HomeStreet, Inc.
Form S-1/A
February 10, 2012
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As filed with the Securities and Exchange Commission on February 10, 2012

Registration No. 333-173980

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

AMENDMENT NO. 10

TO

FORM S-1

REGISTRATION STATEMENT

UNDER

THE SECURITIES ACT OF 1933

HOMESTREET, INC.

(Exact Name of Registrant as Specified in its Charter)

Washington	**6036**	**91-0186600**
(State or other jurisdiction of incorporation or organization)	**(Primary Standard Industrial Classification Code Number)**	**(I.R.S. Employer Identification No.)**

601 Union Street, Suite 2000

Seattle, WA 98101

(206) 623-3050

(Address, including zip code, and telephone number, including area code, of registrant s principal executive offices)

Mark K. Mason

Chief Executive Officer

HomeStreet, Inc.

601 Union Street, Suite 2000

Seattle, WA 98101

(206) 623-3050

(Name, address, including zip code, and telephone number, including area code, of agent for service)

Copy to:

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As soon as practicable after the effective date of this Registration Statement.

(Approximate date of commencement of proposed sale to the public)

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933 check the following box. ¨

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ¨

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ¨

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ¨

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

Large accelerated filer	¨	Accelerated filer	¨
Non-accelerated filer	x	Smaller reporting company	¨

CALCULATION OF REGISTRATION FEE

Title of Each Class of Securities to be Registered	**Amount to be Registered(1)**	**Proposed Maximum Offering Price Per Share**	**Proposed Maximum Aggregate Offering Price(2)**	**Amount of Registration Fee**
Common Stock, no par value per share	1,829,545	$45.00	$82,329,525	$9,434(3)

(1) Includes the underwriters option to purchase up to an additional 238,636 shares to cover over-allotments, if any.
(2) Estimated solely for the purpose of determining the amount of the registration fee in accordance with Rule 457(o) promulgated under the Securities Act of 1933, as amended. Includes offering price of additional shares that the underwriters have the option to purchase to cover over-allotments, if any. See Underwriting.
(3) Previously paid.

THE REGISTRANT HEREBY AMENDS THIS REGISTRATION STATEMENT ON SUCH DATE OR DATES AS MAY BE NECESSARY TO DELAY ITS EFFECTIVE DATE UNTIL THE REGISTRANT SHALL FILE A FURTHER AMENDMENT WHICH SPECIFICALLY STATES THAT THIS REGISTRATION STATEMENT SHALL THEREAFTER BECOME EFFECTIVE IN ACCORDANCE WITH SECTION 8(a) OF THE SECURITIES ACT OF 1933, AS AMENDED, OR UNTIL THIS REGISTRATION STATEMENT SHALL BECOME EFFECTIVE ON SUCH DATE AS THE COMMISSION, ACTING PURSUANT TO SAID SECTION 8(a), MAY DETERMINE.

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The information in this preliminary prospectus is not complete and may be changed. We may not sell these securities or accept any offer to buy these securities until the registration statement filed with the Securities and Exchange Commission is effective. This preliminary prospectus is not an offer to sell these securities and we are not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.

PRELIMINARY PROSPECTUS *(SUBJECT TO COMPLETION) DATED February 10, 2012*

1,590,909 Shares of Common Stock

This is our initial public offering. Prior to this offering, there has been no public market for our common stock. We currently expect the initial public offering price to be between $43.00 and $45.00 per share. See Underwriting for a discussion of the factors to be considered in determining the initial public offering price. The market price of the shares after the offering may be higher or lower than the initial offering price.

We have applied to have our common stock listed on the Nasdaq Global Market under the symbol HMST.

We and our wholly owned subsidiary Home Street Bank (the Bank) are currently operating under orders to cease and desist initially issued by the Office of Thrift Supervision, or the OTS, and now administered by the Board of Governors of the Federal Reserve System, or the Federal Reserve, and by the Federal Deposit Insurance Corporation, or the FDIC, and the Washington State Department of Financial Institutions, Division of Banks, or the DFI, respectively. As a result of these orders, we and the Bank are required to augment regulatory capital and reduce problem assets, and are subject to certain restrictions on our operations.

Investing in our common stock is speculative and involves a significant degree of risk. You should consider carefully the risks and uncertainties in the section entitled Risk Factors beginning on page 21 of this prospectus before investing in our common stock.

The shares of our common stock are not deposits, bank accounts or obligations of any bank, are not insured by the FDIC or any other governmental agency and are subject to investment risks, including possible loss of the entire amount invested.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

	Per Share	Total
Initial public offering price	$	$
Underwriting discounts and commission(1)	$	$
Proceeds to us, before expenses	$	$

(1) For a description of the compensation to be received by the underwriters in addition to discounts and commissions, see Underwriting .
We have granted an over-allotment option which will allow the underwriters to purchase up to an additional 238,636 shares of our common stock from us at the initial offering price within 30 days following the date of this prospectus solely to cover over-allotments, if any.

The underwriters expect to deliver our common stock in book entry form only, through the facilities of The Depository Trust Company, against payment therefor on or about , 2012.

FBR Capital Markets

The date of this prospectus is , 2012

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You should rely only on the information contained in this prospectus. Neither we nor the underwriters have authorized any other person to provide you with different information. We and the underwriters are offering to sell, and seeking offers to buy, shares of our common stock only in jurisdictions where offers and sales are permitted. The information contained in this prospectus is accurate only as of the date on the front cover of this prospectus or such other date stated in this prospectus. You should assume that the information appearing in this prospectus is accurate only as of that date. Our business, financial condition, results of operations and prospects may have changed since that date.

Unless we state otherwise or the context otherwise requires, references in this prospectus to HomeStreet we, our, us and the Company refer t HomeStreet, Inc., a Washington corporation, HomeStreet Bank (Bank), HomeStreet Capital Corporation (HomeStreet Capital) and HomeStreet, Inc. s other direct and indirect subsidiaries.

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SUMMARY

The following summary highlights information contained elsewhere in this prospectus. This summary is not intended to be complete and does not contain all the information you should consider before investing in our common stock. We encourage you to read carefully this entire prospectus, including the section entitled Risk Factors and our financial statements and related notes appearing elsewhere in this prospectus, before deciding to invest in our common stock.

Our Company

We are a 90-year-old diversified financial services company headquartered in Seattle, Washington, that has grown from a small mortgage bank to a full-service community bank serving consumers and businesses in the Pacific Northwest and Hawaii. In 1986 we established the Bank to fund our lending activities and to offer a broader range of products and services. Our banking strategy has allowed us to expand our lending activities while building stable core deposits and a more diversified core customer base that offers better cross-selling opportunities. The Bank has the oldest continuous relationship of all Fannie Mae seller servicers in the nation, having been the second company approved by Fannie Mae at its founding in 1938.

Our primary subsidiaries are HomeStreet Bank and HomeStreet Capital Corporation. HomeStreet Bank is a Washington state-chartered savings bank that provides deposit and investment products and cash management services. The Bank also provides loans for single family homes, commercial real estate, construction, land development and commercial businesses. HomeStreet Capital Corporation, a Washington corporation, originates, sells and services multifamily mortgage loans under the Fannie Mae Delegated Underwriting and Servicing Program (DUS) in conjunction with HomeStreet Bank. We also provide insurance products and services for consumers and businesses as HomeStreet Insurance and loans for single family homes through a joint venture, Windermere Mortgage Services Series LLC (WMS). At September 30, 2011, we had total assets of $2.32 billion, net loans held for investment of $1.36 billion, deposits of $2.06 billion, and shareholders equity of $80.3 million. At December 31, 2010, we had total assets of $2.49 billion, net loans held for investment of $1.54 billion, deposits of $2.13 billion and shareholders equity of $58.8 million. We recognized net income of $15.3 million for the third quarter of 2011, as compared to net income of $1.3 million for the second quarter of 2011 and a net loss of $5.4 million for the third quarter of 2010.

Recent Developments

In the fourth quarter of 2011 and January of 2012, we continued to be profitable and improve our asset quality metrics. Our net income for the fourth quarter of 2011 and the month ended January 31, 2012 was $7.0 million and $8.2 million, respectively, with a net interest margin of 2.50% for each of those periods, as compared to 2.38% for the third quarter of 2011. An increase in refinancing of existing loans in the single family mortgage loan market and related increase in our loan origination activities was a contributing factor to the increase in our profits in the month of January, and such increased activity may not be indicative of future performance. As of December 31, 2011 and January 31, 2012, we had total assets of $2.26 billion and $2.24 billion, respectively, net loans held for investment of $1.30 billion and $1.31 billion, respectively, and shareholders equity of $86.4 million and $96.0 million, respectively. Our January 2012 results do not reflect loan loss provision or impairment charges, which we assess primarily at the end of each fiscal quarter, however, we have recorded loan loss provisions as an expense in prior quarters and expect to record such provision expense at the end of the first quarter of 2012. We also experienced continued profitability for the fourth quarter and the month ended January 31, 2012, including net mortgage servicing rights and related hedge valuation gains of $1.6 million in January 2012. Our profit in the fourth quarter of 2011 was slightly offset by a $189,000 net valuation loss on mortgage servicing rights and related hedge instruments.

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Our classified assets also declined by $36.9 million from $225.0 million at September 30, 2011 to $188.2 million, or 16.4%, at December 31, 2011, and increased to $191.2 million, or 15.0%, at January 31, 2012, with nonperforming assets as a percentage of total assets declining from 6.9% at September 30, 2011 to 5.1% at December 31, 2011 and 4.9% at January 31, 2012. Nonperforming loans decreased from $95.1 million at September 30, 2011 to $76.5 million at December 31, 2011, and to $75.4 million at January 31, 2012, representing decreases of 19.6% and 20.7%, respectively, primarily due to credit upgrades in all loan classes as well as pay-downs, charge-offs and net transfers of $4.2 million to OREO principally during the fourth quarter of 2011. In addition to the improvement in nonperforming loans, OREO decreased from $64.4 million at September 30, 2011 to $38.6 million at December 31, 2011 (a 40.1% decrease), and to $35.5 million at January 31, 2012 (a 44.8% decrease), due to OREO sales of $26.0 million during the fourth quarter of 2011 and $2.9 million in January 2012 and downward valuation adjustments of $4.2 million principally during the fourth quarter of 2011. Of the $35.5 million of OREO as of January 31, 2012, $5.5 million, or 15.6%, is contracted for sale, $3.9 million of which is scheduled to close in February. For the same period we recognized a loss of 0.3% on sales of OREO, and 0.1% gain on sales for the year ended December 31, 2011. The total amount of delinquent loans decreased from $144.1 million (10.2% of total loans) as of September 30, 2011 to $139.9 million (10.4% of total loans) as of December 31, 2011, and increased to $161.0 million (11.9% of total loans) as of January 31, 2012, although total delinquent loans excluding single family Ginnie Mae guaranteed loans decreased from $106.9 million at September 30, 2011 to $94.6 million at December 31, 2011, and increased to $113.3 million at January 31, 2012. Total loans also decreased from $1.41 billion as of September 30, 2011 to $1.34 billion as of December 31, 2011 and increased $1.35 billion as of January 31, 2012.

Single family loan origination for the year ended December 31, 2011 was $1.72 billion, compared to $2.07 billion for the year ended December 31, 2010 and $2.7 billion for the year ended December 31, 2009.

Our financial results for the fourth quarter of 2011 and as of and for the year ended December 31, 2011 presented in this prospectus have not yet been audited and are subject to finalization. The January 2012 information has not been subjected to an audit or review and will not be subjected to audit or review procedures until later in 2012 as part of the normal quarterly interim review procedures and annual audit process. January results may not be indicative of our results for the full first quarter.

In January 2012, in order to expand our mortgage banking business and accelerate our plans to increase mortgage origination volume, we made offers of employment to a significant majority of the mortgage personnel employed in Washington, Oregon and Idaho by MetLife Home Loans whose parent, MetLife, Inc., had recently announced that it would no longer originate forward mortgages and would wind down their business. As of February 3, 2012, we have hired approximately 140 mortgage professionals from this Pacific Northwest regional group. We anticipate that we will open approximately 11 additional stand-alone lending centers in Washington and Idaho, primarily in the Puget Sound area, in order to accommodate these new hires. As a result of this expansion of our mortgage operations, we estimate that we will incur additional expenses of approximately $8.0 million in the first half of 2012 for compensation, facilities and other integration expenses. While we anticipate that this group will generate enough revenue to cover these expenses over the same period, these costs may not be completely offset by such additional loan origination revenue in that period as these loan professionals will need to rebuild their origination volume at the Bank. Our estimated expenses may also increase as we hire additional employees from this group.

Our Business

As of January 31, 2012, we had a network of 20 bank branches and nine stand-alone lending centers located in the Puget Sound, Olympia, Vancouver and Spokane regions of Washington, the Portland and Salem regions of Oregon, and the Hawaiian Islands of Oahu, Maui and Hawaii. As a result of our expansion of our single family lending business, we expect to open approximately 11 additional stand-alone lending centers in Washington and Idaho in the first half of 2012. Our bank branches have average deposits per branch of $102.8 million as of

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September 30, 2011. WMS provides point-of-sale loan origination services through 42 Windermere Real Estate offices in Washington and Oregon.

We operate four primary lines of business: Community Banking, Single Family Lending, Income Property Lending and Residential Construction Lending.

Community Banking. We provide diversified financial products and services to our consumer and business customers, including deposit products, investment products, insurance products, cash management services and consumer and business loans.

Single Family Lending. We originate, sell and service residential mortgage loans both directly and through our relationship with WMS. We also originate and service loans for our portfolio on a selective basis.

Income Property Lending. We originate commercial real estate loans with a focus on multifamily lending through Fannie Mae s DUS program. These loans are sold to or securitized by Fannie Mae, and we generally retain the right to service them. We also originate commercial real estate construction, land, bridge and permanent loans for our own portfolio.

Residential Construction Lending. We originate residential construction and land development loans primarily for our own portfolio.

Impact of Economic Downturn

As the economic downturn began in late 2007 and continued into mid-2009, our business experienced a series of interrelated negative events, the combination of which led to significant operating losses that diminished our capital and weakened our financial condition. During this period, home prices and the volume of home sales decreased significantly along with occupancy and rental rates on commercial real estate. Related declines in the value of residential and commercial real estate, especially residential land and finished lots, significantly impacted the economic viability of many of our borrowers construction projects and investments and reduced the value of our collateral.

The impact of the foregoing events on our asset quality, results of operations, financial condition and regulatory capital ratios has been severe. Our classified assets increased from $114.8 million at December 31, 2007 to a peak of $759.7 million at June 30, 2009 and nonperforming assets increased from $35.7 million at December 31, 2007 to their peak of $482.0 million at December 31, 2009. For the years ended December 31, 2010 and December 31, 2009, we recognized net losses of $34.2 million and $110.3 million, respectively. For the nine months ended September 30, 2011, we recognized net income of $9.1 million. Additionally, despite our efforts to decrease total assets to mitigate the impact of losses on our regulatory capital ratios, our Tier 1 and total risk-based capital ratios fell from 9.0% and 11.2% at December 31, 2007, to 4.5% and 8.5% at December 31, 2009, respectively.

As a result of the deterioration in our asset quality, operating performance and capital adequacy, on May 8, 2009, we entered into an agreement with HomeStreet Bank s primary banking regulators, the Federal Deposit Insurance Corporation, or FDIC, and the Washington State Department of Financial Institutions, or DFI, pursuant to which we consented to the entry of an Order to Cease & Desist from certain allegedly unsafe and unsound banking practices. On May 18, 2009, we entered into a similar agreement with HomeStreet, Inc. s then primary regulator, the Office of Thrift Supervision, or OTS. As of July 21, 2011, the OTS has been abolished and its supervisory and regulatory functions with respect to savings and loan holding companies, including the Company, have been transferred to the Board of Governors of the Federal Reserve System, or the Federal Reserve. References in this prospectus to the Federal Reserve shall include the OTS prior to the transfer date with respect to those functions transferred to the Federal Reserve. We refer to the Order to Cease & Desist with the

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FDIC and DFI as the Bank Order, the Order to Cease & Desist with the Federal Reserve as the Company Order, and to the Bank Order and Company Order collectively as the Orders. Among other things, the Orders directed us to increase our capital to certain specified levels, improve management, reduce classified assets and improve earnings.

Pursuant to the Company Order, the Company has agreed, among other things, to refrain from engaging in all unsafe and unsound practices that have resulted in the Company s low earnings and inadequate capital. The Company Order does not contain specific minimum capital ratios or asset quality measures.

Pursuant to the Bank Order, the Bank was directed, among other things, to have and maintain a Tier 1 capital ratio that equals or exceeds 10% and a total risk-based capital ratio that equals or exceeds 12% by October 5, 2009, as well as to develop and adopt a plan to reduce the Bank s exposure to adversely classified assets.

Upon the successful completion of this offering, we expect to contribute approximately $44.0 million of the net proceeds of this offering to the Bank. The Bank is required by the Bank Order to maintain a Tier 1 leverage capital ratio of at least 10% and a risk-based capital ratio of at least 12%. While this offering will improve our capital position and bring the bank closer to compliance with these requirements, we will not be able to fully satisfy the requirements of the Bank Order based on this offering alone. However, we believe that following the contribution to the Bank of at least $44.0 million in capital from this offering and subject to the completion of an on-site examination of the Bank by our primary regulators confirming our condition, we will qualify for replacement of the Bank Order with another form of enforcement agreement between the Bank and our regulators, which we expect would include provisions for maintenance of at least an 8.5% Tier 1 capital ratio and continued improvement in the Bank s asset quality. Management does not have any reason to believe that the risk-based capital ratio will be increased in any subsequent enforcement order.

We anticipate that a contribution of approximately $44.0 million of the aggregate net proceeds from this offering, together with the Bank s preliminary January earnings and expected February earnings, will bring the Bank s Tier 1 capital ratio to no less than 8.5%. However, if management determines that a greater or lesser amount would be necessary to reach that targeted capital ratio, taking into account, among other things, changes in the average assets and variations in the Bank s net income that may affect our regulatory capital ratios, we may adjust the actual amount of the contribution up to the aggregate net proceeds.

We have implemented a plan for the Bank to reduce those loans that were classified as substandard or doubtful as of December 31, 2008, to which the FDIC and DFI issued a letter of nonobjection. The Bank did not achieve the target reduction of those classified assets to 40.0% of Tier 1 capital plus allowance for loan losses by February 28, 2010, primarily due to lower than projected capital. As of February 28, 2010 that ratio was 91.6%. However, we achieved the 40.0% target as of June 30, 2011, as our ratio of remaining assets classified as substandard and doubtful as of December 31, 2008 was 38.2% of Tier 1 capital plus allowance for loan losses. As of September 30, 2011 and December 31, 2011, our ratio of remaining assets classified as substandard and doubtful as of December 31, 2008 was 25.7% and 13.5% of Tier 1 capital plus allowance for loan losses, respectively.

The Bank has taken several other actions to comply with the requirements of the Bank Order including:

- retained a new Chief Executive Officer and other senior management who possess the qualifications, experience and proven ability to manage a bank of comparable size and experience in upgrading a low-quality loan portfolio, raising capital and improving earnings;

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enhanced the infrastructure for the Bank s credit administration functions; and

implemented revised lending, loan concentration and collection policies and procedures.

Similarly, HomeStreet, Inc., is not in compliance with the Company Order s requirement to increase capital. But for the exceptions noted above, we believe that we are in compliance in all material respects with the Orders. Based on guidance from the Company s regulator, we believe that we will need to further reduce our classified assets in the future to qualify for the lifting of the Company Order.

The Orders and material actions taken to date are described in more detail under Regulation and Supervision Cease and Desist Orders.

Management Changes

In light of the then-prevailing economic conditions confronting our organization and to develop and implement a bank turnaround strategy, the boards of directors of the Company and the Bank recruited and retained a new executive management team. Starting in August of 2009, we added the following executives:

Mark K. Mason, *Director, Chief Executive Officer and President of HomeStreet, Inc.; Director, Chairman of the Board, Chief Executive Officer and President of HomeStreet Bank*. Mr. Mason has over 25 years of experience in credit, lending, operations and finance. A substantial portion of Mr. Mason s career has been spent resolving or recapitalizing troubled institutions, restructuring operations and upgrading troubled loan portfolios. Since joining the Company in late 2009, Mr. Mason has led the Company s significant turnaround. Prior to that, Mr. Mason has served as an executive officer, director and consultant to banks and mortgage companies, most significantly as the chairman of the board, chief executive officer and chief lending officer of Fidelity Federal Bank.

David E. Hooston, *Executive Vice President and Chief Financial Officer of HomeStreet, Inc. and HomeStreet Bank.* Mr. Hooston has over 30 years of experience in the financial services industry. He has extensive experience in turning around troubled institutions, raising public and private capital and negotiating and executing mergers and acquisitions. Mr. Hooston has served as president and chief operating officer, chief financial officer and as a director of banks and bank holding companies including Placer Sierra Bancshares, Belvedere Capital Partners, LLC and ValliCorp Holdings, Inc.

Jay C. Iseman, *Executive Vice President and Chief Credit Officer of HomeStreet, Inc. and HomeStreet Bank*. Mr. Iseman has 20 years of credit management experience at major national banks in commercial and real estate lending. This includes significant experience in troubled loan workouts, special assets and credit administration. Prior to joining the Bank, Mr. Iseman served as a senior vice president and senior portfolio manager of commercial special assets with Bank of America.

Godfrey B. Evans, Executive Vice President, General Counsel, Chief Administrative Officer and Corporate Secretary of HomeStreet, Inc. and HomeStreet Bank. Mr. Evans has 30 years of experience in banking and corporate securities law, including significant roles in the recapitalization and restructuring of financial institutions. Mr. Evans is an experienced public company general counsel. Prior to joining the Company, Mr. Evans served as the general counsel, chief administrative officer and corporate secretary to Fidelity Federal Bank and prior to that was a corporate lawyer for Gibson, Dunn & Crutcher, LLP in Los Angeles.

Turnaround Plan

Under the leadership of our new management team, we have implemented a plan to stabilize and turn around the institution. The principal elements of this plan are to improve asset quality, upgrade our credit culture,

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restructure the balance sheet, improve core earnings, control noninterest expense, maintain satisfactory regulatory relations and recapitalize the Company. Notwithstanding the progress we have made under our turnaround plan, there can be no assurance that we can successfully execute the remaining aspects of our plan with favorable results or within the scheduled timeline.

Improve Asset Quality and Upgrade Credit Culture

We have addressed the risks that contributed to the deterioration in our asset quality and earnings, including reducing and limiting loan concentrations in higher risk loan types and market segments where we have continuing concerns about deterioration in collateral values. Since 2007, we have dramatically curtailed most types of lending in response to deteriorating economic conditions and in order to preserve regulatory capital ratios. We have also implemented or are implementing a number of additional measures aimed at improving our asset quality, including:

- *Aggressively managing troubled loans*. Where appropriate, we have restructured loans to improve our position, including negotiated principal reductions and additional collateral, aggressively collected on loans and guaranties, and obtained and enforced writs of attachment on bank accounts and personal property when necessary. Where restructuring has proven impossible or impracticable, we have negotiated deeds in lieu of foreclosure or have foreclosed on real property.

- *Actively marketing and selling other real estate owned (OREO)*. We have actively marketed and sold OREO to end users, such as developers and investors, who make direct and immediate use of such properties. We have generally avoided selling to financial buyers or other intermediaries who typically hold properties for a limited period of time and who do not usually improve or add value to the properties.

- *Restructuring our credit administration and approval infrastructure*. We restructured our credit administration infrastructure to create more oversight at the board level and to better manage our loan approval process and credit exposure. We hired a Chief Credit Officer and centralized all credit approval, administration and portfolio monitoring functions under his authority. We also established a special assets department of our credit administration group to manage troubled loans and OREO.

- *Upgrading our underwriting policies and procedures*. We revised our lending policies and procedures to reflect more conservative underwriting standards, such as lower loan-to-value ratios, increased cash equity requirements and debt service coverage, lower maximum loan sizes, more restrictive financial covenants, including total debt, leverage and minimum cash flow, minimum net worth, liquidity and experience requirements, lower loan-to-one borrower limits, global financial reviews of borrowers and their credit histories and use of inter-creditor agreements when appropriate.

Balance Sheet Restructuring and Core Earnings Improvement

We are restructuring our balance sheet by increasing loan yields, extending the duration of our investment securities and diversifying our credit risk by reducing the relative size and concentration of our loan portfolio in residential construction and land loans. In addition, because our net interest margin had been negatively affected by variable rate loans originated without interest rate floors, management has instituted interest rate floors upon the renewal, restructuring or origination of new loans. Between September 30, 2009, and September 30, 2011, loans without interest rate floors have decreased by $699.6 million, or 69.3%. The total balance of loans without interest rate floors was $309.8 million at September 30, 2011.

We have also focused on reducing our noncore funding and improving our core deposit base. As the banking system began to stabilize in 2009, we began moving to a more normalized liquidity management and

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investment strategy, reducing noncore deposits and wholesale funding while retaining and increasing core deposit balances and customers. Between September 30, 2009 and September 30, 2011, advances from the Federal Home Loan Bank of Seattle, or FHLB, and brokered deposits have decreased from $1.01 billion to $67.9 million. This funding has been generally replaced with retail deposits or retired with proceeds from the sales of investment securities. The composition of our deposit portfolio continues to improve. We have initiated marketing strategies to attract and retain relationship-based customers and eliminate rate-sensitive time deposit customers, which has the dual effect of creating a more stable funding base representative of a relationship-based institution and helping us return to a more normalized liquidity profile. Between September 30, 2009, and September 30, 2011, core deposits consisting of checking, savings and certificates of deposits with balances less than $250,000 have increased from 63.8% of bank funding to 93.6% of bank funding.

Improving our deposit mix and increasing loan yields have significantly improved our net interest margin. Our net interest margin has increased from 0.85% for the quarter ended September 30, 2009 to 2.38% for the quarter ended September 30, 2011.

Controlling Noninterest Expense

We have experienced, and we expect in the near term to continue to experience, higher than normal noninterest expense associated with loan resolution activities, dispositions of OREO, increased deposit insurance costs and efforts associated with compliance with the Orders. However, during this time we have reduced other core banking compensation and general and administrative expenses by streamlining operations and reducing unnecessary staff, freezing salaries, suspending our 401(k) plan employer match from July 2009 to July 2010 and reducing travel and entertainment budgets. Going forward, we plan to manage future changes in all noninterest expense categories based on changes in revenue growth, reductions in problem assets and removal of the Orders. Upon satisfaction and removal of the Orders, we anticipate lower regulatory-related expenses, deposit insurance assessments, professional fees, and time devoted by management and staff to the compliance with the Orders.

Maintain Satisfactory Regulatory Relations

Maintaining the confidence of our regulators is an integral part of our turnaround plan. Beginning in the fourth quarter of 2009, management initiated monthly conference calls with our regulators to present and discuss progress on management changes, problem asset reduction, capital adequacy, interest rate risk, liquidity maintenance, funding restructuring and earnings. These meetings have produced transparency in our relationship with our regulators and have facilitated current reporting of the status of management s turnaround plan. As of July 21, 2011, the Company s primary federal regulator, the OTS, has been abolished and its supervisory and regulatory functions with respect to the Company have been transferred to the Federal Reserve.

Recapitalize the Company

Upon the successful completion of this offering, we expect to contribute approximately $44.0 million of the net proceeds of this offering to the Bank. The Bank is required by the Bank Order to maintain a Tier 1 leverage capital ratio of at least 10% and a risk-based capital ratio of at least 12%. While this offering will improve our capital position and bring the Bank closer to compliance with these requirements, we will not be able to fully satisfy the requirements of the Bank Order based on this offering alone. However, we believe that following the contribution to the Bank of at least $44.0 million in capital from this offering, and subject to the completion of an on-site examination of the Bank by our primary regulators confirming our condition, we will qualify for replacement of the Bank Order with another form of enforcement agreement between the Bank and our regulators, which we expect would include provisions for maintenance of at least an 8.5% Tier 1 capital ratio and

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continuing improvement in the Bank s asset quality. Management does not have any reason to believe that the risk-based capital ratio will be increased in any subsequent enforcement order. Based on guidance from the Federal Reserve, we believe that we will need to further reduce our classified assets in the future to qualify for the lifting of the Company Order. The requirements imposed by the Company Order do not include quantitative capital ratio or asset quality targets. However, if we were to take more aggressive measures, such as bulk sales, to dispose of classified assets or OREO, we may incur additional valuation adjustments or may recognize additional losses on sales of classified assets. These events would be recorded as charges against earnings, which would reduce our financial performance in the affected periods, and in some cases may require that we raise additional capital.

We anticipate that a contribution of approximately $44.0 million of the aggregate net proceeds from this offering, together with the Bank s preliminary January earnings and expected February earnings, will bring the Bank s Tier 1 capital ratio to no less than 8.5%. However, if management determines that a greater or lesser amount would be necessary to reach that targeted capital ratio taking into account, among other things, changes in the average assets and variations in the Bank s net income that may affect our regulatory capital ratios, we may adjust the actual amount of the contribution, up to the aggregate net proceeds. On a proforma basis as of September 30, 2011, we would have needed to contribute a total of $107.9 million to the Bank to achieve a Tier 1 capital ratio of 10.0%, or $69.8 million to achieve a Tier 1 capital ratio of 8.5%. Using preliminary, unaudited data as of December 31, 2011, we would need to contribute $98.7 million or $60.3 million, respectively, to achieve Tier 1 capital ratios of 10.0% and 8.5%.

The table below presents the Bank s Tier 1 leverage and total risk-based capital ratios, as of January 31, 2012, both actual and on a pro forma basis giving effect to both this offering and the anticipated contribution to the Bank of approximately $44.0 million from the aggregate net proceed as well as the Company s consolidated pro forma capital ratios reflecting the condition of both the Bank and the Company after giving effect to such events.

	Bank Actual	**Pro Forma Bank(1)**	**Well Capitalized**
Tier 1 Leverage Capital Ratio	6.5%	8.5%	5.0%
Total Risk-Based Capital Ratio	11.6%	14.8%	10.0%

(1) Reflects an anticipated contribution to the Bank of approximately $44.0 million from the proceeds of this offering.

We intend to contribute a substantial portion of the aggregate net proceeds of this offering to the Bank. As a result, the Company does not expect to have sufficient capital immediately following the offering to bring current the deferred interest due on our outstanding trust preferred securities when that deferral period expires in December 2013. To the extent that we are not able to generate enough operating profit at the Bank and/or distribute such profit to the Company prior to the end of that deferral period, we will need to raise such additional capital from external sources, which may include a capital raise through the sale of additional equity securities.

Third-Party Loan Review. In preparation for this offering, and to provide an independent assessment of the adequacy of our allowance for loan losses, confirm the accuracy and timeliness of our asset classifications, and assess the accuracy of management s carrying values of our loan portfolio and other real estate owned, or OREO, we retained Unicon Financial Services, Inc., an independent third-party loan review consultant. As of June 30, 2011, Unicon reviewed a sample of our loan portfolio with a particular focus on our largest and highest-risk loans. Unicon reviewed approximately 81% of our commercial and commercial real estate loans, as well as 82% of our OREO, including 100% of pass graded loans in excess of $2.5 million and 100% of adversely classified loans in excess of $1.0 million. Additionally, Unicon performed a macroanalysis of our single family

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loan and home equity loan portfolios. Based upon this review, Unicon reported that management s allowance for loan losses as of June 30, 2011 was adequate; that our current risk rating system was reasonable and accurately reflects the significant risks associated with individual credits; and that the collateral values used in estimating the carrying values of our loans and OREO were materially correct.

Selected Turnaround Plan Results

As illustrated below, we believe that as a direct result of the effective execution of certain elements of our turnaround plan, described above, we have made significant progress to date toward reducing our credit risk and improving our financial condition and results of operations. We believe part of this success is demonstrated by our results of operations, which have improved from a net loss of $110.3 million in 2009 to a net loss of $34.2 million in 2010. For the nine months ended September 30, 2011 we recognized net income of $9.1 million as compared to a net loss of $19.9 million in the nine months ended September 30, 2010. We recognized net income of $16.1 million in 2011 and $8.2 million for the month ended January 31, 2012. Our financial results for the year ended December 31, 2011 have not yet been audited and are subject to finalization. Our January 2012 financial results have not been subjected to an audit or review and will not be subjected to audit or review procedures until later 2012 as part of the normal quarterly interim review procedures and annual audit process. January results also do not include loan loss provision or impairment charges, which we assess primarily at the end of each fiscal quarter, however, we have recorded loan loss provisions as an expense in prior quarters and expect to record such provision expense at the end of the first quarter of 2012. January results may not be indicative of our results for the full first quarter of 2012.

The following selected turnaround results reflect improvements since September 30, 2009, which coincides with the commencement of our turnaround plan.

	Month Ended	Three Months Ended $ Thousands (Unaudited)					
	31-Jan-12(1)	31-Dec-11 (1)	30-Sep-11	30-Jun-11	31-Mar-11	31-Dec-10	30-Sep-09
Total Construction Loans	$ 171,493	$ 173,405	$ 213,001	$ 234,062	$ 271,676	$ 285,131	$ 733,394
Provision for Loan Losses			1,000	2,300		8,200	35,555
Classified Assets	191,217	188,167	225,022	276,476	298,742	363,947	737,925
Nonperforming Loans	75,379	76,484	95,094	90,912	124,118	113,210	388,663
OREO	35,533	38,572	64,368	102,697	98,863	170,455	63,321
Nonperforming Assets	110,912	115,056	159,462	193,609	222,981	283,665	451,984
Total Delinquencies and Nonaccruing Loans (2)	161,009	139,860	144,133	132,481	188,013	178,286	495,168
Total Assets	$ 2,244,249	$ 2,264,957	$2,316,839	$2,233,505	$ 2,342,639	$ 2,485,697	$ 3,224,464
Nonperforming Assets/Total Assets	4.9%	5.1%	6.9%	8.7%	9.5%	11.4%	14.0%
Nonperforming Loans/Loans	5.6%	5.7%	6.7%	6.26%	7.94%	7.06%	17.7%
Total Delinquencies and Nonaccruing Loans/Loans	11.9%	10.4%	10.2%	9.1%	12.0%	11.1%	22.6%
Net Income (Loss)	$ 8,236	$ 7,026	$ 15,258	$ 1,284	$ (7,449)	$ (14,395)	$ (43,311)
Return on Average Assets	1.44%	1.23%	2.67%	0.23%	(1.25)%	(2.23)%	(5.37)%
Return on Average Equity	36.13%	33.44%	83.04%	8.97%	(51.26)%	(72.28)%	(120.44)%
Shareholders Equity per Share	$ 71.10	$ 63.96	$ 59.47	$ 43.17	$ 37.91	$ 43.52	$ 89.74
Net Interest Margin	2.50%	2.50%	2.38%	2.35%	2.17%	2.34%	0.85%
Operating Efficiency Ratio (3)	46.29%	74.78%	47.74%	70.05%	83.31%	69.51%	108.05%

(1) Amounts presented are preliminary and subject to finalization.

(2) Includes $47.7 million, $45.2 million, $37.3 million, $34.0 million, $39.4 million and $36.1 million, respectively, of loans guaranteed by Ginnie Mae for which we have little or no risk of loss.

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(3) We include an operating efficiency ratio which is not calculated based on accounting principles generally accepted in the United States (GAAP), but which we believe provides important information regarding our result of operations. Our calculation of the operating efficiency ratio is computed by dividing noninterest expense less costs related to OREO (gains (losses) on sales, valuation allowance adjustments, and maintenance and taxes) by total revenue (net interest income and noninterest income). Management uses this non-GAAP measurement as part of its assessment of performance in managing noninterest expense. We believe that costs related to OREO are more appropriately considered as credit-related costs rather than as an indication of operating efficiency. The following table provides a reconciliation of non-GAAP to GAAP measurement.

	31-Jan-12	31-Dec-11	30-Sep-11	30-Jun-11	31-Mar-11	31-Dec-10	30-Sep-09
Efficiency ratio	50.23%	84.07%	66.25%	88.43%	128.42%	111.77%	115.43%
Less impact of OREO expenses	3.94%	9.29%	18.51%	18.38%	45.11%	42.26%	7.38%
Operating efficiency ratio	46.29%	74.78%	47.74%	70.05%	83.31%	69.51%	108.05%

Our Growth Strategy

Our growth strategy is comprised of the following:

Integrated Consumer and Business Financial Services Delivery Strategy

Our community banking strategy involves the development of an integrated consumer and business financial services delivery platform. We seek to meet our customers financial services needs by providing consumer and business banking products, investment advice and products, and insurance products through our bank branches and our dedicated investment advisors, insurance agents and business banking officers. We have historically offered a limited line of investment, cash management and insurance products; however, we are currently in the process of significantly enhancing and expanding our products and services by:

- expanding our investment product offerings through a third-party broker dealer, building a staff of dedicated investment advisors and sales representatives and licensing additional qualified branch personnel for annuity sales;

- enhancing our business cash management service offerings and building a team of business cash management sales and support personnel; and

- expanding our insurance product offerings and further integrating sales of these products into our consumer and business financial advisory activities.

Expand Core Deposit Base

We plan to grow our consumer core deposit base through limited media advertising, effective deposit product design, account cash incentives, cash referral bonuses and relationship incentives. To attract new business customers, we offer money market and business savings accounts as well as a competitive array of cash management products and services.

Our growth strategy will be limited by our regulatory status, which generally would preclude us from obtaining the required consent from the FDIC and the DFI in order to open new bank branches. However, once the Orders are lifted, we intend to expand our bank branch network to support core deposit growth, expand our consumer and business financial services customer base and increase access to our services and products for our current customers.

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Business Banking Growth

During our turnaround, we have focused on retaining our existing customers and developing new deposit-oriented customer relationships. As the economy improves, we believe we will be well positioned to attract new middle-market business customers requiring commercial business and owner-occupied real estate loans. The number of competitors for middle-market business customers has decreased since the economic downturn as a result of bank failures and market consolidation. In recent years, national banks have focused on larger customers in order to achieve economies of scale in lending and depository relationships and have also consolidated business banking operations and support and reduced service levels in the Pacific Northwest. Additionally, high levels of problem loans at many local banks combined with low levels of capital have significantly impaired competitors capacity to make new loans.

New loan demand is generally weak because of the economic downturn and has resulted in increased competition for good customers in spite of industry consolidation. However, as the economy improves and new loan demand increases, we believe our community banking focus will distinguish us from our competitors because we are able to offer quicker, local decision making and to provide customers with direct access to our senior managers. At the same time, our larger capital base and broader offering of products and services will enable us to compete effectively against smaller banks. As a result, we believe we have a substantial opportunity to attract additional borrowers and depositors and expand our presence and market share, especially in the high-growth Puget Sound area.

Single Family Mortgage Origination and Servicing Portfolio Growth

During the real estate boom of 2004 through 2007, we maintained our historical focus on originating conforming conventional and FHA and VA loans for sale in the secondary market while supplementing those products with some portfolio lending. Our adherence to traditional credit standards limited our loan originations during the peak of the expansion of the subprime and option adjustable rate mortgage lending boom, and we lost market share to competitors during this time. However, our conventional conforming mortgage banking expertise positioned us to expand our originations when market conditions changed as a result of the tightening of lending standards and the market s reliance on government sponsored entities and agencies for secondary market liquidity. As a result, we have grown our single family origination and servicing business substantially since 2007. We originated $1.43 billion, $1.53 billion, $1.45 billion and $1.57 billion in home loans in 2004, 2005, 2006 and 2007, respectively, followed by $1.74 billion, $2.73 billion and $2.07 billion in 2008, 2009 and 2010, respectively. During the nine months ended September 30, 2011, we originated $1.09 billion. Because we retain servicing rights on substantially all of the single family residential mortgages that we sell into the secondary markets, our portfolio of single family loans serviced for others has grown significantly during this period and stood at $6.65 billion at September 30, 2011.

We have accelerated our plans to expand our single family mortgage origination business by hiring approximately 140 mortgage personnel formerly associated with MetLife Home Loans, which announced plans to discontinue their forward mortgage origination plans in January 2012. We expect to open approximately 11 additional loan production offices in Washington and Idaho, the majority of which will be in the Puget Sound are, in order to accommodate this expansion, and anticipate a significant increase in our loan origination volume for single family mortgage loans.

We intend to continue to grow our market share and maintain our focus on conventional conforming single family mortgage banking and use portfolio lending to complement, but not replace, secondary market lending, particularly for well qualified borrowers with loan sizes greater than the conventional conforming limits. In addition, we plan to open a correspondent lending channel and to increase our Internet-based lending.

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Multifamily Mortgage Banking Growth

As market conditions improve we plan to grow our multifamily mortgage banking business, particularly through our status as an approved Fannie Mae Delegated Underwriting and Servicing, or DUS, lender. We expect to expand beyond our current markets by forming strategic alliances with producers in the Western Region of the United States.

We intend to expand our multifamily residential mortgage lending business by targeting strong apartment markets and experienced borrowers with whom we have had prior working relationships. We expect to continue to benefit from being one of approximately 25 companies nationally that is an approved Fannie Mae DUS lender. The Fannie Mae DUS program has become a key multifamily funding source nationally due to the turmoil in the financial services industry and the resulting loss of other financing sources. We have historically supported our DUS program by providing short-term bridge loans to experienced borrowers who purchase apartment buildings for renovation, which we would then seek to replace with permanent takeout financing through the Fannie Mae DUS program upon completion of the renovations. As market conditions warrant, we will also originate for our portfolio permanent loans and construction loans.

Strategic Acquisitions

The economic downturn and related banking crisis have led to increased regulatory and compliance burdens, management fatigue and limited access to capital. As a result, we anticipate there will be opportunities to acquire smaller institutions in the Pacific Northwest that would enhance our franchise and complement our branch network. Following this recapitalization, we may consider such strategic opportunities to acquire other institutions or branches. We may need to raise more equity or additional capital to implement this strategy.

Competitive Strengths

The Bank has a number of competitive strengths and advantages that position the institution for continued growth.

Established and Well-respected Seattle-based Franchise

We have developed a footprint in the Pacific Northwest, including the highly attractive Puget Sound region in Washington and the greater Portland region in Oregon, as well as selected markets in Hawaii. Through our 90-year history, we have developed a highly skilled and dedicated workforce who understand our business and have long-standing relationships with our customers. Furthermore, we have a strong tradition of involvement in our communities, and promote management participation in charitable, civic and social organizations that we believe enhance the visibility and reputation of the HomeStreet brand in our target markets. We are a leading single family mortgage originator in the markets we serve. For example, according to *MortgageDataWeb*, www.mortgagedataweb.com, in the Seattle area we had market share rankings of #10 and #7 among originators of conventional and government-sponsored loan programs, respectively, in 2010.

Experienced and Talented Management Team

We have assembled an executive management team that possesses significant depth of knowledge and expertise in bank turnaround situations and in operating and growing community banks. Additionally, the Bank has significant depth and experience in its senior management ranks. The five senior managers in our lending units average 33 years of industry experience and average 25 years with the Bank. In our mortgage banking units, each of the managers has built strong working relationships with our investor partners, particularly Fannie Mae.

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Three managers currently serve on four of Fannie Mae s primary advisory boards and councils. Our Retail Banking Director has 32 years of industry experience, including 26 years with the Bank. Our Chief Credit Officer, Risk & Regulatory Oversight Director and Treasurer have an average of 25 years of industry experience and 11 years on average with the Bank.

Disciplined Underwriting and Credit Culture

Since 2008, we have made significant modifications to our credit policies and procedures designed to foster disciplined underwriting practices and create a strong credit culture. Our CEO has significant credit management experience, and we have bolstered our credit and underwriting expertise at the board and management levels. We have restructured our credit administration infrastructure to create more oversight at the board level and better manage our loan approval process and credit exposure and have centralized all credit approval, administration and portfolio monitoring functions under the authority of our Chief Credit Officer. We have also revised our lending policies and procedures to reflect more conservative underwriting standards, such as lower loan-to-value ratios and increased cash equity and debt service coverage requirements.

Significant Sources of Noninterest Income

Our noninterest income is substantially higher than traditional banks.

Highly Profitable Single Family Mortgage Origination and Servicing Business. Throughout the economic downturn, our mortgage origination and servicing business has provided us with a continuing source of profitability and internal capital generation. Our mortgage banking expertise has positioned us well to take advantage of current market conditions. HomeStreet has been primarily a conventional conforming loan originator, making mortgage loans conforming to Fannie Mae, Freddie Mac, and FHA and VA guidelines, supplemented by a small menu of portfolio products. As noted earlier, the Bank has the oldest continuous relationship of all Fannie Mae seller-servicers in the nation. We have been an FHA-approved lender continuously since 1937 and a VA approved lender continuously since that program was founded in 1944. We possess the product expertise and servicing infrastructure to originate and service government guaranteed loans and specialized products such as 203(k) rehabilitation loans and Department of Hawaiian Home Lands loans that require specific product knowledge and servicing expertise. The Bank derives significant competitive benefits from the scale and longevity of WMS, its joint venture with Windermere Real Estate (Windermere), the largest real estate brokerage company in the Pacific Northwest by sales volume. A primary benefit is the diversification of loan origination capabilities through mortgage consultants located in Windermere real estate offices, who can reach potential purchase customers and referral sources early in the home-buying process. We also benefit from increased loan production, which improves the efficiency and profitability of our mortgage origination infrastructure and helps us achieve better pricing and terms with Fannie Mae, Freddie Mac and other correspondent lenders. Windermere s focus on the purchase market adds significantly to volume, loan quality and profits during strong purchase markets.

Multifamily Mortgage Origination and Servicing Expertise. Our HomeStreet Capital subsidiary was one of the first DUS lenders approved by Fannie Mae and we remain one of only 25 approved lenders nationally.

Growth Opportunity in Fee-Generating Banking Services. We are currently expanding our cash management, investment and insurance product and service offerings. We believe our integrated approach to the delivery of these products and services will enhance customers sales experience and enable growth in our customer base and fee revenues.

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Compliance Culture

Historically, we have emphasized compliance in all of our activities. In addition to general banking regulations, our single family lending and loan servicing businesses and our investment advisory and product sales businesses are subject to complex regulations. In particular, our single family mortgage and multifamily origination and servicing businesses are highly dependent upon successful compliance with underwriting and servicing guidelines of Fannie Mae, Freddie Mac and Ginnie Mae as well as a myriad of federal and state consumer compliance regulations. Additionally, our significant volume of lending to low- and moderate-income areas and direct community investment contribute to our uninterrupted record of outstanding CRA ratings since the inception of the Bank in 1986. The financial services industry generally, and the single family mortgage banking industry in particular, is experiencing consolidation caused, in part, by the ever-increasing operational and cost burden of compliance. We believe our ability to maintain our historically strong regulatory compliance culture and our track record of compliance with regulations and guidelines are significant competitive advantages.

Our Structure

HomeStreet, Inc. was established in 1921 as Continental Mortgage and Loan Company, initially offering financing for commercial real estate and home mortgages. Continental Savings Bank was established in 1986 and changed its name to HomeStreet Bank in 2000. Our activities are conducted through the following consolidated subsidiaries:

HomeStreet, Inc. operates a personal lines insurance agency offering home, auto, life, umbrella, boat, motorcycle, recreational vehicle, earthquake, difference in conditions and notary bond insurance products. It is licensed to do business in Washington and Oregon under the name HomeStreet Insurance and is licensed to do business in Hawaii for life insurance only.

HomeStreet Bank, a regional state-chartered savings bank headquartered in Seattle, Washington.

We hold common securities in four statutory business trusts, which have, in turn, issued trust preferred securities. We have previously commenced tender offers for all of the outstanding trust preferred securities issued by these trusts; however, we have terminated those tender offers. See Dividend Policy below for a further description of the trust preferred securities.

HomeStreet Capital Corporation or its predecessor have been selling and servicing multifamily residential loans made through the Fannie Mae DUS program since 1988.

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Union Street Holdings LLC, a Washington limited liability company, holds title to, markets and disposes of real estate acquired through foreclosure.

HomeStreet Reinsurance, Ltd. was established in 2000 as a limited-purpose reinsurance company. It is incorporated in the Turks and Caicos Islands and reinsures private mortgage insurance solely with respect to mortgage loans originated by the Bank. We discontinued all new reinsurance business at the end of 2008 and we are monitoring market conditions to determine if and when we will begin writing new reinsurance risk.

Continental Escrow Company provides reconveyance services solely for the Bank in connection with deeds of trust on one-to-four family residential loans, or single family residential loans, originated by the Bank.

HomeStreet/WMS, Inc. holds a joint venture interest in Windermere Mortgage Services Series LLC, or WMS. The remaining equity interest in WMS is held by certain franchisees of Windermere Real Estate Services Company, the largest real estate brokerage company in the Pacific Northwest by sales volume. Through WMS, we provide point-of-sale loan origination services in 42 Windermere Real Estate offices in Washington and Oregon.

Risk Factors

An investment in our common stock involves certain risks. You should carefully consider the risks described under Risk Factors beginning on page 21 of this prospectus as well as other information included in this prospectus, including our financial statements and the notes thereto, before making an investment decision.

Corporate Information

Our principal executive offices are located at 601 Union Street, Suite 2000, Seattle, WA 98101. Our telephone number is (206) 623-3050. Our Internet address is www.homestreet.com. The information on our website does not constitute a part of this prospectus.

The Offering

Common stock offered	1,590,909 shares of our common stock(1)
Common stock to be outstanding after this offering	2,983,460.4 shares of our common stock(1)(2)
Price per share of our common stock	$44.00(3)
Use of Proceeds	We estimate that we will receive aggregate net proceeds from this offering of approximately $62.5 million, assuming no exercise of the over-allotment option and after deducting the underwriters discounts and commission and estimated offering expenses payable by us. We intend to contribute approximately $44.0 million of the aggregate net proceeds of this offering to the Bank to improve the Bank s compliance with its regulatory capital requirement under the Bank Order. While this offering will improve our capital position and bring the Bank closer to compliance with these requirements, we will not be able to full satisfy the requirements of the Bank Order based on this offering alone. However, we believe that following the contribution to the Bank of at least $44.0 million in capital from this offering, and subject to the completion of an on-site examination of the Bank by our primary regulators confirming our condition, we will qualify for replacement of the Bank Order with another form of enforcement agreement between the Bank and our regulators which we expect would include provisions for maintenance of at least an 8.5% Tier 1 capital ratio and continued improvement in the Bank s asset quality. Management does not have any reason to believe that the risk-based capital ratio will be increased in any subsequent enforcement order. We anticipate that a contribution of approximately $44.0 million of the aggregate net proceeds from this offering, together with the Bank s preliminary January earnings and expected February earnings, will bring the Bank s Tier 1 capital ratio to no less than 8.5%. However, if management determines that a greater or lesser amount would be necessary to reach that targeted capital ratio, taking into account, among other things, changes in the average assets and variations in the Bank s net income that may affect our regulatory capital ratios, we may adjust the actual amount of the contribution, up to the aggregate net proceeds. We also expect that if we are unable to raise adequate capital from internal sources, we may need to sell additional equity to raise capital prior to December 2013 to fund the Company s operations and payment of deferred interest on our outstanding trust preferred securities. See Use of Proceeds.

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Dividends	We do not intend to pay cash dividends on our common stock in the near future and the Orders prohibit the payment of dividends. Any determination to pay dividends in the future will be at the discretion of our board of directors and will depend upon our earnings, financial condition, results of operations, capital requirements, regulatory restrictions, contractual restriction and other factors that our board of directors may deem relevant. Any dividends paid by us would be subject to various federal and state regulatory limitations as well as the ability of the Bank to pay dividends to us. See Dividend Policy.
Ownership Restrictions	The acquisition of 10.0% or more of the voting stock of a savings and loan holding company, such as the Company, may, under certain circumstances, constitute the acquisition of control under regulatory guidelines. An investor wishing to acquire and hold more than 10.0% of our common stock after this offering may be required to file a change of control application with the Federal Reserve that would need to be approved before such investor could acquire more than 10.0% of our common stock. See Description of Capital Stock. A change of control of the Company or the Bank requires a filing of an application with the DFI.
Proposed Nasdaq symbol	We have obtained approval for listing of our common stock on the Nasdaq Global Market under the symbol HMST.
Risk Factors	Investment in our common stock involves risk. See Risk Factors beginning on page 21 and other information included in this prospectus for a discussion of factors you should consider carefully before deciding whether to invest in shares of our common stock.

Unless otherwise indicated all information in this prospectus, other than historical financial information, reflects a 1-for-2.5 reverse stock split of our common stock effective July 19, 2011.

(1) Assumes the underwriter s option to purchase up to an additional 238,636 shares of our common stock to cover over-allotments is not exercised.

(2) The number of shares of our common stock to be outstanding after this offering includes 41,677 shares subject to restricted stock awards to be issued to certain employees and our non-employee directors under our 2010 equity incentive plan on completion of this offering and excludes (a) a number of shares equal to 10.0% of the number of our issued and outstanding shares of common stock following the closing of this offering on a fully diluted basis less the 41,677 shares of restricted stock granted contingent upon the completion of this offering, or approximately 252,501 shares, assuming the expected sale of 1,590,909 shares in this offering and no exercise by the underwriters of their over-allotment option, which shares will be issuable under equity-based awards not yet granted under our 2010 equity incentive plan, (b) 111,600 shares of our common stock issuable upon the exercise of options granted to certain of our employees in 2010 for retention purposes outside of our 2010 equity incentive plan, and (c) 42,000 shares of our common stock issuable to our non-employee directors under our 2011 director equity compensation plan to be implemented following the closing of this offering. Our board of directors has determined that it will not issue equity grants under the 2010 equity incentive plan in an amount that would cause the aggregate amount of awards granted pursuant to the 2010 plan and the 2010 retention grants to exceed 10% of the number of shares outstanding immediately following the closing of this offering (not including any shares to be issued at closing subject to restricted stock grants made under the 2010 plan that will be effective upon the closing).

(3) Assumed price per share for the purposes of this preliminary prospectus is the midpoint of the estimated price range set forth on the cover page.

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NON-GAAP FINANCIAL MEASURES

In this prospectus, we sometimes use certain non-GAAP financial measures as a supplemental measure of our performance that is not required by, or presented in accordance with, accounting principles generally accepted in the United States (GAAP). Examples of non-GAAP measures used in this prospectus include certain profitability, such as operating segment results and interest income on a taxable-equivalent basis, and performance metrics, such as the operating efficiency ratio.

These are not a measurement of our financial performance or condition under GAAP and should not be considered in isolation or as an alternative to net income or any other performance measure derived in accordance with GAAP or as an alternative to cash flows from operating activities as a measure of our liquidity.

Summary Selected Historical Consolidated Financial and Other Data

The following table sets forth selected historical consolidated financial and other data for us at the dates and for each of the periods ended as described below. The selected historical consolidated financial data as and for the three and nine month periods ended September 30, 2011 and 2010 have been derived from our unaudited consolidated financial statements and related notes included in this prospectus. The selected historical consolidated financial data as of December 31, 2010 and 2009 and for each of the years ended December 31, 2010, 2009 and 2008 have been derived from, and should be read together with, our audited consolidated financial statements and related notes included elsewhere in this prospectus. The selected historical consolidated financial data as of December 31, 2008, 2007 and 2006 for each of the years ended December 31, 2007 and 2006 have been derived from our audited consolidated financial statements for those years, which are not included in this prospectus.

You should read the summary selected historical consolidated financial and other data presented below in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and our financial statements and the notes thereto, which are included elsewhere in this prospectus. We have prepared our unaudited information on the same basis as our audited consolidated financial statements and have included the adjustments that we consider necessary for a fair presentation of the financial information set forth in that information.

Our historical consolidated financial results may not be indicative of our future performance.

	At or for the Three Months Ended September 30,		At or for the Nine Months Ended September 30,		At or for the Year Ended December 31,				
	2011	2010	2011	2010	2010	2009	2008	2007	2006
(in thousands, except share data)									
Income Statement (for the period ended):									
Net interest income	$ 11,970	$ 10,288	$ 35,474	$ 25,548	$ 39,034	$ 31,502	$ 75,885	$ 90,037	$ 86,779
Provision for loan losses	1,000	12,000	3,300	29,100	37,300	153,515	34,411	10,955	6,471
Noninterest income	37,268	27,710	70,649	68,816	96,931	59,230	40,346	23,298	19,313
Noninterest expense	32,618	31,992	93,342	85,716	132,215	94,448	70,189	71,253	68,131
Net income (loss) before taxes	15,620	(5,994)	9,481	(20,452)	(33,550)	(157,231)	11,631	31,127	31,490
Income taxes	362	(633)	388	(600)	697	(46,955)	3,202	10,663	10,173
Net income (loss)	$ 15,258	$ (5,361)	$ 9,093	$ (19,852)	$ (34,247)	$ (110,276)	$ 8,429	$ 20,464	$ 21,317
Basic earnings per common share (1)	$ 11.29	$ (3.97)	$ 6.73	$ (14.70)	$ (25.35)	$ (81.63)	$ 6.25	$ 15.15	$ 15.75
Diluted earnings per common share (1)	$ 11.29	$ (3.97)	$ 6.73	$ (14.70)	$ (25.35)	$ (81.63)	$ 6.24	$ 15.09	$ 15.60
Shareholders equity per share (1)	$ 59.47	$ 60.08	$ 59.47	$ 60.08	$ 43.52	$ 68.03	$ 152.57	$ 147.00	$ 133.39
Dividends per share (1)	$ -	$ -	$ -	$ -	$ -	$ -	$ 2.25	$ 2.25	$ 2.13
Dividend payout ratio	-	-	-	-					

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	At or for the Three Months Ended September 30, 2011	2010	At or for the Nine Months Ended September 30, 2011	2010	At or for the Year Ended December 31, 2010	2009	2008	2007	2006
Financial position (at period end):									
Cash and cash equivalents	$ 138,429	$ 267,009	$ 138,429	$ 267,009	$ 72,639	$ 217,103	$ 270,577	$ 43,635	$ 53,972
Investment securities available for sale	339,453	291,050	339,453	291,050	313,513	657,840	56,337	111,621	115,327
Loans held for sale	226,590	116,976	226,590	116,976	212,602	57,046	48,636	77,969	67,914
Loans held for investment, net	1,360,219	1,633,392	1,360,219	1,633,392	1,538,521	1,964,994	2,425,887	2,428,214	2,067,247
Mortgage servicing rights (2)	74,083	60,569	74,083	60,569	87,232	78,372	57,699	53,422	50,270
Other real estate owned	64,368	202,008	64,368	202,008	170,455	107,782	20,905	1,974	1
Total assets	2,316,839	2,678,719	2,316,839	2,678,719	2,485,697	3,209,536	2,958,911	2,793,935	2,428,054
Deposits	2,056,977	2,319,231	2,056,977	2,319,231	2,129,742	2,332,333	1,911,311	1,717,681	1,536,768
FHLB advances	67,919	165,869	67,919	165,869	165,869	677,840	705,764	746,386	575,063
Liabilities									
Shareholders equity	80,336	81,167	80,336	81,167	58,789	91,896	206,103	198,052	180,322
Financial position (averages):									
Investment securities available for sale	272,294	305,342	295,988	492,668	457,930	372,320	119,720	113,333	133,424
Loans held for investment	1,427,763	1,813,447	1,509,296	1,936,583	1,868,039	2,307,215	2,519,811	2,239,639	1,901,996
Total interest earning assets	2,019,243	2,466,010	2,066,943	2,749,454	2,642,693	3,056,755	2,762,723	2,435,145	2,103,862
Total interest bearing deposits	1,787,388	2,075,361	1,837,708	2,106,583	2,071,237	2,012,971	1,557,533	1,452,742	1,255,402
FHLB advances	72,267	178,260	105,410	454,947	382,083	685,715	734,989	617,225	520,881
Total interest bearing liabilities	$ 1,921,512	$ 2,320,478	$ 2,005,843	$ 2,628,480	$ 2,522,767	$ 2,776,163	$ 2,485,786	$ 2,170,807	$ 1,863,969
Shareholders equity	$ 73,499	$ 86,704	$ 62,958	$ 92,150	$ 89,267	$ 160,145	$ 203,358	$ 190,590	$ 169,977
Financial performance:									
Return on average common shareholder equity (3)	83.04%	(24.73)%	19.26%	(28.73)%	(38.00)%	(68.90)%	4.14%	10.74%	12.54%
Return on average assets	2.67%	(0.80)%	0.53%	(0.89)%	(1.19)%	(3.47)%	0.29%	0.79%	0.96%
Net interest margin (4)	2.38%	1.68%	2.30%	1.25%	1.49%	1.04%	2.78%	3.45%	4.16%
Efficiency ratio (5)	66.25%	84.19%	87.96%	90.84%	97.24%	104.10%	60.39%	62.87%	64.22%
Operating efficiency ratio (6)	47.74%	59.99%	62.95%	75.35%	73.56%	92.55%	59.06%	62.82%	64.14%
Credit quality:									
Allowance for loan losses	$ 53,167	$ 70,554	$ 53,167	$ 70,554	$ 64,177	$ 109,472	$ 58,587	$ 38,804	$ 27,834
Allowance for loan losses/Total loans	3.76%	4.14%	3.76%	4.14%	4.00%	5.28%	2.36%	1.57%	1.33%
Allowance for loan losses/Nonperforming loans	55.91%	37.41%	55.91%	37.41%	56.69%	29.25%	77.72%	114.95%	828.15%
Total classified assets	$ 225,022	$ 484,269	$ 225,022	$ 484,269	$ 363,947	$ 570,013	$ 376,424	$ 114,797	$ 30,468
Classified assets/total assets	9.71%	18.08%	9.71%	18.08%	14.64%	17.76%	12.72%	4.11%	1.25%
Total nonaccrual loans (7)	$ 95,094	$ 188,592	$ 95,094	$ 188,592	$ 113,210	$ 374,218	$ 75,385	$ 33,758	$ 3,361
Nonaccrual loans/Total loans	6.73%	11.07%	6.73%	11.07%	7.06%	18.04%	3.03%	1.37%	0.16%
Total nonperforming assets	$ 159,462	$ 390,600	$ 159,462	$ 390,600	$ 283,665	$ 482,000	$ 96,290	$ 35,732	$ 3,362
Nonperforming assets/total assets	6.88%	14.58%	6.88%	14.58%	11.41%	15.02%	3.25%	1.28%	0.13%

Net charge-offs	$ 7,673	$ 36,209	$ 14,480	$ 68,580	$ 83,156	$ 101,680	$ 14,628	$ (15)	$ 117
Regulatory capital ratios for the bank:									
Tier 1 capital to total assets (leverage)	5.6%	4.9%	5.6%	4.9%	4.5%	4.5%	8.7%	9.0%	9.9%
Tier 1 risk-based capital	8.5%	7.4%	8.5%	7.4%	6.9%	7.2%	10.5%	9.9%	11.0%
Total risk-based capital	9.8%	8.7%	9.8%	8.7%	8.2%	8.5%	11.8%	11.2%	12.3%

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	At or for the Three Months Ended September 30,		At or for the Nine Months Ended September 30,		At or for the Year Ended December 31,				
	2011	2010	2011	2010	2010	2009	2008	2007	2006
SUPPLEMENTAL DATA:									
Loans serviced for others:									
Single family	$ 6,649,546	$ 6,144,555	$ 6,649,546	$ 6,144,555	$ 6,343,158	$ 5,820,946	$ 4,695,804	$ 3,775,362	$ 3,389,050
Multifamily	770,401	787,961	770,401	787,961	776,671	810,910	822,512	715,946	729,715
Other	57,151	67,377	57,151	67,377	58,765	69,839	74,230	77,329	53,682
Total loans serviced for others	$ 7,477,098	$ 6,999,893	$ 7,477,098	$ 6,999,893	$ 7,178,594	$ 6,701,695	$ 5,592,546	$ 4,568,637	$ 4,172,447
Loan origination activity:									
Single family	484,434	586,669	$ 1,085,902	$ 1,393,693	$ 2,069,144	$ 2,727,457	$ 1,735,897	$ 1,568,834	$ 1,445,218
Other	31,749	21,903	97,642	62,873	120,058	124,433	817,438	1,332,147	1,650,072
Total loan origination activity	516,183	608,572	$ 1,183,544	$ 1,456,566	$ 2,189,202	$ 2,851,890	$ 2,553,335	$ 2,900,981	$ 3,095,290

(1) Per share data shown after giving effect to the 1-for-2.5 reverse stock split implemented on July 19, 2011.

(2) On January 1, 2010, we elected to carry mortgage servicing rights related to single family loans at fair value, and elected to carry single family mortgage loans held for sale using the fair value option.

(3) Net earnings (loss) available to common shareholders divided by average common shareholders equity.

(4) Net interest income divided by total average earning assets on a tax equivalent basis.

(5) The efficiency ratio is noninterest expense divided by total revenue (net interest income and noninterest income).

(6) We include an operating efficiency ratio which is not calculated based on accounting principles generally accepted in the United States (GAAP), but which we believe provides important information regarding our result of operations. Our calculation of the operating efficiency ratio is computed by dividing noninterest expense less costs related to OREO (gains (losses) on sales, valuation allowance adjustments, and maintenance and taxes) by total revenue (net interest income and noninterest income). Management uses this non-GAAP measurement as part of its assessment of performance in managing noninterest expense. We believe that costs related to OREO are more appropriately considered as credit-related costs rather than as an indication of our operating efficiency. The following table provides a reconciliation of non-GAAP to GAAP measurement.

	At or for the Three Months Ended September 30,		At or for the Nine Months Ended September 30,		At or for the Year Ended December 31,				
	2011	2010	2011	2010	2010	2009	2008	2007	2006
Efficiency ratio	66.25%	84.19%	87.96%	90.84%	97.24%	104.10%	60.39%	62.87%	64.22%
Less impact of OREO expenses	18.51%	24.20%	25.01%	15.49%	23.68%	11.55%	1.33%	0.05%	0.08%
Operating efficiency ratio	47.74%	59.99%	62.95%	75.35%	73.56%	92.55%	59.06%	62.82%	64.14%

(7) Generally, loans are placed on nonaccrual status when they are 90 or more days past due.

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RISK FACTORS

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

Risks Related to our Business

We are operating under cease and desist orders from the Federal Reserve, the FDIC and the DFI that prohibit us, among other things, from paying dividends without the consent of our regulators and that place other limitations and obligations on the Company and Bank. We are not in full compliance with the Bank Order, and noncompliance may subject us to additional enforcement action.

On May 8, 2009, the Bank consented to the issuance by the FDIC and the DFI of a supervisory order, which we refer to as the Bank Order, following a review of the Bank s financial and lending data. The Bank Order alleges that the Bank had engaged in certain unsafe or unsound banking practices and had violated federal and state law and/or regulations, and orders the Bank to cease and desist from certain practices relating to poor management, inadequate board oversight, inadequate liquidity and capital for our assets, excessive poor quality loans, operating losses and failure to comply with certain laws or regulations.

The Bank Order places certain restrictions on the Bank, including, but not limited to, prohibiting cash dividends and limiting our ability to solicit or renew brokered deposits and to extend additional credit to borrowers who have outstanding, uncollected loans or credit agreements that have been charged off or classified as a loss. Additionally, the Bank cannot extend additional credit to any borrower with outstanding, uncollected loans or credit agreements that have been classified as substandard or doubtful without prior approval of a majority of the Bank s board of directors or the credit committee of the board. Moreover, the Bank Order requires the Bank to adopt and adhere to certain policies relating to, among other things, reduction of classified assets and reliance on noncore funding sources.

The Bank Order also requires the Bank to take certain affirmative actions, including, but not limited to increasing the Bank s Tier 1 and risk-based capital ratios to specified levels, improving lending and collection policies, reducing outstanding commercial real estate and acquisition, development and construction loans, reducing the level of classified assets, and retaining qualified management. At December 31, 2011, the Bank was not in compliance with the Bank Order requiring the Bank to achieve and thereafter maintain a Tier 1 leverage capital ratio of at least 10.0% and a risk-based capital ratio of at least 12.0% and the contribution that the Company expects to make to the Bank upon completion of this offering will not be sufficient to achieve those capital ratios.

While we have complied with the additional requirement to develop and submit a plan for the reduction of its commercial real estate and land acquisition and development and construction loans, we did not achieve our internally established targets for December 31, 2011 of 277% of risk-based capital and 99% of risk based capital, respectively. At December 31, 2011, the commercial real estate ratio was 404%, and the land acquisition and development and construction ratio was 155%.

In addition, the Bank Order required the Bank to formulate, and submit to the FDIC and the DFI, a plan to reduce the aggregate balance of adversely classified assets as of December 31, 2008 to 40% of risk-based capital

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by February 28, 2010. The Bank did not meet that target as of February 28, 2010 but we did achieve that target as of June 30, 2011, when our ratio was 38.2%. At December 31, 2011, this ratio had been reduced further to 13.5%.

We also are operating under an order to cease and desist issued by the OTS on May 18, 2009, which we refer to as the Company Order (and together with the Bank Order, the Orders), which requires the Company to refrain from engaging in all unsafe and unsound practices that have resulted in the operation of HomeStreet, Inc. with low earnings and inadequate capital. On July 21, 2011, the OTS was abolished and its supervisory and regulatory functions with respect to savings and loan holding companies, including the Company, have been transferred to the Federal Reserve. References in this prospectus to the Federal Reserve include the OTS prior to the transfer date with respect to those functions transferred to the Federal Reserve. The Company Order requires the consent of the Federal Reserve for the Company to pay dividends, make capital distributions, incur, issue, renew, repurchase, make payments on or roll over any debt (including our trust preferred securities, or TruPS), increase any current lines of credit, guarantee the debt of any entity, make certain severance or indemnification payments and make any change in directors or senior executive officers without the prior approval of the Federal Reserve.

Pursuant to the Company Order, we have developed a plan to manage our liquidity, capital and risk profile, and to address our financial obligations, including interest payments on the TruPS, without relying on dividends from the Bank for 2009 through 2011. The Company Order will remain in effect until terminated, modified or suspended by the Federal Reserve.

Because of the restrictions contained in Orders, we may be limited in our ability to take certain actions and pursue certain operating strategies that might otherwise have resulted in greater benefits to our earnings and results of operations. Moreover, both the pendency of the Orders and the circumstances that gave rise to their issuance may place other limitations on our business, such as making it more difficult to attract and retain depositors, increasing the burdens required to satisfy our contractual obligations and increasing our operating and general and administrative expenses. In addition, failure to comply with these regulatory actions or any future actions could result in further regulatory actions or restrictions, including monetary penalties and the potential closure of the Bank. The Orders are described in more detail in this prospectus under Regulation and Supervision Cease and Desist Orders. For a summary of additional restrictions that may be placed on the Bank, see Regulation and Supervision Regulation of HomeStreet Bank Capital and Prompt Corrective Action Requirements.

We may need to raise additional capital to meet operational requirements and payment of existing obligations in the future, but that capital may not be available when it is needed and that capital may be dilutive to shareholders.

We intend to contribute a substantial portion of the aggregate net proceeds of this offering to the Bank. As a result, the Company does not expect to have adequate capital to fund operating expenses and to bring current the deferred interest due on our outstanding trust preferred securities when that deferral period expires in December 2013, and we expect that we will need to raise additional capital prior to the end of that deferral period either from external sources or from distributions of operating profit from the Bank, assuming regulatory approval of such distributions. The Bank may not be able to generate enough operating profit or distribute such profit to the Company in an amount adequate to mitigate any capital shortfall existing after the completion of this offering. In addition, we are required by federal and state regulatory authorities to maintain adequate levels of capital to support our operations. The contribution of proceeds from this offering to the Bank will not be sufficient to meet the capital requirements set forth in the Bank Order and while we believe that following the contribution to the Bank of $44.0 million in capital from this offering subject to the completion of an on-site examination of the Bank confirming our condition, the Bank Order will be lifted, we expect that it will be replaced with another form of enforcement agreement with the Bank which we expect will include provisions for maintenance of at least an 8.5% Tier 1 capital ratio and continued improvement in the Bank s asset quality. Management does not

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have any reason to believe that the risk-based capital ratio will be increased in any subsequent enforcement order. If we cannot meet those capital requirements, or if our regulators determine that we do not have adequate capital to support our operations, we may need to raise additional capital to satisfy the operational requirements and deferred interest payments described above.

Our ability to raise additional capital will depend on conditions in the capital markets at that time, which are outside our control, and on our financial condition and performance. Accordingly, we may not be able to raise additional capital on terms that are acceptable to us, if at all. If we cannot raise additional capital when needed, our operations could be materially impaired and our financial condition and liquidity could be materially and adversely affected. In addition, if we are unable to raise additional capital when required by the FDIC, the DFI or the Federal Reserve, we may be subject to additional adverse regulatory action. We may be subject to more severe future regulatory enforcement actions if our financial condition or performance weakens further.

Our auditor s opinions on our 2009 and 2010 financial statements include a going concern explanatory paragraph.

Our consolidated financial statements have been prepared assuming that the Company will continue as a going concern. Accordingly, our consolidated financial statements do not include any adjustments to reflect the possible future effects that may result from the outcome of various uncertainties as discussed below.

The effects of the severe economic contraction caused HomeStreet to incur net losses for the years ended December 31, 2010 and 2009. HomeStreet and the Bank are operating under significant regulatory restrictions including a requirement to achieve certain capital requirements, enhance liquidity and improve asset quality. In response, management is conducting this offering in order to raise capital to meet the requirements of the Orders.

Based upon its plans and expectations, management believes HomeStreet has sufficient capital and liquidity to achieve realization of assets and the discharge of liabilities in the normal course of business. However, uncertainties exist as to future economic conditions, regulatory actions and the successful implementation of plans to improve our financial condition and meet the requirements of the Orders. These circumstances raise substantial doubt about our ability to continue as a going concern. The consolidated financial statements do not include any adjustments that might result from the lack of success in implementing our plans or the occurrence of other events that could adversely affect its condition or operations.

We may be subject to continuing enhanced supervision by our regulators even if the cease and desist orders are lifted or replaced.

We anticipate that the Bank Order will be replaced following the successful completion of this offering, including the contribution of at least $44.0 million to the Bank, and an on-site examination of the Bank by our primary regulators confirming our condition. However, if we suffer any adverse developments, such as a material increase in our classified assets, or if our banking regulators are not satisfied with the outcome of their examination, the Bank Order may not be lifted or replaced, and the capital to be contributed to the Bank following this offering may not be adequate to bring the Bank into compliance with the Bank Order. In addition, in the event the Bank Order is lifted, we expect that our banking regulators will replace it with another form of enforcement agreement with the Bank which we expect to include provisions for maintenance of at least an 8.5% Tier 1 capital ratio and continued improvement in the Bank s asset quality. Management does not have any reason to believe that the risk-based capital ratio will be increased in any subsequent enforcement order.

We cannot guarantee that we will be able to comply with the requirements of the Bank Order or, in the event it is not lifted following this offering, the requirements of any replacement order issued by our regulators including any capital requirements or that we will not suffer additional increases in classified assets or other adverse developments in the foreseeable future. In addition, our regulators are under no obligation to lift or replace the Bank Order based on the anticipated outcome of this offering and in the event they do not agree to lift or replace the Bank Order, we would remain subject to extraordinary supervisory action.

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We expect our regulators will continue to monitor our business more closely while we are subject to the Bank Order and any replacement order and may keep in effect all or some of the existing restrictions or adopt new or additional restrictions on our operations. Such restrictions could limit our ability to grow our earning assets, increase our operating expenses and make it more difficult to raise additional capital if needed in the future. Any such measures, if taken, may have an adverse effect upon the value of our common stock. Other banks that have had cease and desist orders similar to ours often have subsequently been required to enter into informal supervisory agreements with the FDIC and the DFI. These arrangements have included increased capital requirements and asset quality targets, restrictions on payment of dividends and indebtedness, limits on appointment and compensation of directors and senior executive officers and other limitations on operations. We expect any informal order imposed by our banking regulators will result in continued restrictions on our operations and continued increased compliance costs.

We expect to maintain capital levels higher than many of our peers did before the financial crisis, which may cause us to be less profitable.

The Orders require us to maintain capital levels in excess of what would normally be required for an adequately capitalized or well capitalized bank, and significantly above the levels maintained by many of our peers prior to the financial crisis. If the Orders are lifted, we expect to maintain capital levels higher than those that may be required of some of our peers, in part because we expect to be subject to continued enhanced regulatory oversight, including a replacement enforcement agreement from our banking regulators which we expect would include provisions for maintenance of at least an 8.5% Tier 1 capital ratio and continued improvement in the Bank s asset quality. Management does not have any reason to believe that the risk-based capital ratio will be increased in any subsequent enforcement order. In addition, new regulatory requirements in connection with the Dodd-Frank Act and Basel III may mandate increased capital levels. While decreasing our leverage by maintaining higher capital levels will cause us to be less sensitive to adverse economic changes in our markets, it will also result in lower profits for the Company as we will not be able to grow our lending as quickly as we might otherwise be able to do if we were to maintain lower capital levels.

We have incurred substantial losses and cannot assure you that we will remain profitable.

Prior to the second quarter of 2011, we had sustained losses in each quarter since the beginning of 2009. Our ability to remain profitable going forward depends primarily on our ability to originate loans and either sell them into the secondary market or hold them in our loan portfolio and collect interest and principal as they come due. When loans become nonperforming or their ultimate collection is in doubt, our income is adversely affected. Our provisions for loan losses were $34.4 million in the year ended December 31, 2008, $153.5 million in the year ended December 31, 2009 and $37.3 million in the year ended December 31, 2010, and $3.3 million in the year ended December 31, 2011. During these same periods our net interest income has declined, reflecting the significant increase in our nonaccrual loans. This resulted in net income of $8.4 million in 2008 and net losses of $110.3 million and $34.2 million being reported for the years ended December 31, 2009 and 2010, respectively. Although we earned net income of $16.1 million during the year ended December 31, 2011, we cannot offer assurances that we will remain profitable in the future. Our ability to sustain a return to profitability will significantly depend on the successful resolution of nonperforming assets and the subsequent stabilization of our loan portfolio, the timing and certainty of which cannot be predicted. No assurance can be given that we will be successful in such efforts.

The completion of this offering will limit our ability to use our accumulated net operating losses to offset future taxable income.

As of December 31, 2011 we had a net operating loss carryforward for federal tax purposes amounting to $11.2 million, which under certain circumstances could be used to offset future taxable income for U.S. federal income tax purposes. We recognized a valuation allowance for financial statement purposes against the carrying value of that tax benefit, and the current carrying value of our net operating loss carryforward on our financial statements is zero. The completion of this offering is expected to result in an ownership change of HomeStreet within the meaning of Section 382 of the Internal Revenue Code of 1986, as amended. Section 382 substantially limits the ability of a corporate taxpayer to offset accumulated net operating losses incurred prior to an ownership change against income earned after an ownership change. A change in ownership under Section 382 may also limit our ability to deduct certain charges and recover our basis in assets in future periods. The Treasury Regulations adopted under Section 382 are complex, and the actual amount of such limitation varies depending on a variety of factors. In our case, we expect the residual benefit of our accumulated net operating loss carryforward to be nominal and anticipate a potential limitation on deductibility of future charges if completion of this offering triggers an ownership change under Section 382.

HomeStreet, Inc. primarily relies on dividends from the Bank and payment of dividends by the Bank is restricted under the Orders and may continue to be restricted even after such Orders are lifted or replaced.

HomeStreet, Inc. is a separate legal entity from the Bank, and although we do receive some dividends from HomeStreet Capital, the primary source of our funds from which we service our debt, pay dividends and otherwise satisfy our obligations is the receipt of dividends from the Bank. The availability of dividends from the Bank is limited by various statutes and regulations. Depending upon the financial condition of the Bank and other factors, the applicable regulatory authorities could assert that payment of dividends or other payments, including payments to us, is an unsafe or unsound practice. In this regard, the Bank Order currently prohibits the Bank from paying dividends to us without the prior written approval of the FDIC and the DFI. If the Bank s ability to pay dividends continues to be restricted or is restricted in the future, even if it was replaced by another form of enforcement agreement with the Bank on the lifting of the Bank Order, we may be limited in our ability to service our debts and fund operations.

Our turnaround plan has been designed and is being implemented in a period of unpredictable market conditions, and there can be no assurance that the turnaround plan can be implemented with positive or the anticipated results or on the schedule forecasted by management.

In 2009, the Company recruited and retained a new executive management team who designed and are implementing a turnaround plan for the Company to address its weakened financial condition. The success of this turnaround plan depends in part on the ability of our new management team to implement the plan and on economic conditions in our markets, which in recent years have been and continue to be unpredictable. A worsening of current economic indicators, such as real estate property values and continued high unemployment, will slow, limit or otherwise negatively affect the success of the turnaround plan. In addition, the executive management team responsible for implementing the turnaround plan is relatively new to the Company and may not have anticipated all of the issues that may face the Company and its geographic marketplace with regard to the plan. As a result, there can be no assurance that the turnaround plan can be completed with positive or the anticipated results or on the schedule forecasted by management.

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

Since late 2008, the capital and credit markets have experienced difficulty stemming in part from dramatic declines in the housing market, increasing foreclosures and rising unemployment. These difficulties have negatively impacted residential and commercial real estate values and the performance of mortgage, residential construction and other loans and required significant write-downs of asset values by financial institutions. As a result, many financial institutions, including the Company and the Bank, have been faced with the choice of seeking additional capital, merging with stronger institutions or failing. Many lenders and institutional investors have curtailed lending due to concern for the stability of the market, including lending to other financial institutions. This market turmoil and tightening of credit have led to an increased level of loan defaults and delinquencies, lack of consumer confidence, increased market volatility and widespread reduction of business activity generally, all of which has adversely affected our business, financial condition and results of operations. We expect that these difficult conditions in the financial markets will improve, if at all, slowly, and that a worsening of these conditions may prolong or exacerbate the adverse effects already felt by us and the rest of the financial institutions industry. In particular, we may face risks related to market conditions that may negatively impact our business opportunities and plans, such as:

- uncertainty related to increased regulation and enforcement in the financial sector, including increased costs of compliance;
- the models we use to assess the creditworthiness of our customers may become less reliable in predicting future behaviors which may impair our ability to effectively make underwriting decisions;
- challenges in accurately estimating the ability of our borrowers to repay their loans if our forecasts of economic conditions and other economic predictions are not accurate;
- further increases in FDIC insurance premiums due to additional depletion of that agency s insurance funds;
- restrictions in our ability to engage in routine funding transactions due to the commercial soundness of other financial institutions and government sponsored entities; and
- increased competition from further consolidation in the financial services industry.

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.

Adverse economic conditions in the Pacific Northwest and other regions where we have operations have caused and could continue to cause us to incur losses.

Our mortgage banking and retail and commercial banking operations are currently concentrated in the Puget Sound area of Washington, and to a lesser extent, the Vancouver, Washington and Portland, Oregon regions and Hawaii. We also have lending offices in Spokane and Aberdeen, Washington, and Salem, Oregon. For example, according to the Case-Shiller Housing Prices Index, Seattle housing prices experienced a decline of approximately 27.9% from the market peak of July 2007 through December 2010, and declined 6.0% from December 2009 to December 2010 and 6.3% for the twelve months ended November 30, 2011, reflecting average values last experienced in November 2004. Portland, our second-largest market, has performed similarly, with the Case-Shiller index indicating a 4.8% decline in housing prices for the twelve months ended November 30, 2011. Residential mortgage delinquencies remain elevated, with 6.7% of Washington State residential mortgages being delinquent during the second quarter of 2011 according to published reports. As a result of this geographic concentration, our results of operations currently depend largely upon economic conditions in these areas. Deterioration in economic conditions in these markets, including decreasing real estate values and sales and increasing unemployment and commercial real estate vacancy rates, are having and may continue to have a material adverse impact on the quality of our loan portfolio and the demand for retail and commercial banking products and services. In particular, the economic slowdown in our markets has resulted in many of the following conditions, which have had, and may continue to have, an adverse impact on the Bank s business:

- an increase in loan delinquencies, problem assets and foreclosures;

a decline in the demand for products and services, including a material reduction in the volume of our single family purchase loan transactions and commercial real estate loan transactions;

a decline in the value of loan collateral, especially real estate, which in turn may reduce customers borrowing power;

a decline in the demand for loans; and

a decline in the origination of loans, especially residential construction, income property and business banking loans.

Each of these conditions has had and may continue to have a material adverse effect on our results of operations, including but not limited to a decrease in fee income and net interest income.

In addition, as a result of the significant deterioration in economic conditions in our markets, our loan portfolio suffered substantial deterioration during 2008, 2009 and 2010. During 2010, we experienced continuing high provisions for loan losses and charge-offs but at a lower level than in 2009. Total classified assets, which comprise the outstanding balance of all loans classified as substandard or doubtful and the carrying value of all other real estate owned (OREO), totaled $363.9 million, or 14.6% of total assets, as of December 31, 2010 and $188.2 million, or 8.3% of total assets as of December 31, 2011. We had an additional $153.3 million, or 6.8% of total assets that we classified as special mention as of December 31, 2011. At December 31, 2010 and December 31, 2011, our nonaccrual loans totaled $113.2 million, or 7.2%, and $76.5 million, or 5.7% of loans held for investment, respectively. No assurance can be given that additional loans will not be added to classified or special mention status or that existing classified or special mention loans will not migrate into lower classifications, either of which would require us to recognize additional provisions for loan losses. Additionally, we cannot assure you that we can foreclose on and sell real estate collateral without incurring additional losses.

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

Approximately 69.0%, 66.0% and 58.1% of our consolidated revenues (interest income plus noninterest income) in the years ended December 31, 2011, 2010 and 2009, respectively, were derived from originating, selling and servicing residential mortgages, and 29.0%, 28.5% and 24.9% of our consolidated total assets as of the end of each of those periods, respectively, represented residential mortgage loans held for investment. In addition, in January and February 2012 we significantly expanded our single family mortgage loan operation, which we expect will further increase the percentage of our revenue derived from residential mortgage lending, thereby increasing our exposure to risks in that sector. Residential mortgage lending in general has experienced substantial volatility in recent years, and each of our primary geographic market areas has recorded more significant declines in real estate values and higher levels of foreclosures and mortgage defaults than the national averages for those statistical categories. Were these trends to be protracted or exacerbated, our financial condition and result of operations may be affected materially and adversely.

The significant concentration in our portfolio of real estate secured loans has had and may continue to have a negative impact on our asset quality and profitability as a result of continued or worsening conditions on the real estate market and higher than normal delinquency and default rates.

Substantially all of our loans are secured by real property. As of December 31, 2011, 95.6% of all of our outstanding loans, totaling $1.29 billion, were secured by real estate, including $496.9 million in single family residential loans, $402.1 million in commercial real estate loans (including $102.4 million in owner-occupied loans underwritten based on the cash flows of the business), $56.4 million in multifamily residential loans, $173.4 million in construction and land development loans and $158.9 million in home equity loans.

Our real estate secured lending is generally sensitive to regional and local economic conditions, making loss levels difficult to predict. Declines in real estate sales and prices, as well as the adverse impacts of the economic

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slowdown and recession and an associated increase in unemployment, have resulted in higher than expected loan delinquencies and foreclosures, problem loans and OREO, net charge-offs and provisions for credit and OREO losses. We may continue to incur losses and may suffer additional adverse impacts to our capital ratios and our business. If the significant decline in market values continues, the collateral for our loans will provide less security and our ability to recover the principal, interest and costs due on defaulted loans by selling the underlying real estate will be diminished, leaving us more likely to suffer additional losses on defaulted loans. Such declines may have a greater effect on our earnings and capital than on the earnings and capital of financial institutions whose loan portfolios are more diversified.

Continued or 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 loans held for investment have historically been concentrated in construction and residential land acquisition, development and construction loans, which have a higher risk of loss than residential mortgage loans, and we have experienced increased delinquencies and loan losses related to those loans.

Construction and residential land acquisition, development and construction loans (ADC loans) represented 12.9%, 17.7% and 30.3% of our total loan portfolio at December 31, 2011, 2010 and 2009, respectively. Such loans represented 63.3%, 58.3% and 79.1% of our nonperforming loans at those dates. In 2010 and 2009, 82.5% and 80.7% of our charge-offs came from construction and ADC loans. If current downward trends in the housing and real estate markets continue, we expect that we will continue to experience increased delinquencies and credit losses from these loans. An increase in our delinquencies and credit losses would adversely affect our financial condition and results of operations, perhaps materially.

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 lending institutions, we maintain an allowance for loan losses to provide for defaults and nonperformance, which is a reserve established through a provision for loan losses charged to expense that represents management s best estimate of probable incurred losses inherent in the loan portfolio. Such allowance may not be adequate to cover actual losses, and future provisions for losses could adversely affect our financial condition, results of operations and cash flows.

The level of the allowance for loan losses reflects management s continuing evaluation of specific credit risks and loan loss experience, current loan portfolio quality, present economic, political and regulatory conditions, industry concentrations and other unidentified losses inherent in the current loan portfolio. 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 significant estimates of current credit risks and future trends,

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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.

If the credit quality of our customer base materially decreases, if the risk profile of a market, industry or group of customers changes materially or if our allowance for loan losses is not adequate, our business, financial condition, including our liquidity and capital, and results of operations could be materially adversely affected. A significant source of risk arises from the possibility that we could sustain losses caused by the failure of borrowers, guarantors and related parties to perform in accordance with the terms of their respective loans. The underlying credit monitoring polices and procedures that we have adopted to address this risk may not prevent unexpected losses that could have a significant adverse effect on our financial condition, results of operations and cash flows. Unexpected losses may arise from a variety of specific systematic factors, many of which are beyond our ability to predict, influence or control.

Subsequent evaluations of our loan portfolios may reveal that estimated levels of loss frequency and or severity used in determining the allowance for loan losses differed significantly from actual experience, and in such circumstances we may have to record an increased provision for loan losses in subsequent periods, thereby reducing earnings in those periods. As an integral part of the examination process, our independent accountants, federal and state regulatory agencies all review our loans, loan-related commitments and allowance for loan loss methodology. As of December 31, 2011, 2010 and 2009, our allowance for loan losses was $42.7 million, $64.2 million and $109.5 million, respectively, and as of those same dates, the allowance for loan losses as a percentage of nonperforming loans was 55.8%, 56.7% and 29.3%, respectively. While we believe that our allowance for loan losses is adequate to cover losses inherent in the Bank s loan portfolios, we cannot guarantee that we will not need to increase further the allowance for loan losses or that regulators will not require such an increase. An increase in the level of loan loss allowance, whether voluntary or compelled by regulators, may have a material adverse effect on our financial condition, results of operations and cash flows.

Nonperforming assets take significant time to resolve and adversely affect our financial condition and results of operations.

At December 31, 2011 and 2010, nonperforming loans totaled $76.5 million, or 5.7%, and $113.2 million, or 7.0%, respectively, of our total loan portfolio. At December 31, 2011 and 2010, our nonperforming assets (which include OREO) were $115.1 million, or 5.1%, and $283.7 million, or 11.4%, respectively, of our total assets. In addition, we had $35.8 million at December 31, 2011 and $43.5 million at December 31, 2010 in loans that were 90 or more days past due and still held on accrual status and $27.6 million at December 31, 2011 and $21.6 million at December 31, 2010 in loans 30 to 89 days delinquent. Until economic and market conditions improve, we may continue to incur additional losses relating to an increase in nonperforming assets. We do not record interest income on nonaccrual loans, which adversely affects our income. Additionally, higher levels of nonperforming assets increase our loan administration and legal expenses.

In addition, when we take possession of collateral through foreclosure or other similar proceedings, we are required to record the related collateral at the then fair value of the collateral less selling costs, which may result in a loss. Nonperforming assets increase our risk profile and the level of capital we and our regulators believe is adequate in light of such risks. Impairment of the value of these assets, the value of the underlying collateral, the liquidity and net worth of guarantors, or our borrowers performance or financial conditions, whether or not due to economic and market conditions beyond our control, have adversely affected, and may continue to adversely affect, our business, results of operations and financial condition. See discussion below regarding additional risks associated with other real estate owned.

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Our OREO may be subject to additional impairment and expense associated with ownership, and such properties may ultimately be sold at below appraised values.

Real estate owned by the Bank and not used in the ordinary course of its operations is referred to as other real estate owned, or OREO. We foreclose on and take title to the real estate collateral for defaulted loans as part of our business. We obtain appraisals on these assets prior to taking title to the properties and periodically thereafter. However, due to the rapid and severe deterioration in our markets, there can be no assurance that such valuations will reflect the amount which may be paid by a willing purchaser in an arms-length transaction at the time of the final sale. Moreover, we cannot assure investors that the losses associated with OREO will not exceed the estimated amounts, which would adversely affect future results of our operations. The calculation for the adequacy of write-downs of our OREO is based on several factors, including the appraised value of the real property, economic conditions in the property s sub-market, comparable sales, current buyer demand, availability of financing, entitlement and development obligations and costs and historic loss experience. All of these factors have caused further write-downs in recent periods and can change without notice based on market and economic conditions.

In addition, our earnings may be affected by various expenses associated with OREO, including personnel costs, insurance, taxes, completion and repair costs and other costs associated with property ownership, as well as by the funding costs associated with assets that are tied up in OREO. Moreover, our ability to sell OREO properties is affected by public perception that banks are inclined to accept large discounts from market value in order to quickly liquidate properties. Any decrease in market prices may lead to OREO write-downs, with a corresponding expense in our statement of operations. Further write-downs on OREO or an inability to sell OREO properties could have a material adverse effect on our results of operations and financial conditions. Furthermore, the management and resolution of nonperforming assets, which include OREO, increases our costs and requires significant commitments of time from our management and directors, which can be detrimental to the performance of their other responsibilities. There can be no assurance that we will not experience further increases in nonperforming assets in the future.

Our underwriting practices may not have adequately captured the risk inherent in our loan portfolio and our past underwriting practices may result in loans that expose us to a greater risk of loss.

We seek to mitigate the risks inherent in our loan portfolio by adhering to specific underwriting practices. These practices will often include analysis of a borrower s prior credit history, financial statements, tax returns and cash flow projections; valuation of collateral; obtaining personal guarantees of loans to businesses; and verification of liquid assets. If our underwriting process fails to capture accurate information or proves to be inadequate, we may incur losses on loans that meet our underwriting criteria, and those losses may exceed the amounts set aside as reserves in the allowance for loan losses.

Prior to the revision of our lending policies in September 2008, which are further described in Business Risk Management Credit Risk Management, we granted exceptions to our loan-to-value limits, and our current aggregate loan-to-value exceptions remain elevated, although within regulatory guidelines. As a result, some of our single family residential loans are secured by liens on mortgage properties in which the borrowers have little or no equity. During 2008 we began originating up to 100.0% loan-to-value loans to qualifying consumers to purchase select properties on which we hold a construction lien and also converted some of our construction loans to permanent investor rental property loans, many of which are in excess of 85.0% loan-to-value. We also originated first mortgage loans of up to an 80.0% loan-to-value ratio and a concurrent purchase money second mortgage with a combined loan-to-value ratio of up to 100.0% for purchase borrowers select properties. In addition, certain of our home equity lines of credit may have, when added to existing senior lien balances, a post-funding combined loan-to-value ratio of greater than 100.0% of the value of the property securing the loan. We do not consider the level of these high loan-to-value loans to be material to the Bank s operations. Residential loans with high combined loan-to-value ratios are more sensitive to declining property values than those with lower combined loan-to-value ratios and, therefore, may experience a higher incidence of default and severity of losses. In addition, if the borrowers sell their homes, such borrowers may be unable to repay their loans in full from the sale.

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A substantial amount of our residential mortgage loans and home equity lines of credit also have adjustable interest rates, and these loans may experience a higher rate of default in a rising interest rate environment. In addition, loans with combined loan-to-values in excess of 90.0% for owner-occupied property loans and 85.0% for investor rental property loans may experience higher rates of delinquencies, defaults and losses. In declining real estate or rental markets, investor property borrowers may not have the incentive to carry the burden of negative cash flow and thus may have higher default rates. We are actively working to reduce our concentrations of those loans with a higher risk of default; however, we are still subject to an increased exposure of loss due to those loans.

The fair value of our single family mortgage servicing rights is subject to substantial interest rate risk.

The value our mortgage servicing rights (MSRs) change with fluctuations in interest rates reflecting the changing expectations of mortgage prepayment activity. To mitigate potential losses of economic value of MSRs related to changes in interest rates, we actively hedge this risk utilizing derivative financial instruments. Hedging is a complex process, requiring sophisticated models, experienced and skilled personnel and continual monitoring. As it would be both impracticable and economically infeasible to hedge away substantially all of our interest rate risk, we do not seek to hedge this risk completely. Changes in the value of our hedging instruments may not correlate positively with changes in the value of our MSRs, and we could incur a net valuation loss as a result of our hedging activities, because our hedging instruments are imperfect, or both. Prior to January 2010, we valued our MSRs at the lower of cost or market value. For the years ended December 31, 2006, 2007, 2008 and 2009, we recognized net MSR/hedge gains and (losses) of $1.7 million, $1.7 million, $5.4 million and $(4.7) million, respectively. In January 2010, we elected to value our MSRs at fair value which has enabled more effective hedging strategies. In 2010 and 2011, we recognized net MSR/hedge gains of $4.3 million and $13.4 million, respectively. Following the expansion of our single family mortgage operations in early 2012 through the addition of a significant number of residential mortgage personnel, we expect the volume of our MSRs to increase substantially which will increase our exposure to the risks associated with the impact of interest rate fluctuations on MSRs.

We may incur significant losses as a result of ineffective hedging of interest rate risk related to our single family loans held for sale.

A substantial portion of our single family loans are sold into the secondary market. We are exposed to the risk of decreases in the fair value of our single family loans held for sale as a result of changes in interest rates. We use derivative financial instruments to hedge this risk; however our hedging strategies, techniques and judgments may not be effective and may not anticipate every event that would affect the fair value of our single family loans held for sale. Our inability to effectively reduce the risk of fluctuations in the fair value of our single family loans could negatively affect our results of operations due to decreases in the fair value of these assets.

Our real estate lending also exposes us to the risk of 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.

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

When we sell mortgage loans in the ordinary course of business, we are required to make certain representations and warranties to the purchaser about the mortgage loans and the manner in which they were originated. Our loan sale agreements require us to repurchase mortgage loans if we have breached any of these representations or warranties, in which case we may be required to repurchase such loan and/or bear any subsequent loss on the loan. We may not have any remedies available to us against an originating broker or other third party for such losses, or the remedies available to us may not be as broad as the remedies available to the purchaser of the mortgage loan against us. In addition, if there are remedies against a third party available to us, we face further risk that such third party may not have the financial capacity to perform remedies that otherwise may be available to us. Therefore, if a purchaser enforces remedies against us, we may not be able to recover our losses from a third party and may be required to bear the full amount of the related loss. If repurchase and indemnity demands increase, our liquidity, results of operations and financial condition will be adversely affected. In the aggregate, from January 1, 2006 through December 31, 2011, we sold approximately $10.07 billion of mortgage loans subject to repurchase obligations. During that same period, we incurred $0.8 million of indemnification losses. As of December 31, 2011, our reserve for loan recourse losses was $0.5 million.

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

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

We may be subject to claims relating to documentation and procedures under various foreclosure laws.

In 2010, concerns surfaced among state attorneys general, federal regulators and government-sponsored entities that some mortgage loan servicers have commenced foreclosure proceedings in reliance on affidavits and other documents that were not signed or completed by persons with personal knowledge of the facts asserted in the documents (a practice commonly referred to as robo-signing). Similarly, some loan servicers have not been able to establish their legal standing to foreclose under applicable state law because they have not been able to demonstrate possession of the note evidencing the underlying debt or that they are the legal owner of the lien that is in default and the subject of a foreclosure action (problems commonly referred to as chain of title defects). Loan servicers that initiate foreclosures where there are chain of title defects or that are based on faulty affidavits may be exposed to litigation and regulatory risk for violating state and federal consumer protection laws, for breach of contract under servicing agreements and/or repurchase or indemnification obligations if the servicer was also the originator of the mortgage loans. In addition, these servicers then incur a loss because of an inability to foreclose on the collateral due to non-compliance with foreclosure statutes. Because of our substantial mortgage servicing activities and the current regulatory and economic environment related to the housing markets, it is possible that the Bank may be subject to future complaints, lawsuits or regulatory or investor challenges relating to foreclosure laws.

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The proposed restructuring of Fannie Mae and Freddie Mac and changes in existing government-sponsored and federal mortgage programs could negatively affect our business.

We originate and purchase, sell and thereafter service single family and multifamily mortgages under the Fannie Mae, and to a lesser extent the Freddie Mac, single family purchase programs and the Fannie Mae multifamily Delegated Underwriting and Servicing, or DUS, program. These activities represented 72.1%, 67.5% and 59.9% of our consolidated revenues (interest income plus noninterest income) for the years ended 2011, 2010 and 2009, respectively. 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. None of these proposals have yet been defined with any specificity, and so we cannot predict how any such initiative would impact our business. However, any restructuring of Fannie Mae and Freddie Mac that restricts their loan repurchase programs may have a material adverse effect on our business and results of operations. Moreover, we have recorded on our balance sheet an intangible asset relating to our right to service single and multifamily loans sold to Fannie Mae and Freddie Mac. That asset was valued at $77.3 million and $87.2 million at December 31, 2011 and 2010, respectively. Changes in Fannie Mae s and Freddie Mac s policies and operations that adversely affect our single family residential loan and DUS mortgage servicing assets may require us to record impairment charges to the value of these assets, and significant impairment charges could be material and adversely affect our business.

Through our wholly owned subsidiary Home Street Capital Corporation, we participate as a lender in the Fannie Mae Delegated Underwriting and Servicing program, or DUS. Fannie Mae delegates responsibility for originating, underwriting and servicing mortgages, and we assume a limited portion of the risk of loss during the remaining term on each commercial mortgage loan that we sell to Fannie Mae. In the years ended December 31, 2011 and 2010, we originated $125.7 million and $55.8 million in loans through the DUS program, respectively.

Fannie Mae and Freddie Mac are under conservatorship with the Federal Housing Finance Agency. On February 11, 2011, the Obama administration presented Congress with a report titled *Reforming America s Housing Finance Market, A Report to Congress*, outlining its proposals for reforming America s housing finance market with the goal of scaling back the role of the U.S. government in, and promoting the return of private capital to, the mortgage markets and ultimately winding down Fannie Mae and Freddie Mac. Without mentioning a specific time frame, the report calls for 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. The report presents three options for the long-term structure of housing finance, all of which call for the unwinding of Fannie Mae and Freddie Mac and a reduced role of the government in the mortgage market. We cannot be certain if or when Fannie Mae and Freddie Mac will be wound down, if or when reform of the housing finance market will be implemented or what the future role of the U.S. government will be in the mortgage market, and, accordingly, we will not be able to determine the impact that any such reform may have on us until a definitive reform plan is adopted.

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 the FHA, which facilitate the issuance of mortgage-backed securities in the secondary market. These programs have been reduced in recent periods due to current economic conditions, and the size of loans that Fannie Mae and Freddie Mac can guarantee declined as of October 1, 2011. 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. Further, the Dodd-Frank Act imposes a requirement that 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.

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The lending qualification and limits of FHA and VA may also be subject to changes that may limit our origination of loans guaranteed or insured by the agencies in the future.

We originate and sell FHA and VA loans. The origination of FHA and VA loans represented 29.5%, 29.3% and 28.4% of the dollar value of loans originated in the years ended December 31, 2011, 2010 and 2009, respectively. Housing finance reform legislation decreased FHA loan limits effective October 1, 2011 from $567,500 to $506,000 in our primary markets in King, Pierce and Snohomish Counties, still substantially above the limit of $417,000 that existed prior to February 2009. FHA loan limits also decreased for certain other counties. The FHA mutual mortgage insurance premiums changed in April 2011, with the premium collected at closing or financed in the loan amount decreasing from 2.25% to 1.00%, while the annual premium increased from 0.55% to 1.15%. As a result, conventional financing has become more affordable and more attractive relative to FHA financing for high loan-to-value borrowers who can afford the 5.0% minimum down payment required for conventional loans. While it is too soon to know what the long-term impacts of this legislation will be on our business, our FHA loan production was down slightly in July and September when compared to the overall trend for 2011.

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.

Our earnings are highly 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. In addition, changes to market interest rates may impact the level of loans, deposits and investments and the credit quality of existing loans. Changes in interest rates also affect demand for our residential loan products and the revenue realized on the sale of loans. A decrease in the volume of loans sold can decrease our revenues and net income. These rates may be affected by many factors beyond our control, including general and economic conditions and the monetary and fiscal policies of various governmental and regulatory authorities. Changes in interest rates may 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. Changes in interest rates may reduce our mortgage revenues, which would negatively impact our noninterest income.

Our net interest margin, which represents the effective yield on interest earning assets, declined steadily from 4.16% for the year 2006 to 1.04% for the year 2009 before improving to 1.49% for the year 2010 and to 2.35% for the year 2011. We have taken certain actions that have improved our net interest margin, and our business plan contains certain additional business initiatives intended to further improve our net interest margin. These actions may not prove to be successful.

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

A significant portion of our noninterest income is derived from originating residential mortgage loans and selling them into the secondary market. That business has benefited from a long period of historically low interest rates. To the extent interest rates rise, particularly if they rise substantially or quickly, we may experience a reduction in mortgage refinancing and financing of new home purchases. These factors may negatively affect our mortgage loan origination volume and adversely affect our noninterest income.

Our mortgage servicing rights carry interest rate risk because the total amount of servicing fees earned, as well as the amortization of the investment in the servicing rights, fluctuates based on loan prepayments (affecting the expected average life of a portfolio of residential mortgage servicing rights). At December 31, 2011, we were servicing $6.89 billion of residential loans for third parties. 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 ceases 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.

We may be required, in the future, 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, as required by generally accepted accounting principles in the United States, and as of December 31, 2011 and 2010, we did not recognize any securities as other-than-temporarily impaired. There can be no assurance, however, that future evaluations of the securities portfolio will not require us to recognize an impairment charge with respect to these and other holdings.

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. At December 31, 2011 and 2010, we had stock in the FHLB totaling $37.0 million. The FHLB stock held by us is carried at cost and is subject to recoverability testing under applicable accounting standards. The FHLB has discontinued the repurchase of its stock and discontinued the distribution of dividends. As of December 31, 2011 and 2010, we have not recognized an impairment charge related to our FHLB stock holdings. There can be no assurance, however, that future negative changes to the financial condition of the FHLB may not require us to recognize an impairment charge with respect to such holdings.

Inability to access and maintain liquidity could impair our ability to fund operations and jeopardize our financial condition.

Liquidity is essential to our business. An inability to raise funds through deposits, borrowings, the sale of loans and other sources could have a material adverse effect on our liquidity that would negatively impact our ability to fund continued loan growth and may negatively affect asset growth and, therefore, our earnings capability.

The termination or restructuring of Fannie Mae or Freddie Mac may have an adverse impact on our ability to fund and sell loans and to generate loan fees and gains on sales and create servicing income.

Our main sources of liquidity are loan sales, deposits, payments of principal and interest received on loans and investment securities. In addition, we also rely on borrowing lines with the FHLB and the Federal Reserve Bank of San Francisco, or FRBSF. However, the FHLB has discontinued the repurchase of its stock and discontinued the distribution of dividends. Based on the foregoing, there can be no assurance the FHLB will have sufficient resources to continue to fund our borrowings at their current levels. In the event of a deterioration in our financial conditions or a further downturn in the economy, particularly in the housing market, our ability to access these funding resources could be negatively affected, which could limit the funds available to us and make it difficult for us to maintain adequate funding for loan growth. In addition, our customers ability to raise capital and refinance maturing obligations could be adversely affected, resulting in a further unfavorable impact on our business, financial condition and results of operations.

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In addition, if we were to suffer a significant drop in our capital levels due to a decrease in our business activity or other factors such that we were no longer considered adequately capitalized, we would no longer be eligible to borrow from the FRBSF. Interest rate competition, negative views and expectations about the prospects for the financial services industry as a whole, continued turmoil in the domestic and worldwide credit markets or a severe disruption of the financial markets may also impact the ability to access capital markets and maintain necessary liquidity levels. Our business is also impacted by the fiscal and monetary policies of the U.S. federal government and its agencies, including the Federal Reserve.

At present, under the Bank Order, we may not solicit, retain or rollover any brokered deposits without the approval of the FDIC. At December 31, 2011 we held no brokered deposits, although we have used brokered deposits in the past. If we need brokered deposits in the future for liquidity purposes, we may be unable to accept such brokered deposits, which may materially and adversely affect our liquidity position. In addition, as a result of the Orders, we have been designated as a less than well capitalized institution under applicable regulations. Because we have been designated less than well capitalized, since January 1, 2010, we have been required to price our deposit interest rates based on national average rates. If local competitors are able to offer higher rates, our ability to attract deposits as a source of liquidity may also be adversely impacted.

We have relied heavily in the past, and may continue to rely, on wholesale borrowing and brokered deposits to fund our lending activities.

We historically have relied on a high level of wholesale borrowings and brokered deposits to fund our lending activities. We borrow on a collateralized basis from the FHLB, and, as back-up, from the FRBSF. In the past, we have also used brokered deposits, although the Bank Order prohibits us from soliciting, retaining or rolling over brokered deposits. Our liquidity has been negatively affected because of limitations on our access to these funds. The FHLB and the FRBSF are not obligated to continue to extend credit to us, and our access to credit from either or both of these agencies for future borrowings may be discontinued at any time. There can be no assurance that actions by the FHLB or the FRBSF, limitations on our available collateral or adverse regulatory action against us would not reduce or eliminate our borrowing capacity or that we would be able to continue to attract nonbrokered deposits at competitive rates. To this end, the FHLB recently changed its collateral requirements for the Bank, moving away from blanket custody towards physical custody and eliminating loans held for sale as eligible collateral. These changes in policy have constrained our additional borrowing capacity from the FHLB. We also may not be in compliance with certain covenants in our borrowing agreement with the FHLB relating to safe and sound banking practices, and without a waiver of such covenants, we may not be able to obtain future advances from the FHLB, or we may be required to satisfy additional conditions or may face limitations as to the timing or amounts of such advances, until the Bank Order is lifted. Such events have and could continue to have a material adverse impact on our results of operations and financial condition.

Adverse operating results or changes in industry conditions could lead to difficulty or an inability to access additional funding sources. Our financial flexibility will be severely constrained if we are unable to maintain our access to funding or if adequate financing is not available to accommodate future growth at acceptable interest rates. Finally, if we are required to rely more heavily on more expensive funding sources to support future growth, our revenues may not increase proportionately to cover our costs. In this case, our operating margins and profitability would be adversely affected.

We may have reduced access to wholesale funding sources, which may adversely affect our liquidity and cost of funds.

As part of liquidity management, we use a number of funding sources in addition to core deposit growth and repayments and maturities of loans and investments. We generally select funding sources based on decisions regarding cost and liquidity. If we lose access to one or more wholesale funding sources, our liquidity may be impaired and our cost of borrowing may increase. If we are required to rely more heavily on costlier funding

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sources, our revenues may not increase proportionately to cover our costs, and our earnings and profitability would be adversely affected. Changes in accounting standards could materially impact our consolidated financial statements.

Emergency measures designed to stabilize the U.S. financial markets are beginning to wind down.

Since mid-2008, a host of government actions have been implemented in response to the financial crisis and the recession. Some of the programs are beginning to expire and the impact of the wind-down of these programs on the financial sector and on the economic recovery is unknown. As government support programs are cancelled, changed or withdrawn, there is a possibility that we, as well as other financial institutions, may have insufficient access to, or incur higher costs associated with, deposit or other funding alternatives, which could have a material adverse effect on our business, financial condition, results of operations and prospects. In particular, although the Dodd-Frank Act provides a full FDIC guarantee for certain non-interest bearing transaction accounts for an unlimited amount of coverage through the end of 2012, some accounts previously covered under the voluntary Transaction Account Guarantee (TAG) program, such as certain low-rate Negotiable Order of Withdrawal, or NOW, accounts, did not benefit from the coverage extension that took effect upon the TAG program s expiration on December 31, 2010. This change could adversely affect us, especially in light of the concerns about our financial viability. In addition, a stall in the economic recovery or continuation or worsening of current financial market conditions could exacerbate these effects.

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

Our operations are subject to extensive regulation by federal, state and local governmental authorities, including the FDIC, the DFI and the Federal Reserve, and are subject to various laws and judicial and administrative decisions imposing requirements and restrictions on part or all of our operations. Because our business is highly regulated, the laws, rules and regulations to which we are subject are evolving and change frequently. Changes to those laws, rules and regulations are also sometimes retroactively applied. Furthermore, the on-site examination cycle for an institution in our circumstances is frequent and extensive. Examination findings by the regulatory agencies may result in adverse consequences to the Company. 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.

Legislative or regulatory action regarding foreclosures, forced mortgage principal reduction, or bankruptcy laws may negatively impact our business.

Legislation and regulations have been proposed which, among other things, 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. These legislative and regulatory proposals generally have focused primarily, if not exclusively, on residential mortgage origination, but we cannot offer assurances as to which, if any, of these initiatives may be adopted or, if adopted, to what extent they would affect our business. Any such initiatives may limit our ability to take actions that may be essential to preserve the value of the mortgage loans we service or hold for investment. Any restriction on our ability to foreclose on a loan, any requirement that we forego a portion of the amount otherwise due on a loan or any requirement that we modify any original loan terms may require us to

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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.

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 of HomeStreet Bank.

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 changes the laws as they apply to financial institutions and revises and expands the rulemaking, supervisory and enforcement authority of federal banking regulators. It is also expected to have a material impact on our relationships with current and future customers. Although the statute will have a greater impact on larger institutions than regional bank holding companies such as the Company, many of its provisions will apply to us. Among other things, the Dodd-Frank Act:

- transfers supervision and regulation of HomeStreet, Inc. from the OTS to the Federal Reserve, which has stricter capital requirements for bank holding companies than those historically imposed on savings and loan holding companies, potentially limiting our ability to deploy our capital into earning assets, which would serve to limit our own earnings;
- grants the FDIC back-up supervisory authority with respect to depository institution holding companies that engage in conduct that poses a foreseeable and material risk to the Deposit Insurance Fund and heightens the Federal Reserve s authority to examine, prescribe regulations and take action with respect to all subsidiaries of a bank holding company;
- prohibits insured state-chartered banks such as ours from engaging in certain derivatives transactions unless the chartering state s lending limit laws take into consideration credit exposure to derivatives transactions;
- subjects both large and small financial institutions to data and information gathering by a newly created Office of Financial Research;
- creates a new Consumer Bureau given rulemaking, examination and enforcement authority over consumer protection matters and contains provisions on mortgage-related matters such as steering incentives, determinations as to a borrowers ability to repay and prepayment penalties; and
- imposes certain corporate governance and executive compensation standards that may increase costs of operation and adversely affect our ability to attract and retain management.

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

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The short-term and long-term impacts of the new Basel III capital standards and the forthcoming new capital rules to be proposed for non-Basel III U.S. banks is uncertain.

The Basel Committee on Banking Supervision (Basel Committee) recently adopted new standards that could lead to significantly higher capital requirements, higher capital charges, a cap on the level of mortgage servicing rights that can be included in capital, and more restrictive leverage and liquidity ratios. These new Basel III capital standards will be phased in from January 1, 2013 until January 1, 2019, and it is not yet known how these standards will be implemented by U.S. regulators or applied to community banks of our size and their holding companies. Implementation of these standards, or any other new regulations, might adversely affect our ability to pay dividends or require us to reduce business levels or raise capital, including in ways that may adversely affect our results of operations or financial condition.

The loss of our key management or the inability to attract and retain key employees could result in a material adverse effect on our business.

The Bank Order requires us to attract and retain qualified management, including a chief executive officer and chief credit officer with the qualifications and experience to manage a bank of comparable size, upgrading low-quality loan portfolios, improving earnings and other matters needing particular attention. We depend on our executive officers and key personnel to continue the implementation of our business strategy and could be harmed by the loss of their services. We believe that our growth and future success will depend in large part upon the skills of our management team. Additionally, our future success and growth will depend upon our ability to recruit and retain highly skilled employees with strong community relationships and specialized knowledge in the financial services industry. The competition for qualified personnel in the financial services industry is intense, and the loss of our key personnel or an inability to continue to attract, retain and motivate key personnel could adversely affect our business. We cannot assure you that we will be able to retain our existing key personnel or attract additional qualified personnel.

The financial services industry is highly competitive.

We face heavy competition in virtually all aspects of our business, and the number and character of our competitors are continuing to increase. Among other things, investment accounts may cause clients to consider higher-earning alternatives to bank deposits, particularly during periods such as now, when deposit interest rates are near historic lows. Moreover, technology allows customers and prospective customers much greater access to accounts with other institutions that pay higher rates on deposits, which may limit our ability to raise deposits or increase the associated interest expense. Likewise, we face competition on loans from other commercial banks, as well as from credit unions, insurance companies, mutual funds, and other institutional investors; this competition may limit our earning capacity by limiting our ability to generate loans or by reducing the interest rates we can charge on our loans.

The rapid expansion of our single family mortgage loan operations could pose a challenge if we are not able to successfully integrate our new hires and new offices, and could require significant resources or divert our management s attention.

The rapid expansion of our single family mortgage loan operations through the hiring of a substantial number of mortgage loan personnel previously affiliated with MetLife Home Loans will involve significant expense and expose us to potential additional risks, including the expense of hiring and training a large number of new employees, costs associated with opening new stand-alone loan offices to provide for the new employees, diversion of management s attention from the daily operations of the business and the potential loss of other key employees. We cannot guarantee that these costs will be fully offset by increased revenue generated by the expansion in this business line in the near future, or at all.

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

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

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

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

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

Our independent public accounting firm has identified certain significant deficiencies in our internal controls. If we fail to remediate these internal control deficiencies, address the potential for future deficiencies and maintain an effective system of internal controls over financial reporting, we may not be able to accurately report our financial results.

During their audit of our financial statements for the year ended December 31, 2010, our independent registered public accounting firm, identified certain deficiencies in our internal controls, including deficiencies considered to be significant deficiencies. A significant deficiency is a deficiency, or a combination of deficiencies, in internal controls over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those responsible for oversight of the registrant s financial reporting.

Specifically, our independent auditors identified a significant deficiency relating to a monitoring control over the adoption of new accounting policies. They also identified a significant deficiency relating to a monitoring control over the identification and ongoing evaluation of our non-GAAP accounting methods for materiality.

Management has taken steps to address these identified deficiencies through implementation of additional internal control procedures. However, it is possible that these deficiencies may not be fully remediated by these actions, or that we or our independent auditors may identify significant deficiencies in our internal control over financial reporting in the future. Any failure or difficulties in implementing and maintaining these controls could cause us to fail to meet the periodic reporting obligations that we will be subject to after this offering or result in material misstatements in our financial statements.

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

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

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

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

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

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

In addition, a significant barrier to online financial transactions is the secure transmission of confidential information over public networks. Our Internet banking system relies on encryption and authentication technology to provide the security and authentication necessary to effect secure transmission of confidential information. Advances in computer capabilities, new discoveries in the field of cryptography or other developments could result in a compromise or breach of the algorithms our third-party service providers use to protect customer transaction date. 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 cost of additional finance and accounting systems, procedures and controls in order to satisfy our new public company reporting requirements will increase our expenses.

As a result of the completion of this offering, we will become a public reporting company. We expect that the obligations of being a public company, including the substantial public reporting obligations and compliance

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with related regulations, will require significant expenditures and place additional demands on our management team. Compliance with these rules will, among other things, require us to assess our internal controls and procedures and evaluate our accounting systems. We have made, and will continue to make, changes to our internal controls and procedures for financial reporting and accounting systems to meet our reporting obligations as a public company. However, the measures we take may not be sufficient to satisfy these obligations. In addition, we have hired, and may need to hire further additional compliance, accounting and financial staff with appropriate public company experience and technical knowledge, and we may not be able to do so in a timely fashion. As a result, we may need to rely on outside consultants to provide these services for us until qualified personnel are hired. These obligations will increase our operating expenses, although we cannot predict or estimate the amount of additional costs we may incur in order to comply with these requirements, and could divert our management s attention from our operations.

An interruption in or breach of our information systems could impair our ability to originate loans on a timely basis and may result in lost business.

We rely heavily upon communications and information systems to conduct our lending business. Any failure or interruption or breach in security of our information systems or the third-party information systems that we rely on could cause delays in our operations. We cannot assure you that no failures or interruptions will occur or, if they do occur, that we or the third parties on which we rely will adequately address them. The occurrence of any failures or interruptions could significantly harm our business, financial condition and results of operations.

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

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

Risks Associated with our Securities

There has been no trading market for our common stock and an active market may not be developed or maintained, and the market price of our common stock may be volatile.

Before this offering, there has been no public market for our common stock. Although we have applied for listing of our common stock on the Nasdaq Global Market, an active trading market for our common stock may never develop or be sustained. In addition, you will pay a price for our common stock in this offering that was not established in a competitive market. Instead, you will pay a price that we negotiated with the underwriter. See Underwriting for factors considered in determining the initial public offering price. The initial public offering price does not necessarily bear any relationship to our book value or the fair market value of our assets and may be higher than the market price of our common stock after this offering. In particular, we cannot assure you as to:

- the likelihood that an active public trading market for the shares of our common stock will develop after this offering, or, if developed, that a public trading market can be sustained;

- the liquidity of any such market;

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- the ability of our shareholders to sell their shares of our common stock; or
- the price that our shareholders may obtain for their shares of our common stock.

If no public market develops, it may be difficult or impossible to resell our common stock if you should desire to do so. Even if an active trading market develops, the market price for shares of our common stock may be highly volatile and could be subject to wide fluctuations after this offering. We cannot predict how the shares of our common stock will trade in the future. Some of the factors that could negatively affect our share price include:

- actual or anticipated variations in our quarterly operating results and, in particular, further deterioration of asset quality;
- changes in revenue or financial estimates or publication of research reports and recommendations by financial analysts;
- issuances of new equity pursuant to future offerings; and
- publication of research reports about us or the commercial and residential real estate industry;
- our ability to continue as a going concern;
- fluctuations in the stock price and operating results of our competitors;
- our ability to execute our business plan and forecasted growth;
- additions or departures of key management personnel;
- proposed or adopted regulatory changes or developments;
- speculation in the press or investment community;
- general market and economic conditions.

The stock market and, in particular, the market for financial institution stocks, has experienced significant volatility recently. As a result, the market price of our common stock may be volatile. The trading price of our common stock will depend on many factors, which may change from time to time, including, without limitation, our financial condition, performance, creditworthiness and prospects, future sales of our equity or equity related securities and other factors identified in the Summary above under the heading Forward-Looking Statements. Accordingly, the shares of our common stock that an investor purchases, whether in this offering or in the secondary market, may trade at a price lower than that at which they were purchased. In some cases, the markets have produced downward pressure on stock prices and credit availability for certain issuers without regard to those issuers underlying financial strength.

A significant decline in our stock price could result in substantial losses for individual stockholders and could lead to costly and disruptive securities litigation.

Your interest in us may be diluted if we issue additional shares.

We may need to raise additional capital including through the issuance of additional equity.

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We intend to contribute a substantial portion of the aggregate net proceeds of this offering to the Bank. As a result, the Company does not expect to have adequate capital to fund operating expenses and to bring current the deferred interest due on our outstanding trust preferred securities when that deferral period expires in December 2013, and we expect that we will need to raise additional capital prior to the end of that deferral period. In addition, we are required by federal and state regulatory authorities to maintain adequate levels of capital to support our operations. If we cannot meet those capital requirements, or if our regulators determine that we do not have adequate capital to support our operations, we may need to raise additional capital to satisfy those requirements.

Existing shareholders and potential investors in this offering do not have preemptive rights to purchase or subscribe for any common stock issued by us in the future. Given our anticipated need for additional capital, subject to market conditions, we may seek to issue additional shares of our common stock in public or private transactions. In addition, we face significant regulatory and other governmental risk as a financial institution, and it is possible that capital requirements and directives could in the future require us to change the amount or composition of our current capital, including common equity.

If we sell additional common stock in the future, sell securities that are convertible into common stock or issue options or warrants exercisable for shares of common stock, the investors purchasing shares in this offering will likely experience dilution of their equity investment. In addition, we could sell securities at a price less than the then-current net asset value per share.

In addition to any capital raise we may need to do to meet our operational needs, shortly after this offering, we intend to file a registration statement on Form S-8 to register shares of our common stock issuable under our 2010 Equity Incentive Plan as well as shares to be issued as awards under a director equity compensation plan, and a registration statement to register the resale of shares held in our Employee Stock Ownership Plan. Once registered, all of these shares of our common stock will be freely tradable without restriction or further registration under the federal securities laws except to the extent purchased by one of our affiliates. See Shares Available for Future Sale.

The proceeds from this offering will not be sufficient to satisfy our near term capital requirements and liquidity needs or to satisfy our regulatory requirements, As a result, we may need even more capital and could be subject to further regulatory restrictions, either of which could significantly adversely affect us and the trading price of our stock.

We must maintain certain minimum regulatory capital ratios. The capital to be contributed to the Bank following this offering is not adequate to bring the Bank into compliance with the Bank Order. While we believe our banking regulators will agree to lift or replace the Bank Order following the contribution of at least $44.0 million to the Bank and an on-site examination of the Bank confirming our overall condition, if we suffer any adverse developments, such as a material increase in our classified assets, or if our banking regulators are not satisfied with the outcome of their examination, the Bank Order may not be lifted. In addition, if the Bank Order is lifted, we expect that our banking regulators will replace it with another form of enforcement agreement with the Bank which we expect would include provisions for maintenance of at least an 8.5% Tier I Capital ratio and confirmed improvement in the Bank s asset quality. Management does not have any reason to believe that the risk-based capital ratio will be increased in any subsequent enforcement order. If we are unable to meet the minimum capital ratios imposed on us by such regulatory orders, we may be forced to raise additional capital. In addition, the Company does not expect to have adequate capital to fund operating expenses and to bring current the deferred interest due on our outstanding trust preferred securities when that deferral period expires in December 2013, and we expect that we will need to raise additional capital prior to the end of that deferral period either from external sources or from distributions of operating profit from the Bank or from a combination of the two. We may also elect to raise additional capital to support our business or to finance potential acquisitions, if any, or we may otherwise elect to raise additional capital. No assurance can be given that sufficient additional

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capital would be available on acceptable terms or at all. Factors affecting whether we would need to raise additional capital include, among others, changing requirements of regulators, additional provisions for loan losses and loan charge-offs and other risks discussed in this Risk Factors section.

Our ability to raise additional capital will depend on conditions in the capital markets at such time that are outside our control, as well as on our financial performance. If sufficient capital were not available, we would consider a variety of alternatives, including the sale of assets. Under such forced-sale conditions, we may not be able to realize the fair value of the assets sold. Other alternatives would include changing our business practices or entering into additional equity transactions. Even if capital is available, the terms and pricing of such securities may be dilutive to existing shareholders and cause the price of our outstanding securities to decline.

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.

There are substantial regulatory limitations on ownership of our common stock and changes of control.

Federal and state regulations place limitations on the level of ownership of our common stock. Under the federal Change in Bank Control Act and the Savings and Loan Holding Company Act, a notice must be submitted to the Federal Reserve if any person (including a company), or group acting in concert, seeks to acquire control of a savings and loan holding company. An acquisition of control can occur upon the acquisition of 10.0% or more of any class of the voting stock of a savings and loan holding company or savings institution or as otherwise defined by the Federal Reserve. Under the Change in Bank Control Act, the Federal Reserve has 60 days from the filing of a complete notice to act, taking into consideration certain factors, including the financial and managerial resources of the acquirer and the antitrust effects of the acquisition. Any company that acquires control under the Savings and Loan Holding Company Act would then be subject to regulation as a savings and loan holding company. Any direct or indirect change of control of the Bank under Washington state law (generally 25% or more of the outstanding stock or voting power) requires filing of an application with DFI.

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We have deferred payment of the interest on our outstanding TruPS for each quarter since December 15, 2008 and, accordingly, we are prohibited from declaring or paying dividends or distributions on, and from making liquidation payments with respect to, our common stock.

There are currently four separate series of the TruPS outstanding, each issued under a separate indenture and with a separate guarantee. Each of these indentures, together with the related guarantee, prohibits us, subject to limited exceptions, from declaring or paying any dividends or distributions on, or redeeming, repurchasing, acquiring or making any liquidation payments with respect to, any of our capital stock at any time when (a) there is an event of default under such indenture (including a default that will occur solely with passage of time); (b) we are in default with respect to payment of any obligations under such guarantee; or (c) we have deferred payment of interest on the debentures outstanding under that indenture. We are entitled, at our option but subject to certain conditions, to defer payments of interest on each series of debentures from time to time for up to five years.

Events of default under each indenture generally consist of our failure to pay interest on the TruPS (except in certain circumstances, including a deferral of interest described in (c) above), our failure to pay any principal of, or premium, if any, on, such TruPS when due, our failure to comply with certain covenants under such indenture, and certain events of bankruptcy, insolvency or liquidation relating to us or, in some cases certain of our significant subsidiaries.

Because we have deferred payments of interest on each series of the TruPS, we are prohibited by the indentures from declaring or paying any dividends on our common stock, repurchasing or otherwise acquiring our common stock and making any payments to holders of our common stock in the event of our liquidation. These restrictions, which will continue until we are current on interest payments with respect to these indentures, may have a material adverse effect on the market value of our common stock. This will cause us to incur increasing interest expense as deferred interest payments are capitalized to principal, and may limit our ability to raise additional capital.

The proceeds of this offering will not provide sufficient capital, to pay deferred interest payments and we may not have sufficient capital absent an additional capital raise to provide liquidity at HomeStreet, Inc. for the payment of future interest on TruPS in the event that HomeStreet Bank is unable to make sufficient dividend distributions to HomeStreet, Inc. to make future interest payments.

Moreover, without notice to or consent from the holders of our common stock, we may issue additional series of TruPS in the future with terms similar to those of the existing debentures, or enter into other financing agreements that limit our ability to purchase or to pay dividends or distributions on our capital stock, including our common stock.

Management and the board of directors have significant discretion over the investment of the proceeds from this offering and may not be able to achieve acceptable returns on such proceeds.

We will have significant flexibility in determining how to apply the net proceeds of this offering and you will not be able to influence how we deploy this capital in the near term. If we do not apply these funds effectively, we may lose significant business opportunities. Our management may use the proceeds from this offering for corporate purposes that may not increase our market value or make us profitable. Our failure to utilize these funds effectively could reduce our profitability and our stock price could decline if the market does not view our use of the net proceeds from this offering favorably. We have not established a timetable for the effective deployment of the proceeds, and we cannot predict how long it will take to deploy the proceeds. Investing the proceeds in securities until we are able to deploy the proceeds will provide lower margins than we generally earn on loans, potentially adversely affecting shareholder returns, including earnings per share, return on assets and return on equity.

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An investment in our common stock is not an insured deposit.

Our common stock is not a bank savings account or deposit and, therefore, is not insured against loss by the FDIC, any other deposit insurance fund or any other public or private entity. As a result, if you acquire our common stock, you could lose some or all of your investment.

FORWARD-LOOKING STATEMENTS

This prospectus, including statements under Summary, Risk Factors, Dividend Policy, Management s Discussion and Analysis of Financial Condition and Results of Operations, Business and elsewhere, contains forward-looking statements concerning the Company, the Bank, and their respective subsidiaries, operations, performance, financial conditions and likelihood of success. Forward-looking statements are based on many beliefs, assumptions, estimates and expectations of our future performance, taking into account information currently available to us, and include statements about the competitiveness of the banking industry. When used in this prospectus, the words anticipate, believe, could, estimate, expect, intend, may, plan, potential, should, will and would and similar expressions (or the negative of these terms) ger forward-looking statements. Statements regarding the following subjects, among others, are forward-looking by their nature:

- our business strategy and projected operating results;
- our ability to effectively implement and manage our turnaround plan;
- the removal of the Orders, including the date by which the Orders will be removed, if at all;
- our ability to effectively use the proceeds of this offering;
- our ability to grow, including managing that growth;
- the quality of our loan and investment portfolios;
- our ability to compete in the marketplace;
- market trends; and
- projected capital and operating expenditures.

Our beliefs, assumptions and expectations can change as a result of many possible events or factors, not all of which are known to us or within our control. If a change occurs, our business, financial condition, liquidity and results of operations may vary materially from those expressed in our forward-looking statements. You should carefully consider these risks before you make an investment decision with respect to our common stock, along with, among others, the following factors that could cause actual results to vary from our forward-looking statements:

- the factors referenced in this prospectus, including those set forth under the sections captioned Risk Factors, Management s Discussion and Analysis of Financial Condition and Results of Operations and Business ;

our ability to manage the credit risks of our lending activities, including potential increases in loan delinquencies, nonperforming assets and write offs, decreased collateral values, inadequate loan reserve amounts and the effectiveness of our hedging strategies;

general economic conditions, either nationally or in our market area, including a continuation or worsening of the housing market, employment trends, business contraction, consumer confidence, real estate values and other recessionary pressures;

changes in the levels of general interest rates, deposit interest rates, our net interest margin and funding sources;

potential changes in interest rates which may affect demand for our products as well as the success of our interest rate risk management strategies;

compliance with regulatory requirements, including new laws and regulations such as the Dodd-Frank Act as well as restrictions that may be imposed by the FDIC, the DFI, the Federal Reserve or other regulatory authorities pursuant to the cease and desist orders or other discretionary enhanced supervision which could adversely affect our capital, liquidity and earnings;

our ability to control costs while meeting operational needs and retaining key members of our senior management team and other key managers and business producers;

the possibility of a significant reduction in our mortgage banking profitability if we are not able to or are limited in our ability to resell mortgages; and

increased competition in our industry due in part to consolidation.

Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. You should not place undue reliance on these forward-looking statements, which apply only as of the date of this prospectus. We are not obligated to update any forward-looking statements, whether as a result of new information, future events or otherwise.

Nothing contained in this prospectus is, or should be relied upon as, a promise, a guaranty or representation as to our future performance. You may lose some or all of your investment if you invest in our common stock.

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NOTE REGARDING MARKET AND INDUSTRY DATA

This prospectus contains market and industry data that we have obtained from independent industry sources and publications as well as from research and third-party and governmental reports and publications prepared for other purposes. Although we believe that these sources are reliable, neither we nor the underwriters have independently verified the data obtained from these sources.

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USE OF PROCEEDS

We estimate that the aggregate net proceeds that we will receive in this offering will be approximately $62.5 million, based upon the expected sale of 1,590,909 shares of our common stock by us in this offering at an assumed offering price of $44.00 per share, the midpoint of the range set forth on the cover page of this prospectus, and after deducting the underwriter s discounts and commissions and estimated offering expenses payable by us. A $1.00 increase or decrease in the assumed initial public offering price of $44.00 per share would increase or decrease the net proceeds to us from this offering by approximately $1.6 million, assuming the number of shares offered by us as indicated on the cover page of this prospectus remains the same. This estimated amount of net proceeds and the projected impact of an increase or decrease in the offering price per share assumes that the underwriters over-allotment option is not exercised. If the over-allotment option is exercised in full, our net proceeds are expected to increase by approximately $9.8 million.

We intend to contribute approximately $44.0 million of aggregate net proceeds from this offering to the Bank as equity capital. While this capital contribution will not be sufficient to allow the Bank to comply with the minimum capital ratio requirements of the Bank Order, it will improve our capital position and bring the Bank closer to compliance with these requirements. However, we believe that following the contribution to the Bank of at least $44.0 million in capital from this offering and subject to the successful completion of an on-site examination of the Bank by our primary regulators confirming our condition, we will qualify for replacement of the Bank Order with another form of enforcement agreement between the Bank and our regulators which we expect would include provisions for maintenance of at least an 8.5% Tier 1 capital ratio and continued improvement in the Bank s asset quality. We expect that we will continue to face significant restrictions on our operations under both the Bank Order and any other enforcement agreement that replaces the Bank Order.

We anticipate that a contribution of approximately $44.0 million of the aggregate net proceeds from this offering, together with the Bank s preliminary earnings for January and expected earnings in February, will be adequate to bring the Bank s Tier 1 capital ratio to no less than 8.5%. However, if management determines that a greater or lesser amount would be necessary to reach that targeted capital ratio taking into account, among other things, changes in the average assets and variations in the Bank s net income that may affect our regulatory capital ratios, we may adjust the actual amount of the contribution, up to the aggregate net proceeds.

The remaining proceeds will be used by HomeStreet, Inc., for general corporate purposes.

The amount and timing of the actual use of proceeds described above may vary significantly and depend on a number of factors. See Risk Factors, Regulation and Supervision Cease and Desist Orders.

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CAPITALIZATION

The following table sets forth, among other things, our liabilities, capitalization and regulatory capital ratios as of September 30, 2011:

- on an actual basis; and
- on a pro forma basis to give effect to, and show the impact of, (a) the issuance of our common stock in this offering at $44.00 per share, net of the underwriters discounts and commissions and other offering expenses paid by us in connection with this offering (b) the grant of restricted stock awards to certain of our employees and/or non-employee directors of an aggregate 41,677 shares of common stock contingent on the completion of this offering and (c) as to the Bank s capital ratios, the contribution of approximately $44.0 million from the proceeds of this offering to the Bank.

In each case, the information presented gives effect to the 1-for-2.5 reverse split of our common stock implemented on July 19, 2011. This table should be read in conjunction with the more detailed information contained elsewhere in this prospectus, including Use of Proceeds, Management s Discussion and Analysis of Financial Condition and Results of Operations, Selected Historical Consolidated Pro Forma and Separate Financial and Other Data and the audited annual and unaudited interim financial statements and other financial information and related notes included elsewhere in this prospectus. Proforma capital ratios depicted below assume a contribution to the Bank of approximately $44.0 million from the aggregate proceeds of this offering.

		Adjustments	
	As reported	Offering of the Common Stock Pursuant to this Prospectus	Pro Forma
Liabilities			
Deposits	$ 2,056,977	$	$ 2,056,977
FHLB Advances	67,919		67,919
Senior debentures	61,857		61,857
Accrued expenses and other liabilities	49,750		49,750
Total liabilities	$ 2,236,503	$	$ 2,236,503
Shareholders Equity			
Preferred stock, no par value; 10,000 shares authorized; no shares issued and outstanding			
Common stock, no par value; 40,000,000 shares authorized; 1,350,874.4 shares issued and outstanding, actual; and 2,983,460.4 shares issued and outstanding, pro forma	$ 511	$ 62,500	$ 63,011
Additional paid in capital	28		28
Retained earnings	74,720		74,720
Treasury stock			
Accumulated other comprehensive loss, net of taxes	5,077		5,077
Total shareholders equity	$ 80,336	$ 62,500	$ 142,836
Per Common Share			
Common book value per share	$ 59.47		$ 48.55
Tangible common book value per share	$ 59.16		48.37
Regulatory Capital Ratios for the Bank:			
Tier 1 Leverage Capital Ratio	5.6%		7.5%
Tier 1 Risk-Based Capital Ratio	8.5%		10.8%
Total Risk-Based Capital Ratio	9.8%		12.0%

Regulatory Capital Ratios	Consolidated	
Tier 1 Leverage Capital Ratio	4.1%	8.0%
Tier 1 Risk-Based Capital Ratio	5.9%	11.8%
Total Risk-Based Capital Ratio	9.6%	13.0%

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DIVIDEND POLICY

The board of directors of HomeStreet, Inc. has in the past authorized an annual cash dividend. The most recent dividend it declared was paid on April 15, 2008 to shareholders of record as of April 1, 2008 at a rate of $2.25 per share (giving effect to the 1-for-2.5 reverse stock split implemented on July 19, 2011), which equated to $3.0 million, or 14.9% of our net income for the year ended December 31, 2007.

The amount and timing of any future dividends has not been determined. The payment of dividends will depend upon a number of factors, including capital requirements, the Company s and the Bank s financial condition and results of operations, tax considerations, statutory and regulatory limitations, general economic conditions and certain restrictions described below.

We are currently subject to a cease and desist order from the Federal Reserve Board that prohibits us from declaring, making or paying any dividends on our common stock without the prior written consent of the Federal Reserve. See Regulation and Supervision Cease and Desist Orders for information on that regulatory restriction. Washington law also imposes certain restrictions on the ability of the Company to pay dividends. See Regulation and Supervision Regulation of the Company Dividend Policy.

Our outstanding trust preferred securities, or TruPS, also restrict the payment of dividends under the terms of their indentures. We have issued $61.9 million in junior subordinated debentures in connection with the sale of TruPS by the HomeStreet Statutory Trusts. The related indenture agreements, guarantees and declarations of trust for each statutory trust prohibit us, subject to limited exceptions, from declaring or paying any dividends or distributions on, or redeeming, repurchasing, acquiring or making any liquidation payments with respect to, any of our capital stock at any time when (1) an event of default has occurred or is occurring under such debentures (2) we are in default with respect to payment of any obligations under such guarantee or (3) we have deferred payment of interest on the outstanding junior subordinated debentures, which deferral of interest is permitted by the terms of the indentures from time to time for up to five years. We have deferred payment of interest on all of the junior subordinated debentures for each quarter since December 15, 2008. Accordingly, the restrictions on dividends and repurchases described in this paragraph are effective and will continue to be effective until we are current on our interest payments with respect to the junior subordinated debentures. See Business Our Structure.

Our ability to pay dividends will also depend, in large part, upon receipt of dividends from the Bank. We will have limited sources of income other than dividends from the Bank and earnings from the investment of proceeds from this offering that we retain. The Bank is also currently subject to a cease and desist order issued by the FDIC and the DFI that prohibits the Bank from declaring, making or paying any dividends on its common stock without prior written consent of the FDIC and the DFI. See Regulation and Supervision Cease and Desist Orders for more information on that regulatory restriction. In addition, any declaration of dividend by the Bank is subject to a 30 day advance notice to the Federal Reserve and is subject to restrictions under federal and state law. See Regulation and Supervision Regulation and Supervision of HomeStreet Bank Dividends.

For the foregoing reasons, there can be no assurance that we will pay dividends on our common stock in any future period.

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SELECTED HISTORICAL CONSOLIDATED FINANCIAL AND OTHER DATA

The following table sets forth selected historical consolidated financial and other data for us at and for each of the periods ended as described below. The selected historical consolidated financial data as of and for the three and nine months ended September 30, 2011 and 2010 have been derived from our unaudited consolidated financial statements and related notes included in this prospectus. The selected historical consolidated financial data as of December 31, 2010 and 2009 and for each of the years ended December 31, 2010, 2009 and 2008 have been derived from, and should be read together with, our audited consolidated financial statements and related notes included elsewhere in this prospectus. The selected historical consolidated financial data as of December 31, 2008, 2007 and 2006 for each of the years ended December 31, 2007 and 2006 have been derived from our audited consolidated financial statements for those years, which are not included in this prospectus. You should read the summary selected historical consolidated financial and other data presented below in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and our financial statements and the notes thereto, which are included elsewhere in this prospectus. We have prepared our unaudited information on the same basis as our audited consolidated financial statements and have included, in our opinion, all adjustments that we consider necessary for a fair presentation of the financial information set forth in that information.

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	At or for the Three Months Ended September 30, 2011	2010	At or for the Nine Months Ended September 30, 2011	2010	At or for the Year Ended December 31, 2010	2009	2008	2007	2006
(in thousands, except share data)									
Income Statement (for the period ended):									
Net interest income	$ 11,970	$ 10,288	$ 35,474	$ 25,548	$ 39,034	$ 31,502	$ 75,885	$ 90,037	$ 86,779
Provision for loan losses	1,000	12,000	3,300	29,100	37,300	153,515	34,411	10,955	6,471
Noninterest income	37,268	27,710	70,649	68,816	96,931	59,230	40,346	23,298	19,313
Noninterest expense	32,618	31,992	93,342	85,716	132,215	94,448	70,189	71,253	68,131
Net income (loss) before taxes	15,620	(5,994)	9,481	(20,452)	(33,550)	(157,231)	11,631	31,127	31,490
Income taxes	362	(633)	388	(600)	697	(46,955)	3,202	10,663	10,173
Net income (loss)	$ 15,258	$ (5,361)	$ 9,093	$ (19,852)	$ (34,247)	$ (110,276)	$ 8,429	$ 20,464	$ 21,317
Basic earnings per common share (1)	$ 11.29	$ (3.97)	$ 6.73	$ (14.70)	$ (25.35)	$ (81.63)	$ 6.25	$ 15.15	$ 15.75
Diluted earnings per common share (1)	$ 11.29	$ (3.97)	$ 6.73	$ (14.70)	$ (25.35)	$ (81.63)	$ 6.24	$ 15.09	$ 15.60
Common shares outstanding (1)	1,350,874	1,350,874	1,350,874	1,350,874	1,350,874	1,350,874	1,350,874	1,356,277	1,366,478
Weighted average common shares									
Basic	1,350,874	1,350,874	1,350,874	1,350,874	1,350,874	1,350,874	1,348,649	1,350,540	1,353,665
Diluted	1,350,874	1,350,874	1,350,874	1,350,874	1,350,874	1,350,874	1,350,358	1,356,277	1,366,478
Shareholders equity per share	$ 59.47	$ 60.08	$ 59.47	$ 60.08	$ 43.52	$ 68.03	$ 152.57	$ 147.00	$ 133.39
Dividends per share	$	$	$	$	$	$	$ 2.25	$ 2.25	$ 2.13
Dividend payout ratio							36.00%	14.85%	13.49%
Financial position (at period end):									
Cash and cash equivalents	$ 138,429	$ 267,009	$ 138,429	$ 267,009	$ 72,639	$ 217,103	$ 270,577	$ 43,635	$ 53,972
Investment securities available for sale	339,453	291,050	339,453	291,050	313,513	657,840	56,337	111,621	115,327
Loans held for sale	226,590	116,976	226,590	116,976	212,602	57,046	48,636	77,969	67,914
Loans held for investment, net	1,360,219	1,633,392	1,360,219	1,633,392	1,538,521	1,964,994	2,425,887	2,428,214	2,067,247
Mortgage servicing rights (2)	74,083	60,569	74,083	60,569	87,232	78,372	57,699	53,422	50,270
Other real estate owned	64,368	202,008	64,368	202,008	170,455	107,782	20,905	1,974	1

Total assets	2,316,839	2,678,719	2,316,839	2,678,719	2,485,697	3,209,536	2,958,911	2,793,935	2,428,054
Deposits	2,056,977	2,319,231	2,056,977	2,319,231	2,129,742	2,332,333	1,911,311	1,717,681	1,536,768
FHLB advances	67,919	165,869	67,919	165,869	165,869	677,840	705,764	746,386	575,063
Liabilties									
Shareholders equity	80,336	81,167	80,336	81,167	58,789	91,896	206,103	198,052	180,322
Financial position (averages):									
Investment securities available for sale	272,294	305,342	295,988	492,668	457,930	372,320	119,720	113,333	133,424
Loans held for investment	1,427,763	1,813,447	1,509,296	1,936,583	1,868,039	2,307,215	2,519,811	2,239,639	1,901,996
Total interest earning assets	2,019,243	2,466,010	2,066,943	2,749,454	2,642,693	3,056,755	2,762,723	2,435,145	2,103,862
Total interest bearing deposits	1,787,388	2,075,361	1,837,708	2,106,583	2,071,237	2,012,971	1,557,533	1,452,742	1,255,402
FHLB advances	72,267	178,260	105,410	454,947	382,083	685,715	734,989	617,225	520,881
Total interest bearing liabilities	$ 1,921,512	$ 2,320,478	$ 2,005,843	$ 2,628,480	$ 2,522,767	$ 2,776,163	$ 2,485,786	$ 2,170,807	$ 1,863,969
Shareholders equity	$ 73,499	$ 86,704	$ 62,958	$ 92,150	$ 89,267	$ 160,145	$ 203,358	$ 190,590	$ 169,977
Financial performance:									
Return on average common shareholder equity (3)	83.04%	(24.73)%	19.26%	(28.73)%	(38.00)%	(68.90)%	4.14%	10.74%	12.54%
Return on average assets	2.67%	(0.80)%	0.53%	(0.89)%	(1.19)%	(3.47)%	0.29%	0.79%	0.96%
Net interest margin (4)	2.38%	1.68%	2.30%	1.25%	1.49%	1.04%	2.78%	3.45%	4.16%
Efficiency ratio (5)	66.25%	84.19%	87.96%	90.84%	97.24%	104.10%	60.39%	62.87%	64.22%
Operating efficiency ratio (6)	47.74%	59.99%	62.95%	75.35%	73.56%	92.55%	59.06%	62.82%	64.17%
Credit quality:									
Allowance for loan losses	$ 53,167	$ 70,554	$ 53,167	$ 70,554	$ 64,177	$ 109,472	$ 58,587	$ 38,804	$ 27,834

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	At or for the Three Months Ended September 30,		At or for the Nine Months Ended September 30,		At or for the Year Ended December 31,				
	2011	2010	2011	2010	2010	2009	2008	2007	2006
Allowance for loan losses/Total loans	3.76%	4.14%	3.76%	4.14%	4.00%	5.28%	2.36%	1.57%	1.33%
Allowance for loan losses/nonperforming loans	55.91%	37.41%	55.91%	37.41%	56.69%	29.25%	77.72%	114.95%	828.15%
Total classified assets	$ 225,022	$ 484,269	$ 225,022	$ 484,269	$ 363,947	$ 570,013	$ 376,424	$ 114,797	$ 30,468
Classified assets/total assets	9.71%	18.08%	9.71%	18.08%	14.64%	17.76%	12.72%	4.11%	1.25%
Total nonaccrual loans (7)	$ 95,094	$ 188,592	$ 95,094	$ 188,592	$ 113,210	$ 374,218	$ 75,385	$ 33,758	$ 3,361
Nonaccrual loans/Total loans	6.73%	11.07%	6.73%	11.07%	7.06%	18.04%	3.03%	1.37%	0.16%
Total nonperforming assets	$ 159,462	$ 390,600	$ 159,462	$ 390,600	$ 283,665	$ 482,000	$ 96,290	$ 35,732	$ 3,362
Nonperforming assets/total assets	6.88%	14.58%	6.88%	14.58%	11.41%	15.02%	3.25%	1.28%	0.13%
Net charge-offs	$ 7,673	$ 36,209	$ 14,480	$ 68,581	$ 83,156	$ 101,680	$ 14,628	$ (15)	$ 117
Regulatory capital ratios for the bank:									
Tier 1 capital to total assets (leverage)	5.6%	4.9%	5.6%	4.9%	4.5%	4.5%	8.7%	9.0%	9.9%
Tier 1 risk-based capital	8.5%	7.4%	8.5%	7.4%	6.9%	7.2%	10.5%	9.9%	11.0%
Total risk-based capital	9.8%	8.7%	9.8%	8.7%	8.2%	8.5%	11.8%	11.2%	12.3%
SUPPLEMENTAL DATA:									
Loans serviced for others:									
Single-family	$ 6,649,546	$ 6,144,555	$ 6,649,546	$ 6,144,555	$ 6,343,158	$ 5,820,946	$ 4,695,804	$ 3,775,362	$ 3,389,050
Multifamily	770,401	787,961	770,401	787,961	776,671	810,910	822,512	715,946	729,715
Other	57,151	67,377	57,151	67,377	58,765	69,839	74,230	77,329	53,682
Total loans serviced for others	$ 7,477,098	$ 6,999,893	$ 7,477,098	$ 6,999,893	$ 7,178,594	$ 6,701,695	$ 5,592,546	$ 4,568,637	$ 4,172,447
Loan origination activity:									
Single-family	$ 484,434	$ 586,669	$ 1,085,902	$ 1,393,693	$ 2,069,144	$ 2,727,457	$ 1,735,897	$ 1,568,834	$ 1,445,218
Other	31,749	21,903	97,642	62,873	120,058	124,433	817,438	1,332,147	1,650,072
Total loan origination activity	$ 516,183	$ 608,572	$ 1,183,544	$ 1,456,566	$ 2,189,202	$ 2,851,890	$ 2,553,335	$ 2,900,981	$ 3,095,290

(1) Shares outstanding and earnings per share are shown after giving effect to the 1-for-2.5 reverse stock split effected on July 19, 2011.

(2) On January 1, 2010, we elected to carry mortgage servicing rights related to single family loans at fair value, and elected to carry single family mortgage loans held for sale using the fair value option.

(3) Net earnings (loss) available to common shareholders divided by average common shareholders equity.

(4) Net interest income divided by total average earning assets on a taxable-equivalent basis.

(5) The efficiency ratio is noninterest expense divided by total revenue (net interest income and noninterest income).

(6) We include an operating efficiency ratio which is not calculated based on accounting principles generally accepted in the United States (GAAP), but which we believe provides important information regarding our result of operations. Our calculation of the operating efficiency ratio is computed by dividing noninterest expense less costs related to OREO (gains (losses) on sales, valuation allowance adjustments, and maintenance and taxes) by total revenue (net interest income and noninterest income). Management uses this non-GAAP measurement as part of its assessment of performance in managing noninterest expense. We believe that costs related to OREO are more appropriately considered as credit-related costs rather than as an indication of our operating efficiency. The following table provides a reconciliation of non-GAAP to GAAP measurement.

	At or for the Three Months Ended September 30,		At or for the Nine Months Ended September 30,		At or for the Year Ended December 31,				
	2011	2010	2011	2010	2010	2009	2008	2007	2006
Efficiency ratio	66.25%	84.19%	87.96%	90.84%	97.24%	104.10%	60.39%	62.87%	64.22%
Less impact of OREO expenses	18.51%	24.20%	25.01%	15.49%	23.68%	11.55%	1.33%	0.05%	0.08%
Operating efficiency ratio	47.74%	59.99%	62.95%	75.35%	73.56%	92.55%	59.06%	62.82%	64.14%

(7) Generally, loans are placed on nonaccrual status when they are 90 or more days past due.

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MANAGEMENT S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This section presents management s perspective on the financial condition and results of operations of HomeStreet, Inc. The following discussion and analysis is intended to highlight and supplement data and information presented elsewhere in this prospectus, including the consolidated financial statements and related notes, and should be read in conjunction with the accompanying tables and our annual audited and quarterly unaudited financial statements. To the extent this discussion describes prior performance, the descriptions relate only to the periods listed and readers are cautioned that prior performance may not be indicative of our future financial outcomes. In addition, some of the information contained in this section or set forth elsewhere in this prospectus, including discussions about our plans and strategy for our business and our expectations for the effects of those plans, includes forward-looking statements that involve risks, uncertainties and assumptions. See Forward-Looking Statements described in the Summary section above. Actual results could differ materially from the results described in or implied by the forward-looking statements contained in the following discussion and analysis as a result of many factors, including those discussed in Risk Factors.

Overview

We are a 90-year-old diversified financial services company headquartered in Seattle, Washington, that has grown from a small mortgage bank to a full-service community bank serving consumers and businesses in the Pacific Northwest and Hawaii. In 1986 we established the Bank to fund our lending activities and to offer a broader range of products and services. Our banking strategy has allowed us to expand our lending activities while building stable core deposits and a more diversified core customer base that offers cross-selling opportunities. The Bank has the oldest continuous relationship of all Fannie Mae seller servicers in the nation, having been the second company approved by Fannie Mae at its founding in 1938.

Our primary subsidiaries are HomeStreet Bank and HomeStreet Capital Corporation. HomeStreet Bank is a Washington state-chartered savings bank that provides deposit and investment products and cash management services. The Bank also provides loans for single family homes, commercial real estate, construction, land development and commercial businesses. HomeStreet Capital Corporation, a Washington corporation, originates, sells and services multifamily mortgage loans under the Fannie Mae Delegated Underwriting and Servicing Program (DUS) in conjunction with HomeStreet Bank. We also provide insurance products and services for consumers and businesses as HomeStreet Insurance and loans for single family homes through a joint venture, Windermere Mortgage Services Series LLC (WMS). At September 30, 2011, we had total assets of $2.32 billion, net loans held for investment of $1.36 billion, deposits of $2.06 billion, and shareholders equity of $80.3 million. At December 31, 2010, we had total assets of $2.49 billion, net loans held for investment of $1.54 billion, deposits of $2.13 billion and shareholders equity of $58.8 million. We recognized net income of $15.3 million for the third quarter of 2011, as compared to a net income of $1.3 million for the second quarter of 2011 and a net loss of $5.4 million for the third quarter of 2010.

Recent Developments

In the fourth quarter of 2011 and January of 2012, we continued to be profitable and improve our asset quality metrics. Our net income for the fourth quarter of 2011 and the month ended January 31, 2012 was $7.0 million and $8.2 million, respectively, with a net interest margin of 2.50% for each of those periods, as compared to 2.38% for the third quarter of 2011. An increase in refinancing of existing loans in the single family mortgage loan market and related increase in our loan origination activities was a contributing factor to the increase in our profits in the month of January, and such increased activity may not be indicative of future performance. As of December 31, 2011 and January 31, 2012, we had total assets of $2.26 billion and $2.24 billion, respectively, net loans held for investment of $1.30 billion and $1.31 billion, respectively, and shareholders equity of $86.4 million and $96.0 million, respectively. Our January 2012 results do not reflect loan loss provision or impairment

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charges, which we assess primarily at the end of each fiscal quarter, however, we have recorded loan loss provisions as an expense in prior quarters and expect to record such provision expense at the end of the first quarter of 2012. We also experienced continued profitability for the fourth quarter and the month ended January 31, 2012, including net mortgage servicing rights and related hedge valuation gains of $1.6 million in January 2012. Our profit in the fourth quarter of 2011 was slightly offset by a $189,000 net valuation loss on mortgage servicing rights and related hedge instruments.

Our classified assets also declined by $36.9 million from $225.0 million at September 30, 2011 to $188.2 million, or 16.4%, at December 31, 2011, and increased to $191.2 million, or 15.0%, at January 31, 2012, with nonperforming assets as a percentage of total assets declining from 6.9% at September 30, 2011 to 5.1% at December 31, 2011 and 4.9% at January 31, 2012. Nonperforming loans decreased from $95.1 million at September 30, 2011 to $76.5 million at December 31, 2011, and to $75.4 million at January 31, 2012, representing decreases of 19.6% and 20.7%, respectively, primarily due to credit upgrades in all loan classes as well as pay-downs, charge-offs and net transfers of $4.2 million to OREO principally during the fourth quarter of 2011. In addition to the improvement in nonperforming loans, OREO decreased from $64.4 million at September 30, 2011 to $38.6 million at December 31, 2011 (a 40.1% decrease), and to $35.5 million at January 31, 2012 (a 44.8% decrease), due to OREO sales of $26.0 million during the fourth quarter of 2011 and $2.9 million in January 2012 and downward valuation adjustments of $4.2 million principally during the fourth quarter of 2011. Of the $35.5 million of OREO as of January 31, 2012, $5.5 million, or 15.6%, is contracted for sale, $3.9 million of which is scheduled to close in February. For the same period we recognized a loss of 0.3% on sales of OREO, and 0.1% gain on sales for the year ended December 31, 2011. The total amount of delinquent loans decreased from $144.1 million (10.2% of total loans) as of September 30, 2011 to $139.9 million (10.4% of total loans) as of December 31, 2011, and increased to $161.0 million (11.9% of total loans) as of January 31, 2012, although total delinquent loans excluding single family Ginnie Mae guaranteed loans decreased from $106.9 million at September 30, 2011 to $94.6 million at December 31, 2011, and increased to $113.3 million at January 31, 2012. Total loans also decreased from $1.41 billion as of September 30, 2011 to $1.34 billion as of December 31, 2011 and increased to $1.35 billion as of January 31, 2012.

Single family loan origination for the year ended December 31, 2011 was $1.72 billion, compared to $2.07 billion for the year ended December 31, 2010 and $2.7 billion for the year ended December 31, 2009.

Our financial results for the fourth quarter of 2011 and as of and for the year ended December 31, 2011 presented in this prospectus have not been audited and are subject to finalization. The January 2012 information has not been subjected to an audit or review and will not be subjected to audit or review procedures until later in 2012 as part of the normal quarterly interim review procedures and annual audit process. January results may not be indicative of our results for the first quarter.

In January 2012, in order to expand our mortgage banking business and accelerate our plans to increase mortgage origination volume, we made offers of employment to hire a significant majority of the mortgage personnel employed in Washington, Oregon and Idaho by MetLife Home Loans whose parent, MetLife, Inc., had recently announced that it would no longer originate forward mortgages. As of February 3, 2012, we have hired approximately 140 mortgage personnel from this group, including the former Pacific Northwest regional sales manager and the former regional builder services manager, as well as regional and branch managers, mortgage consultants and related production support staff. We anticipate that we will open approximately 11 additional stand-alone lending centers in Washington and Idaho, primarily in the Puget Sound area, in order to accommodate these new hires. As a result of this expansion of our mortgage operations, we estimate that we will incur additional expenses of approximately $8.0 million in the first half of 2012 for compensation, facilities and other integration expenses. While we anticipate that this group will generate enough revenue to cover these expenses over the same period, these costs may not be completely offset by such additional loan origination revenue in that period as these loan professionals will need to rebuild their origination volume at the Bank. Our estimated expenses may also increase as we hire additional employees from this group.

We generate revenue through positive net interest income and by earning noninterest income. Net interest income is primarily the difference between our interest income earned on loans and investment securities

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less the interest we pay on deposits, Federal Home Loan Bank advances, and other borrowings. We earn noninterest income from the origination, sale and servicing of loans, and fees earned on deposit services and investment and insurance sales.

Impact of Economic Downtown

Beginning in approximately 2004, we increased our concentration in construction lending in an effort to offset the earnings volatility of our single family lending. We also expanded our branch network in order to grow our deposit base to help fund these loans. However, driven by our opportunities to lend in the fast-growing residential construction sector, we also continued to supplement the funding provided by our growing core deposit base with higher cost and potentially more volatile noncore retail and brokered certificates of deposits and with borrowings that included increasing advances on our line of credit with the Federal Home Loan Bank of Seattle (the FHLB). Additionally, to fund the scheduled maturity of our $30.0 million senior credit facility with USAA Life Insurance Company and to augment working capital at HomeStreet, Inc. and regulatory capital at the Bank, between 2005 and 2007 we issued approximately $61.9 million in trust preferred securities. The global recession, which began in 2007 and continued until June 2009, caused our business to experience a series of interrelated events, the combination of which triggered significant loan and operating losses, eroded capital, seriously weakened our financial condition, challenged our ability to maintain liquidity and strained our regulatory relations.

The U.S. economic recession resulted in deteriorating conditions in the U.S. housing market that have continued to depress real estate values. We believe these conditions will only improve slowly for the foreseeable future. As a result, many lenders have been forced out of business or have severely curtailed their operations and most remaining lenders have tightened underwriting standards. As a consequence of these changing conditions in real estate loan availability and the reduction in owners equity due to falling real estate values, many borrowers have been unable either to refinance existing loans or sell their homes. Similarly, many prospective home buyers have found it harder to obtain credit. Unemployment rates remain elevated, foreclosure rates have increased, housing inventories have ballooned and home prices have declined. Affected borrowers have struggled to keep their loans current or to refinance into lower interest rate products. These forces have combined to result in significant credit deterioration, particularly in our construction and land development portfolios.

Primarily as a result of rising defaults on residential construction and land loans, our ratio of nonperforming loans to total loans increased from 1.4% at December 31, 2007 to 3.0% at December 31, 2008 and 18.0% at December 31, 2009.

Moreover, although our average interest earning assets increased from $2.44 billion during 2007 to $3.06 billion during 2009, our average loans held for investment remained relatively constant over that period, increasing from $2.24 billion during 2007 to $2.31 billion during 2009. Additionally, due to rising levels of problem assets, nonperforming assets increased from $35.7 million at December 31, 2007 to $482.0 million at December 31, 2009. During this same period, we established and maintained a high level of liquidity and invested this liquidity in short duration, low-yielding investments. At the same time, in response to the economic turmoil in the national economy, the Federal Reserve Open Market Committee reduced the target interest rate for Federal Funds to its lowest level since 1955 and market interest rates, including the prime rate and LIBOR, decreased accordingly. Most of our loans are variable interest rate loans tied to these indexes. The impact of declining interest rates has been more significant than with our peer institutions as a result of the absence of interest rate floors on many of our loans. At December 31, 2007, $1.35 billion of loans, or 54.8% of net loans, did not have interest rate floors. This combination of circumstances led to a substantial decline in our net interest income, which declined from $90.0 million for the year ended December 31, 2007, to $75.9 million for 2008 and to $31.5 million for 2009. In addition, due to deteriorating credit quality, our provision for loan losses increased from $11.0 million for the year ended December 31, 2007 to $34.4 million and $153.5 million for the years ended December 31, 2008 and 2009, respectively. The economic impact of the foregoing on our results of operations, financial condition and regulatory capital ratios has been severe. For the year ended December 31, 2009, we recognized a net loss of $110.3 million. Additionally, despite our efforts to decrease total assets to mitigate the impact of losses on our regulatory capital ratios, our Tier 1 leverage and total risk-based capital ratios fell from 9.0% and 11.2% at December 31, 2007, to 4.5% and 8.5% at December 31, 2009.

As a result of the deterioration in our asset quality, operating performance and capital adequacy, on May 8, 2009, we entered into an agreement with HomeStreet Bank s primary banking regulators, the Federal Deposit Insurance Corporation, or FDIC, and the Washington State Department of Financial Institutions, or DFI, pursuant to which we consented to the entry of an Order to Cease & Desist from certain allegedly unsafe and unsound banking practices. On May 18, 2009, we entered into a similar agreement with HomeStreet, Inc. s primary regulator, the Office of Thrift Supervision, or OTS. On July 21, 2011, the OTS was abolished and its supervisory and regulatory functions with respect to savings and loan holding companies, including the Company, were transferred to the Board of Governors of the Federal Reserve System, or the Federal Reserve. References in this prospectus to the Federal Reserve include the OTS prior to the transfer date with respect to those functions transferred to the Federal Reserve.

We refer to the Order to Cease & Desist with the FDIC and the DFI as the Bank Order, the Order to Cease & Desist with the Federal Reserve as the Company Order, and to the Bank Order and Company Order collectively as the Orders. Among other things, the Orders required us to increase our capital to certain specified levels, improve management, reduce classified assets and improve earnings. The Orders are described in more detail under Regulation and Supervision Cease and Desist Orders.

In light of the then-prevailing economic conditions confronting our organization and to acquire management experienced in bank turnaround and capital raising, the boards of directors of the Company and the Bank recruited a management team that has proven expertise in raising capital and in turning around troubled financial institutions. Beginning in late 2009, we hired Mark Mason, our Chief Executive Officer, David Hooston, our Chief Financial Officer, Jay Iseman, our Chief Credit Officer, and Godfrey Evans, our General Counsel and Chief Administrative Officer. These executives have developed and implemented a plan to manage and reduce our credit risk, reduce other real estate owned, or OREO, and associated loan and real estate loss exposures, improve our asset yields, maintain liquidity, increase and improve our core deposit base, reduce noncore funding dependence, reduce noninterest expenses, raise capital, and improve our relationships with our federal and state banking regulators. See Business Turnaround Plan.

As discussed below in greater detail, our new management team has improved our business since joining us, substantially improving our financial condition, results of operations and credit risk profile. Among other things, under our new management team:

- For the nine months ended September 30, 2011 we recognized $9.1 million of net income, comprised of net income of $15.3 million for the three months ended September 30, 2011, net income of $1.3 million for the three months ended June 30, 2011 and a net loss of $7.4 million for the three months ended March 31, 2011. Our net income for the quarter ended September 30, 2011 included net valuation gains of $12.2 million relating to changes in value of MSRs and associated hedging investments. Our net loss of $34.2 million for the year ended December 31, 2010 was a significant improvement over the $110.3 million loss for the year ended December 31, 2009. Our net loss in 2009 included the recognition of $40.0 million of tax benefit related to the carry back of 2009 net operating losses to prior periods.

- We have continued to improve and expand our single family mortgage banking operations. Loan volume, gain on mortgage loan origination and sales activities and servicing income have fluctuated along with interest rate trends during 2011. Loan volume and gain on loan origination and sales activities decreased during the first half of 2011, reflecting increases in mortgage interest rates during that period, followed by an increase in loan volume and corresponding gains during the third quarter of 2011 as interest rates declined. For the periods ended December, 2009 and 2010, the Bank originated $2.73 billion and $2.07 billion of single family loans, respectively, and originated $1.09 billion and $1.39 billion for the nine months ended September 30, 2011 and 2010, respectively.

Classified assets have declined by $512.9 million, or 69.5% from $737.9 million, or 22.9% of total assets, at September 30, 2009 to $225.0 million, or 9.7% of total assets at September 30, 2011. Our nonperforming assets have declined by $292.5 million, or 64.7% from $452.0 million, or 14.0% of total assets at September 30, 2009 to $159.5 million, or 6.9% of total assets at September 30, 2011. More significantly, nonperforming loans have decreased to $95.1 million, or 6.7% of total loans, at September 30, 2011 from $388.7 million, or 17.7% of total loans, at September 30, 2009, and our ratio of total delinquent and nonaccruing loans to total loans has declined to 10.2% from 22.6% over the same period.

Construction and land loans, the type of loans from which we have experienced the highest default and losses during this economic downturn, have decreased to $213.0 million, or 15.1% of total loans at September 30, 2011 from $733.4 million, or 33.4% of total loans, at September 30, 2009.

Loan loss provisions and net charge-offs have decreased to $3.3 million and $14.5 million, respectively, for the first three quarters of 2011, from $37.3 million and $83.2 million for 2010 and $153.5 million and $101.7 million for 2009.

Bank noncore funding (retail certificates of deposit greater than $250,000, brokered deposits and FHLB advances) has decreased to $136.1 billion, or 6.4% of Bank funding, at September 30, 2011 from $1.09 billion, or 36.2% of Bank funding, at September 30, 2009. As of September 30, 2011, we had no brokered deposits.

Bank core funding (checking, savings and core retail certificates of deposit less than $250,000) has increased to $1.99 billion, or 93.6% of Bank funding, at September 30, 2011 from $1.91 billion, or 63.8% of Bank funding, at September 30, 2009, and in particular, total consumer and business checking balances and accounts have increased to $204.2 million and 22,554 accounts from $172.8 million and 19,572 accounts during that same period.

The yield on earning assets has increased to 3.79% for the third quarter of 2011 from 3.40% for the third quarter of 2009. This increase is due to the combined effect of: (1) establishing interest rate floors on loans at origination, extension, renewal or restructuring, (2) reducing our nonperforming assets and (3) changing the composition and extending the average duration of the investment securities portfolio.

The net interest margin has increased to 2.38% for the third quarter of 2011 from 0.85% for the third quarter of 2009.

Full time equivalent staff has been reduced by 4.1% in areas other than the single family lending segment between September 2009 and September 30, 2011. This includes a 53.1% reduction in residential construction lending staff and a 2.3% decrease in corporate operations departments.

Our Tier 1 leverage capital and total risk-based capital ratios stood at 5.6% and 9.8%, respectively, at September 30, 2011, as compared to 5.2% and 9.3% at September 30, 2009. Notwithstanding the net losses incurred in 2009 and 2010 and in the first quarter of 2011, the Bank s regulatory capital ratios have remained sufficient to be considered adequately capitalized within the meaning of the FDIC s prompt corrective action guidelines, in part as a result of our efforts to reduce total assets, which decreased from $3.22 billion at September 30, 2009 to $2.49 billion at December 31, 2010 and $2.32 billion at September 30, 2011.

This offering reflects one of management s primary initiatives to improve our regulatory capital ratios. The Bank has not yet satisfied the capital ratios mandated by the Bank Order, and while this offering will improve our capital position and bring the Bank closer to compliance with these requirements, we will not be able to fully satisfy the requirements of the Bank Order based on this offering alone. However, we believe that following the contribution to the Bank of at least $44.0 million in capital and subject to the successful completion of an on-site examination of the Bank by our primary regulators confirming our overall condition, we will qualify for replacement of the Bank Order with another form of enforcement agreement between the Bank and our regulators which we expect would include provisions for maintenance of at least an 8.5% Tier 1 capital ratio and continued improvement in the Bank s asset quality. Management does not have any reason to believe that the risk-based capital ratio will be increased in any subsequent enforcement order.

We anticipate that a contribution of approximately $44.0 million of the aggregate net proceeds from this offering, together with the Bank s preliminary earnings for January and expected earnings in February, will bring the Bank s Tier 1 capital ratio to not less than 8.5%. However, if management determines that a greater or lesser amount would be necessary to reach that targeted capital ratio taking into account, among other things, changes in the average assets and variations in the Bank s net income that may affect our regulatory capital ratios, we may adjust the actual amount of the contribution, up to the aggregate net proceeds.

Critical Accounting Policies and Estimates

The preparation of financial statements in accordance with the accounting principles generally accepted in the United States (GAAP) requires management to make a number of judgments, estimates and assumptions that affect the reported amount of assets, liabilities, income and expense in the financial statements. Various elements of our accounting policies, by their nature, involve the application of highly sensitive and judgmental estimates and assumptions. Some of these policies and estimates relate to matters that are highly complex and contain inherent uncertainties. It is possible that, in some instances, different estimates and assumptions could reasonably have been made and used by management, instead of those we applied, which might have produced different results that could have had a material effect on the financial statements.

We have identified the following accounting policies and estimates that, due to the judgments and assumptions inherent in those policies and estimates and the potential sensitivity of its financial statements to those judgments and assumptions, are critical to an understanding of our financial statements. We believe that the judgments, estimates and assumptions used in the preparation of its financial statements are appropriate.

Allowance for Loan Losses

The allowance for loan losses represents management s estimate of incurred credit losses inherent within our loan portfolio. Determining the appropriateness of the allowance is complex and requires judgment by management about the effect of matters that are inherently uncertain. Subsequent evaluations of the loan portfolio, in light of the factors then prevailing, may result in significant changes in the allowance for loan losses in those future periods.

We employ a disciplined process and methodology to establish our allowance for loan losses including a specific allowance for impaired loans equal to the amount of impairment calculated on those loans, charging off amounts determined to be uncollectible. A loan is considered impaired when it is probable that all contractual principal and interest payments due will not be collected substantially in accordance with the terms of the loan agreement. Factors we consider in determining whether a loan is impaired include payment status, collateral value, borrower financial condition, guarantor support, and the probability of collecting scheduled principal and interest payments when due.

When a loan is identified as impaired, impairment is measured as the difference between the recorded investment in the loan and the present value of expected future cash flows discounted at the loan s effective interest rate or the loan s observable market price. For impaired collateral dependent loans, impairment is measured as the difference between the recorded investment in the loan and the fair value of the underlying collateral, less disposal cost. In accordance with our appraisal policy, the fair value of impaired collateral dependent loans is based upon independent third-party appraisals or on collateral valuations prepared by in-house appraisers at the intervening six month point. We require an independent third-party appraisal at least annually

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for substandard loans and OREO. Once a third-party appraisal is six months old, or if our chief appraiser determines that market conditions, changes to the property, changes in intended use of the property, or other factors indicate that an appraisal is no longer reliable, we perform an internal collateral valuation to assess whether a change in collateral value requires an additional adjustment to carrying value. A collateral valuation is a restricted-use report prepared by our internal appraisal staff in accordance with our appraisal policy. Upon the receipt of an updated appraisal or collateral valuation, loan impairments are remeasured and recorded. If the calculated impairment is determined to be permanent, fixed or nonrecoverable, the impairment will be charged off. Loans designated as impaired are generally placed on nonaccrual and remain in that status until all principal and interest payments are current and the prospects for future payments in accordance with the loan agreement are reasonably assured, at which point the loan is returned to accrual status. In the case of troubled debt restructurings (TDRs), such loans continue to be classified as impaired for so long as the loan is designated as a TDR. See Management s Discussion and Analysis Credit Risk Management Asset Quality and Nonperforming Assets.

The provision for loan losses recorded through earnings is based on management s assessment of the amount necessary to maintain the allowance for loan losses at a level appropriate to cover probable incurred losses inherent within the loans held for investment portfolio. The amount of provision and the corresponding level of allowance for loan losses are based on our evaluation of the collectability of the loan portfolio based on historical loss experience and other significant qualitative factors, including:

- the level and trends of delinquencies;
- variability in collateral valuations;
- regional economic activity, including trends in regional unemployment;
- the time periods during which the loans were originated;
- the ability of the customer to continue to make payments as interest rates change;
- changes in the experience, ability and depth of lending management;
- the volume of nonaccrual and adversely classified loans; and
- the results of internal and external loan reviews.

The methodology for evaluating the adequacy of the allowance for loan losses has two basic elements: first, the identification of impaired loans and the measurement of impairment for each individual loan identified; and second, a method for estimating an allowance for all other loans.

In estimating the general allowance for loan losses for unimpaired loans, such loans are segregated into loan portfolio segments. Loans are designated into homogeneous pools based on product types and similar risk characteristics or areas of risk concentration.

For each homogeneous loan pool, we estimate inherent losses by applying a rate of loss equal to four trailing quarters of historical losses. Additional incurred losses are also estimated for these same pools of loans based upon key risk indicators. Key risk indicators for each pool include the following: (1) loan delinquency trends, (2) variability in collateral valuation, (3) regional economic activity and trends, (4) current levels of interest rates and (5) the vintage of loans at origination. Key risk indicators are expressed in basis points and are adjusted downward or upward based on management s judgment as to the potential loss impact of each qualitative factor to a particular loan pool at the date of the analysis.

Prior to issuing our financial statements, we review updated independent third-party appraisals received and internal collateral valuations prepared subsequent to the reporting period end and those currently in process to determine whether the fair value of loan collateral or OREO has changed. Additionally, we review agreements to sell OREO properties executed prior to and subsequent to the reporting period end to identify changes in the fair value of OREO properties. If we determine that current valuations have changed materially from the prior valuations, we record any additional loan impairments or adjustments to OREO carrying values as of the end of the prior reporting period.

Additionally, our credit administration department continually monitors conditions that affect the carrying values of our collateral, including local and regional economic factors as well as asset-specific factors such as tax values, comparable sales, and factors that affect or suggest changes in the actual collateral values. They also monitor and adjust for changes in comparable sales or competing projects, changes in zoning or entitlement status, changes in occupancy rates for income properties, and similar factors. If we deem such factors to be material, we generally perform an internal collateral valuation or will order an independent appraisal sooner than required under our appraisal policy.

The FDIC and the DFI, as an integral part of their examination process, review the allowance for loan losses. These agencies may require changes in the classification of criticized or adversely classified loans and additions to the allowance for loan losses based on their judgment about information available at the time of their examinations.

The allowance for loan losses, as reported in our consolidated statements of financial condition, is increased by a provision for loan losses, which is recognized in earnings, and reduced by the charge off of loan amounts, net of recoveries.

Fair Value

A portion of our assets are carried at fair value, including mortgage servicing rights, loans held for sale, interest rate lock commitments, investment securities available for sale and derivatives used in our hedging programs. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The degree of management judgment involved in estimating the fair value of a financial instrument or other asset generally correlates to the level of observable pricing. Fair value measured from observable quoted market prices in an active market will generally require less management judgment. Conversely, financial instruments or other assets rarely traded or not quoted will generally require a higher degree of judgment from management to estimate fair value by choosing and applying valuation models to estimate the fair value. These valuation models may use inputs such as forward yield curves, loan prepayment assumptions, expected loss assumptions, market volatilities and pricing spreads using market-based inputs where available. While we believe that these inputs are comparable to those that would be used by other market participants, different assumptions could result in significant changes in valuation. Estimated fair value cannot be determined with precision and may not be realized in the actual sale or transfer of the asset or liability being valued in a current market exchange.

The following financial instruments and other assets require the management s most complex judgments and assumptions when estimating fair value:

Mortgage Servicing Rights

On January 1, 2007, we adopted Accounting Standards Codification 860, *Transfers and Servicing* (ASC 860). ASC 860 requires that the carrying value of mortgage servicing rights, or MSRs, resulting from the sale or securitization of loans be initially measured at fair value at the date of transfer, and permits an election between fair value and the lower of amortized cost or fair value for subsequent measurement. As of January 1, 2010, management elected to account for single family mortgage servicing rights at fair value during the life of the MSR, with subsequent changes in fair value recorded through current period earnings. Fair value adjustments encompass market-driven valuation changes as well as run-off of value that occurs due to the passage of time. We continue to value multifamily MSRs at the lower of amortized cost or fair value.

MSRs are recorded as separate assets upon purchase of the rights or when we retain the right to service loans that we have originated and sold. Net gains on mortgage loan origination and sale activities depend, in part, on the fair value of MSRs. We value MSRs based on quoted market prices, other observable market data, or a discounted cash flow model depending on the availability of market information.

Subsequent fair value measurements of single family MSRs are determined by calculating the present value of estimated future net servicing income because MSRs are not traded in an active market with readily observable market prices. The discounted cash flow model uses several significant assumptions, such as market interest rates, projected prepayment speeds, discount rates, estimated costs of servicing and other income and additional expenses associated with the collection of delinquent loans. In addition, third-party valuations estimating the fair value of the mortgage servicing asset portfolio are obtained at least annually and compared to the carrying values of our MSRs.

Market expectations about loan duration, and correspondingly the expected term of future servicing cash flows, may vary from time to time due to changing prepayment activity, especially when interest rates rise or fall. Market expectations of increased loan prepayment speeds may negatively impact the fair value of the single family mortgage servicing rights. Fair value is also dependent on the discount rate used in calculating present value, which is imputed from observable market activity and market participants. Management reviews and adjusts the discount rate on an ongoing basis. An increase in the discount rate would reduce the estimated fair value of the single family mortgage servicing rights asset.

The mortgage servicing assets are reported in our consolidated statements of financial condition. The changes in fair value for the single family mortgage servicing assets and the amortization of the multifamily mortgage servicing assets are reported in our consolidated statements of operations.

Investment Securities

Investment securities are classified as available for sale and are carried at fair value. Amortization of premiums and accretion of discounts are recognized in interest income using the interest method, adjusted for anticipated prepayments where applicable. Unrealized holding gains and losses, net of income taxes, are excluded from earnings and reported as a separate component of accumulated other comprehensive income and reclassified into earnings when realized, such as upon sale of the security.

Management monitors the portfolio of securities classified as available for sale for impairment, which may result from credit deterioration of the issuer, changes in market interest rates relative to the rate of the instrument, or changes in duration. An evaluation of each investment security is performed no less frequently than quarterly to assess if impairment is considered other-than-temporary. In conducting this evaluation, management considers many factors, including but not limited to whether we expect to recover the entire amortized cost basis of the security in light of adverse changes in expected future cash flows, the length of time the security has been impaired and the severity of the unrealized loss. Management also considers whether we intend to sell the security or if it is more likely than not that we will be required to sell the security prior to recovery. The determination of other-than-temporary impairment is a subjective process, requiring the use of judgments and assumptions in interpreting relevant market data. Other-than-temporary valuation losses on securities classified as available for sale are reported in our consolidated statements of operations.

Derivatives and Hedging Activities

We enter into contracts to manage the various risks associated with certain assets, liabilities or probable forecasted transactions. When we enter into derivative contracts, the derivative instrument is designated as: (1) a hedge of changes in fair value of a recognized asset or liability or of an unrecognized firm commitment (a fair value hedge), (2) a hedge of the variability in expected future cash flows associated with an existing recognized asset or liability or a probable forecasted transaction (a cash flow hedge) or (3) held for other risk management purposes (risk management derivatives).

All derivatives, whether designated in hedging relationships or not, are recorded at fair value as either assets or liabilities in our consolidated statements of financial condition. Changes in fair value of derivatives that are not in hedge accounting relationships, such as risk management derivatives, are recorded in our consolidated statements of operations in the period in which the change occurs. Changes in the fair value of derivatives in qualifying fair value hedge accounting relationships are recorded each period in earnings along with the change in fair value of the hedged item attributable to the risk being hedged. Changes in fair value of derivatives that are designated as cash flow hedges, to the extent such hedges are deemed highly effective, are recorded as a separate component of accumulated other comprehensive income and reclassified into earnings when the earnings effect of the hedged cash flows is recognized.

The determination of whether a derivative qualifies for hedge accounting requires complex judgments about the application of ASC 815, *Derivatives and Hedging*. Additionally, this standard requires contemporaneous documentation of our hedging relationships. Such documentation includes the nature of the risk being hedged, the identification of the hedged item, or the group of hedged items that share the risk exposure that is designated as being hedged, the selection of the instrument that will be used to hedge the identified risk and the method used to assess effectiveness of the hedge relationship. The assessment of hedge effectiveness must support the determination that the hedging relationship is expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk during the period that the hedge is designated. If our assessment of effectiveness is not considered to be adequate to achieve hedge accounting treatment, the derivative is treated as a free-standing risk management instrument.

Income Taxes

In establishing an income tax provision, we must make judgments and interpretations about the application of these inherently complex tax laws. We must also make estimates about when in the future certain items will affect taxable income. Our interpretations may be subjected to review during examination by taxing authorities and disputes may arise over the respective tax positions. We monitor tax authorities and revise our estimates of accrued income taxes due to changes in income tax laws and their interpretation by the courts and regulatory authorities on a quarterly basis. Revisions of our estimate of accrued income taxes also may result from our own income tax planning and from the resolution of income tax controversies. Such revisions in our estimates may be material to our operating results for any given quarter.

Income taxes are accounted for using the asset and liability method, which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements. Under this method, a deferred tax asset or liability is determined based on the differences between the financial statements and tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse. The effect of a change in tax rates on deferred tax assets and liabilities is recognized in income in the period that includes the enactment date.

The Company records net deferred tax assets to the extent it is believed that these assets will more likely than not be realized. In making such determination, management considers all available positive and negative evidence, including future reversals of existing taxable temporary differences, projected future taxable income, tax planning strategies, and recent financial operations. After reviewing and weighing all of the positive and negative evidence, if the positive evidence outweighs the negative evidence, then the Company does not record a valuation allowance for deferred tax assets. If the negative evidence outweighs the positive evidence, then a valuation allowance for all or a portion of the deferred tax assets is recorded.

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The Company recognizes interest and penalties related to unrecognized tax benefits as income tax expense in the consolidated statements of operations. Accrued interest and penalties are included within the related tax liability line in the consolidated statements of financial condition.

Results of Operations

	At or for the Three Months Ended September 30,		At or for the Nine Months Ended September 30,		At or for the Year Ended December 31,		
	2011	2010	2011	2010	2010	2009	2008
Net income (loss), in thousands	$ 15,258	$ (5,361)	$ 9,093	$ (19,852)	$ (34,247)	$ (110,276)	$ 8,429
Basic earnings (loss) per common share	$ 11.29	$ (3.97)	$ 6.73	$ (14.70)	$ (25.35)	$ (81.63)	$ 6.25
Diluted earnings (loss) per common share	$ 11.29	$ (3.97)	$ 6.73	$ (14.70)	$ (25.35)	$ (81.63)	$ 6.24
Return on average assets	2.67%	(0.80)%	0.53%	(0.89)%	(1.19)%	(3.47)%	0.29%
Return on average common shareholder equity	83.04%	(24.73)%	19.26%	(28.73)%	(38.00)%	(68.90)%	4.14%

Comparison of the three and nine month periods ended September 30, 2011 to September 30, 2010

For the three and nine month periods ended September 30, 2011, we reported net income of $15.3 million and $9.1 million, respectively, compared with net losses of $5.4 million and $19.9 million for the same periods in the prior year.

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Average Balances and Rates

Average balances, together with the total dollar amounts of interest income and expense, on a taxable-equivalent basis related to such balances and the weighted average rates, for the three months ended September 30, 2011 and 2010 were as follows:

	Three Months Ended September 30,					
	2011			2010		
(in thousands)	Average Balance	Interest	Average Yield/Cost	Average Balance	Interest	Average Yield/Cost
Assets:						
Interest-earning assets(1):						
Cash & cash equivalents	$ 192,323	$ 114	0.23%	$ 209,331	$ 130	0.24%
Investment securities	272,294	1,444	2.14%	305,342	1,071	1.35%
Loans held for sale	126,863	1,362	4.33%	137,890	1,811	5.26%
Loans held for investment	1,427,763	16,268	4.54%	1,813,447	19,042	4.19%
Total interest-earning assets(2)	2,019,243	19,188	3.79%	2,466,010	22,054	3.57%
Noninterest-earning assets(3)	265,216			224,811		
Total assets	$ 2,284,459			$ 2,690,821		
Liabilities and Shareholders Equity:						
Deposits:						
Interest-bearing demand accounts	$ 133,006	140	0.42%	$ 112,051	173	0.61%
Savings accounts	58,043	73	0.50%	49,319	106	0.85%
Money market accounts	461,278	715	0.62%	378,482	990	1.04%
Certificate accounts	1,135,061	4,920	1.72%	1,535,509	8,082	2.09%
Deposits	1,787,388	5,848	1.30%	2,075,361	9,351	1.79%
FHLB advances	72,267	855	4.69%	178,260	1,258	2.80%
Long-term debt	61,857	459	2.97%	66,857	1,084	6.48%
Total interest-bearing liabilities(2)	1,921,512	7,162	1.48%	2,320,478	11,693	2.00%
Other noninterest-bearing liabilities	289,448			283,639		
Total liabilities	2,210,960			2,604,117		
Shareholders equity	73,499			86,704		
Total liabilities and shareholders equity	$ 2,284,459			$ 2,690,821		
Net interest income(4)		$ 12,026			$ 10,361	
Net interest spread			2.31%			1.57%
Impact of noninterest-bearing sources			0.07%			0.11%
Net interest margin			2.38%			1.68%

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

(2) Average interest-earning assets and interest-bearing liabilities were computed using daily average balances.

(3) Includes loan balances that have been foreclosed and are now reclassified to other real estate owned.

(4) Includes taxable-equivalent adjustments primarily related to tax-exempt income on certain loans and securities of $56,000 and $73,000 for the quarters ended September 30, 2011 and 2010, respectively. The federal statutory tax rate was 35% for the periods presented.

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Average balances, together with the total dollar amounts of interest income and expense, on a taxable-equivalent basis related to such balances and the weighted average rates, for the nine months ended September 30, 2011 and 2010 were as follows:

	Nine Months Ended September 30,					
	2011			2010		
(in thousands)	Average Balance	Interest	Average Yield/Cost	Average Balance	Interest	Average Yield/Cost
Assets:						
Interest-earning assets(1):						
Cash & cash equivalents	$ 151,763	$ 265	0.23%	$ 217,573	$ 469	0.29%
Investment securities	295,988	5,215	2.35%	492,668	5,881	1.59%
Loans held for sale	109,896	3,566	4.33%	102,630	4,300	5.59%
Loans held for investment	1,509,296	50,756	4.49%	1,936,583	59,744	4.12%
Total interest-earning assets(2)	2,066,943	59,802	3.86%	2,749,454	70,394	3.42%
Noninterest-earning assets(3)	241,181			221,204		
Total assets	$ 2,308,124			$ 2,970,658		
Liabilities and Shareholders Equity:						
Deposits:						
Interest-bearing demand accounts	$ 126,769	458	0.48%	$ 108,701	520	0.64%
Savings accounts	55,367	257	0.62%	55,720	377	0.91%
Money market accounts	438,922	2,297	0.70%	372,372	3,085	1.11%
Certificate accounts	1,216,650	16,415	1.80%	1,569,790	27,020	2.30%
Deposits	1,837,708	19,427	1.41%	2,106,583	31,002	1.97%
FHLB advances	105,410	3,122	3.95%	454,947	10,316	3.03%
Long-term debt	62,725	1,586	3.37%	66,857	3,298	6.58%
Other borrowings		1	0.00%	93	3	0.00%
Total interest-bearing liabilities(2)	2,005,843	24,136	1.61%	2,628,480	44,619	2.27%
Other noninterest-bearing liabilities	239,323			250,028		
Total liabilities	2,245,166			2,878,508		
Shareholders equity	62,958			92,150		
Total liabilities and shareholders equity	$ 2,308,124			$ 2,970,658		
Net interest income(4)		$ 35,666			$ 25,775	
Net interest spread			2.25%			1.15%
Impact of noninterest-bearing sources			0.05%			0.10%
Net interest margin			2.30%			1.25%

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

(2) Average interest-earning assets and interest-bearing liabilities were computed using daily average balances.

(3) Includes loan balances that have been foreclosed and are now reclassified to other real estate owned.

(4) Includes taxable-equivalent adjustments primarily related to tax-exempt income on certain loans and securities of $192,000 and $227,000 for the nine months ended September 30, 2011 and 2010, respectively. The federal statutory tax rate was 35% for the periods presented.

We have not included interest income from nonaccrual loans in the tables presented above. The additional interest income that would have been recorded during the periods presented if the loans had been accruing was

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$1.1 million and $2.5 million for the three months ended September 30, 2011 and 2010, respectively, and $4.0 million and $9.2 million for the nine months ended September 30, 2011 and 2010, respectively. The primary reason for this decline is a decrease of $93.5 million, or 49.6%, in nonaccrual loans, to $95.1 million at September 30, 2011 from $188.6 million at September 30, 2010 which includes a decrease of $29.0 or 23.4% from $124.1 million at March 31, 2011.

Rate and Volume Analysis

The following tables present the extent to which changes in interest rates and changes in the volume of our interest-earning assets and interest-bearing liabilities have affected our interest income and interest expense, excluding interest income from nonaccrual loans. Information is provided in each category with respect to: (1) changes attributable to changes in volume (changes in volume multiplied by prior rate), (2) changes attributable to changes in rate (changes in rate multiplied by prior volume), (3) changes attributable to changes in rate and volume (changes in rate multiplied by changes in volume), which were allocated in proportion to the percentage change in average volume and average rate and included in the relevant column and (4) the net change.

	Three Months Ended September 30, 2011 vs. 2010		
	Increase (Decrease) Due to		Total
(in thousands)	**Rate**	**Volume**	**Change**
Assets:			
Interest-earning assets:			
Cash & cash equivalents	$ (4)	$ (12)	$ (16)
Investment securities	505	(132)	373
Loans held for sale	(309)	(140)	(449)
Total loans held for investment	1,539	(4,313)	(2,774)
Total interest-earning assets	1,731	(4,597)	(2,866)
Liabilities:			
Deposits:			
Interest-bearing demand accounts	(62)	29	(33)
Savings accounts	(49)	16	(33)
Money market accounts	(461)	186	(275)
Certificate accounts	(1,276)	(1,886)	(3,162)
Deposits	(1,848)	(1,655)	(3,503)
FHLB advances	581	(984)	(403)
Long-term debt	(548)	(77)	(625)
Total interest-bearing liabilities	(1,815)	(2,716)	(4,531)
Total changes in net interest income	$ 3,546	$ (1,881)	$ 1,665

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	Nine Months Ended September 30, 2011 vs. 2010 Increase (Decrease) Due to		
	Rate	Volume	Total Change
(in thousands)			
Assets:			
Interest-earning assets:			
Cash & cash equivalents	$ (79)	$ (125)	$ (204)
Investment securities	2,184	(2,850)	(666)
Loans held for sale	(1,070)	336	(734)
Loans held for investment	5,021	(14,009)	(8,988)
Total interest-earning assets	$ 6,056	$ (16,648)	$ (10,592)
Liabilities:			
Deposits:			
Interest-bearing demand accounts	$ (140)	$ 78	$ (62)
Savings accounts	(117)	(3)	(120)
Money market accounts	(1,273)	485	(788)
Certificate accounts	(5,195)	(5,410)	(10,605)
Deposits	(6,725)	(4,850)	(11,575)
FHLB advances	2,449	(9,643)	(7,194)
Long-term debt	(1,521)	(191)	(1,712)
Other borrowings		(2)	(2)
Total interest-bearing liabilities	(5,797)	(14,686)	(20,483)
Total changes in net interest income	$ 11,853	$ (1,962)	$ 9,891

Net Interest Income

Our profitability depends partially on our level of net interest income, which is the difference between income earned on our interest-earning assets, primarily loans and investment securities, and the rate paid on interest-bearing liabilities, primarily deposits and borrowed funds, including our outstanding trust preferred securities, interest paid on our recently retired senior notes, and advances from the FHLB of Seattle.

Net interest income, on a tax equivalent basis, for the three and nine months ended September 30, 2011 was $12.0 million and $35.7 million respectively, increases of $1.7 million, or 16.1% and $9.9 million, or 38.4%, respectively, compared with $10.4 million and $25.8 million for the same periods in the prior year. The net interest margin for the third quarter of 2011 was 2.38% and for the nine months ended September 30, 2011 was 2.30% compared to 1.68% and 1.25% for the same periods in the prior year. Our balance sheet restructuring activities, which began in 2010, include strategies designed to improve our yield on interest earning assets and decrease our dependence on high-cost, noncore, high-balance retail certificates of deposit, brokered certificates of deposit and FHLB borrowings and attract more stable, relation-based, lower-cost consumer and business transaction account deposits. These results were partially offset by a decrease in our portfolio of loans held for investment, which reduced our net interest income. Also, during this time we have established interest rate floors, or minimum interest rates, on our variable-rate loans upon extension, renewal or restructuring. These actions to date have resulted in a significant increase in our net interest margin. As we continue to restructure our balance sheet focusing on improving interest margins, we expect continued improvement in net interest income and net interest margin.

We experienced a significant change in the components of net interest income from the three months ended September 30, 2011 compared to the three months ended September 30, 2010. In the third quarter of 2011, total

interest income, on a tax equivalent basis, decreased $2.9 million, or 13.0% from the same period of 2010 to $19.2 million. Our average balances of outstanding loans held for investment declined $385.7 million, which had the effect of lowering our interest income by $4.3 million. Partially offsetting this decrease was an increase in the average yield on loans in our held for investment portfolio, reflecting the impact of lower average nonaccrual loan balances and higher interest rates upon loan renewal or extension, all of which had the effect of increasing interest income from loans held for investment by $1.5 million. Our average balances of investment securities available for sale declined $33.0 million, which had the effect of lowering our interest income by $0.1 million. Partially offsetting this decrease was an increase in the weighted-average yield on investment securities available for sale, reflecting an increase in the average duration of the portfolio, which had the effect of increasing interest income by $0.5 million.

At the same time total interest expense decreased $4.5 million, or 38.7% to $7.2 million. Our average balance of FHLB borrowings declined $106.0 million, which had the effect of lowering interest expense by $1.0 million. During 2010 and continuing through the first nine months of 2011, we reduced wholesale funding by pre-paying or allowing FHLB borrowings and higher cost noncore and brokered certificate accounts to mature without renewal. Our average certificate account balances declined $400.4 million with a corresponding decrease in the weighted-average cost of these deposits, which had a combined effect of decreasing interest expense by $3.2 million.

We experienced significant changes in the components of net interest income for the first nine months of 2011 as compared to the first nine months of 2010 consistent with the trends between the three months ended September 30, 2011 and the three months ended September 30, 2010. For the nine months ended September 30, 2011, total interest income, on a tax equivalent basis, decreased $10.6 million, or 15.0%, to $59.8 million. Our average balances of outstanding loans held for investment declined $427.3 million, which had the effect of lowering our interest income by $14.0 million. Partially offsetting this decrease was an increase in the average yield on loans in our held for investment portfolio, reflecting the impact of lower average nonaccrual loan balances and higher interest rates upon loan renewal or extension, all of which had the effect of increasing interest income by $5.0 million. As a result, our interest income decreased by $9.0 million. Our average balances of investment securities available for sale declined $196.7 million, which had the effect of lowering our interest income by $2.9 million. Partially offsetting this decrease was an increase in the weighted-average yield on investment securities available for sale, reflecting an increase in the average duration of the portfolio, which had the effect of increasing interest income by $2.2 million.

At the same time total interest expense decreased $20.5 million, or 45.9%, to $24.1 million. Our average balance of FHLB borrowings declined $349.5 million, which had the effect of lowering interest expense by $9.6 million. During 2010 and continuing through the first three quarters of 2011, we reduced wholesale funding by pre-paying or allowing FHLB borrowings and higher cost noncore and brokered certificate accounts to mature without renewal. Our average certificate account balances declined $353.1 million with a corresponding decrease in the weighted-average cost of these deposits, which had a combined effect of decreasing interest expense by $10.6 million.

Provision for Loan Losses

We recorded loan loss provision expense of $1.0 million and $3.3 million for the three and nine month periods ended September 30, 2011, respectively, compared with $12.0 million and $29.1 million for the same periods in the prior year. No provision expense was recorded for the first quarter of 2011. These declines resulted primarily from reductions in classified and nonperforming assets and related reductions in net loan charge-offs. Additionally, in the first nine months of 2011, we recorded loan recoveries of $6.6 million, including a $4.0 million recovery in the first three months of 2011. The decline in provision expense results from a reduction in total loans held for investment of 11.6% to $1.36 billion at September 30, 2011 from $1.54 billion at December 31, 2010, coupled with an overall improvement in credit quality. Our improvements in credit quality

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include a reduction in classified assets to $225.0 million at September 30, 2011 from $363.9 million at December 31, 2010, a decrease of $138.9 million, or 38.2%. Similarly, nonperforming assets declined over that same period to $159.5 million from $283.7 million, a decrease of $124.2 million, or 43.8%. Likewise, net charge-offs declined to $14.5 million during the first three quarters of 2011 from $83.2 million during the year ended December 31, 2010, an annualized decrease of approximately 76.8%. The provision for loan losses is discussed in greater detail below in Risk Management Credit Risk Management .

Noninterest Income

Noninterest income for the three and nine months ended September 30, 2011 was $37.3 million and $70.6 million, respectively, increases of $9.6 million, or 34.5% ,and $1.8 million, or 2.7% from $27.7 million and $68.8 million for the same periods in the prior year. Our noninterest income is heavily dependent upon our single family mortgage banking activities. The level of our mortgage banking activity fluctuates and is influenced by mortgage interest rates, the economy, employment and housing affordability, among other factors. These increases in noninterest income reflect an increase in mortgage servicing income, partially offset by decreases in net gains on mortgage loan origination and sales activities. Additionally, in the first quarter of 2011 we recognized a $2.0 million gain on the early retirement of our USAA long-term debt. Gain on sale of investment securities available for sale of $6.0 million for the nine months ended September 30, 2010 was the result of balance sheet restructuring activities during the second quarter of 2010, the proceeds of which were utilized to prepay FHLB advances.

Noninterest income consisted of the following:

(in thousands)	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010	Dollar Change	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010	Dollar Change
Noninterest income						
Net gains on mortgage loan origination and sales activities	$ 16,055	$ 19,439	$ (3,384)	$ 30,454	$ 38,026	$ (7,572)
Mortgage servicing	18,532	6,076	12,456	32,093	19,242	12,851
Income from Windermere Mortgage Services	902	676	226	1,380	1,356	24
Gain on debt extinguishment				2,000		2,000
Depositor and other retail banking fees	778	875	(97)	2,313	2,569	(256)
Insurance commissions	103	238	(135)	724	714	10
Gain on sale of investment securities available for sale	642	88	554	643	6,016	(5,373)
Other	256	318	(62)	1,042	893	149
Total noninterest income	$ 37,268	$ 27,710	$ 9,558	$ 70,649	$ 68,816	$ 1,833

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

Net gains on mortgage loan origination and sales activities were $16.1 million and $30.5 million for the three and nine month periods ended September 30, 2011, respectively, reflecting decreases of $3.4 million, or 17.4%, and $7.6 million, or 19.9%, from $19.4 million and $38.0 million for the same periods in the prior year. These decreases were primarily due to a reduction in single family loan origination volume, which declined from $586.7 million and $1.39 billion for the three and nine month periods ended September 30, 2010 to $484.4 million and $1.09 billion for the same periods in 2011, reductions of 17.4% and 22.1%, respectively. For the nine months ended September 30, 2011, decreases due to reductions in single family loan origination volume were partially offset by higher profit margins available in the marketplace.

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Mortgage servicing income consisted of the following:

	Three Months Ended September 30,						Dollar Change
	2011			2010			2011 vs. 2010
(in thousands)	Single family	Multifamily	Total	Single family	Multifamily	Total	Total
Servicing fees and other	$ 5,548	$ 1,245	$ 6,793	$ 5,221	$ 714	$ 5,935	$ 858
Changes in fair value, single-family mortgage servicing rights:							
Due to changes in model or assumptions(1)	(20,068)	n/a	(20,068)	(10,479)	n/a	(10,479)	(9,589)
Due to payments on loan balances and other(2)	(6,073)	n/a	(6,073)	(4,036)	n/a	(4,036)	(2,037)
Amortization	n/a	(455)	(455)	n/a	(312)	(312)	(143)
Net gain from derivatives economically hedging MSR	38,335		38,335	14,968		14,968	23,367
Mortgage servicing	$ 17,742	$ 790	$ 18,532	$ 5,674	$ 402	$ 6,076	$ 12,456

(1) Principally reflects changes in discount rates and prepayment speed assumptions, mostly due to changes in interest rates.
(2) Represents changes due to collection/realization of expected cash flows and curtailments over time.

	Nine Months Ended September 30,						Dollar Change
	2011			2010			2011 vs. 2010
(in thousands)	Single family	Multifamily	Total	Single family	Multifamily	Total	Total
Servicing fees and other	$ 16,339	$ 3,268	$ 19,607	$ 15,241	$ 2,312	$ 17,553	$ 2,054
Changes in fair value, single-family mortgage servicing rights:							
Due to changes in model or assumptions(1)	(21,582)	n/a	(21,582)	(28,373)	n/a	(28,373)	6,791
Due to payments on loan balances and other(2)	(10,332)	n/a	(10,332)	(11,035)	n/a	(11,035)	703
Amortization	n/a	(1,121)	(1,121)	n/a	(1,043)	(1,043)	(78)
Net gain from derivatives economically hedging MSR	45,521		45,521	42,140		42,140	3,381
Mortgage servicing	$ 29,946	$ 2,147	$ 32,093	$ 17,973	$ 1,269	$ 19,242	$ 12,851

(1) Principally reflects changes in discount rates and prepayment speed assumptions, mostly due to changes in interest rates.
(2) Represents changes due to collection/realization of expected cash flows and curtailments over time.

For the three and nine month periods ended September 30, 2011, mortgage servicing income was $18.5 million and $32.1 million, respectively, reflecting increases of $12.5 million, or more than 100% and $12.9 million, or 66.8%, from $6.1 million and $19.2 million for the same periods in the prior year. For the same periods servicing fees and other increased $0.9 million, or 14.5%, and $2.1 million, or 11.7%, primarily as a result of growth in our portfolio of single family loans serviced for others. Substantially all of our new mortgage loan originations are designated as held for sale, most of which are sold with servicing retained. Mortgage

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servicing income also includes changes in the fair value of single family mortgage servicing rights, or MSRs, during the period as well as changes in value of derivatives (economic hedges) used to hedge changes in fair value of our single family MSRs. Multifamily MSRs are recorded at the lower of amortized cost or fair value.

For the three month period ended September 30, 2011, we recognized net valuation gains of $12.2 million ($26.1 million decrease in fair value of single family MSRs offset by $38.3 million of hedge gains), compared with $0.5 million of net MSR valuation gains ($14.5 million decrease in fair value of single family MSRs offset by a $15.0 million hedge gain) for the same period in the prior year. As a result of global economic events during the third quarter of 2011 interest rates experienced an abrupt and severe decline, the spread between mortgage interest rates and swap interest rates widened and current and estimated future prepayments declined from previously modeled rates. As a consequence of the foregoing, we experienced significantly higher net MSR/hedge valuation gains in this period as compared to the prior periods.

For the nine month period ended September 30, 2011, we recognized net valuation gains of $13.6 million ($31.9 million decrease in fair value of single family MSRs offset by a $45.5 million hedge gain), compared with a $2.7 million net MSR valuation gain ($39.4 million decrease in fair value of single family MSRs offset by a $42.1 million hedge gain) for the same period in the prior year.

Income from Windermere Mortgage Services, Inc. was $902,000 and $1.4 million for the three and nine month periods ended September 30, 2011, respectively, an increase of $226,000, or 33.4%, and an increase of $24,000, or 1.8%, from $676,000 and $1.4 million for the same periods in the prior year. Changes in income from Windermere Mortgage Services for the three months ended September 30, 2011 compared with 2010 were primarily due to premium loan pricing, reflecting current market conditions.

Gain on debt extinguishment was $2.0 million for the first three quarters of 2011, compared with $0 for the same period in the prior year. This increase was due to the negotiated settlement of the long-term debt arrangement with USAA during the first quarter of 2011 for $3.0 million, a $2.0 million discount recorded as a gain from the $5.0 million carrying value of the debt.

Depositor and other retail banking fees were $778,000 and $2.3 million for the three and nine month periods ended September 30, 2011, respectively, reflecting decreases of $97,000, or 11.1%, and $256,000, or 10.0%, from $875,000 and $2.6 million for the same periods in the prior year. These decreases are primarily due to the decrease in insufficient funds fees associated with the impacts of regulatory changes, partially offset by an increase in the number of customer transaction accounts.

Insurance commissions income was $103,000 and $724,000 for the three and nine month periods ended September 30, 2011, respectively, reflecting a decrease of $135,000, or 56.7%, and an increase of $10,000, or 1.4%, from $238,000 and $714,000 for the same periods in the prior year. The decrease for the three months ended September 30, 2011 was primarily a result of a decrease in annuity sales.

Gain on sale of securities available for sale was $642,000 and $643,000 for the three and nine month periods ended September 30, 2011, respectively, reflecting a change from $88,000 and $6.0 million for the same periods in the prior years. During 2010, the sale of certain investment securities was an integral part of balance sheet restructuring activities.

Other income was $256,000 and $1.0 million for the three and nine month periods ended September 30, 2011, respectively, reflecting a decrease of $62,000, or 19.5%, and an increase of $149,000, or 16.7%, from $318,000 and $893,000 for the same periods in the prior year reflecting changes in derivative fair values, primarily interest rate swaps, used as interest rate risk management instruments.

Noninterest Expense

Noninterest expense for the three and nine month periods ended September 30, 2011 was $32.6 million and $93.3 million, respectively, reflecting increases of $626,000, or 2.0%, and $7.6 million, or 8.9%, from $32.0

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million and $85.7 million in the prior year periods. Increasing noninterest expense for the three months ended September 30, 2011 as compared to the prior year period was primarily due to increases in salaries and related costs, reflecting increases in headcount as we continue to expand single family lending operations, as well as an increase in the general and administrative expenses partially offset by a decrease in federal deposit insurance corporation assessment. For the nine months ended September 30, 2011, the increase was primarily due to increases in OREO expenses and valuation reserves recorded in the first three quarters of 2011, partially offset by a decrease in FHLB prepayment penalties of $5.5 million associated with the early retirement of $390.7 million of FHLB borrowings in the second quarter of 2010.

Noninterest expense consisted of the following:

(in thousands)	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010	Dollar Change	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010	Dollar Change
Noninterest expense						
Salaries and related costs	$ 13,217	$ 12,685	$ 532	$ 37,056	$ 36,132	$ 924
General and administrative	4,599	4,204	395	13,059	11,310	1,749
Federal Home Loan Bank prepayment penalty					5,458	(5,458)
Legal	983	813	170	2,286	2,841	(555)
Consulting	270	311	(41)	633	929	(296)
Federal Deposit Insurance Corporation assessments	1,264	1,898	(634)	4,278	5,788	(1,510)
Occupancy	1,663	1,645	18	5,031	4,887	144
Information services	1,509	1,239	270	4,466	3,755	711
Other real estate owned expense (income)	9,113	9,197	(84)	26,533	14,616	11,917
Total noninterest expense	$ 32,618	$ 31,992	$ 626	$ 93,342	$ 85,716	$ 7,626

Salaries and related costs were $13.2 million and $37.1 million for the three and nine month periods ended September 30, 2011, respectively, reflecting increases of $532,000, or 4.2%, and $924,000, or 2.6%, from $12.7 million and $36.1 million in the same periods in the prior year. These increases were primarily due to our continued expansion of single family lending operations.

General and administrative expenses were $4.6 million and $13.1 million for the three and nine month periods ended September 30, 2011, respectively, reflecting increases of $395,000, or 9.4%, and $1.7 million, or 15.5%, from $4.2 million and $11.3 million in the same periods in the prior year. These increases were primarily due to increases in reinsurance losses and collection and foreclosure related expenses as well as an increase in repurchase reserves, offset by lower loan processing expenses as a result of lower origination volume in the period.

Federal Home Loan Bank prepayment penalty of $5.5 million reflects the prepayment of $390.7 million of FHLB borrowings during the second quarter of 2010. As part of our balance sheet restructuring activities during 2010, proceeds from the sale of shorter-term and lower-yielding securities available for sale were used to pre-pay these borrowings.

Legal expenses were $983,000 and $2.3 million for the three and nine month periods ended September 30, 2011, respectively, reflecting an increase of $170,000, or 20.9%, and a decrease of $550,000, or 19.5%, from $813,000 and $2.8 million in the same periods in the prior year. These fluctuations are primarily due to changes in legal activity associated with ongoing problem asset resolution efforts.

Consulting expenses were $270,000 and $633,000 for the three and nine month periods ended September 30, 2011, respectively, reflecting decreases of $41,000, or 13.2%, and $296,000, or 31.9%, from

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$311,000 and $929,000 for the same periods in the prior year. During the first three quarters of 2010, higher consulting expenses included services related to enhancing our hedging strategies as well as pre-employment compensation of certain members of our executive management team prior to the approval of their appointments by our regulators.

FDIC Assessments were $1.3 million and $4.3 million for the three and nine month periods ended September 30, 2011, respectively, reflecting decreases of $634,000, or 33.4%, and $1.5 million, or 26.1%, from $1.9 million and $5.8 million in the same periods in the prior year. These decreases were due to a change in how FDIC fees are assessed, which is now primarily based on average assets and average Tier 1 capital rather than average deposit balances.

Occupancy expenses were $1.7 million and $5.0 million for the three and nine month periods ended September 30 2011, respectively, reflecting increases of $18,000, or 1.1%, and $144,000, or 2.9%, from $1.6 million and $4.9 million in the same periods in the prior year. These increases were primarily due to higher effective facility rents.

Information services expenses were $1.5 million and $4.5 million for the three and nine month periods ended September 30, 2011, respectively, reflecting increases of $270,000, or 21.8%, and $711,000, or 18.9%, from $1.2 million and $3.8 million in the same periods in the prior year. These increases were primarily due to higher maintenance and service costs, partially offset by lower depreciation expense.

Other real estate owned expenses were $9.1 million and $26.5 million for the three and nine month periods ended September 30, 2011, respectively, reflecting a decrease of $84,000, or 0.9%, and an increase of $11.9 million, or 81.5%, from $9.2 million and $14.6 million in the same periods in the prior year. The increase for the nine months ended September 30, 2011 reflects $23.5 million of valuation losses compared to $11.1 million for the same period in the prior year. The increases in OREO expenses in 2011 reflect continued deterioration in residential land and commercial land development values and the expedited sale of certain OREO properties. Late in the third quarter we elected to accelerate the disposition of OREO by entering into sales agreements, which reflect pricing substantially below appraised values but which gave us the advantage of shortened due diligence periods and expedited closing dates. The contracted sale of these OREO properties, which total $15.8 million, resulted in the recognition of $3.9 million in valuation losses in the third quarter of 2011.

Income Tax Expense

Income tax expense (benefit) for the nine months ended September 30, 2011 and 2010 was $388,000 and $(600,000), respectively. Our effective tax rate for the nine months ended September 30, 2011 and 2010 varied from the Federal statutory rate due to alternative minimum taxes and valuation allowances established on deferred tax assets due to uncertainty as to our ability to realize these assets in the future.

In 2009 and 2010 we recorded a valuation allowance for financial statement purposes against the carrying value of our net deferred tax asset due to uncertainty as to our future utilization of such tax benefits.

The completion of this offering will result in a change of control of HomeStreet within the meaning of Section 382 of the Internal Revenue Code of 1986, as amended. Section 382 substantially limits the ability of a corporate taxpayer to use realized built-in losses and net operating loss carryforwards incurred prior to a change of control against income earned after a change of control. The rules adopted by the Internal Revenue Service under Section 382 are complex, and the actual amount of such limitation varies depending on a variety of factors. We expect the residual benefit of our accumulated net operating loss carryforward to be nominal immediately following the completion of this offering.

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Capital Expenditures. We had no significant capital expenditures during the first nine months of 2011 or 2010.

Comparison of the year ended 2010 to the year ended 2009

For the year ended 2010, we reported a net loss of $34.3 million, compared with a net loss of $110.3 million for 2009.

Average Balances and Rates

Average balances, together with the total dollar amounts of interest income and expense, on a tax equivalent basis related to such balances and the weighted average rates, for years ended December 31, 2010 and 2009 were as follows:

	Year Ended December 31,					
	2010			2009		
(in thousands)	Average Balance	Interest	Average Yield/Cost	Average Balance	Interest	Average Yield/Cost
Assets:						
Interest-earning assets(1):						
Cash & cash equivalents	$ 196,109	$ 538	0.27%	$ 259,665	$ 584	0.23%
Investment securities	457,930	7,831	1.71%	372,320	4,376	1.18%
Loans held for sale	120,619	6,263	5.19%	117,555	7,647	6.51%
Loans held for investment	1,868,035	79,266	4.24%	2,307,215	99,130	4.30%
Total interest-earning assets(2)	2,642,693	93,898	3.55%	3,056,755	111,737	3.66%
Noninterest-earning assets(3)	238,024			119,395		
Total assets	$ 2,880,717			$ 3,176,150		
Liabilities and Shareholders Equity:						
Deposits:						
Interest-bearing demand accounts	$ 110,637	686	0.62%	$ 99,884	1,259	1.26%
Savings accounts	54,340	479	0.88%	112,562	2,900	2.58%
Money market accounts	381,054	3,973	1.04%	304,832	4,515	1.48%
Certificate accounts	1,525,206	33,912	2.22%	1,495,693	45,679	3.05%
Deposits	2,071,237	39,050	1.89%	2,012,971	54,353	2.70%
Fed discount borrowings			0.00%	688	3	0.50%
FHLB advances	382,083	11,682	3.06%	685,715	21,068	3.07%
Securities sold under agreements to repurchase	2,521	11	0.43%	9,317	267	2.87%
Long-term debt	66,857	3,824	5.72%	66,857	4,270	6.39%
Other borrowings	69	2	3.03%	615	(92)	-14.97%
Total interest-bearing liabilities(2)	2,522,767	54,569	2.16%	2,776,163	79,869	2.88%
Other noninterest-bearing liabilities	268,683			239,842		
Total liabilities	2,791,450			3,016,005		
Shareholders equity	89,267			160,145		
Total liabilities and shareholders equity	$ 2,880,717			$ 3,176,150		
Net interest income(4)		$ 39,329			$ 31,868	

Net interest spread	1.39%	0.78%
Impact of noninterest-bearing sources	0.10%	0.26%
Net interest margin	1.49%	1.04%

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

(2) Average interest-earning assets and interest-bearing liabilities were computed using daily average balances.

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(3) Includes loans balances that have been foreclosed and are now reclassified to other real estate owned.

(4) Includes taxable-equivalent adjustments primarily related to tax-exempt income on certain loans and securities of $295,000 and $366,000 for the years ended 2010 and 2009, respectively. The federal statutory tax rate was 35% for the periods presented.

We have not included interest income from nonaccrual loans in interest income. The additional interest income that would have been recorded during the period if the loans had been accruing was $10.1 million and $15.1 million for the years ended December 31, 2010 and 2009, respectively.

Rate and Volume Analysis

The following table presents the extent to which changes in interest rates and changes in the volume of our interest-earning assets and interest-bearing liabilities have affected our interest income and interest expense, excluding interest income from nonaccrual loans. Information is provided in each category with respect to: (1) changes attributable to changes in volume (changes in volume multiplied by prior rate), (2) changes attributable to changes in rate (changes in rate multiplied by prior volume), (3) changes attributable to changes in rate and volume (change in rate multiplied by change in volume), which were allocated in proportion to the percentage change in average volume and average rate and included in the relevant column and (4) the net change.

	2010 vs. 2009 Increase (Decrease) Due to		
(in thousands)	**Rate**	**Volume**	**Total Change**
Assets:			
Interest-earning assets:			
Cash & cash equivalents	$ 113	$ (159)	$ (46)
Investment securities	2,294	1,159	3,455
Loans held for sale	(1,579)	195	(1,384)
Total loans held for investment	(1,213)	(18,651)	(19,864)
Total interest-earning assets	(385)	(17,454)	(17,839)
Liabilities:			
Deposits:			
Interest-bearing demand accounts	(696)	124	(573)
Savings accounts	(1,356)	(1,066)	(2,421)
Money market accounts	(1,518)	976	(542)
Certificate accounts	(12,652)	885	(11,767)
Deposits	(16,222)	919	(15,303)
Fed discount borrowings		(3)	(3)
FHLB advances	(102)	(9,285)	(9,387)
Securities sold under agreements to repurchase	(138)	(118)	(256)
Long-term debt	(446)		(446)
Other borrowings	54	40	94
Total interest-bearing liabilities	(16,854)	(8,447)	(25,301)
Total changes in net interest income	$ 16,469	$ (9,007)	$ 7,462

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Net Interest Income

Our profitability depends partially on net interest income, which is the difference between income earned on our interest-earning assets, primarily loans and investment securities and the rate paid on interest-bearing liabilities. Our interest-bearing liabilities consist primarily of deposits and borrowed funds, including our outstanding trust preferred securities, interest paid on our recently retired senior credit facility and advances from the FHLB.

Net interest income on a tax equivalent basis for the year ended December 31, 2010, was $39.3 million, an increase of $7.5 million, or 23.4%, compared with $31.9 million for 2009. The net interest margin for the year ended December 31, 2010 was 1.49% compared to 1.04% for 2009. Our balance sheet restructuring activities during 2010 included a shift away from high-cost noncore high balance retail certificates of deposit, brokered certificates of deposit and FHLB borrowings toward more stable, lower-cost consumer- and business-based local deposits, resulting in an increase to our net interest income. This trend was partially offset by decreases in our loans held for investment balances which reduced our net interest income. At the same time we have begun to establish floors, or minimum interest rates, on our variable-rate loans upon extension, renewal or restructuring. As we continue to restructure our balance sheet focusing on improving interest margins, we expect a significant improvement in net interest income and net interest margin.

We experienced a significant change in the components of net interest income from 2009 to 2010. Total interest income, on a tax equivalent basis, decreased $17.8 million, or 16.0%, in 2010 to $93.9 million. Our average balances of outstanding loans held for investment declined by $439.2 million, which had the effect of lowering our interest income by $18.7 million and decreasing the related yield on the loans held for investment portfolio. As a result, our net interest income decreased by $1.2 million. Declines in the yield on loans held for sale balances, resulting from decreased interest rates, also decreased net interest income by $1.6 million in 2010. Partially offsetting these declines was an increase in yield and average balances of investment securities available for sale, increasing net interest income by $2.3 million and $1.2 million, respectively. The increase in the yield of investment securities reflects a shift from shorter- to longer-term instruments as part of our balance sheet restructuring activities. We expect this shift to continue to benefit net interest income over future periods.

At the same time, total interest expense decreased $25.3 million or 31.7% to $54.6 million during 2010, from $79.9 million during 2009, primarily due to a $12.7 million decline interest paid on certificate accounts resulting from a general decline in interest rates and a change in our pricing strategy. During 2010, we allowed higher cost noncore and brokered certificate accounts to mature without renewal. Also driving the decline in interest expense was the maturity and prepayment of $512.0 million of FHLB balances, which generally carry a higher cost than other funding sources such as consumer deposits, resulting in a decrease of $9.3 million in interest expense during 2010. As we continue to emphasize consumer deposits over higher cost brokered or wholesale funding sources, we also expect this shift to benefit net interest income over future periods.

Provision for Loan Losses

Our loan loss provision expense for 2010 was $37.3 million, compared with $153.5 million for 2009, a decline of $116.2 million, or 75.7%. This decline resulted primarily from reductions in classified and nonperforming assets and related reductions in loan charge offs. This improvement reflects an improvement in our overall asset quality in 2010 as we began to experience what we believe was the bottom of the economic cycle in late 2009 and early 2010. We expect to continue recognizing higher than normal provisions for loan losses in the near term as we continue to work through our remaining problem loans; however, in the absence of further economic turmoil, we do not expect a return to the levels of loan loss provisions experienced in recent years. The provision for loan losses is discussed in greater detail below in Credit Risk Management.

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Noninterest Income

Noninterest income was $96.9 million for the year ended December 31, 2010, an increase of $37.7 million, or 63.7%, from $59.2 million in 2009. Our noninterest income is heavily dependent upon our single family mortgage banking activities. The level of our mortgage banking activity fluctuates and is influenced by mortgage interest rates, the economy, employment and housing affordability, among other factors. Noninterest income in 2010 benefited from growth in our portfolio of loans serviced for others as well as an improved hedging strategy for single family mortgage servicing rights enabled by our change in accounting to carry single family mortgage servicing assets at fair value, as of January 1, 2010. See Critical Accounting Policies and Estimates Mortgage Servicing Rights. Our mortgage banking origination volumes decreased in 2010 as compared with 2009; however, our revenues per loan increased during the same period. While mortgage origination volume decreased from 2009, our origination volume continued to be high in comparison to historic levels as a result of a sustained period of historically low interest rates in 2010 and a one-time federal tax credit to first time home buyers. In addition, our revenues per loan increased as a result of continued higher profit margins available in the market place due to a continued contraction in competition resulting from the economic downturn and increased regulation. Revenues per loan also increased due to somewhat higher purchase volumes as a percentage of overall loan origination because purchase loans have a higher value of retained servicing.

Noninterest income consisted of the following:

(in thousands)	Year ended December 31, 2010	Year ended December 31, 2009	Dollar Change 2010 vs. 2009
Noninterest income			
Net gains on mortgage loan origination and sales activities	$ 57,127	$ 52,831	$ 4,296
Mortgage servicing	26,226	(4,495)	30,721
Income from Windermere Mortgage Services	2,162	4,663	(2,501)
Depositor and other retail banking fees	3,397	3,352	45
Insurance commissions	1,164	792	372
Gain on sale of investment securities available for sale	6,016	237	5,779
Other	839	1,850	(1,011)
Total noninterest income	$ 96,931	$ 59,230	$ 37,701

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

Net gains on mortgage loan origination and sales activities were $57.1 million in 2010, an increase of $4.3 million, or 8.1%, from $52.8 million in 2009, and primarily reflects the impact of a change in accounting to carry loans held for sale at fair value and an increase in the profit margin on loans sold offset by a decrease in loan origination and sales volume.

As of January 1, 2010, management elected to carry single family loans held for sale at fair value. Using this methodology, $8.3 million of 2010 origination costs that otherwise would have been deferred and recognized as a reduction to net gain on loan origination and sales activities was instead recognized as noninterest expense. Had 2009 been recorded under the fair value method, thereby excluding these origination costs, net gain on loan origination and sales activities would have been $63.6 million, or $10.7 million higher than reported, which reflects a decrease of $6.4 million between 2009 and 2010 principally associated with a reduction in single family loan origination volume.

On this comparable basis, net gains on mortgage loan origination and sales activities for single family loans decreased to $55.3 million in 2010, from $62.4 million in 2009. This $7.1 million decline was the net result of two factors: volume and rate. A decrease in volume, to $1.88 billion for 2010 compared to $2.55 billion in 2009,

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was partly offset by higher revenue per loan sold during 2010. The drop in loan sales volumes contributed $16.5 million to the year-over-year decrease in revenue while a partially offsetting increase of $9.4 million was due to an improvement in our net revenue per loan sold. The rate for 2010 was 295 basis points while the comparable rate for 2009 was 245 basis points.

Net gains on mortgage loan origination and sales activities of Fannie Mae Delegated Underwriting and Servicing Program, or DUS, loans was $1.1 million in 2010, down from $1.2 million in 2009. This decrease was primarily due to reduced loan volumes, which were $43.4 million in 2010, down 12.7% from $50.0 million in 2009.

Mortgage servicing income consisted of the following:

	Year Ended December 31,						Dollar Change 2010 vs. 2009
	2010			2009			
(in thousands)	Single family	Multifamily	Total	Single family	Multifamily	Total	Total
Servicing fees and other	$ 20,112	$ 3,167	$ 23,279	$ 15,612	$ 3,477	$ 19,089	$ 4,190
Changes in fair value, single family mortgage servicing rights:							
Due to changes in model or assumptions(1)	(7,594)	n/a	(7,594)	n/a	n/a		(7,594)
Due to payments on loan balances and other(2)	(13,513)	n/a	(13,513)	n/a	n/a		(13,513)
Amortization	n/a	(1,370)	(1,370)	(17,576)	(1,302)	(18,878)	17,508
Recovery/(impairment)(3)	n/a			1,335		1,335	(1,335)
Net gain (loss) from derivatives economically hedging MSRs	25,424		25,424	(6,041)		(6,041)	31,465
Total Mortgage servicing	$ 24,429	$ 1,797	$ 26,226	$ (6,670)	$ 2,175	$ (4,495)	$ 30,721

(1) Principally reflects changes in discount rates and prepayment speed assumptions, mostly due to changes in interest rates.

(2) Represents changes due to collection and realization of expected cash flows and curtailments over time.

(3) Represents adjustments to the carrying value of MSRs due to temporary (impairment) or recovery in accordance with the lower of amortized cost or fair value methodology.

For the year ended December 31, 2010, mortgage servicing income was $26.2 million, an increase of $30.7 million from a loss of $4.5 million in 2009. During 2010, mortgage servicing income benefited from our election as of January 1, 2010 to value single family mortgage servicing rights, or MSRs, at fair value. As a result of this change, we recognized a $6.5 million increase to carrying value and a corresponding increase in the 2010 beginning shareholders equity. Recording single family MSRs at fair value allows for all changes in value to be fully realized in the period of change, whereas the prior accounting method (lower of amortized cost or fair value) limited upward changes in value to a maximum of amortized cost. This change in valuation methodology allowed us to more closely align offsetting changes in value between single family MSRs and hedging derivatives resulting in more effective hedging results.

During 2009 and 2010 we experienced significant volatility in MSR values because of a significant increase in loan payoffs due to a low interest rate environment followed by an increased rate environment near each year end. To mitigate the impact of changes in the fair value of our single family MSRs, we use a variety of derivative financial instruments as economic hedges, including positions in futures, options on treasury securities, forward sales commitments on mortgage-backed securities and interest rate swap contracts. In 2010 the net change in the fair value of single family MSRs and related hedging instruments was a gain of $4.3 million as compared to a loss of $22.3 million in 2009.

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The loans serviced for others portfolio increased to $7.18 billion at December 31, 2010, as compared with $6.70 billion as of December 31, 2009. Substantially all of our new loan originations are designated as held for sale, much of which are sold with servicing retained. Also contributing to the increase in servicing fees was a shift in the composition of loans sold with servicing retained. Ginnie Mae conforming loans generally benefit from a higher servicing fee. During 2008, 2009 and 2010 13.0%, 18.4% and 20.9%, respectively, of loans sold with servicing retained conformed to Ginnie Mae guidelines thereby increasing the average servicing fee per loan sold, from 29 basis points during 2008 to 30 basis points during 2009 and 33 basis points during 2010.

Income from Windermere Mortgage Services was $2.2 million, a decrease of $2.5 million, or 53.6%, from $4.7 million in 2009. This decrease was primarily due to a 24.9% decrease in loans originated by our WMS joint venture. Loan origination fee income also decreased due to the decrease in loan volume, from 83 basis points for 2009 to 58 basis points for 2010.

Depositor and other retail banking fees were $3.4 million, a slight increase from 2009. The following table presents the composition of depositor and other retail banking fees for the periods indicated.

(in thousands)	Year Ended December 31, 2010	2009	Dollar Change 2010 vs. 2009
Fees:			
Monthly maintenance and deposit related fees	$ 1,978	$ 2,184	$ (206)
Debit Card/ATM fees	1,217	957	260
Other fees	202	211	(9)
Total depositor and related fees	$ 3,397	$ 3,352	$ 45

Insurance commissions income was $1.2 million in 2010 and $0.8 million in 2009. These commissions increased as a result of increased annuity sales resulting from increased licensing of Bank personnel.

Gain on sale of investment securities available for sale was $6.0 million, as compared to $237,000 in 2009. This increase was predominantly due to the sale of $693.5 million of investment securities at a gain of $5.7 million during 2010, as compared with sales of $93.2 million in 2009. These securities sales were part of our balance sheet restructuring activities during 2010. Balance sheet restructuring is discussed in greater detail in Liquidity Risk and Capital Resources HomeStreet Bank below.

Other income was $0.8 million in 2010, down from $1.9 million in 2009. 2009 income included gains on interest rate swaps not repeated in 2010.

Noninterest Expense

Noninterest expense was $132.2 million in 2010, an increase of $37.8 million or 40.0% from $94.5 million in 2009. Noninterest expense increased primarily due to an increase in other real estate owned (OREO) expenses as a result of higher levels of OREO balances and increases in OREO valuation reserves as well as increases in salaries and related costs, general and administrative expenses and FHLB prepayment penalties. These increases were partially offset by decreases in consulting expenses and a FHLB debt extension fee paid in 2009.

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Noninterest expense consisted of the following:

(in thousands)	Year ended December 31, 2010	2009	Dollar Change 2010 vs. 2009
Noninterest expense			
Salaries and related costs	$ 49,816	$ 39,926	$ 9,890
General and administrative	18,213	12,772	5,441
Federal Home Loan Bank prepayment penalty	5,458		5,458
Legal	3,573	3,353	220
Consulting	2,761	5,163	(2,402)
Federal Deposit Insurance Corporation assessments	7,618	8,757	(1,139)
Occupancy	7,356	6,486	870
Information services	5,223	5,503	(280)
Other real estate owned	32,197	10,479	21,718
Federal Home Loan Bank debt extension fee		2,009	(2,009)
Total noninterest expense	$ 132,215	$ 94,448	$ 37,767

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

Salaries and related costs were $49.8 million in 2010, an increase of $9.9 million or 24.8%, from $39.9 million in 2009. Salaries and related costs for 2010 include $8.3 million of direct origination costs that prior to 2010 would have been deferred and recognized as a decrease to net gain on loan origination/sales activities. Upon management s election to carry single family loans held for sale at fair value, as of January 1, 2010, these costs are no longer deferred and are expensed as incurred. Had 2009 reflected fair value accounting for loans held for sale, salaries and related costs and total noninterest expense would have been $50.7 million and $105.2 million, respectively. After consideration of the foregoing, the remaining decrease in salaries and related costs was due to reduced commissions on lower single family loan production and staff reductions offset by increased health insurance costs.

General and administrative expense was $18.2 million in 2010, an increase of $5.4 million, or 42.6%, from $12.8 million in 2009. This increase was primarily due to increases in collection and foreclosure expenses. Additionally general and administrative expenses in 2009 included a credit of $1.9 million from a refund of prior year business and occupancy tax.

FHLB prepayment penalty was $5.5 million in 2010 as compared with $0 in 2009. The Company pre-paid $390.7 million of FHLB advances in 2010, incurring a prepayment penalty of $5.5 million, as part of our balance sheet restructuring activities during 2010.

Legal expense was $3.6 million in 2010, an increase of $0.2 million, or 6.6%, from $3.4 million in 2009. This increase was primarily due to our efforts to resolve problem loans and other real estate owned.

Consulting expense was $2.8 million in 2010, a decrease of $2.4 million, or 46.5%, from $5.2 million in 2009. This decrease was primarily due to higher expenses related to our unsuccessful capital raising efforts in 2009.

FDIC Assessments were $7.6 million in 2010, a decrease of $1.1 million or 13.0% from $8.8 million in 2009, predominantly due to a one-time special assessment fee of $1.5 million during 2009, partially offset by an increase in the FDIC fee rate for 2010.

Occupancy expense was $7.4 million in 2010, an increase of $0.9 million, or 13.4%, from $6.5 million in 2009 primarily due to the impacts of lease expenses associated with the Company s branches and corporate office.

Information services expense was $5.2 million in 2010, a decrease of $0.3 million or 5.1% from $5.5 million in 2009. This decrease was primarily due to a decrease in maintenance related expenses.

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Other real estate owned expense was $32.2 million in 2010, an increase of $21.7 million from $10.5 million in 2009. This increase was primarily due to higher levels of other real estate owned (OREO) balances and related increases in OREO valuation reserves, which increased by $18.6 million. This increase reflects ongoing declines in real estate values resulting from continued deterioration in the housing market, as well as an increase of $2.5 million in maintenance and operating expenses, including payment of delinquent property taxes. The remaining annual variance was due to declines in the gains on sale of OREO.

FHLB debt extension fee was $0 in 2010 as compared with $2.0 million in 2009. We paid a debt extension fee to the FHLB in 2009 to extend maturities on certain FHLB advances.

Income Tax Expense (Benefit)

Income tax expense (benefit) for the years ended December 31, 2010 and 2009 was $697,000 and $(47.0) million, respectively. Our effective tax rate was less than 2.1% and 29.9% for the same periods. As a result of the Worker, Homeownership and Business Assistance Act of 2009, we were able to carry back net operating losses incurred in 2009 to prior taxable years, which had been previously unavailable for carry back. Predominately due to this change, in 2010 and 2009 we recognized current tax benefits of $6.5 million and $41.0 million, respectively. Our effective tax rate in 2010 and 2009 varied from the Federal statutory rate due to valuation allowances established on deferred tax assets because of uncertainty as to our ability to realize these assets in the future.

In 2009 and 2010, we recorded a valuation allowance for financial statement purposes against the carrying value of our deferred tax asset, and the current carrying value of our net operating loss carryforwards on our financial statements is zero. Ordinarily, the book value of that asset would not limit our ability to offset accumulated operating losses against future income. However, the completion of this offering will result in an ownership change of HomeStreet within the meaning of Section 382 of the Internal Revenue Code of 1986, as amended. Section 382 substantially limits the ability of a corporate taxpayer to use operating loss carryforwards incurred prior to an ownership change against income earned after an ownership change. The Treasury Regulations adopted under Section 382 are complex, and the actual amount of such limitation varies depending on a variety of factors, but in our case, we expect the residual benefit of our accumulated net operating loss carryforward to be nominal immediately following the completion of this offering.

Capital Expenditures

We had no material capital expenditures in 2009 or 2010. We expect a modest increase in capital expenditures during 2011 targeted to advance strategic initiatives such as branch expansions, new retail and single family products and new methods of product distribution.

Comparison of the year ended 2009 to the year ended 2008

For the year ended December 31, 2009, we reported a net loss of $110.3 million, compared with a net gain of $8.4 million for 2008.

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Average Balances and Rates

Average balances, together with the total dollar amounts of interest income and expense, on a tax equivalent basis related to such balances and the weighted average rates, for years ended December 31, 2009 and 2008 were as follows:

	Year Ended December 31,					
	2009			2008		
(in thousands)	Average Balance	Interest	Average Yield/ Cost	Average Balance	Interest	Average Yield/ Cost
Assets:						
Interest-earning assets(1):						
Cash & cash equivalents	$ 259,665	$ 584	0.23%	$ 32,070	$ 524	1.63%
Investment securities	372,320	4,376	1.18%	119,720	5,503	4.60%
Loans held for sale	117,555	7,647	6.51%	91,123	5,190	5.70%
Loans held for investment	2,307,215	99,130	4.30%	2,519,811	156,920	6.23%
Total interest-earning assets(2)	3,056,755	111,737	3.66%	2,762,723	168,137	6.09%
Noninterest-earning assets(3)	119,395			145,232		
Total assets	$ 3,176,150			$ 2,907,955		
Liabilities and Shareholders Equity:						
Deposits:						
Interest-bearing demand accounts	$ 99,884	1,259	1.26%	$ 82,033	1,254	1.53%
Savings accounts	112,562	2,900	2.58%	31,302	631	2.02%
Money market accounts	304,832	4,515	1.48%	304,550	7,827	2.57%
Certificate accounts	1,495,693	45,679	3.05%	1,139,648	44,953	3.94%
Deposits	2,012,971	54,353	2.70%	1,557,533	54,665	3.51%
Fed discount borrowings	688	3	0.50%	86,594	1,940	2.24%
FHLB advances	685,715	21,068	3.07%	734,989	29,030	3.95%
Securities sold under agreements to repurchase	9,317	267	2.87%	24,159	672	2.78%
Long-term debt	66,857	4,270	6.39%	78,890	5,205	6.60%
Other borrowings	615	(92)	-14.97%	3,621	212	5.86%
Total interest-bearing liabilities(2)	2,776,163	79,869	2.88%	2,485,786	91,723	3.69%
Other noninterest-bearing liabilities	239,842			218,811		
Total liabilities	3,016,005			2,704,597		
Shareholders equity	160,145			203,358		
Total liabilities and shareholders equity	$ 3,176,150			$ 2,907,955		
Net interest income(4)		$ 31,868			$ 76,414	
Net interest spread			0.78%			2.40%
Impact of noninterest-bearing sources			0.26%			0.38%
Net interest margin			1.04%			2.78%

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

(2) Average interest-earning assets and interest-bearing liabilities were computed using daily average balances.

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(3) Includes loan balances that have been foreclosed and are now reclassified to other real estate owned.

(4) Includes taxable-equivalent adjustments primarily related to tax-exempt income on certain loans and securities of $366,000 and $529,000 for the years ended 2009 and 2008, respectively. The federal statutory tax rate was 35% for the periods presented.

We have not included interest income from nonaccrual loans in interest income. The additional interest income that would have been recorded during the period if the loans had been accruing was $15.1 million and $3.0 million for the years ended December 31, 2009 and 2008, respectively.

Rate and Volume Analysis

The following table presents the extent to which changes in interest rates and changes in the volume of our interest-earning assets and interest-bearing liabilities have affected our interest income and interest expense, excluding interest income from nonaccrual loans. Information is provided in each category with respect to: (1) changes attributable to changes in volume (changes in volume multiplied by prior rate), (2) changes attributable to changes in rate (changes in rate multiplied by prior volume), (3) changes attributable to changes in rate and volume (change in rate multiplied by change in volume), which were allocated in proportion to the percentage change in average volume and average rate and included in the relevant column and (4) the net change.

	2009 vs. 2008		
	Increase (Decrease) Due to		
(in thousands)	**Rate**	**Volume**	**Total Change**
Assets:			
Interest-earning assets:			
Cash & cash equivalents	$ (8)	$ 68	$ 60
Investment securities	614	(1,741)	(1,127)
Loans held for sale	808	1,649	2,457
Total loans held for investment	(45,429)	(12,361)	(57,790)
Total interest-earning assets	(44,015)	(12,385)	(56,400)
Liabilities:			
Deposits:			
Interest-bearing demand accounts	(241)	246	5
Savings accounts	220	2,049	2,269
Money market accounts	(3,319)	7	(3,312)
Certificate accounts	(11,478)	12,204	726
Deposits	(14,818)	14,506	(312)
Fed discount borrowings	(850)	(1,086)	(1,936)
FHLB advances	(6,116)	(1,846)	(7,962)
Securities sold under agreements to repurchase	20	(425)	(405)
Long-term debt	(162)	(773)	(935)
Other borrowings	(247)	(57)	(304)
Total interest-bearing liabilities	(22,173)	10,319	(11,854)
Total changes in net interest income	$ (21,842)	$ (22,704)	$ (44,546)

Net Interest Income

Net interest income on a tax equivalent basis for the year ended December 31, 2009 was $31.9 million, a decrease of $44.5 million, or 58.4%, from $76.4 million in 2008, largely reflecting a decrease in the net interest

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margin which declined from 2.78% as of December 31, 2008 to 1.04% as of December 31, 2009. The decline in net interest income is comprised of a decline in total interest income of $56.4 million, or 33.6%, which was partially offset by a decline in interest expense of $11.9 million, or 12.9%. Interest income decreased to $111.7 million for 2009, compared with $168.1 million in 2008. The reduction in interest income is primarily due to a $57.8 million decline in interest earned on loans held for investment, which is comprised of a $45.4 million decline associated with the reduction in average yield from 6.23% to 4.30%, and a $12.4 million decline in interest income associated with the decrease in our average portfolio of loans held for investment from $2.52 billion in 2008 to $2.31 billion in 2009. The decline in yield on loans held for investment reflects the significant decline in market interest rates experienced during the periods compounded by the absence of interest rate floors on a substantial amount of our loans and an increase in nonperforming loans, which increased to $374.2 million as of December 31, 2009 compared with $75.4 million as of December 31, 2008. The decline in interest expense between 2008 and 2009 primarily reflects the significant decline in market interest rates experienced during the periods and, in turn, the rates we paid on deposits and borrowings, offset by an increase in the average balance of certificate accounts, which increased from $1.14 billion in 2008 to $1.50 billion in 2009.

Provision for Loan Losses

Our loan loss provision expense for 2009 was $153.5 million, an increase of $119.1 million, or more than 100.0%, from $34.4 million in 2008 which resulted primarily from increases in classified and nonperforming assets and related increases in loan charge offs. This deterioration reflects the impact of the economic downturn on our borrowers ability to service our loans, declining collateral values and the diminished capacity of our guarantors. The provision for loan losses is discussed in greater detail below in Credit Risk Management.

Noninterest Income

Noninterest income was $59.2 million for the year ended December 31, 2009, an increase of $18.9 million, or 46.8%, from $40.3 million in 2008. The increase in noninterest income was the result of several factors. Our noninterest income is heavily dependent upon loan volumes from our mortgage banking activities. The level of mortgage banking activity fluctuates and is influenced significantly by mortgage interest rates, the health of the general economy and housing affordability among other factors. Our mortgage banking volumes, as well as revenues per loan, increased in 2009 as compared to 2008. Loan volumes increased in 2009 over 2008 due to falling and historically low interest rates on mortgage loans. Revenues per loan increased in 2009 over 2008 due to increased profit margins available in the marketplace because of a reduction in competition in the mortgage industry resulting from the economic downturn and related regulation requirements. The significant components of our noninterest income were:

(in thousands)	Year ended December 31, 2009	Year ended December 31, 2008	Dollar Change 2009 vs. 2008
Noninterest income			
Net gains on mortgage loan origination and sales activities	$ 52,831	$ 15,833	$ 36,998
Mortgage servicing	(4,495)	13,025	(17,520)
Income from Windermere Mortgage Services	4,663	2,423	2,240
Debt extinguishment		2,451	(2,451)
Federal Home Loan Bank dividend		352	(352)
Depositor and other retail banking fees	3,352	2,885	467
Insurance commissions	792	807	(15)
Gain on sale of investment securities available for sale	237	1,067	(830)
Other	1,850	1,503	347
Total noninterest income	$ 59,230	$ 40,346	$ 18,884

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Net gains on mortgage loan origination and sales activities was $52.8 million in 2009, an increase of $37.0 million, or more than 100.0%, from $15.8 million in 2008. The increase resulted from higher loan origination volumes and improved revenue per loan on single family loans originated and sold into the secondary market. Lower mortgage interest rates, government stimulus programs for first time home buyers, and reduced competition due to dislocations in the financial services industry influenced our increase in single family residential loan sales volume, which increased to $2.55 billion in 2009 from $1.45 billion in 2008.

In addition, we originated $45.2 million in multifamily residential loans and sold $49.7 million of such loans in 2009 (including some loans originated in 2008 and sold in 2009), compared to $265.6 million originated and $211.6 million sold during 2008. The decline in multifamily origination volume in 2009 was due primarily to decreases in the value of multifamily properties generally and the related decline in the number of purchases and sales of multifamily properties.

Mortgage servicing income consisted of the following:

	Year Ended December 31,						Dollar Change 2009 vs. 2008
	2009			2008			
(in thousands)	Single family	Multifamily	Total	Single family	Multifamily	Total	Total
Servicing fees and other	$ 15,612	$ 3,477	$ 19,089	$ 13,275	$ 3,635	$ 16,910	$ 2,179
Amortization	(17,576)	(1,302)	(18,878)	(7,992)	(1,282)	(9,274)	(9,604)
Recovery/(impairment)	1,335		1,335	(9,197)		(9,197)	10,532
Net gain (loss) from derivatives economically hedging MSR	(6,041)		(6,041)	14,586		14,586	(20,627)
Mortgage servicing	$ (6,670)	$ 2,175	$ (4,495)	$ 10,672	$ 2,353	$ 13,025	$ (17,520)

(1) Principally reflects changes in discount rates and prepayment speed assumptions, mostly due to changes in interest rates.

(2) Represents changes due to collection/realization of expected cash flows over time.

(3) Represents adjustments to the carrying value of multifamily MSRs due to temporary (impairment) or recovery in accordance with the lower of amortized cost or fair value methodology.

Mortgage servicing revenues, net of amortization and impairment, includes servicing fee income and related fees less amortization of mortgage servicing rights and mortgage servicing rights impairment charges or recoveries, net of hedging gains and losses. We recognized a loss of $4.5 million for 2009 for mortgage servicing, net of amortization and impairment, as compared to income of $13.0 million for 2008.

The decrease of $17.5 million in mortgage servicing income was due to a $9.6 million increase in amortization of servicing rights, which was caused by a high level of prepayments on the loans in our portfolio of loans serviced for others resulting from low mortgage rates in 2009 and a $10.1 million decrease in net servicing impairment or recovery and hedging gains and losses reflecting the volatility in the financial markets during these periods. These decreases in mortgage servicing income in 2009 were partially offset by an increase in loan servicing fees and other fees of $2.2 million as a result of growth in our average portfolio of loans serviced for others. The loans serviced for others portfolio increased to $6.70 billion at December 31, 2009 from $5.59 billion at December 31, 2008. Also contributing to the increase in servicing fees was an increase in the average servicing fee per loan which increased from 29 basis points in 2008 to 30 basis points in 2009, reflecting a shift in the composition of loans sold with servicing retained to a higher composition of Ginnie Mae conforming loans, which carry a higher servicing fee.

Income from Windermere Mortgage Services Income derived from the Bank s Windermere Mortgage Services affiliate was $4.7 million, an increase of $2.2 million, or 92.4%, in 2009 from $2.4 million in 2008. The

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improvement in income was primarily attributable to a 28.2% increase in loan origination volume between 2008 and 2009.

Debt extinguishment For 2008, we recorded a gain of $2.5 million on the early extinguishment of long-term debt. We prepaid $25.0 million of our senior notes due to USAA at a discount of 10.0% and extended the maturity of the remaining $5.0 million of senior notes from March 1, 2009, to March 1, 2011. This debt was retired for $3.0 million in the first quarter of 2011.

FHLB dividend HomeStreet received no dividend income from the FHLB in 2009. In 2008, the Company recorded $0.4 million in FHLB dividends.

Depositor and other retail banking fees was $3.4 million for 2009, an increase of $0.5 million or 16.2% from $2.9 million in 2008. This increase is a reflection of continued growth in our deposits and the related transaction fee income.

(in thousands)	Year Ended December 31, 2009	2008	Dollar Change 2009 vs. 2008
Fees:			
Monthly maintenance and deposit related fees	$ 2,184	1,868	$ 316
Debit Card/ATM fees	957	799	158
Other fees	211	218	(7)
Total depositor and related fees	$ 3,352	$ 2,885	$ 467

Insurance commissions income was $0.8 million in 2009 and 2008. Agency commissions were generally unchanged during these periods due to limited marketing efforts and market conditions.

Gain on sale of investment securities available for sale was $0.2 million in 2009, a decrease of $0.8 million, or 77.8%, from $1.1 million in 2008. The gains in 2008 were the result of repositioning securities to reduce the portfolio s risk weighting.

Other noninterest income was $1.9 million in 2009, an increase of $0.3 million, or 23.1% from $1.5 million in 2008. The increase was largely due to gains on interest rate swaps.

Noninterest Expense

Noninterest expense increased to $94.4 million in 2009, an increase of $24.3 million, or 34.5% from $70.2 million in 2008. Our levels of noninterest expense in 2009 were significantly impacted by the deterioration in our asset quality, capital, and regulatory status. The significant components of noninterest expense in 2009 and explanations of changes from 2008 are discussed below:

(in thousands)	Year ended December 31, 2009	2008	Dollar Change 2009 vs. 2008
Noninterest expense			
Salaries and related costs	$ 39,926	$ 38,784	$ 1,142
General and administrative	12,772	13,936	(1,164)
Legal	3,353	1,541	1,812
Consulting	5,163	985	4,178
Federal Deposit Insurance Corporation assessments	8,757	1,606	7,151
Occupancy	6,486	6,743	(257)
Information services	5,503	5,051	452
Other real estate owned	10,479	1,543	8,936
Federal Home Loan Bank debt extension fee	2,009		2,009

Total noninterest expense	$ 94,448	$ 70,189	$ 24,259

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Salaries and related costs was $39.9 million for 2009, an increase of $1.1 million, or 2.9%, from $38.8 million in 2008. The increases were primarily due to increased staffing needs related to credit administration functions and the increased commissions related to the high level of single family loan production. Offsetting these higher compensation expenses were the deferral of direct costs of loan production of $12.2 million for 2009 and $10.0 million for 2008. Retirement contributions decreased to $0.1 million in 2009 from $0.7 million in 2008 due to the elimination of 401(k) matching contributions in mid-2009.

General and administrative expenses was $12.8 million in 2009, a decrease of $1.2 million, or 8.4%, from $13.9 million in 2008. The decrease is primarily due to a $2.1 million decrease in business and occupation tax expense as a result of a favorable outcome from litigation with the State of Washington to exempt payment of business and occupation tax on loan servicing fees. Offsetting this decrease were increases in other general and administrative expenses.

Legal expenses was $3.4 million for 2009, an increase of $1.8 million, or more than 100.0%, from $1.5 million for 2008. These increases were primarily the result of the increased volume of problem loans and other real estate owned and management s efforts to raise capital.

Consulting expense was $5.2 million in 2009, an increase of $4.2 million, or more than 100.0%, from $1.0 million in 2008. The increase was due primarily to unsuccessful capital raising initiatives in 2009. These items reflect costs that would have been capitalized had the offering proved successful.

Federal Deposit Insurance Corporation assessments was $8.8 million for 2009, an increase of $7.2 million, or more than 100.0%, from $1.6 million in 2008. The increase was due to a one-time special assessment of $1.5 million to replenish the insurance fund as well as increases in risk premium charges due to the Bank s financial condition.

Occupancy expense was $6.5 million in 2009, a decrease of $0.3 million or 3.8% from $6.7 million in 2008. This decrease was primarily due to the completion of the amortization period for which certain tenant improvement expenses were recognized.

Information services expense was $5.5 million in 2009, an increase of $0.5 million or 8.9% from $5.1 million in 2008. This increase was primarily due to the replacement of certain hardware systems, increasing maintenance related expenses.

Other real estate owned expenses were $10.5 million for 2009, an increase of $8.9 million, or more than 100.0%, from $1.5 million for 2008. The increase of $8.9 million in 2009 was primarily related to the increase in other real estate owned balances. Specifically, OREO valuation provisions increased $8.0 million, while OREO maintenance expenses increased $2.5 million. Partly offsetting these expenses, gains on OREO sales increased $1.6 million.

FHLB debt extension fee. In 2009, the Bank paid a debt extension fee of $2.0 million to the FHLB to extend the maturities on certain FHLB advances to strengthen the Company s long-term liquidity position.

Income Tax Expense (Benefit)

Income tax expense (benefit) for the years ended December 31, 2009 and 2008 was $(47.0) million and $3.2 million, respectively. Our effective tax rate was (29.9)% and 27.5% for the same periods. As a result of the Worker, Homeownership and Business Assistance Act of 2009, we were able to carry back net operating losses incurred in 2009 to prior taxable years, which had been previously unavailable for carry back. Predominately due to this change, in 2009 we recognized current tax benefits of $41.0 million. Our effective tax rate in 2009 and

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2008 varied from the Federal statutory rate due to valuation allowances established on deferred tax assets due to uncertainty as to our ability to realize these assets in the future.

Review of Financial Condition

Total assets were $2.32 billion at September 30, 2011, $2.49 billion at December 31, 2010 and $3.21 billion at December 31, 2009. The decreases in total assets are predominately due to decreases in our portfolio of loans held for investment and our balance sheet restructuring activities during 2010. The portfolio of loans held for investment has declined as a direct result of our ongoing problem loan resolution activities. These activities have resulted in accelerated repayments, charge-offs and transfers to OREO as a result of foreclosures and deed-in-lieu agreements. We have also been an active seller of OREO properties during these periods. During the first nine months of 2011, we also sold a significant portion of our OREO, including the sale in the first quarter of 2011 of our largest OREO property, known as the Cascadia project, which we sold for $49.1 million. To ensure our ability to fund unexpected deposit outflows and to provide confidence to our deposit customers and regulators, in 2008 and 2009 we increased our on-balance sheet liquidity through increased FHLB borrowings and brokered deposits. We invested some of these funds in highly liquid, short duration government securities and we increased our cash position. While this strategy was effective for liquidity risk management purposes, this high level of liquidity adversely affected our net interest income and margin. During 2010, with the stabilization of the Company and changing depositors attitudes toward the risk of deposits in troubled banks, we began reducing on-balance sheet liquidity. We do not anticipate reducing on-balance sheet liquidity to normalized levels until the Orders are lifted or replaced and our overall risk profile returns to normal.

Cash and Cash Equivalents totaled $138.4 million as of September 30, 2011, compared with $72.6 million as of December 31, 2010 and $217.1 million as of December 31, 2009. The increase during the first nine months of 2011 reflects the continued reduction of troubled assets.

Investment Securities Available for Sale totaled $339.5 million as of September 30, 2011, compared with $313.5 million at December 31, 2010, and $657.8 million as of December 31, 2009. The increase during the first nine months of 2011 is largely due to our investment in longer duration and higher yielding investment securities during the third quarter of 2011. These balances remained relatively constant during the latter half of 2010 and the first half of 2011. The decrease in the securities portfolio during 2010 is a result of our decision to maintain lower on-balance sheet liquidity.

We primarily hold investment securities for liquidity purposes, while providing a relatively stable source of interest income. Substantially all securities held are designated as available for sale. We hold two securities having a face amount and a fair value of approximately $200,000, which are designated as held-to-maturity.

We carry our available-for-sale securities at fair value. The following table sets forth certain information regarding the amortized cost and fair values of our investment securities available for sale for the periods indicated.

	At September 30,		At December 31,					
	2011		2010		2009		2008	
(in thousands)	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Available for sale:								
Mortgage-backed								
FNMA	$	$	$ 1,519	$ 1,585	$ 2,151	$ 2,218	$ 3,171	$ 3,148
GNMA	7,989	8,393	2,915	3,112	3,863	3,984	5,235	5,258
U.S. Government sponsored enterprises							10,227	10,284
Municipal bonds(1)	1,186	1,059	6,648	6,549	8,650	8,535	16,249	15,862
Collateralized mortgage obligations	257,182	262,030	229,415	221,921	157,971	155,900	21,798	21,785
Corporate Debt(2)					20,039	20,196		
US Treasury	68,018	67,971	80,384	80,346	467,017	467,007		
Total available for sale	$ 334,375	$ 339,453	$ 320,881	$ 313,513	$ 659,691	$ 657,840	$ 56,680	$ 56,337

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(1) Comprised of general obligation bonds (i.e., backed by the general credit of the issuer) and revenue bonds (i.e., backed by revenues from the specific project being financed) issued by various municipal corporations. As of September 30, 2011 no bonds were rated below A .

(2) As of September 30, 2011, the corporate debt securities portfolio consisted of debt securities issued under the Temporary Liquidity Guarantee Program, or TLGP.

The following tables present the fair value of investment securities available for sale by contractual maturity along with the associated contractual yield, at September 30, 2011 and December 31, 2010. Contractual maturities for mortgage backed securities and collateralized mortgage obligations were determined assuming no prepayments. Remaining expected maturities will differ from contractual maturities as borrowers may have the right to prepay obligations before the underlying mortgages mature. The weighted average yield is computed using the contractual coupon of each security weighted based on the fair value of each security and does not include adjustments to a tax equivalent basis.

	September 30, 2011									
	Within one year		After one year through five years		After five years through ten years		After ten years		Total	
(in thousands)	Fair Value	Weighted Average Yield	Fair Value	Weighted Average Yield	Fair Value	Weighted Average Yield	Fair Value	Weighted Average Yield	Fair Value	Weighted Average Yield
Available for sale:										
Mortgage-backed	$		$		$		$ 8,393	1.98%	$ 8,393	1.98%
Municipal bonds							1,059	4.13%	1,059	4.13%
Collateralized mortgage obligations							262,030	2.50%	262,030	2.50%
US Treasury	30,070	0.26%	37,901	0.25%					67,971	0.26%
Total available for sale	$ 30,070	0.26%	$ 37,901	0.25%	$		$ 271,482	2.49%	$ 339,453	2.04%

	At December 31, 2010									
	Within one year		After one year through five years		After five years through ten years		After ten years		Total	
(in thousands)	Fair Value	Weighted Average Yield	Fair Value	Weighted Average Yield	Fair Value	Weighted Average Yield	Fair Value	Weighted Average Yield	Fair Value	Weighted Average Yield
Available for sale:										
Mortgage-backed	$		$		$		$ 4,697	4.51%	$ 4,697	4.51%
Municipal bonds	930	3.66%	1,271	3.64%	503	3.60%	3,845	4.12%	6,549	3.92%
Collateralized mortgage obligations			1,556	4.77%		0.00%	220,365	3.16%	221,921	3.17%
US Treasury	80,346	0.25%							80,346	0.25%
Total available for sale	$ 81,276	0.29%	$ 2,827	4.26%	$ 503	3.60%	$ 228,907	3.20%	$ 313,513	2.46%

Each of the mortgage-backed securities and the collateralized mortgage obligations in our investment portfolio are insured or guaranteed by Fannie Mae, Ginnie Mae or Freddie Mac. Investments in these instruments involve a risk that actual prepayments will vary from the estimated prepayments over the life of the security. This may require adjustments to the amortization of premium or accretion of discount relating to such instruments,

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thereby changing the net yield on such securities. At September 30, 2011 and December 31, 2010, the aggregate net premium associated with our MBS portfolio was $0.07 million and $0.04 million, or 0.9% and 0.9% of the aggregate unpaid principal balance of our MBS, respectively. The aggregate net premium associated with our collateralized mortgage portfolio as of September 30, 2011 and December 31, 2010 was $1.0 million and $680,000, or 0.4% and 0.3% of the aggregate unpaid principal balance, respectively. There is also reinvestment risk associated with the cash flows from such securities and the market value of such securities may be adversely affected by changes in interest rates.

Management monitors the portfolio of securities classified as available for sale for impairment, which may result from credit deterioration of the issuer, changes in market interest rates relative to the rate of the instrument or changes in prepayment speeds. We evaluate each investment security at least once a quarter to assess if impairment is considered other than temporary. In conducting this evaluation, management considers many factors, including but not limited to whether we expect to recover the entire amortized cost basis of the security in light of adverse changes in expected future cash flows, the length of time the security has been impaired and the severity of the unrealized loss. We also consider whether we intend to sell the security (or whether we will be required to sell the security) prior to recovery of its amortized cost basis, which may be at maturity.

Based on this evaluation, management concluded that unrealized losses as of September 30, 2011 and December 31, 2010 were the result of changes in interest rates. Management does not intend to sell such securities nor is it likely it will be required to sell such securities prior to recovery of the security s amortized cost basis. Accordingly, none of the unrealized losses as of September 30, 2011 and December 31, 2010 were considered other than temporary.

Loans Held for Sale totaled $226.6 million as of September 30, 2011, compared with $212.6 million as of December 31, 2010 and $57.0 million at December 31, 2009. Loans held for sale includes single family and multifamily residential loans that are intended for sale, typically within 30 days of closing the loan. The slight increase in loans held for sale is primarily due to the timing in which loans are settled. The increase during 2010 is primarily due to higher sales of loans near the end of 2009, which served to increase cash balances and decrease the balance of loans held for sale as of December 31, 2009. Substantially all loan originations during the first three quarters of 2011 and for the year ended 2010 were designated for sale.

Loans Held for Investment, net totaled $1.36 billion as of September 30, 2011, compared with $1.54 billion as of December 31, 2010 and $1.96 billion at December 31, 2009. Our loans held for investment continue to decline as we resolve problem loans through payoff, pay-down, charge off or default and foreclosure on collateral. During the first three quarters of 2011, transfers from loans held for investment to OREO as a result of foreclosures totaled $35.8 million, net of charge-offs of $20.9 million. For the full year 2010, loans held for investment balances decreased $426.5 million, or 21.7%. This decrease is primarily a result of transfers of $182.7 million to OREO along with charge-offs and repayment of loans. We generally stopped all new loan origination for investment in 2008 to enable the Company to focus on problem loan resolution and to decrease total assets to aid in the maintenance of regulatory capital ratios.

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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 as of the periods indicated:

	At September 30, 2011		At December 31, 2010		2009		2008		2007		2006	
(in thousands)	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
Single family	$ 496,741	35.0%	$ 526,462	32.8%	$ 590,695	28.4%	$ 568,974	22.9%	$ 493,483	20.0%	$ 406,298	19.3%
Commercial real estate(1)	407,891	28.8%	426,879	26.5%	449,373	21.6%	469,527	18.9%	348,721	14.1%	306,163	14.6%
Multifamily residential	58,972	4.2%	104,497	6.5%	85,522	4.3%	94,857	3.9%	117,173	4.8%	93,191	4.5%
Construction/land development	213,001	15.0%	285,131	17.7%	631,525	30.3%	959,309	38.4%	1,135,170	45.9%	984,453	46.8%
Commercial business	73,559	5.2%	82,959	5.2%	109,322	5.3%	150,924	6.1%	134,339	5.4%	88,388	4.2%
Home equity	167,453	11.8%	181,537	11.3%	209,944	10.1%	243,909	9.8%	242,499	9.8%	223,134	10.6%
Total loans held for investment	$ 1,417,617	100.0%	$ 1,607,465	100.0%	$ 2,076,381	100.0%	$ 2,487,500	100.0%	$ 2,471,385	100.0%	$ 2,101,627	100.0%
Less:												
Allowance for loan losses	$ 53,167		$ 64,177		$ 109,472		$ 58,587		$ 38,804		$ 27,834	
Net deferred loan fees and discounts	4,231		4,767		1,915		3,026		4,367		6,546	
Total loans held for investment, net	$ 1,360,219		$ 1,538,521		$ 1,964,994		$ 2,425,887		$ 2,428,214		$ 2,067,247	

(1) September 30, 2011 and December 31, 2010 balances comprised of $110.6 million and $133.7 million of owner occupied loans, respectively, and $297.3 million and $293.2 million of non-owner occupied loans, respectively.

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The following tables show the composition of the loan portfolio by fixed-rate and adjustable-rate loans at the dates indicated and the repricing characteristics as of the following periods.

	At September 30, 2011		At December 31, 2010		2009		2008	
(in thousands)	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
FIXED-RATE LOANS								
Single family	$ 199,697	14.1%	$ 195,618	12.1%	$ 189,998	9.2%	$ 150,332	6.0%
Commercial	158,544	11.2%	181,372	11.3%	207,255	10.0%	221,398	8.9%
Commercial business	43,587	3.1%	58,767	3.7%	74,869	3.5%	89,447	3.6%
Home Equity	62,913	4.4%	69,586	4.3%	84,103	4.1%	109,566	4.4%
Total fixed-rate loans	464,741	32.8%	505,343	31.4%	556,225	26.8%	570,743	22.9%
ADJUSTABLE-RATE LOANS								
Single family	297,044	21.0%	330,844	20.6%	400,697	19.3%	418,641	16.8%
Commercial	249,347	17.6%	245,507	15.3%	242,118	11.7%	248,129	10.0%
Multifamily residential	58,972	4.2%	104,497	6.5%	85,522	4.1%	94,857	3.8%
Construction/land development, net (1)	213,001	15.0%	285,131	17.7%	631,525	30.4%	959,309	38.6%
Commercial business	29,972	2.0%	24,192	1.5%	34,453	1.6%	61,478	2.5%
Home Equity	104,540	7.4%	111,951	7.0%	125,841	6.1%	134,343	5.4%
Total adjustable-rate loans	952,876	67.2%	1,102,122	68.6%	1,520,156	73.2%	1,916,757	77.1%
Total loans	$ 1,417,617	100.0%	$ 1,607,465	100.0%	$ 2,076,381	100.0%	$ 2,487,500	100.0%
Less:								
Deferred loan fees	$ (4,231)		$ (4,767)		$ (1,915)		$ (3,026)	
Allowance for loan losses	(53,167)		(64,177)		(109,472)		(58,587)	
Loans receivable, net	$ 1,360,219		$ 1,538,521		$ 1,964,994		$ 2,425,887	

(1) Construction/land development is presented net of the undisbursed portion of the loan commitment.

	December 31, 2010	
(in thousands)	Balance	Percent of Gross Loans
Repricing Characteristic		
Adjustable Rates		
LIBOR	$ 677,163	42%
Prime Rate	216,956	13%
FHLB	135,790	8%
Treasury	73,056	5%
Total Adjustable	1,102,965	69%
Fixed Rates	504,500	31%
Total Gross Loans	$ 1,607,465	100%

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The following table shows the contractual maturity of our loan portfolio by loan type at December 31, 2010:

	At December 31, 2010				Loans Over One Year by Rate Sensitivity	
(in thousands)	One Year or Less	One Through Five Years	Over Five Years	Total	Fixed Rate	Floating Rate
Single family residential	$ 1,478	$ 997	$ 523,987	$ 526,462	$ 196,732	$ 328,252
Commercial real estate	75,476	138,247	213,156	426,879	133,974	217,429
Multifamily residential	36,352	59,283	8,862	104,497	8,477	59,668
Construction/land development	214,462	70,669		285,131	2,024	68,645
Commercial business	20,019	40,194	22,746	82,959	59,390	3,550
Home Equity	68	566	180,903	181,537	68,967	112,502
Total loans held for investment	$ 347,855	$ 309,956	$ 949,654	$ 1,607,465	$ 469,564	$ 790,046

The following table presents the loan portfolio by loan type and region as of September 30, 2011:

	Washington						Idaho
	Puget Sound						
(in thousands)	King(1)	Snohomish(2)	Pierce(1)	Thurston(1)	Vancouver(2)(3)	Spokane(2)	Boise(2)
Single family	$ 164,491	$ 83,447	$ 53,715	$ 15,280	$ 37,659	$ 27,501	$ 7,044
Commercial real estate	167,766	85,332	30,325		29,246	4,383	757
Multifamily residential	12,258	2,528	7,168			9,821	984
Construction/land development	75,034	10,851	42,408	33,381	9,085	11,278	2,241
Commercial business	56,748	5,515	4,022		1,447	255	
Home Equity	68,635	22,050	14,050	4,645	15,953	3,360	147
Total loans	$ 544,932	$ 209,723	$ 151,688	$ 53,306	$ 93,390	$ 56,598	$ 11,173

	Oregon						
(in thousands)	Portland(2)	Bend(2)	Eugene(2)	Salem(2)	Hawaii	Other(4)	Total
Single family	$ 51,928	$ 6,130	$ 1,612	$ 19,373	$ 28,561	$	$ 496,741
Commercial real estate	61,600	759	4,774	14,332	689	7,928	407,891
Multifamily residential	23,299	2,914					58,972
Construction/land development	12,395	2,433	10,077	3,061	757		213,001
Commercial business	5,536				36		73,559
Home Equity	18,138	240	484	8,412	11,339		167,453
Total loans	$ 172,896	$ 12,476	$ 16,947	$ 45,178	$ 41,382	$ 7,928	$ 1,417,617

(1) Refers to a specific county.

(2) Refers to a specific city.

(3) Also includes surrounding counties

(4) Includes Alaska, Florida in commercial real estate and WCRA participation pool of loans in multifamily residential.

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The following table presents the loan portfolio by loan type and region as of December 31, 2010:

	Washington						Idaho
	Puget Sound						
(in thousands)	King(1)	Snohomish(2)	Pierce(1)	Thurston(1)	Vancouver(2)(3)	Spokane(2)	Boise(2)
Single family	$ 180,385	$ 86,099	$ 54,614	$ 14,631	$ 40,991	$ 29,383	$ 7,519
Commercial real estate	186,036	84,494	25,136		33,417	4,456	769
Multifamily residential	58,387	2,456	6,830	508	1,080	9,358	951
Construction/land development	82,159	20,028	54,373	54,966	10,471	14,111	2,678
Commercial business	61,763	7,135	4,285		2,433	556	
Home Equity	74,359	23,909	14,880	4,930	16,899	3,855	145
Total loans	$ 643,089	$ 224,121	$ 160,118	$ 75,035	$ 105,291	$ 61,719	$ 12,062

	Oregon						
(in thousands)	Portland(2)	Bend(2)	Eugene(2)	Salem(2)	Hawaii	Other(4)	Total
Single family	$ 56,333	$ 6,592	$ 1,520	$ 20,324	$ 28,071	$	$ 526,462
Commercial real estate	60,566	677	6,937	14,621	1,734	8,036	426,879
Multifamily residential	21,244	2,822				861	104,497
Construction/land development	22,462	3,053	10,540	8,983	1,307		285,131
Commercial business	6,680	64			43		82,959
Home Equity	20,237	357	483	9,266	12,217		181,537
Total loans	$ 187,522	$ 13,565	$ 19,480	$ 53,194	$ 43,372	$ 8,897	$ 1,607,465

(1) Refers to a specific county.

(2) Refers to a specific city.

(3) Also includes surrounding counties.

(4) Includes Alaska and Florida in commercial real estate and Washington Community Reinvestment Association participation pool loans in multifamily residential.

The following table presents the loan portfolio as of December 31, 2010 by loan type and year of origination:

	December 31, 2010						
(in thousands)	Prior to 2000	2000-2004	2005-2006	2007-2008	2009	2010	Total
Single family	$ 11,375	$ 45,292	$ 66,602	$ 257,118	$ 116,937	$ 29,138	$ 526,462
Commercial real estate	740	61,803	110,057	238,933	5,279	10,067	426,879
Multifamily residential		3,469	3,153	66,165		31,710	104,497
Construction/land development			86,493	173,046	15,900	9,692	285,131
Commercial business		1,885	22,405	35,559	7,581	15,529	82,959
Home equity	32	27,837	65,765	81,403	4,238	2,262	181,537
Total loans	$ 12,147	$ 140,286	$ 354,475	$ 852,224	$ 149,935	$ 98,398	$ 1,607,465

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The following table presents loan origination volume and loan sales during the periods indicated:

(in thousands)	Nine Months Ended September 30, 2011	Year Ended December 31, 2010	2009	2008
Loans Originated:				
Real estate:				
Single family:				
Originated by HomeStreet	$ 728,309	$ 1,446,850	$ 1,898,622	$ 1,089,416
Originated by Windermere Mtge Services	357,593	622,294	828,835	646,481
Single family	1,085,902	2,069,144	2,727,457	1,735,897
Multifamily residential	80,487	60,690	45,205	265,584
Commercial	3,000	26,595	13,988	131,451
Construction/land development	10,210	24,484	52,517	288,532
Total real estate	1,179,599	2,180,913	2,839,167	2,421,464
Commercial business	3,945	8,049	11,570	64,613
Home equity		240	1,153	67,258
Total loans originated by HomeStreet or mortgage affiliates	1,183,544	2,189,202	2,851,890	2,553,335
Loans sold:				
Single family	$ 1,028,514	$ 1,875,430	$ 2,547,742	$ 1,450,682
Multifamily residential	86,016	43,358	49,678	211,610
Total	$ 1,114,530	$ 1,918,788	$ 2,597,420	$ 1,662,292

Other real estate owned totaled $64.4 million as of September 30, 2011, compared with $170.5 million as of December 31, 2010 and $107.8 million as of December 31, 2009. OREO balances decreased during the first three quarters of 2011 primarily due to management s continued efforts to resolve problem assets. In the first three quarters of 2011, we completed the sale of several large properties, including the sale in the first quarter of 2011 of our largest OREO property, known as the Cascadia project, which had a book value of $48.0 million as of December 31, 2010. Sales of OREO during the first three quarters of 2011 totaled $118.4 million. During the same period, we acquired through foreclosure real estate with a fair value, less estimated costs to sell, of $35.8 million. For the year 2010, OREO balances increased $62.7 million, or 58.2%. During 2010, we acquired through foreclosure real estate with a fair value, less estimated costs to sell, of $189.0 million, and we sold $98.9 million of OREO properties. As of September 30, 2011 and December 31, 2010, 32.4% and 60.6% of OREO properties have been held less than six months.

FHLB Stock totaled $37.0 million as of September 30, 2011, December 31, 2010 and 2009, which is used to collateralize advances from the FHLB. FHLB stock is carried at par value and can only be purchased or redeemed at par value in transactions between the FHLB and its member institutions. Both cash and stock dividends received on FHLB stock are reported in earnings.

On November 6, 2009, the FHLB s regulator reaffirmed its capital classification as undercapitalized. Under the Federal Housing Finance Agency regulations, a Federal Home Loan Bank that fails to meet any regulatory capital requirement may not declare a dividend or redeem or repurchase capital stock. As such, the FHLB will not be able to redeem, repurchase or declare dividends on stock outstanding while the risk-based capital deficiency exists. Accordingly, even though our FHLB borrowings have significantly declined, there has not been a corresponding decrease in the amount of our FHLB stock.

Management periodically evaluates FHLB stock for other than temporary impairment based on its assessment of ultimate recoverability of par value, rather than recognizing temporary declines in value. The determination of whether the decline affects the ultimate recoverability is influenced by criteria such as (1) the significance of the

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decline in net assets of the FHLB as compared to the capital stock amount for the FHLB and the length of time this situation has persisted, (2) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FHLB, (3) the impact of legislative and regulatory changes on institutions and, accordingly, on the customer base of the FHLB and (4) the liquidity position of the FHLB. The FHLB continues to benefit from a superior credit rating from Standard & Poor s, which allows the FHLB to secure funding for its activities at attractive rates and terms, further supporting continued access to liquidity. Based on its evaluation, management determined there is not other-than-temporary impairment on the FHLB stock investment as of September 30, 2011, December 31, 2010 or December 31, 2009.

We may also borrow, on a collateralized basis, from the Federal Reserve Bank of San Francisco, or FRBSF. At September 30, 2011, December 31, 2010 and 2009, we did not have any outstanding borrowings from the FRBSF. Based on the amount of qualifying collateral available, borrowing capacity from the FRBSF was $160.6 million and $192.9 million at September 30, 2011 and December 31, 2010. The FRBSF is also not contractually bound to offer credit to us, and our access to this source for future borrowings may be discontinued at any time.

Deposits

Through our 20 bank branches, we offer various types of deposit accounts to consumers and businesses, including savings accounts, checking accounts, money market accounts and a variety of certificate of deposit accounts (CDs). We also offer cash management services to businesses. Deposits at September 30, 2011 were $2.06 billion compared to $2.13 billion at December 31, 2010 and $2.33 billion at December 31, 2009. For the first three quarters of 2011 deposit balances decreased $72.8 million, or 3.4%, as we continued to manage reductions in noncore retail CD balances through offering less competitive rates. These decreases were partially offset by increases in core consumer and business deposits. Similarly, for the year 2010 deposit balances decreased $202.6 million, or 8.7% as a result of our integrated consumer and business financial services delivery strategy.

Deposit balances and average rates paid were as follows for the period indicated:

	At September 30,		At December 31,					
(in thousands)	**2011**		**2010**		**2009**		**2008**	
Noninterest bearing accounts	$ 287,862	0.00%	$ 235,890	0.00%	$ 182,155	0.00%	$ 154,789	0.00%
NOW accounts	145,668	0.34%	121,534	0.52%	107,210	0.75%	92,081	1.34%
Statement savings accounts due on demand	59,974	0.49%	51,075	0.69%	88,597	2.41%	83,998	2.63%
Money market accounts due on demand	469,289	0.60%	413,401	0.75%	374,577	1.21%	265,810	1.79%
Time, under $100,000	620,178	1.60%	811,409	1.80%	1,059,921	2.80%	774,994	3.78%
Time, $100,000 to $250,000	405,867	1.76%	409,070	2.03%	441,642	2.69%	272,486	3.71%
Time, $250,000 or more	68,139	1.87%	87,363	2.03%	78,231	2.55%	267,153	2.90%
	$ 2,056,977	1.06%	$ 2,129,742	1.35%	$ 2,332,333	2.19%	$ 1,911,311	2.90%

Borrowings

We had no outstanding securities sold under repurchase agreements at September 30, 2011, December 31, 2010 and 2009 and no outstanding federal funds purchased at September 30, 2011, December 31, 2010 or 2009.

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FHLB advances totaled $67.9 million as of September 30, 2011, compared with $165.9 million as of December 31, 2010 and $677.8 million as of December 31, 2009. FHLB advances are collateralized by stock in the FHLB, pledged mortgage-backed securities and unencumbered qualifying mortgage loans. As of September 30, 2011, December 31, 2010, 2009 and 2008, FHLB borrowings had weighted average interest rates of 4.7%, 3.3%, 3.0% and 3.5%, respectively. Of the total FHLB borrowings outstanding as of December 31, 2010, $108.0 million mature prior to December 31, 2011. We had $244.8 million, $72.8 million and $1.0 million of additional borrowing capacity with the FHLB as of September 30, 2011, December 31, 2010 and 2009, respectively. Our lending agreement with the FHLB permits the FHLB to refuse to make advances under that agreement during periods in which an event of default (as defined in that agreement) is continuing. An event of default occurs when the FHLB gives notice to the Bank of an intention to take any of a list of permissible actions following the occurrence of specified events or conditions affecting the Bank. Among those events is the issuance or entry of any supervisory or consent order pertaining to the Bank, which would include the Bank Order. To date the FHLB has not declared a default under this agreement, and has not notified the Bank that future advances would not be made available, although it has required the Bank to deliver physical possession of certain negotiable instruments and related documentation as collateral for borrowings under that agreement.

Long-term debt totaled $61.9 million at September 30, 2011, compared with $66.9 million at December 31, 2010 and 2009. During the first quarter of 2011, we repurchased and retired our long-term debt arrangement with USAA for $3.0 million, a $2.0 million discount from the $5.0 million carrying value of the debt. The $2.0 million discount was recognized as noninterest income. The remaining long-term debt is $61.9 million of trust preferred securities (TruPS) issued by HomeStreet Statutory Trust, a subsidiary of HomeStreet, Inc. TruPS allow investors to buy subordinated debt through a variable interest entity trust which issues preferred securities to third-party investors and invests the cash received to purchase subordinated debt from the issuer. That debt is the sole asset of the trust and the coupon on the debt mirrors the dividend payment on the preferred securities. These securities are nonvoting and are not convertible into capital stock, and the trust is not consolidated in our financial statements.

We elected to defer the payment of interest on our outstanding TruPS that was due on December 15, 2008. Subsequent to December 31, 2008, we elected to continue the deferral of interest payments commencing on March 15, 2009. We are entitled, at our option, subject to certain conditions, to defer payments of interest up to five years under the related TruPS agreements. Under these agreements, as a consequence of electing the deferral of interest payments, we are prohibited from declaring or paying dividends or distributions on, and from making liquidation payments with respect to, our common stock until we are current on all interest payments due on the TruPS. As of September 30, 2011, December 31, 2010 and 2009, total deferred interest was $10.0 million, $8.5 million and $4.8 million, respectively.

Capital

Shareholders equity on a per share basis, calculated after giving effect to the 1-for-2.5 reverse stock split implemented on July 19, 2011, increased to $59.47 as of September 30, 2011, from $43.52 as of December 31, 2010 and $68.03 as of December 31, 2009.

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Return on Equity and Assets

The following table presents certain information regarding our returns on average equity and average total assets for the three and nine month periods ended September 30, 2011 and 2010.

	At or for the Three Months Ended September 30,		At or for the Nine Months Ended September 30,	
(in thousands)	**2011**	**2010**	**2011**	**2010**
Return on assets(1)	2.67%	(0.80)%	0.53%	(0.89)%
Return on equity(2)	83.04%	(24.73)%	19.26%	(28.73)%
Dividend payout ratio(3)				
Equity assets ratio(4)	3.22%	3.22%	2.73%	3.10%

(1) Net income divided by average total assets.

(2) Net income divided by average equity.

(3) Dividends declared per share divided by net income per share.

(4) Average equity divided by average total assets.

Business Lines

HomeStreet has four lines of business we report as operational segments: Community Banking, Single Family Lending, Income Property Lending and Residential Construction Lending. The results for these segments are based on a management accounting process that assigns income statement items to each responsible line of business. This process is dynamic and, unlike financial accounting, there is no comprehensive, authoritative guidance for management accounting equivalent to GAAP. The management accounting process measures the performance of the lines of business based on our management structure and is not necessarily comparable with similar information for other financial services companies. We define our lines of business by product type and customer segment. If the management structure or the allocation process changes, allocations, transfers and assignments may change.

We use various management accounting methodologies to assign certain balance sheet and income statements items to the responsible lines of business, including:

- a funds transfer pricing system, which allocates interest income credits and funding charges between the lines of business and our treasury division, with that division assigning to each such line of business a funding credit for its liabilities, such as deposits, and a charge to fund its assets; and

- an allocation of charges for services rendered to the lines of business by centralized functions, such as corporate overhead, which are generally based on each segment s consumption patterns.

- income taxes for the Company on a consolidated basis, which are allocated based on the effective tax rate applied to the segment s pretax income or loss.

Financial highlights by line of business were as follows:

Community Banking

We provide diversified financial products and services to our consumer and business customers, including deposit products, investment products, insurance products, cash management services and consumer and business loans. In 1986 we established our bank to fund our lending activities and to offer a broader range of products and services to our customers. In 2000, we began offering commercial business loans as well as business deposit products and cash management services. We have expanded our bank branch network to 20 branches, primarily in the historically higher growth Puget Sound area. At September 30, 2011 and December 31, 2010, our core deposits totaled $1.99 billion and $1.74 billion and our business banking loan portfolio totaled $228.2 million and $259.3 million, respectively.

(in thousands)	Nine Months Ended September 30, 2011 2011	2010	Year ended December 31, 2010	2009	2008
Net interest income	$ 23,616	$ 25,518	$ 32,316	$ 24,557	$ 22,134
Provision for loan losses	(193)	(3,431)	(3,434)	(4,685)	(4,023)
Noninterest income	3,281	3,290	4,631	4,147	3,681
Noninterest expense	(17,643)	(17,007)	(22,479)	(23,487)	(18,135)
Inter-segment expense	(5,980)	(5,278)	(7,820)	(7,651)	(5,978)
Income/(loss) before income taxes	3,081	3,092	3,214	(7,119)	(2,321)
Income tax benefit	126	91	(67)	(2,126)	(639)
Net income/(loss)	$ 2,955	$ 3,001	$ 3,281	$ (4,993)	$ (1,682)

Community banking net income was $3.0 million in the first three quarters of 2011, a decrease of $46,000 from $3.0 million in the same period of the prior year. Net income decreased primarily due to a decrease in net interest income, reflecting a decrease in consumer deposit balances for which the segment receives a funds transfer pricing credit, largely offset by a decrease in the provision for loan losses of $3.2 million reflecting an improvement in the segment s asset quality.

Community banking net income was $3.3 million in 2010, an increase of $8.3 million from a loss of $5.0 million in 2009. Net income improved primarily due to an increase in net interest income, reflecting an increase in consumer deposit balances for which the segment receives a funds transfer pricing credit as well as lower deposit costs.

Single Family Lending

We originate and sell into the secondary market residential mortgage loans both directly and through our relationship with Windermere Mortgage Services. This segment also originates and services loans for our portfolio on a selective basis including home equity loans and lines of credit. We originate mortgages using secondary market standards, and the majority are sold to or securitized by Fannie Mae, Freddie Mac or Ginnie Mae, while we retain the right to service these loans. A small percentage of the loans are brokered or sold on a servicing-released basis to correspondent lenders.

(in thousands)	Nine Months Ended September 30, 2011 2011	2010	Year ended December 31, 2010	2009	2008
Net interest income	$ 14,891	$ 13,787	$ 22,004	$ 22,365	$ 22,250
Provision for loan losses	(1,902)	(9,890)	(11,793)	(8,887)	(2,134)
Noninterest income	60,838	57,353	83,436	50,739	27,034
Noninterest expense	(28,072)	(26,531)	(40,941)	(19,463)	(20,737)
Inter-segment expense	(9,610)	(8,016)	(11,877)	(11,620)	(9,080)
Income before income taxes	36,145	26,703	40,829	33,134	17,333
Income tax (benefit) expense	1,479	783	(848)	9,895	4,772
Net income	$ 34,666	$ 25,920	$ 41,677	$ 23,239	$ 12,561

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Single family lending net income was $34.7 million in the first three quarters of 2011, an increase of $8.7 million from $25.9 million in the first three quarters of 2010. Net income increased primarily due to increases in mortgage servicing revenue as well as a decrease in the provision for loan losses, reflecting an improvement in the segment s asset quality.

Single family lending net income was $41.7 million in 2010, an increase of $18.4 million from $23.2 million in 2009. Net income increased primarily due to an increase in mortgage servicing revenue. Partially offsetting this increase was an increase in noninterest expense due to increases in other real estate owned expenses as well as an increase in foreclosure and collection expenses.

Income Property Lending

We originate commercial real estate loans with a focus on multifamily lending through our Fannie Mae DUS business. These loans are sold to or securitized by Fannie Mae, and we generally continue to service them after the sale. At September 30, 2011 and December 31, 2010, we serviced $770.4 million and $776.7 million, respectively, of loans we had originated through the Fannie Mae DUS program. We also originate commercial construction and land loans, bridge loans and permanent loans for our own portfolio.

	Nine Months Ended September 30, 2011		Year ended December 31,		
(in thousands)	**2011**	**2010**	**2010**	**2009**	**2008**
Net interest income	$ 6,261	$ 2,318	$ 6,114	$ 2,776	$ 12,463
Provision for loan losses	(431)	(2,042)	(810)	(34,275)	(2,825)
Noninterest income	4,010	1,784	2,952	3,339	5,774
Noninterest expense	(2,958)	(3,151)	(4,894)	(4,338)	(4,515)
Inter-segment expense	(2,195)	(1,679)	(2,487)	(2,434)	(1,902)
Income/(loss) before income taxes	4,687	(2,770)	875	(34,932)	8,995
Income tax (benefit) expense	192	(81)	(18)	(10,432)	2,476
Net income/(loss)	$ 4,495	$ (2,689)	$ 893	$ (24,500)	$ 6,519

Income Property net income was $4.5 million in the first three quarters of 2011, an increase of $7.2 million from a loss of $2.7 million in the first three quarters of 2010. Net income improved primarily due to a decrease in the provision for loan losses of $1.6 million as well an increase in net interest income, reflecting a decrease in nonaccrual loan balances. Noninterest income also increased, primarily due to fees associated with the origination and sale of a single income property totalling $35.0 million under our DUS program.

Income Property net income was $0.9 million in 2010, an increase of $25.4 million from a loss of $24.5 million in 2009. Net income improved primarily due to a decrease the provision for loan losses of $33.5 million.

Residential Construction Lending

We originate residential construction and land loans primarily for our own portfolio. Beginning in 2007, we substantially curtailed new originations in order to reduce our concentration in this category.

	Nine Months Ended September 30, 2011		Year ended December 31,		
(in thousands)	**2011**	**2010**	**2010**	**2009**	**2008**
Net interest income	$ 494	$ (2,999)	$ (2,386)	$ (6,279)	$ 19,169
Provision for loan losses	(774)	(13,737)	(21,263)	(105,668)	(25,429)
Noninterest income	98	6	8	12	(198)
Noninterest expense	(23,863)	(15,812)	(32,371)	(18,396)	(7,562)
Inter-segment expense	(2,214)	(1,460)	(2,163)	(2,116)	(1,654)

Loss before income taxes	(26,259)	(34,002)	(58,175)	(132,447)	(15,674)
Income tax expense (benefit)	(1,075)	(998)	1,209	(39,554)	(4,315)
Net loss	$ (25,184)	$ (33,004)	$ (59,384)	$ (92,893)	$ (11,359)

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Residential construction lending recorded a loss of $25.2 million in the first three quarters of 2011, improving results by $7.8 million from a loss of $33.0 million in the first three quarters of 2010. The net loss decreased primarily due to a decrease in the provision for loan losses, reflecting an improvement in the segment s credit quality, and an increase in net interest income due to decreases in nonaccrual loan balances. Partially offsetting these improvements are an increase in non-interest expense, reflecting an increase in OREO expenses as the first three quarters of 2010 included downward valuation adjustments on OREO properties of $9.1 million, compared with downward valuation adjustments of $19.9 million during the first three quarters of 2011.

Residential construction lending reported a loss of $59.4 million in 2010, an improvement from a loss of $92.9 million in 2009. Net income improved primarily due to a decrease in the provision for loan losses of $84.4 million.

Off-Balance Sheet Arrangements

In the normal course, we are a party to financial instruments with off-balance-sheet risk. These financial instruments (which consist of commitments to originate loans and commitments to purchase loans) include elements of credit risk in excess of the amount recognized in the accompanying consolidated financial statements as discussed below. The contractual amounts of those instruments reflect the extent of our involvement in those particular classes of financial instruments.

Commitments, Guarantees and Contingencies

We may incur liabilities under certain contractual agreements contingent upon the occurrence of certain events. Our known contingent liabilities include:

Credit agreements. We have made commitments to lend to customers in accordance with predetermined contractual provisions, some of which may not be terminated without payment of a fee. The total amount of unused commitments do not necessarily represent future credit exposure or cash requirements, in that commitments often expire without being drawn upon. The following table presents unfunded commitments to extend credit for the periods indicated:

	At September 30,	At December 31,		
	2011	2010	2009	2008
Commitments to originate loans:				
Variable-rate	$ 8,638	$ 4,953	$ 13,300	$ 10,283
Fixed-rate	329,206	132,599	149,633	321,485
Total	$ 337,844	$ 137,552	$ 162,933	$ 331,768

Commitments to originate loans increased as of September 30, 2011, as compared with December 31, 2010, as single family loan production increased. The decrease of $25.4 million between December 31, 2010 and 2009 and $168.8 million from December 31, 2008 to December 31, 2009 reflects the inability of borrowers to access or qualify for credit facilities.

Options. The Bank writes options such as interest rate lock commitments on mortgage loans that are exercisable at the option of the borrower. Interest rate lock commitment options are exercised when a borrower locks an offered interest rate for a loan application that requires closing of that loan within a specified time frame, typically within 90 days. We are exposed to market risk on interest rate lock commitments if interest rates rise between the effective date of the interest rate lock and the sale date of the loan. The fair value of interest rate lock commitments existing at September 30, 2011 and December 31, 2010, was $9.3 million and $2.3 million, respectively. We mitigate the risk of future changes in the fair value of interest rate lock commitments through the use of options and forward sale commitments.

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Leases. The Company is obligated under noncancelable leases for office space. The office leases also contain renewal and space options. Rental expense under noncancelable operating leases totaled $6.5 million, $5.4 million and $5.4 million for the years ended December 31, 2010, 2009 and 2008, respectively.

Loss sharing. We originate, sell and service multifamily loans through HomeStreet Capital, our Fannie Mae DUS multifamily (DUS) origination business. Loans are sold to Fannie Mae with limited recourse. HomeStreet Capital services the loans for Fannie Mae and shares in the risk of loss with Fannie Mae under the terms of the DUS contracts. Under the DUS program, the DUS lender is contractually responsible for the first 5% of losses and then shares in the remainder of losses with Fannie Mae with a maximum lender loss of 20% of the original principal balance of each DUS loan. The total principal balance of loans outstanding under the DUS program as of September 30, 2011 and December 31, 2010 was $770.4 million and $776.7 million, respectively, and our reserve related to our 5% first loss position and 20% maximum loss share risk was $3.7 million and $4.1 million as of September 30, 2011 and December 31, 2010, respectively.

Origination defect claims. In our single family lending business, we sell loans we originate without recourse, however, if such loans had defects in the origination process, such as documentation errors, underwriting errors and judgments, early payment default and fraud, we may be required under the terms of our loan sale agreements with investors to either repurchase the loan on default or indemnify the investor for losses sustained if the investor incurs losses in the collection or foreclosure process. We call these claims origination defect claims. As of September 30, 2011 and December 31, 2010, the total principal balance of loans sold without recourse under these terms and conditions totaled $6.71 billion and $6.40 billion. We have established a mortgage repurchase reserve of $0.8 million and $0.5 million as of September 30, 2011 and December 31, 2010, respectively, to provide for estimated future losses on origination defect claims by investors. Actual origination defect claim losses of $0.4 million, $0.4 million, $0.1 million and $0 were incurred for the first three quarters of 2011 and the years ended December 31, 2010, 2009 and 2008, respectively.

Derivative Counterparty Credit Risk

Derivative financial instruments expose us to credit risk in the event of nonperformance by counterparties to such agreements. This risk consists primarily of the termination value of agreements where we are in a favorable position. Credit risk related to derivative financial instruments is considered within the fair value measurement of the instrument. We manage the credit risk associated with our various derivative agreements through counterparty credit review, counterparty exposure limits and monitoring procedures. From time to time, we may provide or obtain collateral from certain counterparties for amounts in excess of exposure limits due to the counterparty credit policies of the parties. We have entered into agreements with derivative counterparties which include netting arrangements whereby the counterparties are entitled to settle their positions on a net basis. As a result of our weakened financial condition and regulatory status, we have been required to provide certain derivative counterparties collateral against derivative financial instruments. As of December 31, 2010 and 2009, counterparties held $58.6 million and $9.0 million of our investment securities as collateral which was in excess of the credit exposure to those counterparties.

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Contractual Obligations

The following table summarizes our significant fixed and determinable contractual obligations, within the categories described below, by payment date or contractual maturity as of December 31, 2010. The payment amounts for financial instruments shown below represent principal amounts contractually due to the recipient and do not include any unamortized premiums or discounts, or other similar carrying value adjustments.

(in thousands)	Within one year	After one but within three years	After three but within five years	More than five years	Total
Deposits(1)	$ 1,353,340	$ 745,679	$ 30,723	$	$ 2,129,742
FHLB advances	107,950	35,834	5,700	16,385	165,869
Senior Notes(2)	5,000				5,000
Trust preferred securities				61,857	61,857
Operating leases	5,096	9,495	7,998	7,820	30,409
Purchase obligations(3)	3,273	3,206	843	2,852	10,174
Total	$ 1,474,659	$ 794,214	$ 45,264	$ 88,914	$ 2,403,051

(1) Deposits with indeterminate maturities, such as demand, savings and money market accounts, are reflected as obligations due within one year.

(2) Represents $5.0 million in senior credit facility repurchased by the Company in March 2011.

(3) Represents agreements to purchase goods or services.

Enterprise Risk Management

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

Historically, we have managed risk in a decentralized manner, with senior managers and management-level and board-level committees overseeing the management of various risks. We use internal audits, quality control and loan review functions to assess the strength of and adherence to risk management policies, internal controls and regulatory requirements. Similarly, external reviews, examinations and audits are conducted by independent accountants, regulators and others. In addition, our compliance, appraisal, corporate security and information security personnel provide additional risk management services in their areas of expertise.

Management recommends the appropriate level of risk in our strategic and business plans and in our board-approved credit and operating policies. The Bank s board of directors and its committees oversee the monitoring and controlling of significant risk exposures, including the policies governing risk management. Under the terms of the Bank Order, the actions taken by board committees are subsequently ratified by the full board. These committees include:

Audit Committee. The audit committee oversees our financial reporting process and compliance activities on behalf of our board of directors. Specifically, the audit committee reviews our financial reporting and the controls over financial reporting; reviews the adequacy of the allowance for loan losses; appoints, oversees and terminates the independent auditor and the Chief Audit Officer; oversees the internal audit activity; and oversees our management of legal, regulatory and compliance risks. The Audit Committee approves the following policies: Allowance for Loan Loss Policy, Code of Conduct, Audit Services Pre-Approval Policy, Internal Audit

Policy, Compliance Policy, Corporate Business Resumption Plan

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Policy, Bank Secrecy Act Policy, Branch Opening, Closing and Relocating Policy, Corporate Information Security Policy, Security Program Policy, Pandemic Policy and Consecutive Time Off Policy.

Finance Committee. The finance committee oversees the consolidated companies activities related to balance sheet management, interest rate risk management, counterparty risk management, including approval of broker/dealer relationships and open trade limits and liquidity risk management. The finance committee approves the Asset Liability Management Policy, which includes policies related to liquidity and liquidity contingency planning.

Credit Committee. The credit committee reviews new lending activity, loan portfolio credit performance, concentrations of risk, charge-off activity, adequacy of loan loss reserves, measurement of losses on impaired loans, certain large loans, loan workouts and have approval authority over new loans or increases in large loans that are recommended by management within the restrictions of the Bank Order and Bank policies. The credit committee also approves credit policies, products and programs subject to ratification by the full board of directors.

Human Resources and Corporate Governance Committee. The human resources and corporate governance committee, or HRCG, of HomeStreet, Inc., on behalf of the board of directors, reviews all matters concerning our human resources, compensation, benefits, and corporate governance. HRCG s policy objectives are to ensure that HomeStreet and its operating subsidiaries meet their corporate objectives of attracting and retaining a well-qualified workforce, to oversee our human resource strategies and policies and to ensure processes are in place to assure compliance with employment laws and regulations. HRCG is authorized by the board of directors to take any action on the board s behalf as described in its charter or as otherwise delegated by the board, except as otherwise specifically reserved by law, regulation, other committees charters or the Bank s charter documents for action solely by the full board or another board committee.

As part of the strategic planning process, in the fall of 2010 we conducted a structured enterprise-wide risk assessment to further our understanding of our risk profile, provide a benchmark against which to evaluate proposed future initiatives and strategies and assess the potential impact of initiatives and strategies on overall company risk. The enterprise-wide risk assessment was conducted under the leadership of the Risk and Regulatory Oversight Director who reports to the General Counsel and Chief Administrative Officer. We plan to create an enterprise risk management framework to support future enterprise risk assessments and ongoing monitoring and reporting structures.

Using the risk assessment model espoused by the Office of the Comptroller of the Currency, or OCC, in its examination handbook, we assessed risk in the following areas: credit, interest rate, price, liquidity, operational, compliance and regulatory, strategic and reputation. To assess the risks, we reviewed and documented our assessment of the quantity of risk and the quality of risk management to determine an aggregate level of risk (high, moderate or low) as well as the direction of each risk (increasing, decreasing or stable). Our risk profile based on the risk assessment is summarized in the following table.

RISK PROFILE

Risk Category	Quantity of Risk (Low, Mod, High)	Quality of Risk Management (Weak, Satisfactory, Strong)	Aggregate Level of Risk (Low, Mod, High)	Direction of Risk (Increasing, Stable, Decreasing)
Credit	High	Strong	High	Stable
Interest Rate	Moderate	Satisfactory	Moderate	Stable
Price	High	Strong	High	Stable
Liquidity	Moderate	Strong	Moderate	Stable
Operational	High	Satisfactory	Moderate	Stable
Compliance/Regulatory	High	Strong	Moderate	Stable/increasing
Strategic	High	Satisfactory	High	Increasing
Reputation	Moderate	Satisfactory	Moderate	Stable/decreasing

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The following is a discussion of our risk management practices for these risk categories. The risks related to credit, liquidity, interest rate and price warrant in-depth discussion due to the significance of these risks and the impact they have had on our business in the recent past.

Credit Risk Management

Credit risk is defined as the risk to current or anticipated earnings or capital arising from an obligor s failure to meet the terms of any contract with the bank, including those in the lending, securities and derivative portfolios, or otherwise perform as agreed. Factors relating to the degree of credit risk include the size of the asset or transaction, the contractual terms of the related documents, the credit characteristics of the borrower, the channel through which assets are acquired, the features of loan products or derivatives, the existence and strength of guarantor support, the availability, quality and adequacy of any underlying collateral and the economic environment after the loan is originated or the asset is acquired. Our overall portfolio credit risk is also impacted by asset concentrations within the portfolio.

Our credit risk management process is governed centrally. Our overall credit process includes comprehensive credit policies, judgmental or statistical credit underwriting, frequent and detailed risk measurement and modeling and continual loan review, quality control and audit processes. In addition, we have an independent loan review function that reports to the credit committee of our board of directors and regulatory examiners and internal and external auditors review and perform detailed tests of our credit underwriting, loan administration and allowance processes.

The Chief Credit Officer s primary responsibilities include directing the activities of the credit risk management function as it relates to the loan portfolio, overseeing loan portfolio performance and ensuring compliance with established credit policies, standards and limits, determining the reasonableness of the our allowance for loan losses, reviewing and approving large credit exposures, and delegating credit approval authorities. Senior credit administrators who oversee the lines of business have both transaction approval authority and governance authority for the approval of procedures within established policies, standards and limits. The Chief Credit Officer reports directly to the President and Chief Executive Officer.

The Bank loan committee, established by the credit committee of the Bank s board of directors, provides direction and oversight within our risk management framework. The committee seeks to ensure effective portfolio risk analysis and policy review and to support sound implementation of defined business and risk strategies. Additionally, the Bank loan committee periodically approves credits larger than the Chief Credit Officer s and the Chief Executive Officer s approval authority. The members of the committee are the President and Chief Executive Officer, Chief Credit Officer and Chief Financial Officer.

The loan review officer s primary responsibility includes the review of our loan portfolios to provide an independent assessment of credit quality, portfolio oversight and credit management, including accuracy of loan grading. Loan review also conducts targeted credit-related reviews and credit process reviews at the request of the board of directors and management and reviews a sample of newly originated loans for compliance with closing conditions and accuracy of loan grades. Loan review reports directly to the Bank board s credit committee and administratively to the Risk and Regulatory Oversight Director.

The treasury function s primary responsibilities include directing the activities of the credit risk management function as it relates to securities and derivative portfolios, overseeing derivative portfolio performance and ensuring compliance with established credit policies, standards and limits. The Treasurer reports directly to the Chief Financial Officer, who reports to the President and Chief Executive Officer.

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Appraisal Policy

An integral part of our credit risk management process is the valuation of the collateral supporting the loan portfolio, which is primarily comprised of loans secured by real estate. We maintain a board-approved appraisal policy for real estate appraisals that conforms to the Uniform Standards of Professional Appraisal Practice (USPAP) and the FDIC regulatory requirements. Our Chief Appraiser, who is independent of the business unit and credit administration departments, is responsible for maintaining the appraisal policy and recommending changes to the policy subject to Bank loan committee and board credit committee approval.

Real Estate

Our appraisal policy requires that market value appraisals be prepared at loan origination, subsequent loan extensions and for loan monitoring purposes. Our appraisals are prepared by independent third-party appraisers and our staff appraisers. We use state certified and licensed appraisers with appropriate expertise as it relates to the subject property type and location. All appraisals contain as is values based upon the definition of market value as set forth in the FDIC appraisal regulations. For commercial properties we may also obtain upon completion and upon stabilization values as appropriate to the loan type and status. The appraisal standard for the non-tract development properties (four units or less) is retail value of individual units. For tract development properties with five or more units, the appraisal standard is the bulk value of the tract as a whole.

We review all appraisals prior to approval of a loan transaction. Commercial real estate appraisals are reviewed by our in-house appraisal staff. Single family appraisal reviews are generally conducted by our single family loan underwriters. Complex single family appraisals or appraisals with unusual characteristics are referred to our appraisal department for review.

For loan monitoring and problem loan management purposes our appraisal requirements are as follows:

- We generally do not perform valuation monitoring for pass graded credits due to minimal credit risk.

- For loans graded special mention an annual appraisal or collateral valuation is performed depending upon property complexity, market area, market conditions, intended use and other considerations.

- For loans graded substandard or doubtful and for all OREO properties, we require an independent third- party appraisal every 12 months until disposition or loan upgrade. At the intervening six month point, we prepare a collateral valuation. A collateral valuation is an in-house restricted use appraisal report prepared by our staff appraisers.

- In addition, if we determine that market conditions, changes to the property, changes in the intended use of the property or other factors indicate an appraisal is no longer reliable, we will also obtain an updated collateral valuation and assess whether a change in collateral value requires an additional adjustment to carrying value.

Other

Our appraisal requirements for loans not secured by real estate-secured loans such as business loans secured by equipment include valuation methods ranging from evidence of sales price or verification with a recognized guide for new equipment to a valuation opinion by a professional appraiser for multiple pieces of used equipment.

Nonaccrual Policy

Loans are placed on nonaccrual status when the full and timely collection of interest and principal is doubtful, generally when the loan becomes 90 days or more past due for interest or principal payments or if part

of the principal balance has been charged off. All payments received on nonaccrual loans are accounted for using the cash method. Under the cash method, all payments are applied to the principal balance until all principal and interest payments are brought current and the prospects for future payments in accordance with the loan agreement are reasonably assured, at which point the loan is returned to accrual status and no longer designated as impaired unless the loan is designated as a performing troubled debt restructuring (TDR), in which case it will remain designated as impaired. Loans that are well-secured and in the collection process are maintained on accrual status, even if they are 90 days or more past due. 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.

Troubled Debt Restructuring Policy

Loans are reported as TDRs when we grant concessions that we would not otherwise consider to borrowers experiencing financial difficulty. Concessions to borrowers not experiencing financial difficulties that represent an insignificant delay in performance are not considered TDRs. These payment concessions represent delays in payments that are insignificant relative to the unpaid principal or collateral value of the loan and will result in an insignificant shortfall in the contractual amount due, and the delay in timing of the restructured payment period is insignificant relative to the frequency of payments, the debt s original contractual maturity, or original expected duration.

In the current economic environment, we have modified loans for various reasons for borrowers not experiencing financial difficulties. For example, we have extended maturities on certain loans to allow additional time for sales or leasing of residential and commercial real estate construction or rehabilitation projects. Other short term extensions have been granted to allow time for receipt of appraisals and other financial reporting information to facilitate underwriting of loan extensions and renewals.

TDRs are designated as impaired because interest and principal payments will not be received in accordance with original contract terms. TDRs that are performing and on accrual status as of the date of the modification remain on accrual status. TDRs that are nonperforming as of the date of modification generally remain as nonaccrual until the prospect of future payments in accordance with the modified loan agreement is reasonably assured, generally demonstrated when the borrower maintains compliance with the restructured terms for a predetermined period, normally at least six months. TDRs with temporary below-market concessions remain designated as a TDR regardless of the accrual or performance status until the loan is paid off.

When there is a well-conceived and prudent workout plan that supports the ultimate collection of principal and interest, we may enter into TDRs to help maximize the likelihood of success for a given workout strategy. In each case we also assess whether it is in the best interests of the Bank to foreclose or modify the terms. We have made concessions such as interest-only payment terms, interest rate reductions, principal and interest forgiveness and payment restructures. Since mid-2009, concessions to construction and land development borrowers have been focused primarily on forgiveness of principal in conjunction with settlement activities so as to allow us to acquire control of the real estate collateral. For single family mortgage borrowers, we have generally granted interest rate reductions for periods of three years or less to reduce payments and provide the borrower time to resolve their financial difficulties. In each case, we carefully analyze the borrower s current financial condition to assure that they can make the modified payment.

Impairment Policy

A loan is considered impaired when it is probable that all contractual principal and interest payments due will not be collected in accordance with the terms of the loan agreement. Factors considered by management in determining whether a loan is impaired include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due.

Impairment for loans for which collection is dependent upon the performance or liquidation of the collateral is measured as the difference between the recorded investment balance of the loan and the fair value of the collateral, less estimated selling costs. Impairment for loans that are not collateral dependent is measured as the difference between the discounted value of the expected future cash flows, based on the original effective interest rate, and the recorded investment balance of the loan. A specific allowance is provided for equal to the calculated impairment and included in the allowance for loan losses. If the calculated impairment is determined to be permanent or not recoverable, the impairment will be charged off.

In accordance with our appraisal policy, the fair value of impaired collateral dependent loans is determined using independent third-party appraisals, obtained at least annually, or is based on collateral valuations prepared by in house appraisers at the intervening six month point. Upon the receipt of an updated appraisal or collateral valuation, loan impairments are remeasured and recorded. If the calculated impairment is determined to be permanent, fixed or nonrecoverable, the impairment will be charged off. Loans designated as impaired are generally placed on nonaccrual and remain in that status until all principal and interest payments are brought current and the prospects for future payments in accordance with the loan agreement are reasonably assured at which point the loan is returned to accrual status and generally no longer considered impaired. Loans designated as TDRs are considered impaired for so long as the loan is designated as a TDR.

Asset Quality and Nonperforming Assets

The primary markets in which we do business have been especially impacted by the deterioration in the U.S. housing market that began in 2007. In response to the current challenges in our operating environment, we have and will continue to revise our credit risk policies and monitoring, including revising the limits on credit exposure by geographical region, product type and borrower. We generally stopped our new loan origination for investment in 2008 to enable us to focus on problem loan resolution and improving overall asset quality. During 2009, 2010 and through the first nine months of 2011, our lending practices and underwriting standards tightened as we shifted to primarily originating single family loans that conform to government-sponsored enterprise parameters and Fannie Mae Delegated Underwriting and Servicing multifamily loans, substantially all of which was designated for sale.

Faced with unfavorable market conditions, more borrowers have defaulted on their loans, thereby contributing to an increase in delinquency rates which peaked in our loan portfolio during 2009. Furthermore, the rate at which delinquent loans moved to foreclosure increased during 2010 as we resolved problem loans. Nonaccrual loans totaled $113.2 million, $374.2 million and $75.4 million as of December 31, 2010, 2009 and 2008, respectively, and OREO balances totaled $170.5 million, $107.8 million and $20.9 million at the same dates.

Primarily as a result of these economic factors, our loan portfolio experienced accelerated credit deterioration during the latter part of 2008 and 2009. To provide for the growing loss potential, we substantially increased our provisions for loan losses during this period. As of December 31, 2009, we increased our allowance for loan losses, both in absolute terms and as a percentage of loans held in portfolio, to $109.5 million or 5.28%, up from $58.6 million or 2.36% as of the end of 2008. During 2009 and to a lesser extent in 2010, we realized a significant amount of the anticipated credit losses as troubled loans were modified, paid down, charged-off or migrated to OREO status. Total charge-offs were $83.2 million and $101.7 million in 2010 and 2009. During 2010, as problem loans were resolved and credit losses are realized, the balance of and the credit risk inherent within the loans held for investment portfolio declined. Consequently, the level of our allowance for loan losses also declined. Our loan portfolio, excluding the allowance for loan losses, decreased $471.8 million or 22.7% during 2010 and decreased $410.0 million or 16.5% during 2009. As of December 31, 2010, the allowance for loan losses decreased to $64.6 million or 4.0% of the loans held for investment portfolio.

These credit trends are reflected in the decrease in our provision for loan losses during 2010, compared with an increase during 2009. Provision expense was $37.3 million for the year ended December 31, 2010, a decrease of $116.2 million, compared to $153.5 million for 2009. Provision amounts for 2009 increased $119.1 million from 2008 levels.

During the first three quarters of 2011, we experienced further improvement in our overall asset quality with lower net charge-offs and lower classified and nonperforming assets. For the first three quarters of 2011, net charge-offs totaled $14.5 million, comprised of charge-offs of $21.1 million offset by loan recoveries of $6.6 million, compared with net charge-offs of $68.6 million in the first three quarters of 2010, comprised of charge-offs of $70.9 million offset by recoveries of $2.3 million. In the first three quarters of 2011 loan recoveries were predominately related to one borrower.

Classified assets have decreased to $225.0 million or 9.7% of total assets, as of September 30, 2011, compared with $363.9 million, or 14.6% of total assets, as of December 31, 2010. Nonperforming assets also improved, decreasing to $159.5 million, or 6.9% of total assets, as of September 30, 2011, compared with $283.7 million, or 11.4% of total assets, as of December 31, 2010. As of September 30, 2011, nonperforming loans decreased $18.1 million, or 16.0%, to $95.1 million compared with $113.2 million as of December 31, 2010 and OREO balances decreased $106.1 million, or 62.2%, to $64.4 million compared with $170.5 million for the same periods.

Our loans held for investment portfolio, net of allowance for loan losses, decreased $178.3 million, or 11.6%, to $1.36 billion as of September 30, 2011, compared with $1.54 billion as of December 31, 2010. As of September 30, 2011 the allowance for loan losses was $53.2 million, or 3.8% of the loans held for investment balance, compared with $64.2 million, or 4.0% of the loans held for investment balance at December 31, 2010.

The following table presents certain information about our impaired loans and valuation allowances at September 30, 2011, and December 31, 2010 and 2009, as well as interest payments on impaired loans at and for the quarter or years then ended.

	September 30, 2011	December 31, 2010	December 31, 2009
Allowance for credit losses:			
Beginning balance	$ 64,566	$ 110,422	$ 58,588
Charge-offs	(21,087)	(86,053)	(102,011)
Recoveries	6,607	2,897	330
Provision/reallocation	3,300	37,300	153,515
Ending Balance	$ 53,386	$ 64,566	$ 110,422
Collectively evaluated for impairment	$ 27,547	$ 46,469	$ 81,974
Individually evaluated for impairment	25,839	18,097	28,448
Total	$ 53,386	$ 64,566	$ 110,422
Loans held for investment:			
Collectively evaluated for impairment	$ 1,252,029	$ 1,469,290	$ 1,698,496
Individually evaluated for impairment	165,588	138,175	377,885
Total	$ 1,417,617	$ 1,607,465	$ 2,076,381

The allowance for credit losses represents management s estimate of the incurred credit losses inherent within our loan portfolio. The methodology for evaluating the adequacy of the allowance for loan losses has two basic elements: first, identification of impaired loans and the measurement of impairment for each individual loan so identified; and second, a method for collectively evaluating impairment of all other loans not identified as impaired. See Management s Discussion and Analysis Critical Accounting Policies and Estimates Allowance for Loan Losses.

The allowance for credit losses decreased by $11.2 million, or 17.3%, to $53.4 million at September 30, 2011 from $64.6 million at December 31, 2010, which was a decrease of $45.9 million, or 41.5%, from $110.4 million at December 31, 2009. The decline since December 31, 2009 reflects a decrease of $658.8 million, or 31.7%, in total loans held for investment to $1.42 billion at September 30, 2011 from $2.08 billion at December 31, 2009. The

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reduction in the required allowance for loan losses also reflects the overall improvement in credit quality of loans held for investment.

The following table presents the recorded investment, unpaid principal balance, and related allowance for impaired loans, broken down by those with and those without an asset-specific allowance, as of September 30, 2011, December 31, 2010 and December 31, 2009.

	Recorded Investment(1)	Unpaid Principal Balance(2)	Related Allowance
September 30, 2011			
Loans with no related allowance recorded	$ 72,898	$ 79,250	
Loans with an allowance recorded	92,690	97,303	$ 25,839
Total	$ 165,588	$ 176,553	$ 25,839
December 31, 2010			
Loans with no related allowance recorded	$ 66,406	$ 69,829	
Loans with an allowance recorded	71,769	83,380	$ 18,097
Total	$ 138,175	$ 153,209	$ 18,097
December 31, 2009			
Loans with no related allowance recorded	$ 132,584	$ 135,732	
Loans with an allowance recorded	245,301	$ 282,931	$ 28,448
Total	$ 377,885	$ 418,663	$ 28,448

Impaired loans totaled $165.6 million, $138.2 million and $377.9 million at September 30, 2011, and December 31, 2010 and 2009, respectively. The decline in total impaired loans since December 31, 2009 reflects management s continued efforts to resolve troubled assets. The increase in total impaired loans since December 31, 2010 reflects the additional TDRs identified pursuant to the provisions of Accounting Standards Update (ASU) No. 2011-02, *A Creditor s Determination of Whether a Restructuring Is a Troubled Debt Restructuring*, adopted by the Company as of July 1, 2011. Impaired loans without specific loan loss reserves totaled $72.9 million, $66.4 million and $132.6 million and represented 44.0%, 48.1% and 35.1% of total impaired loans at September 30, 2011, and December 31, 2010 and 2009, respectively. Generally, impaired loans with no related allowance are loans with carrying values which have been reduced to the fair value of collateral less costs of disposal through a partial charge-off of the loan. Impaired loans with a related allowance are loans with probable losses that are not yet fixed and permanent. We maintain an allowance for loan loss policy that is approved annually by the board of directors of the Bank. The policy includes our methodology for determining the adequacy of the allowance for loan losses.

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

	At September 30, 2011			December 31, 2010			2009			2008		
(in thousands)	Amount	Percent of Allowance to Total Allowance	Loan category (1) as a % of Total loans	Amount	Percent of Allowance to Total Allowance	Loan category (1) as a % of Total loans	Amount	Percent of Allowance to Total Allowance	Loan category (1) as a % of Total loans	Amount	Percent of Allowance to Total Allowance	Loan category (1) as a % of Total loans
Single family	$ 11,226	21.0%	35.0%	$ 11,977	18.6%	32.8%	$ 17,308	15.7%	28.5%	$ 7,768	13.3%	23.0%
Commercial real estate	3,722	7.0%	28.8%	10,060	15.6%	26.6%	10,761	9.7%	21.6%	9,785	16.7%	19.0%
Multifamily Residential	357	0.7%	4.2%	1,795	2.8%	6.5%	1,947	1.8%	4.1%	1,389	2.4%	4.0%
Construction/Land Development	31,343	58.7%	15.0%	33,478	51.9%	17.8%	67,764	61.4%	30.5%	33,511	57.2%	38.0%
Commercial Business	1,496	2.8%	5.2%	2,761	4.3%	5.2%	5,794	5.2%	5.2%	4,806	8.2%	6.0%
Home Equity	5,242	9.8%	11.8%	4,495	7.0%	11.3%	6,848	6.2%	10.2%	1,329	2.3%	10.0%
Total allowance for credit losses	$ 53,386	100.0%	100.0%	$ 64,566	100.0%	100.0%	$ 110,422	100.0%	100.0%	$ 58,588	100.0%	100.0%

(1) Excludes loans held for sale

	At December 31, 2007			2006		
(in thousands)	Amount	Percent of Allowance to Total Allowance	Loan category (1) as a % of Total loans	Amount	Percent of Allowance to Total Allowance	Loan category (1) as a % of Total loans
Single family	$ 4,466	11.5%	20.0%	$ 2,472	8.9%	19.0%
Commercial real estate	5,156	13.3%	14.0%	5,482	19.7%	15.0%
Multifamily Residential	1,059	2.7%	6.0%	876	3.1%	4.0%
Construction/Land Development	21,840	56.3%	45.0%	15,326	55.1%	47.0%
Commercial Business	4,741	12.2%	5.0%	2,530	9.1%	4.0%
Home Equity	1,542	4.0%	10.0%	1,148	4.1%	11.0%
Total allowance for credit losses	$ 38,804	100.0%	100.0%	$ 27,834	100.0%	100.0%

(1) Excludes loans held for sale

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The following table presents activity in our allowance for credit losses for the periods indicated:

	Nine Months Ended September 30,	For the Year Ended December 31,				
(in thousands)	**2011**	**2010**	**2009**	**2008**	**2007**	**2006**
Allowance at the beginning of period	$ 64,566	$ 110,422	$ 58,587	$ 38,804	$ 27,834	$ 21,480
Provision for loan losses	3,300	37,300	153,515	34,411	10,955	6,471
Recoveries:						
Single family residential	163	607				
Construction/land development	6,126	2,010	31	44		
Commercial business	208	243	257	91	243	49
Home equity	110	37	42	3	2	
Total recoveries	6,607	2,897	330	138	245	49
Charge-offs:						
Single family residential	6,329	9,103	8,244	397		
Commercial real estate	578	1,187	4,160			
Construction/land development:						
Residential	1,352	64,026	71,241	10,454	220	
Commercial	8,407	6,998	11,114			
Construction/land development charge-offs	9,759	71,024	82,355	10,454	220	
Commercial business	849	1,652	3,943	3,615	8	159
Home equity	3,572	3,087	3,308	300	2	7
Total charge-offs	21,087	86,053	102,010	14,766	230	166
(Charge-offs), net of recoveries	(14,480)	(83,156)	(101,680)	(14,628)	15	(117)
Balance at end of period	$ 53,386	$ 64,566	$ 110,422	$ 58,587	$ 38,804	$ 27,834
Allowance for loan losses as a percentage of total loans	3.76%	4.02%	5.32%	2.36%	1.57%	1.33%
Net charge-offs to average loans receivable, net	1.01%	4.45%	4.41%	0.58%		0.01%
Nonperforming loans as a percentage of total loans	6.73%	7.06%	18.03%	3.03%	1.37%	0.06%

We manage asset quality and control credit risk by diversifying our loan portfolio and by applying policies designed to promote sound underwriting and loan monitoring practices. The Bank s credit group is charged with monitoring asset quality, establishing credit policies and procedures, and enforcing the consistent application of these policies and procedures across the organization.

We regularly review loans in our portfolio to assess credit quality indicators and determine appropriate loan classification and grading in accordance with applicable regulations. We assign these grades as follows:

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

Watch. An asset graded as watch has a remote risk of default, but is exhibiting deficiency or weakness that requires monitoring.

Special Mention. A special mention loan does not currently expose us to a sufficient degree of risk to warrant an adverse classification, but does possess a correctable deficiency or potential weakness deserving management s close attention.

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Substandard. A substandard asset is inadequately protected by the current secured worth and paying capacity of the borrower or of collateral pledged on the loan, if any. Assets so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt, such as a high probability of payment default and are characterized by the distinct possibility that the institution will sustain some loss if deficiencies are not corrected.

Doubtful. An asset classified as doubtful has all of the weaknesses inherent in those classified substandard, with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions and values, highly questionable or improbable. Doubtful is considered to be a temporary classification until resolution of pending weaknesses enables us to more fully evaluate the potential for loss.

Loss. That portion of an asset classified as loss is considered uncollectible and of so little value that its characterization as an asset is not warranted. A loss classification does not mean that an asset has absolutely no recovery or salvage value, but rather it is not reasonable to defer charging off all or that portion of the asset deemed uncollectible even though partial recovery may occur in the future.

As of September 30, 2011 and December 31, 2010, $288.8 million and $323.0 million of loans were graded watch, $154.5 million and $156.5 million of loans were graded special mention and $160.7 million and $193.5 million of loans were graded substandard, respectively; no loans were graded doubtful. In 2010, $86.1 million of loans were graded loss, and charged off. Classified assets include loans graded as substandard, doubtful and loss as well as OREO. The total amount of classified assets was $225.0 million, $363.9 million and $570.0 million as of September 30, 2011, December 31, 2010 and 2009, respectively.

The following table sets forth our loans held for investment portfolio and loans graded special mention, substandard and designated as nonaccrual as of September 30, 2011. There were no loans graded doubtful at September 30, 2011.

Balances as of September 30, 2011

(in thousands)

			Special Mention		Substandard		
Loan Category	**Committed Balance (1)**	**Recorded Investment (2)**	**Committed Balance (1)**	**Recorded Investment (2)**	**Committed Balance (1)(3)**	**Recorded Investment (2)(3)**	**Nonaccrual (2)**
Single family	$ 496,741	$ 496,741	$ 36,024	$ 36,024	$ 15,469	$ 15,469	$ 15,469
Commercial real estate	408,397	407,891	56,802	56,606	46,853	46,853	10,959
Multifamily residential	59,041	58,972			8,038	7,972	5,196
Construction/land development	226,828	213,001	60,934	55,704	89,674	82,946	58,705
Commercial business	97,856	73,559	5,198	4,174	5,216	4,642	1,993
Home equity	241,674	167,453	2,066	2,032	2,870	2,772	2,772
Total	1,530,537	1,417,617	$ 161,024	$ 154,540	$ 168,120	$ 160,654	$ 95,094
Undisbursed construction loan funds	(13,827)	n/a					
Undisbursed home equity and business banking line funds	(99,093)	n/a					
Net deferred loan fees and discounts	(4,231)	(4,231)					
Allowance for loan and lease losses (4)	(53,167)	(53,167)					
Loans held for investment, net	$ 1,360,219	$ 1,360,219					

(1) Includes undisbursed construction loan funds and home equity and business banking lines.
(2) Excludes undisbursed construction loan funds.

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(3) Balances have been reduced by amounts of charge-offs.
(4) Allowance for loan losses includes specific valuation allowances of $25.8 million.

The following table sets forth our loans held for investment portfolio and loans graded special mention, substandard and designated as nonaccrual as of December 31, 2010. There were no loans graded Doubtful at December 31, 2010.

(in thousands)

			Special Mention		Substandard		
Loan Category	**Committed Balance (1)**	**Recorded Investment (2)**	**Committed Balance (1)**	**Recorded Investment (2)**	**Committed Balance (1)(3)**	**Recorded Investment (2)(3)**	**Nonaccrual (2)**
Single family	$ 526,749	$ 526,462	$ 5,504	$ 5,216	$ 13,938	$ 13,938	$ 13,938
Commercial real estate	423,338	426,879	70,639	69,862	47,285	47,285	20,259
Multifamily residential	104,992	104,497			8,167	8,167	8,167
Construction/land development	312,229	285,131	90,502	75,863	118,172	111,532	65,952
Commercial business	108,016	82,959	5,807	4,926	11,717	10,035	2,359
Home equity	262,425	181,537	630	596	2,604	2,535	2,535
Total	1,737,749	1,607,465	$ 173,082	$ 156,463	$ 201,883	$ 193,492	$ 113,210
Undisbursed construction loan funds	(27,098)	n/a					
Undisbursed home equity and business banking line funds	(103,186)	n/a					
Net deferred loan fees and discounts	(4,767)	(4,767)					
Allowance for loan and lease losses (4)	(64,177)	(64,177)					
Loans held for investment, net	$ 1,538,521	$ 1,538,521					

(1) Includes undisbursed construction loan funds and home equity and business banking lines.

(2) Excludes undisbursed construction loan funds. Reflects the disbursed loan amount net of any direct write-down of the loan.

(3) Balances have been reduced by amounts of charge-offs.

(4) Allowance for loan losses includes specific valuation allowances of $18.1 million.

Loans are placed on nonaccrual, and designated as impaired, when collection of principal or interest is doubtful, generally when a loan becomes 90 days or more past due. See Management s Discussion and Analysis Critical Accounting Policies and Estimates Allowance for Loan Losses. All payments received on nonaccrual loans are accounted for using the cash method. Under the cash method, all payments are applied to the principal balance until all principal and interest payments are brought current and the prospects for future payments in accordance with the loan agreement are reasonably assured, at which point the loan is returned to accrual status and no longer designated as impaired. Loans that are well-secured and in the collection process are maintained on accrual status, even if they are 90 days or more past due. 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.

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Loans are reported as troubled debt restructurings (TDRs) when the Company grants concessions that we would not otherwise consider to borrowers experiencing financial difficulty. Concessions to borrowers that represent an insignificant delay in performance are not designated TDRs. TDRs are designated as impaired because interest and principal payments will not be received in accordance with original contract terms. TDRs that are performing and on accrual status as of the date of the modification remain on accrual status. TDRs that are nonperforming as of the date of modification generally remain as nonaccrual until the prospect of future payments in accordance with the modified loan agreement is reasonably assured, generally demonstrated when the borrower maintains compliance with the restructured terms for a predetermined period, normally at least six months. TDRs placed on accrual status and reported as a TDR as of year end are identified as performing TDRs as are TDRs in accrual status where the borrower has received below-market interest rate concessions. TDRs where the borrower has received an at market interest rate concession at the time of modification which have demonstrated performance over a period of time are removed from TDR disclosures in the first eligible period following the annual reporting cycle. TDRs where the borrower has received a below market interest rate concession remain classified as a TDR regardless of the accrual or performance status until the loan is paid off.

When there is a well-conceived and prudent workout plan that supports the ultimate collection of principal and interest, we may enter into TDRs to help maximize the likelihood of success for a given workout strategy. In each case we also assess whether it is in the best interests of the Bank to foreclose or modify the terms. For example, we may make concessions such as interest-only payment terms for income property borrowers in order to allow time for properties to achieve full occupancy. In the past, we also have granted concessions such as interest rate reductions and payment restructures for construction and land development borrowers to allow time for plat completion and sell out. Since mid-2009, concessions to this segment have been focused primarily on forgiveness of principal in conjunction with settlement activities so as to allow us to acquire control of the real estate collateral. For single family mortgage borrowers, we may grant interest rate reductions for periods of three years or less to reduce payments and provide the borrower time to resolve their financial difficulties. In each case, we carefully analyze the borrower s current financial condition to assure that they can make the modified payment. Additionally, the Bank Order limits our ability to enter into loan modifications with delinquent borrowers, and we comply with each of these limitations in considering whether to enter into a TDR.

As of July 1, 2011, the Company adopted Accounting Standards Update (ASU) No. 2011-02, *A Creditor s Determination of Whether a Restructuring Is a Troubled Debt Restructuring*. This guidance clarifies the evaluation of whether a loan receivable restructuring constitutes a troubled debt restructuring, and requires that a creditor separately conclude that both of the following exists: (1) the restructuring constitutes a concession; and (2) the debtor is experiencing financial difficulties. As a result of adopting the amendments in ASU 2011-2, which required retrospective application to January 1, 2011, we reassessed all loan restructurings that occurred after January 1, 2011 to determine if any of the loan restructurings would be a troubled debt restructuring under the new guidance. We identified certain receivables that were now troubled debt restructurings under the new guidance for which the allowance for credit losses had previously been measured under a general allowance for credit losses methodology. Upon identifying those receivables as troubled debt restructurings, we identified them as impaired under the guidance in ASC 310-10-35. The amendments in ASU 2011-2 require prospective application of the impairment measurement guidance in ASC 310-10-35 for those receivables newly identified as impaired. As of the end of the first interim period of adoption (September 30, 2011), the recorded investment in receivables for which the allowance for credit losses was previously measured under a general allowance for credit losses methodology and are now impaired under ASC 310-10-35 was $14.7 million, and the allowance for credit losses associated with those receivables, on the basis of a current evaluation of loss, was $0.3 million.

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The table below contains TDRs reported as of the indicated dates, types of concession granted and the current status of such TDRs as of September 30, 2011.

(dollars in thousands)				
At September 30, 2011			**Status**	
Concession Type	**Balance**	**% TDR current on restructured terms**	**% Upgraded or Paid Off**	**% Failed**
Interest Rate Reduction	$ 64,564	100		
Payment Restructure	$ 27,966	100		
Forgiveness of Principal	$ 1,937	100		
	$ 94,467			
At June 30, 2011				
Concession Type	**Balance**	**% TDR current on restructured terms**	**% Upgraded or Paid Off**	**% Failed**
Interest Rate Reduction	$ 44,014	100		
Payment Restructure	$ 23,802	100		
Forgiveness of Principal	$ 2,027	100		
	$ 69,843			
At March 31, 2011				
Concession Type	**Balance**	**% TDR current on restructured terms**	**% Upgraded or Paid Off**	**% Failed**
Interest Rate Reduction	$ 40,985	99	1	
Payment Restructure	$ 15,770	100		
Forgiveness of Principal	$ 2,688	100		
	$ 59,443			
At December 31, 2010			**Status**	
Concession Type	**Balance**	**% TDR current on restructured terms**	**% Upgraded or Paid Off**	**% Failed**
Interest Rate Reduction	$ 39,347	97	1	2
Payment Restructure	$ 15,770	100		
Forgiveness of Principal	$ 1,752	100		
Total	$ 56,869			
At December 31, 2009			**Status**	
Concession Type	**Balance**	**% TDR current on restructured terms**	**% Upgraded or Paid Off**	**% Failed**
Interest Rate Reduction	$ 58,575	18	53	29
Payment Restructure	$ 3,240		95	5

Total	$ 61,815

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At December 31, 2008			Status	
Concession Type	Balance	% TDR current on restructured terms	% Upgraded or Paid Off	% Failed
Payment Restructure	$ 51,585		13	87
Total	$ 51,585			

At December 31, 2007			Status	
Concession Type	Balance	% TDR current on restructured terms	% Upgraded or Paid Off	% Failed
Interest Rate Reduction	$ 2,778			100
Total	$ 2,778			

TDRs during 2007 and 2008 have had a lower success rate than those executed in the subsequent years. A TDR is considered failed upon transfer to other real estate owned. Through September 30, 2011 we have not experienced any TDRs whose borrowers failed to adhere to the restructured terms (a situation we refer to as failed TDRs) executed subsequent to 2009.

The following table contains the amount of TDRs by loan type on accrual and nonaccrual as of the indicated dates.

(in thousands)
At September 30, 2011

Loan Type	Accrual	Nonaccrual	Total
Single Family	40,989	1,326	42,315
Commercial Real Estate	25,090		25,090
Multifamily Residential	2,777	2,786	5,563
Construction/Land Development		18,237	18,237
Commercial Business	237	706	943
Home Equity	2,031	288	2,319
	$ 71,124	$ 23,343	$ 94,467

At June 30, 2011

Loan Type	Accrual	Nonaccrual	Total
Single Family	$ 26,295	$ 896	$ 27,191
Commercial Real Estate	$ 15,770	$	$ 15,770
Multifamily Residential	$ 2,784	$ 2,841	$ 5,625
Construction/Land Development	$	$ 18,346	$ 18,346
Commercial Business	$ 271	$ 789	$ 1,060
Home Equity	$ 1,642	$ 209	$ 1,851
	$ 46,762	$ 23,081	$ 69,843

At March 31, 2011

Loan Type	Accrual	Nonaccrual	Total
Single Family	$ 15,684	$ 527	$ 16,211

Commercial Real Estate	$ 15,770	$ 47	$ 15,817
Multifamily Residential	$ 2,791	$ 2,862	$ 5,653
Construction/Land Development	$	$ 19,907	$ 19,907
Commercial Business	$	$ 24	$ 24
Home Equity	$ 1,643	$ 188	$ 1,831
	$ 35,888	$ 23,555	$ 59,443

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At December 31, 2010

Loan Type	Accrual	Nonaccrual	Total
Single Family	$ 13,836	$ 194	$ 14,030
Commercial Real Estate	$ 15,770	$ 329	$ 16,099
Multifamily Residential	$	$ 5,711	$ 5,711
Construction/Land Development	$ 367	$ 18,666	$ 19,033
Commercial Business	$	$ 163	$ 163
Home Equity	$ 1,833	$	$ 1,833
	$ 31,806	$ 25,063	$ 56,869

At December 31, 2009

Loan Type	Accrual	Nonaccrual	Total
Single Family	$ 14,951	$ 3,035	$ 17,986
Commercial Real Estate	$ 25,871	$	$ 25,871
Multifamily Residential	$	$	$
Construction/Land Development	$ 1,924	$ 16,034	$ 17,958
Commercial Business	$	$	$
Home Equity	$	$	$
	$ 42,746	$ 19,069	$ 61,815

At December 31, 2008

Loan Type	Accrual	Nonaccrual	Total
Single Family	$ 8,698	$ 44	$ 8,742
Commercial Real Estate	$	$	$
Multifamily Residential	$	$	$
Construction/Land Development	$ 29,117	$ 13,726	$ 42,843
Commercial Business	$	$	$
Home Equity	$	$	$
	$ 37,815	$ 13,770	$ 51,585

At December 31, 2007

Loan Type	Accrual	Nonaccrual	Total
Single Family	$	$	$
Commercial Real Estate	$	$	$
Multifamily Residential	$	$	$
Construction/Land Development	$	$ 2,778	$ 2,778
Commercial Business	$	$	$
Commercial Land	$	$	$
Home Equity	$	$	$
	$	$ 2,778	$ 2,778

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The following table presents the composition of nonperforming assets at the dates indicated.

(in thousands)	At September 30, 2011	At December 31, 2010	2009	2008	2007	2006
Loans accounted for on a nonaccrual basis: (1)						
Single family	$ 15,469	$ 13,938	$ 48,400	$ 14,874	$ 6,153	$ 3,247
Commercial real estate	10,959	20,259	15,981	857	4,071	
Multifamily residential	5,196	8,167	8,489			
Construction/land development	58,705	65,952	295,966	57,306	23,258	
Commercial business	1,993	2,359	3,195	642		
Home Equity	2,772	2,535	2,187	1,706	276	114
Total loans on nonaccrual	$ 95,094	$ 113,210	$ 374,218	$ 75,385	$ 33,758	$ 3,361
Other real estate owned (2)	64,368	170,455	107,782	20,905	1,974	1
Total nonperforming assets	$ 159,462	$ 283,665	$ 482,000	$ 96,290	$ 35,732	$ 3,362
Loans 90 days or more past due and accruing	$ 29,998	$ 43,503	$ 11,439	$ 21,068	$ 362	$
Performing TDR loans (3)	$ 71,124	$ 31,806	$ 42,746	$ 37,815	$	$
Nonperforming TDR loans (3)	23,343	25,063	19,069	13,770	2,778	
Total TDR loans	$ 94,467	$ 56,869	$ 61,815	$ 51,585	$ 2,778	$
Allowance for loan losses as a percent of nonperforming loans	55.9%	56.7%	29.5%	77.7%	115.0%	828.1%
Nonaccrual loans as a percentage of total loans	6.7%	7.06%	18.0%	3.0%	1.4%	0.2%
Nonperforming assets as a percentage of total assets	6.9%	11.4%	15.0%	3.3%	1.3%	0.1%

(1) If interest on nonaccrual loans under the original terms had been recognized, such income is estimated to have been $4.0 million in September 30, 2011, and $10.1 million in December 31, 2010.
(2) Other real estate owned is shown net of related charge-offs.
(3) At September 30, 2011, TDRs (performing and nonperforming), are comprised of 97 loan relationships totaling $94.5 million, including $48.9 million of commercial construction and land development loans and $44.6 million of single family residential loans.

As indicated in the table above, OREO increased from $20.9 million at December 31, 2008, to $107.8 million at December 31, 2009 and to $170.5 million at December 31, 2010. These increases were due primarily to transfers from the construction and land development loan portfolios. OREO decreased to $64.4 million as of September 30, 2011 as we sold $118.4 million of OREO properties during the first three quarters of 2011 for a gain of $0.3 million, including our largest OREO property, Cascadia.

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

	September 30, 2011					
(in thousands)	30-59 Days Past Due	60-89 Days Past Due	Nonaccrual	90 Days or More and Accruing	Total Past Due Loans	Other Real Estate Owned
Single family	$ 11,406	$ 5,398	$ 15,469	$ 29,998	$ 62,271	$ 10,419
Commercial real estate			10,959		10,959	2,152
Multifamily residential			5,196		5,196	
Construction/land development			58,705		58,705	51,797
Commercial business			1,993		1,993	
Home equity	1,020	1,217	2,772		5,009	
Total	$ 12,426	$ 6,615	$ 95,094	$ 29,998	$ 144,133	$ 64,368

	December 31, 2010					
(in thousands)	30-59 Days Past Due	60-89 Days Past Due	Nonaccrual	90 Days or More and Accruing	Total Past Due Loans	Other Real Estate Owned
Single family	$ 6,743	$ 6,223	$ 13,938	$ 30,173	$ 57,077	$ 18,839
Commercial real estate		4,871	20,259		25,130	6,257
Multifamily residential			8,167		8,167	
Construction/land development			65,952	12,955	78,907	145,359
Commercial business		907	2,359	375	3,641	
Home equity	1,645	1,184	2,535		5,364	
Total	$ 8,388	$ 13,185	$ 113,210	$ 43,503	$ 178,286	$ 170,455

	At December 31, 2009					
(in thousands)	30-59 Days Past Due	60-89 Days Past Due	Nonaccrual	90 Days or More and Accruing	Total Past Due Loans	Other Real Estate Owned
Single family	$ 10,921	$ 6,569	$ 48,400	$	$ 65,890	$ 13,612
Commercial real estate			15,981		15,981	
Multifamily residential			8,489		8,489	
Construction/land development	27,935	24,847	295,966	11,439	360,189	94,170
Commercial business	41	477	3,195		3,713	
Home equity	903	927	2,187		4,017	
Total	$ 39,802	$ 32,820	$ 374,218	$ 11,439	$ 458,279	$ 107,782

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The following table presents nonperforming assets by loan type by region at September 30, 2011.

	Washington						
	Puget Sound						Idaho
(in thousands)	King(1)	Snohomish(2)	Pierce(1)	Thurston(1)	Vancouver & Other(2)(3)	Spokane(2)	Boise(2)
Loans on nonaccrual status:							
Single family	$ 4,412	$ 4,319	$ 2,914	$ 553	$ 557	$ 470	$
Commercial real estate	7,388	240					
Multifamily residential		2,409					
Construction/land development	5,742	381	3,252	21,996	9,085	5,853	
Commercial business	1,638		174		181		
Home equity	1,473	184	281	46	369	107	
Total loans on nonaccrual status	$ 20,653	$ 7,533	$ 6,621	$ 22,595	$ 10,192	$ 6,430	$
Other real estate owned:							
Single family	$ 1,698	$ 1,748	$ 3,136	$	$ 438	$ 119	$
Commercial real estate					2,152		
Multifamily residential							
Construction/land development	2,006	4,659	15,578	17,844	5,080	18	1,501
Commercial business							
Home equity							
Total other real estate owned	$ 3,704	$ 6,407	$ 18,714	$ 17,844	$ 7,670	$ 137	$ 1,501
Total nonperforming assets	$ 24,357	$ 13,940	$ 25,335	$ 40,439	$ 17,862	$ 6,567	$ 1,501

	Oregon						
(in thousands)	Portland(2)	Bend(2)	Eugene(2)	Salem(2)	Hawaii	Other(4)	Total
Loans on nonaccrual status:							
Single family	$ 1,412		$	$	$ 832		$ 15,469
Commercial real estate	2,781		550				10,959
Multifamily residential	2,787						5,196
Construction/land development	2,319		10,077				58,705
Commercial business							1,993
Home equity	139	11	12	82	68		2,772
Total loans on nonaccrual status	$ 9,438	$ 11	$ 10,639	$ 82	$ 900	$	$ 95,094
Other real estate owned:							
Single family	$ 1,724	$ 185	$	$ 229	$ 1,142	$	$ 10,419
Commercial real estate							2,152
Multifamily residential							
Construction/land development	1,970	184	428	2,529			51,797
Commercial business							
Home equity							
Total other real estate owned	$ 3,694	$ 369	$ 428	$ 2,758	$ 1,142	$	$ 64,368
Total nonperforming assets	$ 13,132	$ 380	$ 11,067	$ 2,840	$ 2,042	$	$ 159,462

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The following table presents nonperforming assets by loan type by region as of December 31, 2010.

	Washington						Idaho
	Puget Sound						
(in thousands)	King(1)	Snohomish(1)	Pierce(1)	Thurston(1)	Vancouver(2)(3)	Spokane(2)(3)	Boise(2)
Loans on nonaccrual status:							
Single family	$ 4,707	$ 2,726	$ 3,914	$ 341	$ 185	$ 288	$
Commercial real estate	6,200	723	10,020		2,237		
Multifamily residential		2,456					
Construction/land development	7,487	678	10,423	21,810	5,985		277
Commercial business	1,873		298		188		
Home equity	1,139	37	446	75	194	51	
Total loans on nonaccrual status	$ 21,406	$ 6,620	$ 25,101	$ 22,226	$ 8,789	$ 339	$ 277
Other real estate owned:							
Single family	$ 5,511	$ 4,314	$ 828	$	$ 1,056	$ 275	$ 700
Commercial real estate	4,318	1,939					
Multifamily residential							
Construction/land development	25,262	10,514	72,690	18,603	7,462		2,417
Commercial business							
Home equity							
Total other real estate owned	$ 35,091	$ 16,767	$ 73,518	$ 18,603	$ 8,518	$ 275	$ 3,117
Total nonperforming assets	$ 56,497	$ 23,387	$ 98,619	$ 40,829	$ 17,307	$ 614	$ 3,394

	Oregon						
(in thousands)	Portland (2)(3)	Bend (2)(3)	Eugene (2)(3)	Salem (2)(3)	Hawaii	Other (4)	Total
Loans on nonaccrual status:							
Single family	$ 560	$	$	$ 130	$ 1,087	$	$ 13,938
Commercial real estate	501		578				20,259
Multifamily residential	2,889	2,822					8,167
Construction/land development	8,890	30	10,372				65,952
Commercial business							2,359
Home equity	87	89		81	336		2,535
Total loans on nonaccrual status	$ 12,927	$ 2,941	$ 10,950	$ 211	$ 1,423	$	$ 113,210
Other real estate owned:							
Single family	$ 1,839	$ 561	$	$ 1,266	$ 2,489	$	$ 18,839
Commercial real estate							6,257
Multifamily residential							
Construction/land development	4,764	2,391		231		1,025	145,359
Commercial business							
Home equity							
Total other real estate owned	$ 6,603	$ 2,952	$	$ 1,497	$ 2,489	$ 1,025	$ 170,455
Total nonperforming assets	$ 19,530	$ 5,893	$ 10,950	$ 1,708	$ 3,912	$ 1,025	$ 283,665

(1) Refers to a specific county.

(2) Refers to a specific city.

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(3) Also includes surrounding counties.

(4) Includes Alaska and Florida in commercial real estate and Washington Community Reinvestment Association participation pool loans in multifamily residential.

The following table presents the single family loan portfolio by FICO score as of September 30, 2011.

Greater Than	Less Than or Equal To	Percentage[1]
N/A	N/A	6.5%
<	500	0.1%
500	549	0.4%
550	599	1.5%
600	649	5.6%
650	699	20.5%
700	749	30.3%
750	>	35.1%
	TOTAL	100.0%

[1] Percentages based on aggregate loan amounts.

The following table presents our single family loan held for investment portfolio by FICO score as of December 31, 2010.

Single Family Residential Loan Portfolio as of December 31, 2010

- FICO Score Distributions

Greater Than	Less Than or Equal To	Percentage[1]
N/A	N/A	7.2%
<	500	0.0%
500	549	0.3%
550	599	1.6%
600	649	5.6%
650	699	20.1%
700	749	30.6%
750	>	34.6%
	TOTAL	100.0%

[1] Percentages based on aggregate loan amounts.

From the latter part of 2008 through September 30, 2011, substantially all of the loans we originated were single family mortgages that conform to government-sponsored enterprise underwriting standards and were designated for sale.

Our underwriting standards for single family and home equity loans require evaluating and understanding a borrower s credit, collateral and ability to repay the loan. Credit is determined based on how well a borrower manages their current and prior debts, documented by a credit report that provides credit scores and the borrower s current and past information about their credit history. Collateral is based on the type and use of property, occupancy and market value, largely determined by property appraisals. Ability to repay the loan is based on several factors, including the borrower s employment, income, current debt, assets and level of equity in the property. We also consider loan-to-property value and debt-to-income ratios, loan amount and lien position in assessing whether to originate a loan. Single family and home equity borrowers are particularly susceptible to downturns in economic trends that negatively affect housing prices and demand and levels of unemployment.

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For commercial, multifamily residential and construction lending, we consider the same factors with regard to the borrower and the guarantors. In addition, we evaluate liquidity, net worth, leverage, other outstanding indebtedness of the borrower, an analysis of cash expected to flow through the borrower (including the outflow to other lenders) and prior experience with the borrower. We use this information to assess financial capacity, profitability and experience. Ultimate repayment of these loans is sensitive to interest rate changes, general economic conditions, liquidity and availability of long-term financing.

Liquidity Risk 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 of 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. We establish liquidity guidelines for HomeStreet, Inc. as well as for its banking subsidiaries.

HomeStreet, Inc. and the Bank have separate liquidity risk management policies as each has different funding needs and sources of liquidity and separate regulatory capital requirements. In addition, the Bank Order requires the Bank to maintain a minimum primary liquidity ratio (net cash plus short term and marketable assets divided by net deposits plus short-term liabilities) of 15.0% and a maximum non-core funding dependency ratio of 20.0%.

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 trust preferred securities. The main cash outflows are 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. Our federal and state regulators have prohibited both HomeStreet, Inc. and the Bank from paying dividends without consent, and HomeStreet, Inc. is also contractually restricted from paying dividends to shareholders under the terms of our TruPS. As a result, no dividends were paid to shareholders in 2009 and 2010, and we have deferred all interest payments on the TruPS since December 2008.

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 though the sale of securities under agreements to repurchase and advances from the Federal Reserve Bank of San Francisco, or FRBSF. 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.

As of September 30, 2011 and December 31, 2010, the Bank had borrowing capacity of $244.8 million and $72.8 million from the FHLB, respectively, and $160.6 million and $192.9 million from the FRBSF, respectively.

Our lending agreement with the FHLB permits the FHLB to refuse to make advances under that agreement during periods in which an event of default (as defined in that agreement) is continuing. An event of default occurs when the FHLB gives notice to the Bank of an intention to take any of a list of permissible actions following the occurrence of specified events or conditions affecting the Bank. Among those events is the issuance or entry of any supervisory or consent order pertaining to the Bank, which would include the Bank Order. To date the FHLB has not declared a default under this agreement, and has not notified the Bank that future advances would not be made available, although it has required the Bank to deliver physical possession of certain negotiable instruments and related documentation as collateral for borrowings under that agreement.

Further, we have been notified by the FRBSF that due to our financial and regulatory condition, we face increases in borrowing costs and increases in administration and oversight by FRBSF. As a practical matter, this limitation may serve to increase our costs of funding or may make it more difficult for us to take the steps necessary to preserve this source of financing.

During 2007, 2008 and 2009, in response to the credit crisis and general economic downturn, we secured our availability to funds through increased FHLB borrowings and brokered deposits and invested these funds in highly liquid investment securities as well as carrying elevated levels of cash and cash equivalent balances, enabling us to quickly react to changes in the risk environment. In November 2008, we adopted a revised liquidity policy for the Bank that required us to increase and maintain the Bank s primary liquidity ratio to 15.0% by June 30, 2009, which was achieved and surpassed. 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. While this strategy was effective for risk management purposes, this high level of liquidity has also adversely affected our net interest income and margin. With the stabilization of the Company and changing depositors attitude toward the risk of deposits in troubled banks as a consequence of, among other things, government programs insuring noninterest bearing accounts including provisions of the Dodd-Frank Act, we believe it is no longer necessary to sustain such a position. Going forward we anticipate reducing on-balance sheet liquidity further as we continue to reduce non-core funding. As of September 30, 2011, December 31, 2010 and 2009, our primary liquidity ratio was 31.7%, 23.9% and 32.1% respectively.

As part of our funding strategy, we increased the Bank s FHLB borrowings to $575.1 million and $746.4 million as of December 31, 2006 and 2007, respectively. As of December 31, 2008, 2009, 2010 and September 30, 2011, FHLB borrowings declined to $705.8 million, $677.8 million, $165.9 million and $67.9 million, respectively.

Deposit balances increased from $1.54 billion as of December 31, 2006 to $1.72 billion, $1.92 billion and $2.33 billion as of December 31, 2007, 2008 and 2009, respectively, and declined to $2.13 billion and $2.06 billion as of December 31, 2010 and September 30, 2011, respectively. As of September 30, 2011, brokered CD balances decreased to zero from $297.4 million as of December 31, 2009. As part of our balance sheet restructuring activities and in order to comply with the Bank Order, brokered CD balances were allowed to mature without renewal.

Cash balances as of September 30, 2011 increased $65.8 million to $138.4 million, from $72.6 million as of December 31, 2010. The increase reflects the continued reduction of troubled assets during the first three quarters of 2011 as well as the settlement of loans sold. As of December 31, 2010 cash balances declined $144.5 million to $72.6 million, from $217.1 million as of December 31, 2009 reflecting our decision to reduce our primary liquidity.

Capital Resources

Shareholders equity was $80.3 million as of September 30, 2011, compared with $58.8 million as of December 31, 2010, an increase of $21.5 million or 36.7%. The increase is primarily due to the result of net income of $9.1 million for the first three quarters of 2011 as well as valuation increases in investment securities available for sale, reflecting declines in interest rates. Shareholders equity was $58.8 million as of December 31, 2010, compared with $91.9 million as of December 31, 2009, a decrease of $33.1 million or 36.0%. The decline is primarily due to the result of a net loss of $34.2 million and a loss of $5.4 million in accumulated other

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comprehensive income, partially offset by an upward fair value adjustment of $6.5 million related to management s election to record and carry its single family MSR assets at fair value as of January 1, 2010. There were no dividends declared or paid, share repurchases or deferred compensation recorded during the nine months ended September 30, 2011 or the years ended 2010 and 2009.

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) total risk-based capital ratio, (2) Tier 1 risk-based capital ratio and (3) Tier 1 leverage ratio. In order to qualify as well capitalized, a bank must have a total risk-based capital ratio of at least 10.0%, a Tier 1 risk-based capital ratio of at least 6.0% and a leverage ratio of at least 5.0%. In order to be deemed adequately capitalized, a bank generally must have a total risk-based capital ratio of at least 8.0%, a Tier 1 risk-based capital ratio of at least 4.0% and a leverage ratio of at least 4.0%. The FDIC retains the right to require a depository institution to maintain a higher capital level based on its particular risk profile. Under the Bank Order, we are required to maintain a total risk-based capital ratio of at least 12.0% and a Tier 1 leverage capital ratio of at least 10.0%.

As of September 30, 2011, the Bank had a total risk-based capital ratio, Tier 1 risk-based capital ratio and Tier 1 leverage capital ratio of 9.8%, 8.5% and 5.6%, respectively. As of December 31, 2010, the Bank had a total risk-based capital ratio, Tier 1 risk-based capital ratio and Tier 1 leverage capital ratio of 8.2%, 6.9% and 4.5%, respectively. As such, the Bank is currently adequately capitalized within the meaning of the FDIC s prompt corrective action guidance, however, the Bank s current ratios do not satisfy the requirements of the Bank Order and under FDIC regulations, a bank cannot be categorized as well-capitalized so long as it has a cease and desist or similar order outstanding.

The Bank s actual capital amounts and ratios are included in the following table:

(in thousands)	Actual		For Minimum Capital Adequacy Purposes		To Be Categorized As Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
As of September 30, 2011:						
Total risk-based capital (to risk-weighted assets)	$ 144,751	9.8%	$ 118,306	8.0%	$ 147,883	10.0%
Tier I risk-based capital (to risk-weighted assets)	125,835	8.5%	59,153	4.0%	88,730	6.0%
Tier I leverage capital (to average assets)	125,835	5.6%	89,252	4.0%	111,565	5.0%
As of December 31, 2010:						
Total risk-based capital (to risk-weighted assets)	$ 138,924	8.2%	$ 136,154	8.0%	$ 170,193	10.0%
Tier I risk-based capital (to risk-weighted assets)	117,115	6.9%	68,077	4.0%	102,116	6.0%
Tier I leverage capital (to average assets)	117,115	4.5%	103,608	4.0%	129,509	5.0%

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(in thousands)	Actual Amount	Actual Ratio	For Minimum Capital Adequacy Purposes Amount	For Minimum Capital Adequacy Purposes Ratio	To Be Categorized As Well Capitalized Under Prompt Corrective Action Provisions Amount	To Be Categorized As Well Capitalized Under Prompt Corrective Action Provisions Ratio
As of December 31, 2009:						
Total risk-based capital (to risk-weighted assets)	$ 170,364	8.5%	$ 160,413	8.0%	$ 200,517	10.0%
Tier I risk-based capital (to risk-weighted assets)	144,245	7.2%	80,207	4.0%	120,310	6.0%
Tier I leverage capital (to average assets)	144,245	4.5%	127,484	4.0%	159,356	5.0%

The following table presents the Bank s capital as compared to the regulatory capital requirements at September 30, 2011:

(in thousands)	The Bank s Capital		Capital Ratio Requirement		Capital Shortfall
Tier 1 leverage capital	$ 125,835	5.64%	$ 223,130	10.00%	$ (97,295)
Total risk-based capital	$ 144,751	9.79%	$ 177,459	12.00%	$ (32,708)

The following table presents the Bank s capital as compared to the regulatory requirements at December 31, 2010:

(in thousands)	The Bank s Capital		Capital Ratio Requirement		Capital Shortfall
Tier 1 leverage capital	$ 117,115	4.52%	$ 259,019	10.00%	$ (141,904)
Total risk-based capital	138,924	8.16%	204,232	12.00%	(65,308)

Impact of Inflation

The consolidated financial statements presented in this prospectus have been prepared in accordance with accounting principles generally accepted in the United States, which require the measurement of financial position and operating results in terms of historical dollar amounts or market value without considering the changes in the relative purchasing power of money over time due to inflation. The impact of inflation is reflected in the increased cost of our operations. Unlike industrial companies, nearly all of our assets and liabilities are monetary in nature. As a result, interest rates have a greater impact on our performance than do the effects of general levels of inflation.

Market Risk Management

Market risk is defined as the sensitivity of income, fair market values and capital to changes in interest rates, foreign currency exchange rates, commodity prices and other relevant market rates or prices. The primary market risks to which we are exposed are price and interest rate risk. Price risk is defined as the risk to current or anticipated earnings or capital arising from changes in the value of either trading portfolios or other obligations 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 HomeStreet, price and interest rate risks arise from the financial instruments and positions we hold. This includes loans, mortgage servicing rights, securities, deposits, borrowings, long-term debt and derivative

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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.

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 net income to changing interest rates to achieve our overall financial objectives. ALCO is a management-level committee whose members include the Chief Financial Officer, acting as the chair, the Chief Executive Officer and President, the Treasurer and a senior financial analyst. The committee meets monthly, and is responsible for:

- understanding the nature and level of interest rate risk we take;
- assessing how that risk fits within our overall business strategies;
- ensuring an appropriate level of formality and sophistication of the risk management process given the overall level of risk;
- developing asset/liability management policy;
- formulating and implementing strategies to improve balance sheet mix and earnings; and
- reviewing interest rate sensitivity.

The finance committee provides oversight of the asset/liability management process, reviews the results of interest rate risk analysis and approves 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, or 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 and changes in the shape of the yield curve. From mid-2008 to mid-2010, our balance sheet management was focused primarily on liquidity management and secondarily on earnings. As our financial condition stabilizes and improves, we have changed our liquidity and funding strategy placing more emphasis on growing earnings.

We estimate the sensitivity of our net interest income to changes in market interest rates using an interest rate simulation model that assumes the level of balance sheet growth, deposit repricing characteristics and the rate of prepayments for each interest rate change scenario. 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 sensitivity 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: immediate to three months; more than three months to six months; more than six months to twelve months; more than twelve months to three years; more than three years to five years; more than five years; and on a cumulative basis. The differences are known as interest sensitivity gaps.

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The following table presents sensitivity gaps for these different intervals as of December 31, 2010:

	December 31, 2010							
	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
	(Dollar in thousands)							
Interest-earning assets:								
Cash & cash equivalents	$ 72,639	$	$	$	$	$	$	$ 72,639
FHLB Stock						37,027		37,027
Investment securities(1)	9,903	12,878	89,671	56,346	49,063	95,652		313,513
Mortgage loans held for sale	212,602							212,602
Loans held for investment(1)(2)	948,892	167,027	88,427	183,404	99,405	115,543		1,602,698
Total interest-earning assets	1,244,036	179,905	178,098	239,750	148,468	248,222		2,238,479
Non-interest-earning assets							247,218	247,218
Total Assets	$ 1,244,036	$ 179,905	$ 178,098	$ 239,750	$ 148,468	$ 248,222	$ 247,218	$ 2,485,697
Interest-bearing liabilities:								
NOW accounts(3)	$ 121,534	$	$	$	$	$	$	$ 121,534
Statement savings accounts(3)	51,075							51,075
Money market accounts(3)	413,401							413,401
Certificates of deposit	114,621	172,413	244,910	746,220	29,630	48		1,307,842
FHLB advances	51,325	36,625	20,000	35,834	5,700	16,385		165,869
Long-term debt(4)	30,000	20,000		15,000		1,857		66,857
Total interest-bearing liabilities	781,956	229,038	264,910	797,054	35,330	18,290		2,126,578
Non-interest bearing liabilities							300,330	300,330
Equity							58,789	58,789
	$ 781,956	$ 229,038	$ 264,910	$ 797,054	$ 35,330	$ 18,290	$ 359,119	$ 2,485,697
Interest sensitivity gap	$ 462,080	$ (49,133)	$ (86,812)	$ (557,304)	$ 113,138	$ 229,932		
Cumulative interest sensitivity gap	$ 462,080	$ 412,947	$ 326,135	$ (231,169)	$ (118,031)	$ 111,901		
Cumulative interest sensitivity gap as a percentage of total assets	18.6%	16.6%	13.1%	(9.3)%	(4.7)%	4.5%		
Cumulative interest-earning assets as a percentage of cumulative interest-bearing liabilities	159%	141%	126%	89%	94%	105%		

(1) Based on contractual maturities, repricing dates and forecasted principal payments assuming normal amortization and, where applicable, prepayments.

(2) Projected average constant prepayment rates for the next twelve months are 15.0%.

(3) Assumes 100% of interest bearing non-maturity deposits are subject to repricing in three months or less.

(4) Based on contractual maturity.

As of December 31, 2010, the Bank was asset sensitive overall, but liability sensitive in the more than three months to six months more than six months to 12 months and more than 12 months to three years periods. 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.

Changes in the mix of earning assets or supporting liabilities can either increase or decrease the net interest margin, without affecting interest rate sensitivity. In addition, the interest rate spread between an asset and its

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supporting 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 or our exposure to changes in interest rates.

The estimated impact on our net interest income over a time horizon of one year as of December 31, 2010 is provided in the table below. For the scenarios shown, the interest rate simulation assumes an instantaneous and sustained shift in market interest rates ratably over a twelve-month period and no change in the composition or size of the balance sheet.

Change in Interest Rates	December 31, 2010		December 31, 2009	
	Percentage Change			
(basis points)	Net Interest Income(1)	Net Portfolio Value(2)	Net Interest Income(1)	Net Portfolio Value(2)
+200	14%	-44%	8%	-44%
+100	7%	-20%	4%	-13%
-100	-3%	3%	7%	-4%
-200	-8%	-5%	-1%	-1%

(1) This percentage change represents the impact to net interest 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 December 31, 2010, we believe our net interest income was in an asset-sensitive position, as the repricing characteristics were such that an increase in market interest rates would have a positive effect on net interest income and a decrease in market interest rates would have a negative effect on net interest income. At December 31, 2009, net interest income was asset sensitive in three of the four scenarios. 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 which 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 deposit base.

Risk Management Instruments

We originate fixed-rate residential home mortgages primarily for sale into the secondary market. These loans are economically hedged against interest rate fluctuations from the time of the loan commitment until the loans are sold (typically 30 to 60 days).

We have been able to manage interest rate risk by matching both on- and off-balance sheet assets and liabilities within reasonable limits through short-term maturities and variable interest rates. Where appropriate, we also use hedging techniques including the use of forward sale commitments and option contracts on mortgage-backed securities and interest rate swaps.

In order to protect the economic value of our mortgage servicing rights, we employ hedging strategies utilizing derivative financial instruments which include forward interest rate swaps, options on interest rate swap contracts and commitments to purchase mortgage backed securities. We utilize these instruments as economic hedges and changes in the fair value of these instruments are recognized in current income as a component of mortgage servicing income. During the third quarter, we amended our mortgage servicing rights hedging policy to require management to hedge the impact on the value of our mortgage servicing rights of a low probability

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extreme sudden increase in interest rates. This policy requires that we hedge estimated losses to a maximum of a $1.0 million loss, subject to the limitations of hedging effectiveness including market risk, basis risk, counterparty credit risk and others.

On a periodic basis, our management reports to our board of directors regarding the results of our hedging strategies. The financial instruments we used for hedging purposes consisted of the following:

(in thousands)

September 30, 2011:	**Notional Amount**	**Fair Value**		**Hedged Risk**				
		Asset Derivatives	**Liability Derivatives**	**Asset(1) Interest rate locks**	**Asset(1) Loans held for sale**	**Asset(1) MSR**	**Asset(2) Loans held for investment**	**Liabilities(2) Certificates of deposit**
Forward sale commitments	$ 563,072	$ 324	$ (3,924)	$	$ (3,924)	$ 324	$	$
Interest rate locks on loans	320,933	9,269		9,269				
Option contracts	280,500	7				7		
Interest rate swaps	322,143	15,880	(9,056)			15,880	(9,056)	n/a
	$ 1,486,648	$ 25,480	$ (12,980)	$ 9,269	$ (3,924)	$ 16,211	$ (9,056)	$

As of December 31, 2010:	**Notional Amount**	**Fair Value**		**Hedged Risk**				
		Asset Derivatives	**Liability Derivatives**	**Asset(1) Interest rate locks**	**Asset(1) Loans held for sale**	**Asset(1) MSR**	**Asset(2) Loans held for investment**	**Liabilities(2) Certificates of deposit**
Forward sale commitments	$ 308,973	$ 2,263	$	$	$ 2,263	$	$	$
Interest rate locks on loans	129,287	2,302		2,302				
Interest rate swaps	367,910		(22,221)			(14,447)	(7,774)	n/a
	$ 806,170	$ 4,565	$ (22,221)	$ 2,302	$ 2,263	$ (14,447)	$ (7,774)	$

As of December 31, 2009:	**Notional Amount**	**Fair Value**		**Hedged Risk**				
		Asset Derivatives	**Liability Derivatives**	**Asset(1) Interest rate locks**	**Asset(1) Loans held for sale**	**Asset(1) MSR**	**Asset(2) Loans held for investment**	**Liabilities(2) Certificates of deposit**
Forward sale commitments	$ 315,246	$ 1,805	$	$	$ 3,033	$ (1,228)	$	$
Futures	85,000		(648)			(648)		
Interest rate locks on loans	119,654		(994)	(994)				
Interest rate swaps	266,770	339	(5,506)				(5,506)	339
	$ 786,670	$ 2,144	$ (7,148)	$ (994)	$ 3,033	$ (1,876)	$ (5,506)	$ 339

(1) Economic fair value hedge.

(2) Fair value hedge in accordance with hedge accounting standards.

We determine the fair value of financial instruments used for hedging purposes using broker-quoted prices or other observable market data. We may implement other hedge transactions using forward loan sales, futures, option contracts and interest rate swaps or possibly interest rate floors, financial futures, forward rate agreements

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and U.S. Treasury options on futures or bonds. Prior to considering any hedging activities, we analyze the costs and benefits of the hedge in comparison to other viable alternative strategies.

Operational Risk Management

Operational risk is defined as the risk to current or anticipated earnings or capital arising from inadequate or failed internal processes or systems, the misconduct or errors of people, and adverse external events.

Each line of business has primary responsibility for identifying, monitoring and controlling its operational risks. In addition, centralized departments such as our risk and regulatory oversight, legal, compliance, security, information security and finance provide support to the business lines as they develop and implement risk management practices specific to their needs. Our audit team provides independent feedback on the strength of operational risk controls and compliance with Company policies and procedures. Additionally, we maintain mature change management, business resumption and data and customer information security processes. We also maintain a code of conduct with periodic training, setting a tone from the top that articulates a strong focus on ethical standards and a zero tolerance approach to unethical or fraudulent behavior.

Compliance/Regulatory Risk Management

Compliance risk is the risk to current or anticipated earnings or capital arising from violations of, or nonconformance with, laws, rules, regulations, prescribed practices, internal policy and procedures or ethical standards.

As a regulated financial institution with a significant mortgage banking operation we have significant compliance and regulatory risk. Historically, we have maintained a strong compliance culture and compliance management processes as evidenced by minimal compliance issues. Each business unit is responsible for compliance with laws and regulations and has identified an individual to participate on our compliance committee which is chaired by the Compliance Officer. The Compliance Officer monitors all new regulations and changes to existing regulations and the new requirements are discussed at the compliance committee to determine impact to the business units and to assign responsibilities and timelines for implementation.

The level of compliance risk is increasing, primarily due to the enactment of the Dodd-Frank Act and the significant amount of new regulation that will be created to implement the requirements in that Act. Management has established a tracking process for monitoring the status of pending regulations and for implementing the regulatory requirements as they are published and become effective.

Strategic Risk Management

Strategic risk is the risk to current or anticipated earnings, capital or enterprise value arising from adverse business decisions, improper implementation of decisions, or lack of responsiveness to industry changes.

Strategic risk is managed by the board of directors and senior management through development of strategic plans and successful implementation of business initiatives. The aggregate level of strategic risk is expected to increase based on the board s and management s plans to launch new business initiatives following successful capital-raising activities. We believe that the new senior management team is comprised of individuals with strong leadership skills and requisite experience in the banking industry to manage strategic risk.

Reputation Risk Management

Reputation risk is defined as the risk to current or anticipated earnings, capital, or enterprise value arising from negative public opinion.

We believe that we have an excellent reputation in the community primarily due to our longevity and significant outreach to the communities we serve. The Bank has earned Outstanding ratings on every Bank

Community Reinvestment Act (CRA) examination since the inception of the Bank in 1986. Of late, our reputation has been challenged due to the publicity surrounding the Orders, although we believe negative customer reaction was limited, partially due to ongoing U.S. government support of the overall financial system and actions taken to strengthen deposit insurance. We anticipate that reputation risk will moderate when credit problems are resolved, we are successful in raising capital, and the Orders have been removed.

Accounting Standards Adopted in 2010

Effective January 1, 2010 we adopted Accounting Standards Update (ASU) 2009-16 *Accounting for Transfers of Financial Assets (Statement of Financial Accounting Standards (FAS) 166, Accounting for Transfers of Financial Assets an amendment of Financial Accounting Standards Board (FASB) Statement No. 140)* which amends certain guidance contained in Accounting Standards Codification 860, *Transfers and Servicing*. This update eliminates the concept of qualifying special purpose entities and provides additional criteria transferors must use to evaluate transfers of financial assets. The adoption of ASU 2009-16 did not have a material impact on our consolidated financial statements.

Effective January 1, 2010 we adopted ASU 2009-17, *Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities (FAS 167, Amendments to FASB Interpretation No. 46(R)* which amends several key consolidation provisions related to variable interest entities (VIEs) included in ASC 810, *Consolidation*. The update changes the approach we must use to identify VIEs for which we are deemed to be the primary beneficiary and are required to consolidate. Under the new guidance, a VIE s primary beneficiary is the entity that has the power to direct the activities of the VIE that most significantly impact the VIE s economic performance, and has an obligation to absorb losses or the right to receive benefits that could be potentially significant to the VIE. In addition, we are required to continually reassess whether we are the primary beneficiary of a VIE, whereas the previous rules only required reconsideration upon the occurrence of certain triggering events. The adoption of ASU 2009-17 did not have a material impact on our consolidated financial statements.

Effective January 1, 2010 we adopted ASU 2010-06, *Improving Disclosures about Fair Value Measurements* which amends the disclosure requirements for fair value measurements. We are required to disclose significant transfers in and out of Levels 1 and 2 of fair value hierarchy, whereas the previous rules only required the disclosure of transfers in and out of Level 3. Additionally, in the rollforward of Level 3 activity, we must present information on purchases, sales, issuances and settlements on a gross basis rather than on a net basis. The update also clarifies that fair value measurement disclosures should be presented for each class of assets and liabilities. A class is typically a subset of a line item in the statement of financial condition. We should also provide information about the valuation techniques and inputs used to measure fair value for recurring and nonrecurring instruments classified as either Level 2 or Level 3. The adoption of ASU 2010-06 had no impact on our consolidated financial statements since it amends only the disclosure requirements.

Effective for the year ended December 31, 2010 we adopted ASU 2010-20, *Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses* which provides disclosures that facilitate financial statement users evaluation of (1) the nature of credit risk inherent in our portfolio of financing receivables, (2) how that risk is analyzed and assessed in arriving at the allowance for credit losses and (3) the changes and reasons for those changes in the allowance for credit losses. This update presents disclosure on a disaggregated basis and defines two levels of disaggregation, portfolio segment and class of financing receivable. A portfolio segment is defined as the level at which an entity develops and documents a systematic method for determining its allowance for credit losses. Classes of financing receivables generally are a disaggregation of a portfolio segment.

Accounting Changes in 2010

Effective January 1, 2010 we elected to measure and carry our mortgage servicing rights (MSRs) related to single family loans at fair value. Under this election, purchased single family MSRs and MSRs resulting from the

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sale or securitization of single family loans are capitalized and carried at fair value. Prior to this election, we capitalized purchased single family MSRs at cost, and MSRs resulting from the sale or securitization of single family loans were initially measured at fair value at the date of transfer and subsequently carried at the lower of amortized cost or fair value. Upon the remeasurement of our MSRs related to single family loans at fair value on January 1, 2010, we recorded a cumulative effect adjustment to increase the 2010 beginning balance of retained earnings by $6.5 million in shareholders equity. We continue to measure MSRs resulting from the sale of multifamily loans at fair value at the date of transfer and subsequently measured at the lower of amortized cost or fair value.

Effective January 1, 2010 we also elected to carry our single family residential mortgage loans held for sale using the fair value option. Under the fair value option, single family residential mortgage loans held for sale will be stated at fair value and any changes in fair value will be recognized in current earnings. Prior to this election, single family residential mortgage loans held for sale were stated at the lower of amortized cost or fair value. At December 31, 2009 we stated our single family residential mortgage loans held for sale at fair value, thus there was no impact to the 2010 beginning balance of retained earnings.

Accounting Standards Adopted in 2011

ASU 2010-06, *Improving Disclosures about Fair Value Measurements*, amends the disclosure requirements for fair value measurements. Companies are required to disclose significant transfers in and out of Levels 1 and 2 of fair value hierarchy, whereas the previous rules only required the disclosure of transfers in and out of Level 3. In the rollforward of Level 3 activity, companies must present information on purchases, sales, issuances, and settlements on a gross basis rather than on a net basis. ASU 2010-06 also clarifies that fair value measurement disclosures should be presented for each class of assets and liabilities. A class is typically a subset of a line item in the statement of financial condition. Companies should also provide information about the valuation techniques and inputs used to measure fair value for recurring and nonrecurring instruments classified as either Level 2 or Level 3. In first quarter 2011, we adopted the requirement for gross presentation in the Level 3 rollforward with prospective application. The remaining provisions were effective for the Company January 1, 2010. The adoption of ASU 2010-06 had no impact on the Company s consolidated financial statements since it amends only the disclosure requirements.

ASU 2011-02, *A Creditor s Determination of Whether a Restructuring is a Troubled Debt Restructuring,* provides an update for factors to be considered when evaluating whether a restructuring constitutes a troubled debt restructuring. ASU 2011-02 provides that a creditor must separately conclude that both of the following exist: (1) the restructuring constitutes a concession; and (2) the debtor is experiencing financial difficulties. In addition, the amendments to Topic 310 clarify that a creditor is precluded from using the effective interest rate test in the debtor s guidance on restructuring of payables (paragraph 470-60-55-10) when evaluating whether a restructuring constitutes a troubled debt restructuring. The amendments in this Update are effective for the first interim or annual period beginning on or after June 15, 2011 (third quarter of 2011), and will be applied retrospectively to the beginning of the year. The Company is currently assessing the potential impact of adopting this guidance.

Current Accounting Developments

ASU 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS*, amends requirements for measuring fair value and for disclosing information about fair value measurements. ASU 2011-04 clarifies how a principal market is determined, addresses the fair value measurement of instruments with offsetting market or counterparty credit risks and the concept of valuation premise and highest and best use and extends the prohibition on blockage factors to all three levels of the fair value hierarchy. Companies are required to disclose all transfers between Level 1 and Level 2 of the fair value hierarchy, whereas the previous rules only required the disclosure of significant transfers between those levels. For Level 3 fair value measurements, quantitative information about significant unobservable inputs used,

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a qualitative discussion about the sensitivity of the fair value measurement to changes in unobservable inputs and the interrelationship between inputs and a description of the Company s valuation process should be disclosed. For financial instruments not measured at fair value but for which disclosure of fair value is required, companies are required to disclose the fair value hierarchy level in which the fair value measurements were determined. The amendments in this ASU are effective for interim and annual periods beginning on or after December 15, 2011. The Company is currently assessing the potential impact of adopting this guidance.

ASU 2011-05, *Presentation of Comprehensive Income*, eliminates the option to include components of other comprehensive income in the statement of shareholders equity. The ASU requires entities to present the components of comprehensive income in either a single statement or in two separate statements, with the statement of comprehensive income immediately following the statement of income. Under either option chosen, reclassification adjustments for items that are reclassified from other comprehensive income to net income are required to be shown on the face of the financial statements. This new guidance does not change the items that must be reported in other comprehensive income or when an item from other comprehensive income must be reclassified to net income. The guidance must be applied retrospectively and is effective for the interim and annual periods beginning after December 15, 2011. The adoption of ASU 2011-05 will impact the presentation of comprehensive income but will not affect our financial position, results of operations or shareholders equity.

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BUSINESS

Overview

Description of Business and Company History

We are a 90-year-old diversified financial services company headquartered in Seattle, Washington, that has grown from a small mortgage bank to a full-service community bank serving consumers and businesses in the Pacific Northwest and Hawaii. Our banking strategy has allowed us to expand our lending activities while building stable core deposits and a more diversified core customer base that provides greater cross-selling opportunities. The Bank has the oldest continuous relationship of all Fannie Mae seller servicers in the nation, having been the second company approved by Fannie Mae at its founding in 1938.

Our primary subsidiaries are HomeStreet Bank and HomeStreet Capital Corporation. HomeStreet Bank is a Washington state-chartered savings bank that provides deposit and investment products and cash management services. The Bank also provides loans for single family homes, commercial real estate, construction, land development and commercial businesses. HomeStreet Capital Corporation, a Washington corporation, originates, sells and services multifamily mortgage loans under the Fannie Mae Delegated Underwriting and Servicing Program (DUS) in conjunction with HomeStreet Bank. We also provide insurance products and services for consumers and businesses as HomeStreet Insurance and loans for single family homes through a joint venture, Windermere Mortgage Services Series LLC (WMS). At September 30, 2011 and December 31, 2010, we had total assets of $2.32 billion and $2.49 billion, net loans held for investment of $1.36 billion and $1.54 billion, deposits of $2.06 billion and $2.13 billion and shareholders equity of $80.3 million and $58.8 million, respectively. We recognized a net income of $15.3 million for the third quarter of 2011, as compared to net income of $1.3 million for the second quarter of 2011 and a net loss of $5.4 million for the third quarter of 2010.

As of January 31, 2012 we had a network of 20 bank branches and nine stand-alone lending centers located in the Puget Sound, Olympia, Vancouver and Spokane regions of Washington, the Portland and Salem regions of Oregon, and the Hawaiian Islands of Oahu, Maui and Hawaii. In January and February 2012, we significantly expanded our mortgage banking business by hiring approximately 140 additional mortgage personnel who were previously part of MetLife Home Loan. In connection with this expansion, we anticipate that we will open approximately 11 additional stand-alone lending centers in Washington and Idaho, the majority of which will be in the Puget Sound area. Our bank branches have average deposits per branch of $102.8 million as of September 30, 2011. WMS provides point-of-sale loan origination services through 42 Windermere Real Estate offices in Washington and Oregon.

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We operate four primary lines of business: Community Banking, Single Family Lending, Income Property Lending and Residential Construction Lending.

Community Banking. We provide diversified financial products and services to our consumer and business customers, including deposit products, investment products, insurance products, cash management services and consumer and business loans. In 1986 we established our bank to fund our lending activities and to offer a broader range of products and services to our customers. In 2000, we began offering commercial business loans as well as business deposit products and cash management services. We have expanded our bank branch network to 20 branches, primarily in the historically higher growth Puget Sound area. At September 30, 2011 and December 31, 2010, our core funding totaled $1.99 billion and $1.74 billion, respectively, and our business banking loan portfolio totaled $228.2 million and $259.3 million, respectively.

Single Family Lending. We originate and sell into the secondary market residential mortgage loans both directly and through our relationship with WMS. This segment also originates and services loans for our portfolio on a selective basis including home equity loans and lines of credit. Our single family lending business is one of our long-established strengths. We originate mortgages using secondary market standards, and the majority are sold to or securitized by Fannie Mae, Freddie Mac or Ginnie Mae, while we retain the right to service these loans. A small percentage of the loans are brokered or sold on a servicing-released basis to correspondent lenders. This part of our business predates the creation of the FHA, Fannie Mae or Freddie Mac, and it has evolved with the many changes to the industry. During 2009 and 2010 we originated $2.73 billion and $2.07 billion, respectively, of single family loans and during the nine months ended September 30, 2011, we originated $1.09 billion. At September 30, 2011 and December 31, 2010, our portfolio of single family loans serviced for others totaled $6.65 billion and $6.34 billion, respectively.

Income Property Lending. We originate commercial real estate loans with a focus on multifamily lending through our Fannie Mae DUS business. These loans are sold to or securitized by Fannie Mae and we generally continue to service those loans after the sale. At September 30, 2011 and December 31, 2010, we serviced $770.4 million and $776.7 million of loans, respectively, we originated through the Fannie Mae DUS program. We also originate commercial construction and land development loans, bridge loans and permanent loans for our own portfolio. Beginning in 2007, we substantially curtailed our portfolio loan origination, while continuing to originate loans under the Fannie Mae DUS program. Going forward, we plan to resume portfolio lending, but with a reduced concentration in commercial construction and land development lending.

Residential Construction Lending. We originate residential construction and land development loans primarily for our own portfolio. Beginning in 2007, we substantially curtailed new originations in order to reduce our concentration in this category. Going forward we plan to resume originating residential construction loans with a significantly reduced portfolio concentration and a focus on home construction as opposed to land development.

Recent Developments

In January 2012, in order to expand our mortgage banking business and accelerate our plans to increase mortgage origination volume, we made offers of employment to hire a significant majority of the mortgage personnel employed in Washington, Oregon and Idaho by MetLife Home Loans whose parent, MetLife, Inc., had recently announced that it would no longer originate forward mortgages. As of February 3, 2012, we have hired 140 mortgage personnel from this group, including the former Pacific Northwest regional sales manager and the former regional builder services manager as well as regional and branch managers, mortgage consultants and production support staff and related production support staff. We anticipate that we will open approximately 11 additional stand-alone lending centers in Washington and Idaho, primarily in the Puget Sound area, in order to accommodate these new hires. As a result of this expansion of our mortgage operations, we anticipate that we will incur additional expenses for compensation, facilities and other integration expenses that will not be completely offset by loan origination revenue in the first quarter of 2012 as these loan professionals rebuild their origination volume at the Bank.

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As a result of the economic downturn, which began in mid-to-late 2007 and continued until June 2009, our business experienced a series of interrelated adverse events, the combination of which led to significant operating losses that diminished our capital and weakened our financial condition. During this period, home prices and the volume of home sales decreased significantly along with occupancy and rental rates on commercial real estate. Related declines in the value of residential and commercial real estate, especially residential land and finished lots, significantly impacted the economic viability of many of our borrowers construction projects and investments and reduced the value of our collateral. Our classified assets increased from $114.8 million at December 31, 2007 to a peak of $759.7 million at June 30, 2009 and nonperforming assets increased from $35.7 million at December 31, 2007 to their peak of $482.0 million at December 31, 2009.

Although our average interest-earning assets increased from $2.44 billion during 2007, to $3.06 billion during 2009, our average loans held for investment remained relatively constant over that period, increasing from $2.24 billion during 2007, to $2.31 billion during 2009. Additionally, due to rising levels of problem assets, nonperforming assets increased from $35.7 million at December 31, 2007, to $482.0 million at December 31, 2009. During this same period, we established and maintained a high level of liquidity and invested this liquidity in short-duration, low-yielding investments. At the same time, in response to the economic turmoil in the national economy, the Federal Reserve reduced the target interest rate for Federal Funds to its lowest level since 1955 and market interest rates including the prime rate and LIBOR decreased accordingly. Most of our loans are variable interest rate loans tied to these indexes. The impact of declining interest rates has been more significant than with our peer institutions as a result of the absence of interest rate floors on many of our loans. At December 31, 2007, $1.35 billion of our loans, or 54.8% of our total loans, did not have interest rate floors. This combination of circumstances led to a substantial decline in our net interest income, which declined from $90.0 million for the year ended December 31, 2007 to $75.9 million for 2008 and to $31.5 million for 2009.

As a result of the deterioration in our asset quality, operating performance and capital adequacy, on May 8, 2009, we entered into an agreement with HomeStreet Bank s primary banking regulators, the Federal Deposit Insurance Corporation, or FDIC, and the Washington State Department of Financial Institutions, or DFI, pursuant to which we consented to the entry of an Order to Cease & Desist from certain allegedly unsafe and unsound banking practices. On May 18, 2009, we entered into a similar agreement with HomeStreet, Inc. s primary regulator, the Office of Thrift Supervision, or OTS. As of July 21, 2011, the OTS has been abolished and its supervisory and regulatory functions with respect to savings and loan holding companies, including the Company, have been transferred to the Board of Governors of the Federal Reserve System, or the Federal Reserve. References in this prospectus to the Federal Reserve shall include the OTS prior to the transfer date with respect to those functions transferred to the Federal Reserve. Among other things, the Orders directed us to increase our capital to certain specified levels, improve management, reduce classified assets and improve earnings. The Orders are described in more detail under Regulation and Supervision Cease and Desist Orders.

Pursuant to the Company Order, the Company has agreed, among other things, to refrain from engaging in all unsafe and unsound practices that have resulted in the Company s low earnings and inadequate capital. The Company Order does not contain specific minimum capital ratios or asset quality measures.

Pursuant to the Bank Order, the Bank was directed, among other things, to have and maintain a Tier 1 leverage capital ratio that equals or exceeds 10% and a total risk-based capital ratio that equals or exceeds 12% by October 5, 2009, as well as to develop and adopt a plan to reduce the Bank s exposure to adversely classified assets. As of September 30, 2011, the minimum amount of additional capital necessary to satisfy the capital ratio requirements of the Bank Order was $97.3 million.

The Bank has not yet satisfied the capital ratios mandated by the Bank Order. While this offering will improve our capital position and bring the Bank closer to compliance with these requirements, we will not be able to fully satisfy the requirements of the Bank Order based on this offering alone. However, we believe that, following the contribution to the Bank of at least $44.0 million in capital and subject to the successful completion of an on-site examination of the Bank by our primary regulators confirming our condition, we will qualify for replacement of the Bank Order with another form of enforcement agreement between the Bank and our

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regulators, which we expect would include provisions for maintenance of at least an 8.5% Tier 1 capital ratio and continued improvement in the Bank s asset quality. Management does not have any reason to believe that the risk-based capital ratio will be increased in any subsequent enforcement order.

We anticipate that a contribution of approximately $44.0 million of the aggregate net proceeds from this offering together with the Bank s preliminary January 2012 earnings and expected February earnings, will be adequate to bring the Bank s Tier 1 capital ratio to not less than 8.5%. However, if management determines that a greater or lesser amount would be necessary to reach that targeted capital ratio, taking into account, among other things, changes in the average assets and variations in the Bank s net income that may affect our regulatory capital ratios, we may adjust the actual amount of the contribution, up to the aggregate net proceeds. On a proforma basis as of September 30, 2011, we would have needed to contribute a total of $107.9 million to the Bank to achieve a Tier 1 capital ratio of 10.0%, or $69.8 million to achieve a Tier 1 capital ratio of 8.5%. Using preliminary, unaudited data as of December 31, 2011, we would need to contribute $98.7 million or $60.3 million, respectively, to achieve Tier 1 capital ratios of 10.0% and 8.5%.

We have implemented a plan for the Bank to reduce those loans that were classified as substandard or doubtful as of December 31, 2008, to which the FDIC and DFI issued a letter of nonobjection. However, the Bank did not achieve the target reduction of classified assets to 40.0% of Tier 1 capital plus allowance for loan losses by February 28, 2010, primarily due to lower than projected capital. As of February 28, 2010 that ratio was 91.6%. However, we achieved the 40.0% target as of June 30, 2011, as our ratio of remaining assets classified as substandard and doubtful as of December 31, 2008 was reduced to 38.2% of Tier 1 capital plus allowance for loan losses as of that date. As of September 30, 2011, our ratio of remaining assets classified as substandard and doubtful as of December 31, 2008 was 25.7% of Tier 1 capital plus allowance for loan losses.

The Bank has taken several other actions to comply with the requirements of the Bank Order including:

- retained a new Chief Executive Officer and other senior management who possess the qualifications, experience and proven ability to manage a bank of comparable size and experience in upgrading a low quality loan portfolio, raising capital and improving earnings;
- enhanced the infrastructure for the Bank s credit administration functions; and
- implemented revised lending, loan concentration and collection policies and procedures.

Similarly, HomeStreet, Inc., is not in compliance with the Company Order s requirement to increase capital. But for the exceptions noted above, we believe that we are in compliance in all material respects with the Orders.

The Orders and material actions taken to date are described in more detail under Regulation and Supervision Cease and Desist Orders.

Management Changes

In light of the then-prevailing economic conditions confronting our organization and to acquire bank turnaround and capital raising experience, the boards of directors of the Company and the Bank recruited and retained a management team that has proven expertise in raising capital and in turning around troubled financial institutions. Beginning in late 2009, additional executives were added: Mark Mason, our Chief Executive Officer, David Hooston, our Chief Financial Officer, Jay Iseman, our Chief Credit Officer and Godfrey Evans, our General Counsel and Chief Administrative Officer. These executives immediately began to implement a plan to reduce our credit risk and associated loan loss provisions, increase loan yields, maintain liquidity, restructure our high-cost deposit and funding structure, reduce operating costs, raise capital, and maintain our relationships with our federal and state banking regulators. See Management Executive Officers.

Turnaround Plan

Under the leadership of our new management team, we have implemented a plan to stabilize and turn around the institution. The principal elements of this plan are to improve asset quality and upgrade our credit

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culture, restructure the balance sheet and improve core earnings, control noninterest expense, maintain satisfactory regulatory relations and recapitalize the Company.

Improve Asset Quality and Upgrade Credit Culture

We have addressed the risks that contributed to the deterioration in our asset quality and earnings, including reducing and limiting loan concentrations in higher risk loan types and market segments where we have continuing concerns about deterioration in collateral values. Since 2007, we have dramatically curtailed most types of lending in response to deteriorating economic conditions and to preserve our regulatory capital ratios. We have also implemented or are implementing a number of additional measures aimed at improving our asset quality, including:

- *Aggressively managing troubled loans*. Where appropriate, we have restructured loans to improve our position, including negotiating principal reductions and additional collateral; aggressively collected on loans and guaranties; and obtained and enforced writs of attachment on bank accounts and personal property when necessary. Where restructuring has proven impossible or impracticable, we have negotiated deeds in lieu of foreclosure or have foreclosed on real property.

- *Actively marketing and selling other real estate owned (OREO)*. We have actively marketed and sold OREO to end users, such as developers and investors, who make direct and immediate use of such properties. We have generally avoided selling to financial buyers or other intermediaries who typically hold properties for a limited period of time and who do not generally improve or add value to the properties.

- *Restructured our credit administration and approval infrastructure*. We restructured our credit administration infrastructure to create more oversight at the board level and to better manage our loan approval process and credit exposure. We hired a Chief Credit Officer and centralized all credit approval, administration and portfolio monitoring functions under his authority. We also established a special assets department of our credit administration group to manage troubled loans and OREO. In addition, we hired an internal loan review officer who reports to the Bank board s credit committee.

- *Upgraded our underwriting policies and procedures*. We revised our lending policies and procedures to reflect more conservative underwriting standards, such as lower loan-to-value ratios, increased cash equity requirements and debt service coverage, lower maximum loan sizes, more restrictive financial covenants, including total debt, leverage and minimum cash flow, minimum net worth, liquidity and experience requirements, lower loan-to-one borrower limits, global financial reviews of borrowers and their credit histories and use of inter-creditor agreements when appropriate.

Balance Sheet Restructuring and Core Earnings Improvement

Our net interest margin had been negatively affected by variable rate loans originated without interest rate floors. To improve our net interest margin, management has instituted interest rate floors upon the renewal, restructuring or origination of loans. Between September 30, 2009, and September 30, 2011, loans without interest rate floors have decreased by $699.6 million, or 69.3%. The total balance of loans without interest rate floors was $309.8 million at September 30, 2011.

Historically, we had funded a portion of our asset growth by using FHLB borrowing facilities. To address potential liquidity risks related to the economic crisis, we had increased our reliance on FHLB borrowings and also used brokered deposits starting in late 2007 through 2009 to boost liquidity and provide coverage for potential deposit withdrawals. This increased liquidity was invested in short-term, highly liquid investment securities or carried as cash and cash equivalents, preparing us to react quickly to potential changes in the risk environment. While this strategy provided funding to address the liquidity concerns of regulators and depositors, it also had an adverse impact on our net interest income and net interest margin.

As the banking system began to stabilize in early 2010, we began moving to a more normalized liquidity management and investment strategy, reducing non-core deposits and wholesale funding while retaining and increasing core deposit balances and customers. In the second quarter of 2010 we sold $434.6 million of investment securities (predominantly U.S. Treasury securities and Ginnie Mae backed collateralized mortgage obligations), resulting in a $5.7 million gain. We used the proceeds from this transaction to pay down $390.7 million of FHLB borrowings, resulting in prepayment penalties of $5.5 million. We replaced an additional $121.3 million of FHLB borrowings that matured during 2010 with retail deposits. Management moderately lengthened the duration of the remaining investment securities portfolio such that current liquidity investments produce a positive net interest margin. Between September 30, 2009, and September 30, 2011, FHLB advances and brokered deposits have decreased from $1.01 billion to $67.9 million. This noncore funding has been generally replaced with retail deposits or retired with proceeds from the sales of investment securities.

The composition of our deposit portfolio continues to improve. We have changed our certificate of deposit interest rate strategy to position ourselves as neither the highest nor the lowest rate in our markets and to also provide our bank branch managers with the ability to negotiate limited rate exceptions on new certificates of deposit to reward those customers who currently have or bring their primary checking account to the Bank. Additionally, we have initiated a marketing strategy to attract new consumer checking account relationships through cash payments available to new customers for the use of certain services such as direct deposit. Through this strategy we are attracting and retaining relationship-based customers and eliminating rate-sensitive time deposit customers, which has the dual effect of creating a more stable funding base that is representative of a relationship-based institution and returning us to a more normalized liquidity profile. Our ability to reduce excess liquidity has been dependent on our ability to reduce deposits. The results of our strategy to increase core deposit relationships while encouraging the outflow of non-core deposit relationships through lower interest rates on certificates of deposit has been effective. Between September 30, 2009 and September 30, 2011, core deposits (checking, savings and certificates of deposits with balances less than $250,000) have increased from 63.8% of bank funding to 93.6% of bank funding.

As a result of the actions we have taken, our net interest margin has increased from 0.85% for the quarter ended September 30, 2009 to 2.38% for the quarter ended September 30, 2011.

Control Noninterest Expense

We have experienced, and we expect in the near term to continue to experience, higher than normal noninterest expense associated with loan resolution activities, dispositions of OREO, increased deposit insurance costs and costs associated with compliance with the Orders. However, during this time we have reduced other core banking compensation and general and administrative expenses by streamlining operations and reducing unnecessary staff, freezing salaries, suspending our 401(k) plan employer match from July 2009 to July 2010 and reducing travel and entertainment budgets. Going forward, we plan to manage future changes in all noninterest expense categories based on changes in revenue growth, reductions in problem assets and removal of the Orders. Upon satisfaction and removal of the Orders, we anticipate lower regulatory-related expenses, deposit insurance assessments, professional fees, and time devoted by management and staff to compliance with the Orders.

Maintain Satisfactory Regulatory Relations

Maintaining the confidence of our regulators is an integral part of our turnaround plan. Beginning in the fourth quarter of 2009, management initiated monthly conference calls with our regulators to present and discuss progress on management changes, problem asset reduction, capital adequacy, interest rate risk, liquidity maintenance, funding restructuring and earnings. These meetings have produced transparency in our relationship with our regulators and have facilitated current reporting of the status of management s turnaround plan.

In order to maintain satisfactory regulatory capital ratios, we have to the extent practicable, reduced total assets. Our Tier 1 leverage capital and Tier 1 risk-based capital ratios stood at 5.6% and 9.8%, respectively, at September 30, 2011, as compared to 4.5% and 8.2% at December 31, 2010, 4.5% and 8.5% at December 31, 2009, and 8.7% and 11.8% at December 31, 2008. While the contribution to the Bank of at least $44.0 million from the aggregate net proceeds of this offering will not fully satisfy the requirements of the Bank Order we believe that following the contribution to the Bank of at least $44.0 million in capital from this offering, and subject to the completion of an on-site examination of the Bank by our primary regulators, we will qualify for replacement of the Bank Order with another form of enforcement agreement between the Bank and our regulators which we expect would include provisions for the maintenance of at least an 8.5% Tier 1 capital ratio and continued improvement in the Bank s asset quality. Management does not have any reason to believe that the risk-based capital ratio will be increased in any subsequent enforcement order.

Recapitalize the Company

Capital

Upon the successful completion of this offering, we expect to contribute approximately $44.0 million of the net proceeds to the Bank. The Bank is required by the Bank Order to maintain a Tier 1 leverage capital ratio of at least 10% and a risk-based capital ratio of at least 12%. While this offering will improve our capital position and bring the Bank closer to compliance with these requirements, we will not be able to fully satisfy the requirements of the Bank Order based on this offering alone. However, we believe that following the contribution to the Bank of at least $44.0 million in capital from this offering, and subject to the completion of an on-site examination of the Bank by our primary regulators confirming our condition, we will qualify for replacement of the Bank Order with another form of enforcement agreement between the Bank and our regulators which we expect to include provisions for maintenance of at least an 8.5% Tier 1 capital ratio and continued improvement in the Bank s asset quality. Management does not have any reason to believe that the risk-based capital ratio will be increased in any subsequent enforcement order. Based on guidance from the Federal Reserve, we believe that we will need to further reduce our classified assets in the future to qualify for the lifting of the Company Order.

We anticipate that a contribution of approximately $44.0 million of the aggregate net proceeds from this offering together with the Bank s preliminary January earnings and expected February earnings, will be adequate to bring the Bank s Tier 1 capital ratio to 8.5%. However, if management determines that a greater or lesser amount would be necessary to reach that targeted capital ratio taking into account, among other things, changes in the average assets and variations in the Bank s net income that may affect our regulatory capital ratios, we may adjust the actual amount of the contribution, up to the aggregate net proceeds. On a proforma basis as of September 30, 2011, we would have needed to contribute a total of $107.9 million to the Bank to achieve a Tier 1 capital ratio of 10.0%, or $69.8 million to achieve a Tier 1 capital ratio of 8.5%. Using preliminary, unaudited data as of December 31, 2011, we would need to contribute $98.7 million or $60.3 million, respectively, to achieve Tier 1 capital ratios of 10.0% and 8.5%.

The table below presents the Bank s Tier 1 leverage and total risk-based capital ratios, as of January 31, 2012, both actual and on a pro forma basis giving effect to the anticipated contribution in the Bank of approximately $44.0 million from the proceeds of this offering, as well as the Company s consolidated pro forma capital ratios reflecting the condition of both the Bank and the Company after giving effect to such events.

	Bank Actual	**Pro Forma Bank(1)**	**Well Capitalized**
Tier 1 Leverage Capital Ratio	6.5%	8.5%	5.0%
Total Risk-Based Capital Ratio	11.6%	14.8%	10.0%

(1) Reflects an anticipated contribution to the Bank of approximately $44.0 million from the proceeds of this offering.

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We intend to contribute a substantial portion of the aggregate net proceeds of this offering to the Bank. As a result, the Company does not expect to have adequate capital to fund operating expenses and to bring current the deferred interest due on our outstanding trust preferred securities when that deferral period expires in December 2013 based on this offering alone. To the extent that we are not able to generate enough operating profit at the Bank and/or distribute such profit to the Company prior to the end of that deferral period in an amount adequate to mitigate any capital shortfall existing after the completion of this offering, we will need to raise such additional capital from external sources, which may include a capital raise through the sale of additional equity securities.

Third-Party Loan Review

In preparation for this offering and to provide an independent assessment of the adequacy of our allowance for loan losses, confirm the accuracy and timeliness of our asset classifications, and assess the accuracy of management s carrying values of our loan portfolio and OREO, we retained Unicon Financial Services, Inc., an independent third-party loan review consultant. Based upon its review, the scope of which is described below, Unicon reported that management s allowance for loan losses as of June 30, 2011, and without giving effect to subsequent events, was adequate; that our current risk rating system was reasonable and accurately reflected the significant risks associated with individual credits; and the carrying values of our loans and OREO were materially correct. Unicon s report was provided to us in July 2011 and was based on our loan portfolio, OREO and financial position as of June 30, 2011.

Commercial Loan and Commercial Real Estate Loan Portfolios. Unicon conducted detailed reviews of selected commercial and commercial real estate loans and of all OREO, as well as a macroanalysis of the two homogenous portfolios (single family residential loans and home equity lines of credit). In the commercial and commercial real estate pass loan portfolio, Unicon sampled 100% of the loans with funded amounts and unfunded loan commitments greater than $2.5 million; 40% of loans of $1.0 million to $2.5 million, 15% of loans of $0.5 million to $1.0 million, and a sample of loans with balances of less than $0.5 million. Of the loans internally graded special mention, substandard or doubtful, Unicon sampled all loans with funded amounts and unfunded loan commitments greater than $1.0 million; 50% of the loans of $0.5 million to $1.0 million, and a sample of loans less than $0.5 million. Unicon also sampled loans with balances greater than $250,000 that were past due or on nonaccrual status. Unicon also sampled the remainder of the portfolio including new and renewed loans originated in the last 12 months, restructured loans, loans with approved loan policy exceptions, construction loans, asset based lending facilities and other loans whose terms may give rise to elevated risk. Overall, Unicon reviewed 299 commercial and commercial real estate loans totaling $808 million in loan commitments (funded amounts are from funded loan amounts) which represents approximately 81% of the total loans in the commercial and commercial real estate loan portfolio as of June 30, 2011.

Single Family Residential Loans and Home Equity Lines of Credit. Unicon conducted a macroanalysis of the entire single family residential loan and home equity line of credit portfolios. The total loan commitments for these two portfolios (funded amounts are from funded loan amounts) were $686 million. Unicon reviewed the Bank s statistical analysis and the raw data to develop their view of these loans.

OREO. Unicon conducted a detailed review of the Bank s carrying value of the OREO portfolio. Unicon s sample included 100% of the OREO with a book balance of $300,000 or more. In total, Unicon reviewed 57 OREO properties with a total book balance of $84 million, which represented 82% of the Bank s total OREO portfolio at June 30, 2011. Unicon reviewed each OREO property to determine if the Bank s carrying value was accurate and complied with regulatory guidelines.

With respect to the allowance for loan losses, Unicon concluded that the allowance for loan losses as of June 30, 2011 was adequate. Unicon found that the amount of allowance for loan losses was adequate to absorb losses inherent in our portfolio of loans held for investment based on the information currently available to Bank management. In reaching its conclusions, Unicon considered the results of its risk rating review and the bank regulatory agencies policy statements on factors to be used to determine the appropriate level for the allowance for loan losses.

Unicon reviewed the adequacy of management s forward-looking assessment of the Bank s loan portfolio over the next 12 months. In reviewing that assessment, Unicon reported that management s evaluation was reasonable. In the course of their review Unicon applied assumptions over a range of scenarios that could have potential adverse effects on the loan portfolio including assumptions about borrowers ability to repay, potential liquidation values that could be achieved and the economy. This forward-looking assessment, according to Unicon, took a more aggressive approach than required by applicable regulatory guidance or the Bank s policy for establishing the amount of the allowance for loan losses.

Unicon assessed the accuracy of the management s risk rating system for the Bank s loans. Unicon determined that management s current risk rating system was reasonable and accurately reflected the significant risks associated with individual credits. Unicon agreed with management s ratings for individual loans and any grading differences noted during their review were insignificant and were not considered material. In the course of assessing credit quality, Unicon considered the underwriting of each commercial and commercial real estate credit, as well as the borrower s financial capacity based on the available financial information, payment performance and estimated collateral values.

Unicon found that collateral values used in establishing the Bank s reserves for impaired, collateral dependent real estate loans were materially correct. In reaching this conclusion, Unicon considered the likelihood that the borrowers would be able to meet their contractual obligations and repay both the principal and interest. In addition, Unicon s review of the carrying values of the Bank s OREO revealed no material discrepancies.

Unicon reviewed the reasonableness of management s assessment of the recoverability of its loans. Unicon found that on an overall basis, management s assessments regarding the potential recovery of the loans to be reasonable and supported by sufficient documented analysis. Unicon s conclusions were based on various documents in the Bank s files including problem loan reports as well as interviews with management regarding the assessment of troubled loans along with their collection strategies.

Unicon was not engaged to verify borrower information provided and was not in position to assess the Bank s loan files and loan portfolios for bank fraud. Unicon s findings and views are based on review of the Bank s records and discussions with management, which Unicon assumed to be accurate and reliable. Unicon s findings are subject to changes in the condition and operations of the Bank, and as such, future changes may affect Unicon s conclusions. Factors that could alter Unicon s conclusions include: changes in management, changes in management s collection strategies, changes in the allowance methodology, changes in the economy, new regulatory requirements and/or potential actions or inactions. Unicon stated that reliance on their report should diminish with the passage of time.

As illustrated below, we believe that as a direct result of the effective execution of certain elements of our turnaround plan, described above, we have made significant progress to date toward reducing our credit risk and improving our financial condition and results of operations. We believe part of this success is demonstrated by our results of operations, which have improved from a net loss of $110.3 million in 2009 to a net loss of $34.2 million in 2010. For the nine months ended September 30, 2011 we recognized net income of $9.1 million as compared to a net loss of $19.9 million in the nine months ended September 30, 2010. We recognized net income of $16.1 million in 2011 and $8.2 million for the month ended January 31, 2012. Our financial results for the year ended December 31, 2011 have not yet been audited and are subject to finalization. Our January 2012 financial results have not been subjected to an audit or review and will not be subjected to audit or review procedures until later 2012 as part of the normal quarterly interim review procedures and annual audit process. January results also do not include loan loss provision or impairment charges, which we assess primarily at the end of each fiscal quarter, however, we have recorded loan loss provisions as an expense in prior quarters and expect to record such provision expense at the end of the first quarter of 2012. January results may not be indicative of our results for the full first quarter of 2012.

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The following selected turnaround results reflect improvements since September 30, 2009, which coincides with the commencement of our turnaround plan.

	Month Ended		Three Months Ended $ Thousands (Unaudited)				
	31-Jan-12(1)	31-Dec-11 (1)	30-Sep-11	30-Jun-11	31-Mar-11	31-Dec-10	30-Sep-09
Total Construction Loans	$ 171,493	$ 173,405	$ 213,001	$ 234,062	$ 271,676	$ 285,131	$ 733,394
Provision for Loan Losses			1,000	2,300		8,200	35,555
Classified Assets	191,217	188,167	225,022	276,476	298,742	363,947	737,925
Nonperforming Loans	75,379	76,484	95,094	90,912	124,118	113,210	388,663
OREO	35,533	38,572	64,368	102,697	98,863	170,455	63,321
Nonperforming Assets	110,912	115,056	159,462	193,609	222,981	283,665	451,984
Total Delinquencies and Nonaccruing Loans (2)	161,009	139,860	144,133	132,481	188,013	178,286	495,168
Total Assets	$ 2,244,249	$ 2,264,957	$2,316,839	$2,233,505	$ 2,342,639	$ 2,485,697	$ 3,224,464
Nonperforming Assets/Total Assets	4.9%	5.1%	6.9%	8.7%	9.5%	11.4%	14.0%
Nonperforming Loans/Loans	5.6%	5.7%	6.7%	6.26%	7.94%	7.06%	17.7%
Total Delinquencies and Nonaccruing Loans/Loans	11.9%	10.4%	10.2%	9.1%	12.0%	11.1%	22.6%
Net Income (Loss)	$ 8,236	$ 7,026	$ 15,258	$ 1,284	$ (7,449)	$ (14,395)	$ (43,311)
Return on Average Assets	1.44%	1.23%	2.67%	0.23%	(1.25)%	(2.23)%	(5.37)%
Return on Average Equity	36.13%	33.44%	83.04%	8.97%	(51.26)%	(72.28)%	(120.44)%
Shareholders Equity per Share	$ 71.10	$ 63.96	$ 59.47	$ 43.17	$ 37.91	$ 43.52	$ 89.74
Net Interest Margin	2.50%	2.50%	2.38%	2.35%	2.17%	2.34%	0.85%
Operating Efficiency Ratio (3)	46.29%	74.78%	47.74%	70.05%	83.31%	69.51%	108.05%

(1) Amounts presented are preliminary and subject to finalization.

(2) Includes $47.7 million, $45.2 million, $37.3 million, $34.0 million, $39.4 million and $36.1 million respectively, of loans guaranteed by Ginnie Mae for which we have little or no risk of loss

(3) We include an operating efficiency ratio which is not calculated based on accounting principles generally accepted in the United States (GAAP), but which we believe provides important information regarding our result of operations. Our calculation of the operating efficiency ratio is computed by dividing noninterest expense less costs related to OREO (gains (losses) on sales, valuation allowance adjustments, and maintenance and taxes) by total revenue (net interest income and noninterest income). Management uses this non-GAAP measurement as part of its assessment of performance in managing noninterest expense. We believe that costs related to OREO are more appropriately considered as credit-related costs rather than as an indication of operating efficiency. The following table provides a reconciliation of non-GAAP to GAAP measurement.

	31-Jan-12	31-Dec-11	30-Sep-11	30-Jun-11	31-Mar-11	31-Dec-10	30-Sep-09
Efficiency ratio	50.23%	84.07%	66.25%	88.43%	128.42%	111.77%	115.43%
Less impact of OREO expenses	3.94%	9.29%	18.51%	18.38%	45.11%	42.26%	7.38%
Operating efficiency ratio	46.29%	74.78%	47.74%	70.05%	83.31%	69.51%	108.05%

Our Growth Strategy

Integrated Consumer and Business Financial Services Delivery Strategy

Our Community Banking strategy involves the development of an integrated consumer and business financial services delivery platform. We seek to meet the financial services needs of our consumer and business customers by providing targeted banking products, investment advice and products, and insurance products through our bank branches and through dedicated investment advisors, insurance agents and business banking officers. We have historically offered a limited line of investment, cash management and insurance products. We are currently in the process of significantly enhancing and expanding our products and services by:

- expanding our investment product offerings through a third-party broker dealer, building a staff of dedicated investment advisors and sales representatives and licensing additional qualified branch personnel for annuity sales;
- providing a comprehensive investment product offering that includes mutual funds, annuities and individual securities;
- providing comprehensive succession planning, estate planning and financial planning to individuals and business owners using a third-party financial services company;
- enhancing our business cash management service offerings and building a team of business cash management sales and support personnel; and
- expanding our insurance product offerings and integrating sales of these products into our consumer and business financial advisory activities.

Expand Core Deposit Base

We plan to grow our bank branch core deposit base through limited media advertising, effective deposit product design, consumer account cash incentives, cash referral bonuses and relationship incentives. For example, we promote special usage-based offers to reward consumers for opening their primary checking account at HomeStreet Bank. We also have enhanced our deposit interest rate strategy so that our rates are neither the highest nor the lowest in the market, and we promote rate incentives for customers who have more than just certificates of deposit with us. We expect this strategy to help us attract and retain customers who are less rate-sensitive and more relationship-oriented.

Our growth strategy will be limited by our regulatory status, which generally would preclude consent from the FDIC and the DFI in order to open new bank deposit branches. However, once the Orders are lifted we intend to expand our bank branch network to support core deposit growth and expand our consumer and business financial services customer base as well as to increase access to our services and products for our current customers. In the near term, we will concentrate this growth in the Puget Sound area to create greater branch density. Longer term, we intend to increase our bank branch density in all of our current markets. We may also open additional stand-alone loan production offices to support our mortgage and business banking activities.

We also intend to grow our core deposits by increasing business deposits from local businesses near our branches and from our existing business banking clients. To attract new business customers, we offer money market and business savings accounts as well as a competitive array of cash management products including business online banking, automated clearing house, wire transfer, remote deposit capture and courier and merchant card services.

Business Banking Growth

During our turnaround, we have focused on retaining our existing customers and developing new deposit-oriented customer relationships. As the economy improves, we believe we will be well positioned to attract new middle market business customers requiring commercial business and owner-occupied real estate loans. The number of competitors for middle-market business customers has decreased in recent years due to bank failures and consolidations. In recent years national banks have focused on larger customers in order to achieve economies of scale in lending and depository relationships and have also consolidated business banking operations and support, and reduced service levels in the Pacific Northwest. Additionally, high levels of problem loans at many local banks combined with low levels of capital have significantly impaired reduced competitors capacity to make new loans.

New loan demand is generally weak because of the economic downturn, resulting in increased competition for good customers in spite of industry consolidation. However, as the economy improves and new loan demand

increases we believe our community banking focus will distinguish us from our competitors, because we are able to offer quicker, local decision making and provide customers with direct access to our senior managers. At the same time, our larger capital base and broader offering of products and services enables us to compete effectively against smaller banks. As a result, we believe we have a substantial opportunity to attract additional borrowers and depositors and expand our presence and market share, especially in the high-growth Puget Sound area.

Single Family Mortgage Origination and Servicing Portfolio Growth

During the real estate boom of 2004 to 2007 we maintained our historical focus on originating conforming conventional and FHA and VA loans for sale in the secondary market while supplementing those products with some portfolio lending. Our adherence to traditional credit standards limited our loan originations during the peak of the expansion of the subprime and option adjustable rate mortgage lending boom, and we lost market share to competitors during this time. However, our conventional mortgage banking expertise positioned us to expand our originations when market conditions changed as a result of the tightening in lending standards and the market s reliance on government sponsored entities and agencies for secondary market liquidity, and we believe that our high quality standards for lending documentation has limited our exposure to some of the difficulties in enforcing foreclosures that have faced other mortgage lenders. As a result, we have grown our single family origination and servicing business substantially since 2007. We originated $1.43 billion, $1.53 billion, $1.45 billion and $1.57 billion in home loans in 2004, 2005, 2006 and 2007, respectively, followed by $1.74 billion, $2.73 billion, and $2.07 billion in 2008, 2009, and 2010, respectively. For the nine months ended September 30, 2011, we originated $1.09 billion. At December 31, 2008, 2009 and 2010 our portfolio of single family residential loans serviced for others stood at $4.70 billion, $5.82 billion, and $6.34 billion, respectively, and was $6.65 billion at September 30, 2011.

The Obama administration and Congress have offered several proposals for reducing the role of the federal government in housing finance, including the eventual unwinding of Fannie Mae and Freddie Mac. These proposals are intended to protect taxpayers from risk and to attract private capital to home financing. We are following these proposals very closely, and we plan to adapt to the changes and seize opportunities to lend and sell into the secondary market as it evolves beyond its over-reliance on government guaranteed lending.

The loan quality of our single family mortgage originations historically has been better than the averages for the government-sponsored entities that buy and insure our loans. Our two largest relationships are with Fannie Mae, to which we sell most of our conforming conventional loans, and Ginnie Mae, to which we sell FHA-insured and VA-guaranteed loans. As of January 2011, our Fannie Mae single family serious delinquency rate (loans more than 90 days delinquent) was 1.0%, compared with Fannie Mae s serious delinquency rate of 3.5% overall on non-credit enhanced loans. Our FHA Compare Ratio, which measures delinquency rates among the FHA s participating originators was 64.0%, which means that our originations serious delinquency plus claims rate was 64.0% of the FHA average.

We have taken advantage of market dislocations since mid-2007 to add many new loan originators, and we plan to continue to grow our single family mortgage banking business in the near term by adding experienced loan originators and managers and opening additional branch offices in our current markets. In early 2012, we took advantage of another opportunity to add experienced loan originators and accelerate our plans to expand our single family mortgage origination business by hiring approximately 140 mortgage personnel formerly associated with MetLife Home Loans, which announced plans to discontinue their forward mortgage origination plans in January 2012. We expect to open approximately 11 additional loan production offices in Washington and Idaho in order to accommodate this expansion, and anticipate a significant increase in our loan origination volume for single family mortgage loans. We also continue to add offices and loan originators to WMS. We have been able to leverage these additional originators, along with our reputation for high quality service and reliable loan closing, to increase our market share significantly over the last three years. In that regard, we have added underwriting, processing and funding capacity to support this growth in loan volume.

We intend to continue focusing on conventional conforming single family mortgage banking and use portfolio lending to complement, but not replace, secondary market lending, particularly for well qualified borrowers with loan sizes greater than the conventional conforming limits. In addition, we plan to open a correspondent lending channel to purchase loans originated by credit unions and small community banks, and we are exploring strategies to increase our Internet lending.

Multifamily Mortgage Banking Growth

We plan to grow our multifamily mortgage banking business, particularly through our Fannie Mae DUS origination and servicing relationships. We plan to expand beyond our current markets by forming strategic alliances with producers and underwriters in the Western Region of the United States.

We intend to expand our multifamily residential mortgage lending business by targeting strong apartment markets and experienced borrowers with whom we have had prior working relationships. We expect to continue to benefit from being one of only approximately 25 companies nationally that has Fannie Mae DUS selling and servicing approval. The Fannie Mae DUS program has become a key multifamily funding source nationally, due to the turmoil in the financial services industry and the resulting loss of other financing sources. We have historically supported our DUS program by providing short-term bridge loans to experienced borrowers who purchase apartment buildings for renovation, which we then seek to replace with permanent takeout financing through the Fannie Mae DUS program upon completion of the renovations. As market conditions warrant, we also may originate permanent loans and construction loans. Historically, our Fannie Mae multifamily DUS loan portfolio has had strong credit quality. Since we began originating Fannie Mae DUS loans in 1988 we have never experienced a material delinquency or credit loss, nor have we been required to buy back any loans.

Strategic Acquisitions

The economic downturn and related banking crisis have led to increased regulatory and compliance burdens, management fatigue and limited access to capital. As a result, we anticipate there will be opportunities to acquire small institutions in the Pacific Northwest that would enhance our franchise and complement our branch network. Following this recapitalization we may consider such strategic opportunities to acquire other institutions or branches. We may need to raise more equity or additional capital to implement this strategy.

Competitive Strengths

The Bank has a number of competitive strengths and advantages that position the institution for future growth.

Established and Well-Respected Seattle-based Franchise

Through our 90-year history, we have developed a highly skilled, dedicated workforce who understand our business and have long-standing relationships with our customers. Furthermore, we have a strong tradition of involvement in our communities, and promote management participation in charitable, civic and social organizations that we believe enhance the visibility of the HomeStreet brand in each of our communities. We have developed a footprint in the Pacific Northwest, that includes the highly attractive Puget Sound region in Washington and the greater Portland region in Oregon, as well as selected markets in Hawaii. We are a leading mortgage originator in the markets we serve. For example, according to *MortgageDataWeb*, www.mortgagedataweb.com, in the Seattle area we had a conventional and government market share ranking of #10 and #7, respectively, in 2010.

Experienced and Talented Management Team

We have assembled an executive management team that possesses significant depth of knowledge and expertise in bank turnaround situations and in operating and growing community banks. Additionally, the Bank has significant depth and experience in its senior management ranks. The five senior managers in our lending units average 33 years of industry experience and average 25 years with the Bank. In our mortgage banking units, each of the managers has built strong working relationships with our investor partners, particularly Fannie Mae. Three managers currently serve on four of Fannie Mae s primary advisory boards/councils. Our Retail Banking Director has 32 years of industry experience, including 26 years with the Bank. Our Chief Credit Officer, Risk & Regulatory Oversight Director, and Treasurer have an average of 25 years of industry experience and 11 years on average with the Bank.

Disciplined Underwriting and Credit Culture

Since 2008, we have made significant modifications to our credit policies and procedures designed to foster disciplined underwriting practices and create a strong credit culture. Our Chief Executive Officer has significant credit management experience, and we bolstered our added credit and underwriting expertise at the board and management levels. We have restructured our credit administration infrastructure to create more oversight at the board level and to better manage our loan approval process and credit exposure and centralized all credit approval, administration and portfolio monitoring functions under the authority of our Chief Credit Officer. We also revised our lending policies and procedures to reflect more conservative underwriting standards, such as lower loan-to-value ratios, and increased cash equity and debt service coverage requirements.

Significant Sources of Noninterest Income

Our noninterest income is substantially higher than traditional banks.

Highly Profitable Single Family Mortgage Origination and Servicing Business. Throughout the economic downturn, our mortgage origination and servicing business has provided us with a continuing source of profitability and internal capital generation. Our mortgage banking expertise has positioned us well to take advantage of current market conditions. HomeStreet has been primarily a conventional conforming loan originator, making mortgage loans conforming to Fannie Mae, Freddie Mac, and FHA and VA guidelines, supplemented by a small menu of portfolio products. As noted earlier, the Bank has the oldest continuous relationship of all Fannie Mae seller-servicers in the nation. We have been an FHA-approved lender continuously since 1937 and a VA approved lender continuously since its founding in 1944. We possess the product expertise and servicing infrastructure to originate and service government guaranteed loans and specialized products such as 203(k) rehabilitation loans and Department of Hawaiian Home Lands (DHHL) loans that require specific product knowledge and servicing expertise. The Bank derives significant competitive benefits from the scale and longevity of WMS, its joint venture, with Windermere Real Estate Services Company, the largest real estate brokerage company in the Pacific Northwest by sales volume. A primary benefit is the diversification of loan origination capabilities through mortgage consultants located in Windermere Real Estate offices, who can reach potential purchase customers and referral sources early in the home-buying process. We also benefit from increased loan production, which improves the efficiency and profitability of our mortgage origination infrastructure and helps us achieve better pricing and terms with Fannie Mae, Freddie Mac and other correspondent lenders. Windermere s focus on the purchase market adds significantly to volume, loan quality and profits during strong purchase markets.

Multifamily Mortgage Origination and Servicing Expertise. The Company was one of the first lenders approved by Fannie Mae as a DUS lender and we remain one of only 25 DUS lenders nationally.

Growth Opportunity in Fee-generating Banking Services. We are currently expanding our cash management, investment and insurance product and service offerings. We believe our integrated approach to the delivery of these products and services will enhance customers sales experience and enable growth in our customer base and fee revenues.

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Compliance Culture

Historically, we have emphasized compliance in all of our activities. In addition to the general banking regulations, our single family lending, loan servicing businesses and our investment advisory and product sales businesses are subject to complex regulations. In particular, our single family mortgage and multifamily origination and servicing businesses are highly dependent upon successful compliance with underwriting and servicing guidelines of Fannie Mae, Freddie Mac and Ginnie Mae as well as a myriad of federal and state consumer compliance regulations. Additionally, these activities, together with our significant volume of lending to low- and moderate-income areas and direct community investment, contribute to our uninterrupted record of Outstanding CRA ratings since the inception of the Bank in 1986. The financial services industry generally, and the single family mortgage banking industry in particular, is experiencing consolidation caused, in part, by the ever-increasing operational and cost burden of compliance. We believe our ability to maintain our historically strong regulatory compliance culture and our track record of compliance with regulations and guidelines are significant competitive advantages.

Moreover, a number of mortgage servicing enterprises and banks have experienced claims, defenses and counterclaims from consumers and borrowers relating to loan collection practices, particularly associated with mortgage collection and foreclosure activities. We have not received notice of any complaint, threat, or allegation relating to faulty affidavits or chain of title concerns relating to our mortgage servicing and residential mortgage foreclosure activities. Based on our current residential mortgage foreclosure practices and the applicable statutory and case law, we are aware of no material contingency, nor quantifiable estimated loss, relating to robosigning or chain-of-title concerns in our foreclosure activities.

Our Structure

HomeStreet, Inc. was established in 1921 as Continental Mortgage and Loan Company, initially offering financing for commercial real estate and home mortgages. Continental Savings Bank was established in 1986 and changed its name to HomeStreet Bank in 2000. Our activities are conducted through the following consolidated subsidiaries:

HomeStreet, Inc. operates a personal lines insurance agency offering home, auto, life, umbrella, boat, motorcycle, recreational vehicle, earthquake, difference in conditions and notary bond insurance products.

It is licensed to do business in Washington and Oregon under the name HomeStreet Insurance and is licensed to do business in Hawaii for life insurance only.

HomeStreet Bank, a regional state-chartered savings bank headquartered in Seattle, Washington.

We hold common securities in four statutory business trusts, which have, in turn, issued trust preferred securities. We have previously commenced tender offers for all of the outstanding trust preferred securities issued by these trusts; however, we have terminated those tender offers. See Dividend Policy above for a further description of the trust preferred securities.

HomeStreet Capital Corporation has been originating, selling and servicing multifamily residential loans made through the Fannie Mae DUS program since 2000.

Union Street Holdings LLC, a Washington limited liability company, holds title to, markets and disposes of real estate acquired through foreclosure.

HomeStreet Reinsurance, Ltd. was established in 2000 as a limited-purpose reinsurance company. It is incorporated in the Turks and Caicos Islands and reinsures private mortgage insurance solely with respect to mortgage loans originated by the Bank. We discontinued all new reinsurance business at the end of 2008 and we are monitoring market conditions to determine if and when we will begin writing new reinsurance risk.

Continental Escrow Company provides reconveyance services solely for the Bank in connection with deeds of trust on one-to-four family residential loans, or single family residential loans, originated by the Bank.

HomeStreet/WMS, Inc. holds joint venture interest in Windermere Mortgage Services Series LLC, or WMS. The remaining equity interest in WMS is held by certain franchisees of Windermere Real Estate Services Company, one of the largest real estate brokerage companies in the Pacific Northwest by sales volume. Through WMS, we provide point-of-sale loan origination services in 42 Windermere Real Estate offices in Washington and Oregon.

Market Opportunities

Pacific Northwest Market

The Pacific Northwest has experienced dramatic dislocations in its banking and real estate markets that are similar in severity and duration to the national downturns in these markets. For example, according to the Case-Shiller Housing Prices Index, housing prices in Seattle, our largest market, experienced a decline of approximately 27.9% from the market peak of July 2007 through December 2010, and declined 6.0% from December 2009 to December 2010 and 1.2% from December 2010 to August 2011, reflecting average values last experienced in November 2004. Portland, our second-largest market, has also suffered, with the Case-Shiller index indicating a 7.6% decline in housing prices for the twelve months ended August 31, 2011. Portland home prices in August 2011 were on par with those experienced in February 2005. Residential mortgage delinquencies remained elevated, with 6.7% of Washington State residential mortgages being delinquent during the second quarter of 2011 according to published reports.

Economic recovery has been hampered by a variety of factors in our markets, most prominently including continuing slow improvement in unemployment statistics, with Washington State s unemployment rate decreasing slightly from 9.4% in September 2010 to 9.1% in September 2011, according to the Bureau of Labor Statistics. Our markets continue to be affected adversely by residential foreclosures. In August 2011, the three-county Metropolitan Seattle area (King, Pierce and Snohomish Counties) had a foreclosure rate the 93rd highest among the 206 U.S. areas with more than 200,000 people. Washington had the 23rd highest rate among states and Washington DC.

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While the path of the national economic recovery remains unclear, we believe our market areas have unique strengths that will support a faster recovery than the national economy.

The greater Seattle and the Portland metropolitan areas have higher median household incomes than both the national average and their respective state averages. The U.S. Bureau of Economic Analysis ranked the Seattle-Tacoma-Bellevue areas number 13 in the country for per capita personal income in 2009.

We expect population to grow in Seattle and Portland metropolitan areas through a combination of organic growth and net in-migration. Moreover, we believe that job growth and recovery will outpace the national recovery in our Pacific Northwest markets, in part due to:

- the Seattle area s port, aircraft and high-tech industries, well-educated workforce, high incomes, and strong population trends;

- the stabilizing presence of a large military base in the Tacoma area; and

- a continued influx of young, educated workers in the Portland market and the presence there of high-tech industries, especially chip manufacturers.

Regional economic forecasts estimate that housing prices in our Pacific Northwest markets will rise approximately 25.1% from 2012 through 2015 after declining in 2011, as depicted below.

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Based on these same forecasts, single family permits in our Pacific Northwest markets are anticipated to increase on average 163.7% through 2014.

These same data reflect that multifamily construction permits in our Pacific Northwest markets will increase 63.8% through 2015.

In October 2011, The Urban Land Institute and PricewaterhouseCoopers evaluated major real estate markets (metropolitan areas with a population over 3 million) in their 2011 Emerging Trends in Real Estate report. Seattle is ranked number five overall. Seattle was among the markets described as having established 24-hour characteristics, diversified economies and prominent locations with geographic barriers along global pathways combine to offer relative stability: values tend to appreciate more in up markets and rebound more quickly in downturns.

Industry Dislocations

We have taken advantage of the failures and takeovers of certain of our competitors by recruiting well-qualified employees and attracting new customers who seek long term stability, quality products and expertise.

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We believe there is a significant opportunity for a well-capitalized, community-focused bank that emphasizes responsive and personalized service to provide a full range of financial services to small and middle-market commercial and retail customers in those markets where we do business. In particular, the 2008 failure of Washington Mutual, Seattle s largest financial institution prior to its failure, has created significant opportunities for locally managed consumer and business banks. As the second largest locally headquartered bank in Seattle, HomeStreet Bank has been in a strong position to fill this vacuum.

Barriers to Entry Single Family Mortgage Origination and Servicing

Compliance burden. The mortgage industry is compliance-intensive and requires significant expertise and internal control systems to ensure origination and servicing of mortgages that meet all origination, processing, underwriting, servicing and disclosure requirements. New entrants to the industry must make significant investments in experienced personnel and specialized systems to manage this process. These investments represent a significant barrier to entry.

Capital requirements. Lending in conventional mortgage products, including FHA and VA loans, requires significantly higher capitalization than had previously been required for mortgage brokers and non-bank mortgage bankers. This has reduced competition as mortgage brokers have been forced to liquidate when their capital has been exhausted by the requirement to fund mortgage buy-backs required by investors. This has also limited new entry into the markets.

Warehouse line availability. Beginning in mid-2007, the number of lenders providing warehouse funding to non-bank mortgage companies shrank dramatically. Recently, capacity has grown as smaller banks have entered the market to partially fill the void left by the exit of large lenders. Credit standards remain strict, however, making it more difficult for many non-bank mortgage companies to secure warehouse lines. This has created an opportunity for banking institutions such as HomeStreet to increase market share due to our capacity to fund our mortgage originations through our deposit and wholesale funding sources. The market for warehouse lines for Fannie Mae DUS lenders experienced similar disruptions; recently a limited amount of warehouse line capacity has been made available in the market to Fannie Mae DUS lenders.

Since the summer of 2011, a number of well-publicized reports suggest that the Obama administration is seeking to develop a housing refinance program. We also have seen a number of reports that state attorneys general are nearing a settlement with large mortgage originators on the robo-signing and similar scandals, as well as reports that litigation over mortgage securitizations and class actions over foreclosure processes are increasing. We also note the increasing burdens brought about by the Dodd-Frank Act and other consumer protection legislation and regulations, as well as claims brought by Fannie Mae and Freddie Mac against originators, securitizers and servicers of legacy loans. Further, historically low interest rates have limited investors willingness to purchase mortgage backed securities, and large mortgage originators such as Bank of America are exiting lines of business that have a heavy focus on residential mortgages. We anticipate that these trends will continue for at least the next year and that they ultimately will lead to deconsolidation of the mortgage industry.

Multifamily Opportunities

Demographic changes. We expect that demographic changes over the next decade will spur demand for multifamily housing. The following information is reprinted from *The State of the Nation s Housing 2010* with permission from the Joint Center for Housing Studies of Harvard University. All rights reserved.

> The aging of the echo-boom generation into young adulthood, augmented by immigration, will increasingly drive household growth over the next 15 years. The sheer size of the echo-boom generation

will produce record numbers of households headed by young adults**.** At 80.8 million strong, this generation is even larger than the baby-boom generation is now.

Under the Census Bureau s current estimate about immigration, the number of echo boomers will swell to 92.9 million by 2025. Even with immigration at half that pace, their numbers will grow to 86.5 million. This highly diverse generation will give demand for apartments and smaller starter homes a lift over the next 15 years.

The large share of second-generation Americans (children born in the US to immigrant parents) among the echo boomers more than twice the share in the baby-bust generation and more than three times that in the baby-boom generation will be important in shaping the characteristics of future households. This is good news in that US-born children of immigrants have incomes and education levels more like those of other native-born Americans than of their parents. In fact, among householders aged 25 64, second-generation Americans typically have higher household incomes than both foreign-born and other native-born households of all races and ethnicities.

Meanwhile, the baby boomers will boost demand for senior housing. The units built over the next 10 20 years that intentionally cater to older Americans will be the housing available for generations to come, given that growth of the over-65 population will slow dramatically as the now similarly sized babybust generation moves into retirement. So far, however, federal support for senior housing is limited to minimal new construction of subsidized units. Moreover, the current funding system encourages expensive trips to skilled nursing facilities to the detriment of lower-cost, less institutional assisted living options and programs that allow elders to remain in their homes. Senior housing issues will therefore gain much greater urgency over the coming decade.

Affordability index. Although low interest rates and falling house prices have significantly increased the number of borrowers who would be able to qualify to purchase a home nationally, selected markets with higher relative real estate prices are attractive multifamily markets. According to Trulia Real Estate Research it is cheaper to rent than to buy in 26% of major metropolitan markets in the United States. Of these markets, Seattle was the fourth least affordable place to buy, while Portland was in seventh place. (Trulia Real Estate Search Rent vs Buy Index July 2011). This points to continued demand for multifamily housing in our core markets.

Loan Approval Procedures and Authority

The Bank s board of directors approves our lending policies and delegates lending authority and responsibility to its credit committee, the bank loan committee, the Chief Credit Officer, the Chief Executive Officer and specified officers of the Bank, including business unit credit administrators and the Single Family Operations Director. The Bank s Income Property Lending Director also has limited loan approval authority for multifamily loans originated under the Fannie Mae DUS program. See Credit Risk Management below.

Credit Risk Management

Credit risk is the risk of loss from adverse changes in a borrower s or counterparty s actual or perceived ability to meet its financial obligations under agreed-upon terms and exists primarily in lending, securities and derivative portfolios. The degree of credit risk is determined by factors including the size of the asset or transaction, the contractual terms of the related documents, the credit characteristics of the borrower, the channel through which assets are acquired, the features of loan products or derivatives, the existence and strength of guarantor support, the availability, quality and adequacy of any underlying collateral and the economic environment after the loan is originated or the asset is acquired. Our overall portfolio credit risk is also impacted by asset concentrations within the portfolio.

Our credit risk management process is governed centrally. Our overall credit process includes comprehensive credit policies, judgmental or statistical credit underwriting, detailed risk measurement and modeling and periodic loan review, loan quality control and internal audit. In addition, regulatory examiners review and perform detailed tests of our credit underwriting, loan administration and allowance processes.

The Chief Credit Officer s primary responsibilities include directing the activities of the credit risk management function as it relates to the loan portfolio, overseeing loan portfolio performance and ensuring compliance with established credit policies, standards and limits, determining the reasonableness of the Company s allowance for loan losses, reviewing and approving large credit exposures and delegating credit approval authorities. Senior credit administrators who oversee the lines of business have both transaction approval authority and governance authority for the approval of credit procedures within established policies, standards and limits. The Chief Credit Officer reports directly to the President and Chief Executive Officer.

The Bank loan committee, established by the credit committee of the board of directors, provides direction and oversight for the Company within our risk management framework. The loan committee seeks to ensure effective portfolio risk analysis and policy review to support sound implementation of defined business and risk strategies. Additionally the Bank loan committee periodically approves credits larger than the Chief Credit Officer s and Chief Executive Officer s approval authority. The members of the Bank loan committee consist of the Chief Executive Officer, Chief Credit Officer and Chief Financial Officer.

The Loan Review Officer s primary responsibility includes the review of the Company s loan portfolios to provide an independent assessment of credit quality, portfolio oversight and credit management, including accuracy of loan grading. Loan review also conducts targeted credit-related reviews and credit process reviews at the request of the board and management and reviews a sample of newly originated loans for compliance with closing conditions and accuracy of loan grades. Loan review reports directly to the board credit committee and administratively to the Risk and Regulatory Oversight Director.

The Treasury function s primary responsibilities include directing the activities of the credit risk management function as it relates to securities and derivative portfolios, overseeing derivative portfolio performance and ensuring compliance with established credit policies, standards and limits. The Treasurer reports directly to the Chief Financial Officer, who reports to the President and Chief Executive Officer.

Subsidiaries and Other Activities

HomeStreet Capital Corporation, a wholly owned subsidiary of HomeStreet, Inc., has been servicing multifamily loans sold through the Fannie Mae DUS program since 2000. HomeStreet, Inc. also operates a personal lines insurance agency licensed to do business in Washington and Oregon, and in Hawaii for life insurance products, under the name HomeStreet Insurance and holds common securities in four statutory business trusts referred to herein as the HomeStreet Statutory Trusts. For further information regarding the HomeStreet Statutory Trusts, see Dividend Policy.

The Bank s principal subsidiaries consist of HomeStreet/WMS, Inc., HomeStreet Reinsurance, Ltd., Continental Escrow Company and Union Street Holdings LLC. HomeStreet/WMS, Inc. holds a 50% equity interest in WMS. HomeStreet Reinsurance, Ltd. reinsured private mortgage insurance solely with respect to mortgage loans originated by the Bank. We discontinued all new reinsurance business at the end of 2008 and we are monitoring market conditions to determine if and when we will continue this line of business. Continental Escrow Company provides reconveyance services solely for HomeStreet Bank in connection with deeds of trust on single family residential loans originated by the Bank. For more information on our subsidiaries, see Our Structure.

Competition

We face intense competition in originating loans and in attracting deposits within our targeted geographic market. We compete by consistently delivering high quality, personal service to our customers that results in a high level of customer satisfaction.

We attract our deposits through our branch office system. Competition for those deposits is principally from other savings institutions, commercial banks and credit unions located in the same community, as well as mutual funds and other alternative investments. We are facing increasing competition for deposits and other financial products from non-bank institutions such as brokerage firms and insurance companies in such areas as short-term money market funds, mutual funds and annuities. Our key competitors within our largest market area, the Seattle-Tacoma-Bellevue MSA, include Bank of America, Wells Fargo Bank, US Bank, JPMorgan Chase & Co. (as the successor to Washington Mutual Bank) and Key Bank. These competitors controlled approximately 69.2% of the deposit market share with $48.6 billion of the $70.3 billion total deposits in the Seattle MSA as of June 30, 2011.

Our competition for loans comes principally from banks with a nationwide presence along with mortgage bankers, commercial banks, thrift institutions, credit unions and finance companies. Our market area has a high concentration of financial institutions, many of which are branches of large money center and regional banks that have resulted from the consolidation of the banking industry in Washington and other western states. These include such large national lenders as Bank of America, JPMorgan Chase & Co., U.S. Bancorp, Wells Fargo and others in our market area that have greater resources than we do and compete with us for banking business in our targeted market area. Among the advantages of some of these institutions are their ability to make larger loans, finance extensive advertising campaigns, access lower cost funding sources and allocate investment assets to regions of highest yield and demand. Despite these advantages, we believe we can compete with larger financial institutions by offering a value proposition based on outstanding customer service, strong values and integrity, real estate expertise, local knowledge and faster decision-making and a commitment to the communities we serve.

Regulation

Cease and Desist Orders

We are currently operating under cease and desist orders issued by our primary federal banking regulator, the Federal Reserve, and the Bank s primary regulators, the FDIC and the DFI. Under the cease and desist orders, we are required to notify and in certain cases receive the permission of our regulators prior to taking certain actions including paying cash dividends, making payments on any existing debt, incurring, renewing or guaranteeing debt and changing the composition or compensation of our directors and senior executive officers.

Under the Bank Order, the Bank has agreed to certain restrictions and affirmative obligations regarding its management structure and oversight, plans and policies, capital and liquidity requirements, reductions in classified assets and loan concentrations, ability to make loans and other aspects of its business. See Regulation and Supervision Cease and Desist Orders.

Employees

As of September 30, 2011, we had 553 full-time employees and 64 part-time employees compared with 520, 523 and 520 full-time and 62, 74 and 63 part-time employees as of December 31, 2010, 2009 and 2008, respectively. Our employees are not represented by any collective bargaining group. Management believes our employee relations to be good. Information regarding employment agreements with our executive officers is discussed further in Executive Compensation.

We intend to continue to be opportunistic in hiring employees who bring expertise, endorse our value proposition and bring with them an existing portfolio or customer base. We have taken advantage of the failures, takeovers and recapitalizations of certain of our competitors by recruiting well qualified employees and attracting new customers who seek long term stability, quality products and expertise. We have also attracted highly qualified credit administration employees to have enhanced our credit management functions.

Properties

We lease principal offices, which are located in office space in downtown Seattle at 601 Union Street, Suite 2000, Seattle, WA 98101. This office lease provides sufficient space to conduct the management of our business. In addition, we currently lease space for all 29 of our office locations. Our branches include separate lending and retail banking facilities, as well as combined facilities, located in Washington, Oregon and Hawaii.

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 that there is a reasonable possibility that a loss or additional loss may have been incurred. However, it is possible that an unfavorable resolution of one or more such proceedings could in the future materially affect our future liquidity, consolidated financial position and/or results of operations.

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REGULATION AND SUPERVISION

The following is a brief description of certain laws and regulations that are applicable to us. The description of these laws and regulations, as well as descriptions of laws and regulations contained elsewhere in this prospectus, does not purport to be complete and is qualified in its entirety by reference to the applicable laws and regulations. We believe, however, that we have included all descriptions of laws and regulations applicable to us that an investor needs to consider in making an investment decision.

The bank regulatory framework to which we are subject is intended primarily for the protection of bank depositors and the Deposit Insurance Fund and not for the protection of shareholders or other security holders.

General

The Company is a savings and loan holding company and is regulated by the Board of Governors at the Federal Reserve System, or the Federal Reserve, and the Washington State Department of Financial Institutions, Division of Banks, or DFI. The Company is required to register and file reports with, and otherwise comply with, the rules and regulations of the OTS and the DFI.

The Office of Thrift Supervision, or the OTS, previously was the Company s primary financial regulator. Under the Dodd-Frank Act, the OTS was dissolved on July 21, 2011 and its authority to supervise and regulate the Company and its non-bank subsidiaries was transferred to the Federal Reserve. References to the Federal Reserve in this prospectus should be read to include the OTS prior to the date of the transfer with respect to those functions transferred to the Federal Reserve.

The Bank is a Washington state-chartered savings bank. The Bank is subject to regulation, examination and supervision by the DFI and the FDIC.

As a result of the financial crisis, regulation of the financial services industry has been undergoing major changes. Among these is the Dodd-Frank Act, which makes significant modifications to and expansions of the rulemaking, supervisory and enforcement authority of the federal banking regulators. Some of the changes were effective immediately, but others are to be phased in over time. The Dodd-Frank Act requires various regulators, including the banking regulators, to adopt numerous regulations, not all of which have yet been finalized. Accordingly, in many instances, the precise requirements of the Dodd-Frank Act are not yet known.

Further, new statutes, regulations and guidance are considered regularly and are currently being proposed that contain wide-ranging potential changes to the statutes, regulations and competitive relationships of financial institutions operating and doing business in the United States. We cannot predict whether or in what form any proposed statute, regulation or other guidance will be adopted or promulgated, or the extent to which our business may be affected. Any change in such policies, whether by the Federal Reserve, the DFI, the FDIC, the Washington legislature or the United States Congress, could have a material adverse impact on us and our operations and shareholders. In addition, the Federal Reserve, the DFI and the FDIC have significant discretion in connection with their supervisory and enforcement activities and examination policies, including, among other things, policies with respect to the Bank s capital levels, the classification of assets and establishment of adequate loan loss reserves for regulatory purposes.

Our operations and earnings will be affected by domestic economic conditions and the monetary and fiscal policies of the United States government and its agencies. In addition to its role as the regulator of savings and loan holding companies, the Federal Reserve has, and is likely to continue to have, an important impact on the operating results of financial institutions through its power to implement national monetary policy including, among other things, actions taken in order to curb inflation or combat a recession. The Federal Reserve affects the levels of bank loans, investments and deposits through its control over the issuance of United States government securities, its regulation of the discount rate applicable to member banks and its influence over reserve requirements to which banks are subject. We cannot predict the nature or impact of future changes in monetary and fiscal policies.

We are also currently operating under cease and desist orders issued by our primary federal regulator, the Federal Reserve, and the Bank s primary regulators, the FDIC and the DFI, as described below under Cease and Desist Orders. Under the cease and desist orders, we are required to notify, and in certain cases receive the permission of, the Federal Reserve prior to taking certain actions. In addition, the Bank is required to maintain Tier 1 capital in an amount that equals or exceeds 10.0% of the Bank s total assets and total risk-based capital in an amount that equals or exceeds 12.0% of the Bank s total risk-weighted assets, and to meet certain scheduled reductions in classified assets. Despite diligent efforts, the Bank is currently not in compliance with the above-described capital ratios. However, as of June 30, 2011, we have achieved compliance with our classified asset reduction plan targets. We are in frequent communication with the Federal Reserve, the FDIC and the DFI on the status of our efforts to comply with the cease and desist orders. While we have not been advised of any additional regulatory action with respect to the cease and desist orders or the Bank s current noncompliance with the cease and desist orders, we cannot assure you that no further action will be taken by our regulators. See Risk Factors for a discussion of some of the actions that our regulators could take as a result of our failure to comply with the cease and desist orders.

Cease and Desist Orders

Company Order

We are currently operating under an Order to Cease and Desist issued by the OTS on May 18, 2009 and now administered by the Federal Reserve. We refer to this order as the Company Order. Under the Company Order, HomeStreet, Inc. has agreed to refrain from engaging in all unsafe and unsound practices that have resulted in the operation of HomeStreet, Inc. with low earnings and inadequate capital. In addition, HomeStreet, Inc. has also agreed to not do any of the following without the consent of the OTS:

- pay dividends or make any other capital distributions;
- incur, issue, renew, repurchase, make payments on (including payments on trust preferred securities, TruPS,) or roll over any debt;
- increase any current lines of credit;
- guarantee the debt of any entity;
- refrain from making any golden parachute or prohibited indemnification payments unless we have complied with certain statutory and regulatory requirements; and
- comply with certain prior notification requirements for changes in directors or senior executive officers (including the director nominees proposed to be added upon completion of this offering).

As required by the Company Order, we submitted to and received approval from the OTS for an operations plan (Operations Plan) that addresses how we will meet all our financial obligations including, but not limited to, payments on our senior notes, dividend payments on preferred stock and interest payments on TruPS without relying on dividends from the Bank for the calendar years 2009 through 2011. The Operations Plan contains all of the elements required by the Company Order. We are required to submit quarterly reports describing any material deviations from our Operations Plan and we submitted variance reports and required documentation to the OTS and its successor the Federal Reserve, for each quarter beginning with the second quarter of 2009. The

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Company Order will remain in effect until terminated, modified or suspended by the Federal Reserve. We believe we are currently in substantial compliance with the Company Order, although the requirements imposed by the Company Order do not include quantative capital ratio or asset quality targets. However, if we were to take more aggressive measures, such as bulk sales, to dispose of classified assets or OREO, we may incur additional valuation adjustments or may recognize additional losses on sales of classified assets.

Bank Order

The Bank is also currently operating under an Order to Cease and Desist issued by the FDIC and the DFI on May 8, 2009. We refer to this order as the Bank Order. Under the Bank Order, we have agreed to certain restrictions and affirmative obligations regarding its management structure and oversight, plans and policies, capital and liquidity requirements, reductions in classified assets and certain loan concentrations, ability to make loans and other aspects of its business.

We have implemented certain actions at the Bank and intend to continue to comply with each of the following requirements of the Bank Order:

- The board of directors reviewed the qualifications of the management team and implemented the following changes:

  - Retained a new Chief Executive Officer in September 2009 who possesses the qualifications and experience commensurate with his duties and responsibilities at the Bank. Specifically, the Bank s new chief executive officer has proven ability to manage a bank of comparable size, as well as experience in upgrading a low quality loan portfolio and improving earnings. The FDIC, DFI and OTS approved the new Chief Executive Officer in January 2010.

  - Retained a new Chief Credit Officer in January 2009 who had significant and appropriate lending, collection and loan supervision experience, as well as experience in upgrading a low quality loan portfolio. The initial Chief Credit Officer resigned in June 2010 and was replaced by the manager of the Special Assets Group, whose appointment was approved by the FDIC, DFI and OTS in November 2010.

  - Retained a new Chief Financial Officer in August 2009 who possesses significant capital raising knowledge and experience. The FDIC, DFI and OTS approved the new Chief Financial Officer in January 2010.

- Each member of the Bank s management has been provided written authority to implement the provisions of the Bank Order.

- On a quarterly basis, the Bank s board of directors is assessing the qualifications of management on its ability to comply with the Bank Order, operate the Bank in a safe and sound manner, comply with applicable laws and regulations and restore the Bank to a safe and sound condition.

- The Bank will notify the FDIC and the DFI 30 days in advance whenever it proposes to add any new board member or senior executive officer.

- The Bank s board of directors has increased its participation in the affairs of the Bank, including holding meetings no less than monthly and reviewing and approving all required reports and actions.

We have to date completed the following:

Developed an infrastructure for the Bank s credit administration function that we believe is appropriate to the size and complexity of the Bank and that ensures oversight by officers with appropriate credit qualifications and expertise. Those officers have been hired and have implemented the new credit administration infrastructure.

Assessed the function and qualifications of the Board s loan committee and, as a result, created a board-level credit committee with qualified directors and an approved charter that details its appropriate duties and responsibilities.

Implemented revised lending and collection policies to provide effective guidance and control over the Bank s lending function, including policies for placing loans on nonaccrual basis, obtaining adequate and current documentation for all loans in the Bank s portfolio and various other loan policy provisions detailed in the Bank Order.

Revised the Bank s concentrations policy to limit concentrations for commercial real estate and acquisition, development and construction loans in accordance with regulatory rules and guidelines, and adopted a plan for reducing the amount of such loans in compliance with the concentration policy and restricting any such new loans or new loans to existing borrowers unless they are in compliance with the plan, not currently classified substandard and past due on interest and approved by the credit committee.

Submitted a three-year strategic plan, which includes specific goals for the dollar volume of total loans, total investment securities and total deposits as of December 31, 2009, 2010 and 2011. At the request of our regulators, management submitted a revised three-year strategic plan for the Bank in May 2010. The plan contains all of the specific information required by the Bank Order.

Implemented a profit plan for 2009 to address the goals and strategies for improving and sustaining the earnings of the Bank and coordinated the plan with the Bank s funds management policy and loan, investment and operating policies. The plan contains all of the specific information required by the Bank Order. Beginning in 2010, we have monitored our operations at the Bank based on a forecast that was updated monthly and reported to the board and our regulators. For 2011, we developed a budget and a forecast to which we monitor against and report monthly to the board and our regulators.

Implemented a liquidity and funds management policy that addresses specific contingency plans and details actions to be implemented under various liquidity scenarios, with a minimum primary liquidity ratio of at least 15.0%.

Submitted a liquidity and funds management plan to reduce its reliance on non-core funding sources, including brokered deposits and borrowings, and to reduce its non-core funding dependency ratio to not more than 20.0%.

Implemented a plan to reduce its interest rate sensitivity, established prudent limits on the impact of interest rate changes on earnings and implemented processes to mitigate risks from interest rate changes. We continue to focus on mitigation of risk from interest rate changes.

Eliminated use of irrevocable Federal Home Loan Bank standby letters of credit collateralized with Bank assets to secure private deposits in the Bank and revised processes designed to ensure future compliance with all applicable laws and regulations.

Ceased payment of cash dividends and the solicitation and rollover of brokered deposits.

Established a process for submitting written progress reports to the FDIC, DFI and Federal Reserve within 30 days of each quarter end. We have submitted progress reports on the Bank for each quarter beginning with the second quarter of 2009.

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Provided the Bank s shareholder, HomeStreet, Inc., with a copy of the Bank Order.

We have also implemented the following restrictions for the Bank in the management of its loan portfolio:

No extension, directly or indirectly, of any additional credit to, or for the benefit of, any borrower who has a loan or other extension of credit from the Bank that has been charged off or classified, in whole or in part, as Loss and is uncollected.

No extension, directly or indirectly, of any additional credit to, or for the benefit of, any borrower who has a loan or other extension of credit from the Bank that has been classified, in whole or part, as substandard or doubtful without the prior approval of a majority of the Bank s board of directors or the credit committee, which may not be approved without first collecting all past due interest in cash.

The above restrictions do not apply to single family residential mortgage loans modified in accordance with loan modification programs and practices sponsored or approved by the FDIC or other government agencies.

We have not yet satisfied the following requirements of the Bank Order:

We were required to achieve and maintain Tier 1 capital at the Bank that equals or exceeds 10.0% of its total assets within 150 days of the Bank Order, or by October 5, 2009. This level of Tier 1 capital is in addition to a fully funded allowance for loan losses, the adequacy of which must be satisfactory to the FDIC and the DFI. Increases in Tier 1 capital may only be accomplished through certain specified means and may not be accomplished through a deduction from the Bank s allowance for loan losses. Additionally, the Bank must maintain total risk-based capital in such an amount as to equal or exceed 12.0% of its total risk-weighted assets within the same 150 days. Despite diligent efforts, we were not successful in raising capital within the prescribed timeframe due to the extraordinary conditions in the capital markets that have resulted in the markets being effectively closed to capital-raising efforts for open-bank recapitalizations and for banks in troubled condition. To date we have not yet complied with this requirement. Management is maintaining close communication with the FDIC, the DFI and the Federal Reserve on the status of our efforts to raise capital. While our regulators have indicated that further action will not be initiated as long as we make significant efforts to raise capital, see Risk Factors We are operating under cease and desist orders from the Federal Reserve, the FDIC and the DFI that prohibit us, among other things, from paying dividends without the consent of our regulators and that place other limitations and obligations on the Company and Bank. We are not in full compliance with the Bank Order, and noncompliance may subject us to additional enforcement action and Risk Factors We may be subject to continuing enhanced supervision by our regulators even if the cease and desist orders are lifted or replaced for actions that our regulators could take, including the imposition of civil money penalties on directors, for failure to comply with the Bank Order.

While we have complied with the additional requirement of the Bank Order to develop and submit a plan for the reduction of its commercial real estate and land acquisition and development and construction loans, we did not achieve our internally established targets for December 31, 2011 of 277% of risk-based capital and 99% of risk-based capital, respectively. At December 31, 2011, the commercial real estate ratio was 404% and the land acquisition and development and construction ratio was 155%.

In addition, the Bank Order required the Bank to formulate, and submit to the FDIC and the DFI, a plan to reduce the aggregate balance of assets adversely classified as substandard or doubtful as of December 31, 2008. The plan submitted by the Bank, to which the FDIC and the DFI issued a letter of non-objection, set a target of reducing such assets to 40.0% of Tier 1 capital plus allowance for loan losses by February 28, 2010. While the Bank did not meet that target as of February 28, 2010, primarily due to lower than projected capital, we did achieve that target as of June 30, 2011, when our ratio was 38.2%. Prior to achieving such compliance, management formulated an asset-by-asset plan to reduce such assets and provided required monthly progress

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reports to our regulators. Management has also formulated a plan to reduce the total volume of all adversely classified assets, including through collections, charge-offs, or improvements to quality, with monthly progress reports to the board of directors.

The form and manner of the Bank s compliance with the Bank Order is subject to review and determination at subsequent regulatory examinations and/or visitations. Additionally, the Federal Reserve, the FDIC and the DFI each has the authority to impose additional restrictions on us in the event it again determines that we are operating in an unsafe or unsound condition, or if we are engaging in an unsafe or unsound practice. These restrictions could involve the limitation of our asset growth so that our average total assets during any calendar quarter do not exceed our average total assets during the preceding calendar quarter. The Federal Reserve, the FDIC or the DFI, as applicable, may also require prior approval for acquisitions, branching and new lines of business, and the FDIC and the DFI have the authority to impose additional discretionary and mandatory sanctions upon us if we were to become undercapitalized. For example, we could be required to implement a capital restoration plan. See Regulation and Supervision of HomeStreet Bank Capital and Prompt Corrective Action Requirements.

Regulation of the Company

General

Because we have made an election under Section 10(1) of the Home Owners Loan Act (HOLA) for the Bank to be treated as a savings association for purposes of Section 10 of HOLA, the Company is registered as a savings and loan holding company with the Federal Reserve and is subject to Federal Reserve regulations, examinations, supervision and reporting requirements relating to savings and loan holding companies. Among other things, this authority permits the Federal Reserve to restrict or prohibit activities that are determined