costs of doing business with them. For example, certain purchasers of conforming loans, including Fannie Mae and Freddie Mac, raised costs of guarantee fees and other required fees and payments. These changes increased the cost of mortgages to consumers and the cost of selling conforming loans to third party loan purchasers which in turn decreased our margin and negatively impacted our profitability. Additionally, the FHA raised costs for premiums and extended the period for which private mortgage insurance is required on a loan purchased by them. 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.

If we breach any of the representations or warranties we make to a purchaser or securitizer of our mortgage loans or MSRs, we may be liable to the purchaser or securitizer for certain costs and damages.

When we sell or securitize 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 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.

In addition, in connection with the sale of a significant amount of our MSRs to SunTrust Mortgage, Inc., we agreed to indemnify SunTrust Mortgage, Inc. for prepayment of a certain amount of those loans. In the event the holders of such loans prepay the loans, we may be required to reimburse SunTrust Mortgage, Inc. for a certain portion of the anticipated MSR value of that loan.

If repurchase and indemnity demands increase on loans or MSRs that we sell from our portfolios, our liquidity, results of operations and financial condition will be adversely affected.

If we breach any representations or 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, pay penalties, and/or be subjected to litigation from the federal government.

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

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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 and other federal laws and regulations 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.

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 WMS Series LLC, an affiliated business arrangement with certain Windermere real estate brokerage franchise owners.

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.

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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.(1)
31.2	Certification of Chief Accounting Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.(1)
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.(2)
101.INS	XBRL Instance Document(3)(4)
101.SCH	XBRL Taxonomy Extension Schema Document(3)
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document(3)
101.DEF	XBRL Taxonomy Extension Label Linkbase Document(3)
101.LAB	XBRL Taxonomy Extension Presentation Linkbase Document(3)
101.PRE	XBRL Taxonomy Extension Definitions Linkbase Document(3)

(1) Filed herewith.

(2) This exhibit shall not be deemed “filed” for purposes of Section 18 of the Securities Exchange Act of 1934, or 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.

(3) As provided in Rule 406T of Regulation S-T, this information shall not be deemed “filed” for purposes of Section 11 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.

(4) 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 June 30, 2014, formatted in XBRL (eXtensible Business Reporting Language) interactive data files: (i) the Consolidated Statements of Operations for the three and six months ended June 30, 2014 and 2013, (ii) the Consolidated Statements of Financial Condition as of June 30, 2014, and December 31, 2013, (iii) the Consolidated Statements of Stockholders’ Equity and Comprehensive Income for the three and six months ended June 30, 2014 and 2013, (iv) the Consolidated Statements of Cash Flows for the six months ended June 30, 2014 and 2013, 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 August 7, 2014.

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

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