HomeStreet, Inc.
Form 10-K
March 06, 2018

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2017

OR

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

For the transition period from to

Commission file number: 001-35424

HOMESTREET, INC.

(Exact name of registrant as specified in its charter)

Washington	**91-0186600**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification Number)**

601 Union Street, Ste. 2000
Seattle, WA 98101
(Address of principal executive offices) (Zip Code)

Registrant’s telephone number, including area code: (206) 623-3050

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, no par value	**Nasdaq Stock Market LLC**

Securities registered pursuant to Section 12(g) of the Act:

None.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No x

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the Registrant’s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes x No o
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer”, “smaller reporting company” and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	o	Accelerated filer	x
Non-accelerated filer	o (Do not check if a smaller reporting company)	Smaller reporting company	o
Emerging growth Company	¨		

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes o No x

As of June 30, 2017, the last business day of the registrant’s most recently completed second fiscal quarter, the aggregate market value of common stock held by non-affiliates was approximately $635.4 million, based on a closing price of $27.68 per share of common stock on the Nasdaq Global Select Market on such date. Shares of common stock held by each executive officer and director and by each person known to the Company who beneficially owns more than 5% of the outstanding common stock have been excluded in that such persons may under certain circumstances be deemed to be affiliates. This determination of executive officer or affiliate status is not necessarily a conclusive determination for other purposes.
The number of outstanding shares of the registrant's common stock as of March 2, 2018 was 26,941,533.6.

DOCUMENTS INCORPORATED BY REFERENCE
Certain information that will be contained in the definitive proxy statement for the registrant's annual meeting to be held in May 2018 is incorporated by reference into Part III of this Form 10-K.

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

PART I
FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K ("Form 10-K") and the documents incorporated by reference contain, in addition to historical information, “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended (the “Securities Act”) and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). including statements relating to projections of revenues, estimated operating expenses or other financial items; management’s plans and objectives for future operations or programs; future operations, plans, regulatory compliance or approvals; expected cost savings from restructuring or resource optimization activities; proposed new products or services; expected or estimated performance of our loan portfolio; pending or potential expansion activities; pending or future mergers, acquisitions or other transactions; future economic conditions or performance; and underlying assumptions of any of the foregoing.
All statements other than statements of historical fact are "forward-looking statements" for the purpose of these provisions. When used in this Form 10-K, terms such as “anticipates,” “believes,” “continue,” “could,” “estimates,” “expects,” “intends,” “may,” “plans,” “potential,” “predicts,” “should,” or “will” or the negative of those terms or other comparable terms intended to identify such forward-looking statements. These statements involve known and unknown risks, uncertainties and other factors that may cause us to fall short of our expectations or may cause us to deviate from our current plans, as expressed or implied by these statements. The known risks that could cause our results to differ, or may cause us to take actions that are not currently planned or expected, are described below and in Item 1A, Risk Factors.

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

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

ITEM 1 BUSINESS

General

HomeStreet, Inc. (together with its consolidated subsidiaries, “HomeStreet,” the “Company,” “we,” “our” or “us”), a Washingt corporation, is a diversified financial services company founded in 1921, headquartered in Seattle, Washington which serves customers primarily in the western United States, including Hawaii. We are principally engaged in commercial and consumer banking and real estate lending, including commercial real estate and single family mortgage banking operations. Our primary subsidiaries are HomeStreet Bank and HomeStreet Capital Corporation.

HomeStreet Bank (the “Bank”) is a Washington state-chartered commercial bank that provides commercial, consumer and mortgage loans, deposit products, other banking services, non-deposit investment products, private banking and cash management services. Our loan products include commercial business loans, agriculture loans, consumer loans, single family residential mortgages, loans secured by commercial real estate and construction loans for residential and commercial real estate projects. We also offer single family home loans through our partial ownership of WMS Series LLC, an affiliated business arrangement with various owners of Windermere Real Estate Company franchises whose home loan businesses are known as Penrith Home Loans (some of which were formerly known as Windermere Mortgage Services).

HomeStreet Capital Corporation, a Washington corporation, originates, sells and services multifamily mortgage loans under the Fannie Mae Delegated Underwriting and Servicing Program (“DUS®")[1] in conjunction with HomeStreet Bank.

Doing business as HomeStreet Insurance Agency, we provide insurance products and services for consumers.

Shares of our common stock are traded on the Nasdaq Global Select Market under the symbol “HMST.” We also have outstanding $65.0 million in aggregate principal amount of 6.5% senior notes due 2026, of which $64.8 million in aggregate principal amount is registered pursuant to Section 15(d) of the Securities Exchange Act of 1934, as amended.

At December 31, 2017, we had total assets of $6.74 billion, net loans held for investment of $4.51 billion, deposits of $4.76 billion and shareholders’ equity of $704.4 million. Our operations are currently grouped into two reportable segments: our Commercial and Consumer Banking Segment and our Mortgage Banking Segment.

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

Since our initial public offering (“IPO”) in February 2012, we have grown considerably, from 20 retail deposit branches, nine stand-alone home loan centers and 553 full-time employees at the time of our IPO to 59 retail deposit branches, six stand-alone commercial lending centers, 44 primary stand-alone home loan centers and 2,419 employees as of December 31, 2017. We experienced considerable success in our single family mortgage banking business from 2012 through the first half of 2016 and used a substantial portion of the income generated by those operations to restart and grow our commercial lending operations, which had been largely shuttered during the recession. We believe the strategic development of our consumer and commercial banking operations will help to offset the volatility of our mortgage business which, while being a core part of our overall operations, is historically cyclical and seasonal. In 2016 we converted the charter of HomeStreet Bank from a Washington state chartered savings bank to a Washington state chartered commercial bank.

At December 31, 2017, our 59 retail deposit branches were located in the State of Washington, Southern California, the Portland, Oregon area and the State of Hawaii, and our 44 primary stand-alone home loan centers and six primary commercial lending centers were located within our retail deposit branch footprint as well as in Phoenix, Arizona; Northern California (including the San Francisco Bay Area); Eugene, Salem and Bend, Oregon; Boise and northern Idaho; and Salt Lake City, Utah. An affiliated business arrangement, WMS Series LLC, doing business as Penrith Home Loans, provides point-of-sale loan origination services at certain Windermere Real Estate offices in Washington and Oregon, and two stand-alone offices. We also have one stand-alone insurance agency office located in Spokane, Washington. The number of lending offices listed above does not include satellite offices with a limited number of staff who report to a manager located in a separate primary office.

Commercial and Consumer Banking. We provide diversified financial products and services to our commercial and consumer customers through bank branches, lending centers, ATMs, online, mobile and telephone banking. These products and services include deposit products; residential, consumer, business and agricultural portfolio loans; non-deposit investment products; insurance products and cash management services. We originate construction loans, bridge loans, and permanent loans for the

[1] DUS® is a registered trademark of Fannie Mae 4

Company's portfolio on single family residences, and on office, retail, industrial and multifamily properties. We also have a commercial lending team specializing in U.S. Small Business Administration (“SBA”) lending. We pool a portion of our permanent commercial real estate loans, primarily up to $10 million in principal amount, to sell into the secondary market. We also originate multifamily real estate loans for Fannie Mae under the DUS® Program, whereby loans are sold to or securitized by Fannie Mae, while we generally retain the servicing rights. This segment is also responsible for managing our investment securities portfolio.

Mortgage Banking. We originate single family residential mortgage loans for sale in the secondary markets and perform mortgage servicing on a substantial portion of those loans. The majority of our mortgage loans are sold to or securitized by Fannie Mae, Freddie Mac or Ginnie Mae, while we retain the right to service these loans. We are a rated originator and servicer of jumbo nonconforming mortgage loans, allowing us to sell the loans we originate to other entities for inclusion in securities. Additionally, we purchase loans from WMS Series LLC through a correspondent arrangement. We also sell loans on a servicing-released and servicing-retained basis to securitizers and correspondent lenders. A small percentage of our loans are brokered to other lenders or sold on a servicing-released basis to correspondent lenders. On occasion, we may sell a portion of our mortgage servicing rights ("MSR") portfolio. We hedge the loan funding and the interest rate risk associated with the secondary market loan sales and the retained single family mortgage servicing rights using a combination of risk management tools.

Investing in Growth

Our IPO, in February 2012, was part of a plan by our management team to transform HomeStreet from a troubled thrift institution to a regional community bank. Operating under cease and desist orders from our primary regulators, management instituted a plan in 2009 to reduce troubled assets in a strategic and measured way, in order to return the Bank to profitability and raise capital. Our successful IPO restored the institution’s Well-Capitalized status with our regulators and supported growth in our banking operations. In the same quarter that we completed our IPO, we were able to take advantage of a competitor’s exit from the single family mortgage lending market to hire highly experienced management talent and loan production and operations personnel, doubling the size of our single family mortgage lending operation during 2012. This hiring opportunity positioned the Bank to take advantage of a resurgence in mortgage borrowing in our primary markets and to expand our business into Northern California, increasing both our market share and our market footprint. Resolution of our regulatory concerns and increased income from our mortgage lending operations allowed us to focus on growing our commercial and consumer banking operations, geographic footprint and expertise.

We began opening de novo branches to expand our retail deposit branch network and increase our core deposit base, while offering expanded community banking products and services. We have also grown and diversified the Bank through acquisitions of whole banks and retail deposit branches in attractive growth markets on the West Coast, to increase our scale in existing markets and to enter new markets where we can leverage our existing network of single family home loan centers. Our acquisitions have accelerated our growth of interest earning commercial banking assets, strengthened our core deposit base, increased our geographic diversification and added experienced commercial and consumer banking professionals in key target markets. We evaluate acquisition opportunities using certain financial criteria, including: (1) the acquisition must meet a minimum internal rate of return; (2) the return on invested capital must exceed our cost of capital; (3) the acquisition must provide sufficient earnings to be immediately accretive to earnings per share; and (4) the acquisition must offset the initial dilution of tangible book value within four years.

We made our first two whole bank acquisitions -- Fortune Bank ("Fortune") and Yakima National Bank ("YNB") -- simultaneously in the fall of 2013. The Fortune acquisition increased our commercial business loan portfolio and added experienced commercial lending officers and managers in the Seattle area. The YNB acquisition expanded our retail and commercial presence into Eastern Washington. We also acquired two branches and certain related assets in the Seattle metropolitan area from another commercial bank, further increasing our consumer banking presence in our home market.

The next acquisition was Simplicity Bancorp, Inc. ("Simplicity") and its subsidiary, Simplicity Bank, which we acquired by merger on March 1, 2015. Through this acquisition we leveraged our existing home loan center network in Southern California by adding seven retail deposit branches and related branch and loan production staff in the Los Angeles area. We had already expanded our home loan operations into Southern California by adding stand-alone home loan centers and a dedicated home loan processing center in that area. The Simplicity acquisition gave our Southern California operations a significant retail deposit customer base, reduced our reliance on time deposits and increased our portfolios of multifamily and single family mortgages and consumer loans. Interest-earning assets of $803.7 million (including $664.1 million of loans) and $651.2 million of deposits were added to the Bank from the Simplicity merger.

Alongside this expansion of real estate and consumer lending and retail bank deposits in Southern California, we also began to build out our commercial business lending operations in that state. In early 2015, we launched both a commercial real estate lending group through creation of a division of the Bank we refer to as HomeStreet Commercial Capital and a commercial lending team specializing in SBA loans.

In February 2016, we further expanded our presence in Southern California through the acquisition of Orange County Business Bank ("OCBB"), located in Irvine, California. This acquisition complemented our expansion of commercial and consumer banking activities in Southern California, providing us with an additional portfolio of commercial loans and deposits, considerable commercial lending talent, and an additional customer base of commercial banking customers.

In August 2016, we acquired substantially all of the assets, including two retail deposit branches, and certain liabilities from The Bank of Oswego to expand our presence in the Portland, Oregon area, increasing the number of our retail branches in the metropolitan area to five. Entry into the Lake Oswego, Oregon market supported our well-established single family mortgage lending presence and built our retail banking convenience and scale in Oregon.

We have also acquired individual retail bank branches from time to time when we have found bank branches that were attractive, available, well-priced and within our strategic growth footprint. In addition to the acquisition of two bank branches in Seattle in 2013, shortly after the Fortune and YNB acquisition, we acquired a retail bank branch and certain related assets in Dayton, Washington on December 11, 2015, which expanded our presence and retail deposit taking capabilities in Eastern Washington; and two branches in Southern California in November 2016, in Granada and Burbank, expanding our presence and retail deposit base in desirable areas of the Los Angeles region. In September 2017, we acquired a retail deposit branch in El Cajon, California, a fast growing suburb in eastern San Diego County.

In addition to these acquisitions, we have opened de novo branches in markets that we believe are underserved by community banks. From 2012 to 2015, we opened 10 de novo branches in the greater Seattle area. In 2016, we added six de novo branches in San Diego, Hawaii and Eastern Washington and in 2017 we opened three de novo branches in Southern California, Eastern Washington and the greater Seattle area. Overall, from our IPO through December 31, 2017, we added 19 de novo branches and acquired eight branches.

We remain focused on minimizing credit risk and on increasing operating efficiency by growing assets and revenues at a faster pace than expenses through measured growth within our existing markets, while managing costs and improving efficiencies.

Restructuring of Single Family Lending

At the end of 2016 and again in 2017, our Mortgage Banking Segment experienced lower than expected single family loan origination volume due to a lack of housing inventory in our primary markets, compounded by interest rate increases that reduced demand for mortgage refinances. In response to this environment, we implemented a restructuring plan in our Mortgage Banking Segment. During this period, we continued to maintain a significant market share in mortgage banking in our primary markets, and we expect mortgage banking to remain an important part of our overall strategy.

The restructuring of our Mortgage Banking Segment during 2017 included a reduction in full time equivalent staffing of 106 employees; closure of three production offices, consolidation of six offices into three offices, and space reductions in three additional offices; and streamlining of the single family leadership team. Although we anticipate that this restructuring will scale our operations to fit our market opportunities, we will continue to monitor market conditions and assess our mortgage banking office locations and staffing levels to focus on the segment's profitability.

Recent Developments

On December 22, 2017, President Trump signed into law major tax legislation commonly referred to as the Tax Cuts and Jobs Act ("Tax Reform Act"). The Tax Reform Act reduces the U.S. federal corporate income tax rate from 35 percent to 21 percent and makes many other sweeping changes to the U.S. tax code. We were required to revalue our deferred tax assets and liabilities at the new statutory tax rate upon enactment. As a result of this revaluation, in 2017, we recognized a one-time, non-cash, $23.3 million income tax benefit. Additionally, we expect our estimated effective tax rate to fall to between 21% and 22% for 2018.

On September 27, 2017, the federal banking regulatory agencies issued a joint notice of proposed rulemaking regarding several proposed simplifications of the capital rules related to certain standards initially adopted by the Basel Committee on Banking Supervision in December 2010 (which standards are commonly referred to as “Basel III”). If adopted as currently drafted, these proposed changes would significantly benefit our Mortgage Banking business model by reducing the amount of regulatory capital that would be required to be held related to our mortgage servicing assets. Other proposed changes, if adopted, would require an increase in capital related to commercial and residential acquisition, development, and construction lending activity and would offset a portion of the benefit we would expect to receive with respect to our mortgage servicing assets under the proposed rules. The final rules have yet to be published following the end of the comment period, but if they are adopted as currently proposed, we would expect to benefit from a reduction in the regulatory capital requirements beginning sometime in 2018.

Business Strategy

During 2017, we focused our business strategy on continuing to expand our Commercial and Consumer Banking Segment while improving our operating efficiency throughout our operations, following a period of substantial growth in both Mortgage Banking and Commercial and Consumer Banking. In 2017, we added four retail deposit branches within our existing geographic footprint, including three de novo branches and one branch obtained through acquisition. The new branches increase the scale and density of our retail bank branch network, improving convenience for our customers and building brand awareness.

In 2017, in the Mortgage Banking Segment, we continued to build on our heritage as a leading single family mortgage lender by hiring proven loan production officers. During 2017, however, our primary goals were focused on cost containment, including restructuring the organization to right-size for the current market opportunity and developing more efficient processes in our Mortgage Banking operations. These initiatives included substantial investments in increased automation, including implementation of an upgraded loan origination system and improvements to other processing and information systems.

We are pursuing the following strategies in our business segments:

Commercial and Consumer Banking. We believe there is a significant opportunity for a well-capitalized, community-focused bank to compete effectively in West Coast markets, especially those that are not well served by existing community banks. Our strategy is to offer responsive and personalized service while providing a full range of financial services to small- and middle-market commercial and consumer customers, to build loyalty and grow market share. We have grown organically and through strategic acquisitions. Between our IPO in 2012 and December 31, 2017, we have added a total of 16 retail deposit branches through acquisitions in the States of Washington and Oregon and in Southern California, and opened 19 de novo retail deposit branches. We also expanded our commercial lending footprint into California by acquiring experienced commercial lending personnel and growing our commercial loan portfolio, in part through acquisitions such as OCBB. In addition to our acquisitions, we added HomeStreet Commercial Capital, a commercial real estate lending division of the Bank based in Orange County, and a commercial lending team in Northern California. We expect to continue to grow our commercial lending (including SBA lending), commercial real estate and residential construction lending throughout our primary markets.

We plan to expand our commercial real estate business with a focus on multifamily mortgage origination, through our existing commercial banking network as well as through our Fannie Mae DUS® origination and servicing relationships. We expect to continue to benefit from being one of only 25 companies nationally that is an approved Fannie Mae DUS® seller and servicer. We plan to continue supporting our DUS® program by providing new construction and short-term bridge loans to experienced borrowers who intend to build or purchase apartment buildings for renovation, which we then seek to replace with permanent financing upon completion of the projects. We also originate commercial real estate construction loans, bridge loans and permanent loans for our portfolio, primarily on office, retail, industrial and multifamily property types located within our geographic footprint and may in the future sell those types of loans to other investors.

We seek to meet the financial needs of our consumer and small business customers by providing targeted banking products and services, investment services and products, and insurance products through our bank branches and through dedicated investment advisors, insurance agents and business banking officers. During 2017, we invested in enhanced mobile banking and web-based offerings to further grow our core deposits. We intend to continue to grow our retail deposit branch network, primarily focusing on the high-growth areas of Puget Sound in Washington, Portland, Oregon, the San Francisco Bay Area and Southern California.

Mortgage Banking. We have leveraged our reputation for high quality service and reliable loan closing to increase our single family mortgage market share significantly over the last six years. In 2017, single family loan origination volume was lower than expected due to a lack of housing inventory in our primary markets that reduced demand for purchase mortgages. Demand for mortgage refinances was also lower than expected, due to higher interest rates. Therefore, we implemented the restructuring plan mentioned above. We have maintained a significant market share in mortgage banking in our primary markets and expect mortgage banking to remain an important part of the Company's overall strategy. However, the contraction in the total number of mortgage loans being originated in our markets has led us to focus on building a more efficient operation while enhancing the ability to meet the origination and servicing needs of our mortgage lending clients. We intend to continue to focus on conventional conforming and government insured or guaranteed single family mortgage origination. We also offer home equity, jumbo and other portfolio loan products to complement secondary market lending, particularly for well-qualified borrowers with loan sizes greater than the conventional conforming limits.

We retain the right to service a majority of the mortgage loans that we originate, which we believe gives us a competitive advantage over many of our competitors because we have the opportunity to maintain a relationship with our customer after closing, while minimizing the potential for disruptions that are often inherent in transferring servicing and collection activities to a third party. Maintaining an ongoing relationship with our customers allows us to market additional products and services and remarket potential refinance opportunities with a goal of retaining the customer relationship. We believe that our ability to retain the servicing on our mortgage originations has made us a preferred lender for some of our customers. HomeStreet has the capital, liquidity, and infrastructure necessary to successfully retain the rights to service the mortgages we originate, and we believe this provides us with a competitive advantage over many of our competitors.

Our single family mortgage origination and servicing business is highly dependent upon compliance with underwriting and servicing guidelines of Fannie Mae, Freddie Mac, Federal Housing Administration ("FHA"), Department of Veterans Affairs ("VA") and Ginnie Mae as well as a myriad of federal and state consumer compliance regulations. Our demonstrated expertise in these activities, our significant volume of lending in low- and moderate-income areas, and our direct community investments, have allowed us to maintain a Community Reinvestment Act ("CRA") rating of "Satisfactory" or better every year since the program was implemented in 1986. We believe our historically strong compliance culture represents a significant competitive advantage in today's market, especially in the face of increasing regulatory compliance requirements.

For a discussion of operating results of these lines of business, see *"Business Segments"* within Management's Discussion and Analysis of this Form 10-K and Note 19 - Business Segment in the notes to our consolidated financial statements for the fiscal year ended December 31, 2017 included in Item 8 of Part II of this Form 10-K.

Market and Competition

We view our market as the major metropolitan areas in the Western United States, including Hawaii. These metropolitan areas share a number of key demographic factors that are characteristic of growth markets, such as large and growing populations with above-average household incomes, a significant number of large and mid-sized companies, and diverse economies. These markets all share large populations that we believe are underserved due to the rapid consolidation of community banks since the financial crisis. We believe these markets can be well served by a strong regional bank that is focused on providing consumers and businesses with quality customer service and a competitive array of deposit, lending and investment products.

As of December 31, 2017, we operated full service bank branches, as well as stand-alone commercial and residential lending centers, in the Puget Sound and eastern regions of Washington, the Portland, Oregon metropolitan area, the Hawaiian Islands, and Southern California. As of that date, we also had primary stand-alone commercial and residential lending centers in the metropolitan areas of San Francisco, California; Phoenix, Arizona; and Salt Lake City, Utah; as well as central California and Idaho. Over time, we expect to efficiently expand our full service bank branches, on a prudent and opportunistic basis, to areas being served only by stand-alone lending centers.

The financial services industry is highly competitive. We compete with other banks, savings and loan associations, credit unions, mortgage banking companies, insurance companies, finance companies, and investment and mutual fund companies. In particular, we compete with many financial institutions with greater resources, including the capacity to make larger loans, fund extensive advertising campaigns and offer a broader array of products and services. The number of competitors for lower and middle-market business customers has, however, decreased in recent years primarily due to consolidations. At the same time, national banks have been focused on larger customers to achieve economies of scale in lending and depository relationships and have also consolidated business banking operations and support and reduced service levels in many of our markets. We have taken advantage of industry consolidation by recruiting well-qualified employees and attracting new customers who seek long-term stability, local decision-making, quality products and outstanding expertise and customer service.

We believe we are well positioned to take advantage of changes in the single family mortgage origination and servicing industry that have helped to reduce the number of competitors. The mortgage industry is compliance-intensive and requires significant expertise and internal control systems to ensure mortgage loan origination and servicing providers meet all origination, processing, underwriting, servicing and disclosure requirements. We believe our compliance-centered culture affords us a competitive advantage even as the growing complexity of the regulatory landscape poses a barrier to entry for many of our would-be competitors. For example, the Truth in Lending Act-Real Estate Settlement Procedures Act ("TILA-RESPA") Integrated Disclosure (commonly known as "TRID") requirements substantially increased documentation requirements and responsibilities for the mortgage industry, further complicating work flow and increasing training costs, thereby increasing barriers to entry and costs of operations across the mortgage industry. These rules added to the work involved in originating mortgage loans and added to processing costs for all mortgage originators. In some cases, these rules have lengthened the time needed to close loans. Increased costs and additional compliance burdens are causing some competitors to exit the industry. Mortgage lenders must make significant investments in experienced personnel and specialized systems to manage the compliance process, which creates a significant barrier to entry. In addition, lending in conventional and government guaranteed or insured mortgage products, including FHA and VA loans, requires significantly higher capitalization than had previously been required for mortgage brokers and non-bank mortgage companies.

Employees

As of December 31, 2017, we employed 2,419 full-time equivalent employees, compared to 2,552 full-time equivalent employees at December 31, 2016.

Where You Can Obtain Additional Information

We file annual, quarterly, current and other reports with the Securities and Exchange Commission (the "SEC"). We make available free of charge on or through our website http://www.homestreet.com all of these reports (and all amendments thereto), as soon as reasonably practicable after we file these materials with the SEC. Please note that the contents of our website do not constitute a part of our reports, and those contents are not incorporated by reference into this report or any of our other securities filings. You may review a copy of our reports, including exhibits and schedules filed therewith, and obtain copies of such materials at the SEC's Public Reference Room at 100 F Street, NE, Washington, D.C. 20549. You may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains a website (http://www.sec.gov) that contains reports, proxy and information statements and other information regarding registrants, such as HomeStreet, that file electronically with the SEC.

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 Form 10-K, does not purport to be complete and is qualified in its entirety by reference to the applicable laws and regulations.

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 bank holding company which has made an election to be a financial holding company. It is regulated by the Board of Governors of the Federal Reserve System (the "Federal Reserve") and the Washington State Department of Financial Institutions, Division of Banks (the "WDFI"). The Company is required to register and file reports with, and otherwise comply with, the rules and regulations of the Federal Reserve and the WDFI.

The Bank is a Washington state-chartered commercial bank. The Bank is subject to regulation, examination and supervision by the WDFI and the Federal Deposit Insurance Corporation (the "FDIC").

New statutes, regulations and guidance are considered regularly that could contain wide-ranging potential changes to the competitive landscape for financial institutions operating in our markets and in the United States generally. 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 policies, legislation or regulation, whether by the Federal Reserve, the WDFI, the FDIC, the Washington legislature, the United States Congress or any other federal, state or local government branch or agency with authority over us, could have a material adverse impact on us and our operations and shareholders. In addition, the Federal Reserve, the WDFI 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 bank 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 and fiscal 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 in various ways, including 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. Beginning in December 2015, the Federal Reserve has increased short-term interest rates five times and is expected to consider additional increases in 2018. We cannot predict the ultimate impact of these rate changes on the economy or our institution, or the nature or impact of future changes in monetary policies of the Federal Reserve.

Regulation of the Company

General

As a bank holding company, the Company is subject to Federal Reserve regulations, examinations, supervision and reporting requirements relating to bank holding companies. Among other things, the Federal Reserve is authorized to restrict or prohibit activities that are determined to be a serious risk to the financial safety, soundness or stability of a subsidiary bank. Since the Bank is chartered under Washington law, the WDFI has authority to regulate the Company generally relating to its conduct affecting the Bank.

Capital / Source of Strength

During 2015, the Company was a savings and loan holding company and as such became subject to capital requirements under the Dodd-Frank Act, beginning in 2015. Following its conversion to a bank holding company, the Company continues to be subject to these capital requirements. See “Regulation and Supervision of HomeStreet Bank - *Capital and Prompt Corrective Action Requirements - Capital Requirements*.”

Regulations and historical practices of the Federal Reserve have required bank holding companies to serve as a "source of strength" for their subsidiary banks. The Dodd-Frank Act codifies this requirement and extends it to all companies that control an insured depository institution. Accordingly, the Company is required to act as a source of strength for the Bank.

Restrictions Applicable to Bank Holding Companies

Federal law prohibits a bank holding company, including the Company, directly or indirectly (or through one or more subsidiaries), from acquiring:

- control of another depository institution (or a holding company parent) without prior approval of the Federal Reserve (as "control" is defined under the Bank Holding Company Act);
- another depository institution (or a holding company thereof), through merger, consolidation or purchase of all or substantially all of the assets of such institution (or holding company) without prior approval from the Federal Reserve or FDIC;
- more than 5.0% of the voting shares of a non-subsidiary depository institution or a holding company subject to certain exceptions; or
- control of any depository institution not insured by the FDIC (except through a merger with and into the holding company's bank subsidiary that is approved by the FDIC).

In evaluating applications by holding companies to acquire depository institutions or holding companies, the Federal Reserve must consider the financial and managerial resources and future prospects of the company and the institutions involved, the effect of the acquisition on the risk to the insurance funds, the convenience and needs of the community and competitive factors.

Acquisition of Control

Under the federal Change in Bank Control 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 bank holding company. An acquisition of control can occur upon the acquisition of 10.0% or more of the voting stock of a bank holding company 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 (the 60-day period may be extended), taking into consideration certain factors, including the financial and managerial resources of the acquirer and the antitrust effects of the acquisition. Control can also exist if an individual or company has, or exercises, directly or indirectly or by acting in concert with others, a controlling influence over the Bank. Washington law also imposes certain limitations on the ability of persons and entities to acquire control of banking institutions and their parent companies.

Dividend Policy

Under Washington law, the Company is generally permitted to make a distribution, including payments of dividends, only if, after giving effect to the distribution, in the judgment of the board of directors, (1) the Company would be able to pay its debts as they become due in the ordinary course of business and (2) the Company's total assets would at least equal the sum of its total liabilities plus the amount that would be needed if the Company were to be dissolved at the time of the distribution to satisfy the preferential rights upon dissolution of shareholders whose preferential rights are superior to those receiving the distribution. In addition, it is the policy of the Federal Reserve that bank holding companies generally should pay dividends only out of net income generated over the past year and only if the prospective rate of earnings retention appears consistent with the organization's capital needs, asset quality and overall financial condition. The policy also provides that bank holding companies should not maintain a level of cash dividends that places undue pressure on the capital of its subsidiary bank or that may undermine its ability to serve as a source of strength.

The Company's ability to pay dividends to shareholders is significantly dependent on the Bank's ability to pay dividends to the Company. Capital rules as well as regulatory policy impose additional requirements on the ability of the Company and the Bank to pay dividends. See "Regulation and Supervision of HomeStreet Bank - *Capital and Prompt Corrective Action Requirements - Capital Requirements*."

Compensation Policies

Compensation policies and practices at the Company and the Bank are subject to regulation by their respective banking regulators and the SEC.

Guidance on Sound Incentive Compensation Policies. Effective on June 25, 2010, federal banking regulators adopted Sound Incentive Compensation Policies Final Guidance (the "Final Guidance") designed to help ensure that incentive compensation policies at banking organizations do not encourage imprudent risk-taking and are consistent with the safety and soundness of the organization. The Final Guidance applies to senior executives and others who are responsible for oversight of HomeStreet's

11

company-wide activities and material business lines, as well as other employees who, either individually or as a part of a group, have the ability to expose the Bank to material amounts of risk.

Dodd-Frank Act. In addition to the Final Guidance, the Dodd-Frank Act contains a number of provisions relating to compensation applying to public companies such as the Company. The Dodd-Frank Act added a new Section 14A(a) to the Securities and Exchange Act of 1934, as amended (the "Exchange Act") that requires companies to include a separate non-binding resolution subject to shareholder vote in their proxy materials approving the executive compensation disclosed in the materials. In addition, a new Section 14A(b) to the Exchange Act requires any proxy or consent solicitation materials for a meeting seeking shareholder approval of an acquisition, merger, consolidation or disposition of all or substantially all of the company's assets to include a separate non-binding shareholder resolution approving certain “golden parachute” payments made in connection with the transaction. A new Section 10D to the Exchange Act requires the SEC to direct the national securities exchanges to require companies to implement a policy to “claw back” certain executive payments that were made based on improper financial statements.

In addition, Section 956 of the Dodd-Frank Act requires certain regulators (including the FDIC, SEC and Federal Reserve) to adopt regulations or guidelines prohibiting excessive compensation or compensation that could lead to material loss as well as rules relating to disclosure of compensation. On April 14, 2011, these regulators published a joint proposed rulemaking to implement Section 956 of Dodd-Frank for depository institutions, their holding companies and various other financial institutions with $1 billion or more in assets. On June 10, 2016, these regulators published a modified proposed rule. Under the new proposed rule, the requirements and prohibitions will vary depending on the size and complexity of the covered institution. Generally, for covered institutions with less than $50 billion in consolidated assets (such as the Company), the new proposed rule would (1) prohibit incentive-based compensation arrangements for covered persons that would encourage inappropriate risks by providing excessive compensation or by providing compensation that could lead to a material financial loss, (2) require oversight of an institution’s incentive-based compensation arrangements by the institution’s board of directors or a committee and approval by the board or committee of certain payments and awards and (3) require the creation on an annual basis and maintenance for at least seven years of records that (a) document the institution’s incentive compensation arrangements, (b) demonstrate compliance with the regulation and (c) are disclosed to the institution's appropriate federal regulator upon request.

FDIC Regulations. We are further restricted in our ability to make certain “golden parachute” and “indemnification” payments under Part 359 of the FDIC regulations, and the FDIC also regulates payments to executives under Part 364 of its regulations relating to excessive executive compensation.

Regulation and Supervision of HomeStreet Bank

General

As a commercial bank chartered under the laws of the State of Washington, HomeStreet Bank is subject to applicable provisions of Washington law and regulations of the WDFI. As a state-chartered commercial bank that is not a member of the Federal Reserve System, the Bank's primary federal regulator is the FDIC. It is subject to regulation and examination by the WDFI and the FDIC, as well as enforcement actions initiated by the WDFI and the FDIC, and its deposits are insured by the FDIC.

Washington Banking Regulation

As a Washington bank, the Bank's operations and activities are substantially regulated by Washington law and regulations, which govern, among other things, the Bank's ability to take deposits and pay interest, make loans on or invest in residential and other real estate, make consumer and commercial loans, invest in securities, offer various banking services to its customers and establish branch offices. Under state law, commercial banks in Washington also generally have, subject to certain limitations or approvals, all of the powers that Washington chartered savings banks have under Washington law and that federal savings banks and national banks have under federal laws and regulations.

Washington law also governs numerous corporate activities relating to the Bank, including the Bank's ability to pay dividends, to engage in merger activities and to amend its articles of incorporation, as well as limitations on change of control of the Bank. Under Washington law, the board of directors of the Bank generally may not declare a cash dividend on its capital stock if payment of such dividend would cause its net worth to be reduced below the net worth requirements, if any, imposed by the WDFI and dividends may not be paid in an amount greater than its retained earnings without the approval of the WDFI. These restrictions are in addition to restrictions imposed by federal law. Mergers involving the Bank and sales or acquisitions of its branches are generally subject to the approval of the WDFI. No person or entity may acquire control of the Bank until 30 days after filing an application with the WDFI, which has the authority to disapprove the application. Washington law defines “control” of an entity to mean directly or indirectly, alone or in concert with others, to own, control or hold the power to vote 25.0% or more of the outstanding stock or voting power of the entity. Any amendment to the Bank's articles of incorporation requires the approval of the WDFI.

The Bank is subject to periodic examination by and reporting requirements of the WDFI, as well as enforcement actions initiated by the WDFI. The WDFI's enforcement powers include the issuance of orders compelling or restricting conduct by the Bank and the authority to bring actions to remove the Bank's directors, officers and employees. The WDFI has authority to place the Bank under supervisory direction or to take possession of the Bank and to appoint the FDIC as receiver.

Insurance of Deposit Accounts and Regulation by the FDIC

The FDIC is the Bank's principal federal bank regulator. As such, the FDIC is authorized to conduct examinations of, and to require reporting by the Bank. The FDIC may prohibit the Bank from engaging in any activity determined by law, regulation or order to pose a serious risk to the institution, and may take a variety of enforcement actions in the event the Bank violates a law, regulation or order or engages in an unsafe or unsound practice or under certain other circumstances. The FDIC also has the authority to appoint itself as receiver of the Bank or to terminate the Bank's deposit insurance if it were to determine that the Bank has engaged in unsafe or unsound practices or is in an unsafe or unsound condition.

The Bank is a member of the Deposit Insurance Fund (“DIF”) administered by the FDIC, which insures customer deposit accounts. Under the Dodd-Frank Act, the amount of federal deposit insurance coverage was permanently increased from $100,000 to $250,000, per depositor, for each account ownership category at each depository institution. This change made permanent the coverage increases that had been in effect since October 2008.

In order to maintain the DIF, member institutions, such as the Bank, are assessed insurance premiums. The Dodd-Frank Act required the FDIC to make numerous changes to the DIF and the manner in which assessments are calculated. The minimum ratio of assets in the DIF to the total of estimated insured deposits was increased from 1.15% to 1.35%, and the FDIC is given until September 30, 2020 to meet the reserve ratio. In December 2010, the FDIC adopted a final rule setting the reserve ratio of the DIF at 2.0%. As required by the Dodd-Frank Act, assessments are now based on an insured institution's average consolidated assets less tangible equity capital.

Each institution is provided an assessment rate, which is generally based on the risk that the institution presents to the DIF. Institutions with less than $10 billion in assets generally have an assessment rate that can range from 1.5 to 30 basis points. However, the FDIC does have flexibility to adopt assessment rates without additional rule-making provided that the total base assessment rate increase or decrease does not exceed 2 basis points. The assessment rates were lowered effective July 1, 2016, since the reserve ratio reached 1.15% as of June 30, 2016. In the future, if the reserve ratio reaches certain levels, these assessment rates will generally be further lowered. As of December 31, 2017, the Bank's assessment rate was 5 basis points on average assets less average tangible equity capital.

In addition, all FDIC-insured institutions are required to pay a pro rata portion of the interest due on obligations issued by the Financing Corporation to fund the closing and disposal of failed thrift institutions by the Resolution Trust Corporation. The Financing Corporation rate is adjusted quarterly to reflect changes in assessment bases of the DIF. These assessments will continue until the Financing Corporation bonds mature in 2019. The annual rate for the first quarter of 2018 is 0.46 basis points.

Capital and Prompt Corrective Action Requirements

Capital Requirements

In July 2013, federal banking regulators (including the FDIC and the FRB) adopted new capital rules (the “Rules”). The Rules apply to both depository institutions (such as the Bank) and their holding companies (such as the Company). The Rules reflect, in part, certain standards initially adopted by the Basel Committee on Banking Supervision in December 2010 (which standards are commonly referred to as “Basel III”) as well as requirements contemplated by the Dodd-Frank Act. The Rules applied to both the Company and the Bank beginning in 2015.

The Rules recognize three components, or tiers, of capital: common equity Tier 1 capital, additional Tier 1 capital and Tier 2 capital. Common equity Tier 1 capital generally consists of retained earnings and common stock instruments (subject to certain adjustments), as well as accumulated other comprehensive income (“AOCI”) except to the extent that the Company and the Bank exercise a one-time irrevocable option to exclude certain components of AOCI. Both the Company and the Bank made this election in 2015. Additional Tier 1 capital generally includes non-cumulative preferred stock and related surplus subject to certain adjustments and limitations. Tier 2 capital generally includes certain capital instruments (such as subordinated debt) and portions of the amounts of the allowance for loan and lease losses, subject to certain requirements and deductions. The term “Tier 1 capital” means common equity Tier 1 capital plus additional Tier 1 capital, and the term “total capital” means Tier 1 capital plus Tier 2 capital.

The Rules generally measure an institution’s capital using four capital measures or ratios. The common equity Tier 1 capital ratio is the ratio of the institution’s common equity Tier 1 capital to its Tier 1 risk-weighted assets. The Tier 1 capital ratio is the ratio of the institution’s Tier 1 capital to its total risk-weighted assets. The total capital ratio is the ratio of the institution’s total capital to its total risk-weighted assets. The leverage ratio is the ratio of the institution’s Tier 1 capital to its average total consolidated assets. To determine risk-weighted assets, assets of an institution are generally placed into a risk category as prescribed by the regulations and given a percentage weight based on the relative risk of that category. The percentage weights range from 0% to 1,250%. An asset’s risk-weighted value will generally be its percentage weight multiplied by the asset’s value as determined under generally accepted accounting principles. In addition, certain off-balance-sheet items are converted to balance-sheet credit equivalent amounts, and each amount is then assigned to one of the risk categories. An institution’s federal regulator may require the institution to hold more capital than would otherwise be required under the Rules if the regulator determines that the institution’s capital requirements under the Rules are not commensurate with the institution’s credit, market, operational or other risks.

To be adequately capitalized both the Company and the Bank are required to have a common equity Tier 1 capital ratio of at least 4.5% or more, a Tier 1 leverage ratio of 4.0% or more, a Tier 1 risk-based ratio of 6.0% or more and a total risk-based ratio of 8.0% or more. In addition to the preceding requirements, all financial institutions subject to the Rules, including both the Company and the Bank, are required to establish a “conservation buffer,” consisting of common equity Tier 1 capital, which is at least 2.5% above each of the preceding common equity Tier 1 capital ratio, the Tier 1 risk-based ratio and the total risk-based ratio. An institution that does not meet the conservation buffer will be subject to restrictions on certain activities including payment of dividends, stock repurchases and discretionary bonuses to executive officers.

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

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

Both the Company and the Bank were generally required to be in compliance with the Rules on January 1, 2015. The conservation buffer began being phased in beginning in 2016 and would have taken full effect on January 1, 2019. However, in August 2017, the rules were halted at 2017 levels. Certain calculations under the Rules will also have phase-in periods. We believe that the current capital levels of the Company and the Bank are in compliance with the standards under the Rules including the conservation buffer.

On September 27, 2017, the federal banking regulatory agencies issued a joint notice of proposed rulemaking regarding several proposed simplifications of the Basel III capital rules. If adopted as currently drafted, these proposed changes would significantly benefit our Mortgage Banking business model by reducing the amount of regulatory capital that would be required to be held related to our mortgage servicing assets. Other proposed changes, if adopted, would require an increase in capital related to commercial and residential acquisition, development, and construction lending activity and would offset a portion of the benefit we would expect to receive with respect to our mortgage servicing assets. The final rules have yet to be published following the end of the comment period, but if they are adopted without any material changes to the September 2017 proposal, the Company and the Bank would expect to benefit from a reduction in the regulatory capital requirements beginning sometime in 2018.

Prompt Corrective Action Regulations
Section 38 of the Federal Deposit Insurance Act establishes a framework of supervisory actions for insured depository institutions that are not adequately capitalized, also known as "prompt corrective action" regulations. All of the federal banking agencies have promulgated substantially similar regulations to implement a system of prompt corrective action. These regulations apply to the Bank but not the Company. As modified by the Rules, the framework establishes five capital categories; under the Rules, a bank is:

- "well capitalized" if it has a total risk-based capital ratio of 10.0% or more, a Tier 1 risk-based capital ratio of 8.0% or more, a common equity Tier 1 risk-based ratio of 6.5% or more, and a leverage capital ratio of 5.0% or more, and is not subject to any written agreement, order or capital directive to meet and maintain a specific capital level for any capital measure;
- "adequately capitalized" if it has a total risk-based capital ratio of 8.0% or more, a Tier 1 risk-based capital ratio of 6.0% or more, a common equity Tier 1 risk-based ratio of 4.5% or more, and a leverage capital ratio of 4.0% or more;
- "undercapitalized" if it has a total risk-based capital ratio less than 8.0%, a Tier 1 risk-based capital ratio less than 6.0%, a common equity risk-based ratio less than 4.5% or a leverage capital ratio less than 4.0%;
- "significantly undercapitalized" if it has a total risk-based capital ratio less than 6.0%, a Tier 1 risk-based capital ratio less than 4.0%, a common equity risk-based ratio less than 3.0% or a leverage capital ratio less than 3.0%; and
- "critically undercapitalized" if it has a ratio of tangible equity to total assets that is equal to or less than 2.0%.

A bank that, based upon its capital levels, is classified as "well capitalized," "adequately capitalized" or "undercapitalized" may be treated as though it were in the next lower capital category if the appropriate federal banking agency, after notice and opportunity for a hearing, determines that an unsafe or unsound condition, or an unsafe or unsound practice, warrants such treatment.
At each successive lower capital category, an insured bank is subject to increasingly severe supervisory actions. These actions include, but are not limited to, restrictions on asset growth, interest rates paid on deposits, branching, allowable transactions with affiliates, ability to pay bonuses and raises to senior executives and pursuing new lines of business. Additionally, all "undercapitalized" banks are required to implement capital restoration plans to restore capital to at least the "adequately capitalized" level, and the FDIC is generally required to close "critically undercapitalized" banks within a 90-day period.
Limitations on Transactions with Affiliates
Transactions between the Bank and any affiliate are governed by Sections 23A and 23B of the Federal Reserve Act. An affiliate of the Bank is any company or entity which controls, is controlled by or is under common control with the Bank but which is not a subsidiary of the Bank. The Company and its non-bank subsidiaries are affiliates of the Bank. Generally, Section 23A limits the extent to which the Bank or its subsidiaries may engage in "covered transactions" with any one affiliate to an amount equal to 10.0% of the Bank's capital stock and surplus, and imposes an aggregate limit on all such transactions with all affiliates in an amount equal to 20.0% of such capital stock and surplus. Section 23B applies to "covered transactions" as well as certain other transactions and requires that all transactions be on terms substantially the same, or at least as favorable to the Bank, as those provided to a non-affiliate. The term "covered transaction" includes the making of loans to an affiliate, the purchase of or investment in the securities issued by an affiliate, the purchase of assets from an affiliate, the acceptance of securities issued by an affiliate as collateral security for a loan or extension of credit to any person or company, the issuance of a guarantee, acceptance or letter of credit on behalf of an affiliate, or certain transactions with an affiliate that involves the borrowing or lending of securities and certain derivative transactions with an affiliate.
In addition, Sections 22(g) and (h) of the Federal Reserve Act place restrictions on loans, derivatives, repurchase agreements and securities lending to executive officers, directors and principal shareholders of the Bank and its affiliates.
Standards for Safety and Soundness
The federal banking regulatory agencies have prescribed, by regulation, a set of guidelines for all insured depository institutions prescribing safety and soundness standards. These guidelines establish general standards for internal controls, information systems, internal audit systems, loan documentation, credit underwriting, interest rate risk

exposure, asset growth, asset quality, earnings standards, compensation, fees and benefits. In general, the guidelines require appropriate systems and practices to identify and manage the risks and exposures specified in the guidelines before capital becomes impaired. The guidelines prohibit excessive compensation as an unsafe and unsound practice and describe compensation as excessive when

15

the amounts paid are unreasonable or disproportionate to the services performed by an executive officer, employee, director, or principal shareholder.

Each insured depository institution must implement a comprehensive written information security program that includes administrative, technical and physical safeguards appropriate to the institution's size and complexity and the nature and scope of its activities. The information security program also must be designed to ensure the security and confidentiality of customer information, protect against any unanticipated threats or hazards to the security or integrity of such information, protect against unauthorized access to or use of such information that could result in substantial harm or inconvenience to any customer and ensure the proper disposal of customer and consumer information. Each insured depository institution must also develop and implement a risk-based response program to address incidents of unauthorized access to customer information in customer information systems. If the FDIC determines that the Bank fails to meet any standard prescribed by the guidelines, it may require the Bank to submit an acceptable plan to achieve compliance with the standard. The Bank maintains a program to meet the information security requirements.

Real Estate Lending Standards

FDIC regulations require the Bank to adopt and maintain written policies that establish appropriate limits and standards for real estate loans. These standards, which must be consistent with safe and sound banking practices, must establish loan portfolio diversification standards, prudent underwriting standards (including loan-to-value ratio limits) that are clear and measurable, loan administration procedures and documentation, approval and reporting requirements. The Bank is obligated to monitor conditions in its real estate markets to ensure that its standards continue to be appropriate for market conditions. The Bank's board of directors is required to review and approve the Bank's standards at least annually.

The FDIC has published guidelines for compliance with these regulations, including supervisory limitations on loan-to-value ratios for different categories of real estate loans. Under the guidelines, the aggregate amount of all loans in excess of the supervisory loan-to-value ratios should not exceed 100.0% of total capital, and the total of all loans for commercial, agricultural, multifamily or other non-one-to-four family residential properties in excess of such ratios should not exceed 30.0% of total capital. Loans in excess of the supervisory loan-to-value ratio limitations must be identified in the Bank's records and reported at least quarterly to the Bank's board of directors.

The FDIC and the federal banking agencies have also issued guidance on sound risk management practices for concentrations in commercial real estate lending. The particular focus is on exposure to commercial real estate loans that are dependent on the cash flow from the real estate held as collateral and that are likely to be sensitive to conditions in the commercial real estate market (as opposed to real estate collateral held as a secondary source of repayment or as an abundance of caution). The purpose of the guidance is not to limit a bank's commercial real estate lending but to guide banks in developing risk management practices and capital levels commensurate with the level and nature of real estate concentrations.

Risk Retention

The Dodd-Frank Act requires that, subject to certain exemptions, securitizers of mortgage and other asset-backed securities retain not less than five percent of the credit risk of the mortgages or other assets and that the securitizer not hedge or otherwise transfer the risk it is required to retain. In December 2014, the federal banking regulators, together with the SEC, the Federal Housing Finance Agency and the Department of Housing and Urban Development, published a final rule implementing this requirement. Generally, the final rule provides various ways in which the retention of risk requirement can be satisfied and also describes exemptions from the retention requirements for various types of assets, including mortgages. Compliance with the final rule with respect to residential mortgage securitizations was required beginning in December 2015 and was required beginning in December 2016 for all other securitizations.

Volcker Rule

In December 2013, the FDIC, the FRB and various other federal agencies issued final rules to implement certain provisions of the Dodd-Frank Act commonly known as the "Volcker Rule." Subject to certain exceptions, the final rules generally prohibit banks and affiliated companies from engaging in short-term proprietary trading of certain securities, derivatives, commodity futures and options on those instruments, for their own account. The final rules also impose restrictions on banks and their affiliates from acquiring or retaining an ownership interest in, sponsoring or having certain other relationships with hedge funds or private equity funds.

Activities and Investments of Insured State-Chartered Financial Institutions

Federal law generally prohibits FDIC-insured state banks from engaging as a principal in activities, and from making equity investments, other than those that are permissible for national banks. An insured state bank is not prohibited from, among other things, (1) acquiring or retaining a majority interest in certain subsidiaries, (2) investing as a limited partner in a partnership the sole purpose of which is direct or indirect investment in the acquisition, rehabilitation or new construction of a qualified housing project, provided that such limited partnership investments may not exceed 2.0% of the bank's total assets, (3) acquiring up to 10.0% of the voting stock of a company that solely provides or reinsures directors', trustees' and officers' liability insurance coverage or bankers' blanket bond group insurance coverage for insured depository institutions and (4) acquiring or retaining the voting shares of a depository institution if certain requirements are met.

Washington State has enacted a law regarding financial institution parity. The law generally provides that Washington-chartered commercial banks may exercise any of the powers of Washington-chartered savings banks, national banks or federally-chartered savings banks, subject to the approval of the Director of the WDFI in certain situations.

Environmental Issues Associated With Real Estate Lending

The Comprehensive Environmental Response, Compensation and Liability Act, or (the "CERCLA"), is a federal statute that generally imposes strict liability on all prior and present "owners and operators" of sites containing hazardous waste. However, Congress has acted to protect secured creditors by providing that the term "owner and operator" excludes a person whose ownership is limited to protecting its security interest in the site. Since the enactment of the CERCLA, this "secured creditor" exemption has been the subject of judicial interpretations which have left open the possibility that lenders could be liable for cleanup costs on contaminated property that they hold as collateral for a loan. To the extent that legal uncertainty exists in this area, all creditors, including the Bank, that have made loans secured by properties with potential hazardous waste contamination (such as petroleum contamination) could be subject to liability for cleanup costs, which costs often substantially exceed the value of the collateral property.

Reserve Requirements

The Bank is subject to Federal Reserve regulations pursuant to which depositary institutions may be required to maintain non-interest-earning reserves against their deposit accounts and certain other liabilities. Reserves must be maintained against transaction accounts (primarily negotiable order of withdrawal and regular checking accounts). The regulations generally required in 2017 that reserves be maintained as follows:

- Net transaction accounts up to $15.5 million were exempt from reserve requirements.
- A reserve of 3.0% of the aggregate is required for transaction accounts over $15.5 million up to $115.1 million.
- A reserve of 10% is required for any transaction accounts over $115.1 million.

In 2018, the regulations generally require that reserves be maintained as follows:

- Net transaction accounts up to $16.0 million were exempt from reserve requirements.
- A reserve of 3.0% of the aggregate is required for transaction accounts over $16.0 million up to $122.3 million.
- A reserve of 10% is required for any transaction accounts over $122.3 million.

Federal Home Loan Bank System

The Federal Home Loan Bank system consists of 11 regional Federal Home Loan Banks. Among other benefits, each of these serves as a reserve or central bank for its members within its assigned region. Each of the Federal Home Loan Banks makes available loans or advances to its members in compliance with the policies and procedures established by its board of directors. The Bank is a member of the Federal Home Loan Bank of Des Moines (the “Des Moines FHLB”) and is a borrowing non-member financial institution with the Federal Home Loan Bank of San Francisco ("San Francisco FHLB"). As a member of the Des Moines FHLB, the Bank is required to own stock in the Des Moines FHLB. Separately, pursuant to a non-member lending agreement with the San Francisco FHLB that we entered into at the time of the Simplicity Acquisition, we are required to own stock of the San Francisco FHLB so long as we continue to be a borrower from the San Francisco FHLB. As of December 31, 2017, we owned $46.6 million of stock in the FHLB in the aggregate based on these obligations.

Community Reinvestment Act of 1977

Banks are subject to the provisions of the CRA of 1977, which requires the appropriate federal bank regulatory agency to assess a bank's record in meeting the credit needs of the assessment areas serviced by the bank, including low and moderate income neighborhoods. The regulatory agency's assessment of the bank's record is made available to the public. Further, these assessments are considered by regulators when evaluating mergers, acquisitions and applications to open or relocate a branch or facility. The Bank currently has a rating of “Satisfactory” under the CRA.

Dividends

Dividends from the Bank constitute an important source of funds for dividends that may be paid by the Company to shareholders. The amount of dividends payable by the Bank to the Company depends upon the Bank's earnings and capital position and is limited by federal and state laws. Under Washington law, the Bank may not declare or pay a cash dividend on its capital stock if this would cause its net worth to be reduced below the net worth requirements, if any, imposed by the WDFI. In addition, dividends on the Bank's capital stock may not be paid in an amount greater than its retained earnings without the approval of the WDFI.

The amount of dividends actually paid during any one period will be strongly affected by the Bank's policy of maintaining a strong capital position. Federal law prohibits an insured depository institution from paying a cash dividend if this would cause the institution to be “undercapitalized,” as defined in the prompt corrective action regulations. Moreover, the federal bank regulatory agencies have the general authority to limit the dividends paid by insured banks if such payments are deemed to constitute an unsafe and unsound practice. Capital rules that went into effect in 2015 impose additional requirements on the Bank’s ability to pay dividends. See “- *Capital and Prompt Corrective Action Requirements - Capital Requirements*.”

Liquidity

The Bank is required to maintain a sufficient amount of liquid assets to ensure its safe and sound operation. See “Management's Discussion and Analysis - *Liquidity Risk and Capital Resources.”*

Compensation

The Bank is subject to regulation of its compensation practices. See “Regulation and Supervision - *Regulation of the Company - Compensation Policies*.”

Bank Secrecy Act and USA Patriot Act

The Company and the Bank are subject to the Bank Secrecy Act, as amended by the USA PATRIOT Act, which gives the federal government powers to address money laundering and terrorist threats through enhanced domestic security measures, expanded surveillance powers and mandatory transaction reporting obligations. By way of example, the Bank Secrecy Act imposes an affirmative obligation on the Bank to report currency transactions that exceed certain thresholds and to report other transactions determined to be suspicious. Beginning in May 2018, the Bank Secrecy Act will also require financial institutions, including the Bank, to meet certain customer due diligence requirements, including obtaining a certification from the individual opening the account on behalf of the legal entity that identifies the beneficial owner(s) of the entity. The purpose of these requirements is to enable the Bank to be able to predict with relative certainty the types of transactions in which a customer is likely to engage which should in turn assist in determining when transactions are potentially suspicious.

Like all United States companies and individuals, the Company and the Bank are prohibited from transacting business with certain individuals and entities named on the Office of Foreign Asset Control's list of Specially Designated Nationals and Blocked Persons. Failure to comply may result in fines and other penalties. The Office of Foreign Asset Control ("OFAC") has

issued guidance directed at financial institutions in which it asserted that it may, in its discretion, examine institutions determined to be high-risk or to be lacking in their efforts to comply with these prohibitions.
The Bank maintains a program to meet the requirements of the Bank Secrecy Act, USA PATRIOT Act and OFAC.
Identity Theft
Section 315 of the Fair and Accurate Credit Transactions Act ("FACT Act") requires each financial institution or creditor to develop and implement a written Identity Theft Prevention Program to detect, prevent and mitigate identity theft “red flags” in connection with the opening of certain accounts or certain existing accounts.
The Bank maintains a program to meet the requirements of Section 315 of the FACT Act.
Consumer Protection Laws and Regulations
The Bank and its affiliates are subject to a broad array of federal and state consumer protection laws and regulations that govern almost every aspect of its business relationships with consumers. While this list is not exhaustive, these include the Truth-in-Lending Act, the Truth in Savings Act, the Electronic Fund Transfer Act, the Expedited Funds Availability Act, the Equal Credit Opportunity Act, the Fair Housing Act, the Secure and Fair Enforcement in Mortgage Licensing Act, the Real Estate Settlement Procedures Act, the Home Mortgage Disclosure Act, the Fair Credit Reporting Act, the Fair Debt Collection Practices Act, the Service Members' Civil Relief Act, the Right to Financial Privacy Act, the Home Ownership and Equity Protection Act, the Consumer Leasing Act, the Fair Credit Billing Act, the Homeowners Protection Act, the Check Clearing for the 21st Century Act, laws governing flood insurance, laws governing consumer protections in connection with the sale of insurance, federal and state laws prohibiting unfair and deceptive business practices, foreclosure laws and various regulations that implement some or all of the foregoing. These laws and regulations mandate certain disclosure requirements and regulate the manner in which financial institutions must deal with customers when taking deposits, making loans, collecting loans and providing other services. Failure to comply with these laws and regulations can subject the Bank to various penalties, including but not limited to, enforcement actions, injunctions, fines, civil liability, criminal penalties, punitive damages and the loss of certain contractual rights. The Bank has a compliance governance structure in place to help ensure its compliance with these requirements.
The Dodd-Frank Act established the Bureau of Consumer Financial Protection ("CFPB") as a new independent bureau that is responsible for regulating consumer financial products and services under federal consumer financial laws. The CFPB has broad rulemaking authority with respect to these laws and exclusive examination and primary enforcement authority with respect to banks with assets of more than $10 billion.
The Dodd-Frank Act also contains a variety of provisions intended to reform consumer mortgage practices. The provisions include (1) a requirement that lenders make a determination that at the time a residential mortgage loan is consummated the consumer has a reasonable ability to repay the loan and related costs, (2) a ban on loan originator compensation based on the interest rate or other terms of the loan (other than the amount of the principal), (3) a ban on prepayment penalties for certain types of loans, (4) bans on arbitration provisions in mortgage loans and (5) requirements for enhanced disclosures in connection with the making of a loan. The Dodd-Frank Act also imposes a variety of requirements on entities that service mortgage loans and significantly expanded mortgage loan application data collection and reporting requirements under the Home Mortgage Disclosure Act.
The Dodd-Frank Act contains provisions further regulating payment card transactions. The Dodd-Frank Act required the Federal Reserve to adopt regulations limiting any interchange fee for a debit transaction to an amount which is “reasonable and proportional” to the costs incurred by the issuer. The Federal Reserve has adopted final regulations limiting the amount of debit interchange fees that large bank issuers may charge or receive on their debit card transactions. There is an exemption from the rules for issuers with assets of less than $10 billion and the Federal Reserve has stated that it will monitor and report to Congress on the effectiveness of the exemption.
Future Legislation or Regulation

The Trump administration, Congress, the regulators and various states continue to focus attention on the financial services industry. Proposals that affect the industry will likely continue to be introduced. In particular, the Trump administration and various members of Congress have expressed a desire to modify or repeal parts of the Dodd-Frank

Act. We cannot predict whether any of these proposals will be enacted or adopted or, if they are, the effect they would have on our business, our operations or our financial condition or on the financial services industry generally.

ITEM 1A RISK FACTORS

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

Risks Related to Our Operations

We may not be able to continue to grow at our recent pace.

Since our initial public offering ("IPO") in February 2012, we have included targeted and opportunistic growth as a key component of our business strategy for both our Mortgage Banking Segment and our Commercial and Consumer Banking Segment and have expanded our operations at a relatively accelerated pace. We have grown our retail branch presence from 20 branches in 2012 to 59 as of December 31, 2017, including expansion into new geographic regions. Simultaneously, we have added substantially to our mortgage operations in both existing and new markets and continued to expand our commercial lending operations, resulting in substantial growth overall in total assets, total deposits, total loans and employees.

While we expect to continue both strategic and opportunistic growth in the Commercial and Consumer Banking Segment, we recently undertook a restructuring of our Mortgage Banking Segment, where production has been negatively impacted by increasing interest rates and a reduced supply of homes for sale in our primary markets. For the near term, we expect to focus primarily on measured and efficient growth and optimization of our existing mortgage banking operations, which may lead to a substantially slower growth rate than we have experienced in recent years.

We may not recognize the full benefits of our recent restructuring.

In the second and third quarter of 2017, we implemented a restructuring plan to bring our costs and the size of our mortgage banking operations in line with our decreased expectations for origination opportunities for mortgage loans, given both the interest rate environment and the lack of housing inventory in our primary markets. We recorded restructuring expenses totaling $3.7 million in 2017, with an expectation that our annual costs will be reduced significantly going forward. These expenses are associated primarily with a reduction in staffing in the Mortgage Banking Segment, the closure or consolidation of several of our stand-alone home loan centers and other efficiency measures. However, there is no guarantee that we will recognize all or a substantial portion of the anticipated cost savings. Further, if the demand for mortgage loans continues to decline in our markets, we may not recognize the expected income benefit and may have to take additional steps to streamline our mortgage operations further. Conversely, if the demand for mortgage loans increases precipitously in our markets, we may not be able to meet the full amount of the demand with our leaner operations and may find it necessary to increase costs to provide for the necessary staffing and resources.

Volatility in mortgage markets, changes in interest rates, operational costs and other factors beyond our control may adversely impact our profitability.

We have sustained significant losses in the past, and we cannot guarantee that we will remain profitable or be able to maintain profitability at a given level. Changes in the mortgage market, including an increase in interest rates and a sustained and sizable disparity between the supply and demand of houses available for sale in our primary markets, have caused a stagnation in mortgage originations throughout our markets, which adversely impacted our profitability in 2017. This decline in profitability occurred even as our relative market share for mortgage originations remained substantially unchanged. While we have implemented a restructuring of our Mortgage Banking Segment in response, continued volatility in the market could have additional negative effects on our financial results. In addition, our hedging activities may be impacted by unforeseen or unexpected changes. For example, in the fourth quarter of 2016, unexpected increases in interest rates and asymmetrical changes in the values of mortgage servicing rights and certain derivative hedging instruments impacted our earnings for that quarter. We cannot be certain that similar asymmetries may not arise in the future. These and many other factors affect our profitability, and our ability to remain profitable is threatened by a myriad of issues, including:

- Volatility in interest rates may limit our ability to make loans, decrease our net interest income and noninterest income, create disparity between actual and expected closed loan volumes based on historical fallout rates, reduce demand for loans, diminish the value of our loan servicing rights, affect the value of our hedging instruments, increase the cost of deposits and otherwise negatively impact our financial situation;

- Volatility in mortgage markets, which is driven by factors outside of our control such as interest rate changes, imbalances in housing supply and demand and general economic conditions, may negatively impact our ability to originate loans and change the fair value of our existing loans and servicing rights;
- Our hedging strategies to offset risks related to interest rate changes may not be successful and may result in unanticipated losses for the Company;
- Changes in regulations or in regulators' interpretations of existing regulations may negatively impact the Company or the Bank and may limit our ability to offer certain products or services, increase our costs of compliance or restrict our growth initiatives, branch expansion and acquisition activities;
- Increased costs from growth through acquisition could exceed the income growth anticipated from these opportunities, especially in the short term as these acquisitions are integrated into our business;
- Increased costs for controls over data confidentiality, integrity, and availability due to growth or as may be necessary to strengthen the security profile of our computer systems and computer networks may have a negative impact on our net income;
- Changes in government-sponsored enterprises and their ability to insure or to buy our loans in the secondary market may result in significant changes in our ability to recognize income on sale of our loans to third parties;
- Competition in the mortgage market industry may drive down the interest rates we are able to offer on our mortgages, which would negatively impact our net interest income; and
- Changes in the cost structures and fees of government-sponsored enterprises to whom we sell many of these loans may compress our margins and reduce our net income and profitability.

These and other factors may limit our ability to generate revenue in excess of our costs, and in some circumstances may affect the carrying value of our mortgage servicing, either of which in turn may result in a lower rate of profitability or even substantial losses for the Company.

Proxy contests threatened or commenced against the Company could cause us to incur substantial costs, divert the attention of the Board of Directors and management, take up management's attention and resources, cause uncertainty about the strategic direction of our business and adversely affect our business, operating results and financial condition.

In November 2017, an activist investor, Roaring Blue Lion Capital Management, L.P., and its managing member, Charles W. Griege, Jr., filed a Schedule 13D with the SEC with respect to the Company. In December 2017, the Company's Board of Directors met with Mr. Griege, and, at Mr. Griege's request, in January 2018, the Company's Human Resources and Corporate Governance Committee, which acts as our nominating committee, interviewed Mr. Griege to consider him for a position on our Board of Directors. On January 11, 2018, we announced that we would not be offering Mr. Griege a seat on our Board of Directors. On February 26, 2018, Mr. Griege publicly disclosed that he had provided notice to the Company that he intended to nominate directors in opposition to the slate of the Board of Directors at our 2018 Annual Meeting of Shareholders.

A proxy contest or other activist campaign and related actions, such as the ones discussed above, could have a material and adverse effect on us for the following reasons:

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Activist investors may attempt to effect changes in the Company’s strategic direction and how the Company is governed, or to acquire control over the Company. In particular, the above mentioned activist investor has suggested changes to our business that conflict with our strategic direction and could cause uncertainty amongst employees, customers, investors and other constituencies about the strategic direction of our business.

- While the Company welcomes the opinions of all shareholders, responding to proxy contests and related actions by activist investors could be costly and time-consuming, disrupt our operations, and divert the attention of our Board of Directors and senior management and employees away from their regular duties and the pursuit of business opportunities. In addition, there may be litigation in connection with a proxy contest, which would serve as a further distraction to our Board of Directors, senior management and employees and could require the Company to incur significant additional costs.

- Perceived uncertainties as to our future direction as a result of potential changes to the composition of the Board of Directors may lead to the perception of a change in the strategic direction of the business, instability or lack of continuity which may be exploited by our competitors; may cause concern to our existing or potential customers and employees; may result in the loss of potential business opportunities; and may make it more difficult to attract and retain qualified personnel and business partners.

- Proxy contests and related actions by activist investors could cause significant fluctuations in our stock price based on temporary or speculative market perceptions or other factors that do not necessarily reflect the underlying fundamentals and prospects of our business.

The integration of recent and future acquisitions could consume significant resources and may not be successful.

We have completed four whole-bank acquisitions and acquired eight stand-alone branches between September 2013 and December 31, 2017, all of which have required substantial resources and costs related to the acquisition and integration process. For example, we incurred $391 thousand and $4.6 million of acquisition related expenses, net of tax, in the fiscal years ended December 31, 2017 and 2016, respectively. We may in the future undertake additional growth through acquisition. There are certain risks related to the integration of operations of acquired banks and branches, which we may continue to encounter if we acquire other banks or branches in the future.

Any future acquisition we may undertake may involve numerous risks related to the investigation and consideration of the potential acquisition and the costs of undertaking such a transaction, as well as integrating acquired businesses into HomeStreet and HomeStreet Bank, including risks that arise after the transaction is completed. These risks include, but are not limited to, the following:

- Diversion of management's attention from normal daily operations of the business;
- Difficulties in integrating the operations, technologies, and personnel of the acquired companies;
- Difficulties in implementing, upgrading and maintaining our internal controls over financial reporting and our disclosure controls and procedures;
- Increased risk of compliance errors related to regulatory requirements, including customer notices and other related disclosures;
- Inability to maintain the key business relationships and the reputations of acquired businesses;
- Entry into markets in which we have limited or no prior experience and in which competitors have stronger market positions;
- Potential responsibility for the liabilities of acquired businesses;
- Increased operating costs associated with addressing the foregoing risks;
- Inability to maintain our internal standards, procedures and policies at the acquired companies or businesses; and
- Potential loss of key employees of the acquired companies.

In addition, in certain cases our acquisition of a whole bank or a branch includes the acquisition of all or a substantial portion of the target bank's or branch’s assets and liabilities, including all or a substantial portion of its loan portfolio. There may be instances where we, under our normal operating procedures, may find after the acquisition that there may be additional losses or undisclosed liabilities with respect to the assets and liabilities of the target bank or branch, and, with respect to its loan portfolio, that the ability of a borrower to repay a loan may have become impaired, the quality of the value of the collateral securing a loan may fall below our standards, or the allowance for loan losses may not be adequate. One or more of these factors might cause us to have additional losses or liabilities, additional loan charge-offs or increases in allowances for loan losses.

Difficulties in pursuing or integrating any new acquisitions, and potential discoveries of additional losses or undisclosed liabilities with respect to the assets and liabilities of acquired companies, may increase our costs and adversely impact our financial condition and results of operations. Further, even if we successfully address these factors and are successful in closing acquisitions and integrating our systems with the acquired systems, we may nonetheless experience customer losses, or we may fail to grow the acquired businesses as we intend or to operate the acquired businesses at a level that would avoid losses or justify our investments in those companies.

In addition, we may choose to issue additional common stock for future acquisitions, or we may instead choose to pay the consideration in cash or a combination of stock and cash. Any issuances of stock relating to an acquisition may have a dilutive effect on earnings per share, book value per share or the percentage ownership of existng shareholders depending on the value of the assets or entity acquired. Alternatively, the use of cash as consideration in any such acquisitions could impact our capital position and may require us to raise additional capital.

Natural disasters in our geographic markets may impact our financial results.

In the fourth quarter of 2017, certain communities in California suffered significant losses from natural disasters, including devastating wildfires in Northern California in October 2017 that destroyed many homes and forced a short closure of four of our stand-alone home loan centers in those areas. While the impact of these recent natural disasters on our business do not appear to be material, we anticipate that our mortgage banking operations in areas impacted by future disasters may experience an adverse financial impact due to office closures, customers who as a result of their losses may not be able to meet their loan commitments in a timely manner, a further reduction in housing inventory due to the number of structures destroyed in the fire and negative impacts to the local economy as it seeks to recover from these disasters.

Most of our primary markets are located in geographic regions that are at a risk for earthquakes, wildfires, floods, mudslides and other natural disasters. In the event future catastrophic events impact our major markets, our operations and financial results may be adversely impacted.

Our business is geographically confined to certain metropolitan areas of the Western United States, and events and conditions that disproportionately affect those areas may pose a more pronounced risk for our business.

Although we presently have operations in eight states, a substantial majority of our revenues are derived from operations in the Puget Sound region of Washington, the Portland, Oregon metropolitan area, the San Francisco Bay Area, and the Los Angeles and San Diego metropolitan areas in Southern California. All of our markets are located in the Western United States. Each of our primary markets is subject to various types of natural disasters, and each has experienced disproportionately significant economic volatility compared to the rest of the United States in the past decade. In addition, many of these areas are currently experiencing a constriction in the availability of houses for sale as new home construction has not kept pace with population growth in our primary markets, in part due to limitations on permitting and land availability. Economic events or natural disasters that affect the Western United States and our primary markets in that region in particular, or more significantly, may have an unusually pronounced impact on our business and, because our operations are not more geographically diversified, we may lack the ability to mitigate those impacts from operations in other regions of the United States.

The significant concentration of real estate secured loans in our portfolio has had a negative impact on our asset quality and profitability in the past and there can be no assurance that it will not have such impact in the future.

A substantial portion of our loans are secured by real property, a characteristic we expect to continue indefinitely. Our real estate secured lending is generally sensitive to national, regional and local economic conditions, making loss levels difficult to predict. Declines in real estate sales and prices, significant increases in interest rates, unforeseen natural disasters and a degeneration in prevailing economic conditions may result in higher than expected loan delinquencies, foreclosures, problem loans, other real estate owned ("OREO"), net charge-offs and provisions for credit and OREO losses. Although real estate prices are currently stable in the markets in which we operate, if market values decline, the collateral for our loans may provide less security and our ability to recover the principal, interest and costs due on defaulted loans by selling the underlying real estate will be diminished, leaving us more likely to suffer additional losses on defaulted loans. Such declines may have a greater effect on our earnings and capital than on the earnings and capital of financial institutions whose loan portfolios are more diversified.

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

- Reduced 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 mortgage 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.

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

Both the value of our single family mortgage servicing rights, or MSRs, and the value of our single family loans held for sale change with fluctuations in interest rates, among other things, reflecting the changing expectations of mortgage prepayment activity. To mitigate potential losses of fair value of single family loans held for sale and MSRs related to changes in interest rates, we actively hedge this risk with financial derivative instruments. Hedging is a complex process, requiring sophisticated models, experienced and skilled personnel and continual monitoring. Changes in the value of our hedging instruments may not correlate with changes in the value of our single family loans held for sale and MSRs, as occurred in the fourth quarter of 2016, and we could incur a net valuation loss as a result of our hedging activities. As the volume of single family loans held for sale and MSRs increases, our exposure to the risks associated with the impact of interest rate fluctuations on single family loans held for sale and MSRs also increases. Further, in times of significant financial disruption, as in 2008, hedging counterparties have been known to default on their obligations. Any such events or conditions may harm our results of operations.

We have previously had deficiencies in our internal controls over financial reporting, and those deficiencies or others that we have not discovered may result in our inability to maintain control over our assets or to identify and accurately report our financial condition, results of operations, or cash flows.

Our internal controls over financial reporting are intended to assure we maintain accurate records, promote the accurate and timely reporting of our financial information, maintain adequate control over our assets, and detect unauthorized acquisition, use or disposition of our assets. Effective internal and disclosure controls are necessary for us to provide reliable financial reports and effectively prevent fraud and to operate successfully as a public company. If we cannot provide reliable financial reports or prevent fraud, our reputation and operating results may be harmed.

As part of our ongoing monitoring of internal control from time to time we have discovered deficiencies in our internal controls that have required remediation. In the past, these deficiencies have included “material weaknesses,” defined as a deficiency or combination of deficiencies that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected, and “significant deficiencies,” defined as a deficiency or combination of deficiencies in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those responsible for oversight of the Company's financial reporting.

Management has in place a process to document and analyze all identified internal control deficiencies and implement remedial measures sufficient to resolve those deficiencies. To support our growth initiatives and to create operating efficiencies we have implemented, and will continue to implement, new systems and processes. If our project management processes are not sound and adequate resources are not deployed to these implementations, we may experience additional internal control lapses that could expose the Company to operating losses. However, any failure to maintain effective controls or timely effect any necessary improvement of our internal and disclosure controls in the future could harm operating results or cause us to fail to meet our reporting obligations.

If our internal controls over financial reporting are subject to additional defects we have not identified, we may be unable to maintain adequate control over our assets, or we may experience material errors in recording our assets, liabilities and results of operations. Repeated or continuing deficiencies may cause investors to question the reliability of our internal controls or our financial statements, and may result in an erosion of confidence in our management or result in penalties or other potential enforcement action by the Securities and Exchange Commission (the “SEC”). On January 19, 2017, we finalized a settlement agreement with the SEC and paid a fine of $500,000 related to an SEC investigation into errors disclosed in 2014 in our fair value hedge accounting for certain commercial real estate loans and swaps. Neither the errors nor the amount of the settlement was ultimately material to our financial statements in any period. However, inquiries by the SEC took the time and attention of management for significant periods of time and may have had an adverse impact on investor confidence in us and, in turn, the market value of our common stock in the near term. If we were to have future failures of a similar nature, such failures may have a more significant impact than might generally be expected, both because of a potential for enhanced regulatory scrutiny and the potential for further reputational harm.

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, as well as charge-offs in excess of reserves, will reduce our earnings.

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

In addition, as we have acquired new operations, we have added the loans previously held by the acquired companies or related to the acquired branches to our books. In the event that we make additional acquisitions in the future, we may bring additional loans originated by other institutions onto our books. Although we review loan quality as part of our due diligence in considering any acquisition involving loans, the addition of such loans may increase our credit risk exposure, require an increase in our allowance for loan losses, and adversely affect our financial condition, results of operations and cash flows stemming from losses on those additional loans.

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 use 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. As we grow the expectation for the sophistication of our models will increase and we may need to hire additional personnel with sufficient expertise.

Our funding sources may prove insufficient to replace deposits and support our future growth.

We must maintain sufficient funds to respond to the needs of depositors and borrowers. As a part of our liquidity management, we use a number of funding sources in addition to core deposit growth and repayments and maturities of loans and investments. As we continue to grow, we are likely to become more dependent on these sources, which may include Federal Home Loan Bank advances, proceeds from the sale of loans, federal funds purchased and brokered certificates of deposit. Adverse operating results or changes in industry conditions could lead to difficulty or an inability to access these additional funding sources and could make our existing funds more volatile. Our financial flexibility may be materially 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. As rates increase, the cost of our funding often increases faster than we can increase our interest income. For example, in recent periods the FHLB has increased rates on their advances in a quick response to increases in rates by the Federal Reserve and implemented those increased costs earlier than we have been able to increase our own interest income. This asymmetry of the speed at which interests rates rise on our liabilities as opposed to our assets may have a negative impact on our net interest income and, in turn, our financial results. 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 that case, our operating margins and profitability would be adversely affected. Further, the volatility inherent in some of these funding sources, particularly brokered deposits, may increase our exposure to liquidity risk.

Our management of capital could adversely affect profitability measures and the market price of our common stock and could dilute the holders of our outstanding common stock.

Our capital ratios are higher than regulatory minimums. We may choose to have a lower capital ratio in the future in order to take advantage of growth opportunities, including acquisition and organic loan growth, or in order to take advantage of a favorable investment opportunity. On the other hand, we may again in the future elect to raise capital through a sale of our debt or equity securities in order to have additional resources to pursue our growth, including by acquisition, fund our business needs and meet our commitments, or as a response to changes in economic conditions that make capital raising a prudent choice. In the event the quality of our assets or our economic position were to deteriorate significantly, as a result of market forces or otherwise, we may also need to raise additional capital in order to remain compliant with capital standards.

We may not be able to raise such additional capital at the time when we need it, or on terms that are acceptable to us. Our ability to raise additional capital will depend in part on conditions in the capital markets at the time, which are outside our control, and in part on our financial performance. Further, if we need to raise capital in the future, especially if it is in response to changing market conditions, we may need to do so when many other financial institutions are also seeking to raise capital, which would create competition for investors. An inability to raise additional capital on acceptable terms when needed could have a material adverse effect on our business, financial condition, results of operations and prospects. In addition, any capital raising alternatives could dilute the holders of our outstanding common stock and may adversely affect the market price of our common stock.

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

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

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

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

We originate and purchase, sell and thereafter service single family loans, some of which are insured by FHA/HUD or guaranteed by the VA. We certify to the FHA/HUD and the VA that the loans meet their requirements and guidelines. The FHA/HUD and VA audit loans that are insured or guaranteed under their programs, including audits of our processes and procedures as well as individual loan documentation. Violations of guidelines can result in monetary penalties or require us to provide indemnifications against loss or loans declared ineligible for their programs. In the past, monetary penalties and losses from indemnifications have not created material losses to the Bank. As a result of the housing crisis that began in 2008, the FHA/HUD stepped up enforcement initiatives. In addition to regular FHA/HUD audits, HUD's Inspector General has become active in enforcing FHA regulations with respect to individual loans and has partnered with the Department of Justice ("DOJ") in filing lawsuits against lenders for systemic violations. The penalties resulting from such lawsuits can be much more severe, since systemic violations can be applied to groups of loans and penalties may be subject to treble damages. The DOJ has used the Federal False Claims Act and other federal laws and regulations in prosecuting these lawsuits. Because of our significant origination of FHA/HUD insured and VA guaranteed loans, if the DOJ were to find potential violations by the Bank, we could be subject to material monetary penalties and/or losses, and may even be subject to lawsuits alleging systemic violations which could result in treble damages.

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

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

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

Changes in the fee structures by Fannie Mae, Freddie Mac or other third party loan purchasers, such as an increase in guarantee fees and other required fees and payments, may increase the costs of doing business with them and, in turn, increase the cost of mortgages to consumers and the cost of selling conforming loans to third party loan purchasers. Increases in those costs could in turn decrease our margin and negatively impact our profitability. Additionally, increased costs for premiums from mortgage insurers, extensions of the period for which private mortgage insurance is required on a loan purchased by third party purchasers and other changes to mortgage insurance requirements could also increase our costs of completing a mortgage and our margins for home loan origination. Were any of our third party loan purchasers to make such changes in the future, it may have a negative impact on our ability to originate loans to be sold because of the increased costs of such loans and may decrease our profitability with respect to loans held for sale. In addition, any significant adverse change in the level of activity in the secondary market or the underwriting criteria of these third party loan purchasers could negatively impact our results of business, operations and cash flows.

We may incur additional costs in placing loans if our third party purchasers discontinue doing business with us for any reason.

We rely on third party purchasers with whom we place loans as a source of funding for the loans we make to consumers. Occasionally, third party loan purchasers may go out of business, elect to exit the market or choose to cease doing business with us for a myriad of reasons, including but not limited to the increased burdens on purchasers related to compliance, adverse market conditions or other pressures on the industry. In the event that one or more third party purchasers goes out of business, exits the market or otherwise ceases to do business with us at a time when we have loans that have been placed with such purchaser but not yet sold, we may incur additional costs to sell those loans to other purchasers or may have to retain such loans, which could negatively impact our results of operations and our capital position.

Our real estate lending may expose us to environmental liabilities.

In the course of our business, it is necessary to foreclose and take title to real estate, which could subject us to environmental liabilities with respect to these properties. Hazardous substances or waste, contaminants, pollutants or sources thereof may be discovered on properties during our ownership or after a sale to a third party. We could be held liable to a governmental entity or to third parties for property damage, personal injury, investigation and clean-up costs incurred 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.

Market-Related Risks

Restrictions on new home construction and lack of inventory of homes for sale in our primary markets may negatively impact our ability to originate mortgage loans at the volumes we have experienced in the past.

While a desire to purchase single family real estate remains strong in our primary markets, as is evidenced by a continued demand from customers for mortgage loan applications and pre-approvals, new and resale home availability in those markets has not kept pace with demand. Despite sustained job and population growth, Redfin.com reported the number of homes listed for sale in the Seattle and Portland metropolitan area and in California had once again decreased year over year as of December 31, 2017, and there has been no indication that there will be any near-term meaningful change in this imbalance.

While this limit of supply has not negatively impacted our market share to date, it has negatively impacted our loan volume and despite the restructuring of our Mortgage Banking Segment to scale our operations to demand, if this trend continues to increase, the lack of inventory may continue to impair both our volume and earnings in the Mortgage Banking Segment.

The housing supply constraint is complicated by a slow development of new home construction, which is itself constrained by the geography of the West Coast and the lingering effects of the last recession. Newly constructed single family home inventory remains extremely low as homebuilders struggle to find and develop available and appropriate land for new housing and meet increased land use regulations which increase costs and limit the number of lots per parcel. In addition, because the timeline for converting raw land to finished development may exceed five years in many of our markets, the curtailment of development following the recession means that inventory will likely remain low for the foreseeable future.

The demand for houses and financing to purchase houses remains strong in our primary markets due to continued strong job growth and in-migration. As a result, our application volume without property information, which represents customers seeking pre-qualification to shop for a home, is a substantial part of our single family mortgage loan pipeline. The partial underwriting associated with these applications without property information creates expenses without the revenue associated with a closed mortgage loan, which in turn provides a further negative impact on our mortgage banking results.

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

Interest rates may be affected by many factors beyond our control, including general and economic conditions and the monetary and fiscal policies of various governmental and regulatory authorities. For example, unexpected increases in interest rates can result in an increased percentage of rate lock customer closing loans, which would in turn increase our costs relative to income. In addition, increases in interest rates in recent periods has reduced our mortgage revenues by reducing the market for refinancings, which has negatively impacted demand for certain of our residential loan products and the revenue realized on the sale of loans which, in turn, may negatively impact our noninterest income and, to a lesser extent, our net interest income. Market volatility in interest rates can be difficult to predict, as unexpected interest rate changes may result in a sudden impact while anticipated changes in interest rates generally impact the mortgage rate market prior to the actual rate change.

Our earnings are also dependent on the difference between the interest earned on loans and investments and the interest paid on deposits and borrowings. Changes in market interest rates impact the rates earned on loans and investment securities and the rates paid on deposits and borrowings and may negatively impact our ability to attract deposits, make loans and achieve satisfactory interest rate spreads, which could adversely affect our financial condition or results of operations. In addition, changes to market interest rates may impact the level of loans, deposits and investments and the credit quality of existing loans.

Asymmetrical changes in interest rates, for example a greater increase in short term rates than in long term rates, could adversely impact our net interest income because our liabilities, including advances from the FHLB which typically carry a rate based on 30-day LIBOR and interest payable on our deposits, tend to be more sensitive to short term rates while our assets, which tend to be more sensitive to long term rates. In addition, it may take longer for our assets to reprice to adjust to a new rate environment because fixed rate loans do not fluctuate with interest rate changes and adjustable rate loans often have a specified period of readjustment. As a result, a flattening of the yield curve is likely to have a negative impact on our net interest income.

Our securities portfolio also 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. Interest rate fluctuations may impact the value of these securities and as a result, shareholders' equity, and may cause material fluctuations from quarter to quarter. Failure to hold our securities until maturity or until market conditions are favorable for a sale could adversely affect our financial condition.

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

Our mortgage operations are impacted by changes in the housing market, including factors that impact housing affordability and availability.

Housing affordability is directly affected by both the level of mortgage interest rates and the inventory of houses available for sale. The housing market recovery was aided by a protracted period of historically low mortgage interest rates that has made it easier for consumers to qualify for a mortgage and purchase a home, however, mortgage rates are now rising again. Should mortgage rates substantially increase over current levels, it would become more difficult for many consumers to qualify for mortgage credit. This could have a dampening effect on home sales and on home values.

In addition, constraints on the number of houses available for sale in some of our largest markets are driving up home prices, which may also make it harder for our customer to qualify for a mortgage, adversely impact our ability to originate mortgages and, as a consequence, our results of operations. Any return to a recessionary economy could also result in financial stress on our borrowers that may result in volatility in home prices, increased foreclosures and significant write-downs of asset values, all of which would adversely affect our financial condition and results of operations.

The price of our common stock is subject to volatility.

The price of our common stock has fluctuated in the past and may face additional and potentially substantial fluctuations in the future. Among the factors that may impact our stock price are the following:

- Variances in our operating results;
- Disparity between our operating results and the operating results of our competitors;
- Changes in analyst's estimates of our earnings results and future performance, or variances between our actual performance and that forecast by analysts;
- News releases or other announcements of material events relating to the Company, including but not limited to mergers, acquisitions, expansion plans, restructuring activities or other strategic developments;
- Statements made by activist investors criticizing our strategy, our management team or our Board of Directors;
- Future securities offerings by us of debt or equity securities;
- Addition or departure of key personnel;
- Market-wide events that may be seen by the market as impacting the Company;
- The presence or absence of short-selling of our common stock;
- General financial conditions of the country or the regions in which we operate;
- Trends in real estate in our primary markets; or
- Trends relating to the economic markets generally.

The stock markets in general experience substantial price and trading fluctuations, and such changes may create volatility in the market as a whole or in the stock prices of securities related to particular industries or companies that is unrelated or disproportionate to changes in operating performance of the Company. Such volatility may have an adverse effect on the trading price of our common stock.

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

We generate revenue from the interest and fees we charge on the loans and other products and services we sell, and a substantial amount of our revenue and earnings comes from the net interest and noninterest income that we earn from our mortgage banking and commercial lending businesses. Our operations have been, and will continue to be, materially affected by the state of the U.S. economy, particularly unemployment levels and home prices. A prolonged period of slow growth or a pronounced decline in the U.S. economy, or any deterioration in general economic conditions and/or the financial markets resulting from these factors, or any other events or factors that may signal a return to a recessionary economic environment**,** could dampen consumer confidence, adversely impact the models we use to assess creditworthiness, and materially adversely affect our financial results and condition. If the economy worsens and unemployment rises, which also would likely result in a decrease in consumer and business confidence and spending, the demand for our credit products, including our mortgages, may fall, reducing our net interest and noninterest income and our earnings. Significant and unexpected market developments may also make it more challenging for us to properly forecast our expected financial results.

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

The Federal Reserve is responsible for regulating the supply of money in the United States, and as a result its monetary policies strongly influence our costs of funds for lending and investing as well as the rate of return we are able to earn on those loans and investments, both of which impact our net interest income and net interest margin. Changes in interest rates may increase our cost of capital or decrease the income we receive from interest bearing assets, and asymmetrical changes in short term and long term interest rates may result in a more rapid increase in the costs related to interest-bearing liabilities such as FHLB advances and interest-bearing deposit accounts without a correlated increase in the income from interest-bearing assets which are typically more sensitive to long-term interest rates. The Federal Reserve Board's interest rate policies can also materially affect the value of financial instruments we hold, including debt securities, mortgage servicing rights, or MSRs and derivative instruments used to hedge against changes in the value of our MSRs. These monetary policies can also negatively impact our borrowers, which in turn may increase the risk that they will be unable to pay their loans according to the terms or be unable to pay their loans at all. We have no control over the Federal Reserve Board’s policies and cannot predict when changes are expected or what the magnitude of such changes may be.

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

While we have simultaneously grown our Commercial and Consumer Banking Segment revenue and downsized our mortgage lending operations, a substantial portion of our consolidated net revenues (net interest income plus noninterest income) are still derived from originating and selling residential mortgages. Residential mortgage lending in general has experienced substantial volatility in recent periods due to changes in interest rates, a significant lack of housing inventory caused by an increase in demand for housing at a time of decreased supply, and other market forces beyond our control. Lack of housing inventory limits our ability to originate purchase mortgages as it may take longer for loan applicants to find a home to buy after being pre-approved for a loan, which results in the Company incurring costs related to the pre-approval without being able to book the revenue from an actual loan. In addition, interest rate changes may result in lower rate locks and higher closed loan volume which can negatively impact our financial results because we book revenue at the time we enter into rate lock agreements after adjusting for the estimated percentage of loans that are not expected to actually close, which we refer to as “fallout”. When interest rates rise, the level of fallout as a percentage of rate locks declines, which results in higher costs relative to income for that period, which may adversely impact our earnings and results of operations. In addition, an increase in interest rates may materially and adversely affect our future loan origination volume, margins, and the value of the collateral securing our outstanding loans, may increase rates of borrower default, and may otherwise adversely affect our business.

We may incur losses due to changes in prepayment rates.

Our mortgage servicing rights carry interest rate risk because the total amount of servicing fees earned, as well as changes in fair-market value, fluctuate based on expected loan prepayments (affecting the expected average life of a portfolio of residential mortgage servicing rights). The rate of prepayment of residential mortgage loans may be influenced by changing national and regional economic trends, such as recessions or stagnating real estate markets, as well as the difference between interest rates on existing residential mortgage loans relative to prevailing residential mortgage rates. During periods of declining interest rates, many residential borrowers refinance their mortgage loans. Changes in prepayment rates are therefore difficult for us to predict. The loan administration fee income (related to the residential mortgage loan servicing rights corresponding to a mortgage loan) decreases as mortgage loans are prepaid. Consequently, in the event of an increase in prepayment rates, we would expect the fair value of portfolios of residential mortgage loan servicing rights to decrease along with the amount of loan administration income received.

Regulatory-Related Risks

We are subject to extensive regulation that may restrict our activities, including declaring cash dividends or capital distributions or pursuing growth initiatives and acquisition activities, and imposes financial requirements or limitations on the conduct of our business.

Our operations are subject to extensive regulation by federal, state and local governmental authorities, including the FDIC, the Washington Department of Financial Institutions and the Federal Reserve Board, and to various laws and judicial and administrative decisions imposing requirements and restrictions on part or all of our operations. The laws, rules and regulations to which we are subject evolve and change frequently, including changes that come from judicial or regulatory agency interpretations of laws and regulations outside of the legislative process that may be more difficult to anticipate. We are subject to various examinations by our regulators during the course of the year. Regulatory authorities who conduct these examinations have extensive discretion in their supervisory and enforcement activities, including the authority to restrict our operations, our growth and our acquisition activity, adversely reclassify our assets, determine the level of deposit premiums assessed, require us to increase our allowance for loan losses, require customer restitution and impose fines or other penalties. The level of discretion, and the extent of potential penalties and other remedies, have increased substantially during recent years. We have, in the past, been subject to specific regulatory orders that constrained our business and required us to take measures that investors may have deemed undesirable, and we may again in the future be subject to such orders if banking regulators were to determine that our operations require such restrictions or if they determine that remediation of operational deficiencies is required.

In addition, recent political shifts in the United States may result in additional significant changes in legislation and regulations that impact us. Dodd-Frank’s level of oversight and compliance obligations increase significantly for banks with total assets in excess of $10 billion, which may limit our ability to grow beyond that level or may significantly increase the cost and regulatory burden of doing so. While the Trump administration and Republicans controlling Congress have announced that they intend to repeal or revise significant portions of Dodd-Frank and other regulation impacting financial institutions, the nature and extent of such repeals or revisions are not presently known and readers should not rely on the assumption that these changes will come to pass. These circumstances lead to additional uncertainty regarding our regulatory environment and the cost and requirements for compliance. We are unable to predict whether U.S. federal, or, state authorities, or other pertinent bodies, will enact legislation, laws, rules or regulations. Further, an increasing amount of the regulatory authority that pertains to financial institutions comes in the form of informal “guidance”, such as handbooks, guidelines, field interpretations by regulators or similar provisions that will affect our business or require changes in our practices in the future even if they are not formally adopted as laws or regulations. Any such changes could adversely affect our cost of doing business and our profitability.

Changes in regulation of our industry has the potential to create higher costs of compliance, including short-term costs to meet new compliance standards, limit our ability to pursue business opportunities and increase our exposure to the judicial system and the plaintiff’s bar.

Policies and regulations enacted by CFPB may negatively impact our residential mortgage loan business and compliance risk.

Our consumer business, including our mortgage, credit card, and other consumer lending and non-lending businesses, may be adversely affected by the policies enacted or regulations adopted by the Consumer Financial Protection Bureau ("CFPB") which under the Dodd-Frank Act has broad rulemaking authority over consumer financial products and services. For example, in January 2014 new federal regulations promulgated by the CFPB took effect which impact how we originate and service residential mortgage loans. Those regulations, among other things, require mortgage lenders to assess and document a borrower's ability to repay their mortgage loan while providing borrowers the ability to challenge foreclosures and sue for damages based on allegations that the lender failed to meet the standard for determining the borrower's ability to repay their loan. While the regulations include presumptions in favor of the lender based on certain loan underwriting criteria, they have not yet been challenged widely in courts and it is uncertain how these presumptions will be construed and applied by courts in the event of litigation. The ultimate impact of these regulations on the lender's enforcement of its loan documents in the event of a loan default, and the cost and expense of doing so, is uncertain, but may be significant. In addition, the secondary market demand for loans that do not fall within the presumptively safest category of a "qualified mortgage" as defined by the CFPB is uncertain. The 2014 regulations also require changes to certain loan servicing procedures and practices, which has resulted in increased foreclosure costs and longer foreclosure timelines in the event of loan default, and failure to comply with the new servicing rules may result in additional litigation and compliance risk.

The CFPB was also given authority over the Real Estate Settlement Procedures Act, or RESPA, under the Dodd-Frank Act and has, in some cases, interpreted RESPA requirements differently than other agencies, regulators and judicial opinions. As a result, certain practices that have been considered standard in the industry, including relationships that have been established between mortgage lenders and others in the mortgage industry such as developers, realtors and insurance providers, are now being subjected to additional scrutiny under RESPA. Our regulators, including the FDIC, review our practices for compliance with RESPA as interpreted by the CFPB. Changes in RESPA requirements and the interpretation of RESPA requirements by our regulators may result in adverse examination findings by our regulators, which could negatively impact our ability to pursue our growth plans, branch expansion and limit our acquisition activity.

In addition to RESPA compliance, the Bank is also subject to the CFPB's Final Integrated Disclosure Rule, commonly known as TRID, which became effective in October 2015. Among other things, TRID requires lenders to combine the initial Good Faith Estimate and Initial Truth in Lending (“TIL”) disclosures into a single new Loan Estimate disclosure and the HUD-1 and Final TIL disclosures into a single new Closing Disclosure. The definition of an application and timing requirements has changed, and a new Closing Disclosure waiting period has been added. These changes, along with other changes required by TRID, require significant systems modifications, process and procedure changes. Failure to comply with these new requirements may result in regulatory penalties for disclosure and other violations under the Real Estate Settlement Procedures Act (“RESPA”) and the Truth In Lending Act (“TILA”), and private right of action under TILA, and may impact our ability to sell or the price we receive for certain loans.

In addition, the CFPB has adopted and largely implemented additional rules under the Home Mortgage Disclosure Act (“HMDA”) that are intended to improve information reported about the residential mortgage market and increase disclosure about consumer access to mortgage credit. The updates to the HMDA increase the types of dwelling-secured loans that are subject to the disclosure requirements of the rule and expand the categories of information that financial institutions such as the Bank are required to report with respect to such loans and such borrowers, including potentially sensitive customer information. Most of the rule's provisions went into effect on January 1, 2018. These changes increased our compliance costs due to the need for additional resources to meet the enhanced disclosure requirements as well as informational systems to allow the Bank to properly capture and report the additional mandated information. The volume of new data that is required to be reported under the updated rules will also cause the Bank to face an increased risk of errors in the processing of such information. More importantly, because of the sensitive nature of some of the additional customer information to be included in such reports, the Bank may face a higher potential for security breaches resulting in the disclosure of sensitive customer information in the event the HMDA reporting files were obtained by an unauthorized party.

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

Regulatory and judicial interpretation of existing and future federal and state legislation, case law, judicial orders and regulations could also require us to revise our operations and change certain business practices, impose additional costs, reduce our revenue and earnings and otherwise adversely impact our business, financial condition and results of operations. For instance, judges interpreting legislation and judicial decisions made during the recent financial crisis could allow modification of the terms of residential mortgages in bankruptcy proceedings which 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. In addition, the exercise by regulators of revised and at times expanded powers under existing or future regulations 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, limit our ability to pursue growth strategies or force us to discontinue certain business practices and expose us to additional costs, taxes, liabilities, penalties, enforcement actions and reputational risk.

Such judicial decisions or regulatory interpretations may affect the manner in which we do business and the products and services that we provide, restrict our ability to grow through acquisition, restrict our ability to compete in our current business or expand into any new business, and impose additional fees, assessments or taxes on us or increase our regulatory oversight.

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

Federal, state and local laws have been adopted that are intended to eliminate certain practices considered “predatory” or “unfair and deceptive”. These laws prohibit practices such as steering borrowers away from more affordable products, failing to disclose key features, limitations, or costs related to products and services, failing to provide advertised benefits, selling unnecessary insurance to borrowers, repeatedly refinancing loans, imposing excessive fees for overdrafts, and making loans without a reasonable expectation that the borrowers will be able to repay the loans irrespective of the value of the underlying property. It is our policy not to make predatory loans or engage in deceptive practices, but these laws and regulations create the potential for liability with respect to our lending, servicing, loan investment, deposit taking and other financial activities. As a company with a significant mortgage banking operation, we also, inherently, have a significant amount of risk of noncompliance with fair lending laws and regulations. These laws and regulations are complex and require vigilance to ensure that policies and practices do not create disparate impact on our customers or that our employees do not engage in overt discriminatory practices. Noncompliance can result in significant regulatory actions including, but not limited to, sanctions, fines or referrals to the Department of Justice and restrictions on our ability to execute our growth and expansion plans. These risks are enhanced because of our growth activities as we integrate operations from our acquisitions and expand our geographic markets. As we offer products and services to customers in additional states, we may become subject to additional state and local laws designed to protect consumers. The additional laws and regulations may increase our cost of doing business, and ultimately may prevent us from making certain loans, offering certain products, and may cause us to reduce the average percentage rate or the points and fees on loans and other products and services that we do provide.

Changes to regulatory requirements relating to customer information may increase our cost of doing business and create additional compliance risk.

In May 2016, the Financial Crimes Enforcement Network of the U.S. Department of Treasury announced that beginning in May 2018, financial institutions would be required to identify the ultimate beneficial owners of all entity clients as part of their customer due diligence compliance. Meeting this new requirement will increase our overall compliance burden and require us to expend additional resources in the review of customers who are entities. In addition, there may be unforeseen challenges in obtaining beneficial ownership information about all of our entity customers, which increases the risk that we will not be in compliance with this new requirement.

We are subject to more stringent capital requirements under Basel III.

As of January 1, 2015, we became subject to new rules relating to capital standards requirements, including requirements contemplated by Section 171 of the Dodd-Frank Act as well as certain standards initially adopted by the Basel Committee on Banking Supervision, which standards are commonly referred to as Basel III. Many of these rules apply to both the Company and the Bank, including increased common equity Tier 1 capital ratios, Tier 1 leverage ratios, Tier 1 risk-based ratios and total risk-based ratios. In addition, beginning in 2016, all institutions subject to Basel III, including the Company and the Bank are required to establish a “conservation buffer” that is being phased in and will take full effect on January 1, 2019. This conservation buffer consists of common equity Tier 1 capital and will ultimately be required to be 2.5% above existing minimum capital ratio requirements. This means that once the conservation buffer is fully phased in, in order to prevent certain regulatory restrictions, the common equity Tier 1 capital ratio requirement will be 7.0%, the Tier 1 risk-based ratio requirement will be 8.5% and the total risk-based capital ratio requirement will be 10.5%. Any institution that does not meet the conservation buffer will be subject to restrictions on certain activities including payment of dividends, stock repurchases and discretionary bonuses to executive officers.

Additional prompt corrective action rules implemented in 2015 also apply to the Bank, including higher and new ratio requirements for the Bank to be considered Well-Capitalized. The new rules also modify the manner for determining when certain capital elements are included in the ratio calculations, including but not limited to, requiring certain deductions related to mortgage servicing rights and deferred tax assets. While federal banking regulators have proposed a rule change that would increase the amount of mortgage servicing rights that could be included in ratio calculations, there can be no assurance that the proposed rule will be adopted in its current form or at all. For more on these regulatory requirements and how they apply to the Company and the Bank, see "Regulation and Supervision of HomeStreet Bank - *Capital and Prompt Corrective Action Requirements - Capital Requirements*" in this Form 10-K. The application of more stringent capital requirements could, among other things, result in lower returns on invested capital and result in regulatory actions if we were to be unable to comply with such requirements. In addition, if we need to raise additional equity capital in order to meet these more stringent requirements, our shareholders may be diluted.

Any restructuring or replacement of Fannie Mae and Freddie Mac and changes in existing government-sponsored and federal mortgage programs could adversely affect our business.

We originate and purchase, sell and thereafter service single family and multifamily mortgages under the Fannie Mae, and to a lesser extent, the Freddie Mac single family purchase programs and the Fannie Mae multifamily DUS® program. In 2008, Fannie Mae and Freddie Mac were placed into conservatorship, and since then Congress, various executive branch agencies and certain large private investors in Fannie Mae and Freddie Mac have offered a wide range of proposals aimed at restructuring these agencies.

We cannot be certain whether or how Fannie Mae and Freddie Mac ultimately will be restructured or replaced, if or when additional 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. However, any restructuring or replacement of Fannie Mae and Freddie Mac that restricts the current loan purchase programs of those entities may have a material adverse effect on our business and results of operations. Moreover, we have recorded on our balance sheet an intangible asset (mortgage servicing rights, or MSRs) relating to our right to service single family loans sold to Fannie Mae and Freddie Mac. We valued these single family MSRs at $258.6 million at December 31, 2017. Changes in the policies and operations of Fannie Mae and Freddie Mac or any replacement for or successor to those entities that adversely affect our single family residential loan and DUS® mortgage servicing assets may require us to record impairment charges to the value of these assets, and significant impairment charges could be material and adversely affect our business.

In addition, our ability to generate income through mortgage sales to institutional investors depends in part on programs sponsored by Fannie Mae, Freddie Mac and Ginnie Mae, which facilitate the issuance of mortgage-backed securities in the secondary market. Any significant revision or 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.

Changes in accounting standards may require us to increase our Allowance for Loan Losses and could materially impact our financial statements.

From time to time, the Financial Accounting Standards Board (the “FASB”) and the SEC change the financial accounting and reporting standards that govern the preparation of our financial statements. These changes can materially impact how we record and report our financial condition and results of operations. For example, in June 2016, the FASB issued *ASU 2016-13*, *Financial Instruments - Credit Losses (Topic 326)* which changes, among other things, the way companies must record expected credit losses on financial instruments that are not accounted for at fair value through net income, including loans held for investment, available for sale and held-to-maturity debt securities, trade and other receivables, net investment in leases and other commitments to extend credit held by a reporting entity at each reporting date, and require that financial assets measured at amortized cost be presented at the net amount expected to be collected, through an allowance for credit losses that is deducted from the amortized cost basis and eliminate the probable initial recognition in current GAAP and reflect the current estimate of all expected credit losses based upon historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the financial assets.

For purchased financial assets with a more-than-insignificant amount of credit deterioration since origination (“PCD assets”) that are measured at amortized cost, an allowance for expected credit losses will be recorded as an adjustment to the cost basis of the asset. Subsequent changes in estimated cash flows would be recorded as an adjustment to the allowance and through the statement of income. Credit losses relating to available-for-sale debt securities will be recorded through an allowance for credit losses rather than as a direct write-down to the security's cost basis. The amendments in this ASU will be effective for us beginning on January 1, 2020. For most debt securities, the transition approach requires a cumulative-effect adjustment to the statement of financial position as of the beginning of the first reporting period the guidance is effective. For other-than-temporarily impaired debt securities and PCD assets, the guidance will be applied prospectively. We are currently evaluating the provisions of this ASU to determine the impact and developing appropriate systems to prepare for compliance with this new standard, however, we expect the new standard could have a material impact on the Company's consolidated financial statements.

HomeStreet, Inc. primarily relies on dividends from the Bank, which may be limited by applicable laws and regulations.

HomeStreet, Inc. is a separate legal entity from the Bank, and although we may receive some dividends from HomeStreet Capital Corporation, the primary source of our funds from which we service our debt, pay any dividends that we may declare to our shareholders and otherwise satisfy our obligations is dividends from the Bank. The availability of dividends from the Bank is limited by various statutes and regulations, capital rules regarding requirements to maintain a “well capitalized” ratio at the bank, as well as by our policy of retaining a significant portion of our earnings to support the Bank's operations. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations - *Capital Management*” as well as “Regulation and Supervision of HomeStreet Bank - *Capital and Prompt Corrective Action Requirements*” in this Form 10-K. If the Bank cannot pay dividends to us, we may be limited in our ability to service our debts, fund the Company's operations and acquisition plans and pay dividends to the Company's shareholders. While the Company has paid special dividends in some prior quarters, we have not adopted a policy to pay dividends and in recent years our Board of Directors has elected to retain capital for growth rather than to declare a dividend. While management has recently discussed the possibility of paying dividends in the near future, we have not declared dividends in any recent quarters, and the potential of future dividends is subject to board approval, cash flow limitations, capital requirements, capital and strategic needs and other factors.

The financial services industry is highly competitive.

We face pricing competition for loans and deposits. We also face competition with respect to customer convenience, product lines, accessibility of service and service capabilities. Our most direct competition comes from other banks, credit unions, mortgage companies and savings institutions, but more recently has also come from financial technology (or "fintech") companies that rely on technology to provide financial services. The significant competition in attracting and retaining deposits and making loans as well as in providing other financial services throughout our market area may impact future earnings and growth. Our success depends, in part, on the ability to adapt products and services to evolving industry standards and provide consistent customer service while keeping costs in line. There is increasing pressure to provide products and services at lower prices, which can reduce net interest income and non-interest income from fee-based products and services. New technology-driven products and services are often introduced and adopted, including innovative ways that customers can make payments, access products and manage accounts. We could be required to make substantial capital expenditures to modify or adapt existing products and services or develop new products and services. We may not be successful in introducing new products and services or those new products may not achieve market acceptance. We could lose business, be forced to price products and services on less advantageous terms to retain or attract clients, or be subject to cost increases if we do not effectively develop and implement new technology. In addition, advances in technology such as telephone, text, and on-line banking; e-commerce; and self-service automatic teller machines and other equipment, as well as changing customer preferences to access our products and services through digital channels, could decrease the value of our branch network and other assets. As a result of these competitive pressures, our business, financial condition or results of operations may be adversely affected.

We will be subject to heightened regulatory requirements if we exceed $10 billion in assets.

We anticipate that our total assets could exceed $10 billion in the next several years, based on our historic and projected growth rates. The Dodd-Frank Act and its implementing regulations impose various additional requirements on bank holding companies with $10 billion or more in total assets, including compliance with portions of the Federal Reserve’s enhanced prudential oversight requirements and annual stress testing requirements. In addition, banks with $10 billion or more in total assets are primarily examined by the CFPB with respect to various federal consumer financial protection laws and regulations. Currently, our bank is subject to regulations adopted by the CFPB, but the FDIC is primarily responsible for examining our bank’s compliance with consumer protection laws and those CFPB regulations. As a relatively new agency with evolving regulations and practices, there is uncertainty as to how the CFPB’s examination and regulatory authority might impact our business.

To ensure compliance with these heightened requirements when effective, our regulators may require us to fully comply with these requirements or take actions to prepare for compliance even before our or the Bank’s total assets equal or exceed $10 billion. In fact, we have already begun implementing measures to allow us to prepare for the heightened compliance that we expect will be required if we exceed $10 billion in assets, including hiring additional compliance personnel and designing and implementing additional compliance systems and internal controls. We may incur significant expenses in connection with these activities, any of which could have a material adverse effect on our business, financial condition or results of operations. We expect to incur these compliance-related costs even if they are not yet fully required, and may incur them even if we do not ultimately reach $10 billion in asset at the rate we expect or at all. We may also face heightened scrutiny by our regulators as we begin to implement these new compliance measures and grow toward the $10 billion asset threshold, and our regulators may consider our preparation for compliance with these regulatory requirements when examining our operations generally or considering any request for regulatory approval we may make, even requests for approvals on unrelated matters. In addition, compliance with the annual stress testing requirements, part of which must be publicly disclosed, may also be misinterpreted by the market generally or our customers and, as a result, may adversely affect our stock price or our ability to retain our customers or effectively compete for new business opportunities.

Risks Related to Information Systems and Security

A failure in or breach of our security systems or infrastructure, including breaches resulting from cyber-attacks, could disrupt our businesses, result in the disclosure or misuse of confidential or proprietary information, damage our reputation, increase our costs and cause losses.

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

To date we are not aware of any material losses relating to cyber-attacks or other information security breaches, but there can be no assurance that we will not suffer such attacks, breaches and losses in the future. Our risk and exposure to these matters remains heightened because of, among other things, the evolving nature of these threats, our plans to continue to implement our Internet banking and mobile banking channel, our expanding operations and the outsourcing of a significant portion of our business operations. As a result, the continued development and enhancement of our information security controls, processes and practices designed to protect customer information, our systems, computers, software, data and networks from attack, damage or unauthorized access remain a priority for our management. As cyber threats continue to evolve, we may be required to expend significant additional resources to insure, modify or enhance our protective measures or to investigate and remediate important information security vulnerabilities or exposures; however, our measures may be insufficient to prevent physical and electronic break-ins, denial of service and other cyber-attacks or security breaches.

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

We rely on third party vendors and other service providers for certain critical business activities, which creates additional operational and information security risks for us.

Third parties with which we do business or that facilitate our business activities, including exchanges, clearing houses, financial intermediaries or vendors that provide services or security solutions for our operations, could also be sources of operational and information security risk to us, including from breakdowns or failures of their own systems, capacity constraints or failures of their own internal controls. Specifically, we receive core systems processing, essential web hosting and other Internet systems and deposit and other processing services from third-party service providers. In late February 2018, one of our vendors provided notice to us that their independent auditors had determined their internal controls to be inadequate. While we do not believe this particular failure of internal controls would have an impact on us due to the strength of our own internal controls, future failures of internal controls of a vendor could have a significant impact on our operations if we do not have controls to cover those issues. To date none of our third party vendors or service providers has notified us of any security breach in their systems that has resulted in an increased vulnerability to us or breached the integrity of our confidential customer data. Such third parties may also be target of cyber-attacks, computer viruses, malicious code, unauthorized access, hackers or information security breaches that could compromise the confidential or proprietary information of HomeStreet and our customers.

In addition, if any third-party service providers experience difficulties or terminate their services and we are unable to replace them with other service providers, our operations could be interrupted and our operating expenses may be materially increased. If an interruption were to continue for a significant period of time, our business financial condition and results of operations could be materially adversely affected.

Some of our primary third party service providers are subject to examination by banking regulators and may be subject to enhanced regulatory scrutiny due to regulatory findings during examinations of such service providers conducted by federal regulators. While we subject such vendors to higher scrutiny and monitor any corrective measures that the vendors are taking or would undertake, we cannot fully anticipate and mitigate all risks that could result from a breach or other operational failure of a vendor’s system.

Others provide technology that we use in our own regulatory compliance, including our mortgage loan origination technology. If those providers fail to update their systems or services in a timely manner to reflect new or changing regulations, or if our personnel operate these systems in a non-compliant manner, our ability to meet regulatory requirements may be impacted and may expose us to heightened regulatory scrutiny and the potential for payment of monetary penalties.

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

The failure to protect our customers’ confidential information and privacy could adversely affect our business.

We are subject to federal and state privacy regulations and confidentiality obligations that, among other things restrict the use and dissemination of, and access to, certain information that we produce, store or maintain in the course of our business. We also have contractual obligations to protect certain confidential information we obtain from our existing vendors and customers. These obligations generally include protecting such confidential information in the same manner and to the same extent as we protect our own confidential information, and in some instances may impose indemnity obligations on us relating to unlawful or unauthorized disclosure of any such information.

If we do not properly comply with privacy regulations and contractual obligations that require us to protect confidential information, or if we experience a security breach or network compromise, we could experience adverse consequences, including regulatory sanctions, penalties or fines, increased compliance costs, remedial costs such as providing credit monitoring or other services to affected customers, litigation and damage to our reputation, which in turn could result in decreased revenues and loss of customers, all of which would have a material adverse effect on our business, financial condition and results of operations.

The network and computer systems on which we depend could fail for reasons not related to security breaches.

Our computer systems could be vulnerable to unforeseen problems other than a cyber-attack or other security breach. Because we conduct a part of our business over the Internet and outsource several critical functions to third parties, operations will depend on our ability, as well as the ability of third-party service providers, to protect computer systems and network infrastructure against damage from fire, power loss, telecommunications failure, physical break-ins or similar catastrophic events. Any damage or failure that causes interruptions in operations may compromise our ability to perform critical functions in a timely manner (or may give rise to perceptions of such compromise) and could have a material adverse effect on our business, financial condition and results of operations as well as our reputation and customer or vendor relationships.

We continually encounter technological change, and we may have fewer resources than many of our competitors 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.

<u>Anti-Takeover Risk</u>

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 business combinations and similar 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. These restrictions may limit a shareholder’s ability to benefit from a change-in-control transaction that might otherwise result in a premium unless such a transaction is favored by our Board of Directors.

ITEM 1B UNRESOLVED STAFF COMMENTS

None.

ITEM 2 PROPERTIES

We lease principal offices, which are located in downtown Seattle at 601 Union Street, Suite 2000, Seattle, WA 98101. This lease provides sufficient space to conduct the management of our business. The Company conducts Mortgage Lending as well as Commercial and Consumer Banking activities in locations in Washington, California, Oregon, Hawaii, Idaho, Arizona and Utah. As of December 31, 2017, we operated in 44 primary stand-alone home loan centers, six primary commercial lending centers, 59 retail deposit branches, and one insurance office. As of such date, we also operated three facilities for the purpose of administrative and other functions in addition to the principal offices: a loan fulfillment center and a call center and operations support facility, both located in Federal Way, Washington; and loan fulfillment centers in Pleasanton, California and Vancouver, Washington. Of these properties, we own five of the retail deposit branches, the loan fulfillment center and the call center and operations support facility in Federal Way and we own 50% of a retail branch through a joint venture. In addition, we own two parcels of land in Washington State. All facilities are in a good state of repair and appropriately designed for use as banking or administrative office facilities.

ITEM 3 LEGAL PROCEEDINGS

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

ITEM 4 MINE SAFETY DISCLOSURES

Not applicable.

PART II

ITEM 5 MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock is traded on the NASDAQ Global Select Market under the symbol "HMST." The following table sets forth, for the periods indicated, the high and low reported sales prices per share of the common stock as reported on the NASDAQ Global Select Market, our principal trading market.

	High	Low	Special Cash Dividends Declared
For the Year Ended December 31, 2017			
First quarter ended March 31	$32.50	$25.01	$ —
Second quarter ended June 30	29.88	25.40	—
Third quarter ended September 30	28.40	24.00	—
Fourth quarter ended December 31	31.30	26.83	—
For the Year Ended December 31, 2016			
First quarter ended March 31	$22.79	$18.58	$ —
Second quarter ended June 30	22.97	18.74	—
Third quarter ended September 30	27.21	19.07	—
Fourth quarter ended December 31	33.70	24.03	—

As of March 2, 2018, there were 2,476 shareholders of record of our common stock.

Dividend Policy

We have not adopted a formal dividend policy to pay dividends and did not pay any dividends in 2017 or 2016. The amount and timing of any future dividends have not been determined. The payment of dividends will depend upon a number of factors, including regulatory capital requirements, the Company's and the Bank's liquidity, financial condition and results of operations, strategic growth plans, tax considerations, statutory and regulatory limitations and general economic conditions. Our ability to pay dividends to shareholders is significantly dependent on the Bank's ability to pay dividends to the Company, which is limited to the extent necessary for the Bank to meet the regulatory requirements of a "well-capitalized" bank or other formal or informal guidance communicated by our principal regulators. Capital rules implemented beginning on January 1, 2015 have imposed more stringent requirements on the ability of the Bank to maintain "well-capitalized" status and to pay dividends to the Company. See "Regulation and Supervision of HomeStreet Bank - *Capital and Prompt Corrective Action Requirements - Capital Requirements*."

For the foregoing reasons, there can be no assurance that we will pay any further special dividends in any future period.

Sales of Unregistered Securities
There were no sales of unregistered securities in the fourth quarter of 2017.

Stock Repurchases in the Fourth Quarter

Not applicable.

Stock Performance Graph

This performance graph shall not be deemed "soliciting material" or to be "filed" with the SEC for purposes of Section 18 of the Securities Exchange Act of 1934, as amended (Exchange Act), or otherwise subject to the liabilities under that Section, and shall not be deemed to be incorporated by reference into any filing of HomeStreet, Inc. under the Securities Act of 1933, as amended, or the Exchange Act.

The following graph shows a comparison from February 10, 2012 (the date our common stock commenced trading on the NASDAQ Global Select Market) through December 31, 2017 of the cumulative total return for our common stock, the KBW Bank Index (BKX), the Russell 2000 Index (RUT) and the KBW Regional Banking Index (KRX). The graph assumes that $100 was invested at the market close on February 10, 2012 in the common stock of HomeStreet, Inc., the KBW Bank Index, the Russell 2000 Index, the KBW Regional Banking Index and data for HomeStreet, Inc., the KBW Bank Index, the Russell 2000 Index and the KBW Regional Banking Index assumes reinvestments of dividends. The stock price performance of the following graph is not necessarily indicative of future stock price performance. We are adding in the KBW Regional Bank Index this year, to eventually replace KBW Bank Index, in our performance graph as the composition of the KBW Regional Bank index is more relevant to our size and market cap.

ITEM 6 SELECTED FINANCIAL DATA

The data set forth below should be read in conjunction with Item 7, "Management's Discussion and Analysis of Consolidated Financial Condition and Results of Operations," and the Consolidated Financial Statements and Notes thereto appearing at Item 8 of this report.

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 December 31, 2017 and 2016 and for each of the years ended December 31, 2017, 2016 and 2015 have been derived from, and should be read together with, our audited consolidated financial statements and related notes included elsewhere in this Form 10-K. The selected historical consolidated financial data as of December 31, 2015, 2014 and 2013 and for each of the years ended December 31, 2015, 2014 and 2013 have been derived from our audited consolidated financial statements for those years, which are not included in this Form10-K. 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 Form 10-K. 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.

	At or for the Years Ended December 31,				
(dollars in thousands, except share data)	2017	2016	2015	2014	2013
Income statement data (for the period ended):					
Net interest income	$194,438	$180,049	$148,338	$98,669	$74,444
Provision (reversal of provision) for credit losses	750	4,100	6,100	(1,000)	900
Noninterest income	312,154	359,150	281,237	185,657	190,745
Noninterest expense	439,653	444,322	366,568	252,011	229,495
Income before income taxes	66,189	90,777	56,907	33,315	34,794
Income tax (benefit) expense	(2,757)	32,626	15,588	11,056	10,985
Net income	$68,946	$58,151	$41,319	$22,259	$23,809
Basic income per share	$2.57	$2.36	$1.98	$1.50	$1.65
Diluted income per share	$2.54	$2.34	$1.96	$1.49	$1.61
Common shares outstanding	26,888,288	26,800,183	22,076,534	14,856,611	14,799,991
Weighted average number of shares outstanding:					
Basic	26,864,657	24,615,990	20,818,045	14,800,689	14,412,059
Diluted	27,092,019	24,843,683	21,059,201	14,961,081	14,798,168
Book value per share	$26.20	$23.48	$21.08	$20.34	$17.97
Dividends per share	$—	$—	$—	$0.11	$0.33
Financial position (at year end):					
Cash and cash equivalents	$72,718	$53,932	$32,684	$30,502	$33,908
Investment securities	904,304	1,043,851	572,164	455,332	498,816
Loans held for sale	610,902	714,559	650,163	621,235	279,941
Loans held for investment, net	4,506,466	3,819,027	3,192,720	2,099,129	1,871,813
Mortgage servicing rights	284,653	245,860	171,255	123,324	162,463
Other real estate owned	664	5,243	7,531	9,448	12,911
Total assets	6,742,041	6,243,700	4,894,495	3,535,090	3,066,054
Deposits	4,760,952	4,429,701	3,231,953	2,445,430	2,210,821
Federal Home Loan Bank advances	979,201	868,379	1,018,159	597,590	446,590

Federal funds purchased and securities sold under agreements to repurchase	—	—	—	50,000	—
Total shareholders' equity	$ 704,380	$ 629,284	$ 465,275	$ 302,238	$ 265,926

Summary Financial Data (continued)

	At or for the Years Ended December 31,									
(dollars in thousands, except share data)	2017		2016		2015		2014		2013	
Financial position (averages):										
Investment securities	$1,023,702		$834,671		$523,756		$459,060		$515,000	
Loans held for investment	4,178,326		3,668,263		2,834,511		1,890,537		1,496,146	
Total interest-earning assets	5,998,521		5,307,118		4,150,089		2,869,414		2,422,136	
Total interest-bearing deposits	3,588,515		3,145,137		2,499,538		1,883,622		1,661,568	
Federal Home Loan Bank advances	1,037,650		942,593		795,368		431,623		293,871	
Total interest-bearing liabilities	4,755,221		4,189,582		3,368,160		2,386,537		2,020,613	
Shareholders’ equity	675,877		566,148		442,105		289,420		249,081	
Financial performance:										
Return on average shareholders' equity [1]	10.20	%	10.27	%	9.35	%	7.69	%	9.56	%
Return on average total assets	1.05	%	1.01	%	0.91	%	0.69	%	0.88	%
Net interest margin [2]	3.31	%	3.45	%	3.63	%	3.51	%	3.17	% [3]
Efficiency ratio [4]	86.79	%	82.40	%	85.33	%	88.63	%	86.54	%
Asset quality:										
Allowance for credit losses	$39,116		$35,264		$30,659		$22,524		$24,089	
Allowance for loan losses/total loans [5]	0.83	%	0.88	%	0.91	%	1.04	%	1.26	%
Allowance for loan losses/nonaccrual loans	251.63	%	165.52	%	170.54	%	137.51	%	93.00	%
Total nonaccrual loans [6]/[7]	$15,041		$20,542		$17,168		$16,014		$25,707	
Nonaccrual loans/total loans	0.33	%	0.53	%	0.53	%	0.75	%	1.36	%
Other real estate owned	$664		$5,243		$7,531		$9,448		$12,911	
Total nonperforming assets	$15,705		$25,785		$24,699		$25,462		$38,618	
Nonperforming assets/total assets	0.23	%	0.41	%	0.50	%	0.72	%	1.26	%
Net (recoveries) charge-offs	$(3,102	)	$(505	)	$(2,035	)	$565		$4,562	
Regulatory capital ratios for the Bank:										
Basel III - Tier 1 leverage capital (to average assets)	9.67	%	10.26	%	9.46	%	NA		NA	
Basel III - Tier 1 common equity risk-based capital (to risk-weighted assets)	13.22	%	13.92	%	13.04	%	NA		NA	
Basel III - Tier 1 risk-based capital (to risk-weighted assets)	13.22	%	13.92	%	13.04	%	NA		NA	
Basel III - Total risk-based capital (to risk-weighted assets)	14.02	%	14.69	%	13.92	%	NA		NA	
Basel I - Tier 1 leverage capital (to average assets)	NA		NA		NA		9.38	%	9.96	%
Basel I - Tier 1 risk-based capital (to risk-weighted assets)	NA		NA		NA		13.10	%	14.12	%
Basel I - Total risk-based capital (to risk-weighted assets)	NA		NA		NA		14.03	%	15.28	%
Regulatory capital ratios for the Company:										
Basel III - Tier 1 leverage capital (to average assets)	9.12	%	9.78	%	9.95	%	NA		NA	
Basel III - Tier 1 common equity risk-based capital (to risk-weighted assets)	9.86	%	10.54	%	10.52	%	NA		NA	
Basel III - Tier 1 risk-based capital (to risk-weighted assets)	10.92	%	11.66	%	11.94	%	NA		NA	
Basel III - Total risk-based capital (to risk-weighted assets)	11.61	%	12.34	%	12.70	%	NA		NA	

	At or for the Years Ended December 31,				
(in thousands)	2017	2016	2015	2014	2013
SUPPLEMENTAL DATA:					
Loans serviced for others					
Single family	$22,631,147	$19,488,456	$15,347,811	$11,216,208	$11,795,621
Multifamily	1,311,399	1,108,040	924,367	752,640	720,429
Other	79,797	69,323	79,513	82,354	95,673
Total loans serviced for others	$24,022,343	$20,665,819	$16,351,691	$12,051,202	$12,611,723
Loan origination activity					
Single family	$8,091,400	$9,214,463	$7,440,612	$4,697,767	$4,852,879
Other	2,749,291	2,560,549	1,540,455	967,500	603,271
Total loan origination activity	$10,840,691	$11,775,012	$8,981,067	$5,665,267	$5,456,150

(1) Net earnings available to common shareholders divided by average shareholders' equity.
(2) Net interest income divided by total average interest-earning assets on a tax equivalent basis.
(3) Net interest margin for the year ended December 31, 2013 included $1.4 million in interest expense related to the correction of the cumulative effect of an error in prior years, resulting from the under accrual of interest due on the trust preferred securities for which the Company had deferred the payment of interest. Excluding the impact of the prior period interest expense correction, the net interest margin was 3.23% for the year ended December 31, 2013.
(4) Noninterest expense divided by total revenue (net interest income and noninterest income).
(5) Includes loans acquired with bank acquisitions. Excluding acquired loans, allowance for loan losses /total loans was 0.90%, 1.00%, 1.10%, 1.10% and 1.40% at December 31, 2017, 2016, 2015, 2014 and 2013, respectively.
(6) Generally, loans are placed on nonaccrual status when they are 90 or more days past due, unless payment is insured by the FHA or guaranteed by the VA.
(7) Includes $1.9 million and $1.9 million of nonperforming loans at December 31, 2017 and 2016, respectively, which are guaranteed by the Small Business Administration ("SBA").

ITEM 7 MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

NOTICE REGARDING FORWARD LOOKING STATEMENTS

The following discussion contains certain forward-looking statements, which are statements of expectations and not statements of historical fact. Many forward-looking statements can be identified as using words such as “anticipate,” “believe,” “could,” “estimate,” “expect,” “intend,” “may,” “plan,” “potential,” “should,” “will” and “would” and similar expres negative of these terms). Such statements involve inherent risks and uncertainties, many of which are difficult to predict and are generally beyond the control of the Company and are subject to risks and uncertainties, including, but not limited to, those discussed below and elsewhere in this Form 10-K, particularly in Item 1A “Risk Factors,” that could cause actual results to differ significantly from those projected. Although we believe that expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. We undertake no obligation to, and expressly disclaim any such obligation to update, or clarify any of the forward-looking statements after the date of this Form 10-K to reflect changed assumptions, the occurrence of anticipated or unanticipated events, new information or changes to future results over time of otherwise, except as required by law. Readers are cautioned not to place undue reliance on these forward-looking statements, which apply only as of the date of this Form 10-K.

Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with "Selected Consolidated Financial Data” and the Consolidated Financial Statements and Notes included in Items 6 and 8 of this Form 10-K.

Executive Summary

HomeStreet is a diversified financial services company founded in 1921, headquartered in Seattle, Washington, serving customers primarily in the western United States, including Hawaii. We are principally engaged in commercial and consumer banking and real estate lending, including commercial real estate and single family mortgage banking operations.

HomeStreet, Inc. is a bank holding company that has elected to be treated as a financial holding company. Our primary subsidiaries are HomeStreet Bank and HomeStreet Capital Corporation. We also sell insurance products and services for consumer clients under the name HomeStreet Insurance.
HomeStreet Bank is a Washington state-chartered commercial bank providing commercial and consumer loans, mortgage loans, deposit products, other banking services, non-deposit investment products, private banking and cash management services. Our loan products include commercial business loans and agriculture loans, consumer loans, single family residential mortgages, loans secured by commercial real estate and construction loans for residential and commercial real estate projects. We also have partial ownership in WMS Series LLC, an affiliated business arrangement with various owners of Windermere Real Estate Company franchises which operates a home loan business from select Windermere Real Estate Offices that is known as Penrith Home Loans (some of which were formerly known as Windermere Mortgage Services).
HomeStreet Capital Corporation, a Washington corporation, originates, sells and services multifamily mortgage loans under the Fannie Mae Delegated Underwriting and Servicing Program (“DUS®”[1]) in conjunction with HomeStreet Bank.

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

In 2017, we focused on measured growth and increased efficiency in our operations overall. In our Commercial and Consumer Banking Segment, we continued to execute our strategy of diversifying earnings by expanding the business, growing and improving the quality of our deposits, and bolstering our processing, compliance and risk management capabilities. We continued to expand our retail deposit branch network during the year, primarily focusing on high-growth areas of Puget Sound and Southern California, in order to build convenience and market share. As of December 31, 2017 we had 27 retail branches in the Puget Sound region, including two de novo branches added in 2017, and 16 retail branches in Southern California, including one de novo branch and one acquired branch added in 2017. Meanwhile, in our Mortgage Banking Segment, faced with reduced expectations for single family loan origination volume due to the current interest rate environment and, more importantly, a lack of housing inventory in our primary markets, we implemented a restructuring plan that included a reduction in staffing, production office closures and the streamlining of our single family leadership team.

[1] DUS® is a registered trademark of Fannie Mae

As part of our organic growth in commercial real estate lending, in 2015 we launched a new division of the Bank called HomeStreet Commercial Capital, which originates permanent commercial real estate loans, primarily up to $10 million in size, a portion of which we intend to sell into the secondary market.

Management's Overview of2017 Financial Performance

Results for 2017 reflect the continued expansion of our commercial and consumer business as well as the restructuring of our mortgage banking business. During 2017, in our Commercial and Consumer Banking Segment we added three de novo branches and acquired one branch in El Cajon, California. We also added a new stand-alone commercial lending center in Northern California. In response to adverse market conditions, we reduced headcount in the Mortgage Banking Segment by 13.1% during the year, closed three stand-alone home loan centers and consolidated a further six offices down to three, and streamlined our leadership team by eliminating some positions and reducing overall compensation. At December 31, 2017, we had total home loan centers of 44, total commercial lending centers of six and total retail deposit branches of 59. We also have one stand-alone insurance office.

Recent Developments

On December 22, 2017, President Trump signed into law major tax legislation commonly referred to as the Tax Cuts and Jobs Act ("Tax Reform Act"). The Tax Reform Act reduces the U.S. federal corporate income tax rate from 35 percent to 21 percent and makes many other sweeping changes to the U.S. tax code. We were required to revalue our deferred tax assets and liabilities at the new statutory tax rate upon enactment. As a result of this revaluation, in 2017, we recognized a one-time, non-cash, $23.3 million income tax benefit. Additionally, we expect our estimated effective tax rate to fall to between 21% and 22% for 2018.

Known Trends

Trends Impacting Mortgage Origination Volume

Since the second half of 2016, the volume of loan origination for our single family mortgage business has been significantly adversely impacted by a combination of rising interest rates, which lowers the demand for refinancing, and a significant disparity between an increasing demand for housing and a decreasing supply of houses for sale in our primary markets, especially the Puget Sound region and Northern California. The Federal Reserve is expected to raise interest rates again in the near future, decreasing the likelihood that refinancing will regain popularity in the near term. At the same time, populations in many of our major markets are predicted to continue to grow faster than available housing inventory. While we have been focused on optimizing our mortgage banking operations in response to these pressures, management continues to monitor these trends and may implement further measures in an effort to keep the Company's cost structure in line with the expectations of growth or contraction in our business.

Regulatory Compliance Costs

Federally insured financial institutions like the Bank become subject to heightened standards for regulatory compliance as they reach an asset size of $10 billion. As we grow toward that size, we have begun to implement additional compliance systems, procedures and processes to be able to meet these heightened standards. At the same time, we are already subject to additional review by our regulators who have an interest in making sure the Bank's compliance systems are implemented and tested prior to crossing the $10 billion threshold for assets size, and the work of designing systems to meet heightened requirements coupled with additional regulatory scrutiny meant to test those systems may result in additional regulatory challenges for the Bank. As was disclosed in our most recent Community Reinvestment Act rating, we have faced some regulatory challenges including a finding of RESPA violations that have require additional resources and attention from management to remediate. As a result of both of the build out of our compliance management system and the growth in regulatory activity impacting the Bank, we expect our costs for compliance will grow in the near future, that we will continue to be subject to more regulatory scrutiny, and that compliance matters will require more attention from management and the Board.

Consolidated Financial Performance

(in thousands, except per share data and ratios)	At or for the Years Ended December 31, 2017	2016	2015
Selected statement of operations data			
Total net revenue [(1)]	$506,592	$539,199	$429,575
Total noninterest expense	439,653	444,322	366,568
Provision for credit losses	750	4,100	6,100
Income tax (benefit) expense	(2,757)	32,626	15,588
Net income	$68,946	$58,151	$41,319
Financial performance			
Diluted income per share	$2.54	$2.34	$1.96
Return on average common shareholders' equity	10.20 %	10.27 %	9.35 %
Return on average assets	1.05 %	1.01 %	0.91 %
Net interest margin	3.31 %	3.45 %	3.63 %

(1) Total net revenue is net interest income and noninterest income.

Commercial and Consumer Banking Segment Results

Commercial and Consumer Banking Segment net income increased 36.6% to $42.1 million for the year ended December 31, 2017 from $30.8 million in 2016, primarily due to higher net interest income from higher average balances of interest-earning assets, partially offset by higher noninterest expense, primarily the result of organic growth. Included in net income for the years ended December 31, 2017 and 2016 were acquisition related expenses, net of tax of $391 thousand and $4.6 million, respectively. Net income in the year ended December 31, 2017, also includes a one-time, non-cash, $4.2 million tax expense related to the Tax Reform Act, with no similar expenses in 2016.

Commercial and Consumer Banking Segment net interest income was $174.5 million for the year ended December 31, 2017, an increase of $20.5 million, or 13.3%, from $154.0 million for the year ended December 31, 2016, reflecting higher average balances of loans held for investment primarily as a result of organic growth.

The Company recorded a $750 thousand provision for credit losses for the year ended December 31, 2017 compared to a $4.1 million provision for credit losses for the year ended December 31, 2016. The reduction in credit loss provision in the year was due primarily to continued improvements in credit quality reflected in the qualitative reserves and historical loss rates, combined with an increase of $2.6 million in net recoveries over the comparable period.

Net recoveries were $3.1 million in 2017 compared to net recoveries of $505 thousand in 2016. Overall, the allowance for loan losses (which excludes the allowance for unfunded commitments) represented 0.83% of loans held for investment at December 31, 2017 compared to 0.88% at December 31, 2016, which primarily reflected the improved credit quality of the Company's loan portfolio. Excluding acquired loans, the allowance for loan losses was 0.90% of loans held for investment at December 31, 2017 compared to 1.00% at December 31, 2016. Nonperforming assets were $15.7 million, or 0.23% of total assets at December 31, 2017, compared to $25.8 million, or 0.41% of total assets at December 31, 2016.

Commercial and Consumer Banking Segment noninterest expense of $149.0 million for the year ended December 31, 2017 an increase of $10.6 million, or 7.7%, from $138.4 million for the year ended December 31, 2016, primarily due to increased costs related to organic growth of our commercial real estate and commercial business lending units and the expansion of our branch banking network. During 2017, we added four retail deposit branches, three de novo and one through the acquisition in El Cajon, California, and increased the segment's headcount by 7.0%.

Mortgage Banking Segment Results

Mortgage Banking Segment net income was $26.9 million for the year ended December 31, 2017, compared to net income of $27.4 million for the year ended December 31, 2016. The 1.7% decrease in net income is primarily due to a $1.64 billion reduction in rate locks and restructuring related items, net of tax, of $2.4 million, substantially offset by a one-time, non-cash, $27.5 million tax benefit related to the Tax Reform Act. In 2017, due to reduced expectations in our single family loan origination volume, we implemented a restructuring plan to better align our cost structure with market conditions, including a reduction in staffing, production office closures and a streamlining of the single family leadership team.

Mortgage Banking noninterest income of $269.8 million for the year ended December 31, 2017 decreased $53.7 million, or 16.6%, from $323.5 million for the year ended December 31, 2016, primarily due to a 19.0% decrease in single family mortgage interest rate lock commitments. Decreased interest rate lock commitments were the result of both higher mortgage interest rates, which reduced the volume of refinance activity in the period and to a lesser extent the limited supply of housing in our markets, which reduced the volume of purchase mortgage activity in the period. We decreased our mortgage production personnel by 5.2% at December 31, 2017 compared to December 31, 2016, primarily due to our 2017 restructuring in our Mortgage Banking Segment.

Mortgage Banking noninterest expense of $290.7 million for the year ended December 31, 2017 decreased $15.3 million, or 5.0%, from $305.9 million for the year ended December 31, 2016, primarily due to decreased commissions, salary, and related costs on lower closed loan volume, partially offset by a $3.7 million restructuring charge related to our Mortgage Banking Segment. In 2017, we reduced home loan centers by a net of three and decreased the segment's headcount by 13.1% during 2017 primarily the result of our restructuring event.

Regulatory Matters

On January 1, 2015, the Company and the Bank became subject to new capital standards commonly referred to as “Basel III” which raised our minimum capital requirements. The Company and the Bank remain above current “well-capitalized” regulatory minimums since the Company’s initial public offering in 2012, even with the implementation of more stringent capital requirements implemented beginning in 2015 under the capital standards commonly referred to as “Basel III”.
Under the Basel III standards, the Bank's Tier 1 leverage and total risk-based capital ratios at December 31, 2017 were 9.67% and 14.02% and at December 31, 2016 were 10.26% and 14.69%, respectively. The Company's Tier 1 leverage and total risk-based capital ratios were 9.12% and 11.61% at December 31, 2017, and 9.78% and 12.34% at December 31, 2016, respectively.

In September 2017, federal banking regulators issued a proposed rule intended to simplify and limit the impact of the Basel III regulatory capital requirements for certain banks. We believe that these proposed changes, if implemented, would significantly benefit our Mortgage Banking business model by reducing the amount of regulatory capital that we would be required to maintain in relation to our mortgage servicing assets. Other proposed changes to the Basel III capital requirements would require a small increase in capital related to commercial and residential acquisition, development, and construction lending activity which would partially offset some portion of the benefit we would expect to receive with respect to our mortgage servicing assets. The final rules have yet to be published following the comment period, but if they are adopted without any material changes to the current proposal, we would expect to benefit from a significant reduction in the regulatory capital requirements related to our mortgage servicing rights beginning in 2018. Although it is too early to predict the form, if any, in which the final regulations are adopted, certain alternatives we believe to be under consideration would potentially allow us to allocate that capital to other aspects of our operations, including as capital to support our commercial lending operations.
For more on the Basel III requirements as they apply to us, please see “*Capital Management*" within the Liquidity and Capital Resources section and “Business - Regulation and Supervision” of this Form 10-K.

Critical Accounting Policies and Estimates

The preparation of financial statements in accordance with the accounting principles generally accepted in the United States ("U.S. 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 inherent judgments and assumptions and the potential sensitivity of the 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 the Company's financial statements are appropriate. For a further description of our accounting policies, see Note 1–*Summary of Significant Accounting Policies* in the financial statements included in this Form 10-K.

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 that has two basic components: first, an asset-specific component involving the identification of impaired loans and the measurement of impairment for each individual loan identified; and second, a formula-based component for estimating probable principal losses for all other loans.

Based upon this methodology, management establishes an asset-specific allowance for impaired loans based on the amount of impairment calculated on those loans and 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, we measure impairment 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 based on 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. The fair value of the collateral is adjusted for the estimated cost to sell if repayment or satisfaction of a loan is dependent on the sale (rather than only on the operation) of the collateral. 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, which generally are updated every twelve months. We require an independent third-party appraisal at least annually for substandard loans and other real estate owned ("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. When we receive an updated appraisal or collateral valuation, management reassesses the need for adjustments to loan impairment measurements and, where appropriate, records an adjustment. If the calculated impairment is determined to be permanent, fixed or nonrecoverable, the impairment will be charged off. See "*Credit Risk Management – Asset Quality and Nonperforming Assets*” discussions within Management's Discussion and Analysis of this Form 10-K.

In estimating the formula-based component of the allowance for loan losses, loans are segregated into loan classes. Loans are designated into loan classes based on loans pooled by product types and similar risk characteristics or areas of risk concentration. Credit loss assumptions are estimated using a model that categorizes loan pools based on loan type and asset quality rating ("AQR") or delinquency bucket. This model calculates an expected loss percentage for each loan category by considering the probability of default, based on the migration of loans from performing to loss by AQR or delinquency buckets using two-year analysis periods for commercial segments and one-year analysis periods for consumer segments, and the potential severity of loss, based on the aggregate net lifetime losses incurred per loan class.

The formula-based component of the allowance for loan losses also considers qualitative factors for each loan class, including changes in:

- lending policies and procedures;
- international, national, regional and local economic business conditions and developments that affect the collectability of the portfolio, including the condition of various markets;
- the nature of the loan portfolio, including the terms of the loans;
- the experience, ability and depth of the lending management and other relevant staff;
- the volume and severity of past due and adversely classified or graded loans and the volume of nonaccrual loans;
- the quality of our loan review and process;

- the value of underlying collateral for collateral-dependent loans;
- the existence and effect of any concentrations of credit and changes in the level of such concentrations; and
- the effect of external factors such as competition and legal and regulatory requirements on the level of estimated credit losses in the existing portfolio.

Qualitative factors are expressed in basis points and are adjusted downward or upward based on statistical analysis of economic drivers and management's judgment as to the potential loss impact of each qualitative factor to a particular loan pool at the date of the analysis.

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.

The allowance for loan losses, as reported in our consolidated statements of financial condition, is adjusted by a provision for loan losses, which is recognized in earnings, and reduced by the charge-off of loan amounts, net of recoveries. For further information on the allowance for loan losses, see Note 5–*Loans and Credit Quality* in the notes to the financial statements of this Form 10-K.

Fair Value of Financial Instruments, Single Family MSRs and OREO

A portion of our assets are carried at fair value, including single family mortgage servicing rights ("MSRs"), single family 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.

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

A three-level valuation hierarchy has been established under the Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 820 for disclosure of fair value measurements. The valuation hierarchy is based on the observability of inputs to the valuation of an asset or liability as of the measurement date. A financial instrument's categorization within the valuation hierarchy is based on the lowest level of input that is significant to the fair value measurement. The levels are defined as follows:

- Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity can access at the measurement date. An active market for the asset or liability is a market in which transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.
- Level 2 – Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. This includes quoted prices for similar assets and liabilities in active markets and inputs that are observable for the asset or liability for substantially the full term of the financial instrument.
- Level 3 – Unobservable inputs for the asset or liability. These inputs reflect the Company's assumptions of what market participants would use in pricing the asset or liability.

Significant judgment is required to determine whether certain assets and liabilities measured at fair value are included in Level 2 or Level 3. When making this judgment, we consider all available information, including observable market data, indications of market liquidity and orderliness, and our understanding of the valuation techniques and significant inputs used. The classification of Level 2 or Level 3 is based upon the specific facts and circumstances of each instrument or instrument category and judgments are made regarding the significance of the Level 3 inputs to an instrument's fair value measurement in its entirety. If Level 3 inputs are considered significant, the instrument is classified as Level 3.

As of December 31, 2017, our Level 3 recurring fair value measurements consisted of single family MSRs, single family loans held for investment where fair value option was elected, certain single family loans held for sale and interest rate lock and purchase loan commitments.

On a quarterly basis, our Asset/Liability Management Committee ("ALCO") and the Finance Committee of the Board review significant modeling variables used to measure the fair value of the Company’s financial instruments, including the significant inputs used in the valuation of single family MSRs. Additionally, ALCO periodically obtains an independent review of the MSR valuation process and procedures, including a review of the model architecture and the valuation assumptions. We obtain an MSR valuation from an independent valuation firm monthly to assist with the validation of our fair value estimate and the reasonableness of the assumptions used in measuring fair value.

In addition to the recurring fair value measurements, from time to time the Company may have certain nonrecurring fair value measurements. These fair value measurements usually result from the application of lower of cost or fair value accounting or impairment of individual assets. As of December 31, 2017 and 2016, the Company's Level 3 nonrecurring fair value measurements were based on the appraised value of collateral used as the basis for the valuation of collateral dependent loans held for investment and OREO.

Real estate valuations are overseen by our appraisal department, which is independent of our lending and credit administration functions. The appraisal department maintains the appraisal policy and recommends changes to the policy subject to approval by the Credit Committee of the Company's Board of Directors and Company's Loan Committee (the "Loan Committee"), established by the Credit Committee of the Company's Board of Directors and comprised of certain of the Company's management. Appraisals are prepared by independent third-party appraisers and our internal appraisers. Appraisals are reviewed either by our in-house appraisal staff or by independent and qualified third-party appraisers.

For further information on the fair value of financial instruments, single family MSRs and OREO, see Note 1–*Summary of Significant Accounting Policies,* Note 12–*Mortgage Banking Operations* and Note 17–*Fair Value Measurements* in the notes to the financial statements of this Form 10-K.

Income Taxes

In establishing an income tax provision, we must make judgments and interpretations about the application of inherently complex tax laws. We must also make estimates about when in the future certain items will affect taxable income. Our interpretations may be subject 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 strategies and from the resolution of income tax controversies. Such revisions in our estimates may be material to our operating results for any given reporting period.

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 tax basis of assets and liabilities and their reported amounts in the financial statements. 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 management 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.

The Company recognizes potential 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. For further information regarding income taxes, see Note 14–*Income Taxes* to the financial statements of this Form 10-K.

Business Combinations

The Simplicity and Orange County Business Bank acquisitions, as well as the branch acquisitions were accounted for under the acquisition method of accounting pursuant to ASC 805, *Business Combinations*. The assets and liabilities, both tangible and intangible, were recorded at their estimated fair values as of acquisition date. Management made significant estimates and exercised significant judgment in estimating the fair values and accounting for such acquired assets and assumed liabilities, and in certain instances received "bargain purchase gains" or "goodwill" in these transactions.

The valuation of acquired loans, mortgage servicing rights, premises and equipment, core deposit intangibles, deferred taxes, deposits, Federal Home Loan Bank advances and any contingent liabilities that arise as a result of the transaction may be preliminary for a period of time following completion of the acquisition. As such, fair value estimates are subject to adjustment when additional information relative to the closing date fair values becomes available and such information is considered final or up to one year after the acquisition date, or, whichever is earlier.

Management used valuation models to estimate the fair value for certain assets and liabilities. These models incorporate inputs such as forward yield curves, loan prepayment expectations, expected credit loss assumptions, market volatilities, and pricing spreads utilizing market-based inputs where available. We believe our valuation methods are appropriate and consistent with those that would be used by other market participants. However, imprecision in estimating unobservable inputs and other factors may result in these fair value measurements not reflecting the amount that could be realized in an actual sale or transfer of the asset or liability in a current market exchange.

Results of Operations

Average Balances and Rates

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

	Years Ended December 31,								
	2017			2016			2015		
(in thousands)	Average Balance	Interest	Average Yield/Cost	Average Balance	Interest	Average Yield/Cost	Average Balance	Interest	Average Yield/Cost
Assets:									
Interest-earning assets: [1]									
Cash and cash equivalents	$85,430	$567	0.67 %	$39,962	$254	0.63 %	$36,134	$67	0.18 %
Investment securities	1,023,702	25,810	2.54	834,671	21,611	2.57	523,756	14,270	2.72
Loans held for sale	711,063	28,732	4.05	764,222	28,581	3.76	755,688	29,165	3.86
Loans held for investment	4,178,326	187,281	4.46	3,668,263	162,219	4.40	2,834,511	123,680	4.36
Total interest-earning assets	5,998,521	242,390	4.03	5,307,118	212,665	4.00	4,150,089	167,182	4.03
Noninterest-earning assets [2]	591,561			470,021			410,404		
Total assets	$6,590,082			$5,777,139			$4,560,493		
Liabilities and shareholders' equity:									
Deposits:									
Interest-bearing demand accounts	$477,635	1,964	0.41 %	$450,838	$1,950	0.43 %	$317,510	$1,492	0.46 %
Savings accounts	306,151	1,013	0.33	299,502	1,029	0.34	284,309	1,053	0.38
Money market accounts	1,579,115	8,533	0.54	1,370,256	7,344	0.53	1,122,321	4,930	0.44
Certificate accounts	1,225,614	13,028	1.06	1,024,541	9,086	0.88	775,398	4,501	0.58
Total interest-bearing deposits	3,588,515	24,538	0.68	3,145,137	19,409	0.61	2,499,538	11,976	0.48
Federal Home Loan Bank advances	1,037,650	12,589	1.19	942,593	6,030	0.64	795,368	3,669	0.46
Federal funds purchased and securities sold under agreements to repurchase	3,732	48	1.20	803	6	0.40	11,397	29	0.31
Long-term debt	125,228	6,067	4.83	101,049	4,043	3.73	61,857	1,104	1.78
Other borrowings	96	3	0.89	—	—	—	—	—	—
Total interest-bearing liabilities	4,755,221	43,245	0.91	4,189,582	29,488	0.70	3,368,160	16,778	0.50
Noninterest-bearing liabilities	1,158,984			1,021,409			750,228		
Total liabilities	5,914,205			5,210,991			4,118,388		
Shareholders' equity	675,877			566,148			442,105		
Total liabilities and shareholders' equity	$6,590,082			$5,777,139			$4,560,493		
Net interest income [3]		$199,145			$183,177			$150,404	
Net interest spread			3.12 %			3.30 %			3.53 %
Impact of noninterest-bearing sources			0.19 %			0.15 %			0.10 %
Net interest margin			3.31 %			3.45 %			3.63 %

(1) The average balances of nonaccrual assets and related income, if any, are included in their respective categories.
(2) Includes former loan balances that have been foreclosed and are now reclassified to OREO.
(3) Includes taxable-equivalent adjustments primarily related to tax-exempt income on certain loans and securities of $4.7 million, $3.1 million and $2.1 million for the years ended December 31, 2017, 2016 and 2015, respectively. The estimated federal statutory tax rate was 35% for the periods presented.

Interest on Nonaccrual Loans

We do not include interest collected on nonaccrual loans in interest income. When we place a loan on nonaccrual status, we reverse the accrued but unpaid interest, reducing interest income, and we stop amortizing any net deferred fees. Additionally, if interest is received on nonaccrual loans, the interest collected on the loan is recognized as an adjustment to the cost basis of the loan. The net decrease to interest income due to adjustments made for nonaccrual loans, including the effect of additional interest income that would have been recorded during the period if the loans had been accruing, was $1.5 million, $2.2 million and $2.5 million for the years ended December 31, 2017, 2016 and 2015, 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.

	Years Ended December 31,					
	2017 vs. 2016			2016 vs. 2015		
	Increase (Decrease) Due to		Total Change	Increase (Decrease) Due to		Total Change
(in thousands)	Rate	Volume		Rate	Volume	
Assets:						
Interest-earning assets						
Cash and cash equivalents	$27	$287	$314	$180	$7	$187
Investment securities	(656)	4,855	4,199	(1,128)	8,469	7,341
Loans held for sale	2,149	(1,998)	151	(914)	329	(585)
Loans held for investment	2,597	22,464	25,061	2,191	36,348	38,539
Total interest-earning assets	4,117	25,608	29,725	329	45,153	45,482
Liabilities:						
Deposits						
Interest-bearing demand accounts	(103)	116	13	(161)	619	458
Savings accounts	(39)	23	(16)	(81)	57	(24)
Money market accounts	81	1,108	1,189	1,325	1,089	2,414
Certificate accounts	2,179	1,763	3,942	3,130	1,454	4,584
Total interest-bearing deposits	2,118	3,010	5,128	4,213	3,219	7,432
Federal Home Loan Bank advances	5,952	608	6,560	1,682	679	2,361
Securities sold under agreements to repurchase	30	11	41	10	(32)	(22)
Long-term debt	1,124	901	2,025	2,242	697	2,939
Other borrowings	3	—	3	—	—	—
Total interest-bearing liabilities	9,227	4,530	13,757	8,147	4,563	12,710
Total changes in net interest income	$(5,110)	$21,078	$15,968	$(7,818)	$40,590	$32,772

Net Income

Comparison of 2017 to 2016

For the year ended December 31, 2017, net income was $68.9 million, an increase of $10.8 million, or 18.6%, from $58.2 million for the year ended December 31, 2016. Included in net income for the year ended December 31, 2017 was a one-time, non-cash, tax reform benefit of $23.3 million and restructuring as well as merger-related costs (net of tax) of $2.4 million and $391 thousand, respectively. Such merger-related costs (net of tax) relating to prior acquisitions totaled $4.6 million in 2016. There were no similar tax reform benefits or restructuring costs in 2016.

Comparison of 2016 to 2015

For the year ended December 31, 2016, net income was $58.2 million, an increase of $16.8 million, or 40.7%, compared to net income of $41.3 million in 2015. Included in net income for the year ended December 31, 2016 were acquisition-related costs (net of tax) of $4.6 million. Such acquisition-related costs (net of tax) relating to prior acquisitions totaled $10.7 million which were offset by bargain purchase gains of $7.7 million during 2015.

Net Interest Income

Our profitability depends significantly on net interest income, which is the difference between income earned on our interest-earning assets, primarily loans and investment securities, and interest paid on interest-bearing liabilities. Our interest-bearing liabilities consist primarily of deposits and borrowed funds, including our outstanding trust preferred securities, senior unsecured notes and advances from the Federal Home Loan Bank ("FHLB").

Comparison of 2017 to 2016

Net interest income on a tax equivalent basis for the year ended December 31, 2017 increased $16.0 million, or 8.7%, from December 31, 2016 as a result of growth in average interest earning assets, partially offset by a lower net interest margin. The net interest margin decreased to 3.31% for the year ended December 31, 2017 from 3.45% for the year ended December 31, 2016. The decrease in the net interest margin from the year ended December 31, 2016 was due primarily to higher costs of funds related to our long term debt issuance in the second quarter of 2016 and higher FHLB borrowing costs due to higher short-term rates.

Total average interest-earning assets increased by $691.4 million, or 13%, in 2017 compared to 2016 primarily as a result of growth in average loans held for investment from organic growth. Additionally, our average balance of investment securities grew from prior periods as part of the strategic growth of the Company.

Total interest income on a tax equivalent basis in 2017 increased $29.7 million, or 14.0%, from 2016 resulting from higher average balances of loans held for investment, which increased $510.1 million, or 13.9%, from 2016.

Total interest expense in 2017 increased $13.8 million, or 46.7%, from 2016 primarily resulting from higher average balances of interest-bearing deposits and FHLB advances and interest paid on our $65.0 million in senior debt issued in May 2016.

Comparison of 2016 to 2015

Net interest income on a tax equivalent basis for the year ended December 31, 2016 increased $32.8 million, or 21.8%, from December 31, 2015 as a result of growth in average interest earning assets, partially offset by a lower net interest margin. The net interest margin decreased to 3.45% for the year ended December 31, 2016 from 3.63% for the year ended December 31, 2015. The decrease in the net interest margin from the year ended December 31, 2015 was due primarily to shifts in asset mix from growth in lower yielding investment securities and loans held for sale and to higher costs of funds primarily related to our long-term debt issuance in 2016, money market products and FHLB borrowings.

Total average interest-earning assets increased by $1.16 billion, or 28% in 2016 compared to 2015 primarily as a result of
growth in average loans held for investment, both organically and through acquisition activity. Additionally, our average
balance of investment securities grew from prior periods as part of the strategic growth of the Company.

Total interest income on a tax equivalent basis in 2016 increased $45.5 million, or 27.2%, from 2015 resulting from higher average balances of loans held for investment, which increased $833.8 million, or 29.4%, from 2015.

Total interest expense in 2016 increased $12.7 million, or 75.8%, from 2015 primarily resulting from higher average balances of interest-bearing deposits and FHLB advances, and interest paid on our $65.0 million in senior debt issued in May 2016.

Provision for Credit Losses

Management believes that our allowance for loan losses is at a level appropriate to cover estimated incurred losses inherent within the loans held for investment portfolio. Our credit risk profile has continued to improve since our initial public offering in 2012, including year over year improvements from December 31, 2016 and December 31, 2015.

Comparison of 2017 to 2016

The Company recorded a $750 thousand provision for credit losses for the year ended December 31, 2017 compared to a $4.1 million provision for credit losses for the year ended December 31, 2016. The reduction in credit loss provision in the year was due in part to continued improvements in credit quality reflected in the qualitative reserves and historical loss rates, combined with an increase of $2.6 million in net recoveries over the comparable period.

Nonaccrual loans were $15.0 million at December 31, 2017, a decrease of $5.5 million, or 26.8%, from $20.5 million at December 31, 2016. Nonaccrual loans as a percentage of total loans decreased to 0.33% at December 31, 2017 compared to 0.53% at December 31, 2016. Net loan loss recoveries were $3.1 million in 2017 compared to net loan loss recoveries of $505 thousand in 2016. Overall, the allowance for credit losses, which includes the reserve for unfunded commitments, was $39.1 million, or 0.86% of loans held for investment at December 31, 2017, compared to $35.3 million, or 0.92% of loans held for investment at December 31, 2016.

Comparison of 2016 to 2015

The Company recorded a $4.1 million provision for credit losses for the year ended December 31, 2016 compared to a $6.1 million provision for credit losses for the year ended December 31, 2015. The reduction in credit loss provision in the year was due in part to a continuing decline in historical loss rates as a result of net recoveries for the past two years and continued improvements in portfolio performance which was reflected in the qualitative reserves. In 2015, one-time model adjustments contributed to an increase in provision expense.

Nonaccrual loans were $20.5 million at December 31, 2016, an increase of $3.4 million, or 19.7%, from $17.2 million at December 31, 2015. Nonaccrual loans as a percentage of total loans remained steady at 0.53% at both December 31, 2016 and December 31, 2015. Net loan loss recoveries were $505 thousand in 2016 compared to net loan loss recoveries of $2.0 million in 2015. Overall, the allowance for credit losses, which includes the reserve for unfunded commitments, was $35.3 million, or 0.92% of loans held for investment at December 31, 2016, compared to $30.7 million, or 0.95% of loans held for investment at December 31, 2015.

For a more detailed discussion on our allowance for loan losses and related provision for loan losses, see "*Credit Risk Management - Asset Quality and Nonperforming Assets"* in this Form 10-K.

Noninterest Income

Noninterest income consisted of the following.

(in thousands)	Years Ended December 31, 2017	Dollar Change	Percent Change	2016	Dollar Change	Percent Change	2015
Noninterest income							
Gain on loan origination and sale activities [(1)]	$255,876	$(51,437)	(17)%	$307,313	$70,925	30 %	$236,388
Loan servicing income	35,384	2,325	7	33,059	8,809	36	24,250
Income from WMS Series LLC	598	(1,735)	(74)	2,333	709	44	1,624
Depositor and other retail banking fees	7,221	431	6	6,790	909	15	5,881
Insurance agency commissions	1,904	285	18	1,619	(63)	(4)	1,682
Gain on sale of investment securities available for sale	489	(2,050)	(81)	2,539	133	6	2,406
Bargain purchase gain	—	—	NM	—	(7,726)	NM	7,726
Other	10,682	5,185	94	5,497	4,217	329	1,280
Total noninterest income	$312,154	$(46,996)	(13)%	$359,150	$77,913	28 %	$281,237

NM = not meaningful

(1) Single family and multifamily mortgage banking activities.

Comparison of 2017 to 2016

Our noninterest income is heavily dependent upon our single family mortgage banking activities, which are comprised of mortgage origination and sale as well as mortgage servicing activities. The level of our mortgage banking activity fluctuates and is highly sensitive to changes in mortgage interest rates, as well as to general economic conditions such as employment trends and housing supply and affordability. The decrease in noninterest income in 2017 compared to 2016 was primarily due to a decrease in gain on loan origination and sale activities resulting from a 19% decrease in single family rate lock volume.

Comparison of 2016 to 2015

The increase in noninterest income in 2016 compared to 2015 was primarily the result of higher gain on loan origination and sale activities mostly due to increased single family mortgage interest rate lock commitments and higher mortgage servicing income. Included in noninterest income for 2015 was a bargain purchase gain of $7.7 million from the Simplicity merger and our acquisition of a branch in Dayton, Washington. No similar bargain purchase gains occurred in 2016.

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

Gain on loan origination and sale activities consisted of the following.

(in thousands)	Years Ended December 31, 2017	Dollar Change	Percent Change	2016	Dollar Change	Percent Change	2015
Single family held for sale:							
Servicing value and secondary market gains[1]	$209,027	$(51,450)	(20)%	$260,477	$54,964	27 %	$205,513
Loan origination and administrative fees	26,822	(3,144)	(10)	29,966	7,745	35	22,221
Total single family held for sale	235,849	(54,594)	(19)	290,443	62,709	28	227,734
Multifamily DUS®	13,210	1,813	16	11,397	4,272	60	7,125
SBA	2,439	1,025	72	1,414	344	32	1,070
CRE Non-DUS®	4,378	319	8	4,059	3,600	784	459
Gain on loan origination and sale activities	$255,876	$(51,437)	(17)%	$307,313	$70,925	30 %	$236,388

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

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

(in thousands)	For The Years Ended December 31, 2017	Dollar Change	Percent Change	2016	Dollar Change	Percent Change	2015
Single family mortgage closed loan volume [1]	$7,554,185	$(1,443,162)	(16)%	$8,997,347	$1,784,912	25 %	$7,212,435
Single family mortgage interest rate lock commitments [1]	$6,980,477	$(1,640,499)	(19)%	$8,620,976	$1,689,868	24 %	$6,931,108

(1) Includes loans originated by WMS Series LLC and purchased by HomeStreet Bank.

Comparison of 2017 to 2016

The decrease in gain on loan origination and sale activities in 2017 compared to 2016 predominantly reflected lower single family mortgage interest rate lock commitments as a result of higher market interest rates in the period and a limited supply of available housing in our primary markets. In 2017, we reduced the number of employees in the mortgage segment by 13.1% at December 31, 2017 compared to December 31, 2016, primarily due to our Mortgage Banking Segment restructuring. Mortgage production personnel was reduced by 5.2% at December 31, 2017 compared to December 31, 2016.

Comparison of 2016 to 2015

The increase in gain on loan origination and sale activities in 2016 compared to 2015 predominantly reflected higher single family mortgage interest rate lock commitments as a result of the expansion of our mortgage lending network, higher loan production per loan producer and higher refinance volumes. Mortgage production personnel grew by 12.7% during 2016 compared to 2015.

Management records a liability for estimated mortgage repurchase losses, which has the effect of reducing gain on mortgage loan origination and sale activities. The following table presents the effect of changes in our mortgage repurchase liability within the respective line of gain on mortgage loan origination and sale activities. For further information on the Company's mortgage repurchase liability, see Note 13, *Commitments, Guarantees and Contingencies* to the financial statements in this Form 10-K.

	Years Ended December 31,		
(in thousands)	2017	2016	2015
Effect of changes to the mortgage repurchase liability recorded in gain on loan origination and sale activities:			
New loan sales [1]	$(2,528)	$(3,574)	$(2,764)
Other changes in estimated repurchase losses[2]	2,354	2,032	—
	$(174)	$(1,542)	$(2,764)

(1) Represents the estimated fair value of the repurchase or indemnity obligation recognized as a reduction of proceeds on new loan sales.
(2) Represents changes in estimated probable future repurchase losses on previously sold loans.

Loan servicing income consisted of the following.

	Years Ended December 31,						
(in thousands)	2017	Dollar Change	Percent Change	2016	Dollar Change	Percent Change	2015
Servicing income, net:							
Servicing fees and other	$66,192	$12,538	23 %	$53,654	$11,638	28 %	$42,016
Changes in fair value of single family MSRs due to amortization [1]	(35,451)	(2,146)	6	(33,305)	733	(2)	(34,038)
Amortization of multifamily and SBA MSRs	(3,932)	(1,297)	49	(2,635)	(643)	32	(1,992)
	26,809	9,095	51	17,714	11,728	196	5,986
Risk management:							
Changes in fair value of MSRs due to changes in model inputs and/or assumptions	(1,157)	(21,182)	(106)	20,025	13,470	205	6,555
Net gain (loss) from derivatives economically hedging MSRs	9,732	14,412	(308)	(4,680)	(16,389)	(140)	11,709
	8,575	(6,770)	(44)	15,345	(2,919)	(16)	18,264
Loan servicing income	$35,384	$2,325	7 %	$33,059	$8,809	36 %	$24,250

(1) Represents changes due to collection/realization of expected cash flows and curtailments.
(2) Principally reflects changes in market inputs, which include current market interest rates and prepayment model updates, both of which affect future prepayment speed and cash flow projections.

Comparison of 2017 to 2016

The increase in mortgage servicing income in 2017 compared to 2016 was primarily due to higher servicing income, net, offset by lower risk management results. The higher servicing income was primarily attributed to higher servicing fees on higher average balances of loans serviced for others. The lower risk management results were due in part to gains from prepayment model refinements in 2016 to align borrower prepayment behavior with observed borrower prepayment behavior. Mortgage servicing fees collected in 2017 increased compared to 2016 primarily as a result of higher average balances of loans serviced for others during the year. Our loans serviced for others portfolio was $24.02 billion at December 31, 2017 compared to $20.67 billion at December 31, 2016.

MSR risk management results represent changes in the fair value of single family MSRs due to changes in model inputs and assumptions net of the gain/(loss) from derivatives economically hedging MSRs. The fair value of MSRs is sensitive to changes in interest rates, primarily due to the effect on prepayment speeds. MSRs typically decrease in value when interest rates decline because declining interest rates tend to increase mortgage prepayment speeds and therefore reduce the expected life of the net servicing cash flows of the MSR asset. Certain other changes in MSR fair value relate to factors other than interest rate changes and are generally not within the scope of the Company's MSR economic hedging strategy. These factors may include but are not limited to the impact of changes to the housing price index, prepayment model assumptions, the level of home sales activity, changes to mortgage spreads, valuation discount rates, costs to service and policy changes by U.S. government agencies.

Comparison of 2016 to 2015

The increase in mortgage servicing income in 2016 compared to 2015 was primarily due to higher servicing income, net, offset by lower risk management results. The higher servicing income was primarily attributed to higher servicing fees on higher average balances of loans serviced for others and lower modeled amortization. Mortgage servicing fees collected in 2016 increased compared to 2015 primarily as a result of higher average balances of loans serviced for others during the year. Our loans serviced for others portfolio was $20.67 billion at December 31, 2016 compared to $16.35 billion at December 31, 2015.

The lower risk management results in 2016 compared to 2015 were mainly due to adverse results during the fourth quarter driven by the unexpected and significant increases in long-term Treasury rates beginning in November 2016 following the U.S. presidential election, coinciding with an increase in short-term interest rates by the Federal Reserve in December 2016. The unexpected and sustained increase in interest rates during the quarter resulted in asymmetrical changes in valuation between hedging derivatives and servicing valuations. This market dislocation in the fourth quarter reduced the value of our hedging derivatives to a greater extent than value of our mortgage servicing rights increased, resulting in lower risk management results.

Income from WMS Series LLC

Comparison of 2017 to 2016

Income from WMS Series LLC decreased by $1.7 million in 2017 to $598 thousand compared to $2.3 million in 2016, primarily due to a 15.6% decrease in interest rate lock commitments and a 7.7% decrease in closed loan volume, which were $546.5 million and $631.4 million, respectively, in 2017 compared to $647.3 million and $684.1 million, respectively, for the same period in 2016.

Comparison of 2016 to 2015

Income from WMS Series LLC increased by $709 thousand in 2016 to $2.3 million compared to $1.6 million in 2015 primarily due to a 15.1% increase in interest rate lock commitments and a 10.9% increase in closed loan volume, which were $647.3 million and $684.1 million, respectively, in 2016 compared to $562.2 million and $616.9 million, respectively, for the same period in 2015.

Depositor and other retail banking fees for 2017 increased from 2016 primarily due to an increase in the number of transaction accounts in both existing branches and new retail deposit branches. The following table presents the composition of depositor and other retail banking fees for the periods indicated.

(in thousands)	Years Ended December 31, 2017	Dollar Change	Percent Change	2016	Dollar Change	Percent Change	2015
Fees:							
Monthly maintenance and deposit-related fees	$3,085	$ 133	5 %	$2,952	$ 295	11 %	$2,657
Debit Card/ATM fees	3,912	291	8	3,621	476	15	3,145
Other fees	224	7	3	217	138	175	79
Total depositor and other retail banking fees	$7,221	$ 431	6 %	$6,790	$ 909	15 %	$5,881

Noninterest Expense

Noninterest expense consisted of the following.

(in thousands)	Years Ended December 31, 2017	Dollar Change	Percent Change	2016	Dollar Change	Percent Change	2015
Noninterest expense							
Salaries and related costs	$293,870	$(9,484)	(3)%	$303,354	$62,767	26 %	$240,587
General and administrative	65,036	1,830	3	63,206	6,385	11	56,821
Amortization of core deposit intangibles	1,710	(456)	(21)	2,166	242	13	1,924
Legal	1,410	(457)	(24)	1,867	(940)	(33)	2,807
Consulting	3,467	(1,491)	(30)	4,958	(2,257)	(31)	7,215
Federal Deposit Insurance Corporation assessments	3,279	(135)	(4)	3,414	841	33	2,573
Occupancy	38,268	7,738	25	30,530	5,603	22	24,927
Information services	33,143	80	—	33,063	4,009	14	29,054
Net (benefit) cost of operation and sale of other real estate owned	(530)	(2,294)	(130)	1,764	1,104	167	660
Total noninterest expense	$439,653	$(4,669)	(1)%	$444,322	$77,754	21 %	$366,568

The following table shows the acquisition-related expenses impacting the components of noninterest expense.

(in thousands)	Years Ended December 31, 2017	2016	2015
Noninterest expense			
Salaries and related costs	$—	$4,128	$7,672
General and administrative	79	633	1,463
Legal	64	132	830
Consulting	366	1,500	5,703
Occupancy	72	180	382
Information services	21	563	514
Total noninterest expense	$602	$7,136	$16,564

The following table shows the restructuring-related expenses impacting the components of noninterest expense.

(in thousands)	Years Ended December 31, 2017	2016	2015
Noninterest expense			
Salaries and related costs	$648	$ —	$ —
Occupancy	3,072	—	—
Total noninterest expense	$3,720	$ —	$ —

Comparison of 2017 to 2016

The decrease in noninterest expense in 2017 compared to 2016 was primarily due to decreased commissions on lower closed loan volume, partially offset by other costs related to the growth in offices and personnel in connection with our organic expansion of our commercial and consumer banking businesses and restructuring-related costs in our Mortgage Banking Segment.

Included in noninterest expense in 2017 was $602 thousand and $3.7 million of acquisition-related and restructuring-related costs, respectively, compared to $7.1 million in acquisition-related costs in 2016. There were no similar restructuring-related costs in 2016.

Salaries and related costs decreased primarily due to lower commission and incentive expense, as single family mortgage closed loan volumes decreased 16.0%, from 2016 and a 5.2% decrease in full-time equivalent employees at December 31, 2017 compared to December 31, 2016, primarily due to our 2017 restructuring in our Mortgage Banking Segment.

General and administrative and Information services costs increased primarily due to our expansion of our commercial and consumer business.

Comparison of 2016 to 2015

The increase in noninterest expense in 2016 compared to 2015 was primarily due to increased commissions on higher closed
loan volume, as well as other costs related to the growth in offices and personnel in connection with our expansion of our
commercial and consumer and mortgage banking businesses, both organically and through acquisition-related activities.

Included in noninterest expense in 2016 was $7.1 million of acquisition-related costs compared to $16.6 million in 2015 primarily related to Simplicity merger.

Salaries and related costs increased primarily due to a 19.3% increase in full-time equivalent employees at December 31, 2016 compared to December 31, 2015 and higher commission and incentive expense, as single family mortgage closed loan volumes increased 24.7%, from 2015.

General and administrative and Information services costs increased primarily due to increased headcount and continued growth of our mortgage banking business and expansion of our commercial and consumer business.

Income Tax Expense

Comparison of 2017 to 2016

The Tax Reform Act was signed into law in December 2017. We expect that our 2018 effective tax rate will be between 21% and 22%, before discrete items, as a result of this legislation. We also recognized a one-time, non-cash, benefit of $23.3 million from this legislation in 2017 as we revalued our December 31, 2017 net deferred tax liability position at the new federal corporate income tax rate.

For the year ended December 31, 2017, income tax benefit was $2.8 million with an effective tax rate of (4.2)% (inclusive of discrete items) compared to income tax expense of $32.6 million and an effective tax rate of 35.9% (inclusive of discrete items) for the year ended December 31, 2016.

The Company's effective income tax rate for the year ended December 31, 2017 differs from the Federal statutory tax rate of 35% primarily due to the impact of the newly enacted tax law, state income taxes, tax-exempt income and low income housing tax credit investments.

Comparison of 2016 to 2015

The Company's income tax expense for 2016 was $32.6 million, representing an effective tax rate of 35.9% (inclusive of discrete items). In 2015, the Company's tax expense was $15.6 million, representing an effective tax rate of 27.4% (inclusive of discrete items). The Company's effective income tax rate for the year ended December 31, 2015 was significantly less than the Federal statutory tax rate of 35% primarily due to the impact of state income taxes, tax-exempt interest income and low income housing tax credit investments.

Capital Expenditures

Comparison of 2017 to 2016

During 2017, our net expenditures for property and equipment were $42.3 million, compared to net expenditures of $24.5 million during 2016, primarily due to the continued expansion of our commercial and consumer businesses.

Comparison of 2016 to 2015

During 2016, our net expenditures for property and equipment were $24.5 million, compared to net expenditures of $20.6 million during 2015, as we continued the expansion of our commercial and consumer and mortgage banking businesses.

Review of Financial Condition – Comparison of December 31, 2017 to December 31, 2016

Total assets were $6.74 billion at December 31, 2017 and $6.24 billion at December 31, 2016, an increase of $498.3 million.

Cash and cash equivalents were $72.7 million at December 31, 2017 compared to $53.9 million at December 31, 2016, an increase of $18.8 million, or 34.8%.

Investment securities were $904.3 million at December 31, 2017 compared to $1.04 billion at December 31, 2016, a decrease of $139.5 million, or 13.4%, primarily due to sales and principal repayments of securities purchased with temporary excess capital from the 2016 debt and equity issuances.

We primarily hold investment securities for liquidity purposes, while also creating a relatively stable source of interest income. We designated the vast majority of these securities as available for sale. We held securities having a carrying value of $58.0 million at December 31, 2017, which were designated as held to maturity.

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

(in thousands)	At December 31, 2017 Amortized Cost	Fair Value	2016 Amortized Cost	Fair Value
Investment securities available for sale:				
Mortgage-backed securities:				
Residential	$133,654	$130,090	$181,158	$177,074
Commercial	24,024	23,694	25,896	25,536
Municipal bonds	389,117	388,452	473,153	467,673
Collateralized mortgage obligations:				
Residential	164,502	160,424	194,982	191,201
Commercial	100,001	98,569	71,870	70,764
Corporate debt securities	25,146	24,737	52,045	51,122
U.S. Treasury securities	10,899	10,652	10,882	10,620
Agency debentures	9,861	9,650	—	—
Total investment securities available for sale	$857,204	$846,268	$1,009,986	$993,990

Mortgage-backed securities ("MBS") and collateralized mortgage obligations ("CMO") represent securities issued by government sponsored enterprises ("GSEs"). Each of the MBS and CMO securities in our investment portfolio are guaranteed by Fannie Mae, Ginnie Mae or Freddie Mac. Municipal bonds are comprised of general obligation bonds (i.e., backed by the general credit of the issuer) and revenue bonds (i.e., backed by either collateral or revenues from the specific project being financed) issued by various municipal corporations. As of December 31, 2017 and 2016, substantially all securities held were either agency quality or rated investment grade by at least one Nationally Recognized Statistical Rating Organization ("NRSRO").

For information regarding the fair value of investment securities available for sale by contractual maturity along with the associated contractual yield for the periods, see Note 4, *Investment Securities* to the financial statements of this Form 10-K.

Each of the MBS and CMO securities in our investment portfolio are 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, thereby changing the net yield on such securities. At December 31, 2017, the aggregate net premium associated with our MBS portfolio was $8.0 million, or 4.4%, of the aggregate unpaid principal balance, compared with $10.1 million or 4.5% at December 31, 2016. The aggregate net premium associated with our CMO portfolio as of December 31, 2017 and 2016 was $4.8 million, or 1.8%, of the aggregate unpaid principal balance. 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 on a quarterly basis 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 December 31, 2017 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 securities' amortized cost basis. Accordingly, none of the unrealized losses as of December 31, 2017 were considered other than temporary.

Loans held for sale were $610.9 million at December 31, 2017 compared to $714.6 million at December 31, 2016, a decrease of $103.7 million, or 14.5%. Loans held for sale include single family and multifamily residential loans, typically sold within 30 days of closing the loan.

Loans held for investment, net increased $687.4 million, or 18.0%, from December 31, 2016. Our single family loan portfolio increased $297.5 million from 2016. Our commercial and industrial loan portfolio increased $149.8 million from 2016, primarily as a result of the organic growth of our Commercial and Consumer Banking Segment. Our construction loans, including commercial construction and residential construction, increased $51.3 million from 2016, primarily from new originations in our commercial real estate and residential construction lending business.

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

	At December 31,									
	2017		2016		2015		2014		2013	
(in thousands)	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
Consumer loans:										
Single family	$ 1,381,366 (1)	30.5 %	$ 1,083,822 (1)	28.2 %	$ 1,203,180	37.3 %	$ 896,665	42.2 %	$ 904,913	47.7 %
Home equity and other	453,489	10.0	359,874	9.3	256,373	8.0	135,598	6.4	135,650	7.1
	1,834,855	40.5	1,443,696	37.5	1,459,553	45.3	1,032,263	48.6	1,040,563	54.8
Commercial real estate loans:										
Non-owner occupied commercial real estate	622,782	13.8	588,672	15.4	445,903	13.8	379,664	17.8	320,942	16.8
Multifamily	728,037	16.1	674,219	17.5	426,557	13.2	55,088	2.6	79,216	4.2
Construction/ land development	687,631	15.2	636,320	16.5	583,160	18.1	367,934	17.3	130,465	6.9
	2,038,450	45.1	1,899,211	49.4	1,455,620	45.1	802,686	37.7	530,623	27.9
Commercial and industrial loans:										
Owner occupied commercial real estate	391,613	8.6	282,891	7.3	154,800	4.8	143,800	6.8	156,700	8.3
Commercial business	264,709	5.8	223,653	5.8	154,262	4.8	147,449	6.9	171,054	9.0
	656,322	14.4	506,544	13.1	309,062	9.6	291,249	13.7	327,754	17.3
Total loans before allowance, net deferred loan fees and costs	4,529,627	100.0 %	3,849,451	100.0 %	3,224,235	100.0 %	2,126,198	100.0 %	1,898,940	100.0 %
Net deferred loan fees and costs	14,686		3,577		(2,237)		(5,048)		(3,219)	
	4,544,313		3,853,028		3,221,998		2,121,150		1,895,721	
Allowance for loan losses	(37,847)		(34,001)		(29,278)		(22,021)		(23,908)	
	$ 4,506,466		$ 3,819,027		$ 3,192,720		$ 2,099,129		$ 1,871,813	

(1) Includes $5.5 million and $18.0 million of loans at December 31, 2017 and 2016 respectively, where a fair value option election was made at the time of origination and, therefore, are carried at fair value with changes recognized in the consolidated statements of operations.

The following table shows the composition of the loan portfolio by fixed-rate and adjustable-rate loans.

	At December 31,			
	2017		2016	
(in thousands)	Amount	Percent	Amount	Percent
Adjustable-rate loans:				
Single family	$998,237	22.0 %	$657,837	17.1 %
Non-owner occupied commercial real estate	545,076	12.0	512,005	13.3
Multifamily	696,267	15.4	655,271	17.0
Construction/land development, net [1]	596,913	13.2	497,175	12.9
Owner occupied commercial real estate	259,207	5.7	189,689	4.9
Commercial business	189,163	4.2	143,960	3.7
Home equity and other	415,441	9.2	303,565	7.9
Total adjustable-rate loans	3,700,304	81.7	2,959,502	76.8
Fixed-rate loans:				
Single family	383,129	8.5	425,985	11.1
Non-owner occupied commercial real estate	77,706	1.7	76,667	2.0
Multifamily	31,770	0.7	18,949	0.5
Construction/land development, net [1]	90,718	2.0	139,145	3.6
Owner occupied commercial real estate	132,406	2.9	93,201	2.4
Commercial business	75,546	1.7	79,693	2.1
Home equity and other	38,048	0.8	56,309	1.5
Total fixed-rate loans	829,323	18.3	889,949	23.2
Total loans held for investment	4,529,627	100.0 %	3,849,451	100.0 %
Less:				
Net deferred loan fees and costs	14,686		3,577	
Allowance for loan losses	(37,847)		(34,001)	
Loans held for investment, net	$4,506,466		$3,819,027	

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

The following tables show the contractual maturity of our loan portfolio by loan type.

	December 31, 2017				Loans due after one year by rate characteristic	
(in thousands)	Within one year	After one year through five years	After five years	Total	Fixed-rate	Adjustable-rate
Consumer:						
Single family	$1,854	$4,532	$1,374,980	$1,381,366	$381,275	$998,237
Home equity and other	1	80	453,408	453,489	38,047	415,441
Total consumer	1,855	4,612	1,828,388	1,834,855	419,322	1,413,678
Commercial real estate loans:						
Non-owner occupied commercial real estate	28,363	65,470	528,949	622,782	66,565	527,854
Multifamily	11,197	74,237	642,603	728,037	30,046	686,794
Construction/land development	528,813	144,824	13,994	687,631	62,810	96,008
Total commercial real estate	568,373	284,531	1,185,546	2,038,450	159,421	1,310,656
Commercial and industrial loans:						
Owner occupied commercial real estate	9,137	41,416	341,060	391,613	126,316	256,160
Commercial business	60,274	90,704	113,731	264,709	67,061	137,374
Total commercial and industrial	69,411	132,120	454,791	656,322	193,377	393,534
Total loans held for investment	$639,639	$421,263	$3,468,725	$4,529,627	$772,120	$3,117,868

	December 31, 2016				Loans due after one year by rate characteristic	
(in thousands)	Within one year	After one year through five years	After five years	Total	Fixed-rate	Adjustable-rate
Consumer:						
Single family	$7,327	$4,878	$1,071,618	$1,083,823	$418,923	$657,573
Home equity and other	7,156	27,879	324,838	359,873	52,922	299,795
Total consumer	14,483	32,757	1,396,456	1,443,696	471,845	957,368
Commercial real estate:						
Non-owner occupied commercial real estate	22,887	75,403	490,382	588,672	69,668	496,117
Multifamily	1,658	51,766	620,796	674,220	17,664	654,898
Construction/land development	483,211	151,785	1,324	636,320	74,003	79,106
Total commercial real estate	507,756	278,954	1,112,502	1,899,212	161,335	1,230,121
Commercial and industrial:						
Owner occupied commercial real estate	25,232	32,164	225,495	282,891	78,300	179,359
Commercial business	55,820	72,985	94,847	223,652	76,060	91,772
Total commercial and industrial	81,052	105,149	320,342	506,543	154,360	271,131
Total loans held for investment	$603,291	$416,860	$2,829,300	$3,849,451	$787,540	$2,458,620

The following table presents loan origination and loan sale volumes.

(in thousands)	Years Ended December 31, 2017	2016		2015
Loans originated				
Real estate				
Single family				
Originated by HomeStreet	$7,525,248	$8,637,631		$6,834,296
Originated by WMS Series LLC	566,152	576,832		606,316
Total single family	8,091,400	9,214,463		7,440,612
Multifamily	746,748	640,142		322,637
Non-owner occupied commercial real estate	208,130	271,701		134,068
Owner occupied commercial real estate	121,398	173,017		35,236
Construction/land development	1,084,092	1,079,243		767,063
Total real estate	10,251,768	11,378,566		8,699,616
Commercial business	227,880	116,595		105,021
Home equity and other	361,043	279,851		176,430
Total loans originated	$10,840,691	$11,775,012		$8,981,067
Loans sold				
Single family	$7,508,949	$8,785,412		$7,038,635
Multifamily DUS ® (1)	347,084	301,442		204,744
SBA	26,841	17,308		14,275
CRE Non-DUS® (2)	321,699	150,903	(3)	15,038
Total loans sold	$8,204,573	$9,255,065		$7,272,692

(1) Fannie Mae Multifamily Delegated Underwriting and Servicing Program ("DUS®") is a registered trademark of Fannie Mae.
(2) Loans originated as Held for Investment.
(3) Includes $63.2 million of single family portfolio loan sales in 2016.

Mortgage servicing rights were $284.7 million at December 31, 2017 compared to $245.9 million at December 31, 2016, an increase of $38.8 million, or 15.8%, as a result of growth in the loans serviced for others portfolio and changes in market inputs, including current market interest rates and prepayment model updates.

Federal Home Loan Bank stock was $46.6 million at December 31, 2017 compared to $40.3 million at December 31, 2016, an increase of $6.3 million, or 15.6%. 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.

Other assets were $188.5 million at December 31, 2017, compared to $221.1 million at December 31, 2016, a decrease of $32.6 million, or 14.7%.

Deposits

Deposit balances were as follows for the periods indicated:

(in thousands)	At December 31, 2017	2016	2015
Noninterest-bearing accounts - checking and savings	$579,504	$537,651	$370,523
Interest-bearing transaction and savings deposits:			
NOW accounts	461,349	468,812	408,477
Statement savings accounts due on demand	293,858	301,361	292,092
Money market accounts due on demand	1,834,154	1,603,141	1,155,464
Total interest-bearing transaction and savings deposits	2,589,361	2,373,314	1,856,033
Total transaction and savings deposits	3,168,865	2,910,965	2,226,556
Certificates of deposit	1,190,689	1,091,558	732,892
Noninterest-bearing accounts - other	401,398	427,178	272,505
Total deposits	$4,760,952	$4,429,701	$3,231,953

Deposits at December 31, 2017 increased $331.3 million, or 7.5%, from December 31, 2016. During 2017, the Company increased the balances of transaction and savings deposits by $257.9 million, or 8.9%. The $99.1 million, or 9.1%, increase in certificates of deposit since December 31, 2016 was due in part to increases in business and personal CDs, institutional CDs and brokered deposits.

At December 31, 2016, deposits increased $1.20 billion, or 37.1%, from December 31, 2015 primarily due to the acquisition related activities and growth of our deposit branch network. During 2016, the Company increased the balances of transaction and savings deposits by $684.4 million, or 30.7%, reflecting the growth and expansion of our branch banking network. The $358.7 million, or 48.9%, increase in certificates of deposit since December 31, 2015 was primarily due in part to increases in business and personal CDs, institutional CDs and brokered deposits.

Borrowings

FHLB advances were $979.2 million at December 31, 2017 compared to $868.4 million at December 31, 2016. FHLB advances may be collateralized by stock in the FHLB, cash, pledged mortgage-backed securities, real estate-secured commercial loans and unencumbered qualifying mortgage loans. As of December 31, 2017, 2016 and 2015, FHLB borrowings had weighted average interest rates of 1.58%, 0.91% and 0.64%, respectively. Of the total FHLB borrowings outstanding as of December 31, 2017, $963.6 million mature prior to December 31, 2018. We had $579.2 million and $282.8 million of additional borrowing capacity with the FHLB as of December 31, 2017 and 2016, respectively. We use short term funding to lower the cost of funds and manage the sensitivity of our net portfolio value and net interest income which mitigated the impact of changes in interest rates.

We may also borrow, on a collateralized basis, from the Federal Reserve Bank of San Francisco ("FRBSF" or "Federal Reserve Bank"). At December 31, 2017 and 2016, we did not have any outstanding borrowings from the FRBSF. Based on the amount of qualifying collateral available, borrowing capacity from the FRBSF was $331.5 million and $292.1 million at December 31, 2017 and 2016, respectively. The FRBSF is not contractually bound to offer credit to us, and our access to this source for future borrowings may be discontinued at any time.

Long-term debt was $125.3 million and $125.1 million at December 31, 2017 and 2016, respectively. The balance at December 31, 2017 represents $63.4 million of senior notes issued during 2016 and $61.9 million of junior subordinated debentures issued in prior years. Such debentures were issued in connection with the sale of trust preferred securities by HomeStreet Statutory Trusts, subsidiaries of HomeStreet, Inc. Trust preferred securities allow investors to buy subordinated debt through a variable interest entity trust that issues preferred securities to third-party investors and uses the cash received to purchase subordinated debt from the issuer. That debt is the sole asset of the trust and the coupon rate on the debt mirrors the dividend rate on the preferred securities. These securities are nonvoting and are not convertible into capital stock, and the variable interest entity trust is not consolidated in our financial statements.

Shareholders' Equity

Shareholders' equity was $704.4 million at December 31, 2017 compared to $629.3 million at December 31, 2016. This increase was primarily due to net income of $68.9 million and by other comprehensive income of $3.3 million recognized during the year ended December 31, 2017. Other comprehensive income (loss) represents unrealized gains and losses in the valuation of our available for sale investment securities portfolio at December 31, 2017.

Shareholders' equity, on a per share basis, was $26.20 per share at December 31, 2017, compared to $23.48 per share at December 31, 2016.

Return on Equity and Assets

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

	Years Ended December 31,		
	2017	2016	2015
Return on assets (1)	1.05 %	1.01 %	0.91 %
Return on equity (2)	10.20 %	10.27 %	9.35 %
Equity to assets ratio (3)	10.26 %	9.80 %	9.69 %

(1) Net income divided by average total assets.
(2) Net earnings available to common shareholders divided by average common shareholders' equity.
(3) Average equity divided by average total assets.

Business Segments

Our business segments are determined based on the products and services provided, as well as the nature of the related business activities, and they reflect the manner in which financial information is evaluated by management.

This process is dynamic and is based on management's view of the Company's operations and is not necessarily comparable with similar information for other financial institutions. We define our business segments by product type and customer segment. If the management structure or the allocation process changes, allocations, transfers and assignments may change.

We use various management accounting methodologies to assign certain income statement items to the responsible operating segment, including:

- a funds transfer pricing system, which allocates interest income credits and funding charges between the segments, assigning to each segment a funding credit for its liabilities, such as deposits, and a charge to fund its assets;
- an allocation of charges for services rendered to the segments by centralized functions, such as corporate overhead, which are generally based on each segment's consumption patterns; and
- an allocation of the Company's consolidated income taxes which are based on the effective tax rate applied to the segment's pretax income or loss.

Commercial and Consumer Banking Segment

Commercial and Consumer Banking provides diversified financial products and services to our commercial and consumer customers through bank branches and through ATMs, online, mobile and telephone banking. These products and services include deposit products; residential, consumer, business and agricultural portfolio loans; non-deposit investment products; insurance products and cash management services. We originate construction loans, bridge loans and permanent loans for our portfolio primarily on single family residences, and on office, retail, industrial and multifamily property types. We originate multifamily real estate loans through our Fannie Mae DUS® business, whereby loans are sold to or securitized by Fannie Mae, while the Company generally retains the servicing rights. In addition, through HomeStreet Commercial Capital, a division of HomeStreet Bank based in Orange County, California, we originate permanent commercial real estate loans primarily up to $10 million in size, a portion of which we pool and sell into the secondary market. We have a team specializing in U.S. Small Business Administration ("SBA") lending. As of December 31, 2017, our retail deposit branch network consists of 59 branches in the Pacific Northwest, California and Hawaii. At December 31, 2017 and December 31, 2016, our transaction and savings deposits totaled $3.17 billion and $2.91 billion, respectively, and our loan portfolio totaled $4.51 billion and $3.82 billion, respectively. This segment also reflects the results for the management of the Company's portfolio of investment securities.

Commercial and Consumer Banking segment results are detailed below.

(in thousands)	Years Ended December 31, 2017	Dollar Change	Percent Change	2016		Dollar Change	Percent Change	2015	
Net interest income	$174,542	$20,527	13 %	$154,015		$33,995	28 %	$120,020	
Provision for credit losses	750	(3,350)	(82)	4,100		(2,000)	(33)	6,100	
Noninterest income	42,360	6,678	19	35,682		6,315	22	29,367	
Noninterest expense	148,977	10,592	8	138,385		15,787	13	122,598	
Income before income tax expense	67,175	19,963	42	47,212		26,523	128	20,689	
Income tax expense	25,114	8,702	53	16,412		13,740	514	2,672	
Net income	$42,061	$11,261	37 %	$30,800		$12,783	71 %	$18,017	
Total assets	$5,875,329	$605,877	11 %	$5,269,452		$1,223,402	30 %	$4,046,050	
Efficiency ratio (1)	68.68 %			72.95 %				82.07 %	
Full-time equivalent employees (ending)	1,068	70	7 %	998		170	21 %	828	
Production volumes for sale to the secondary market:									
Loan originations									
Multifamily DUS ® (2)	$341,308	$15,457	5 %	$325,851		$121,013	59 %	$204,838	
SBA	39,009	25,279	184 %	13,730		13,730	NM	$—	
Loans sold									
Multifamily DUS ® (2)	$347,084	$45,642	15 %	$301,442		$96,698	47 %	$204,744	
SBA	26,841	9,533	55 %	17,308		3,033	21 %	14,275	
CRE Non-DUS (3)	321,699	170,796	113 %	150,903	(4)	135,865	903 %	15,038	
Net gain on mortgage loan origination and sale activities:									
Multifamily DUS ® (2)	$13,210	$1,813	16 %	$11,397		$4,272	60 %	$7,125	
SBA	2,439	1,025	72 %	1,414		344	32 %	1,070	
CRE Non-DUS (3)	4,378	319	8 %	4,059	(5)	3,600	784 %	459	(5)
	$20,027	$3,157	19 %	$16,870		$8,216	95 %	$8,654	

(1) Noninterest expense divided by total net revenue (net interest income and noninterest income).
(2) Fannie Mae Multifamily Delegated Underwriting and Servicing Program (“DUS®) is a registered trademark of Fannie Mae.
(3) Loans originated as Held for Investment.
(4) Includes $63.2 million of single family portfolio loan sales in 2016.
(5) Includes $2.8 million net gain on sale of single family portfolio loan during fourth quarter of 2016 and $27 thousand during fourth quarter of 2015.

Comparison of 2017 to 2016

Commercial and Consumer Banking net income increased in 2017 primarily due to increased net interest income resulting from higher average balances of interest-earning assets, partially offset by increased noninterest expense. These increases were primarily due to organic growth. Included in net income for the year ended December 31, 2017 and 2016 were $391 thousand and $4.6 million, respectively, in acquisition related expenses, net of tax. Additionally, the year ended December 31, 2017 included a $4.2 million, one-time, non-cash, income tax expense related to the Tax Reform Act.

The segment recorded a provision for credit losses of $750 thousand for the year ended December 31, 2017 compared to a $4.1 million provision for credit losses for the year ended December 31, 2016. The reduction in credit loss provision in the year was due in part to continued improvements in credit quality reflected in the qualitative reserves and historical loss rates combined with an increase of $2.6 million in net recoveries over the comparable period.

Resulting from the growth of this segment, noninterest income increased for the year ended December 31, 2017 due primarily to an increase in gain on sale income driven by higher commercial real estate loan sales volume.

Noninterest expense increased primarily due to the growth of our commercial real estate and commercial business lending units and the expansion of our retail deposit banking network. In 2017, we added four retail deposit branches, three de novo and one acquired retail branch. Full-time equivalent employees increased by 70, or 7.0%, from 2016. Included in noninterest expense for 2017 and 2016 was $602 thousand and $7.1 million, respectively, of acquisition-related costs.

Comparison of 2016 to 2015

Commercial and Consumer Banking net income was $30.8 million for the year ended December 31, 2016, an increase of $12.8 million from $18.0 million for the year ended December 31, 2015. The increase in 2016 was primarily due to increased net interest income resulting from higher average balances of interest-earning assets and higher commercial net gain on loan origination and sale activities, partially offset by increased noninterest expense primarily resulting from the expansion of this segment.

The segment recorded a provision for credit losses of $4.1 million for the year ended December 31, 2016 compared to a $6.1 million provision for credit losses for the year ended December 31, 2015. The reduction in credit loss provision in the year was due in part to a continuing decline in historical loss rates as a result of net recoveries for the past two years and continued improvements in portfolio performance which was reflected in the qualitative reserves. In 2015, one-time model adjustments contributed to an increase in provision expense.

Resulting from the growth of this segment, noninterest income increased for the year ended December 31, 2016 due primarily to increases in net gain on loan origination and sale activities, mortgage servicing income and depositor and other retail banking fees. Included in noninterest income for the year ended December 31, 2015 was a bargain purchase gain of $7.7 million from the merger with Simplicity and the Dayton, Washington branch acquisition. There were no similar bargain purchase gains in 2016.

Noninterest expense increased primarily due to the growth of our commercial real estate and commercial business lending units and the expansion of our retail deposit banking network. In 2016, we added 11 retail deposit branches, six de novo and five from acquisitions. Full-time equivalent employees increased by 170, or 20.5%, from 2015. Included in noninterest expense for 2016 was $7.1 million of acquisition-related costs. In 2015, such acquisition-related expenses related to prior acquisitions were $16.6 million.

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

	At December 31,	
(in thousands)	2017	2016
Commercial		
Multifamily DUS®	$1,311,399	$1,108,040
Other	79,797	69,323
Total commercial loans serviced for others	$1,391,196	$1,177,363

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

	Years Ended December 31,		
(in thousands)	2017	2016	2015

		Dollar Change	Percent Change		Dollar Change	Percent Change	
Servicing income, net:							
Servicing fees and other	$7,263	$1,649	29 %	$5,614	$1,335	31 %	$4,279
Amortization of multifamily and SBA MSRs	(3,932)	(1,297)	49	(2,635)	(643)	32	(1,992)
Commercial mortgage servicing income	$3,331	$352	12 %	$2,979	$692	30 %	$2,287

Mortgage Banking Segment

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

Mortgage Banking segment results are detailed below.

(in thousands)	Years Ended December 31, 2017	Dollar Change	Percent Change	2016	Dollar Change	Percent Change	2015
Net interest income	$19,896	$(6,138)	(24)%	$26,034	$(2,284)	(8)%	$28,318
Noninterest income	269,794	(53,674)	(17)	323,468	71,598	28	251,870
Noninterest expense	290,676	(15,261)	(5)	305,937	61,967	25	243,970
Income (loss) before income tax (benefit) expense	(986)	(44,551)	(102)	43,565	7,347	20	36,218
Income tax (benefit) expense	(27,871)	(44,085)	(272)	16,214	3,298	26	12,916
Net income	$26,885	$(466)	(2)%	$27,351	$4,049	17 %	$23,302
Total assets	$866,712	$(107,536)	(11)%	$974,248	$125,803	15 %	$848,445
Efficiency ratio [1]	100.34 %			87.54 %			87.07 %
Full-time equivalent employees (ending)	1,351	(203)	(13)%	1,554	243	19 %	1,311
Production volumes for sale to the secondary market:							
Single family mortgage closed loan volume [2][3]	$7,554,185	$(1,443,162)	(16)%	$8,997,347	$1,784,912	25 %	$7,212,435
Single family mortgage interest rate lock commitments[2]	6,980,477	(1,640,499)	(19)	8,620,976	1,689,868	24	6,931,108
Single family mortgage loans sold[2]	$7,508,949	$(1,276,463)	(15)%	$8,785,412	$1,778,075	25 %	$7,007,337

(1) Noninterest expense divided by total net revenue (net interest income and noninterest income).
(2) Includes loans originated by WMS Series LLC and purchased by HomeStreet Bank and brokered loans where HomeStreet receives fee income but does not fund the loan on its balance sheet or sell it into the secondary market.
(3) Represents single family mortgage production volume designated for sale to the secondary market during each respective period.

Comparison of 2017 to 2016

The decrease in Mortgage Banking net income for 2017 compared to 2016 was primarily due to $1.64 billion of lower rate lock and purchase loan commitments and related lower noninterest expense resulting from lower commission expense from the decreased closed loan volume, partially offset by the recognition of a one-time, non-cash, tax benefit of $27.9 million from the revaluation of our net deferred tax liability position at December 31, 2017 related to the Tax-Reform Act. In 2017, we implemented a restructuring plan to better align our costs structure with market conditions, including a reduction in staffing, production office closures and a streamlining of the single family leadership team. Included in net income for the year ended December 31, 2017, was restructuring-related items, net of tax, of $2.4 million. There were no similar charges in 2016.

74

Comparison of 2016 to 2015

The increase in Mortgage Banking net income for 2016 compared to 2015 was primarily due to the higher gain on single family mortgage loan origination and sale activities resulting from higher interest rate lock commitments and higher servicing fee income, partially offset by higher noninterest expense resulting from higher commission expense from increased closed loan volume, as well as continued growth and expansion of our mortgage banking segment, increased costs resulting from new regulatory disclosure requirements for the mortgage industry and lower risk management results.

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

(in thousands)	Years Ended December 31, 2017	Dollar Change	Percent Change	2016	Dollar Change	Percent Change	2015
Single family: [1]							
Servicing value and secondary market gains[2]	$209,027	$(51,450)	(20)%	$260,477	$54,964	27 %	$205,513
Loan origination and funding fees	26,822	(3,144)	(10)	29,966	7,745	35	22,221
Total mortgage banking gain on mortgage loan origination and sale activities[1]	$235,849	$(54,594)	(19)%	$290,443	$62,709	28 %	$227,734

(1) Excludes inter-segment activities.

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

Comparison of 2017 to 2016

The decrease in gain on mortgage loan origination and sale activities in 2017 compared to 2016 is primarily the result of a 19.0% decrease in interest rate lock commitments primarily due to the impact of higher interest rates, which reduced the volume of refinance activity in 2017. During 2017, as a result of our restructuring, we have decreased our lending footprint by a net of three home loan centers to bring our total primary home loan centers to 44 as of December 31, 2017.

Comparison of 2016 to 2015

The increase in gain on mortgage loan origination and sale activities in 2016 compared to 2015 is primarily the result of a 24.4% increase in interest rate lock commitments, which was mainly driven by the expansion of our mortgage production offices and personnel. During 2016, we increased our lending footprint to bring our total primary home loan centers to 48 as of December 31, 2016.

Mortgage Banking servicing income consisted of the following.

(in thousands)	Years Ended December 31, 2017	Dollar Change	Percent Change	2016	Dollar Change	Percent Change	2015
Servicing income, net:							
Servicing fees and other	$58,929	$10,889	23 %	$48,040	$10,303	27 %	$37,737
Changes in fair value of MSRs due to amortization (1)	(35,451)	(2,146)	6	(33,305)	733	(2)	(34,038)
	23,478	8,743	59	14,735	11,036	298	3,699
Risk management:							
Changes in fair value of MSRs due to changes in market inputs and/or model updates (2)	(1,157)	(21,182)	(106)	20,025	13,470	205	6,555
Net gain (loss) from derivatives economically hedging MSRs	9,732	14,412	(308)	(4,680)	(16,389)	(140)	11,709
	8,575	(6,770)	(44)	15,345	(2,919)	(16)	18,264
Mortgage Banking servicing income	$32,053	$1,973	7 %	$30,080	$8,117	37 %	$21,963

(1) Represents changes due to collection/realization of expected cash flows and curtailments.
(2) Principally reflects changes in model assumptions, including prepayment speed assumptions, which are primarily affected by changes in mortgage interest rates.

Comparison of 2017 to 2016

The increase in Mortgage Banking servicing income in 2017 compared to 2016 was primarily attributable to higher servicing income, net, offset by lower risk management results. The higher servicing income was primarily attributed to higher servicing fees on higher average balances of loans serviced for others. The lower risk management results were due in part to gains from prepayment model refinements in 2016 to align borrower prepayment behavior with observed borrower prepayment behavior. Mortgage servicing fees collected in the year ended December 31, 2017 increased compared to the year ended December 31, 2016 primarily as a result of higher average balances of loans serviced for others during the year. Our single family loans serviced for others portfolio was $22.63 billion at December 31, 2017 compared to $19.49 billion at December 31, 2016.

MSR risk management results represent changes in the fair value of single family MSRs due to changes in model inputs and assumptions net of the gain/(loss) from derivatives economically hedging MSRs. The fair value of MSRs is sensitive to changes in interest rates, primarily due to the effect on prepayment speeds. MSRs typically decrease in value when interest rates decline because declining interest rates tend to increase mortgage prepayment speeds and therefore reduce the expected life of the net servicing cash flows of the MSR asset. Certain other changes in MSR fair value relate to factors other than interest rate changes and are generally not within the scope of the Company's MSR economic hedging strategy. These factors may include but are not limited to the impact of changes to the housing price index, prepayment model assumptions, the level of home sales activity, changes to mortgage spreads, valuation discount rates, costs to service and policy changes by U.S. government agencies.

Comparison of 2016 to 2015

The increase in Mortgage Banking servicing income in 2016 compared to 2015 was primarily due to higher servicing income, partially offset by lower risk management results. The higher servicing income was primarily attributed to higher servicing fees on higher average balances of loans serviced for others and lower modeled amortization. Mortgage servicing fees collected in the year ended December 31, 2016 increased compared to the year ended December 31, 2015 primarily as a result of higher average balances of loans serviced for others during the year. Our loans serviced for others portfolio was $20.67 billion at December 31, 2016 compared to $16.35 billion at December 31, 2015.

The lower risk management results in 2016 were mainly due to adverse results during the fourth quarter driven by the unexpected and significant increases in long-term Treasury rates beginning in November 2016 following the U.S.

presidential election, coinciding with an increase in short-term interest rates by the Federal Reserve in December 2016. The unexpected and sustained increase in interest rates during the quarter resulted in asymmetrical changes in valuation between hedging derivatives and servicing valuations. This market dislocation in the fourth quarter reduced the value of our hedging derivatives to a greater extent than value of our mortgage servicing rights increased, resulting in lower risk management results.

Model assumptions are regularly updated to better align observed borrower prepayment behavior with modeled borrower prepayment behavior.

Single family loans serviced for others consisted of the following.

	At December 31,	
(in thousands)	2017	2016
Single family		
U.S. government and agency	$22,123,710	$18,931,835
Other	507,437	556,621
Total single family loans serviced for others	$22,631,147	$19,488,456

Comparison of 2017 to 2016

Mortgage Banking noninterest expense in 2017 decreased from 2016 primarily due to decreased commissions, salary and related costs on lower closed loan volumes, partially offset by a $3.7 million charge related to the restructuring of our mortgage segment and other costs related to the implementation of a new loan origination system. In 2017, as a result of our mortgage banking restructuring, we have decreased our lending footprint by a net of three home loan centers to bring our total primary home loan centers to 44 as of December 31, 2017.

Comparison of 2016 to 2015

Mortgage Banking noninterest expense in 2016 increased from 2015 primarily due to the continued expansion of offices in new markets and increases of our mortgage production and support staff along with related salary, insurance, and benefit costs as well as increased costs resulting from new regulatory disclosure requirements for the mortgage industry. In 2016, we increased our lending footprint by adding home loan centers to bring our total primary home loan centers to 48.

Off-Balance Sheet Arrangements

In the normal course of business, we are a party to financial instruments with off-balance sheet risk. These financial instruments (which include commitments to originate loans and commitments to purchase loans) include potential credit risk in excess of the amount recognized in the accompanying consolidated financial statements. These transactions are designed to (1) meet the financial needs of our customers, (2) manage our credit, market or liquidity risks, (3) diversify our funding sources and/or (4) optimize capital.

For more information on off-balance sheet arrangements, see Note 13, *Commitments*, *Guarantees and Contingencies* to the financial statements of this Form 10-K.

Commitments, Guarantees and Contingencies

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

- *Unfunded loan commitments.* We make certain unfunded loan commitments as part of our lending activities that have not been recognized in the Company's financial statements. These include commitments to extend credit made as part of our lending activities on loans we intend to hold in our loans held for investment portfolio. The aggregate amount of these unrecognized unfunded loan commitments existing at December 31, 2017 and 2016 was $56.9 million and $42.6 million, respectively.
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Credit agreements. We extend secured and unsecured open-end loans to meet the financing needs of our customers. These commitments, which primarily related to unused home equity and commercial real estate lines of credit and business banking funding lines, totaled \$456.1 million and \$289.3 million at December 31, 2017 and 2016, respectively. Undistributed construction loan proceeds, where the Company has an obligation to advance funds for construction progress payments, was \$706.7 million and \$603.8 million at December 31, 2017 and 2016, respectively. The total amounts of unused commitments do not necessarily represent future credit exposure or cash requirements in that commitments may expire without being drawn upon.

Interest rate lock commitments. The Company writes options in the form of interest rate lock commitments on single family mortgage loans that are exercisable at the option of the borrower. We are exposed to market risk on interest rate lock commitments. The fair value of interest rate lock commitments existing at December 31, 2017 and 2016, was $12.9 million and $19.2 million, respectively. We mitigate the risk of future changes in the fair value of interest rate lock commitments primarily through the use of forward sale commitments.

Credit loss sharing. We originate, sell and service multifamily loans through the Fannie Mae DUS program. Multifamily loans are sold to Fannie Mae subject to a loss sharing arrangement. 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, in general the DUS lender is contractually responsible for all losses on the first 5% of the unpaid principal balance of the loan (determined as of the day prior to valuation of the asset for loss purposes) and then shares in the remainder of losses with Fannie Mae with the lender being responsible for 25% of any losses that exceed 5% of the unpaid principal balance up to 20% of the unpaid principal balance and 10% of any losses that exceed 20% of the unpaid principal balance. The maximum lender loss on most DUS program loans is 20% of the original principal balance. The total principal balance of loans outstanding under the DUS program as of December 31, 2017 and 2016 was $1.31 billion and $1.11 billion, respectively, and our loss reserve was $2.0 million and $1.8 million as of December 31, 2017 and 2016, respectively.

Mortgage repurchase liability. In our single family lending business, we sell residential mortgage loans to government sponsored and other entities. In addition, the Company pools Federal Housing Administration ("FHA")-insured and Department of Veterans' Affairs ("VA")-guaranteed mortgage loans into Ginnie Mae, Fannie Mae and Freddie Mac guaranteed mortgage-backed securities. We have made representations and warranties that the loans sold meet certain requirements. We may be required to repurchase mortgage loans or indemnify loan purchasers due to defects in the origination process of the loan, such as documentation errors, underwriting errors and judgments, early payment defaults and fraud.

These obligations expose us to mark-to-market and credit losses on the repurchased mortgage loans after accounting for any mortgage insurance that we may receive. Generally, the maximum amount of future payments we would be required to make for breaches of these representations and warranties would be equal to the unpaid principal balance of such loans that are deemed to have defects that were sold to purchasers plus, in certain circumstances, accrued and unpaid interest on such loans and certain expenses.

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

As of December 31, 2017 and 2016, the total principal balance of loans sold on a servicing-retained basis that were subject to the terms and conditions of these representations and warranties totaled $22.71 billion and $19.56 billion, respectively. The recorded mortgage repurchase liability for loans sold on a servicing-retained and a servicing-released basis was $3.0 million and $3.4 million at December 31, 2017 and 2016, respectively. The Company's mortgage repurchase liability reflects management's estimate of losses for loans sold on a servicing-retained and servicing-released basis for which we could have a repurchase obligation. Actual repurchase losses of $541 thousand, $1.1 million and $1.8 million were incurred for the years ended December 31, 2017, 2016 and 2015, respectively.

Leases. The Company is obligated under non-cancelable leases for office space and leased equipment. The office leases also contain renewal and space options. Rental expense under non-cancelable operating leases totaled $26.1

million, $22.7 million and $20.1 million for the years ended December 31, 2017, 2016 and 2015, respectively.

- *Small business investment company ("SBIC") investment funds.* In 2017 and 2016, we entered into agreements to invest $8.3 million and $5.0 million, respectively, over time in qualifying small businesses and small enterprises. At December 31, 2017 and 2016 we had unfunded commitments of $11.0 million and $4.0 million, respectively, related to these agreements.

78

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 collateral to certain counterparties for amounts in excess of exposure limits as outlined by the counterparty credit policies of the parties. We have entered into agreements with derivative counterparties that include netting arrangements whereby the counterparties are entitled to settle certain positions on a net basis. At December 31, 2017 and 2016, our net exposure to the credit risk of derivative counterparties was $19.8 million and $69.4 million, respectively.

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, 2017. 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	More than five years	Total
Deposits (1)	$4,460,052	$ 269,919	$ 30,827	$154	$4,760,952
FHLB advances	963,611	10,000	—	5,590	979,201
Long term debt	—	—	—	65,000	65,000
Trust preferred securities (2)	—	—	—	61,857	61,857
Interest (3)	14,815	15,990	13,457	41,526	85,788
Operating leases	26,477	44,589	32,752	48,752	152,570
Purchase obligations (4)	14,768	8,278	782	—	23,828
Total	$5,479,723	$ 348,776	$ 77,818	$222,879	$6,129,196

(1) Deposits with indeterminate maturities, such as demand, savings and money market accounts, are reflected as obligations due less than one year.
(2) Trust preferred securities are included in long-term debt on the consolidated statements of financial condition.
(3) Represents the future interest obligations related to interest-bearing time deposits and long-term debt in the normal course of business. These interest obligations assume no early debt redemption. We estimated variable interest rate payments using December 31, 2017 rates, which we held constant until maturity.
(4) Represents agreements to purchase goods or services.

Enterprise Risk Management

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

Our Board of Directors (the "Board") and executive management have overall and ultimate responsibility for management of these risks. The Board, its committees and senior managers oversee the management of various risks. The Company utilizes a risk management framework which includes three lines of defense. The business units, which are the first line of defense, have responsibility to identify, monitor, control and escalate risks in their respective areas. The second line of defense, comprised of independent risk management functions, operating under the Chief Risk

Officer, establishes the risk governance framework and assesses, tests and reports on risks by business unit and on an enterprise-wide basis. Our internal audit department provides independent assurance that the risk framework, policies, procedures and controls are appropriate and operating as intended and is considered the third line of defense. The Chief Risk Officer reports directly to the Enterprise Risk Management Committee of the Board and is responsible for oversight of enterprise risk management, compliance, Bank Secrecy Act, quality control and regulatory affairs functions. The Chief Audit Officer reports directly to the Audit Committee of the Board.

The Board and its committees work closely with senior management in overseeing risk. Management recommends the appropriate level of risk in our strategic and business plans and in our board-approved credit and operating policies and has responsibility for measuring, managing, controlling and reporting on risks. The Board and its committees oversee the monitoring and controlling of significant risk exposures, including the policies governing risk management. The Board authorizes its committees to take any action on its behalf as described in their respective charter or as otherwise delegated by the Board, except as otherwise specifically reserved by law, regulation, other committees' charters or the Company's charter documents for action solely by the full board or another board committee. These committees include:

- *Audit Committee.* The Audit Committee oversees the policies and management activities relating to our financial reporting and internal and external audit.
- *Finance Committee.* The Finance Committee oversees the consolidated companies' activities related to balance sheet management, major financial risks including market, interest rate, liquidity and funding risks and counterparty risk management, including trading limits.
- *Credit Committee.* The Credit Committee oversees the annual Loan Review Plan, lending policies, credit performance and trends, the allowance for credit loss policy and loan loss reserves, large borrower exposure and concentrations, and approval of broker/dealer relationships.
- *Human Resources and Corporate Governance Committee*. The Human Resources and Corporate Governance Committee (the "HRCG") of HomeStreet, Inc. 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.
- *Enterprise Risk Management Committee.* The Enterprise Risk Management Committee (the "ERMC") oversees the Company's enterprise-wide risk management framework, including evaluating management's identification and assessment of the significant risks and the related infrastructure to address such risks and monitors the Company's compliance with its risk appetite and risk limit structures and effective remediation of non-compliance on an ongoing, enterprise-wide, and individual entity basis. The ERMC also oversees policies and management activities relating to operational, regulatory, legal and compliance risks. The ERMC does not duplicate the risk oversight of the Board's other committees, but rather helps ensure end-to-end understanding and oversight of all risk issues in one Board committee and enhances the Board's and management's understanding of the Company's aggregate enterprise-wide risk profile.

The following is a discussion of our risk management practices. 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 may have on our business.

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 Company, 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 primarily centrally governed. Our overall credit process includes comprehensive credit policies, judgmental or statistical credit underwriting, frequent and detailed risk measurement and modeling and loan review, quality control and audit processes. In addition, we have an independent loan review function that reports directly to the Credit Committee of the Board, and internal auditors and 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, ensuring compliance with regulatory requirements and the Company's established credit policies, standards and limits, determining the reasonableness of 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's role also includes direct oversight of appraisal and environmental functions. The Chief Credit Officer reports directly to the Chief Executive Officer.

The Loan Committee 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 Loan Committee periodically approves credits larger than the Chief Credit Officer’s or Chief Executive Officer’s individual approval authorities allow. The members of the Loan Committee are the Chief Executive Officer, Chief Credit Officer and the Commercial Banking Director.

The loan review department'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 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 Credit Committee and administratively to the Chief Credit Officer.

Credit limits for capital markets counterparties, including derivative counterparties, are defined in the Company's Counterparty Risk policy, which is reviewed annually by the Bank Loan Committee, with final approval by the Board Credit Committee. The treasury function is responsible for directing the activities related to securities and derivative portfolios, including overseeing derivative portfolio performance and ensuring compliance with established credit policies, standards and limits. The Chief Investment Officer and Treasurer reports directly to both the Chief Executive Officer and Chief Financial Officer.

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 and FDIC regulatory requirements. Our Chief Appraiser, who is independent of the business units, is responsible for maintaining the appraisal policy and recommending changes to the policy subject to Loan Committee and Credit Committee approval.

Real Estate

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

We review all appraisals and evaluations prior to the closing of a loan transaction. Commercial and single family real estate appraisals and evaluations are reviewed by either our in-house appraisal staff or by independent and qualified third-party appraisers.

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

- We generally do not perform valuation monitoring for pass-graded credits because we believe they carry minimal credit risk.

- For commercial loans secured by real estate that are graded special mention, an appraisal is performed at the time of loan downgrade, and an appraisal or evaluation is performed at least every two years thereafter, depending upon property complexity, market area, market conditions, intended use and other considerations.
- For commercial loans secured by real estate that are graded substandard or doubtful and for all OREO properties, we require an independent third-party appraisal at the time of downgrade or transfer to OREO and at least every twelve months thereafter until disposition or loan upgrade. For loans where foreclosure is probable, an appraisal or evaluation is prepared at the intervening six-month period prior to foreclosure.
- For performing consumer segment loans secured by real estate that are graded special mention or substandard, property values are determined semi-annually from automated valuation model services employed by the Bank.

• 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 appraisal or evaluation 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, 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.

Loan Modifications

We have modified loans for various reasons for borrowers not experiencing financial difficulties. Those modifications generally are short-term extensions granted to allow time for receipt of appraisals and other financial reporting information to facilitate underwriting of loan extensions and renewals.
Our policy allows modifications for borrowers with financial difficulty when there is a well-conceived and prudent workout plan that supports the ultimate collection of principal and interest. We may enter into a loan modification 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 Company 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. For single family mortgage borrowers, we have generally provided for granting 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.

Asset Quality and Nonperforming Assets

Nonperforming assets ("NPAs") were $15.7 million, or 0.23% of total assets at December 31, 2017, compared to $25.8 million, or 0.41% of total assets at December 31, 2016. Nonaccrual loans of $15.0 million, or 0.33% of total loans at December 31, 2017, decreased $5.5 million, or 26.8%, from $20.5 million, or 0.53% of total loans at December 31, 2016. Net recoveries in 2017 were $3.1 million compared with net recoveries of $505 thousand in 2016 and net recoveries of $2.0 million in 2015.

At December 31, 2017, our loans held for investment portfolio, net of the allowance for loan losses, was $4.51 billion, an increase of $687.4 million from December 31, 2016. The allowance for loan losses was $37.8 million, or 0.83% of loans held for investment, compared to $34.0 million, or 0.88% of loans held for investment at December 31, 2016.

The Company recorded a provision for credit losses of $750 thousand for the year ended December 31, 2017 compared to a $4.1 million of provision for credit losses for the year ended December 31, 2016 and a $6.1 million provision for credit losses for the year ended December 31, 2015. Management considers the current level of the allowance for loan losses to be appropriate to cover estimated incurred losses inherent within our loans held for investment portfolio.

For information regarding the activity on our allowance for credit losses, which includes the reserves for unfunded commitments, and the amounts that were collectively and individually evaluated for impairment, see Note 5, *Loans and Credit Quality* to the financial statements of this Form 10-K.

The allowance for credit losses represents management’s estimate of the incurred credit losses inherent within our loan portfolio. For further discussion related to credit policies and estimates see "*Critical Accounting Policies and*

Estimates ~~A~~llowance for Loan Losses" within Management's Discussion and Analysis of this Form 10-K.

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

	At December 31, 2017		
(in thousands)	Recorded Investment	Unpaid Principal Balance (2)	Related Allowance
Impaired loans:			
Loans with no related allowance recorded	$78,696 (3)	$80,904	$ —
Loans with an allowance recorded	5,150	5,288	289
Total	$83,846 (1)	$86,192	$ 289

	At December 31, 2016		
(in thousands)	Recorded Investment	Unpaid Principal Balance (2)	Related Allowance
Impaired loans:			
Loans with no related allowance recorded	$86,723	$92,431	$ —
Loans with an allowance recorded	3,785	3,875	379
Total	$90,508 (1)	$96,306	$ 379

	At December 31, 2015		
(in thousands)	Recorded Investment	Unpaid Principal Balance (2)	Related Allowance
Impaired loans:			
Loans with no related allowance recorded	$90,547	$94,058	$ —
Loans with an allowance recorded	3,126	3,293	567
Total	$93,673 (1)	$97,351	$ 567

(1) Includes $69.6 million, $73.1 million and $74.7 million in single family performing troubled debt restructurings ("TDRs") at December 31, 2017, 2016 and 2015, respectively.

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

(3) Includes $231 thousand of fair value option loans.

The Company had 335 impaired loan relationships totaling $83.8 million at December 31, 2017 and 282 impaired loan relationships totaling $90.5 million at December 31, 2016. Included in the total impaired loan relationship amounts were 297 single family TDR loan relationships totaling $72.0 million at December 31, 2017 and 239 single family TDR relationships totaling $76.0 million at December 31, 2016. The increase in the number of impaired loan relationships at December 31, 2017 from 2016 was primarily due to an increase in the number of single family impaired loans. At December 31, 2017, there were 286 single family impaired relationships totaling $69.6 million that were performing per their current contractual terms. Additionally, the impaired loan balance included $46.7 million of loans insured by the FHA or guaranteed by the VA. The average recorded investment in these loans for the year ended December 31, 2017 was $89.8 million, compared to $94.4 million for the year ended December 31, 2016. Impaired loans of $5.2 million and $3.8 million had a valuation allowance of $289 thousand and $379 thousand at

December 31, 2017 and 2016, respectively.

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

	At December 31,								
	2017			2016			2015		
(in thousands)	Amount	Percent of Allowance to Total Allowance	Loan Category as a % of Total Loans (1)	Amount	Percent of Allowance to Total Allowance	Loan Category as a % of Total Loans (1)	Amount	Percent of Allowance to Total Allowance	Loan Category as a % of Total Loans (1)
Consumer loans									
Single family	$9,412	24.1 %	30.4 %	$8,196	23.2 %	27.8 %	$8,942	29.2 %	36.9 %
Home equity and other	7,081	18.1	10.0	6,153	17.4	9.4	4,620	15.1	8.0
	16,493	42.2	40.4	14,349	40.6	37.2	13,562	44.3	44.9
Commercial real estate loans									
Non-owner occupied commercial real estate	4,755	12.1	13.8	4,481	12.7	15.4	3,594	11.7	13.9
Multifamily	3,895	10.0	16.1	3,086	8.8	17.6	1,194	3.9	13.3
Construction/land development	8,677	22.2	15.2	8,553	24.3	16.6	9,271	30.2	18.2
	17,327	44.3	45.1	16,120	45.8	49.6	14,059	45.8	45.4
Commercial and industrial loans									
Owner occupied commercial real estate	2,960	7.5	8.7	2,199	6.2	7.4	1,253	4.1	4.9
Commercial business	2,336	6.0	5.9	2,596	7.4	5.8	1,785	5.8	4.8
	5,296	13.5	14.5	4,795	13.6	13.2	3,038	9.9	9.7
Total allowance for credit losses	$39,116	100.0 %	100.0 %	$35,264	100.0 %	100.0 %	$30,659	100.0 %	100.0 %

(1) Excludes loans held for investment balances that are carried at fair value.

The following tables present the composition of TDRs by accrual and nonaccrual status.

(in thousands)	At December 31, 2017 Accrual	Number of accrual relationships	Nonaccrual	Number of nonaccrual relationships	Total	Total number of relationships
Consumer						
Single family [1]	$69,555	280	$ 2,451	11	$72,006	291
Home equity and other	1,254	16	36	2	1,290	18
	70,809	296	2,487	13	73,296	309
Commercial real estate loans						
Multifamily	507	1	—	—	507	1
Construction/land development	454	1	—	—	454	1
	961	2	—	—	961	2
Commercial and industrial loans						
Owner occupied commercial real estate	876	1	—	—	876	1
Commercial business	377	3	62	1	439	4
	1,253	4	62	1	1,315	5
	$73,023	302	$ 2,549	14	$75,572	316

(1) Includes loan balances insured by the FHA or guaranteed by the VA of $46.7 million at December 31, 2017.

(in thousands)	At December 31, 2016 Accrual	Number of accrual relationships	Nonaccrual	Number of nonaccrual relationships	Total	Total number of relationships
Consumer						
Single family [1]	$73,147	229	$ 2,885	10	$76,032	239
Home equity and other	1,247	18	216	3	1,463	21
	74,394	247	3,101	13	77,495	260
Commercial real estate loans						
Multifamily	508	1	—	—	508	1
Construction/land development	1,186	1	707	1	1,893	2
	1,694	2	707	1	2,401	3
Commercial and industrial loans						
Owner occupied commercial real estate	—	—	933	1	933	1
Commercial business	493	4	133	1	626	5
	493	4	1,066	2	1,559	6
	$76,581	253	$ 4,874	16	$81,455	269

(1) Includes loan balances insured by the FHA or guaranteed by the VA of $35.1 million at December 31, 2016.

(in thousands)	At December 31, 2015 Accrual	Number of accrual relationships	Nonaccrual	Number of nonaccrual relationships	Total	Total number of relationships
Consumer						
Single family [(1)]	$ 74,685	213	$ 2,452	11	$ 77,137	224
Home equity and other	1,340	20	271	4	1,611	24
	76,025	233	2,723	15	78,748	248
Commercial real estate loans						
Multifamily	3,014	2	—	—	3,014	2
Construction/land development	3,714	3	—	—	3,714	3
	6,728	5	—	—	6,728	5
Commercial and industrial loans						
Owner occupied commercial real estate	—	—	1,023	1	1,023	1
Commercial business	1,658	4	185	1	1,843	5
	1,658	4	1,208	2	2,866	6
	$84,411	242	$ 3,931	17	$88,342	259

(1) Includes loan balances insured by the FHA or guaranteed by the VA of $29.6 million at December 31, 2015.

The increase in the number of TDR loan relationships at December 31, 2017 from 2016 and 2015 was primarily due to an increase in the number of single family loan TDRs. TDR loans within the loans held for investment portfolio and the related reserves are included in the impaired loan tables above. At December 31, 2017 and 2016 and 2015, the Company had no unfunded commitments related to TDR loans.

	At December 31,				
(in thousands)	2017	2016	2015	2014	2013
Loans accounted for on a nonaccrual basis: [1]					
Consumer					
Single family	$11,091	$12,717	$12,119	$8,368	$8,861
Home equity and other	1,404	1,571	1,576	1,526	1,846
	12,495	14,288	13,695	9,894	10,707
Commercial real estate loans					
Non-owner occupied commercial real estate	—	871	—	193	3,200
Multifamily	302	337	119	—	—
Construction/land development	78	1,376	339	—	—
	380	2,584	458	193	3,200
Commercial and industrial loans					
Owner occupied commercial real estate	640	1,256	2,341	4,650	9,057
Commercial business	1,526	2,414	674	1,277	2,743
	2,166	3,670	3,015	5,927	11,800
Total loans on nonaccrual	15,041	20,542	17,168	16,014	25,707
Other real estate owned	664	5,243	7,531	9,448	12,911
Total nonperforming assets	$15,705	$25,785	$24,699	$25,462	$38,618
Loans 90 days or more past due and accruing [2]	$37,171	$40,846	$36,612	$34,987	$46,811
Accruing TDR loans	$73,023	$76,581	$84,411	$107,815	$101,905
Nonaccrual TDR loans	2,549	4,874	3,931	4,110	4,731
Total TDR loans	$75,572	$81,455	$88,342	$111,925	$106,636
Allowance for loan losses as a percent of nonaccrual loans	251.63 %	165.52 %	170.54 %	137.51 %	93.00 %
Nonaccrual loans as a percentage of total loans	0.33 %	0.53 %	0.53 %	0.75 %	1.36 %
Nonperforming assets as a percentage of total assets	0.23 %	0.41 %	0.50 %	0.72 %	1.26 %

(1) If interest on nonaccrual loans under the original terms had been recognized, such income is estimated to have been $1.5 million, $2.2 million and $2.5 million for the years ended December 31, 2017, 2016 and 2015.

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

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

(in thousands)	At December 31, 2017 30-59 Days Past Due	60-89 Days Past Due	Nonaccrual	90 Days or More Past Due and Accruing		Total Past Due Loans	Other Real Estate Owned
Consumer loans							
Single family	$ 10,493	$ 4,437	$ 11,091	$ 37,171	(1)	$ 63,192	$ 664
Home equity and other	750	20	1,404	—		2,174	—
	11,243	4,457	12,495	37,171		65,366	664
Commercial real estate loans							
Multifamily	—	—	302	—		302	—
Construction/land development	641	—	78	—		719	—
	641	—	380	—		1,021	—
Commercial and industrial loans							
Owner occupied commercial real estate	—	—	640	—		640	—
Commercial business	377	—	1,526	—		1,903	—
	377	—	2,166	—		2,543	—
Total	$ 12,261	$ 4,457	$ 15,041	$ 37,171		$ 68,930	$ 664

(1) FHA-insured and VA-guaranteed single family loans that are 90 days or more past due are maintained on accrual status if they are determined to have little to no risk of loss. At December 31, 2017, these past due loans totaled $37.2 million.

(in thousands)	At December 31, 2016 30-59 Days Past Due	60-89 Days Past Due	Nonaccrual	90 Days or More Past Due and Accruing		Total Past Due Loans	Other Real Estate Owned
Consumer loans							
Single family	$ 4,310	$ 5,459	$ 12,717	$ 40,846	(1)	$ 63,332	$ 2,133
Home equity and other	251	442	1,571	—		2,264	—
	4,561	5,901	14,288	40,846		65,596	2,133
Commercial real estate loans							
Non-owner occupied commercial real estate	23	—	871	—		894	—
Multifamily	—	—	337	—		337	—
Construction/land development	—	—	1,376	—		1,376	2,712
	23	—	2,584	—		2,607	2,712
Commercial and industrial loans							
Owner occupied commercial real estate	48	205	1,256	—		1,509	398
Commercial business	202	—	2,414	—		2,616	—
	250	205	3,670	—		4,125	398
Total	$ 4,834	$ 6,106	$ 20,542	$ 40,846		$ 72,328	$ 5,243

(1) FHA-insured and VA-guaranteed single family loans that are 90 days or more past due are maintained on accrual status as they have little to no risk of loss. At December 31, 2016, these past due loans totaled $40.8 million.

(in thousands)	At December 31, 2015 30-59 Days Past Due	60-89 Days Past Due	Nonaccrual	90 Days or More Past Due and Accruing		Total Past Due Loans	Other Real Estate Owned
Consumer loans							
Single family	$7,098	$ 3,537	$ 12,119	$ 36,595	(1)	$59,349	$ 301
Home equity and other	1,095	398	1,576	—		3,069	—
	8,193	3,935	13,695	36,595		62,418	301
Commercial real estate loans							
Non-owner occupied commercial real estate	—	—	—	—		—	4,071
Multifamily	—	—	119	—		119	—
Construction/land development	77	—	339	—		416	3,159
	77	—	458	—		535	7,230
Commercial and industrial loans							
Owner occupied commercial real estate	233	—	2,341	—		2,574	—
Commercial business	—	—	675	17		692	—
	233	—	3,016	17		3,266	—
Total	$8,503	$ 3,935	$ 17,169	$ 36,612		$66,219	$ 7,531

(1) FHA-insured and VA-guaranteed single family loans that are 90 days or more past due are maintained on accrual status as they have little to no risk of loss. At December 31, 2015, these past due loans totaled $36.6 million.

The following tables present the single family loan held for investment portfolio by original FICO score.

At December 31, 2017 Greater Than		Less Than or Equal To		Percentage (1)
N/A	(2)	N/A	(2)	1.9%
<		500		0.1%
500		549		0.1%
550		599		0.5%
600		649		4.1%
650		699		13.1%
700		749		30.8%
750		>		49.4%
		TOTAL		100.0%

(1) Percentages based on aggregate loan amounts.
(2) Information is not available.

At December 31, 2016

Greater Than	Less Than or Equal To	Percentage (1)
N/A (2)	N/A (2)	2.5%
<	500	—%
500	549	0.1%
550	599	0.7%
600	649	4.8%
650	699	16.0%
700	749	28.6%
750	>	47.2%
	TOTAL	100.0%

(1) Percentages based on aggregate loan amounts.
(2) Information is not available.

Loan Underwriting Standards

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 or evaluations in accordance with our appraisal policy. A borrower's ability to repay the loan is based on several factors, including employment, income, current debt, assets and level of equity in the property. We also consider loan-to-property value and debt-to-income ratios, amount of liquid financial reserves, 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.

For commercial, multifamily and construction loans, 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.

Additional considerations for commercial permanent loans secured by real estate:

Our underwriting standards for commercial permanent loans generally require that the loan-to-value ratio for these loans not exceed 75% of appraised value or discounted cash flow value, as appropriate, and that commercial properties attain debt coverage ratios (net operating income divided by annual debt servicing) of 1.25 or better.

Our underwriting standards for multifamily residential permanent loans generally require that the loan-to-value ratio for these loans not exceed 80% of appraised value, cost, or discounted cash flow value, as appropriate, and that multifamily residential properties attain debt coverage ratios of 1.15 or better. However, underwriting standards can be influenced by competition and other factors. We endeavor to maintain the highest practical underwriting standards while balancing the need to remain competitive in our lending practices.

Additional considerations for commercial construction loans secured by real estate:

We originate a variety of real estate construction loans. Underwriting guidelines for these loans vary by loan type but include loan-to-value limits, term limits, loan advance limits and pre-leasing requirements, as applicable.

Our underwriting guidelines for commercial real estate construction loans generally require that the loan-to-value ratio not exceed 75% and stabilized debt coverage ratios of 1.25 or better.

Our underwriting guidelines for multifamily residential construction loans generally require that the loan-to-value ratio not exceed 80% and stabilized debt coverage ratios of 1.20 or better.

Our underwriting guidelines for single family residential construction loans to builders generally require that the loan-to-value ratio not exceed 85%.

As noted above, underwriting standards can be influenced by competition and other factors. However, we endeavor to maintain the highest practical underwriting standards while balancing the need to remain competitive in our lending practices.

Liquidity and Capital Resources

Liquidity risk management is primarily intended to ensure we are able to maintain sources of cash to adequately fund operations and meet our obligations, including demands from depositors, draws on lines of credit and paying any creditors, on a timely and cost-effective basis, in various market conditions. Our liquidity profile is influenced by changes in market conditions, the composition of the balance sheet and risk tolerance levels. HomeStreet, Inc., HomeStreet Capital ("HSC") and the Bank have established liquidity guidelines and operating plans that detail the sources and uses of cash and liquidity.

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

HomeStreet, Inc.

The main source of liquidity for HomeStreet, Inc. is proceeds from dividends from the Bank and HomeStreet Capital. HomeStreet, Inc. has raised capital through the issuance of common stock, senior debt and trust preferred securities. Additionally, we also have an available line of credit from which we can borrow up to $30.0 million. At December 31, 2017, no advances were outstanding against this line.

Historically, the main cash outflows have been distributions to shareholders, interest and principal payments to creditors and payments of operating expenses. HomeStreet, Inc.’s ability to pay dividends to shareholders depends substantially on dividends received from the Bank. We do not currently pay a dividend and our most recent special dividend to shareholders was declared during the first quarter of 2014. We are generally deploying our capital toward strategic growth, and at this time our Board of Directors has not authorized the payment of a dividend.

HomeStreet Capital

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

HomeStreet Bank

The Bank’s primary sources of funds include deposits, advances from the FHLB, repayments and prepayments of loans, proceeds from the sale of loans and investment securities, interest from our loans and investment securities and capital contributions from HomeStreet, Inc. We have also raised short-term funds through the sale of securities under agreements to repurchase and federal funds purchased. While scheduled principal repayments on loans are a relatively predictable source of funds, deposit inflows and outflows and loan prepayments are greatly influenced by interest rates, economic conditions and competition. The Bank uses the primary liquidity ratio as a measure of liquidity. The primary liquidity ratio is defined as net cash, short-term investments and other marketable assets as a percent of net deposits and short-term borrowings. At December 31, 2017, our primary liquidity ratio was 18.1% compared with 31.2% at December 31, 2016 and 25.4% at December 31, 2015.

At December 31, 2017, 2016 and 2015, the Bank had available borrowing capacity of $579.2 million, $282.8 million and $320.4 million, respectively, from the FHLB, and $331.5 million, $292.1 million and $382.1 million, respectively, from the Federal Reserve Bank of San Francisco.

Cash Flows

For the years ended December 31, 2017, 2016 and 2015, cash and cash equivalents increased $18.8 million, increased $21.2 million and increased $2.2 million, respectively. The following discussion highlights the major activities and transactions that affected our cash flows during these periods.

Cash flows from operating activities

The Company's operating assets and liabilities are used to support our lending activities, including the origination and sale of mortgage loans. For the year ended December 31, 2017, net cash of $160.6 million was provided by operating activities, as our cash proceeds from the sale of loans exceeded cash used to fund loans held for sale production. We believe that cash flows from operations, available cash balances and our ability to generate cash through short-term debt are sufficient to fund our operating liquidity needs. For the year ended December 31, 2016, net cash of $44.8 million was used in operating activities, as our net income was less than the net fair value adjustment and gain on sale of loans held for sale. For the year ended December 31, 2015, net cash of $8.3 million was provided by operating activities, as our net income exceeded the net amount of cash used to fund loans held for sale production and proceeds from the sale of loans.

Cash flows from investing activities

The Company's investing activities primarily include available-for-sale securities and loans originated as held for investment. For the year ended December 31, 2017, net cash of $556.2 million was used in investing activities, primarily due to $998.6 million cash used for the origination of portfolio loans net of principal repayments and $368.1 million of cash used for the purchase of investment securities, and $42.3 million used for the purchase of property and equipment, partially offset by $397.5 million from proceeds from sale of investment securities, $324.7 million proceeds from sale of loans held for investment and $105.8 million from principal repayments. For the year ended December 31, 2016, net cash of $819.3 million was used in investing activities, primarily due to cash used for the origination of portfolio loans and principal repayments and purchases of investment securities, partially offset by $153.5 million from proceeds from sale of loans originated as held for investment and $112.2 million from principal repayments and maturities of investment securities. For the year ended December 31, 2015, net cash of $418.3 million was used in investing activities, primarily due to cash used for the origination of portfolio loans and principal repayments and purchases of investment securities, partially offset by $132.4 million of net cash received from acquisitions, primarily from the Simplicity merger.

Cash flows from financing activities

The Company's financing activities are primarily related to customer deposits and net proceeds from the FHLB. For the year ended December 31, 2017, net cash of $414.4 million was provided by financing activities, primarily resulting from a $309.8 million growth in deposits and $111.0 million net proceeds from FHLB advances. For the year ended December 31, 2016, net cash of $885.3 million was provided by financing activities, primarily resulting from a $919.5 million growth in deposits, $58.7 million net proceeds from our equity offering and $63.2 million in net proceeds from our senior note offering, partially offset by $164.0 million from net repayments of FHLB advances. For the year ended December 31, 2015, net cash of $412.2 million was provided by financing activities, primarily resulting from net proceeds of $355.0 million of FHLB advances and a $111.9 million growth in deposits.

Capital Management

In July 2013, federal banking regulators (including the FDIC and the FRB) adopted new capital rules (as used in this section, the “Rules”). The Rules apply to both depository institutions (such as the Bank) and their holding companies (such as the Company). The Rules reflect, in part, certain standards initially adopted by the Basel Committee on Banking Supervision in December 2010 (which standards are commonly referred to as “Basel III”) as well as requirements contemplated by the Dodd-Frank Act. Since 2015, the Rules have applied to both the Company and the Bank.

The Rules recognize three components, or tiers, of capital: common equity Tier 1 capital, additional Tier 1 capital and Tier 2 capital. Common equity Tier 1 capital generally consists of retained earnings and common stock instruments (subject to certain adjustments), as well as accumulated other comprehensive income (“AOCI”) except to the extent that the Company and the Bank exercise a one-time irrevocable option to exclude certain components of AOCI. Both the Company and the Bank elected this one-time option in 2015 to exclude certain components of AOCI. Additional Tier 1 capital generally includes non-cumulative preferred stock and related surplus subject to certain adjustments and limitations. Tier 2 capital generally includes certain capital instruments (such as subordinated debt) and portions of the amounts of the allowance for loan and lease losses, subject to certain requirements and deductions. The term “Tier 1 capital” means common equity Tier 1 capital plus additional Tier 1 capital, and the term “total capital” means Tier 1 capital plus Tier 2 capital.

The Rules generally measure an institution’s capital using four capital measures or ratios. The common equity Tier 1 capital ratio is the ratio of the institution’s common equity Tier 1 capital to its total risk-weighted assets. The Tier 1 capital ratio is the ratio of the institution’s total Tier 1 capital to its total risk-weighted assets. The total capital ratio is the ratio of the institution’s total capital to its total risk-weighted assets. The leverage ratio is the ratio of the institution’s Tier 1 capital to its average total consolidated assets. To determine risk-weighted assets, assets of an institution are generally placed into a risk category and given a percentage weight based on the relative risk of that category. The percentage weights range from 0% to 1,250%. An asset’s risk-weighted value will generally be its percentage weight multiplied by the asset’s value as determined under generally accepted accounting principles. In addition, certain off-balance-sheet items are converted to balance-sheet credit equivalent amounts, and each amount is then assigned to one of the risk categories. An institution's federal regulator may require the institution to hold more capital than would otherwise be required under the Rules if the regulator determines that the institution's capital requirements under the Rules are not commensurate with the institution's credit, market, operational or other risks.

To be classified as "well capitalized," both the Company and the Bank are required to have a common equity Tier 1 capital ratio of at least 6.5%, a Tier 1 risk-based ratio of at least 8.0%, a total risk-based ratio of at least 10.0% and a Tier 1 leverage ratio of at least 5.0%. In addition to the preceding requirements, all financial institutions subject to the Rules, including both the Company and the Bank, are required to establish a "conservation buffer" of common equity Tier 1 capital that was subject to a three year phase-in period that began on January 1, 2016 and would have been fully phased-in on January 1, 2019 at 2.5% above the required common equity Tier 1 capital ratio, the Tier 1 risk-based ratio and the total risk-based ratio. However in 2017, the FDIC issued a final rule to extend the 2017 transition provision on a go-forward basis, so the full phase in has been halted. The required phase-in capital conservation buffer during 2017 was 0.625%. A financial institution with a conservation buffer of less than the required amount is subject to limitations on capital distributions, including dividend payments and stock repurchases, and certain discretionary bonus payments to executive officers. At December 31, 2017, our capital conservation buffers for the Company and the Bank were 3.61% and 6.02%, respectively.

The Rules set forth the manner in which certain capital elements are determined, including but not limited to, requiring certain deductions related to mortgage servicing rights and deferred tax assets. Holding companies with less than $15 billion in total assets as of December 31, 2009 (which includes the Company) are permitted under the rules to continue to include trust preferred securities issued prior to May 19, 2010 in Tier 1 capital, generally up to 25% of other Tier 1 capital. Because our trust preferred securities were issued prior to May 19, 2010, we include those in our Tier 1 capital calculations.

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

Certain calculations under the rules related to deductions from capital had phase-in periods through 2017. Specifically, the capital treatment of mortgage servicing rights was to be phased in through the transition periods. Under the prior rules, the Bank deducted 10% of the value of MSRs (net of deferred tax) from Tier 1 capital ratios. However, under Basel III, the Bank and Company must deduct a much larger portion of the value of MSRs from Tier 1 capital.

- MSRs in excess of 10% of Tier 1 capital before threshold based deductions must be deducted from common equity. The disallowable portion of MSRs was phased in incrementally (40% in 2015; 60% in 2016; 80% in 2017 and beyond).
- In addition, the combined balance of MSRs and deferred tax assets is limited to approximately 15% of the Bank's and the Company's common equity Tier 1 capital. These combined assets must be deducted from common equity to the extent that they exceed the 15% threshold.
- Any portion of the Bank's and the Company's MSRs that are not deducted from the calculation of common equity Tier 1 are subject to a 100% risk weight.

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

At December 31, 2017, the Bank's capital ratios continued to meet the regulatory capital category of "well capitalized" as defined by the FDIC's prompt corrective action rules.

The following tables present regulatory capital information for HomeStreet, Inc. and HomeStreet Bank for the December 31, 2017, 2016 and 2015 respectively, under Basel III.

HomeStreet Bank	At December 31, 2017					
	Actual		For Minimum Capital Adequacy Purposes		To Be Categorized As “Well Capitalized” Under Prompt Corrective Action Provisions	
(in thousands)	Amount	Ratio	Amount	Ratio	Amount	Ratio
Tier 1 leverage capital (to average assets)	$649,864	9.67 %	$268,708	4.0%	$ 335,885	5.0 %
Common equity risk-based capital (to risk-weighted assets)	$649,864	13.22%	$221,201	4.5%	$ 319,512	6.5 %
Tier 1 risk-based capital (to risk-weighted assets)	$649,864	13.22%	$294,935	6.0%	$ 393,246	8.0 %
Total risk-based capital (to risk-weighted assets)	$688,981	14.02%	$393,246	8.0%	$ 491,558	10.0 %

HomeStreet, Inc.	At December 31, 2017					
	Actual		For Minimum Capital Adequacy Purposes		To Be Categorized As “Well Capitalized” Under Prompt Corrective Action Provisions	
(in thousands)	Amount	Ratio	Amount	Ratio	Amount	Ratio
Tier 1 leverage capital (to average assets)	$614,624	9.12 %	$269,534	4.0%	$ 336,918	5.0 %
Common equity risk-based capital (to risk-weighted assets)	$555,120	9.86 %	$253,293	4.5%	$ 365,868	6.5 %
Tier 1 risk-based capital (to risk-weighted assets)	$614,624	10.92%	$337,724	6.0%	$ 450,299	8.0 %
Total risk-based capital (to risk-weighted assets)	$653,741	11.61%	$450,299	8.0%	$ 562,873	10.0 %

HomeStreet Bank	At December 31, 2016					
	Actual		For Minimum Capital Adequacy Purposes		To Be Categorized As “Well Capitalized” Under Prompt Corrective Action Provisions	
(in thousands)	Amount	Ratio	Amount	Ratio	Amount	Ratio
Tier 1 leverage capital (to average assets)	$635,988	10.26%	$248,055	4.0%	$ 310,069	5.0 %
Common equity risk-based capital (to risk-weighted assets)	$635,988	13.92%	$205,615	4.5%	$ 297,000	6.5 %
Tier 1 risk-based capital (to risk-weighted assets)	$635,988	13.92%	$274,154	6.0%	$ 365,538	8.0 %
Total risk-based capital (to risk-weighted assets)	$671,252	14.69%	$365,538	8.0%	$ 456,923	10.0 %

HomeStreet, Inc.	At December 31, 2016					
	Actual		For Minimum Capital Adequacy Purposes		To Be Categorized As “Well Capitalized” Under Prompt Corrective Action Provisions	
(in thousands)	Amount	Ratio	Amount	Ratio	Amount	Ratio
Tier 1 leverage capital (to average assets)	$608,988	9.78 %	$249,121	4.0%	$ 311,402	5.0 %
Common equity risk-based capital (to risk-weighted assets)	$550,510	10.54%	$234,965	4.5%	$ 339,395	6.5 %
Tier 1 risk-based capital (to risk-weighted assets)	$608,988	11.66%	$313,287	6.0%	$ 417,716	8.0 %
Total risk-based capital (to risk-weighted assets)	$644,252	12.34%	$417,716	8.0%	$ 522,146	10.0 %

95

HomeStreet Bank	At December 31, 2015					
	Actual		For Minimum Capital Adequacy Purposes		To Be Categorized As “Well Capitalized” Under Prompt Corrective Action Provisions	
(in thousands)	Amount	Ratio	Amount	Ratio	Amount	Ratio
Tier 1 leverage capital (to average assets)	$455,101	9.46 %	$192,428	4.0%	$ 240,536	5.0 %
Common equity risk-based capital (to risk-weighted assets)	$455,101	13.04%	$157,074	4.5%	$ 226,885	6.5 %
Tier 1 risk-based capital (to risk-weighted assets)	$455,101	13.04%	$209,432	6.0%	$ 279,243	8.0 %
Total risk-based capital (to risk-weighted assets)	$485,761	13.92%	$279,243	8.0%	$ 349,054	10.0 %

HomeStreet, Inc.	At December 31, 2015					
	Actual		For Minimum Capital Adequacy Purposes		To Be Categorized As “Well Capitalized” Under Prompt Corrective Action Provisions	
(in thousands)	Amount	Ratio	Amount	Ratio	Amount	Ratio
Tier 1 leverage capital (to average assets)	$480,038	9.95 %	$193,025	4.0%	$ 241,281	5.0 %
Common equity risk-based capital (to risk-weighted assets)	$423,005	10.52%	$180,912	4.5%	$ 261,317	6.5 %
Tier 1 risk-based capital (to risk-weighted assets)	$480,038	11.94%	$241,216	6.0%	$ 321,621	8.0 %
Total risk-based capital (to risk-weighted assets)	$510,697	12.70%	$321,621	8.0%	$ 402,026	10.0 %

Impact of Inflation

The consolidated financial statements presented in this Form 10-K have been prepared in accordance with U.S. GAAP, which requires 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 cost of our operations as incurred. 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.

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, misconduct or errors, and adverse external events. Each line of business and the departments supporting the lines of business (collectively referred to as “business lines”) have primary responsibility for identifying, monitoring, controlling and escalating their operational risks. In addition, independent risk management functions, such as our enterprise risk management, risk and regulatory affairs, Bank Secrecy Act, quality control, and legal departments provide support to the business lines as they develop and implement operational risk management practices specific to their needs and escalate enterprise-wide operational risks to senior management and the Board. Our internal audit department provides independent assurance on the strength of operational risk controls and compliance with Company policies and procedures. Additionally, we maintain adequate 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 compliance and 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.

To mitigate our compliance risk, and as part of a comprehensive Risk Management System, the Bank is in the process of developing and implementing a Compliance Management System (CMS) which is designed to meet the heightened standards for risk governance framework adopted by the federal banking regulators. The Bank has implemented a "three lines of defense" model: business lines have primary responsibility for identifying, monitoring and controlling compliance risks, then reporting on those compliance risks to the corporate compliance department, which is our second line of defense. The second line is responsible for providing advice to the business lines, as well as assessing, testing and reporting on the status of the Bank's compliance and identified compliance risks to our senior management and the Board of Directors. Our Internal Audit Department serves as the third line of defense, providing independent assurance on the strength of compliance risk controls and compliance with applicable laws and regulations, as well as compliance with Company policies and procedures. The Chief Audit Officer reports to the audit committees of the Board of Directors of HomeStreet and the Bank.
We are still in the process of implementing the heightened standards required for banks with assets over $10 billion as we are not yet at that level but anticipate that we will grow to that size in the next several years. As the Bank continues to grow, our regulators may require us, or we may determine in response to perceived regulatory expectations, to comply with these heightened standards more completely, or to take actions to prepare for compliance, even before the Bank's total assets equal or exceed $10 billion. In preparation for meeting those heightened standards, we have hired an experienced Chief Compliance Officer and additional compliance personnel, and we are designing and implementing additional compliance systems and internal controls.

In addition to the CMS, the Bank's Risk Management System includes a Bank Secrecy Act (BSA) department responsible for designing and implementing processes to support business line efforts meet the requirements of BSA and anti-money laundering (AML) regulations of the Department of Treasury, the Internal Revenue Service and the Office of Foreign Assets Control (OFAC) relating to combatting money laundering, terrorist financing, tax evasion and other financial crimes. As with the CMS requirements, the BSA, AML and OFAC systems being designed and implemented are intended to meet the heightened standards applicable to banks with more than $10 billion in assets. To date, the BSA department has implemented processes to identify, measure, monitor, control, and manage compliance risk as outlined within applicable BSA, AML, and OFAC requirements, and has recently separated the oversight of BSA compliance from the compliance department itself, adding a BSA Officer who reports to the Chief Risk Officer and reorganizing distributed BSA responsibilities under the BSA Officer. We are continuing to assess the adequacy of BSA resources and we are designing and implementing additional BSA compliance systems and internal controls required by the heightened standards for banks with over $10 billion in assets.
Additionally, Corporate Compliance, BSA, and the Company's senior management have established tracking processes for monitoring the status of pending regulations and implementing 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 and senior management through development of strategic plans, successful implementation of business initiatives and reporting to the Board and its committees.

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.

Accounting Developments

See Financial Statements and Supplementary Data—Note 1, *Summary of Significant Accounting Policies*, for a discussion of accounting developments.

ITEM 7A QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market Risk Management

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

For the Company, price and interest rate risks arise from the financial instruments and positions we hold. This includes loans, mortgage servicing rights, investment securities, deposits, borrowings, long-term debt and derivative financial instruments. Due to the nature of our current 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 western United States, including Hawaii.

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

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

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

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 rates (interest rate risk) are influenced to a significant degree by the repricing characteristics of assets and liabilities (timing risk), the relationship between various rates (basis risk), customer options (option risk) and changes in the shape of the yield curve (time-sensitive risk). We manage the available-for-sale investment securities portfolio while maintaining a balance between risk and return. The Company's funding strategy is to grow core deposits while we efficiently supplement using wholesale borrowings.

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

The following table presents sensitivity gaps for these different intervals.

(dollars in thousands)	December 31, 2017 3 Mos. or Less	More Than 3 Mos. to 6 Mos.	More Than 6 Mos. to 12 Mos.	More Than 12 Mos. to 3 Yrs.	More Than 3 Yrs. to 5 Yrs.	More Than 5 Yrs.	Non-Rate-Sensitive	Total
Interest-earning assets:								
Cash & cash equivalents	$72,718	$—	$—	$—	$—	$—	$—	$72,718
FHLB Stock	—	—	—	—	—	46,639	—	46,639
Investment securities(1)	37,240	35,978	46,017	210,030	135,838	439,201	—	904,304
Mortgage loans held for sale	607,445	67	136	598	689	1,967	—	610,902
Loans held for investment(1)	1,398,210	323,288	514,689	970,991	585,363	713,925	—	4,506,466
Total interest-earning assets	2,115,613	359,333	560,842	1,181,619	721,890	1,201,732	—	6,141,029
Non-interest-earning assets	—	—	—	—	—	—	601,012	601,012
Total assets	$2,115,613	$359,333	$560,842	$1,181,619	$721,890	$1,201,732	$601,012	$6,742,041
Interest-bearing liabilities:								
NOW accounts(2)	$461,349	$—	$—	$—	$—	$—	$—	$461,349
Statement savings accounts(2)	293,858	—	—	—	—	—	—	293,858
Money market accounts(2)	1,834,154	—	—	—	—	—	—	1,834,154
Certificates of deposit	395,769	271,297	237,928	255,139	30,555	1	—	1,190,689
FHLB advances	933,611	—	30,000	10,000	—	5,590	—	979,201
Long-term debt(3)	60,274	—	—	—	—	65,000	—	125,274
Total interest-bearing liabilities	3,979,015	271,297	267,928	265,139	30,555	70,591	—	4,884,525
Non-interest bearing liabilities	—	—	—	—	—	—	1,153,136	1,153,136
Equity	—	—	—	—	—	—	704,380	704,380
Total liabilities and shareholders' equity	$3,979,015	$271,297	$267,928	$265,139	$30,555	$70,591	$1,857,516	$6,742,041
Interest sensitivity gap	$(1,863,402)	$88,036	$292,914	$916,480	$691,335	$1,131,141		
Cumulative interest sensitivity gap	$(1,863,402)	$(1,775,366)	$(1,482,452)	$(565,972)	$125,363	$1,256,504		
Cumulative interest sensitivity gap as a percentage of total assets	(28)%	(26)%	(22)%	(8)%	2%	19%		
Cumulative interest-earning assets as a percentage of cumulative interest-bearing liabilities	53%	58%	67%	88%	103%	126%		

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

As of December 31, 2017, the Bank's cumulative interest sensitivity gap was positive, resulting in an asset-sensitive position. Therefore, net interest income would be expected to rise in the long term if interest rates were to rise without changing the slope of the yield curve. The Bank is liability-sensitive in the "three months or less" period which generally indicates that net interest income would be expected to fall in the short term if interest rates were to rise, though deposit interest rate increases generally lag market rate increases.

Changes in the mix of interest-earning assets or interest-bearing liabilities can either increase or decrease the net interest margin, without affecting interest rate sensitivity. In addition, the interest rate spread between an earning asset and its funding

liability can vary significantly, while the timing of repricing for both the asset and the liability remains the same, thereby impacting net interest income. This characteristic is referred to as basis risk. Varying interest rate environments can create unexpected changes in prepayment levels of assets and liabilities that are not reflected in the interest rate sensitivity analysis. These prepayments may have a significant impact on our net interest margin. Because of these factors, an interest sensitivity gap analysis may not provide an accurate assessment of our actual exposure to changes in interest rates.

The estimated impact on our net interest income over a time horizon of one year and the change in net portfolio value as of December 31, 2017 and 2016 are provided in the table below. For the scenarios shown, the interest rate simulation assumes an instantaneous and sustained shift in market interest rates and no change in the composition or size of the balance sheet.

	December 31, 2017		December 31, 2016	
Change in Interest Rates	Percentage Change			
(basis points) [1]	Net Interest Income [2]	Net Portfolio Value [3]	Net Interest Income [2]	Net Portfolio Value [3]
+200	(0.5)%	(8.2)%	2.8 %	(6.2)%
+100	(0.2)	(4.2)	1.4	(3.1)
-100	1.9	(0.9)	1.1	(3.5)
-200	2.3 %	(4.8)%	(2.8)%	(5.6)%

(1) For purposes of our model, we assume interest rates will not go below zero. This "floor" limits the effect of a potential negative interest rate shock in a low rate environment like the one we are currently experiencing.
(2) 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.
(3) 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, 2017, we believe our net interest income sensitivity did not exhibit a strong bias to either an increase in interest rates or a decline in interest rates. Since December 31, 2016, the interest rate sensitivity of the Company’s assets and liabilities both decreased, with a greater decrease in the interest rate sensitivity of the Company’s liabilities. The changes in sensitivity reflect the impact of both higher market interest rates and changes to overall balance sheet composition. Some of the assumptions made in the simulation model may not materialize and unanticipated events and circumstances will occur. Modeling results in extreme interest rate decline scenarios may encounter negative rate assumptions which may cause the results to be inherently unreliable. In addition, the simulation model does not take into account any future actions that we could undertake to mitigate an adverse impact due to changes in interest rates from those expected, in the actual level of market interest rates or competitive influences on our deposits.

Risk Management Instruments

We originate fixed-rate residential home mortgages primarily for sale into the secondary market. These loans are hedged against interest rate fluctuations from the time of the loan commitment until the loans are sold.

We have been able to manage interest rate risk by matching both on- and off-balance sheet assets and liabilities, within reasonable limits, through a range of potential rate and repricing characteristics. Where appropriate, we also use hedging techniques including the use of forward sale commitments, option contracts and interest rate swaps.

In order to protect the economic value of our mortgage servicing rights, we employ hedging strategies utilizing derivative financial instruments including interest rate swaps, 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. Our mortgage servicing rights hedging policy requires management to hedge the impact on the value of our mortgage servicing rights for a low-probability, extreme and sudden increase in interest rates.

The following table presents the financial instruments classified as derivatives.

	At December 31, 2017		
		Fair value	
(in thousands)	Notional amount	Asset derivatives	Liability derivatives
Forward sale commitments	$1,687,658	$1,311	$(1,445)
Interest rate swaptions	120,000	—	—
Interest rate lock commitments	472,733	12,950	(25)
Interest rate swaps	1,869,000	12,172	(23,654)
Eurodollar Futures	3,287,000	—	(101)
	$7,436,391	$26,433	$(25,225)

We may implement other hedge transactions using forward loan sales, futures, option contracts and interest rate swaps, interest rate floors, financial futures, forward rate agreements 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.

ITEM 8 FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the shareholders and the Board of Directors of HomeStreet, Inc.

Opinion on the Financial Statements

We have audited the accompanying consolidated statements of financial condition of HomeStreet, Inc. and subsidiaries (the "Company") as of December 31, 2017 and 2016, and the related consolidated statements of operations, comprehensive income, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2017, and the related notes (collectively referred to as the “financial statements”). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2017 and 2016, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2017, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company's internal control over financial reporting as of December 31, 2017, based on criteria established in *Internal Control - Integrated Framework* (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 6, 2018, expressed an unqualified opinion on the Company's internal control over financial reporting.

Basis for Opinion

These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on the Company’s financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ Deloitte & Touche LLP

Seattle, Washington
March 6, 2018

We have served as the Company’s auditor since 2013.

HOMESTREET, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

	At December 31,	
(in thousands, except share data)	2017	2016
ASSETS		
Cash and cash equivalents (including interest-earning instruments of $30,268 and $34,615)	$72,718	$53,932
Investment securities (includes $846,268 and $993,990 carried at fair value)	904,304	1,043,851
Loans held for sale (includes $577,313 and $656,334 carried at fair value)	610,902	714,559
Loans held for investment (net of allowance for loan losses of $37,847 and $34,001; includes $5,477 and $17,988 carried at fair value)	4,506,466	3,819,027
Mortgage servicing rights (includes $258,560 and $226,113 carried at fair value)	284,653	245,860
Other real estate owned	664	5,243
Federal Home Loan Bank stock, at cost	46,639	40,347
Premises and equipment, net	104,654	77,636
Goodwill	22,564	22,175
Other assets	188,477	221,070
Total assets	$6,742,041	$6,243,700
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities:		
Deposits	$4,760,952	$4,429,701
Federal Home Loan Bank advances	979,201	868,379
Accounts payable and other liabilities	172,234	191,189
Long-term debt	125,274	125,147
Total liabilities	6,037,661	5,614,416
Commitments and contingencies (Note 13)		
Shareholders' equity:		
Preferred stock, no par value, authorized 10,000 shares, issued and outstanding, 0 shares and 0 shares	—	—
Common stock, no par value, authorized 160,000,000 shares, issued and outstanding, 26,888,288 shares and 26,800,183 shares	511	511
Additional paid-in capital	339,009	336,149
Retained earnings	371,982	303,036
Accumulated other comprehensive loss	(7,122)	(10,412)
Total shareholders' equity	704,380	629,284
Total liabilities and shareholders' equity	$6,742,041	$6,243,700

See accompanying notes to consolidated financial statements.

HOMESTREET, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS

	Years Ended December 31,		
(in thousands, except share data)	2017	2016	2015
Interest income:			
Loans	$215,363	$ 190,667	$ 152,621
Investment securities	21,753	18,394	11,590
Other	567	476	903
	237,683	209,537	165,114
Interest expense:			
Deposits	23,912	19,009	11,801
Federal Home Loan Bank advances	12,589	6,030	3,668
Federal funds purchased and securities sold under agreements to repurchase	5	4	8
Long-term debt	6,067	4,043	1,104
Other	672	402	195
	43,245	29,488	16,776
Net interest income	194,438	180,049	148,338
Provision for credit losses	750	4,100	6,100
Net interest income after provision for credit losses	193,688	175,949	142,238
Noninterest income:			
Net gain on loan origination and sale activities	255,876	307,313	236,388
Loan servicing income	35,384	33,059	24,250
Income from WMS Series LLC	598	2,333	1,624
Depositor and other retail banking fees	7,221	6,790	5,881
Insurance agency commissions	1,904	1,619	1,682
Gain on sale of investment securities available for sale	489	2,539	2,406
Bargain purchase gain	—	—	7,726
Other	10,682	5,497	1,280
	312,154	359,150	281,237
Noninterest expense:			
Salaries and related costs	293,870	303,354	240,587
General and administrative	65,036	63,206	56,821
Amortization of core deposit intangibles	1,710	2,166	1,924
Legal	1,410	1,867	2,807
Consulting	3,467	4,958	7,215
Federal Deposit Insurance Corporation assessments	3,279	3,414	2,573
Occupancy	38,268	30,530	24,927
Information services	33,143	33,063	29,054
Net (benefit) cost from operation and sale of other real estate owned	(530)	1,764	660
	439,653	444,322	366,568
Income before income taxes	66,189	90,777	56,907
Income tax (benefit) expense	(2,757)	32,626	15,588
NET INCOME	$68,946	$ 58,151	$ 41,319
Basic income per share	$2.57	$ 2.36	$ 1.98
Diluted income per share	$2.54	$ 2.34	$ 1.96
Basic weighted average number of shares outstanding	26,864,657	24,615,990	20,818,045
Diluted weighted average number of shares outstanding	27,092,019	24,843,683	21,059,201

See accompanying notes to consolidated financial statements.

HOMESTREET, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in thousands)	Years Ended December 31, 2017	2016	2015
Net income	$68,946	$58,151	$41,319
Other comprehensive income (loss), net of tax:			
Unrealized gain (loss) on investment securities available for sale:			
Unrealized holding gain (loss) arising during the year, net of tax expense (benefit) of $1,942, $(3,400) and $(713)	3,607	(6,313)	(1,325)
Reclassification adjustment for net gains included in net income, net of tax expense (benefit) of $172, $889 and $(264)	(317)	(1,650)	(2,670)
Other comprehensive income (loss)	3,290	(7,963)	(3,995)
Comprehensive income	$72,236	$50,188	$37,324

See accompanying notes to consolidated financial statements.

HOMESTREET, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(in thousands, except share data)	Number of shares	Common stock	Additional paid-in capital	Retained earnings	Accumulated other comprehensive income (loss)	Total
Balance, December 31, 2014	14,856,611	$ 511	$ 96,615	$ 203,566	$ 1,546	$ 302,238
Net income	—	—	—	41,319	—	41,319
Share-based compensation expense	—	—	1,267	—	—	1,267
Common stock issued	7,219,923	—	124,446	—	—	124,446
Other comprehensive loss	—	—	—	—	(3,995)	(3,995)
Balance, December 31, 2015	22,076,534	511	222,328	244,885	(2,449)	465,275
Net income	—	—	—	58,151	—	58,151
Share-based compensation expense	—	—	1,788	—	—	1,788
Common stock issued	4,723,649	—	112,033	—	—	112,033
Other comprehensive loss	—	—	—	—	(7,963)	(7,963)
Balance, December 31, 2016	26,800,183	511	336,149	303,036	(10,412)	629,284
Net income		—		68,946		68,946
Share-based compensation expense		—	2,502	—		2,502
Common stock issued	88,105	—	358	—		358
Other comprehensive income		—		—	3,290	3,290
Balance, December 31, 2017	26,888,288	$ 511	$ 339,009	$ 371,982	$ (7,122)	$ 704,380

See accompanying notes to consolidated financial statements.

HOMESTREET, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)	Years Ended December 31, 2017	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	$68,946	$58,151	$41,319
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation, amortization and accretion	22,645	15,667	14,877
Provision for credit losses	750	4,100	6,100
Net fair value adjustment and gain on sale of loans held for sale	(218,331)	(268,104)	9,632
Fair value adjustment of loans held for investment	(1,030)	(354)	2,000
Origination of mortgage servicing rights	(78,412)	(90,520)	(76,417)
Change in fair value of mortgage servicing rights	36,615	13,280	27,483
Net gain on sale of investment securities	(489)	(2,539)	(2,406)
Net gain on sale of loans originated as held for investment	(4,600)	(2,607)	(456)
Net fair value adjustment, gain on sale and provision for losses on other real estate owned	(383)	1,767	176
Loss on disposal of fixed assets	215	253	61
Loss on lease abandonment	5,054	—	—
Net deferred income tax (benefit) expense	(2,094)	31,490	16,389
Share-based compensation expense	2,856	2,062	1,060
Bargain purchase gain	—	—	(7,726)
Origination of loans held for sale	(7,763,844)	(9,169,488)	(7,265,622)
Proceeds from sale of loans originated as held for sale	8,084,916	9,379,720	7,243,990
Changes in operating assets and liabilities:			
Decrease (increase) in accounts receivable and other assets	27,711	(60,946)	(12,151)
(Decrease) increase in accounts payable and other liabilities	(19,957)	43,255	10,002
Net cash provided by (used in) operating activities	160,568	(44,813)	8,311
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchase of investment securities	(368,071)	(743,861)	(247,713)
Proceeds from sale of investment securities	397,492	164,429	112,259
Principal repayments and maturities of investment securities	105,801	112,245	36,798
Proceeds from sale of other real estate owned	6,105	5,672	6,110
Proceeds from sale of loans originated as held for investment	324,745	153,518	34,111
Proceeds from sale of mortgage servicing rights	—	—	4,325
Mortgage servicing rights purchased from others	(565)	—	(9)
Capital expenditures related to other real estate owned	(57)	(720)	—
Origination of loans held for investment and principal repayments, net	(998,638)	(609,981)	(476,062)
Proceeds from sale of property and equipment	—	1,148	—
Purchase of property and equipment	(42,286)	(24,482)	(20,560)
Net cash acquired from acquisitions	19,285	122,760	132,407
Net cash used in investing activities	(556,189)	(819,272)	(418,334)

(in thousands)	Years Ended December 31, 2017	2016	2015
CASH FLOWS FROM FINANCING ACTIVITIES:			
Increase in deposits, net	$ 309,798	$ 919,497	$ 111,906
Proceeds from Federal Home Loan Bank advances	10,972,200	14,734,636	10,618,900
Repayment of Federal Home Loan Bank advances	(10,861,200)	(14,898,636)	(10,263,900)
Proceeds from federal funds purchased and securities sold under agreements to repurchase	875,166	64,804	82,204
Repayment of federal funds purchased and securities sold under agreements to repurchase	(875,166)	(64,804)	(132,204)
Proceeds from Federal Home Loan Bank stock repurchase	187,766	284,662	153,657
Purchase of Federal Home Loan Bank stock	(194,058)	(279,436)	(158,565)
Proceeds from debt issuance, net	(65)	63,184	—
(Payments) proceeds from equity raise, net	(45)	58,713	—
Proceeds from stock issuance, net	11	2,713	178
Excess tax benefit related to the exercise of stock options	—	—	29
Net cash provided by financing activities	414,407	885,333	412,205
NET INCREASE IN CASH AND CASH EQUIVALENTS	18,786	21,248	2,182
CASH AND CASH EQUIVALENTS:			
Beginning of year	53,932	32,684	30,502
End of period	$ 72,718	$ 53,932	$ 32,684
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:			
Cash paid during the period for:			
Interest paid	$ 42,889	$ 28,672	$ 16,647
Federal and state income taxes (refunded) paid , net	(21,885)	14,441	11,328
Non-cash activities:			
Loans held for investment foreclosed and transferred to other real estate owned	1,125	2,056	4,396
Loans transferred from held for investment to held for sale	419,494	169,745	76,178
Loans transferred from held for sale to held for investment	100,049	12,311	25,668
Ginnie Mae loans recognized with the right to repurchase, net	3,534	6,775	7,857
Simplicity acquisition:			
Assets acquired, excluding cash acquired	—	—	738,279
Liabilities assumed	—	—	718,916
Bargain purchase gain	—	—	7,345
Common stock issued	—	—	124,214
Orange County Business Bank acquisition:			
Assets acquired, excluding cash acquired	—	165,786	—
Liabilities assumed	—	141,267	—
Goodwill	—	8,360	—
Common stock issued	$ —	$ 50,373	$ —

See accompanying notes to consolidated financial statements.

HomeStreet, Inc. and Subsidiaries
Notes to Consolidated Financial Statements

NOTE 1–SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

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

The Company’s accounting and financial reporting policies conform to accounting principles generally accepted in the United States of America (U.S. GAAP). Inter-company balances and transactions have been eliminated in consolidation. In preparing the consolidated financial statements, the Company is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the financial statements and revenues and expenses during the reporting periods and related disclosures. These estimates that require application of management's most difficult, subjective or complex judgments often result in the need to make estimates about the effect of matters that are inherently uncertain and may change in future periods. Management has made significant estimates in several areas, including the fair value of assets acquired and liabilities assumed in business combinations (Note 2, *Business Combinations*), allowance for credit losses (Note 5, *Loans and Credit Quality*), valuation of residential mortgage servicing rights and loans held for sale (Note 12, *Mortgage Banking Operations*), valuation of certain loans held for investment (Note 5, *Loans and Credit Quality*), valuation of investment securities (Note 4, *Investment Securities*), valuation of derivatives (Note 11, *Derivatives and Hedging Activities*), other real estate owned (Note 6, *Other Real Estate Owned*), and taxes (Note 14, *Income Taxes*). Actual results could differ materially from those estimates. Certain amounts in the financial statements from prior periods have been reclassified to conform to the current financial statement presentation.

Cash and Cash Equivalents

Cash and cash equivalents include cash, interest-earning overnight deposits at other financial institutions, and other investments with original maturities equal to three months or less. For the consolidated statements of cash flows, the Company considered cash equivalents to be investments that are readily convertible to known amounts, so near to their maturity that they present an insignificant risk of a change in fair value due to change in interest rates, and purchased in conjunction with cash management activities. Restricted cash of $4.4 million and $4.0 million at December 31, 2017 and 2016, respectively, is included in cash and cash equivalents for FNMA DUS pledged securities and related reserves. In addition, restricted cash of $1.2 million and $2.4 million at December 31, 2017 and 2016, respectively, is included in accounts receivable and other assets for reinsurance-related reserves.

Investment Securities

We classify investment securities as trading, held to maturity ("HTM"), or available for sale ("AFS") at the date of acquisition. Purchases and sales of securities are generally recorded on a trade-date basis. We include and record certain certificates of deposit that meet the definition of a security as HTM investments.

Investment securities that we might not hold until maturity are classified as AFS and are reported at fair value in the statement of financial condition. Fair value measurement is based upon quoted market prices in active markets, if available. If quoted prices in active markets are not available, fair value is measured using pricing models or other model-based valuation techniques such as the present value of future cash flows, which consider prepayment assumptions and other factors such as credit losses and market liquidity. Unrealized gains and losses are excluded from earnings and reported, net of tax, in other comprehensive income ("OCI"). Purchase premiums and discounts are recognized in interest income using the effective interest method over the life of the securities. Purchase premiums or discounts related to mortgage-backed securities are amortized or accreted using projected prepayment speeds. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method.

AFS investment securities in unrealized loss positions are evaluated for other-than-temporary impairment ("OTTI") at least quarterly. For AFS debt securities, a decline in fair value is considered to be other-than-temporary if the Company does not

expect to recover the entire amortized cost basis of the security. For AFS equity securities, the Company considers a decline in fair value to be other-than-temporary if it is probable that the Company will not recover its cost basis.
Debt securities are classified as HTM if the Company has both the intent and ability to hold those securities to maturity regardless of changes in market conditions, liquidity needs or changes in general economic conditions. These securities are carried at cost adjusted for amortization of purchase premiums and accretion of purchase discounts. Transfers of securities from available for sale to held to maturity are accounted for at fair value as of the date of the transfer. The difference between the fair value and the par value at the date of transfer is considered a premium or discount and is accounted for accordingly. Any unrealized gain or loss at the date of the transfer is reported in OCI, and is amortized over the remaining life of the security as an adjustment of yield in a manner consistent with the amortization of any premium or discount, and will offset or mitigate the effect on interest income of the amortization of the premium or discount for that held to maturity security.
Impairment may result from credit deterioration of the issuer or collateral underlying the security. In performing an assessment of recoverability, all relevant information is considered, including the length of time and extent to which fair value has been less than the amortized cost basis, the cause of the price decline, credit performance of the issuer and underlying collateral, and recoveries or further declines in fair value subsequent to the balance sheet date.

For debt securities, the Company measures and recognizes OTTI losses through earnings if (1) the Company has the intent to sell the security or (2) it is more likely than not that the Company will be required to sell the security before recovery of its amortized cost basis. In these circumstances, the impairment loss is equal to the full difference between the amortized cost basis and the fair value of the security. For securities that are considered other-than-temporarily-impaired that the Company has the intent and ability to hold in an unrealized loss position, the OTTI write-down is separated into an amount representing the credit loss, which is recognized in earnings, and the amount related to other factors, which is recognized as a component of OCI.

For equity securities, the Company recognizes OTTI losses through earnings if the Company intends to sell the security. The Company also considers other relevant factors, including its intent and ability to retain the security for a period of time sufficient to allow for any anticipated recovery in market value, and whether evidence exists to support a realizable value equal to or greater than the carrying value. Any impairment loss on an equity security is equal to the full difference between the amortized cost basis and the fair value of the security.

Federal Home Loan Bank Stock

As a borrower from the Federal Home Loan Bank of Des Moines and the Federal Home Loan Bank of San Francisco ("FHLB"), the Company is required to purchase an amount of FHLB stock based on our outstanding borrowings with the FHLB. This stock is used as collateral to secure the borrowings from the FHLB and is accounted for as a cost-method investment. FHLB stock is reviewed at least quarterly for possible OTTI, which includes an analysis of the FHLB's cash flows, capital needs and long-term viability.

Loans Held for Sale

Loans originated for sale in the secondary market, which is our principal market, or as whole loan sales are classified as loans held for sale. Management has elected the fair value option for all single family loans held for sale (originated with the intent to be held for sale) and records these loans at fair value. The fair value of loans held for sale is generally based on observable market prices from other loans in the secondary market that have similar collateral, credit, and interest rate characteristics. If quoted market prices are not readily available, the Company may consider other observable market data such as dealer quotes for similar loans or forward sale commitments. In certain cases, the fair value may be based on a discounted cash flow model. Gains and losses from changes in fair value on loans held for sale are recognized in net gain on mortgage loan origination and sale activities within noninterest income. Direct loan origination costs and fees for single family loans originated as held for sale are recognized in earnings. The change in fair value of loans held for sale is primarily driven by changes in interest rates subsequent to loan funding and changes in the fair value of related servicing asset, resulting in revaluation adjustments to the recorded fair value. The use of the fair value option allows the change in the fair value of loans to more effectively offset the change in the fair value of derivative instruments that are used as economic hedges to loans held for sale.

Multifamily and SBA loans held for sale are accounted for at the lower of amortized cost or fair value. Related gains and losses are recognized in net gain on mortgage loan origination and sale activities. Direct loan origination costs and fees for multifamily and SBA loans classified as held for sale are deferred at origination and recognized in earnings at the time of sale.

Loans Held for Investment

Loans held for investment are reported at the principal amount outstanding, net of cumulative charge-offs, interest applied to principal (for loans accounted for using the cost recovery method), unamortized net deferred loan origination fees and costs and unamortized premiums or discounts on purchased loans. Deferred fees and costs and premiums and discounts are amortized over the contractual terms of the underlying loans using the constant effective yield (the interest method) or straight-line method. Interest on loans is accrued and recognized as interest income at the contractual rate of interest. A determination is made as of the loan commitment date as to whether a loan will be held for sale or held for investment. This determination is based primarily on the type of loan or loan program and its related profitability characteristics.

When a loan is designated as held for investment, the intent is to hold these loans for the foreseeable future or until maturity or pay-off. If subsequent changes occur, the Company may change its intent to hold these loans. Once a determination has been made to sell such loans, they are immediately transferred to loans held for sale and carried at the lower of cost or fair value.

From time to time, the Company will originate loans to facilitate the sale of other real estate owned without a sufficient down payment from the borrower. Such loans are accounted for using the installment method and any gain on sale is deferred.

Nonaccrual Loans

Loans are placed on nonaccrual status when the full and timely collection of principal and interest is doubtful, generally when the loan becomes 90 days or more past due for principal or interest payment or if part of the principal balance has been charged off.

All payments received on nonaccrual loans are accounted for using the cost recovery method. Under the cost recovery method, all cash collected is applied to first reduce the principal balance. A loan may be returned to accrual status if all delinquent principal and interest payments are brought current and the collectability of the remaining principal and interest payments in accordance with the loan agreement is reasonably assured. Loans that are well-secured and in the process of collection are maintained on accrual status, even if they are 90 days or more past due. Loans whose repayments are insured by the Federal Housing Administration ("FHA") or guaranteed by the Department of Veterans' Affairs ("VA") are maintained on accrual status even if 90 days or more past due.

Impaired Loans

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.

Troubled Debt Restructurings

A loan is accounted for and reported as a troubled debt restructuring (“TDR”) when, for economic or legal reasons, we grant a concession to a borrower experiencing financial difficulty that we would not otherwise consider. A restructuring that results in only an insignificant delay in payment is not considered a concession. A delay may be considered insignificant if the payments subject to the delay are insignificant relative to the unpaid principal or collateral value and the contractual amount due, or 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.

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 and impaired regardless of the accrual or performance status until the loan is paid off. However, if the TDR loan has been modified in a subsequent restructure with market terms and the borrower is not currently experiencing financial difficulty, then the loan may be de-designated as a TDR.

Allowance for Credit Losses

Credit quality within the loans held for investment portfolio is continuously monitored by management and is reflected within the allowance for credit losses. The allowance for credit losses is maintained at a level that, in management's judgment, is appropriate to cover losses inherent within the Company’s loans held for investment portfolio, including unfunded credit commitments, as of the balance sheet date. The allowance for loan losses, as reported in our consolidated statements of financial condition, is adjusted by a provision for loan losses, which is recognized in earnings, and reduced by the charge-off of loan amounts, net of recoveries.

The loss estimation process involves procedures to appropriately consider the unique characteristics of its two loan portfolio segments, the consumer loan portfolio segment and the commercial loan portfolio segment. These two segments are further disaggregated into loan classes, the level at which credit risk is monitored. When computing allowance levels, credit loss assumptions are estimated using a model that categorizes loan pools based on loss history, delinquency status and other credit trends and risk characteristics. 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 overall loan portfolio, in light of the factors then prevailing, may result in significant changes in the allowance for credit losses in those future periods.

Credit quality is assessed and monitored by evaluating various attributes and utilizes such information in our evaluation of the adequacy of the allowance for credit losses. The following provides the credit quality indicators and risk elements that are most relevant and most carefully considered and monitored for each loan portfolio segment.

Consumer Loan Portfolio Segment

The consumer loan portfolio segment is comprised of the single family and home equity loan classes, which are underwritten after evaluating a borrower’s capacity, credit, and collateral. Capacity refers to a borrower’s ability to make payments on the loan. Several factors are considered when assessing a borrower’s capacity, including the borrower’s employment, income, current debt, assets, and level of equity in the property. Credit refers to how well a borrower manages their current and prior debts as documented by a credit report that provides credit scores and the borrower’s current and past information about their credit history. Collateral refers to the type and use of property, occupancy, and market value. Property appraisals are obtained to assist in evaluating collateral. Loan-to-property value and debt-to-income ratios, loan amount, and lien position are also considered in assessing whether to originate a loan. These borrowers are particularly susceptible to downturns in economic trends such as conditions that negatively affect housing prices and demand and levels of unemployment.

Commercial Loan Portfolio Segment

The commercial loan portfolio segment is comprised of the commercial real estate, non-owner occupied, multifamily residential, construction/land development, owner occupied and commercial business loan classes, whose underwriting standards consider the factors described for single family and home equity loan classes as well as others when assessing the borrower’s and associated guarantors or other related party’s financial position. These other factors include assessing liquidity, the level and composition of net worth, leverage, considering all other lender amounts and position, an analysis of cash expected to flow through the obligors including the outflow to other lenders, and prior experience with the borrower. This information is used to assess adequate 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.

Loan Loss Measurement

Allowance levels are influenced by loan volumes, loan asset quality ratings ("AQR") migration or delinquency status, historic loss experience and other conditions influencing loss expectations, such as economic conditions. The methodology for evaluating the adequacy of the allowance for loan losses has two basic components: first, an asset-specific component involving the identification of impaired loans and the measurement of impairment for each individual loan identified; and second, a formula-based component for estimating probable loan principal losses for all other loans.

Impaired Loans

When a loan is identified as impaired, impairment is measured based on net realizable value, or 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. For impaired loans, we recognize impairment if we determine that the net realizable value of the impaired loan is less than the recorded investment of the loan (net of previous charge-offs and deferred loan fees and costs), except when the sole remaining source of collection is the underlying collateral. In these cases impairment is measured as the difference between the recorded investment balance of the loan and the fair value of the collateral. The fair value of the collateral is adjusted for the estimated cost to sell if repayment or satisfaction of a loan is dependent on the sale (rather than only on the operation) of the collateral.

The starting point for determining the fair value of collateral is through obtaining external appraisals. Generally, collateral values for impaired loans are updated every twelve months, either from external third parties or in-house certified appraisers. A third party appraisal is required at least annually. Third party appraisals are obtained from a pre-approved list of independent, third party, local appraisal firms. Approval and addition to the list is based on experience, reputation, character, consistency and knowledge of the respective real estate market. Generally, appraisals are internally reviewed by the appraisal services group to ensure the quality of the appraisal and the expertise and independence of the appraiser. For performing consumer segment loans secured by real estate that are classified as collateral dependent, the Bank determines the fair value estimates semi-annually using automated valuation services. Once the impairment amount is determined an asset-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. Factors considered by management in determining if impairment is permanent or not recoverable include whether management judges the loan to be uncollectible, repayment is deemed to be protracted beyond reasonable time frames or the loss becomes evident owing to the borrower’s lack of assets or, for single family loans, the loan is 180 days or more past due unless both well-secured and in the process of collection.

Estimate of Probable Loan Losses

In estimating the formula-based component of the allowance for loan losses, loans are segregated into loan classes. Loans are designated into loan classes based on loans pooled by product types and similar risk characteristics or areas of risk concentration.

In determining the allowance for loan losses we derive an estimated credit loss assumption from a model that categorizes loan pools based on loan type and AQR or delinquency bucket. This model calculates an expected loss percentage for each loan category by considering the probability of default, based on the migration of loans from performing to loss by AQR or delinquency buckets using two-year analysis periods for commercial segments and one-year analysis periods for consumer segments, and the potential severity of loss, based on the aggregate net lifetime losses incurred per loan class.

The formula-based component of the allowance for loan losses also considers qualitative factors for each loan class, including changes in the following: (1) lending policies and procedures; (2) international, national, regional and local economic business conditions and developments that affect the collectability of the portfolio, including the condition of various markets; (3) the nature and volume of the loan portfolio including the terms of the loans; (4) the experience, ability, and depth of the lending management and other relevant staff; (5) the volume and severity of past due and adversely classified or graded loans and the volume of nonaccrual loans; (6) the quality of our loan review system; (7) the value of underlying collateral for collateral-dependent loans. Additional factors include (8) the existence and effect of any concentrations of credit, and changes in the level of such concentrations and (9) the effect of external factors such as competition and legal and regulatory requirements on the level of estimated credit losses in the existing portfolio. Qualitative factors 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.

Unfunded Loan Commitments

The Company maintains a separate allowance for losses on unfunded loan commitments, which is included in accounts payable and other liabilities on the consolidated statements of financial condition. Management estimates the amount of probable losses by calculating a one-year commitment usage factor and applying the loss factors used in the allowance for loan loss methodology to the results of the usage calculation to estimate the liability for credit losses related to unfunded commitments for each loan type.

Other Real Estate Owned

Other real estate owned ("OREO") represents real estate acquired for debts previously contracted with the Company, generally through the foreclosure of loans. In certain cases, such as foreclosures on loans involving both the Company and other participating lenders, other real estate owned may be held in the form of an investment in an unconsolidated legal entity that is in-substance real estate. These properties are initially recorded at the net realizable value (fair value of collateral less estimated costs to sell). Upon transfer of a loan to other real estate owned, an appraisal is obtained and any excess of the loan balance over the net realizable value is charged against the allowance for loan losses. The Company allows up to 90 days after foreclosure to finalize determination of net realizable value. Subsequent declines in net realizable value identified from the ongoing analysis of such properties are recognized in current period earnings within noninterest expense as a provision for losses on other real estate owned. The net realizable value of these assets is reviewed and updated at least every six months depending on the type of property, or more frequently as circumstances warrant.

As part of our subsequent events analysis process, we review updated independent third-party appraisals received and internal collateral valuations received subsequent to the reporting period-end 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.

From time to time the Company may elect to accelerate the disposition of certain OREO properties in a time frame faster than the expected marketing period assumed in the appraisal supporting our valuation of such properties. At the time a property is identified and the decision to accelerate its disposition is made, that property’s underlying fair value is re-measured. Generally, to achieve an accelerated time frame in which to sell a property, the price that the Company is willing to accept for the disposition of the property decreases. Accordingly, the net realizable value of these properties is adjusted to reflect this change in valuation.

Mortgage Servicing Rights

We initially record all mortgage servicing rights ("MSRs") at fair value. For subsequent measurement of MSRs, accounting standards permit the election of either fair value or the lower of amortized cost or fair value. Management has elected to account for single family MSRs at fair value during the life of the MSR, with changes in fair value recorded through current period earnings. Fair value adjustments encompass market-driven valuation changes as well as modeled amortization involving the run-off of value that occurs due to the passage of time as individual loans are paid by borrowers. We account for multifamily and SBA MSRs at the lower of amortized cost or fair value.

MSRs are recorded as separate assets on our consolidated statements of financial condition upon purchase of the rights or when we retain the right to service loans that we have sold. Net gains on mortgage loan origination and sale activities depend, in part, on the initial fair value of MSRs, which is based on a discounted cash flow model.

Mortgage servicing income includes the changes in fair value over the reporting period of both our single family MSRs and the derivatives used to economically hedge our single family MSRs. Subsequent fair value measurements of single family MSRs, which are not traded in an active market with readily observable market prices, are determined by considering the present value of estimated future net servicing cash flows. Changes in the fair value of single family MSRs result from changes in (1) model inputs and assumptions and (2) modeled amortization, representing the collection and realization of expected cash flows and curtailments over time. The significant model inputs used to measure the fair value of single family MSRs include assumptions regarding 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.

Market expectations about loan duration, and correspondingly the expected term of future servicing cash flows, may vary from time to time due to changes in expected 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 MSRs. 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 MSRs asset.

For further information on how the Company measures the fair value of its single family MSRs, including key economic assumptions and the sensitivity of fair value to changes in those assumptions, see Note 12, *Mortgage Banking Operations*.

Investment in WMS Series LLC

HomeStreet/WMS, Inc. (Windermere Mortgage Services, Inc.), a wholly owned and consolidated subsidiary of the Bank, has an affiliated business arrangement with Windermere Real Estate, WMS Series Limited Liability Company ("WMS LLC"). The Company and Windermere Real Estate each have 50% joint control over the governance of WMS LLC. The operations of WMS LLC, which is subdivided into 28 individual operating series, are recorded using the equity method of accounting. The Company recognizes its proportionate share of the results of operations of WMS LLC as income from WMS Series LLC in noninterest income within the Company's consolidated statements of operations.

Equity method investment income from WMS LLC was $598 thousand, $2.7 million, and $2.5 million for the years ended December 31, 2017, 2016 and 2015, respectively. The Company’s investment in WMS LLC was $2.0 million and $2.7 million, which is included in accounts receivable and other assets at December 31, 2017 and 2016, respectively.

The Company provides contracted services to WMS LLC related to accounting, loan shipping, loan underwriting, quality control, secondary marketing, and information systems support performed by Company employees on behalf of WMS LLC. The Company recorded contracted services income/(loss) of $844 thousand, $370 thousand, and $(960) thousand for the years ended December 31, 2017, 2016 and 2015, respectively. Income related to WMS LLC, including equity method investment income, is classified as income from WMS Series LLC in noninterest income within the consolidated statements of operations.

The Company purchased $574.3 million, $589.2 million and $616.9 million of single family mortgage loans from WMS LLC for the years ended December 31, 2017, 2016 and 2015, respectively. The Company provides a $25.0 million secured line of credit that allows WMS LLC to fund and close single family mortgage loans in the name of WMS LLC. The outstanding balance of the secured line of credit was $6.1 million and $6.9 million at December 31, 2017, and 2016, respectively. The highest outstanding balance of the secured line of credit was $13.0 million and $17.0 million during 2017 and 2016, respectively. The line of credit matures July 1, 2018.

Premises and Equipment

Furniture and equipment and leasehold improvements are stated at cost less accumulated depreciation or amortization and depreciated or amortized over the shorter of the useful life of the related asset or the term of the lease, generally 3 to 39 years, using the straight-line method. Management periodically evaluates furniture and equipment and leasehold improvements for impairment.

Goodwill

Goodwill is recorded upon completion of a business combination as the difference between the purchase price and the fair value of net identifiable assets acquired. Subsequent to initial recognition, the Company tests goodwill for impairment during the third quarter of each fiscal year, or more often if events or circumstances, such as adverse changes in the business climate, indicate there may be impairment. Goodwill was not impaired at December 31, 2017 or 2016, nor was any goodwill written off due to impairment during 2017, 2016 or 2015.

Changes in the carrying amount of goodwill are detailed in the following table:

	(in thousands)
Goodwill balance at December 31, 2015	$ 11,521
Acquisitions	10,654
Goodwill balance at December 31, 2016	22,175
Acquisitions	389
Goodwill balance at December 31, 2017	$ 22,564

Trust Preferred Securities

Trust preferred securities allow investors the ability to invest in junior subordinated debentures of the Company, which provide the Company with long-term financing. The transaction begins with the formation of a Variable Interest Entity ("VIE") established as a trust by the Company. This trust issues two classes of securities: common securities, all of which are purchased and held by the Company and recorded in other assets on the consolidated statements of financial position, and trust preferred securities, which are sold to third-party investors. The trust holds subordinated debentures (debt) issued by the Company, which the Company records in long-term debt on the consolidated statement of financial position. The trust finances the purchase of the subordinated debentures with the proceeds from the sale of its common and preferred securities.

The junior subordinated debentures are the sole assets of the trust, and the coupon rate on the debt mirrors the dividend payment on the preferred security. The Company also has the right to defer interest payments for up to five years and has the right to call the preferred securities. These preferred securities are non-voting and do not have the right to convert to shares of the issuer. The trust's common equity securities issued to the Company are not considered to be equity at risk because the equity securities were financed by the trust through the purchase of the debentures from the Company. As a consequence, the Company holds no variable interest in the trust, and therefore, is not the trust's primary beneficiary.

Federal Funds Purchased and Securities Sold Under Agreements to Repurchase

From time to time, the Company may enter into federal funds transactions involving purchasing reserve balances on a short-term basis, or sales of securities under agreements to repurchase the same securities (“repurchase agreements”). Repurchase agreements are accounted for as secured financing arrangements with the obligation to repurchase securities sold reflected as a liability in the consolidated statements of financial condition. The dollar amount of securities underlying the repurchase agreements remains in investment securities available for sale. For short-term instruments, including securities sold under agreements to repurchase and federal funds purchased, the carrying amount is a reasonable estimate of the fair value.

Income Taxes

Our income tax expense, deferred tax assets and liabilities, and liabilities for unrecognized tax benefits reflect management’s best assessment of estimated current and future taxes to be paid. We are subject to federal income tax and also state income taxes in a number of different states. Significant judgments and estimates are required in determining the consolidated income tax expense.

Deferred income taxes arise from temporary differences between the tax basis of assets and liabilities and their reported amounts in the financial statements, which will result in taxable or deductible amounts in the future. Changes in tax laws and rates may affect recorded deferred tax assets and liabilities and our effective tax rate in the future. Such changes are accounted for in the period of enactment, and are reflected as discrete tax items in the Company’s tax provision.

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 this determination, the Company 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.

The calculation of our tax liabilities involves dealing with uncertainties in the application of complex tax laws and regulations in different jurisdictions. Accounting Standards Codification ("ASC") 740 states that a tax benefit from an uncertain tax position may be recognized when it is more likely than not that the position will be sustained upon examination, including resolutions of any related appeals or litigation processes, on the basis of the technical merits. We record unrecognized tax benefits as liabilities in accordance with ASC 740 (including any potential interest and penalties) and we adjust these liabilities when our judgment changes as a result of the evaluation of new information not previously available. Because of the complexity of some of these uncertainties, the ultimate resolution may result in a payment that is materially different from our current estimate of the unrecognized tax benefit liabilities. These differences will be reflected as increases or decreases to income tax expense in the period in which new information is available.

Derivatives and Hedging Activities

In order to reduce the risk of significant interest rate fluctuations on the value of certain assets and liabilities, such as certain mortgage loans held for sale or mortgage servicing rights, the Company utilizes derivatives, such as forward sale commitments, interest rate futures, option contracts, interest rate swaps and swaptions as risk management instruments in its hedging strategy.

All free-standing derivatives are required to be recorded on the consolidated statements of financial condition at fair value. As permitted under U.S. GAAP, the Company nets derivative assets and liabilities, and related collateral, when a legally enforceable master netting agreement exists between the Company and the derivative counterparty. The accounting for changes in fair value of a derivative depends on whether or not the transaction has been designated and qualifies for hedge accounting. Derivatives that are not designated as hedges are reported and measured at fair value through earnings. The Company does not use derivatives for trading purposes.

Before initiating a position where hedge accounting treatment is desired, the Company formally documents the relationship between the hedging instrument(s) and the hedged item(s), as well as its risk management objective and strategy.

For derivative instruments qualifying for hedge accounting treatment, the instrument is designed as either: (1) a hedge of changes in fair value of a recognized asset or liability or of an unrecognized firm commitment (a fair value hedge), or (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).

Derivatives where the Company has not attempted to achieve or attempted but did not achieve hedge accounting treatment are referred to as economic hedges. The changes in fair value of these instruments are recorded in our consolidated statements of operations in the period in which the change occurs.

In a fair value hedge, changes in the fair value of the derivative and, to the extent that it is effective, changes in the fair value of the hedged asset or liability attributable to the hedged risk are recorded through current period earnings in the same financial statement category as the hedged item.

In a cash flow hedge, the effective portion of the change in the fair value of the hedging derivative is recorded in accumulated other comprehensive income and is subsequently reclassified into earnings during the same period in which the hedged item affects earnings. The ineffective portion is recognized immediately in noninterest income – other.

The Company discontinues hedge accounting when (1) it determines that the derivative is no longer expected to be highly effective in offsetting changes in fair value or cash flows of the designated item; (2) the derivative expires or is sold, terminated, or exercised; (3) the derivative is de-designated from the hedge relationship; or (4) it is no longer probable that a hedged forecasted transaction will occur by the end of the originally specified time period.

If the Company determines that the derivative no longer qualifies as a fair value or cash flow hedge and therefore hedge accounting is discontinued, the derivative (if retained) will continue to be recorded on the balance sheet at its fair value with changes in fair value included in current earnings. For a discontinued fair value hedge, the previously hedged item is no longer adjusted for changes in fair value.

When the Company discontinues hedge accounting because it is not probable that a forecasted transaction will occur, the derivative will continue to be recorded on the balance sheet at its fair value with changes in fair value included in current earnings, and the gains and losses in accumulated other comprehensive income will be recognized immediately in earnings. When the Company discontinues hedge accounting because the hedging instrument is sold, terminated, or de-designated as a hedge, the amount reported in accumulated other comprehensive income through the date of sale, termination, or de-designation will continue to be reported in accumulated other comprehensive income until the forecasted transaction affects earnings. For fair value hedges that are de-designated, the net gain or loss on the underlying transactions being hedged is amortized to other noninterest income over the remaining contractual life of the loans at the time of de-designation. Changes in the fair value of these derivative instruments after de-designation of fair value hedge accounting are recorded in noninterest income in the consolidated statements of operations. As of December 31, 2017, the Company had no derivatives that were designated as fair value hedges or cash flow hedges.

Interest rate lock commitments ("IRLCs") for single family mortgage loans that we intend to sell are considered free-standing derivatives. For determining the fair value measurement of IRLCs we consider several factors including the fair value in the secondary market of the underlying loan resulting from the exercise of the commitment, the expected net future cash flows related to the associated servicing of the loan and the probability that the loan will not fund according to the terms of the commitment (referred to as a fall-out factor). The value of the underlying loan is affected primarily by changes in interest rates. Management uses forward sales commitments to hedge the interest rate exposure from IRLCs. A forward loan sale commitment protects the Company from losses on sales of loans arising from the exercise of the loan commitments by securing the ultimate sales price and delivery date of the loan. The Company takes into account various factors and strategies in determining the portion of the mortgage pipeline it wants to hedge economically. Unrealized and realized gains and losses on derivative contracts utilized for economically hedging the mortgage pipeline are recognized as part of the net gain on mortgage loan origination and sale activities within noninterest income.

The Company is exposed to credit risk if derivative counterparties to derivative contracts do not perform as expected. This risk consists primarily of the termination value of agreements where the Company is in a favorable position. The Company minimizes counterparty credit risk through credit approvals, limits, monitoring procedures, and obtaining collateral, as appropriate.

Share-Based Employee Compensation

The Company has share-based employee compensation plans as more fully discussed in Note 16, *Share-Based Compensation Plan*s. Under the accounting guidance for stock compensation, compensation expense recognized includes the cost for share-based awards, such as nonqualified stock options and restricted stock grants, which are recognized as compensation expense over the requisite service period (generally the vesting period) on a straight line basis. For stock awards that vest upon the satisfaction of a market condition, the Company estimates the service period over which the award is expected to vest. If all conditions to the vesting of an award are satisfied prior to the end of the estimated vesting period, any unrecognized compensation costs associated with the portion of the award that vested earlier than expected are immediately recognized in earnings.

Fair Value Measurement

The term "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. A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. The Company’s approach is to maximize the use of observable inputs and minimize the use of unobservable inputs when developing fair value measurements. The degree of management judgment involved in estimating the fair value of a financial instrument or other asset is dependent upon the availability of quoted market prices or observable market value inputs for internal valuation models, used for estimating fair value. For financial instruments that are actively traded in the marketplace or whose values are based on readily available market data, little judgment is necessary when estimating the instrument’s fair value. When observable market prices and data are not readily available, significant management judgment often is necessary to estimate fair value. In those cases, different assumptions could result in significant changes in valuation. See Note 17, *Fair Value Measurement*.

Commitments, Guarantees, and Contingencies

U.S. GAAP requires that a guarantor recognize, at the inception of a guarantee, a liability in an amount equal to the fair value of the obligation undertaken in issuing the guarantee. A guarantee is a contract that contingently requires the guarantor to pay a guaranteed party based upon: (a) changes in an underlying asset, liability or equity security of the guaranteed party; or (b) a third party’s failure to perform under a specified agreement. The Company initially records guarantees at the inception date fair value of the obligation assumed and records the amount in other liabilities. For indemnifications provided in sales agreements, a portion of the sale proceeds is allocated to the guarantee, which adjusts the gain or loss that would otherwise result from the transaction. For these indemnifications, the initial liability is amortized to income as the Company’s risk is reduced (i.e., over time as the Company's exposure is reduced or when the indemnification expires).

Contingent liabilities, including those that exists as a result of a guarantee or indemnification, are recognized when it becomes probable that a loss has been incurred and the amount of the loss is reasonably estimable. The contingent portion of a guarantee is not recognized if the estimated amount of loss is less than the carrying amount of the liability recognized at inception of the guarantee (as adjusted for any amortization).

The Company typically sells loans servicing retained in either a pooled loan securitization transaction with a government-sponsored enterprise ("GSE"), a whole loan sale to a GSE, or a whole loan sale to market participants such as other financial institutions, who purchase the loans for investment purposes or include them in a private label securitization transaction, or the loans are pooled and sold into a conforming loan securitization with a GSE, provided loan origination parameters conform to GSE guidelines. Substantially all of the Company’s loan sales are pooled loan securitization transactions with GSEs. These conforming loan securitizations are guaranteed by GSEs, such as Fannie Mae, Ginnie Mae and Freddie Mac.

The Company may be required to repurchase mortgage loans or indemnify loan purchasers due to defects in the origination process of the loan, such as documentation errors, underwriting errors and judgments, early payment defaults and fraud. These obligations expose the Company to any credit loss on the repurchased mortgage loans after accounting for any mortgage insurance that it may receive. Generally, the maximum amount of future payments the Company would be required to make for breaches of these representations and warranties would be equal to the unpaid principal balance of such loans that are deemed to have defects that were sold to purchasers plus, in certain circumstances, accrued and unpaid interest on such loans and certain expenses. See Note 13, *Commitments, Guarantees, and Contingencies*.

The Company sells multifamily loans through the Fannie Mae Delegated Underwriting and Servicing Program ("DUS"®) (DUS® is a registered trademark of Fannie Mae). that are subject to a credit loss sharing arrangement. The Company may also from time to time sell loans with recourse. When loans are sold with recourse or subject to a loss sharing arrangement, a liability is recorded based on the estimated fair value of the obligation under the accounting guidance for guarantees. These liabilities are included within other liabilities. See Note 13, *Commitments, Guarantees, and Contingencies*.

Earnings per Share

Basic earnings per share ("EPS") is computed by dividing net income available to common shareholders by the weighted average common shares outstanding during the period. Diluted EPS is computed by dividing net income available to common shareholders by the weighted average common shares outstanding, plus the effect of common stock equivalents (for example, stock options and unvested restricted stock). Stock options issued under stock-based compensation plans that have an antidilutive effect and shares of restricted stock whose vesting is contingent upon conditions that have not been satisfied at the end of the period are excluded from the computation of diluted EPS. Weighted average common shares outstanding include shares held by the HomeStreet, Inc. 401(k) Savings Plan.

Business Segments

The Company's business segments are determined based on the products and services provided, as well as the nature of the related business activities, and they reflect the manner in which financial information is regularly reviewed by the Company's chief operating decision maker for the purpose of allocating resources and evaluating the performance of the Company's businesses. The results for these business segments are based on management’s accounting process, which assigns income statement items and assets to each responsible operating segment. This process is dynamic and is based on management's view of the Company's operations. See Note 19, *Business Segments*.

Advertising Expense
Advertising costs, which we consider to be media and marketing materials, are expensed as incurred. We incurred $6.8 million, $7.4 million and $8.5 million in advertising expense during the years ended December 31, 2017, 2016 and 2015, respectively.

Recent Accounting Developments

In February 2018 the Financial Accounting Standards Board ('"FASB") issued Accounting Standards Update ("ASU") No. 2018-02, *Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income,* or ASU 2018-02. The amendments in this Update allow a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act. The Update does not have any impact on the underlying ASC 740 guidance that requires the effect of a change in tax law be included in income from continuing operations. The amendments in this Update are effective for all entities for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted and should be applied either in the period of adoption or retrospectively to each period (or periods) in which the effect of the change in the U.S. federal corporate income tax rate in the Tax Cuts and Jobs Act is recognized. The Company is currently evaluating the provisions of this guidance to determine the potential impact the new standard will have on the Company's consolidated financial statements.

In August 2017 the FASB issued ASU No. 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities,* or ASU 2017-12. This standard better aligns an entity's risk management activities and financial reporting for hedging relationships through changes to both the designation and measurement guidance for qualifying hedging relationships and the presentation of hedge results. To meet that objective, the amendments expand and refine hedge accounting for both nonfinancial and financial risk components and align the recognition and presentation of the effects of the hedge instruments and the hedged item in the financial statements. Adoption for this ASU is required for fiscal years and interim periods beginning after December 15, 2018 and early adoption is permitted. The Company is currently evaluating the provisions of this guidance to determine the potential impact the new standard will have on the Company's consolidated financial statements.

In March 2017 the FASB issued ASU No. 2017-08, *Receivables - Nonrefundable Fees and other Costs (Subtopic 320-20): Premium Amortization on Purchased Callable Debt Securities,* or ASU 2017-08. This standard shortens the amortization period for the premium to the earliest call date to more closely align interest income recorded on bonds held at a premium or a discount with the economics of the underlying instrument. Adoption of ASU 2017-08 is required for fiscal years and interim periods within those fiscal years, beginning after December, 15, 2018, early adoption is permitted. The Company is currently evaluating the provisions of this guidance to determine the potential impact the new standard will have on the Company's consolidated financial statements.

In January 2017, the FASB issued ASU No. 2017-04, *Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment,* or ASU 2017-04, which eliminates Step 2 from the goodwill impairment test. ASU 2017-04 also eliminates the requirements for any reporting unit with a zero or negative carrying amount to perform a qualitative assessment and, if it fails that qualitative test, to perform Step 2 of the goodwill impairment test. An entity still has the option to perform the qualitative assessment for a reporting unit to determine if the quantitative impairment test is necessary. Adoption of ASU 2017-04 is required for annual or interim goodwill impairment tests in fiscal years beginning after December 15, 2019 with early adoption being permitted for annual or interim goodwill impairment tests performed on testing dates after January 1,

2017. The Company does not expect the adoption of ASU 2017-04 to have a material impact on its consolidated financial statements.

In January 2017, the FASB issued ASU No. 2017-01, *Business Combinations (Topic 805): Clarifying the Definition of a Business,* for determining whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The new standard is effective for annual periods, and interim periods within those annual periods, beginning after December 15, 2017 with early adoption permitted for transactions that occurred before the issuance date or effective date of the standard if the transactions were not reported in financial statements that have been issued or made available for issuance. The standard must be applied prospectively. Upon adoption, the standard will impact how we assess acquisitions (or disposals) of assets or businesses. Management does not expect the adoption of ASU 2017-01 to have a material impact on its consolidated financial statements.

On November 17, 2016, the FASB issued ASU No. 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash: a Consensus of the FASB Emerging Issues Task Force.* This ASU requires a company’s cash flow statement to explain the changes during a reporting period of the totals for cash, cash equivalents, restricted cash, and restricted cash equivalents. Additionally, amounts for restricted cash and restricted cash equivalents are to be included with cash and cash equivalents if the cash flow statement includes a reconciliation of the total cash balances for a reporting period. This ASU is effective for public business entities for annual periods, including interim periods within those annual periods, beginning after December 15, 2017, with early application permitted. Management does not anticipate that this guidance will have a material impact on the Company's consolidated financial statements.

On August 26, 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows (Topic 230):, Classification of Certain Cash Receipts and Cash Payments*. The amendments in this ASU were issued to reduce diversity in how certain cash receipts and payments are presented and classified in the statement of cash flows in eight specific areas. The amendments in this ASU are effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years and should be applied using a retrospective transition method to each period presented. Early application was permitted upon issuance of the ASU. Management is currently evaluating the impact of this ASU but does not expect this ASU to have a material impact on the Company’s consolidated financial statements.

In June 2016, FASB issued ASU No. 2016-13, *Measurement of Credit Losses on Financial Instruments*. Current GAAP requires an “incurred loss” methodology for recognizing credit losses that delays recognition until it is probable a loss has been incurred. The main objective of this ASU is to provide financial statement users with more decision-useful information about the expected credit losses on financial instruments and other commitments to extend credit held by a reporting entity at each reporting date. The amendment affects loans, debt securities, trade receivables, net investments in leases, off-balance-sheet credit exposures, reinsurance receivables, and any other financial asset not excluded from the scope that have the contractual right to receive cash. The amendments in this ASU replace the incurred loss impairment methodology in current GAAP with a methodology that reflects expected credit losses and requires consideration of a broader range of reasonable and supportable information to inform credit loss estimates. The amendments in this ASU require a financial asset (or group of financial assets) measured at amortized cost basis to be presented at the net amount expected to be collected. The allowance for credit losses is a valuation account that is deducted from the amortized cost basis of the financial asset(s) to present the net carrying value at the amount expected to be collected on the financial asset. The measurement of expected credit losses will be based on relevant information about past events, including historical experience, current conditions, and reasonable and supportable forecasts that affect the collectability of the reported amount. The amendments in this ASU broaden the information that an entity must consider in developing its expected credit loss estimate for assets measured either collectively or individually. The use of forecasted information incorporates more timely information in the estimate of expected credit loss, which will be more decision useful to users of the financial statements. The amendments in this ASU will be effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. The Company is still evaluating the effects this ASU will have on the Company’s consolidated financial statements. The Company has formed an internal committee to oversee the project. Upon adoption, the Company expects a change in the processes and procedures to calculate the allowance for loan losses, including changes in assumptions and estimates to consider expected credit losses over the life of the loan versus the current accounting practice that utilizes the incurred loss model. The new guidance may result in an increase in the allowance for loan losses; however, management is still assessing the magnitude of the increase and its impact on the Company's consolidated financial statements. In addition, the current accounting policy and procedures for other-than-temporary impairment on investment securities available for sale will be replaced with an allowance approach. The Company has begun developing and implementing processes to address the amendments of this ASU.

On February 25, 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. The amendments in this ASU require lessees to recognize a lease liability, which is a lessee's obligation to make lease payments arising from a lease, and a right-of-use asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. This ASU simplifies the accounting for sale and leaseback transactions. The amendments in this ASU are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early application was permitted upon issuance of the ASU. Lessees (for capital and operating leases) and lessors (for sales-type, direct financing, and operating leases) must apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The modified retrospective approach would not require any transition accounting for leases that expired before the earliest comparative period presented. Lessees and lessors may not apply a full retrospective transition approach. During 2018, a proposed ASU was issued by the FASB that provides a practical expedient that would allow companies to use an optional transition method, which would allow for a cumulative adjustment to retained earnings during the period of adoption and prior periods would not require restatement. Management is currently evaluating the provisions of this guidance to determine the potential impact the new standard will have on the Company's consolidated financial statements. While we have not quantified the impact to our balance sheet, upon the adoption of this ASU we expect to report increased assets and liabilities on our Consolidated Statement of Financial Condition as a result of recognizing right-of-use assets and lease liabilities related to these leases and certain equipment under non-cancelable operating lease agreements, which currently are not on our Consolidated Statement of Financial Condition.

In January 2016, FASB issued ASU No. 2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities.* The amendments in this ASU require equity securities to be measured at fair value with changes in the fair value recognized through net income. The amendments allow equity investments that do not have readily determinable fair values to be remeasured at fair value under certain circumstances and require enhanced disclosures about those investments. This ASU simplifies the impairment assessment of equity investments without readily determinable fair values. This ASU also eliminates the requirement to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the consolidated statement of financial position. The amendments in this ASU require separate presentation in other comprehensive income of the portion of the total change in the fair value of a liability resulting from a change in the instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments. This ASU excludes from net income gains or losses that the entity may not realize because those financial liabilities are not usually transferred or settled at their fair values before maturity. The amendments in this ASU require separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (that is, securities or loans and receivables) on the consolidated statement of financial position or in the accompanying notes to the financial statements. The amendments in this ASU are effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The implementation of this guidance will not have a material impact on our consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*. This ASU clarifies the principles for recognizing revenue from contracts with customers. On August 12, 2015, the FASB issued ASU 2015-14 to defer the effective date of ASU 2014-09. Public business entities, certain not-for-profit entities, and certain employee benefit plans should apply the guidance in ASU 2014-09 to annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. Earlier application is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. On March 17, 2016, the FASB issued Accounting Standards Update 2016-08 to clarify the implementation guidance on principal versus agent considerations. We intend to adopt this new guidance on January 1, 2018. We completed an analysis that includes (1) identification of all revenue streams included in the financial statements; (2) of the revenue streams identified, determine which are within the scope of the pronouncement; (3) determination of size, timing and amount of revenue recognition for streams of income within the scope of this pronouncement; (4) determination of the sample size of contracts for further analysis; and (5) completion of analysis on sample of contracts to evaluate the impact of the new guidance. Based on this analysis, we developed processes and procedures in 2017 to address the amendments of this ASU, including new disclosures. The implementation of this guidance will not have a material impact on our consolidated financial statements.

NOTE 2–BUSINESS COMBINATIONS:

Recent Acquisition Activity

On September 15, 2017, the Company completed its acquisition of one branch and its related deposits in Southern California, from Opus Bank. The application of the acquisition method of accounting resulted in goodwill of $389 thousand.

On November 10, 2016, the Company completed its acquisition of two branches and their related deposits in Southern California, from Boston Private Bank and Trust. The provisional application of the acquisition method of accounting resulted in goodwill of $2.3 million.

On August 12, 2016, the Company completed its acquisition of certain assets and liabilities, including two branches in Lake Oswego, Oregon from The Bank of Oswego. The application of the acquisition method of accounting resulted in goodwill of $19 thousand.

On February 1, 2016, the Company completed its acquisition of Orange County Business Bank ("OCBB") located in Irvine, California through the merger of OCBB with and into HomeStreet Bank with HomeStreet Bank as the surviving subsidiary. The purchase price of this acquisition was $55.9 million. OCBB shareholders as of the effective time received merger consideration equal to 0.5206 shares of HomeStreet common stock, and $1.1641 in cash upon the surrender of their OCBB shares, which resulted in the issuance of 2,459,461 shares of HomeStreet common stock. The application of the acquisition method of accounting resulted in goodwill of $8.4 million.

Simplicity Acquisition

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

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

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

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

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

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

The operations of Simplicity are included in the Company's operating results as of the acquisition date of March 1, 2015 through the period ended December 31, 2017. Acquisition-related costs were expensed as incurred in noninterest expense as merger and integration costs.

The following table provides a breakout of Simplicity merger-related expense for the year ended December 31, 2015:

(in thousands)	Year Ended December 31, 2015
Noninterest expense	
Salaries and related costs	$ 7,669
General and administrative	1,256
Legal	530
Consulting	5,539
Occupancy	335
Information services	481
Total noninterest expense	$ 15,810

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

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

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

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

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

NOTE 3–REGULATORY CAPITAL REQUIREMENTS:

In July 2013, federal banking regulators (including the Federal Deposit Insurance Corporation "FDIC" and the Federal Reserve Bank "FRB") adopted new capital rules (the “Rules”). The Rules apply to both depository institutions (such as the Bank) and their holding companies (such as the Company). The Rules reflect, in part, certain standards initially adopted by the Basel Committee on Banking Supervision in December 2010 (which standards are commonly referred to as “Basel III”) as well as requirements contemplated by the Dodd-Frank Act. The Rules applied to both the Company and the Bank beginning in 2015.

Failure to meet minimum capital requirements could initiate certain mandatory and possibly additional discretionary actions by the regulators that, if undertaken, could have a direct material effect on the Company’s financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank and the Company must meet specific capital guidelines that involve quantitative measures of assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. Capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Bank and the Company to maintain minimum amounts and ratios of Tier 1 leverage capital, common equity Tier 1 capital, Tier 1 risk-based capital and total risk-based capital (as defined in the regulations). The regulators also have the ability to impose elevated capital requirements in certain circumstances. At December 31, 2017 and 2016 the Bank's capital ratios meet the regulatory capital category of “well capitalized” as defined by the Rules.

The Bank’s and the Company's capital amounts and ratios under Basel III are included in the following tables:

	At December 31, 2017					
HomeStreet Bank	Actual		For Minimum Capital Adequacy Purposes		To Be Categorized As “Well Capitalized” Under Prompt Corrective Action Provisions	
(in thousands)	Amount	Ratio	Amount	Ratio	Amount	Ratio
Tier 1 leverage capital (to average assets)	$ 649,864	9.67 %	$ 268,708	4.0 %	$ 335,885	5.0 %
Common equity risk-based capital (to risk-weighted assets)	649,864	13.22	221,201	4.5	319,512	6.5
Tier 1 risk-based capital (to risk-weighted assets)	649,864	13.22	294,935	6.0	393,246	8.0
Total risk-based capital (to risk-weighted assets)	688,981	14.02	393,246	8.0	491,558	10.0

	At December 31, 2017					
HomeStreet, Inc.	Actual		For Minimum Capital Adequacy Purposes		To Be Categorized As “Well Capitalized” Under Prompt Corrective Action Provisions	
(in thousands)	Amount	Ratio	Amount	Ratio	Amount	Ratio
Tier 1 leverage capital (to average assets)	$ 614,624	9.12 %	$ 269,534	4.0 %	$ 336,918	5.0 %
Common equity risk-based capital (to risk-weighted assets)	555,120	9.86	253,293	4.5	365,868	6.5
Tier 1 risk-based capital (to risk-weighted assets)	614,624	10.92	337,724	6.0	450,299	8.0
Total risk-based capital (to risk-weighted assets)	653,741	11.61	450,299	8.0	562,873	10.0

	At December 31, 2016					
HomeStreet Bank	Actual		For Minimum Capital Adequacy Purposes		To Be Categorized As “Well Capitalized” Under Prompt Corrective Action Provisions	
(in thousands)	Amount	Ratio	Amount	Ratio	Amount	Ratio
Tier 1 leverage capital (to average assets)	$ 635,988	10.26 %	$ 248,055	4.0 %	$ 310,069	5.0 %
Common equity risk-based capital (to risk-weighted assets)	635,988	13.92	205,615	4.5	297,000	6.5
Tier 1 risk-based capital (to risk-weighted assets)	635,988	13.92	274,154	6.0	365,538	8.0
Total risk-based capital (to risk-weighted assets)	671,252	14.69	365,538	8.0	456,923	10.0

125

HomeStreet, Inc.	At December 31, 2016 Actual		For Minimum Capital Adequacy Purposes		To Be Categorized As "Well Capitalized" Under Prompt Corrective Action Provisions	
(in thousands)	Amount	Ratio	Amount	Ratio	Amount	Ratio
Tier 1 leverage capital (to average assets)	$ 608,988	9.78 %	$ 249,121	4.0 %	$ 311,402	5.0 %
Common equity risk-based capital (to risk-weighted assets)	550,510	10.54	234,965	4.5	339,395	6.5
Tier 1 risk-based capital (to risk-weighted assets)	608,988	11.66	313,287	6.0	417,716	8.0
Total risk-based capital (to risk-weighted assets)	644,252	12.34	417,716	8.0	522,146	10.0

At periodic intervals, the FDIC and the Washington State Department of Financial Institutions ("WDFI") routinely examine the Bank's financial statements as part of their legally prescribed oversight of the banking industry. Based on their examinations, these regulators can direct that the Bank's financial statements be adjusted in accordance with their findings.

NOTE 4–INVESTMENT SECURITIES:

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

(in thousands)	At December 31, 2017 Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
AVAILABLE FOR SALE				
Mortgage-backed securities:				
Residential	$ 133,654	$ 4	$ (3,568)	$ 130,090
Commercial	24,024	8	(338)	23,694
Municipal bonds	389,117	2,978	(3,643)	388,452
Collateralized mortgage obligations:				
Residential	164,502	3	(4,081)	160,424
Commercial	100,001	9	(1,441)	98,569
Corporate debt securities	25,146	67	(476)	24,737
U.S. Treasury securities	10,899	—	(247)	10,652
Agency debentures	9,861	—	(211)	9,650
	$ 857,204	$ 3,069	$ (14,005)	$ 846,268
HELD TO MATURITY				
Mortgage-backed securities:				
Residential	$ 12,062	$ 35	$ (99)	$ 11,998
Commercial	21,015	75	(161)	20,929
Collateralized mortgage obligations	3,439	—	—	3,439
Municipal bonds	21,423	339	(97)	21,665
Corporate debt securities	97	—	—	97

$58,036	$ 449	$(357)	$58,128

126

(in thousands)	At December 31, 2016 Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
AVAILABLE FOR SALE				
Mortgage-backed securities:				
Residential	$181,158	$31	$(4,115)	$177,074
Commercial	25,896	13	(373)	25,536
Municipal bonds	473,153	1,333	(6,813)	467,673
Collateralized mortgage obligations:				
Residential	194,982	32	(3,813)	191,201
Commercial	71,870	29	(1,135)	70,764
Corporate debt securities	52,045	110	(1,033)	51,122
U.S. Treasury securities	10,882	—	(262)	10,620
	$1,009,986	$1,548	$(17,544)	$993,990
HELD TO MATURITY				
Mortgage-backed securities:				
Residential	$13,844	$71	$(90)	$13,825
Commercial	16,303	70	(64)	16,309
Municipal bonds	19,612	99	(459)	19,252
Corporate debt securities	102	—	—	102
	$49,861	$240	$(613)	$49,488

Mortgage-backed securities ("MBS") and collateralized mortgage obligations ("CMO") represent securities issued by government sponsored enterprises ("GSEs"). Each of the MBS and CMO securities in our investment portfolio are guaranteed by Fannie Mae, Ginnie Mae or Freddie Mac. Municipal bonds are comprised of general obligation bonds (i.e., backed by the general credit of the issuer) and revenue bonds (i.e., backed by either collateral or revenues from the specific project being financed) issued by various municipal corporations. As of December 31, 2017 and 2016, all securities held, including municipal bonds and corporate debt securities, were rated investment grade based upon external ratings where available and, where not available, based upon internal ratings which correspond to ratings as defined by Standard and Poor’s Rating Services (“S&P”) or Moody’s Investors Services (“Moody’s”). As of December 31, 2017 and 2016, substantially all securities held had ratings available by external ratings agencies.

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

	At December 31, 2017					
	Less than 12 months		12 months or more		Total	
(in thousands)	Gross unrealized losses	Fair value	Gross unrealized losses	Fair value	Gross unrealized losses	Fair value
AVAILABLE FOR SALE						
Mortgage-backed securities:						
Residential	$(182)	$18,020	$(3,386)	$110,878	$(3,568)	$128,898
Commercial	(113)	15,265	(225)	6,748	(338)	22,013
Municipal bonds	(760)	105,415	(2,883)	134,103	(3,643)	239,518
Collateralized mortgage obligations:						
Residential	(612)	53,721	(3,469)	104,555	(4,081)	158,276
Commercial	(538)	57,236	(903)	35,225	(1,441)	92,461
Corporate debt securities	(15)	5,272	(461)	13,365	(476)	18,637
U.S. Treasury securities	(3)	997	(244)	9,655	(247)	10,652
Agency debentures	(211)	9,650	—	—	(211)	9,650
	$(2,434)	$265,576	$(11,571)	$414,529	$(14,005)	$680,105
HELD TO MATURITY						
Mortgage-backed securities:						
Residential	$(13)	$2,662	$(86)	$4,452	$(99)	$7,114
Commercial	(161)	15,900	—	—	(161)	15,900
Collateralized mortgage obligations	—	3,439	—	—	—	3,439
Municipal bonds	(3)	2,185	(94)	9,465	(97)	11,650
	$(177)	$24,186	$(180)	$13,917	$(357)	$38,103

(in thousands)	At December 31, 2016 Less than 12 months Gross unrealized losses	Fair value	12 months or more Gross unrealized losses	Fair value	Total Gross unrealized losses	Fair value
AVAILABLE FOR SALE						
Mortgage-backed securities:						
Residential	$(3,842)	$144,240	$(273)	$9,907	$(4,115)	$154,147
Commercial	(373)	23,798	—	—	(373)	23,798
Municipal bonds	(6,813)	283,531	—	—	(6,813)	283,531
Collateralized mortgage obligations:						
Residential	(3,052)	175,490	(761)	11,422	(3,813)	186,912
Commercial	(1,005)	60,926	(130)	5,349	(1,135)	66,275
Corporate debt securities	(472)	24,447	(561)	11,677	(1,033)	36,124
U.S. Treasury securities	(262)	10,620	—	—	(262)	10,620
	$(15,819)	$723,052	$(1,725)	$38,355	$(17,544)	$761,407
HELD TO MATURITY						
Mortgage-backed securities:						
Residential	$(90)	$5,481	$—	$—	$(90)	$5,481
Commercial	(64)	13,156	—	—	(64)	13,156
Municipal bonds	(459)	11,717	—	—	(459)	11,717
	$(613)	$30,354	$—	$—	$(613)	$30,354

The Company has evaluated securities available for sale that are in an unrealized loss position and has determined that the decline in value is temporary and is related to the change in market interest rates since purchase. The decline in value is not related to any issuer- or industry-specific credit event. The Company has not identified any expected credit losses on its debt securities as of December 31, 2017 and 2016. In addition, as of December 31, 2017 and 2016, the Company had not made a decision to sell any of its debt securities held, nor did the Company consider it more likely than not that it would be required to sell such securities before recovery of their amortized cost basis.

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

	At December 31, 2017									
	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 securities:										
Residential	$—	— %	$—	— %	$8,914	1.63 %	$121,176	1.97 %	$130,090	1.94 %
Commercial	—	—	15,356	2.07	4,558	2.03	3,780	2.98	23,694	2.21
Municipal bonds	641	2.64	24,456	3.10	39,883	3.25	323,472	3.81	388,452	3.71
Collateralized mortgage obligations:										
Residential	—	—	—	—	—	—	160,424	2.10	160,424	2.10
Commercial	—	—	12,550	2.09	21,837	2.38	64,182	2.13	98,569	2.18
Agency debentures	—	—	—	—	9,650	2.26	—	—	9,650	2.26
Corporate debt securities	1,048	2.11	6,527	2.80	11,033	3.49	6,129	3.57	24,737	3.27
U.S. Treasury securities	997	1.22	—	—	9,655	1.76	—	—	10,652	1.71
Total available for sale	$2,686	1.90 %	$58,889	2.58 %	$105,530	2.67 %	$679,163	2.90 %	$846,268	2.85 %
HELD TO MATURITY										
Mortgage-backed securities:										
Residential	$—	— %	$—	— %	$—	— %	$11,998	2.93 %	$11,998	2.93 %
Commercial	—	—	6,577	2.15	14,352	2.71	—	—	20,929	2.53
Collateralized mortgage obligations	—	—	—	—	—	—	3,439	1.90	3,439	1.90
Municipal bonds	—	—	1,846	3.35	4,630	2.57	15,189	3.50	21,665	3.28
Corporate debt securities	—	—	—	—	—	—	97	6.00	97	6.00
Total held to maturity	$—	— %	$8,423	2.41 %	$18,982	2.68 %	$30,723	3.10 %	$58,128	2.86 %

(in thousands)	At December 31, 2016 Within one year Fair Value	Weighted Average Yield	After one year through five years Fair Value	Weighted Average Yield	After five years through ten years Fair Value	Weighted Average Yield	After ten years Fair Value	Weighted Average Yield	Total Fair Value	Weighted Average Yield
AVAILABLE FOR SALE										
Mortgage-backed securities:										
Residential	$1	0.29 %	$—	— %	$2,122	1.59 %	$174,951	2.03 %	$177,074	2.02 %
Commercial	—	—	20,951	2.13	4,585	2.06	—	—	25,536	2.11
Municipal bonds	3,479	3.30	20,939	2.94	52,043	2.55	391,212	3.08	467,673	3.02
Collateralized mortgage obligations:										
Residential	—	—	—	—	1,639	1.32	189,562	2.06	191,201	2.06
Commercial	—	—	10,860	1.84	19,273	2.74	40,631	1.91	70,764	2.12
Corporate debt securities	—	—	10,516	2.67	21,493	3.74	19,113	3.54	51,122	3.45
U.S. Treasury securities	999	0.64	—	—	9,621	1.76	—	—	10,620	1.66
Total available for sale	$4,479	2.70 %	$63,266	2.43 %	$110,776	2.69 %	$815,469	2.57 %	$993,990	2.57 %
HELD TO MATURITY										
Mortgage-backed securities:										
Residential	$—	— %	$—	— %	$—	— %	$13,825	3.11 %	$13,825	3.11 %
Commercial	—	—	4,581	2.06	11,728	2.71	—	—	16,309	2.53
Municipal bonds	—	—	—	—	6,450	2.73	12,802	3.31	19,252	3.11
Corporate debt securities	—	—	—	—	—	—	102	6.00	102	6.00
Total held to maturity	$—	— %	$4,581	2.06 %	$18,178	2.72 %	$26,729	3.22 %	$49,488	2.93 %

Sales of investment securities available for sale were as follows.

(in thousands)	Years Ended December 31, 2017	2016	2015
Proceeds	$397,492	$164,430	$112,259
Gross gains	1,214	2,782	2,571
Gross losses	(725)	(243)	(165)

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

(in thousands)	At December 31, 2017	At December 31, 2016
Federal Home Loan Bank to secure borrowings	$ 425,866	$ 103,171
Washington and California State to secure public deposits	118,828	30,364
Securities pledged to secure derivatives in a liability position	7,308	9,359
Other securities pledged	6,089	8,123
Total securities pledged as collateral	$ 558,091	$ 151,017

The Company assesses the creditworthiness of the counterparties that hold the pledged collateral and has determined that these arrangements have little risk. There were no securities pledged under repurchase agreements at December 31, 2017 and 2016.

Tax-exempt interest income on securities available for sale totaling $8.8 million, $6.3 million and $3.6 million for the years ended December 31, 2017, 2016 and 2015, respectively, was recorded in the Company's consolidated statements of operations.

NOTE 5–LOANS AND CREDIT QUALITY:

For a detailed discussion of loans and credit quality, including accounting policies and the methodology used to estimate the allowance for credit losses, see Note 1, *Summary of Significant Accounting Policies.*

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

Loans held for investment consist of the following:

	At December 31,	
(in thousands)	2017	2016
Consumer loans		
Single family(1)	$ 1,381,366	$ 1,083,822
Home equity and other	453,489	359,874
Total consumer loans	1,834,855	1,443,696
Commercial real estate loans		
Non-owner occupied commercial real estate	622,782	588,672
Multifamily	728,037	674,219
Construction/land development	687,631	636,320
Total commercial real estate loans	2,038,450	1,899,211

Commercial and industrial loans		
Owner occupied commercial real estate	391,613	282,891
Commercial business	264,709	223,653
Total commercial and industrial loans	656,322	506,544
Loans held for investment before deferred fees, costs and allowance	4,529,627	3,849,451
Net deferred loan fees and costs	14,686	3,577
	4,544,313	3,853,028
Allowance for loan losses	(37,847)	(34,001)
Total loans held for investment	$4,506,466	$3,819,027

(1) Includes $5.5 million and $18.0 million at December 31, 2017 and December 31, 2016, respectively, of loans where a fair value option election was made at the time of origination and, therefore, are carried at fair value with changes recognized in the consolidated statements of operations.

Loans in the amount of $1.81 billion and $1.59 billion at December 31, 2017 and 2016, respectively, were pledged to secure borrowings from the FHLB as part of our liquidity management strategy. Additionally, loans totaling $663.8 million and $554.7 million at December 31, 2017 and 2016, respectively, were pledged to secure borrowings from the Federal Reserve Bank. The FHLB and Federal Reserve Bank do not have the right to sell or re-pledge these loans.

It is the Company's policy to make loans to officers, directors, and their associates in the ordinary course of business on substantially the same terms as those prevailing at the time for comparable transactions with other persons. The following is a summary of activity during the years ended December 31, 2017 and 2016 with respect to such aggregate loans to these related parties and their associates:

	Years Ended December 31,	
(in thousands)	2017	2016
Beginning balance, January 1	$4,379	$4,511
Principal repayments and advances, net	(2,411)	(132)
Ending balance, December 31	$1,968	$4,379

Credit Risk Concentrations

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

Loans held for investment are primarily secured by real estate located in the Pacific Northwest, California and Hawaii. At December 31, 2017, we had concentrations representing 10% or more of the total portfolio by state and property type for the loan class of single family within the state of Washington and California, which represented 15.0% and 10.9% of the total portfolio, respectively. At December 31, 2016 we had concentrations representing 10% or more of the total portfolio by state and property type for the loan classes of single family and non-owner occupied real estate within the state of Washington, which represented 13.8% and 10.1% of the total portfolio, respectively.

Credit Quality

Management considers the level of allowance for loan losses to be appropriate to cover credit losses inherent within the loans held for investment portfolio as of December 31, 2017. In addition to the allowance for loan losses, the Company maintains a separate allowance for losses related to unfunded loan commitments, and this amount is included in accounts payable and other liabilities on the consolidated statements of financial condition. Collectively, these allowances are referred to as the allowance for credit losses.

For further information on the policies that govern the determination of the allowance for loan losses levels, see Note 1, *Summary of Significant Accounting Policies.*

Activity in the allowance for credit losses was as follows.

(in thousands)	Years Ended December 31, 2017	2016	2015
Allowance for credit losses (roll-forward):			
Beginning balance	$35,264	$30,659	$22,524
Provision for credit losses	750	4,100	6,100
Recoveries, net of charge-offs	3,102	505	2,035
Ending balance	$39,116	$35,264	$30,659
Components:			
Allowance for loan losses	$37,847	$34,001	$29,278
Allowance for unfunded commitments	1,269	1,263	1,381
Allowance for credit losses	$39,116	$35,264	$30,659

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

	Year Ended December 31, 2017				
(in thousands)	Beginning balance	Charge-offs	Recoveries	(Reversal of) Provision	Ending balance
Consumer loans					
Single family	$8,196	$(2)	$1,495	$(277)	$9,412
Home equity and other	6,153	(707)	818	817	7,081
Total consumer loans	14,349	(709)	2,313	540	16,493
Commercial real estate loans					
Non-owner occupied commercial real estate	4,481	—	—	274	4,755
Multifamily	3,086	—	—	809	3,895
Construction/land development	8,553	—	1,017	(893)	8,677
Total commercial real estate loans	16,120	—	1,017	190	17,327
Commercial and industrial loans					
Owner occupied commercial real estate	2,199	—	—	761	2,960
Commercial business	2,596	(411)	892	(741)	2,336
Total commercial and industrial loans	4,795	(411)	892	20	5,296
Total allowance for credit losses	$35,264	$(1,120)	$4,222	$750	$39,116

(in thousands)	Year Ended December 31, 2016 Beginning balance	Charge-offs	Recoveries	(Reversal of) Provision	Ending balance
Consumer loans					
Single family	$ 8,942	$ (790)	$ 90	$ (46)	$ 8,196
Home equity and other	4,620	(839)	920	1,452	6,153
Total consumer loans	13,562	(1,629)	1,010	1,406	14,349
Commercial real estate loans					
Non-owner occupied commercial real estate	3,594	—	—	887	4,481
Multifamily	1,194	—	—	1,892	3,086
Construction/land development	9,271	(42)	1,143	(1,819)	8,553
Total commercial real estate loans	14,059	(42)	1,143	960	16,120
Commercial and industrial loans					
Owner occupied commercial real estate	1,253	—	—	946	2,199
Commercial business	1,785	(27)	50	788	2,596
Total commercial and industrial loans	3,038	(27)	50	1,734	4,795
Total allowance for credit losses	$ 30,659	$ (1,698)	$ 2,203	$ 4,100	$ 35,264

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

(in thousands)	At December 31, 2017 Allowance: collectively evaluated for impairment	Allowance: individually evaluated for impairment	Total	Loans: collectively evaluated for impairment	Loans: individually evaluated for impairment	Total	
Consumer loans							
Single family	$9,188	$ 224	$9,412	$1,300,939	$ 74,967	$1,375,906	
Home equity and other	7,036	45	7,081	452,182	1,290	453,472	
Total consumer loans	16,224	269	16,493	1,753,121	76,257	1,829,378	
Commercial real estate loans							
Non-owner occupied commercial real estate	4,755	—	4,755	622,782	—	622,782	
Multifamily	3,895	—	3,895	727,228	809	728,037	
Construction/land development	8,677	—	8,677	687,177	454	687,631	
Total commercial real estate loans	17,327	—	17,327	2,037,187	1,263	2,038,450	
Commercial and industrial loans							
Owner occupied commercial real estate	2,960	—	2,960	388,624	2,989	391,613	
Commercial business	2,316	20	2,336	261,603	3,106	264,709	
Total commercial and industrial loans	5,276	20	5,296	650,227	6,095	656,322	
Total loans evaluated for impairment	38,827	289	39,116	4,440,535	83,615	4,524,150	
Loans held for investment carried at fair value				5,246	231	5,477	(1)
Total loans held for investment	$38,827	$ 289	$39,116	$4,445,781	$ 83,846	$4,529,627	

(in thousands)	At December 31, 2016 Allowance: collectively evaluated for impairment	Allowance: individually evaluated for impairment	Total	Loans: collectively evaluated for impairment	Loans: individually evaluated for impairment	Total	
Consumer loans							
Single family	$7,871	$ 325	$8,196	$985,219	$ 80,676	$1,065,895	
Home equity and other	6,104	49	6,153	358,350	1,463	359,813	
Total consumer loans	13,975	374	14,349	1,343,569	82,139	1,425,708	
Commercial real estate loans							
Non-owner occupied commercial real estate	4,481	—	4,481	587,801	871	588,672	
Multifamily	3,086	—	3,086	673,374	845	674,219	
Construction/land development	8,553	—	8,553	634,427	1,893	636,320	
Total commercial real estate loans	16,120	—	16,120	1,895,602	3,609	1,899,211	
Commercial and industrial loans							
Owner occupied commercial real estate	2,199	—	2,199	281,424	1,467	282,891	
Commercial business	2,591	5	2,596	220,360	3,293	223,653	
Total commercial and industrial loans	4,790	5	4,795	501,784	4,760	506,544	
Total loans evaluated for impairment	34,885	379	35,264	3,740,955	90,508	3,831,463	
Loans held for investment carried at fair value						17,988	(1)
Total loans held for investment	$34,885	$ 379	$35,264	$3,740,955	$ 90,508	$3,849,451	

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

Impaired Loans

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

(in thousands)	At December 31, 2017 Recorded investment (1)	Unpaid principal balance (2)	Related allowance
With no related allowance recorded:			
Consumer loans			
Single family	$71,264 (4)	$72,424	$ —
Home equity and other	782	807	—
Total consumer loans	72,046	73,231	—
Commercial real estate loans			
Multifamily	809	837	—
Construction/land development	454	454	—
Total commercial real estate loans	1,263	1,291	—
Commercial and industrial loans			
Owner occupied commercial real estate	2,989	3,288	—
Commercial business	2,398	3,094	—
Total commercial and industrial loans	5,387	6,382	—
	$78,696	$80,904	$ —
With an allowance recorded:			
Consumer loans			
Single family	$3,934	$4,025	$ 224
Home equity and other	508	508	45
Total consumer loans	4,442	4,533	269
Commercial and industrial loans			
Commercial business	708	755	20
Total commercial and industrial loans	708	755	20
	$5,150	$5,288	$ 289
Total:			
Consumer loans			
Single family (3)	$75,198	$76,449	$ 224
Home equity and other	1,290	1,315	45
Total consumer loans	76,488	77,764	269
Commercial real estate loans			
Multifamily	809	837	—
Construction/land development	454	454	—
Total commercial real estate loans	1,263	1,291	—
Commercial and industrial loans			
Owner occupied commercial real estate	2,989	3,288	—
Commercial business	3,106	3,849	20
Total commercial and industrial loans	6,095	7,137	20
Total impaired loans	$83,846	$86,192	$ 289

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

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

(3) Includes \$69.6 million in single family performing TDRs.

(4) Includes \$231 thousand of fair value option loans.

(in thousands)	At December 31, 2016 Recorded investment (1)	Unpaid principal balance (2)	Related allowance
With no related allowance recorded:			
Consumer loans			
Single family	$77,756	$80,573	$ —
Home equity and other	946	977	—
Total consumer loans	78,702	81,550	—
Commercial real estate loans			
Non-owner occupied commercial real estate	871	898	—
Multifamily	845	851	—
Construction/land development	1,893	2,819	—
Total commercial real estate loans	3,609	4,568	—
Commercial and industrial loans			
Owner occupied commercial real estate	1,467	1,948	—
Commercial business	2,945	4,365	—
Total commercial and industrial loans	4,412	6,313	—
	$86,723	$92,431	$ —
With an allowance recorded:			
Consumer loans			
Single family	$2,920	$3,011	$ 325
Home equity and other	517	517	49
Total consumer loans	3,437	3,528	374
Commercial and industrial loans			
Commercial business	348	347	5
Total commercial and industrial loans	348	347	5
	$3,785	$3,875	$ 379
Total:			
Consumer loans			
Single family(3)	$80,676	$83,584	$ 325
Home equity and other	1,463	1,494	49
Total consumer loans	82,139	85,078	374
Commercial real estate loans			
Non-owner occupied commercial real estate	871	898	—
Multifamily	845	851	—
Construction/land development	1,893	2,819	—
Total commercial real estate loans	3,609	4,568	—
Commercial and industrial loans			
Owner occupied commercial real estate	1,467	1,948	—
Commercial business	3,293	4,712	5
Total commercial and industrial loans	4,760	6,660	5
Total impaired loans	$90,508	$96,306	$ 379

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

(3) Includes $73.1 million in single family performing TDRs.

The following table provides the average recorded investment and interest income recognized on impaired loans by portfolio segment and class.

(in thousands)	Year Ended December 31, 2017		Year Ended December 31, 2016		Year Ended December 31, 2015	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
Consumer loans						
Single family	$80,519	$ 2,963	$82,745	$ 2,873	$78,824	$ 2,670
Home equity and other	1,432	80	1,408	68	1,922	83
Total consumer loans	81,951	3,043	84,153	2,941	80,746	2,753
Commercial real estate loans						
Non-owner occupied commercial real estate	686	—	435	—	10,862	375
Multifamily	824	25	1,299	47	4,035	111
Construction/land development	917	73	2,286	87	4,535	207
Total commercial real estate loans	2,427	98	4,020	134	19,432	693
Commercial and industrial loans						
Owner occupied commercial real estate	2,922	170	2,648	22	3,554	69
Commercial business	2,533	144	3,591	83	4,431	163
Total commercial and industrial loans	5,455	314	6,239	105	7,985	232
	$89,833	$ 3,455	$94,412	$ 3,180	$108,163	$ 3,678

Credit Quality Indicators

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

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

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

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

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

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

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

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

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

- The borrower may be experiencing declining operating trends, strained cash flows or less-than anticipated performance. Cash flow should still be adequate to cover debt service, and the negative trends should be identified as being of a short-term or temporary nature.
- The borrower may have experienced a minor, unexpected covenant violation.
- Companies who may be experiencing tight working capital or have a cash cushion deficiency.
- A loan may also be a watch if financial information is late, there is a documentation deficiency, the borrower has experienced unexpected management turnover, or if they face industry issues that, when combined with performance factors create uncertainty in their future ability to perform.
- Delinquent payments, increasing and material overdraft activity, request for bulge and/or out- of-formula advances may be an indicator of inadequate working capital and may suggest a lower rating.
- Failure of the intended repayment source to materialize as expected, or renewal of a loan (other than cash/marketable security secured or lines of credit) without reduction are possible indicators of a watch or worse risk rating.

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

- Performance is poor or significantly less than expected. There may be a temporary debt-servicing deficiency or inadequate working capital as evidenced by a cash cushion deficiency, but not to the extent that repayment is compromised. Material violation of financial covenants is common.
- Loans with unresolved material issues that significantly cloud the debt service outlook, even though a debt servicing deficiency does not currently exist.
- Modest underperformance or deviation from plan for real estate loans where absorption of rental/sales units is necessary to properly service the debt as structured. Depth of support for interest carry provided by owner/guarantors may mitigate and provide for improved rating.
- This rating may be assigned when a loan officer is unable to supervise the credit properly, an inadequate loan agreement, an inability to control collateral, failure to obtain proper documentation, or any other deviation from prudent lending practices.
- Unlike a substandard credit, there should be a reasonable expectation that these temporary issues will be corrected within the normal course of business, rather than liquidation of assets, and in a reasonable period of time.

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

- Cash flow deficiencies or trends are of a magnitude to jeopardize current and future payments with no immediate relief. A loss is not presently expected, however the outlook is sufficiently uncertain to preclude ruling out the possibility.
- The borrower has been unable to adjust to prolonged and unfavorable industry or economic trends.
- Material underperformance or deviation from plan for real estate loans where absorption of rental/sales units is necessary to properly service the debt and risk is not mitigated by willingness and capacity of owner/guarantor to support interest payments.
- Management character or honesty has become suspect. This includes instances where the borrower has become uncooperative.
- Due to unprofitable or unsuccessful business operations, some form of restructuring of the business, including liquidation of assets, has become the primary source of loan repayment. Cash flow has deteriorated, or been diverted, to the point that sale of collateral is now the Company's primary source of repayment (unless this was the original source of repayment). If the collateral is under the Company's control and is cash or other liquid, highly marketable securities and properly margined, then a more appropriate rating might be special mention or watch.
- The borrower is involved in bankruptcy proceedings where collateral liquidation values are expected to fully protect the Company against loss.
- There is material, uncorrectable faulty documentation or materially suspect financial information.

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

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

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

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

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

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

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

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

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

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

Substandard. A homogeneous retail substandard loan, risk rated 8, is 90-180 days past due from the required payment date at month-end.

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

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

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

	At December 31, 2017				
(in thousands)	Pass	Watch	Special mention	Substandard	Total
Consumer loans					
Single family	$ 1,355,965 (1)	$ 2,982	$ 11,328	$ 11,091	$ 1,381,366
Home equity and other	451,194	143	751	1,401	453,489
	1,807,159	3,125	12,079	12,492	1,834,855
Commercial real estate loans					
Non-owner occupied commercial real estate	613,181	8,801	—	800	622,782
Multifamily	693,190	34,038	507	302	728,037
Construction/land development	664,025	22,062	1,466	78	687,631
	1,970,396	64,901	1,973	1,180	2,038,450
Commercial and industrial loans					
Owner occupied commercial real estate	361,429	20,949	6,399	2,836	391,613
Commercial business	220,461	39,588	1,959	2,701	264,709
	581,890	60,537	8,358	5,537	656,322
	$ 4,359,445	$ 128,563	$ 22,410	$ 19,209	$ 4,529,627

	At December 31, 2016				
(in thousands)	Pass	Watch	Special mention	Substandard	Total
Consumer loans					
Single family	$ 1,051,463 (1)	$ 4,348	$ 15,172	$ 12,839	$ 1,083,822
Home equity and other	357,191	597	514	1,572	359,874
	1,408,654	4,945	15,686	14,411	1,443,696
Commercial real estate loans					
Non-owner occupied commercial real estate	562,950	23,741	1,110	871	588,672
Multifamily	660,234	13,140	508	337	674,219
Construction/land development	615,675	16,074	3,083	1,488	636,320
	1,838,859	52,955	4,701	2,696	1,899,211
Commercial and industrial loans					
Owner occupied commercial real estate	247,046	28,778	6,055	1,012	282,891

Commercial business	171,883	42,767	3,385	5,618	223,653
	418,929	71,545	9,440	6,630	506,544
	$3,666,442	$129,445	$ 29,827	$ 23,737	$3,849,451

(1) Includes $5.5 million and $18.0 million of loans at December 31, 2017 and 2016, respectively, where a fair value option election was made at the time of origination and, therefore, are carried at fair value with changes recognized in the consolidated statements of operations.

As of December 31, 2017 and 2016, none of the Company's loans were rated Doubtful or Loss.

Nonaccrual and Past Due Loans

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

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

	At December 31, 2017		
(in thousands)	30-59 days past due	60-89 days past due	90 days or more past due