HomeStreet, Inc.
Form 10-Q
November 09, 2012

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

# FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended: September 30, 2012
Commission file number: 001-35424

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

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

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes £ No S

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

| | | | |
|---|---|---|---|
| Large Accelerated Filer | £ | Accelerated Filer | £ |
| Non-accelerated Filer | S | Smaller Reporting Company | £ |

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes £ No S

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. After giving effect to a two-for-one forward stock split of our common stock implemented on November 5, 2012, on October 31, 2012, there would have been 14,369,638 shares of no par value Common Stock outstanding.

PART I – FINANCIAL INFORMATION

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

PART I – FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

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

| (in thousands, except share data) | September 30, 2012 | December 31, 2011 |
|---|---|---|
| ASSETS | | |
| Cash and cash equivalents (including interest-bearing instruments of $11,497 and $246,113) | $22,051 | $263,302 |
| Investment securities available for sale | 414,050 | 329,047 |
| Loans held for sale (includes $525,926 and $130,546 carried at fair value) | 532,580 | 150,409 |
| Loans held for investment (net of allowance for loan losses of $27,461 and $42,689) | 1,268,703 | 1,300,873 |
| Mortgage servicing rights (includes $73,787 and $70,169 carried at fair value) | 81,512 | 77,281 |
| Other real estate owned | 17,003 | 38,572 |
| Federal Home Loan Bank stock, at cost | 36,697 | 37,027 |
| Premises and equipment, net | 13,060 | 6,569 |
| Accounts receivable and other assets | 122,285 | 61,877 |
| | $2,507,941 | $2,264,957 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Liabilities: | | |
| Deposits | $1,981,814 | $2,009,755 |
| Federal Home Loan Bank advances | 131,597 | 57,919 |
| Accounts payable and accrued expenses | 93,413 | 49,019 |
| Long-term debt | 61,857 | 61,857 |
| | 2,268,681 | 2,178,550 |
| Shareholders' equity: | | |
| Preferred stock, no par value, Authorized 10,000 shares, Issued and outstanding, 0 shares and 0 shares | — | — |
| Common stock, no par value, Authorized 160,000,000, Issued and outstanding, 14,354,972 shares and 5,403,498 shares | 511 | 511 |
| Additional paid-in capital | 89,264 | 31 |
| Retained earnings | 140,136 | 81,746 |
| Accumulated other comprehensive income | 9,349 | 4,119 |
| | 239,260 | 86,407 |
| | $2,507,941 | $2,264,957 |

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

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (in thousands, except share data) | 2012 | 2011 | 2012 | 2011 |
| Interest income: | | | | |
| Loans | $18,283 | $17,593 | $52,086 | $54,208 |
| Investment securities available for sale | 2,517 | 1,422 | 7,205 | 5,128 |
| Other | 24 | 117 | 216 | 274 |
| | 20,824 | 19,132 | 59,507 | 59,610 |
| Interest expense: | | | | |
| Deposits | 3,908 | 5,848 | 12,985 | 19,427 |
| Federal Home Loan Bank advances | 297 | 855 | 1,506 | 3,122 |
| Securities sold under agreements to repurchase | 19 | — | 69 | — |
| Long-term debt | 305 | 458 | 1,041 | 1,586 |
| Other | 4 | 1 | 12 | 1 |
| | 4,533 | 7,162 | 15,613 | 24,136 |
| Net interest income | 16,291 | 11,970 | 43,894 | 35,474 |
| Provision for credit losses | 5,500 | 1,000 | 7,500 | 3,300 |
| Net interest income after provision for credit losses | 10,791 | 10,970 | 36,394 | 32,174 |
| Noninterest income: | | | | |
| Net gain on mortgage loan origination and sale activities | 64,390 | 15,766 | 138,386 | 29,702 |
| Mortgage servicing income | 506 | 18,532 | 15,470 | 32,093 |
| Income from Windermere Mortgage Services Series LLC | 1,188 | 902 | 3,748 | 1,380 |
| (Loss) gain on debt extinguishment | — | — | (939) | 2,000 |
| Depositor and other retail banking fees | 756 | 778 | 2,262 | 2,313 |
| Insurance commissions | 192 | 103 | 550 | 724 |
| Gain on sale of investment securities available for sale | 397 | 642 | 1,349 | 643 |
| Other | 704 | 256 | 1,919 | 1,042 |
| | 68,133 | 36,979 | 162,745 | 69,897 |
| Noninterest expense: | | | | |
| Salaries and related costs | 31,573 | 13,217 | 81,149 | 37,056 |
| General and administrative | 7,033 | 4,310 | 19,030 | 12,307 |
| Legal | 312 | 983 | 1,471 | 2,286 |
| Consulting | 1,069 | 270 | 1,746 | 633 |
| Federal Deposit Insurance Corporation assessments | 794 | 1,264 | 2,751 | 4,278 |
| Occupancy | 2,279 | 1,663 | 6,160 | 5,031 |
| Information services | 2,411 | 1,509 | 6,129 | 4,466 |
| Other real estate owned expense | 348 | 9,113 | 8,916 | 26,533 |
| | 45,819 | 32,329 | 127,352 | 92,590 |
| Income before income taxes | 33,105 | 15,620 | 71,787 | 9,481 |
| Income tax expense | 11,762 | 362 | 13,397 | 388 |
| NET INCOME | $21,343 | $15,258 | $58,390 | $9,093 |
| Basic income per share | $1.49 | $2.82 | $4.51 | $1.68 |
| Diluted income per share | $1.45 | $2.66 | $4.35 | $1.62 |

| | | | | |
|---|---|---|---|---|
| Basic weighted average number of shares outstanding | 14,335,950 | 5,403,498 | 12,960,212 | 5,403,498 |
| Diluted weighted average number of shares outstanding | 14,699,032 | 5,745,432 | 13,414,476 | 5,608,104 |

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

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

| (in thousands) | Three Months Ended September 30, 2012 | Three Months Ended September 30, 2011 | Nine Months Ended September 30, 2012 | Nine Months Ended September 30, 2011 |
|---|---|---|---|---|
| Net income | $21,343 | $15,258 | $58,390 | $9,093 |
| Other comprehensive income, net of tax: | | | | |
| Unrealized gain on securities: | | | | |
| Unrealized holding gain arising during the period (net of tax expense of $1,564 and $3,135 for the three and nine months ended September 30, 2012 and $0 for the three and nine months ended September 30, 2011) | 3,525 | 7,405 | 6,107 | 13,085 |
| Reclassification adjustment for net gain included in net income (net of tax expense of $139 and $472 for the three and nine months ended September 30, 2012 and $0 for the three and nine months ended September 30, 2011) | (258) | (642) | (877) | (643) |
| Other comprehensive income | 3,267 | 6,763 | 5,230 | 12,442 |
| Comprehensive income | $24,610 | $22,021 | $63,620 | $21,535 |

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

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

| (in thousands, except share data) | Number of shares | Common stock | Additional paid-in capital | Retained earnings | Accumulated other comprehensive income (loss) | Total |
|---|---|---|---|---|---|---|
| Balance, January 1, 2011 | 5,403,498 | $511 | $16 | $65,627 | $ (7,365 ) | $58,789 |
| Net income | — | — | — | 9,093 | — | 9,093 |
| Share-based compensation expense | — | — | 12 | — | — | 12 |
| Other comprehensive income | — | — | — | — | 12,442 | 12,442 |
| Balance, September 30, 2011 | 5,403,498 | $511 | $28 | $74,720 | $ 5,077 | $80,336 |
| Balance, January 1, 2012 | 5,403,498 | $511 | $31 | $81,746 | $ 4,119 | $86,407 |
| Net income | — | — | — | 58,390 | — | 58,390 |
| Share-based compensation expense | — | — | 2,415 | — | — | 2,415 |
| Common stock issued | 8,951,474 | — | 86,818 | — | — | 86,818 |
| Other comprehensive income | — | — | — | — | 5,230 | 5,230 |
| Balance, September 30, 2012 | 14,354,972 | $511 | $89,264 | $140,136 | $ 9,349 | $239,260 |

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

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

| (in thousands) | Nine Months Ended September 30, | |
|---|---|---|
| | 2012 | 2011 |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net income | $58,390 | $9,093 |
| Adjustments to reconcile net income to net cash used in operating activities: | | |
| Amortization/accretion of discount/premium on loans held for investment, net of additions | (919) | (536) |
| Amortization of investment securities | 3,877 | 1,988 |
| Amortization of intangibles | 77 | 99 |
| Amortization of mortgage servicing rights | 1,551 | 1,121 |
| Provision for credit losses | 7,500 | 3,300 |
| Provision for losses on other real estate owned | 10,955 | 23,515 |
| Depreciation and amortization on premises and equipment | 1,864 | 1,469 |
| Originations of loans held for sale | (3,433,925) | (1,201,835) |
| Proceeds from sale of loans held for sale | 3,075,401 | 1,196,931 |
| Fair value adjustment of loans held for sale | (23,647) | (9,085) |
| Fair value adjustment of foreclosed loans transferred to other real estate owned | (489) | — |
| Addition of originated mortgage servicing rights | (33,606) | (19,825) |
| Change in fair value of mortgage servicing rights | 27,889 | 31,914 |
| Net gain on sale of investment securities | (1,349) | (643) |
| Gain on sale of other real estate owned | (2,764) | (326) |
| Gain on early retirement of long-term debt | — | (2,000) |
| Net deferred income tax benefit | (11,494) | (16) |
| Share-based compensation expense | 2,415 | 12 |
| Cash used by changes in operating assets and liabilities: | | |
| Increase in accounts receivable and other assets | (55,462) | (23,232) |
| Increase (decrease) in accounts payable and other liabilities | 37,601 | (15,067) |
| Net cash used in operating activities | (336,135) | (3,123) |
| | | |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Purchase of investment securities | (260,566) | (204,502) |
| Proceeds from sale of investment securities | 159,174 | 155,924 |
| Principal repayments and maturities of investment securities | 28,150 | 33,738 |
| Proceeds from sale of other real estate owned | 47,392 | 118,744 |
| Mortgage servicing rights purchased from others | (65) | (60) |
| Capital expenditures related to other real estate owned | (4,643) | (841) |
| Origination of loans held for investment and principal repayments, net | (62) | 140,922 |
| Property and equipment purchased, net | (8,355) | (1,297) |
| Net cash (used in) provided by investing activities | (38,975) | 242,628 |

| (in thousands) | Nine Months Ended September 30, | |
|---|---|---|
| | 2012 | 2011 |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Decrease in deposits, net | $(27,941) | $(72,765) |
| Proceeds from Federal Home Loan Bank advances | 4,975,490 | 36,398 |
| Repayment of Federal Home Loan Bank advances | (4,901,811) | (134,348) |
| Proceeds from securities sold under agreements to repurchase | 393,500 | — |
| Repayment of securities sold under agreements to repurchase | (393,500) | — |
| Repurchase of Federal Home Loan Bank stock | 330 | — |
| Repayment of long-term debt | — | (3,000) |
| Proceeds from stock issuance, net | 87,791 | — |
| Net cash provided by (used in) financing activities | 133,859 | (173,715) |
| NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS | (241,251) | 65,790 |
| CASH AND CASH EQUIVALENTS: | | |
| Beginning of year | 263,302 | 72,639 |
| End of period | $22,051 | $138,429 |
| SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION: | | |
| Cash paid during the period for - | | |
| Interest | $16,642 | $24,857 |
| Federal and state income taxes | 11,746 | 11 |
| Noncash activities - | | |
| Loans held for investment foreclosed and transferred to other real estate owned | 37,305 | 35,005 |
| Loans originated to finance the sales of other real estate owned | — | 750 |
| Loans transferred from held for investment to held for sale | 9,966 | — |
| Ginnie Mae loans recognized with the right to repurchase, net | 3,330 | 390 |

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

HomeStreet, Inc. and Subsidiaries
Notes to Interim Consolidated Financial Statements (Unaudited)

NOTE 1–SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

HomeStreet, Inc. and its wholly owned subsidiaries (the “Company”) is a diversified financial services company that serves consumers and businesses in the Pacific Northwest and Hawaii. The Company is principally engaged in real estate lending, including mortgage banking activities, and retail and business banking operations. The consolidated financial statements include the accounts of HomeStreet, Inc. and its wholly owned subsidiaries, HomeStreet Capital Corporation and HomeStreet Bank (the “Bank”), and the Bank’s subsidiaries, HomeStreet/WMS, Inc., HomeStreet Reinsurance, Ltd., Continental Escrow Company, Union Street Holdings LLC and Lacey Gateway LLC. HomeStreet Bank was formed in 1986 and is a state-chartered savings bank.

The Company’s accounting and financial reporting policies conform to accounting principles generally accepted in the United States of America (“U.S. GAAP”). Inter-company balances and transactions have been eliminated in consolidation. In preparing the consolidated financial statements, the Company is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the financial statements and revenues and expenses during the reporting period and related disclosures. Although these estimates contemplate current conditions and how they are expected to change in the future, it is reasonably possible that actual conditions could be worse than anticipated in those estimates, which could materially affect the Company’s results of operations and financial condition. Actual results could differ from those estimates. Certain amounts in the financial statements from prior periods have been reclassified to conform to the current financial statement presentation.

The information furnished in these unaudited interim statements reflects all adjustments that are, in the opinion of management, necessary for a fair statement of the results for the periods presented. These adjustments are of a normal recurring nature, unless otherwise disclosed in this Form 10-Q. The results of operations in the interim statements do not necessarily indicate the results that may be expected for the full year. The interim financial information should be read in conjunction with the Company’s Annual Report on Form 10-K for the year ended December 31, 2011, filed with the Securities and Exchange Commission (“2011 Annual Report on Form 10-K”).

Shares outstanding and per share information presented in this Form 10-Q have been adjusted to reflect the 2-for-1 forward stock splits effective on November 5, 2012 and on March 6, 2012, as well as the 1-for-2.5 reverse stock split effective on July 19, 2011.

Accounting Developments in 2012

ASU 2011-04, Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS, amends requirements for measuring fair value and for disclosing information about fair value. The Company adopted the amendments in this ASU effective January 1, 2012, which did not have a material effect on our consolidated financial statements.

NOTE 2–SIGNIFICANT RISKS AND UNCERTAINTIES:

Regulatory Agreements

On May 18, 2009, the Company entered into a Stipulation and Consent to the Issuance of an Order to Cease and Desist (the “Company Order”) with the Office of Thrift Supervision (the “OTS”). The Company Order most significantly provides that the Company shall not pay dividends and shall not incur, issue, renew, repurchase, make payments on (including interest), or rollover any debt, increase any current lines of credit, or guarantee the debt of any entity without prior approval of the Federal Reserve, which subsequently replaced the OTS as the primary regulator. The Company Order will remain in effect until terminated, modified, or suspended, by written notice of such action by the Federal Reserve. The Company Order, however, does not prohibit the Holding Company from transacting its normal business.

On May 8, 2009, HomeStreet Bank (the "Bank") entered into an agreement with its primary banking regulators, the Federal Deposit Insurance Corporation (“FDIC”), and the Washington State Department of Financial Institutions (“DFI”), pursuant to which we consented to the entry of an Order to Cease & Desist from certain allegedly unsafe and unsound banking practices (the “Bank Order”).

As a result of improvement in the Bank's capital position, including the successful completion of our initial public offering and the subsequent contribution of $65.0 million of net proceeds to the Bank, and improvement in the Bank's asset quality, management, earnings, liquidity and sensitivity to interest rates since the imposition of the Bank Order, on March 26, 2012, the FDIC and DFI terminated the Bank Order. In connection with this termination, we and those regulators have entered into a memorandum of understanding, which requires, among other things, that the Bank maintain a minimum Tier 1 leverage capital ratio of 9.0% and continue to reduce the level of adversely classified assets. The memorandum of understanding continues to prohibit the Bank from paying dividends without the regulators' prior written consent.

NOTE 3–INVESTMENT SECURITIES AVAILABLE FOR SALE:

The amortized cost and fair value of investment securities available for sale at September 30, 2012 and December 31, 2011, are summarized as follows.

| (in thousands) | Amortized cost | Gross unrealized gains | Gross unrealized losses | Fair value |
|---|---|---|---|---|
| September 30, 2012: | | | | |
| Mortgage backed securities: | | | | |
| Residential | $62,782 | $704 | $(120) | $63,366 |
| Commercial | 13,813 | 719 | — | 14,532 |
| Municipal bonds [1] | 122,845 | 5,780 | (30) | 128,595 |
| Collateralized mortgage obligations: | | | | |
| Residential | 161,950 | 5,806 | (243) | 167,513 |
| Commercial | 9,055 | 54 | — | 9,109 |
| US Treasury securities | 30,927 | 12 | (4) | 30,935 |
| | $401,372 | $13,075 | $(397) | $414,050 |
| December 31, 2011: | | | | |
| Commercial mortgage backed securities | $13,941 | $542 | $— | $14,483 |
| Municipal bonds [1] | 48,948 | 728 | (92) | 49,584 |
| Collateralized mortgage obligations: | | | | |
| Residential | 220,418 | 3,119 | (147) | 223,390 |
| Commercial | 10,081 | — | (11) | 10,070 |
| US Treasury securities | 31,540 | 3 | (23) | 31,520 |
| | $324,928 | $4,392 | $(273) | $329,047 |

(1) Comprised of general obligation bonds (i.e. backed by the general credit of the issuer) and revenue bonds (i.e. backed by revenues from the specific project being financed) issued by various municipal corporations. As of September 30, 2012 and December 31, 2011, of the bonds that were rated, no bonds were rated below "A."

Mortgage-backed and collateralized mortgage obligations represent securities issued by Government Sponsored Enterprises ("GSEs"). Substantially all securities held are rated and considered at least investment grade, according to their credit rating by Standard and Poor's Rating Services ("S&P") or Moody's Investors Services ("Moody's").

Investment securities that were in an unrealized loss position at September 30, 2012 and December 31, 2011 are presented in the following tables based on the length of time the individual securities have been in an unrealized loss position.

| (in thousands) | Less than 12 months | | 12 months or more | | Total | |
|---|---|---|---|---|---|---|
| | Gross unrealized losses | Fair value | Gross unrealized losses | Fair value | Gross unrealized losses | Fair value |
| September 30, 2012: | | | | | | |
| Mortgage backed securities: | | | | | | |
| Residential | $(120) | $11,516 | $— | $— | $(120) | $11,516 |
| Municipal bonds | (30) | 3,634 | — | — | (30) | 3,634 |
| Collateralized mortgage obligations: | | | | | | |
| Residential | (243) | 20,208 | — | — | (243) | 20,208 |
| US Treasury securities | (1) | 1,603 | (3) | 10,338 | (4) | 11,941 |
| | $(394) | $36,961 | $(3) | $10,338 | $(397) | $47,299 |
| December 31, 2011: | | | | | | |
| Municipal bonds | $— | $— | $(92) | $1,095 | $(92) | $1,095 |
| Collateralized mortgage obligations | | | | | | |
| Residential | (147) | 37,807 | — | — | (147) | 37,807 |
| Commercial | (11) | 10,070 | — | — | (11) | 10,070 |
| US Treasury securities | (23) | 27,510 | — | — | (23) | 27,510 |
| | $(181) | $75,387 | $(92) | $1,095 | $(273) | $76,482 |

The Company has evaluated securities that are in an unrealized loss position and has determined that the decline in value is temporary and is related to the change in market interest rates since purchase. The decline in value is not related to any company- or industry-specific credit event. The Company anticipates full recovery of the amortized cost with respect to these securities at maturity or sooner in the event of a more favorable market interest rate environment and does not have the intent to sell these securities, nor is it more likely than not that the Company will be required to sell such securities.

The following tables present the fair value of investment securities available for sale by contractual maturity along with the associated contractual yield for the periods indicated below. Contractual maturities for mortgage-backed securities and collateralized mortgage obligations were determined assuming no 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 include adjustments to a tax equivalent basis.

| | At September 30, 2012 | | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 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 | $— | — | % | $— | — | % | $— | — | % | $63,366 | 1.97 | % | $63,366 | 1.97 | % |
| Commercial | — | — | % | — | — | % | — | — | % | 14,532 | 3.54 | % | 14,532 | 3.54 | % |
| Municipal bonds | — | — | % | — | — | % | 15,783 | 3.58 | % | 112,812 | 4.59 | % | 128,595 | 4.46 | % |
| Collateralized mortgage obligations | | | | | | | | | | | | | | | |
| Residential | — | — | % | — | — | % | — | — | % | 167,513 | 2.81 | % | 167,513 | 2.81 | % |
| Commercial | — | — | % | — | — | % | — | — | % | 9,109 | 2.06 | % | 9,109 | 2.06 | % |
| U.S. Treasury securities | 4,160 | 0.18 | % | 26,775 | 0.24 | % | — | — | % | — | — | % | 30,935 | 0.23 | % |
| Total available for sale | $4,160 | 0.18 | % | $26,775 | 0.24 | % | $15,783 | 3.58 | % | $367,332 | 3.22 | % | $414,050 | 3.01 | % |

| | At December 31, 2011 | | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Within one year | | | After one year through five years | | | After five years through ten years | | | After ten years | | | Total | | |
| (in thousands) | Fair Value | Weighted Average Yield | | Fair Value | Weighted Average Yield | | Fair Value | Weighted Average Yield | | Fair Value | Weighted Average Yield | | Fair Value | Weighted Average Yield | |
| Available for sale: | | | | | | | | | | | | | | | |
| Commercial mortgage backed securities | $— | — | % | $— | — | % | $— | — | % | $14,483 | 3.23 | % | $14,483 | 3.23 | % |
| Municipal bonds | — | — | % | — | — | % | 2,450 | 2.95 | % | 47,134 | 4.65 | % | 49,584 | 4.56 | % |
| Collateralized mortgage obligations | | | | | | | | | | | | | | | |
| Residential | — | — | % | — | — | % | — | — | % | 223,390 | 2.70 | % | 223,390 | 2.70 | % |
| Commercial | — | — | % | — | — | % | — | — | % | 10,070 | 2.06 | % | 10,070 | 2.06 | % |

| | | | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| U.S. Treasury | 4,010 | 0.23 | % | 27,510 | 0.24 | % | — | — | % | — | — | % | 31,520 | 0.24 | % |
| Total available for sale | $4,010 | 0.23 | % | $27,510 | 0.24 | % | $2,450 | 2.95 | % | $295,077 | 3.02 | % | $329,047 | 2.75 | % |

Sales of investment securities available for sale were as follows.

| (in thousands) | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2012 | 2011 | 2012 | 2011 |
| Proceeds | $39,635 | $146,710 | $159,174 | $155,924 |
| Gross gains | 434 | 642 | 1,780 | 643 |
| Gross losses | (37) | — | (431) | — |

There were no securities pledged to secure advances from the Federal Home Loan Bank ("FHLB") at September 30, 2012 and December 31, 2011. At September 30, 2012 and December 31, 2011 there were $19.3 million and $22.5 million, respectively, of securities pledged to secure derivatives in a liability position.

Tax-exempt interest income on securities available for sale totaling $1.3 million and $41 thousand for the three months ended September 30, 2012 and 2011, respectively, and $3.0 million and $172 thousand, for the nine months ended September 30, 2012 and 2011, respectively, were recorded in the Company's consolidated statements of operations.

NOTE 4–LOANS AND CREDIT QUALITY:

Loans held for investment consist of the following.

| (in thousands) | At September 30, 2012 | At December 31, 2011 |
|---|---|---|
| Consumer loans | | |
| Single family residential | $602,164 | $496,934 |
| Home equity | 141,343 | 158,936 |
| | 743,507 | 655,870 |
| Commercial loans | | |
| Commercial real estate | 360,919 | 402,139 |
| Multifamily residential | 36,912 | 56,379 |
| Construction/land development | 77,912 | 173,405 |
| Commercial business | 80,056 | 59,831 |
| | 555,799 | 691,754 |
| | 1,299,306 | 1,347,624 |
| Net deferred loan fees and costs | (3,142) | (4,062) |
| | 1,296,164 | 1,343,562 |
| Allowance for loan losses | (27,461) | (42,689) |
| | $1,268,703 | $1,300,873 |

Loans are pledged to secure borrowings from the FHLB as part of our liquidity management strategy. The FHLB does not have the right to sell or repledge these loans, which totaled $428.5 million and $490.4 million at September 30, 2012 and December 31, 2011, respectively.

Loans held for investment are primarily secured by real estate located in the states of Washington, Oregon, Idaho and Hawaii.

Loan concentrations may exist when there are amounts loaned to borrowers engaged in similar activities or similar types of loans extended to a diverse group of borrowers that would cause them to be similarly impacted by economic or other conditions. At September 30, 2012 we had concentrations representing 10% or more of the total portfolio by state and property type for the loan classes of single family and commercial real estate within the state of Washington, which represented 34.5% and 20.9% respectively. At December 31, 2011 we had concentrations representing 10% or more of the total portfolio by state and property type for the loan classes of single family, commercial real estate and construction/land development within the state of Washington, which represented 28.4%, 23.8% and 11.1% respectively. These loans were mostly located within the Puget Sound area, particularly within King County.

Credit Quality

Management considers the level of allowance for credit losses to be appropriate to cover credit losses inherent within the loans held for investment portfolio as of September 30, 2012. The allowance for credit losses is comprised of the allowance for loan losses as well as the allowance for unfunded credit commitments, which is reported in accounts payable and accrued expenses on the consolidated statement of financial condition.

Credit quality within the loans held for investment portfolio is continuously monitored by management and is reflected in the allowance for credit losses. Allowance levels are influenced by loan volumes, loan asset quality ratings (AQR) 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 elements: first, the identification of impaired loans and the measurement of impairment for each individual loan identified; and second, a method for estimating an allowance for all other loans.

For further information on the policies that govern the determination of the allowance for loan losses levels, see Note 5, Loans and Credit Quality to the Consolidated Financial Statements within the 2011 Annual Report on Form 10-K.

For the three and nine months ended September 30, 2012 and 2011, activity in the allowance for credit losses by loan portfolio segment and loan class is as follows.

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

| | Three Months Ended September 30, 2011 | | | | |
|---|---|---|---|---|---|
| (in thousands) | Beginning balance | Charge-offs | Recoveries | Provision | Ending Balance |
| Consumer loans | | | | | |
| Single family residential | $10,418 | $(2,160) | $163 | $2,805 | $11,226 |
| Home equity | 4,670 | (1,199) | 84 | 1,687 | 5,242 |
| | 15,088 | (3,359) | 247 | 4,492 | 16,468 |
| Commercial loans | | | | | |
| Commercial real estate | 4,075 | (509) | — | 156 | 3,722 |
| Multifamily residential | 350 | — | — | 7 | 357 |
| Construction/land development | 39,090 | (3,979) | 5 | (3,773) | 31,343 |
| Commercial business | 1,456 | (113) | 35 | 118 | 1,496 |
| | 44,971 | (4,601) | 40 | (3,492) | 36,918 |
| Total allowance for credit losses | $60,059 | $(7,960) | $287 | $1,000 | $53,386 |

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

| (in thousands) | Nine Months Ended September 30, 2011<br>Beginning balance | Charge-offs | Recoveries | Provision | Ending Balance |
|---|---|---|---|---|---|
| Consumer loans | | | | | |
| Single family residential | $11,977 | $(6,329) | $163 | $5,415 | $11,226 |
| Home equity | 4,495 | (3,572) | 110 | 4,209 | 5,242 |
| | 16,472 | (9,901) | 273 | 9,624 | 16,468 |
| Commercial loans | | | | | |
| Commercial real estate | 10,060 | (578) | — | (5,760) | 3,722 |
| Multifamily residential | 1,795 | — | — | (1,438) | 357 |
| Construction/land development | 33,478 | (9,759) | 6,126 | 1,498 | 31,343 |
| Commercial business | 2,761 | (849) | 208 | (624) | 1,496 |
| | 48,094 | (11,186) | 6,334 | (6,324) | 36,918 |
| Total allowance for credit losses | $64,566 | $(21,087) | $6,607 | $3,300 | $53,386 |

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

| (in thousands) | Allowance: collectively evaluated for impairment | Allowance: individually evaluated for impairment | Total | Loans: collectively evaluated for impairment | Loans: individually evaluated for impairment | Total |
|---|---|---|---|---|---|---|
| September 30, 2012 | | | | | | |
| Consumer loans | | | | | | |
| Single family residential | $11,134 | $2,418 | $13,552 | $533,901 | $68,263 | $602,164 |
| Home equity | 4,989 | 44 | 5,033 | 138,574 | 2,769 | 141,343 |
| | 16,123 | 2,462 | 18,585 | 672,475 | 71,032 | 743,507 |
| Commercial loans | | | | | | |
| Commercial real estate | 3,320 | 416 | 3,736 | 328,194 | 32,725 | 360,919 |
| Multifamily residential | 224 | 548 | 772 | 30,882 | 6,030 | 36,912 |
| Construction/land development | 1,373 | 1,491 | 2,864 | 56,766 | 21,146 | 77,912 |
| Commercial business | 632 | 1,038 | 1,670 | 77,612 | 2,444 | 80,056 |
| | 5,549 | 3,493 | 9,042 | 493,454 | 62,345 | 555,799 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Total | $21,672 | $5,955 | $27,627 | $1,165,929 | $133,377 | $1,299,306 |

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| (in thousands) | Allowance: collectively evaluated for impairment | Allowance: individually evaluated for impairment | Total | Loans: collectively evaluated for impairment | Loans: individually evaluated for impairment | Total |
|---|---|---|---|---|---|---|
| December 31, 2011 | | | | | | |
| Consumer loans | | | | | | |
| Single family residential | $9,756 | $915 | $10,671 | $437,264 | $59,670 | $496,934 |
| Home equity | 4,111 | 512 | 4,623 | 155,997 | 2,939 | 158,936 |
| | 13,867 | 1,427 | 15,294 | 593,261 | 62,609 | 655,870 |
| Commercial loans | | | | | | |
| Commercial real estate | 4,051 | 270 | 4,321 | 366,914 | 35,225 | 402,139 |
| Multifamily residential | 320 | 15 | 335 | 47,933 | 8,446 | 56,379 |
| Construction/land development | 4,668 | 16,569 | 21,237 | 103,462 | 69,943 | 173,405 |
| Commercial business | 1,177 | 436 | 1,613 | 58,689 | 1,142 | 59,831 |
| | 10,216 | 17,290 | 27,506 | 576,998 | 114,756 | 691,754 |
| Total | $24,083 | $18,717 | $42,800 | $1,170,259 | $177,365 | $1,347,624 |

The Company had 163 impaired relationships totaling $133.4 million at September 30, 2012 and 145 impaired relationships totaling $177.4 million at December 31, 2011. Impaired loans totaling $72.2 million and $82.5 million had a valuation allowance of $6.0 million and $18.7 million at September 30, 2012 and December 31, 2011, respectively. Interest on impaired loans, applied against loan principal or recognized as interest income, of $1.3 million and $1.1 million was recorded for cash payments received during the three months ended September 30, 2012 and 2011 respectively, and $4.3 million and $2.1 million was recorded for cash payments received during the nine months ended September 30, 2012 and 2011 respectively.

The following table presents impaired loans by loan portfolio segment and loan class as of September 30, 2012 and December 31, 2011.

| (in thousands) | Recorded investment (1) | Unpaid principal balance (2) | Related allowance |
|---|---|---|---|
| September 30, 2012 | | | |
| With no related allowance recorded | | | |
| Consumer loans | | | |
| Single family residential | $18,513 | $19,273 | $— |
| Home equity | 1,766 | 1,811 | — |
| | 20,279 | 21,084 | — |
| Commercial loans | | | |
| Commercial real estate | 24,115 | 25,282 | — |
| Multifamily residential | 3,284 | 3,508 | — |
| Construction/land development | 13,026 | 22,901 | — |
| Commercial business | 459 | 984 | — |
| | 40,884 | 52,675 | — |
| | $61,163 | $73,759 | $— |
| With an allowance recorded | | | |
| Consumer loans | | | |
| Single family residential | $49,750 | $50,241 | $2,418 |
| Home equity | 1,003 | 1,153 | 44 |
| | 50,753 | 51,394 | 2,462 |
| Commercial loans | | | |
| Commercial real estate | 8,610 | 10,740 | 416 |
| Multifamily residential | 2,746 | 2,923 | 548 |
| Construction/land development | 8,120 | 8,204 | 1,491 |
| Commercial business | 1,985 | 1,985 | 1,038 |
| | 21,461 | 23,852 | 3,493 |
| | $72,214 | $75,246 | $5,955 |
| Total | | | |
| Consumer loans | | | |
| Single family residential | $68,263 | $69,514 | $2,418 |
| Home equity | 2,769 | 2,964 | 44 |
| | 71,032 | 72,478 | 2,462 |
| Commercial loans | | | |
| Commercial real estate | 32,725 | 36,022 | 416 |
| Multifamily residential | 6,030 | 6,431 | 548 |
| Construction/land development | 21,146 | 31,105 | 1,491 |
| Commercial business | 2,444 | 2,969 | 1,038 |
| | 62,345 | 76,527 | 3,493 |
| | $133,377 | $149,005 | $5,955 |

| (in thousands) | Recorded investment (1) | Unpaid principal balance (2) | Related allowance |
|---|---|---|---|
| December 31, 2011 | | | |
| With no related allowance recorded | | | |
| Consumer loans | | | |
| Single family residential | $23,617 | $23,859 | $— |
| Home equity | 1,353 | 1,358 | — |
| | 24,970 | 25,217 | — |
| Commercial loans | | | |
| Commercial real estate | 34,444 | 36,224 | — |
| Multifamily residential | 7,938 | 8,585 | — |
| Construction/land development | 27,019 | 36,781 | — |
| Commercial business | 454 | 1,305 | — |
| | 69,855 | 82,895 | — |
| | $94,825 | $108,112 | $— |
| With an allowance recorded | | | |
| Consumer loans | | | |
| Single family residential | $36,053 | $36,323 | $914 |
| Home equity | 1,586 | 1,629 | 512 |
| | 37,639 | 37,952 | 1,426 |
| Commercial loans | | | |
| Commercial real estate | 781 | 1,777 | 271 |
| Multifamily residential | 508 | 508 | 15 |
| Construction/land development | 42,924 | 46,527 | 16,569 |
| Commercial business | 688 | 1,017 | 436 |
| | 44,901 | 49,829 | 17,291 |
| | $82,540 | $87,781 | $18,717 |
| Total | | | |
| Consumer loans | | | |
| Single family residential | $59,670 | $60,182 | $914 |
| Home equity | 2,939 | 2,987 | 512 |
| | 62,609 | 63,169 | 1,426 |
| Commercial loans | | | |
| Commercial real estate | 35,225 | 38,001 | 271 |
| Multifamily residential | 8,446 | 9,093 | 15 |
| Construction/land development | 69,943 | 83,308 | 16,569 |
| Commercial business | 1,142 | 2,322 | 436 |
| | 114,756 | 132,724 | 17,291 |
| | $177,365 | $195,893 | $18,717 |

(1) Net Book Balance, includes partial charge-offs and nonaccrual interest paid.

(2) Unpaid Principal Balance does not include partial charge-offs or nonaccrual interest paid. Related allowance is calculated on Net Book Balances not Unpaid Principal Balances.

The following table provides the average recorded investment in impaired loans by portfolio segment and class for the three and nine months ended September 30, 2012 and 2011. Information related to interest income recognized on average impaired loan balances is not included as it is not operationally practicable to derive this.

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (in thousands) | 2012 | 2011 | 2012 | 2011 |
| Consumer loans | | | | |
| Single family residential | $69,419 | $41,091 | $66,967 | $31,953 |
| Home equity | 2,860 | 2,550 | 2,788 | 2,440 |
| | 72,279 | 43,641 | 69,755 | 34,393 |
| Commercial loans | | | | |
| Commercial real estate | 31,765 | 30,950 | 33,439 | 33,379 |
| Multifamily residential | 5,779 | 8,011 | 6,512 | 8,071 |
| Construction/land development | 19,197 | 66,141 | 43,656 | 72,294 |
| Commercial business | 1,792 | 2,632 | 1,379 | 2,744 |
| | 58,533 | 107,734 | 84,986 | 116,488 |
| | $130,812 | $151,375 | $154,741 | $150,881 |

The following table presents designated loan grades by loan portfolio segment and loan class as of September 30, 2012 and December 31, 2011.

| (in thousands) | Pass | Watch | Special mention | Substandard | Total |
|---|---|---|---|---|---|
| September 30, 2012 | | | | | |
| Consumer loans | | | | | |
| Single family residential | $493,597 | $44,266 | $ 40,365 | $23,936 | $602,164 |
| Home equity | 136,225 | 1,389 | 2,705 | 1,024 | 141,343 |
| | 629,822 | 45,655 | 43,070 | 24,960 | 743,507 |
| Commercial loans | | | | | |
| Commercial real estate | 189,052 | 91,858 | 40,645 | 39,364 | 360,919 |
| Multifamily residential | 11,708 | 19,174 | 3,254 | 2,776 | 36,912 |
| Construction/land development | 14,942 | 6,840 | 41,066 | 15,064 | 77,912 |
| Commercial business | 67,791 | 8,724 | 323 | 3,218 | 80,056 |
| | 283,493 | 126,596 | 85,288 | 60,422 | 555,799 |
| | $913,315 | $172,251 | $ 128,358 | $85,382 | $1,299,306 |
| December 31, 2011 | | | | | |
| Consumer loans | | | | | |
| Single family residential | $395,736 | $43,682 | $ 45,412 | $12,104 | $496,934 |
| Home equity | 153,916 | 500 | 2,056 | 2,464 | 158,936 |
| | 549,652 | 44,182 | 47,468 | 14,568 | 655,870 |
| Commercial loans | | | | | |
| Commercial real estate | 188,885 | 114,010 | 52,456 | 46,788 | 402,139 |
| Multifamily residential | 19,383 | 28,550 | 508 | 7,938 | 56,379 |
| Construction/land development | 29,212 | 19,573 | 46,019 | 78,601 | 173,405 |
| Commercial business | 38,851 | 12,462 | 6,818 | 1,700 | 59,831 |
| | 276,331 | 174,595 | 105,801 | 135,027 | 691,754 |
| | $825,983 | $218,777 | $ 153,269 | $149,595 | $1,347,624 |

The following table presents an aging analysis of past due loans by loan portfolio segment and loan class as of September 30, 2012 and December 31, 2011.

| (in thousands) | 30-59 days past due | 60-89 days past due | 90 days or more past due | Total past due | Current | Total loans | 90 days or more past due and still accruing[1] |
|---|---|---|---|---|---|---|---|
| September 30, 2012 | | | | | | | |
| Consumer loans | | | | | | | |
| Single family residential | $9,658 | $10,374 | $48,048 | $68,080 | $534,084 | $602,164 | $ 35,148 |
| Home equity | 929 | 1,389 | 1,024 | 3,342 | 138,001 | 141,343 | — |
| | 10,587 | 11,763 | 49,072 | 71,422 | 672,085 | 743,507 | 35,148 |
| Commercial loans | | | | | | | |
| Commercial real estate | — | — | 16,186 | 16,186 | 344,733 | 360,919 | — |
| Multifamily residential | — | — | — | — | 36,912 | 36,912 | — |
| Construction/land development | — | — | 5,848 | 5,848 | 72,064 | 77,912 | — |
| Commercial business | — | — | 2,289 | 2,289 | 77,767 | 80,056 | — |
| | — | — | 24,323 | 24,323 | 531,476 | 555,799 | — |
| | $10,587 | $11,763 | $73,395 | $95,745 | $1,203,561 | $1,299,306 | $ 35,148 |
| December 31, 2011 | | | | | | | |
| Consumer loans | | | | | | | |
| Single family residential | $7,694 | $8,552 | $47,861 | $64,107 | $432,827 | $496,934 | $ 35,757 |
| Home equity | 957 | 500 | 2,464 | 3,921 | 155,015 | 158,936 | — |
| | 8,651 | 9,052 | 50,325 | 68,028 | 587,842 | 655,870 | 35,757 |
| Commercial loans | | | | | | | |
| Commercial real estate | — | — | 10,184 | 10,184 | 391,955 | 402,139 | — |
| Multifamily residential | — | — | 2,394 | 2,394 | 53,985 | 56,379 | — |
| Construction/land development | 9,916 | — | 48,387 | 58,303 | 115,102 | 173,405 | — |
| Commercial business | — | — | 951 | 951 | 58,880 | 59,831 | — |
| | 9,916 | — | 61,916 | 71,832 | 619,922 | 691,754 | — |
| | $18,567 | $9,052 | $112,241 | $139,860 | $1,207,764 | $1,347,624 | $ 35,757 |

(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. All single family loans in this category are Ginnie Mae pool loans.

The following table presents performing and nonaccrual loan balances by loan portfolio segment and loan class as of September 30, 2012 and December 31, 2011.

| (in thousands) | Performing | Nonaccrual | Total |
|---|---|---|---|
| September 30, 2012 | | | |
| Consumer loans | | | |
| Single family residential | $589,264 | $12,900 | $602,164 |
| Home equity | 140,319 | 1,024 | 141,343 |
| | 729,583 | 13,924 | 743,507 |
| Commercial loans | | | |
| Commercial real estate | 344,733 | 16,186 | 360,919 |
| Multifamily residential | 36,912 | — | 36,912 |
| Construction/land development | 72,064 | 5,848 | 77,912 |
| Commercial business | 77,767 | 2,289 | 80,056 |
| | 531,476 | 24,323 | 555,799 |
| | $1,261,059 | $38,247 | $1,299,306 |

| (in thousands) | Performing | Nonaccrual | Total |
|---|---|---|---|
| December 31, 2011 | | | |
| Consumer loans | | | |
| Single family residential | $484,830 | $12,104 | $496,934 |
| Home equity | 156,472 | 2,464 | 158,936 |
| | 641,302 | 14,568 | 655,870 |
| Commercial loans | | | |
| Commercial real estate | 391,955 | 10,184 | 402,139 |
| Multifamily residential | 53,985 | 2,394 | 56,379 |
| Construction/land development | 125,018 | 48,387 | 173,405 |
| Commercial business | 58,880 | 951 | 59,831 |
| | 629,838 | 61,916 | 691,754 |
| | $1,271,140 | $76,484 | $1,347,624 |

Loans are reported as troubled debt restructurings ("TDRs") when the Company grants concessions that it would not otherwise consider to borrowers experiencing financial difficulty. A TDR loan is considered re-defaulted when it becomes doubtful that the objectives of the modifications will be met, generally when a TDR loan becomes 90 days or more past due for interest or principal payments.

The Company had 151 loan relationships classified as TDRs totaling $117.2 million at September 30, 2012 with related unfunded commitments of $103 thousand. The Company had 126 loan relationships classified as TDRs in the amount of $118.5 million at December 31, 2011 with related unfunded commitments of $32 thousand. TDR loans within the loans held for investment portfolio and the related reserves are included in the impaired loan tables above. TDR loans held for sale totaled $173 thousand, comprised of one relationship, and $1.0 million, comprised of five relationships, as of September 30, 2012 and December 31, 2011, respectively, and are predominately comprised of loans previously repurchased from Ginnie Mae and cured by modifying interest rate terms.

The following tables present information about TDRs by loan portfolio segment and loan class as of September 30, 2012 and December 31, 2011.

| | September 30, 2012 | | | |
|---|---|---|---|---|
| (dollars in thousands) | Concession type | Number of loan relationships | Recorded investment | Related charge-offs |
| Consumer loans | | | | |
| Single family residential | | | | |
| | Interest rate reduction | 102 | $62,810 | $491 |
| | Payment restructure | 11 | 1,975 | 7 |
| | | 113 | $64,785 | $498 |
| Home equity | | | | |
| | Interest rate reduction | 19 | $2,593 | $176 |
| | Payment restructure | 5 | 176 | — |
| | | 24 | $2,769 | $176 |
| Total consumer | | | | |
| | Interest rate reduction | 121 | $65,403 | $667 |
| | Payment restructure | 16 | 2,151 | 7 |
| | | 137 | $67,554 | $674 |
| Commercial loans | | | | |
| Commercial real estate | | | | |
| | Payment restructure | 3 | 24,256 | 1,264 |
| | | 3 | $24,256 | $1,264 |
| Multifamily residential | | | | |
| | Interest rate reduction | 2 | $5,521 | $— |
| | | 2 | $5,521 | $— |
| Construction/land development | | | | |
| | Interest rate reduction | 5 | $18,971 | $7,086 |
| | Forgiveness of principal | 2 | 676 | 43 |
| | | 7 | $19,647 | $7,129 |
| Commercial business | | | | |
| | Payment restructure | 2 | 176 | 391 |
| | | 2 | $176 | $391 |
| Total commercial | | | | |
| | Interest rate reduction | 7 | $24,492 | $7,086 |
| | Payment restructure | 5 | 24,432 | 1,655 |
| | Forgiveness of principal | 2 | 676 | 43 |
| | | 14 | $49,600 | $8,784 |
| Total loans | | | | |
| | Interest rate reduction | 128 | $89,895 | $7,753 |
| | Payment restructure | 21 | 26,583 | 1,662 |
| | Forgiveness of principal | 2 | 676 | 43 |
| | | 151 | $117,154 | $9,458 |

| (dollars in thousands) | December 31, 2011<br>Concession type | Number of loan relationships | Recorded investment | Related charge-offs |
|---|---|---|---|---|
| Consumer loans | | | | |
| Single family residential | | | | |
| | Interest rate reduction | 76 | $53,969 | $270 |
| | Payment restructure | 13 | 2,612 | — |
| | | 89 | $56,581 | $270 |
| Home equity | | | | |
| | Interest rate reduction | 12 | $2,263 | $7 |
| | Payment restructure | 6 | 212 | — |
| | | 18 | $2,475 | $7 |
| Total consumer | | | | |
| | Interest rate reduction | 88 | $56,232 | $277 |
| | Payment restructure | 19 | 2,824 | — |
| | | 107 | $59,056 | $277 |
| Commercial loans | | | | |
| Commercial real estate | | | | |
| | Payment restructure | 2 | $25,040 | $— |
| | | 2 | $25,040 | $— |
| Multifamily residential | | | | |
| | Interest rate reduction | 3 | $6,053 | $— |
| | | 3 | $6,053 | $— |
| Construction/land development | | | | |
| | Interest rate reduction | 6 | $22,881 | $8,589 |
| | Payment restructure | 1 | 2,750 | — |
| | Forgiveness of principal | 3 | 1,801 | 8,795 |
| | | 10 | $27,432 | $17,384 |
| Commercial business | | | | |
| | Payment restructure | 4 | $878 | $852 |
| | | 4 | $878 | $852 |
| Total commercial | | | | |
| | Interest rate reduction | 9 | $28,934 | $8,589 |
| | Payment restructure | 7 | 28,668 | 852 |
| | Forgiveness of principal | 3 | 1,801 | 8,795 |
| | | 19 | $59,403 | $18,236 |
| Total loans | | | | |
| | Interest rate reduction | 97 | $85,166 | $8,866 |
| | Payment restructure | 26 | 31,492 | 852 |
| | Forgiveness of principal | 3 | 1,801 | 8,795 |
| | | 126 | $118,459 | $18,513 |

The following table presents TDR balances which have subsequently re-defaulted during the three and nine months ended September 30, 2012 and 2011, respectively.

| (dollars in thousands) | Three Months Ended September 30, 2012 Number of loan relationships that subsequently re-defaulted | Recorded investment | 2011 Number of loan relationships that subsequently re-defaulted | Recorded investment |
|---|---|---|---|---|
| Consumer loans | | | | |
| Single family residential | 18 | $4,290 | — | $— |
| Home equity | — | — | 1 | 187 |
| | 18 | 4,290 | 1 | 187 |
| Commercial loans | | | | |
| Commercial real estate | 1 | 7,716 | — | — |
| Construction/land development | — | — | 2 | 4,819 |
| Commercial business | 1 | 21 | 1 | 153 |
| | 2 | $7,737 | 3 | $4,972 |
| | 20 | $12,027 | 4 | $5,159 |

| (dollars in thousands) | Nine Months Ended September 30, 2012 Number of loan relationships that subsequently re-defaulted | Recorded investment | 2011 Number of loan relationships that subsequently re-defaulted | Recorded investment |
|---|---|---|---|---|
| Consumer loans | | | | |
| Single family residential | 41 | $9,551 | — | $— |
| Home equity | 1 | 34 | 1 | 187 |
| | 42 | 9,585 | 1 | 187 |
| Commercial loans | | | | |
| Commercial real estate | 1 | 7,716 | — | — |
| Construction/land development | — | — | 6 | 24,590 |
| Commercial business | 3 | 410 | 1 | 153 |
| | 4 | $8,126 | 7 | $24,743 |
| | 46 | $17,711 | 8 | $24,930 |

NOTE 5–OTHER REAL ESTATE OWNED:

Other real estate owned consisted of the following.

| (in thousands) | September 30, 2012 | December 31, 2011 |
|---|---|---|

| | | |
|---|---|---|
| Single family | $2,890 | $7,006 |
| Commercial real estate | 3,489 | 2,436 |
| Construction/land development | 24,889 | 50,632 |
| | 31,268 | 60,074 |
| Valuation allowance | (14,265 ) | (21,502 ) |
| | $17,003 | $38,572 |

Activity in other real estate owned was as follows for the periods indicated.

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (in thousands) | 2012 | 2011 | 2012 | 2011 |
| Balance, beginning of period | $40,618 | $102,697 | $38,572 | $170,455 |
| Additions | 4,954 | 3,702 | 34,014 | 35,846 |
| Loss provisions | (2,623) | (8,217) | (10,955) | (23,515) |
| Reductions related to sales | (25,946) | (33,814) | (44,628) | (118,418) |
| Balance, end of period | $17,003 | $64,368 | $17,003 | $64,368 |

For the three months ended September 30, 2012 and 2011, OREO properties were sold for a net gain of $2.5 million and a net loss of $37 thousand, respectively. For the nine months ended September 30, 2012 and 2011, OREO properties were sold for a net gain of $2.8 million and $326 thousand, respectively.

Activity in the valuation allowance for other real estate owned was as follows for the periods indicated.

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (in thousands) | 2012 | 2011 | 2012 | 2011 |
| Balance, beginning of period | $12,190 | $37,280 | $21,502 | $29,099 |
| Loss provisions | 2,623 | 8,217 | 10,955 | 23,515 |
| Charge-offs, net of recoveries | (548) | (13,816) | (18,192) | (20,933) |
| Balance, end of period | $14,265 | $31,681 | $14,265 | $31,681 |

At September 30, 2012 and December 31, 2011, we had concentrations within the state of Washington representing 90.7% and 84.5%, respectively, of the total balance of other real estate owned.

At September 30, 2012, construction/land development in Washington, primarily in Thurston County, represented 62.4% of the total portfolio. At December 31, 2011, construction/land development in Washington, primarily in Thurston County, represented 68.6% of the total balance of other real estate owned.

NOTE 6–DERIVATIVES AND HEDGING ACTIVITIES:

The Company uses derivatives to manage exposure to market risk, interest rate risk and to assist customers with their risk management objectives. Derivative transactions are measured in terms of notional amount, which is not recorded on the consolidated statements of financial condition. The notional amount is generally not exchanged and is used as the basis for which interest and other payments are determined. All derivatives are recorded within other assets or liabilities and carried at fair value, with changes in fair value reflected in current period earnings. At September 30, 2012 the Company did not hold any cash flow or foreign currency hedge instruments.

For further information on the policies that govern derivative and hedging activities, see Note 11, Derivatives and Hedging Activities to the Consolidated Financial Statements within the 2011 Annual Report on Form 10-K.

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

| September 30, 2012 | Notional Amount | Fair Value Derivatives | |
|---|---|---|---|
| (in thousands) | | Asset | Liability |

| | | | |
|---|---|---|---|
| Forward sale commitments | $ 1,264,124 | $1,584 | $(16,305) |
| Interest rate swaptions | 135,000 | — | — |
| Interest rate lock commitments | 922,639 | 37,413 | (1) |
| Interest rate swaps | 449,354 | 4,785 | (8,626) |
| Total derivatives | $ 2,771,117 | $43,782 | $(24,932) |

| December 31, 2011 | Notional Amount | Fair Value Derivatives | |
|---|---|---|---|
| | | Asset | Liability |
| Forward sale commitments | $ 428,803 | $ 1,206 | $ (2,223 ) |
| Interest rate swaptions | 110,000 | 1 | — |
| Interest rate lock commitments | 244,138 | 6,836 | — |
| Interest rate swaps | 337,705 | 5,719 | (8,777 ) |
| Total derivatives | $ 1,120,646 | $ 13,762 | $ (11,000 ) |

The ineffective portion of net gains (losses) on derivatives in fair value hedging relationships, recognized in other noninterest income on the consolidated statements of operations, for loans held for investment were $16 thousand and $(92) thousand for the three months ended September 30, 2012 and 2011, respectively and $64 thousand and $(26) thousand for the nine months ended September 30, 2012 and 2011, respectively.

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (in thousands) | 2012 | 2011 | 2012 | 2011 |
| Recognized in noninterest income: | | | | |
| Net gain (loss) on mortgage loan origination and sale activities (1) | $ 891 | $ 2,041 | $ 11,456 | $ (1,941 ) |
| Mortgage servicing (2) | 4,861 | 38,335 | 24,600 | 45,521 |
| | $ 5,752 | $ 40,376 | $ 36,056 | $ 43,580 |

(1) Comprised of mortgage loan interest rate lock commitments and forward contracts used as an economic hedge on loans held for sale.

(2) Comprised of interest rate swaps, interest rate swaptions and forward contracts used as an economic hedge of mortgage servicing rights.

NOTE 7–MORTGAGE BANKING OPERATIONS:

Loans held for sale consist of the following.

| (in thousands) | At September 30, 2012 | At December 31, 2011 |
|---|---|---|
| Single family residential | $ 525,926 | $ 130,546 |
| Multifamily residential | 6,654 | 19,863 |
| | $ 532,580 | $ 150,409 |

Loans sold during the periods indicated consisted of the following.

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (in thousands) | 2012 | 2011 | 2012 | 2011 |
| Single family residential | $ 1,238,879 | $ 370,250 | $ 2,735,893 | $ 1,028,514 |

| | | | | |
|---|---|---|---|---|
| Multifamily residential | 26,515 | 25,144 | 85,116 | 86,016 |
| | $1,265,394 | $395,394 | $2,821,009 | $1,114,530 |

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Net gain on mortgage loan origination and sale activities, including the effects of derivative risk management instruments, consisted of the following during the periods indicated.

| (in thousands) | Three Months Ended September 30, 2012 | Three Months Ended September 30, 2011 | Nine Months Ended September 30, 2012 | Nine Months Ended September 30, 2011 |
|---|---|---|---|---|
| Secondary market gains[1] | $41,550 | $6,415 | $87,034 | $3,083 |
| Provision for repurchase losses[2] | (526) | (289) | (2,846) | (752) |
| Net gain from secondary market activities | 41,024 | 6,126 | 84,188 | 2,331 |
| Mortgage servicing rights originated | 14,789 | 6,331 | 33,606 | 19,826 |
| Loan origination and funding fees | 8,577 | 3,309 | 20,592 | 7,545 |
| Net gain on mortgage loan origination and sale activities | $64,390 | $15,766 | $138,386 | $29,702 |

(1) Comprised of gains and losses on single family and Fannie Mae DUS loans, interest rate lock commitments and forward sale commitments used to economically hedge loans held for sale, less premiums paid to Windermere Mortgage Services Series LLC on loans purchased or committed to be purchased and the fair value of estimated future repurchase or indemnity losses recognized on new loan sales.
(2) Represents changes in estimated probable future repurchase losses on previously sold loans.

The Company’s portfolio of loans serviced for others is primarily comprised of loans held in U.S. government and agency mortgage-backed securities issued by Fannie Mae, Freddie Mac and Ginnie Mae. Loans serviced for others are not included in the consolidated financial statements as they are not assets of the Company. The composition of loans serviced for others is presented below at the unpaid principal balance.

| (in thousands) | September 30, 2012 | December 31, 2011 |
|---|---|---|
| Single family | | |
| U.S. government agency MBS | $7,724,562 | $6,464,815 |
| Other | 385,107 | 420,470 |
| | 8,109,669 | 6,885,285 |
| Commercial | | |
| Multifamily | 760,820 | 758,535 |
| Other | 53,617 | 56,785 |
| | 814,437 | 815,320 |
| Total loans serviced for others | $8,924,106 | $7,700,605 |

The Company has made representations and warranties that the loans sold meet certain requirements. The Company may be required to repurchase mortgage loans or indemnify loan purchasers due to defects in the origination process of the loan, such as documentation errors, underwriting errors and judgments, appraisal errors, early payment defaults and fraud. For further information on the Company's mortgage repurchase liability, see Note 8, Commitments, Guarantees and Contingencies to the Interim Consolidated Financial Statements in this Form 10-Q. The following is a summary of changes in the Company's liability for estimated mortgage repurchase losses.

| (in thousands) | Three Months Ended September 30, 2012 | Three Months Ended September 30, 2011 | Nine Months Ended September 30, 2012 | Nine Months Ended September 30, 2011 |
|---|---|---|---|---|
| Beginning balance | $2,119 | $820 | $471 | $533 |
| Additions [1] | 1,018 | 289 | 3,624 | 752 |
| Realized Losses [2] | (1,202) | (259) | (2,160) | (435) |
| Balance, end of period | $1,935 | $850 | $1,935 | $850 |

(1) Includes additions for new loan sales and changes in estimated probable future repurchase losses on previously sold loans.
(2) Includes principal losses and accrued interest on repurchased loans, “make-whole” settlements, settlements with claimants and certain related expense.

Advances are made to Ginnie Mae mortgage pools for delinquent loan and foreclosure costs and for funding of loans repurchased from Ginnie Mae mortgage pools prior to recovery of guaranteed amounts. Ginnie Mae advances of $5.6 million and $5.8 million were recorded in accounts receivable and other assets as of September 30, 2012 and December 31, 2011, respectively.

When the Company has the unilateral right to repurchase Ginnie Mae pool loans it has previously sold (generally loans that are more than 90 days past due), the Company then records the loan on its consolidated statement of financial condition. At September 30, 2012 and December 31, 2011, delinquent or defaulted mortgage loans currently in Ginnie Mae pools that the Company has recognized on its consolidated statement of financial condition totaled $5.6 million and $2.3 million, respectively, with a corresponding amount recorded within accounts payable and accrued expenses. The recognition of previously sold loans does not impact the accounting for the previously recognized mortgage servicing rights.

Revenue from mortgage servicing, including the effects of derivative risk management instruments, consisted of the following.

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (in thousands) | 2012 | 2011 | 2012 | 2011 |
| Servicing income, net: | | | | |
| Servicing fees and other | $7,168 | $6,793 | $20,310 | $19,607 |
| Changes in fair value of single family MSRs due to modeled amortization [1] | (5,360) | (4,155) | (14,382) | (10,245) |
| Amortization of multifamily MSRs | (598) | (455) | (1,551) | (1,121) |
| | 1,210 | 2,183 | 4,377 | 8,241 |
| Risk management, single family MSRs: | | | | |
| Changes in fair value due to changes in model inputs and/or assumptions [2] | (5,565) | (21,986) | (13,507) | (21,669) |
| Net gain from derivatives economically hedging MSR | 4,861 | 38,335 | 24,600 | 45,521 |
| | (704) | 16,349 | 11,093 | 23,852 |
| Mortgage servicing income | $506 | $18,532 | $15,470 | $32,093 |

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

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

All mortgage servicing rights (“MSRs”) are initially measured and recorded at fair value at the time loans are sold. Single family MSRs are subsequently carried at fair value with changes in fair value reflected in earnings in the periods in which the changes occur, while multifamily MSRs are subsequently carried at the lower of amortized cost or fair value.

The fair value of MSRs is determined based on the price that would be received to sell the MSRs in an orderly transaction between market participants at the measurement date. The Company determines fair value using a valuation model that calculates the net present value of estimated future cash flows. Estimates of future cash flows include contractual servicing fees, ancillary income and costs of servicing, the timing of which are impacted by assumptions, primarily prepayment speeds and discount rates, that relate to the underlying performance of the loans.

The initial fair value measurement of MSRs is adjusted up or down depending on whether the underlying loan pool interest rate is at a premium, discount or par. Key economic assumptions used in measuring the initial fair value of capitalized single family MSRs were as follows.

| (rates per annum) [(1)] | Three Months Ended September 30, | | | | Nine Months Ended September 30, | | | |
|---|---|---|---|---|---|---|---|---|
| | 2012 | | 2011 | | 2012 | | 2011 | |
| Constant prepayment rate [(2)] | 11.62 | % | 13.75 | % | 11.11 | % | 11.80 | % |
| Discount rate [(3)] | 10.24 | % | 10.42 | % | 10.29 | % | 10.40 | % |

(1) Weighted average rates for sales during the period for sales of loans with similar characteristics.
(2) Represents the expected lifetime average.
(3) Discount rate is a rate based on market observations.

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At September 30, 2012, key economic assumptions and the sensitivity of the current fair value for single family MSRs to immediate adverse changes in those assumptions were as follows.

| (in thousands) | September 30, 2012 | |
|---|---|---|
| Fair value of single family MSR | $73,787 | |
| Expected weighted-average life (in years) | 4.30 | |
| Constant prepayment rate [1] | 20.17 | % |
| Impact on fair value of 25 basis points decrease | $(7,299 | ) |
| Impact on fair value of 50 basis points decrease | $(13,949 | ) |
| Discount rate | 10.6 | % |
| Impact on fair value of 100 basis points increase | $(2,187 | ) |
| Impact on fair value of 200 basis points increase | $(4,242 | ) |

(1) Represents the expected lifetime average.

These sensitivities are hypothetical and should be used with caution. As the table above demonstrates, the Company's methodology for estimating the fair value of MSRs is highly sensitive to changes in assumptions. For example, actual prepayment experience may differ and any difference may have a material effect on MSR fair value. Changes in fair value resulting from changes in assumptions generally cannot be extrapolated because the relationship of the change in assumption to the change in fair value may not be linear. Also, in this table, the effect of a variation in a particular assumption on the fair value of the MSRs is calculated without changing any other assumption; in reality, changes in one factor may be associated with changes in another (for example, decreases in market interest rates may indicate higher prepayments; however, this may be partially offset by lower prepayments due to other factors such as a borrower's diminished opportunity to refinance), which may magnify or counteract the sensitivities. Thus, any measurement of MSR fair value is limited by the conditions existing and assumptions made as of a particular point in time. Those assumptions may not be appropriate if they are applied to a different point in time.

The changes in single family MSRs measured at fair value are as follows.

| | Three Months Ended September 30, | | | | Nine Months Ended September 30, | | | |
|---|---|---|---|---|---|---|---|---|
| (in thousands) | 2012 | | 2011 | | 2012 | | 2011 | |
| Beginning balance | $70,585 | | $87,712 | | $70,169 | | $81,197 | |
| Originations | 14,121 | | 5,873 | | 31,442 | | 18,127 | |
| Purchases | 6 | | 27 | | 65 | | 61 | |
| Changes due to modeled amortization[1] | (5,360 | ) | (4,155 | ) | (14,382 | ) | (10,245 | ) |
| Net additions and amortization | 8,767 | | 1,745 | | 17,125 | | 7,943 | |
| Changes in fair value due to changes in model inputs and/or assumptions [2] | (5,565 | ) | (21,986 | ) | (13,507 | ) | (21,669 | ) |
| Ending balance | $73,787 | | $67,471 | | $73,787 | | $67,471 | |

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

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

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (in thousands) | 2012 | 2011 | 2012 | 2011 |
| Beginning balance | $7,655 | $6,608 | $7,112 | $6,035 |
| Origination | 668 | 459 | 2,164 | 1,698 |
| Amortization | (598) | (455) | (1,551) | (1,121) |
| Ending balance | $7,725 | $6,612 | $7,725 | $6,612 |

At September 30, 2012, the expected weighted-average life of the Company’s multifamily MSRs was 8.98 years. Projected amortization expense for the gross carrying value of multifamily MSRs at September 30, 2012 is estimated as follows.

| (in thousands) | September 30, 2012 |
|---|---|
| 2012 | $424 |
| 2013 | 1,485 |
| 2014 | 1,216 |
| 2015 | 1,029 |
| 2016 | 915 |
| 2017 and thereafter | 2,656 |
| Carrying value of multifamily MSR | $7,725 |

NOTE 8–COMMITMENTS, GUARANTEES AND CONTINGENCIES:

Commitments

Commitments to extend credit are agreements to lend to customers in accordance with predetermined contractual provisions. These commitments may be for specific periods or contain termination clauses and may require the payment of a fee by the borrower. The total amounts of unused commitments do not necessarily represent future credit exposure or cash requirements in that commitments may expire without being drawn upon.

In the ordinary course of business, the Company makes unfunded loan commitments as part of its residential mortgage lending activities generally in the form of a written confirmation from the Company to the seller of a property that it will advance the specified sums enabling the buyer to complete the purchase of the property. Unfunded loan commitments totaled $949.9 million ($910.6 million fixed rate and $39.3 million adjustable-rate commitments) at September 30, 2012 and $256.9 million ($250.2 million fixed rate and $6.7 million adjustable-rate commitments) at December 31, 2011.

In the normal course of business, the Company extends secured and unsecured open-end loans to meet the financing needs of its customers. Commitments related to unused home equity lines of credit and business banking line funds totaled $95.4 million and $87.1 million at September 30, 2012 and December 31, 2011. Undistributed construction loan proceeds, where the Company has an obligation to advance funds for construction progress payments, was $11.1 million and $9.7 million at September 30, 2012 and December 31, 2011, respectively. The Company has recorded an allowance for losses on loan commitments, included in accounts payable and accrued expenses on our consolidated statements of financial condition, of $166 thousand and $110 thousand at September 30, 2012 and December 31, 2011, respectively.

Guarantees

In the ordinary course of business, the Company sells loans through the Fannie Mae Multifamily Delegated Underwriting and Servicing Program (“DUS®”) that are subject to a loss sharing relationship. For loans that have been sold through this program and are no longer on the Company's consolidated statement of financial condition, a liability is recorded for this loss sharing relationship under the accounting guidance for guarantees. As of September 30, 2012 and December 31, 2011, the total principal balance of loans sold under this program totaled $760.8 million and $758.5 million. The Company’s reserve liability related to this program totaled $3.6 million and $3.6 million at September 30, 2012 and December 31, 2011, respectively. There were no actual losses incurred under this program during the three and nine months ended September 30, 2012 and 2011.

Mortgage repurchase liability

In the ordinary course of business, the Company sells residential mortgage loans to government-sponsored entities (GSEs) that include the mortgage loans in GSE-guaranteed mortgage securitizations. In addition, the Company pools FHA-insured and VA-guaranteed mortgage loans that are used to back Ginnie Mae-guaranteed securities. The Company has made representations and warranties that the loans sold meet certain requirements. The Company may be required to repurchase mortgage loans or indemnify loan purchasers due to defects in the origination process of the loan, such as documentation errors, underwriting errors and judgments, early payment defaults and fraud.

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

The Company does not typically receive repurchase requests from Ginnie Mae, FHA or VA. As an originator of FHA insured or VA guaranteed loans, the Company is responsible for obtaining the insurance with FHA or the guarantee with the VA. If loans are later found not to meet the requirements of FHA or VA, through required internal quality control reviews or through agency audits, the Company may be required to indemnify FHA or VA against loss. The loans remain in Ginne Mae pools unless and until they qualify for voluntary repurchase by the Company. In general, once a FHA or VA loan becomes 90 days past due, the Company repurchases the FHA or VA loan to minimize the cost of interest advances on the loan. If the loan is cured through 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.

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

At September 30, 2012 and December 31, 2011, the Company has recorded a mortgage repurchase liability, included in accounts payable and accrued expenses on our consolidated statements of financial condition, of $1.9 million and $471 thousand, respectively.

Contingencies

In the normal course of business, the Company may have various legal claims and other similar contingent matters outstanding for which a loss may materialize. For these claims, the Company establishes a liability for contingent losses when it is probable that a loss has been incurred and the amount of loss can be reasonably estimated. For claims determined to be reasonably possible but not probable of incurring a loss, there may be a range of possible losses in excess of the established liability. At September 30, 2012, we reviewed our legal claims and determined that there were no claims that are considered to be probable or reasonably possible of resulting in a loss. As a result, the Company did not have any amounts reserved for legal claims as of September 30, 2012.

NOTE 9–INCOME TAXES:

Income tax expense for the three and nine months ended September 30, 2012 was $11.8 million and $13.4 million, compared with $362 thousand and $388 thousand for the same periods in 2011. The Company's year-to-date income tax expense is based on a projected annual effective income tax rate, which excludes discrete tax benefits of $5.8 million recognized year to date. The Company's effective tax rate differs from the Federal statutory tax rate of 35% primarily due to state income taxes on income in Oregon, Hawaii and Idaho, tax exempt income and a discrete tax benefit related to the full reversal of the Company's beginning of year valuation allowance against deferred tax assets. A valuation allowance is recognized for a deferred tax asset if, based on the weight of the available positive and negative evidence, it is more-likely-than-not that some portion of the entire deferred tax asset will not be realized. More weight is given to evidence that can be objectively verified. Primarily as a result of credit losses, the Company had a three year cumulative pre-tax loss position in 2009. A cumulative loss position is considered significant negative evidence in assessing the realizability of a deferred tax asset and is difficult to overcome and accordingly, the Company established a valuation allowance against the net deferred tax asset at September 30, 2009.

During the second quarter 2012, management analyzed the positive and negative evidence to determine if the benefit of its net deferred tax asset will more likely than not be realized. This evidence included the Company reporting its fifth consecutive quarter of profitability, the future reversals of deferred tax assets and deferred tax liabilities over a similar period of time, future expectations of profitability, significant improvement in overall asset quality and related credit/risk metrics and the expectation that we will be able to exit a three-year cumulative pre-tax loss position in 2012. Based on these factors, we determined during the quarter ended June 30, 2012 that we had sufficient objective positive evidence to reverse the remaining valuation allowance.

As a consequence of our initial public offering in February 2012, the Company experienced a change of control within the meaning of Section 382 of the Internal Revenue Code of 1986, as amended. Section 382 substantially limits the ability of a corporate taxpayer to use recognized built-in losses and net operating loss carryforwards incurred prior to the change of control against income earned after a change of control. Based on our analysis, the change of control will not result in a loss of deferred tax benefits other than a small impact on deferred tax assets related to state income taxes in Oregon.

The Company's income tax expense for the three and nine months ended September 30, 2012 includes a discrete tax expense of $508 thousand related to the true up of tax expense due to the filing of the 2011 tax return. In addition, income tax expense for the three and nine months ended September 30, 2012 includes discrete tax benefits of zero and $6.3 million, respectively, related to the reversal of the beginning of the year valuation allowance against net deferred tax assets.

At September 30, 2012 we had a net deferred tax asset of $6.4 million compared with a net deferred tax liability of $1.8 million at December 31, 2011. For further discussion of the Company's income taxes see Note 14–Income Taxes in Company's 2011 Annual Report on Form 10-K.

NOTE 10–FAIR VALUE MEASUREMENT:

For a further discussion of fair value measurements, including information regarding the Company's valuation methodologies and the fair value hierarchy, see Note 17, Fair Value Measurement of our 2011 Annual Report on Form 10-K.

Valuation Processes

The Company has various processes and controls in place to ensure that fair value is reasonably estimated. The Company's Asset/Liability Management Policy governs, among other things, the application and control of the valuation models used to estimate and measure fair value. On a quarterly basis, the Company's Asset/Liability Management Committee (ALCO) and the Finance Committee of the Bank's Board of Directors 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, at least annually ALCO obtains an independent review of the MSR valuation process and procedures, including a review of the model architecture and the valuation assumptions. The Finance Committee of the Board provides oversight and approves the Company's Asset/Liability Management Policy. The Company obtains an MSR valuation from an independent valuation firm at least quarterly to assist with the validation of the results and the reasonableness of the assumptions used in measuring fair value.

The Company's real estate valuations are overseen by the Company's appraisal department, which is independent of the Company's lending and credit administration functions. The appraisal department maintains the Company's appraisal policy and recommends changes to the policy subject to approval by the Company's Loan Committee and the Credit Committee of the Bank's Board of Directors. The Company's appraisals are prepared by independent third-party appraisers and the Company's internal appraisers. Single family appraisals are generally reviewed by the Company's single family loan underwriters. Single family appraisals with unusual, higher risk or complex characteristics, as well as commercial real estate appraisals, are reviewed by the Company's appraisal department.

The following table summarizes the fair value measurement methodologies, including significant inputs and assumptions, and classification of the Company's assets and liabilities.

| Asset/Liability class | Valuation methodology, inputs and assumptions | Classification |
|---|---|---|
| Cash and cash equivalents | Carrying value is a reasonable estimate of fair value based on the short-term nature of the instruments. | Estimated fair value classified as Level 1. |
| Investment securities available for sale | Observable market prices of identical or similar securities are used where available.<br><br>If market prices are not readily available, value is based on discounted cash flows using the following significant inputs:<br><br>• Expected prepayment speeds<br><br>• Estimated credit losses<br><br>• Market liquidity adjustments | Level 2 recurring fair value measurement |
| Loans held for sale | | |
| Single-family loans | Fair value is based on observable market data, including:<br><br>• Quoted market prices, where available<br><br>• Dealer quotes for similar loans<br><br>• Forward sale commitments | Level 2 recurring fair value measurement |
| Multifamily loans | The sale price is set at the time the loan commitment is made, and as such subsequent changes in market conditions have a very limited effect, if any, on the value of these loans carried on the balance sheet, which are typically sold within 30 days of origination. | Carried at lower of amortized cost or fair value.<br><br>Estimated fair value classified as Level 2. |
| Loans held for investment | | |
| Loans held for investment, excluding collateral dependent loans | Fair value is based on discounted cash flows, which considers the following inputs:<br><br>• Current lending rates for new loans<br><br>• Expected prepayment speeds<br><br>• Estimated credit losses | For the carrying value of loans see Note 1–Summary of Significant Accounting Policies of our 2011 Annual Report on Form 10-K.<br><br>Estimated fair value classified as Level 3. |
| Loans held for investment, collateral dependent | Fair value is based on appraised value of collateral, which considers sales comparison and income approach methodologies. Adjustments are made for various factors, which may include:<br>• Adjustments for variations in specific property qualities such as location, physical dissimilarities, market conditions at the time of sale, income producing characteristics and other factors | Carried at lower of amortized cost or fair value of collateral, less the estimated cost to sell.<br><br>Classified as a Level 3 nonrecurring fair value measurement in periods |

| | |
|---|---|
| • Adjustments to obtain "upon completion" and "upon stabilization" values (e.g., property hold discounts where the highest and best use would require development of a property over time)<br>• Bulk discounts applied for sales costs, holding costs and profit for tract development and certain other properties | where carrying value is adjusted to reflect the fair value of collateral. |

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| Asset/Liability class | Valuation methodology, inputs and assumptions | Classification |
|---|---|---|
| Mortgage servicing rights | | |
| Single family MSRs | For information on how the Company measures the fair value of its single family MSRs, including key economic assumptions and the sensitivity of fair value to changes in those assumptions, see Note 8, Mortgage Banking Operations of this Form 10-Q. | Level 3 recurring fair value measurement |
| Multifamily MSRs | Fair value is based on discounted estimated future servicing fees and other revenue, offset by estimated costs to service the loans. | Carried at lower of amortized cost or fair value<br><br>Estimated fair value classified as Level 3. |
| Derivatives | The fair value is based on quoted prices for identical or similar instruments, when available.<br><br>When quoted prices are not available, fair value is based on internally developed modeling techniques, which require the use of multiple observable market inputs including:<br><br>• Forward interest rates<br><br>• Interest rate volatilities | Level 2 recurring fair value measurement |
| Other real estate owned (“OREO”) | Fair value is based on appraised value of collateral, less the estimated cost to sell. See discussion of "loans held for investment, collateral dependent" above for further information on appraisals. | Carried at lower of amortized cost or fair value of collateral (Level 3), less the estimated cost to sell. |
| Federal Home Loan Bank stock | Carrying value approximates fair value as FHLB stock can only be purchased or redeemed at par value. | Carried at par value.<br><br>Estimated fair value classified as Level 2. |
| Deposits | | |
| Demand deposits | Fair value is estimated as the amount payable on demand at the reporting date. | Carried at historical cost.<br><br>Estimated fair value classified as Level 2. |
| Fixed-maturity certificates of deposit | Fair value is estimated using discounted cash flows based on market rates currently offered for deposits of similar remaining maturities. | Carried at historical cost.<br><br>Estimated fair value classified as Level 2. |
| Federal Home Loan Bank advances | Fair value is estimated using discounted cash flows based on rates currently available for advances with similar terms and remaining maturities. | Carried at historical cost.<br><br>Estimated fair value classified as Level 2. |
| Long-term debt | Fair value is estimated using discounted cash flows based on current lending rates for similar long-term debt instruments with similar terms and remaining maturities. | Carried at historical cost.<br><br>Estimated fair value classified as Level 2. |

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The following presents the levels of the fair value hierarchy for the Company's assets and liabilities measured at fair value on a recurring basis.

| (in thousands) | Fair Value at September 30, 2012 | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| Assets: | | | | |
| Investment securities available for sale | | | | |
| Mortgage backed securities: | | | | |
| Residential | $63,366 | $— | $63,366 | $— |
| Commercial | 14,532 | — | 14,532 | — |
| Municipal bonds | 128,595 | — | 128,595 | — |
| Collateralized mortgage obligations: | | | | |
| Residential | 167,513 | — | 167,513 | — |
| Commercial | 9,109 | — | 9,109 | — |
| U.S. Treasury securities | 30,935 | — | 30,935 | — |
| Single family mortgage servicing rights | 73,787 | — | — | 73,787 |
| Single family loans held for sale | 525,926 | — | 525,926 | — |
| Derivatives | | | | |
| Forward sale commitments | 1,584 | — | 1,584 | — |
| Interest rate lock commitments | 37,413 | — | 37,413 | — |
| Interest rate swaps | 4,785 | — | 4,785 | — |
| Total Assets | $1,057,545 | $— | $983,758 | $73,787 |
| Liabilities: | | | | |
| Derivatives | | | | |
| Forward sale commitments | $16,305 | $— | $16,305 | $— |
| Interest rate swaps | 8,626 | — | 8,626 | — |
| Interest rate locks on loans | 1 | — | 1 | — |
| Total Liabilities | $24,932 | $— | $24,932 | $— |

| (in thousands) | Fair Value at December 31, 2011 | Level 1 | Level 2 | Level 3 |
|---|---|---|---|---|
| Assets: | | | | |
| Investment securities available for sale | | | | |
| Commercial mortgage backed securities | $14,483 | $— | $14,483 | $— |
| Municipal bonds | 49,584 | — | 49,584 | — |
| Collateralized mortgage obligations: | | | | |
| Residential | 223,390 | — | 223,390 | — |
| Commercial | 10,070 | — | 10,070 | — |
| U.S. Treasury securities | 31,520 | — | 31,520 | — |
| Single family mortgage servicing rights | 70,169 | — | — | 70,169 |
| Single family loans held for sale | 130,546 | — | 130,546 | — |
| Derivatives | | | | |
| Forward sale commitments | 1,206 | — | 1,206 | — |
| Interest rate swaptions | 1 | — | 1 | — |
| Interest rate lock commitments | 6,836 | — | 6,836 | — |
| Interest rate swaps | 5,719 | — | 5,719 | — |
| Total Assets | $543,524 | $— | $473,355 | $70,169 |
| Liabilities: | | | | |
| Derivatives | | | | |
| Forward sale commitments | $2,223 | $— | $2,223 | $— |
| Interest rate swaps | 8,777 | — | 8,777 | — |
| Total Liabilities | $11,000 | $— | $11,000 | $— |

There were no transfers between levels of the fair value hierarchy for assets and liabilities held as of September 30, 2012 and December 31, 2011 during the respective nine and twelve month reporting periods. For information regarding fair value changes and activity for single family MSRs during the three and nine months ended September 30, 2012 and 2011, see Note 8–Mortgage Banking Operations of this Form 10-Q.

Certain assets held by the Company are not included in the tables above, but are measured at fair value on a nonrecurring basis. These assets include certain loans held for investment and other real estate owned that are carried at the lower of cost or fair value, less the estimated cost to sell. The following presents assets that were recorded at fair value during the three and nine months ended September 30, 2012 and 2011 and still held at the end of the respective reporting period.

| (in thousands) | For the Three Months Ended September 30, 2012 | | | | |
|---|---|---|---|---|---|
| | Fair Value of Assets Held at September 30, 2012 | Level 1 | Level 2 | Level 3 | Total Losses |
| Loans held for investment[1] | $34,699 | — | — | $34,699 | $(1,817) |
| Other real estate owned[2] | 5,738 | — | — | 5,738 | (2,464) |
| Total | $40,437 | $— | $— | $40,437 | $(4,281) |

| (in thousands) | For the Three Months Ended September 30, 2011 | | | | |
|---|---|---|---|---|---|
| | Fair Value of Assets Held at September 30, | Level 1 | Level 2 | Level 3 | Total Losses |

| | | | | | | |
|---|---|---|---|---|---|---|
| | 2011 | | | | | |
| Loans held for investment[1] | $57,997 | — | — | $57,997 | $(5,385 | ) |
| Other real estate owned[2] | 30,534 | — | — | 30,534 | (6,417 | ) |
| Total | $88,531 | $— | $— | $88,531 | $(11,802 | ) |

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

| (in thousands) | For the Nine Months Ended September 30, 2011 | | | | |
|---|---|---|---|---|---|
| | Fair Value of Assets Held at September 30, 2011 | Level 1 | Level 2 | Level 3 | Total Losses |
| Loans held for investment[1] | $82,141 | — | — | $82,141 | $(9,489) |
| Other real estate owned[2] | 36,827 | — | — | 36,827 | (13,242) |
| Total | $118,968 | $— | $— | $118,968 | $(22,731) |

(1) Represents the carrying value of loans for which adjustments are based on the fair value of the collateral.
(2) Represents other real estate owned where an updated fair value of collateral is used to adjust the carrying amount subsequent to the initial classification as other real estate owned.

The following information presents significant Level 3 unobservable inputs used to measure fair value on a nonrecurring basis during the three and nine months ended September 30, 2012 for assets still held at the end of the period.

| (dollars in thousands) | Fair Value of Assets Held at September 30, 2012 | Valuation Technique | Significant Unobservable Input | Three Months Ended September 30, 2012 | |
|---|---|---|---|---|---|
| | | | | Low | High |
| Loans held for investment | $34,699 | Sales comparison approach | Comparable sale adjustments[1] | 3% | 45% |
| | | Income approach | Capitalization rate | 5% | 9% |
| Other real estate owned | $5,738 | Sales comparison approach | Comparable sale adjustments[1] | 1% | 13% |

| (dollars in thousands) | Fair Value of Assets Held at September 30, 2012 | Valuation Technique | Significant Unobservable Input | Nine Months Ended September 30, 2012 | |
|---|---|---|---|---|---|
| | | | | Low | High |
| Loans held for investment | $35,659 | Sales comparison approach | Comparable sale adjustments[1] | 1% | 45% |
| | | | Other discounts[2] | 28% | 74% |
| | | Income approach | Capitalization rate | 6% | 11% |
| Other real estate owned | $11,035 | Sales comparison approach | Comparable sale adjustments[1] | —% | 70% |
| | | | Other discounts[2] | 4% | 64% |

(1) Represents the range of net adjustments reflecting differences between a comparable sale and the property being appraised.

(2) Includes bulk sale discounts applied to the aggregate retail value of tract development properties, accelerated marketing period discounts and time-hold or other discounts applied to derive the “as is” market value of certain properties requiring a holding period before reaching a state of feasibility or completion (e.g., “upon completion” or "upon stabilization" value).

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

The following presents the carrying values and the hierarchy of the fair values of the Company’s financial instruments other than assets and liabilities measured at fair value on a recurring basis.

| | September 30, 2012 | | | | |
|---|---|---|---|---|---|
| (in thousands) | Carrying Value | Fair Value | Level 1 | Level 2 | Level 3 |
| Assets: | | | | | |
| Cash and cash equivalents | $22,051 | $22,051 | $22,051 | $— | $— |
| Loans held for investment | 1,268,703 | 1,310,234 | — | — | 1,310,234 |
| Loans held for sale – Multifamily | 6,654 | 6,654 | — | 6,654 | — |
| Mortgage servicing rights – Multifamily | 7,725 | 9,118 | — | — | 9,118 |
| Federal Home Loan Bank stock | 36,697 | 36,697 | — | 36,697 | — |
| Liabilities: | | | | | |
| Deposits | $1,981,814 | $1,986,794 | $— | $1,986,794 | $— |
| Federal Home Loan Bank advances | 131,597 | 135,933 | — | 135,933 | — |
| Long-term debt | 61,857 | 60,241 | — | 60,241 | — |

| | December 31, 2011 | | | | |
|---|---|---|---|---|---|
| (in thousands) | Carrying Value | Fair Value | Level 1 | Level 2 | Level 3 |
| Assets: | | | | | |
| Cash and cash equivalents | $263,302 | $263,302 | $263,302 | $— | $— |
| Loans held for investment | 1,300,873 | 1,349,680 | — | — | 1,349,680 |
| Loans held for sale – Multifamily | 19,863 | 19,863 | — | 19,863 | — |
| Mortgage servicing rights – Multifamily | 7,112 | 8,444 | — | | 8,444 |
| Federal Home Loan Bank stock | 37,027 | 37,027 | — | 37,027 | — |
| Liabilities: | | | | | |
| Deposits | $2,009,755 | $2,012,708 | $— | $2,012,708 | $— |
| Federal Home Loan Bank advances | 57,919 | 63,243 | — | 63,243 | — |
| Long-term debt | 61,857 | 60,591 | — | 60,591 | — |

Excluded from the fair value tables above are certain off-balance sheet loan commitments such as unused home equity lines of credit, business banking line funds and undisbursed construction funds. A reasonable estimate of the fair value of these instruments is the carrying value of deferred fees plus the related allowance for credit losses, which amounted to $392 thousand and $413 thousand at September 30, 2012 and December 31, 2011, respectively.

NOTE 11–DEPOSITS:

Deposit balances, including stated rates, are as follows.

| (in thousands) | At September 30, 2012 | At December 31, 2011 |
|---|---|---|
| Noninterest bearing accounts | $345,522 | $270,666 |
| NOW accounts 0.00% to 0.45% | 172,086 | 138,936 |
| Statement savings accounts, due on demand 0.20% to 0.80% | 104,239 | 66,898 |
| Money market accounts, due on demand 0.00% to 1.55% | 675,363 | 499,457 |
| Certificates of deposit 0.20% to 5.00% | 684,604 | 1,033,798 |
| | $1,981,814 | $2,009,755 |

Interest expense on deposits consists of the following.

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (in thousands) | 2012 | 2011 | 2012 | 2011 |
| NOW accounts | $129 | $140 | $368 | $458 |
| Statement savings accounts | 113 | 73 | 289 | 257 |
| Money market accounts | 858 | 716 | 2,394 | 2,298 |
| Certificates of deposit | 2,808 | 4,919 | 9,934 | 16,414 |
| | $3,908 | $5,848 | $12,985 | $19,427 |

There were no public funds included in deposits as of September 30, 2012 and December 31, 2011.

The weighted-average interest rate on certificates of deposit at September 30, 2012 and December 31, 2011 was 1.57% and 1.66%, respectively.

Certificates of deposit outstanding as of September 30, 2012, mature as follows.

| (in thousands) | September 30, 2012 |
|---|---|
| Within one year | $535,435 |
| One to two years | 110,227 |
| Two to three years | 19,575 |
| Three to four years | 9,924 |
| Four to five years | 9,443 |
| | $684,604 |

The aggregate amount of time deposits in denominations of $100,000 or more at September 30, 2012 and December 31, 2011 was $310.7 million and $454.5 million, respectively. The aggregate amount of time deposits in denominations of more than $250,000 at September 30, 2012 and December 31, 2011 was $47.0 million and $67.3 million, respectively. There were no brokered deposits as of September 30, 2012 or December 31, 2011.

NOTE 12–SHARE-BASED COMPENSATION PLANS:

For the three months ended September 30, 2012 and 2011, $199 thousand and $3 thousand of compensation costs, respectively, were recognized for share-based compensation awards. For the nine months ended September 30, 2012 and 2011, $2.4 million and $12 thousand of compensation costs, respectively, was recognized for share-based compensation awards.

2010 Equity Incentive Plan

In January 2010, the shareholders approved the Company's 2010 Equity Incentive Plan (the "2010 EIP"). Under the 2010 EIP, all of the Company's officers, employees, directors and/or consultants are eligible to receive awards. Awards which may be granted under the 2010 EIP include Incentive Stock Options, Nonqualified Stock Options, Stock Appreciation Rights, Restricted Stock Awards, Restricted Stock Unit Awards, Stock Bonus Awards and Incentive Bonus Awards, or a combination of the foregoing. This plan became effective during February 2012, upon the completion of the Company's initial public offering. The maximum amount of HomeStreet, Inc. common stock available for grant under the 2010 EIP is 1,412,612 shares.

Nonqualified Stock Options

Upon the successful completion of the initial public offering in February of 2012, nonqualified options were granted to key senior management personnel. A summary of changes in nonqualified stock options granted, but not vested, for the nine months ended September 30, 2012, is as follows.

| | Number | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term (in yrs.) | Aggregate Intrinsic Value (2) (in thousands) |
|---|---|---|---|---|
| Options outstanding at December 31, 2011 | 457,600 | $0.77 | 8.9 | $ 3,540 |
| Granted | 585,240 | 11.60 | 9.4 | 4,349 |
| Cancelled or forfeited | (7,000) | 0.75 | 0.0 | 128 |
| Exercised | (12,600) | 0.71 | 8.2 | 213 |
| Options outstanding at September 30, 2012 | 1,023,240 | 6.96 | 8.9 | 12,349 |
| Options that are exercisable and expected to be exercisable (1) | 1,010,590 | 6.93 | 8.8 | 12,227 |
| Options exercisable | 337,600 | 0.77 | 8.1 | 6,166 |

(1) Adjusted for estimated forfeitures.
(2) Intrinsic value is the amount by which fair value of the underlying stock exceeds the exercise price.

Under this plan, 12,600 options have been exercised through September 30, 2012, resulting in cash received and related income tax benefits totaling $9 thousand. As of September 30, 2012, there was $1.7 million of total unrecognized compensation costs related to stock options. Compensation costs are recognized over the requisite service period, which typically is the vesting period. Unrecognized compensation costs are expected to be recognized over the remaining weighted-average requisite service period of 2.2 years.

As observable market prices are generally not available for estimating the fair value of stock options, an option-pricing model is utilized to estimate fair value. The fair value of the options granted during the nine months ended September 30, 2012 was estimated as of the grant date using a Black-Scholes Merton ("Black-Scholes") model and the assumptions noted in the following table.

| | | |
|---|---|---|
| Expected term of the option | 6 years | |
| Expected stock price volatility | 36.03 | % |
| Annual risk-free interest rate | 1.34 | % |
| Expected annual dividend yield | 2.44 | % |

The expected term of six years is an estimate based on an expectation that the holders of the stock options, once vested, will exercise them – ultimately reflecting the settlement of all vested options. As the Company does not have historical exercise behavior to reference for these types of options, the Company leveraged the "simplified" method for estimating the expected term of these "plain-vanilla" stock options.

When estimating expected volatility and the dividend yield, the Company considered historical data of other similar entities that are publicly traded over a period commensurate with the life of the options. A single median was derived for each input from this population of banks.

Restricted Shares

Upon the completion of the initial public offering in February of 2012, the Company began granting restricted shares to key senior management personnel and directors. A summary of the status of these restricted shares follows.

| | Number | Weighted Average Grant Date Fair Value |
|---|---|---|
| Restricted shares outstanding at December 31, 2011 | — | $— |
| Granted | 210,860 | 11.44 |
| Cancelled or forfeited | — | — |
| Vested | (178,478) | 11.07 |
| Restricted shares outstanding at September 30, 2012 | 32,382 | 13.50 |

The Company recognized $54 thousand and $2.0 million in compensation expense for restricted shares during the three and nine months ended September 30, 2012, respectively. At September 30, 2012, there was $387 thousand of total unrecognized compensation cost related to nonvested restricted shares. Unrecognized compensation costs are generally expected to be recognized over a weighted average period of 1.8 years. Restricted shares granted to non-employee directors vest one-third at each one year anniversary from the grant date. However, for the restricted stock awards granted to senior management in connection with the initial public offering, the performance goals required to be met for certain vesting events to occur were achieved prior to that expectation, therefore any unrecognized compensation costs associated with the portion of restricted shares that vested earlier than expected were immediately recognized in earnings. These restricted shares granted to key senior management personnel in February 2012 became vested based upon the achievement of certain market conditions: one-third vested when the 30-day rolling average share price exceeded 25% of the grant date fair value; one-third vested when the rolling average share price exceeded 40% of the grant date fair value; and one-third vested when the 30 day rolling average share price exceeded 50% of grant date fair value. Due to the increase in our stock price 178,478 shares of restricted stock were fully vested during the nine months ended September 30, 2012, which resulted in the recognition of approximately $2.0 million in compensation expense.

NOTE 13–EARNINGS PER SHARE:

The following table summarizes the calculation of earnings per share for the three and nine months ended September 30, 2012 and 2011.

| | For the three months ended September 30, | | For the nine months ended September 30, | |
|---|---|---|---|---|
| (in thousands, except share data) | 2012 | 2011 | 2012 | 2011 |
| Net income | $21,343 | $15,258 | $58,390 | $9,093 |
| Weighted average shares: | | | | |
| Basic weighted-average number of common shares outstanding | 14,335,950 | 5,403,498 | 12,960,212 | 5,403,498 |
| Dilutive effect of outstanding common stock equivalents (1) | 363,082 | 341,934 | 454,264 | 204,606 |
| Diluted weighted-average number of common stock outstanding | $14,699,032 | $5,745,432 | $13,414,476 | $5,608,104 |
| Earnings per share: | | | | |

| | | | | |
|---|---|---|---|---|
| Basic earnings per share | $1.49 | $2.82 | $4.51 | $1.68 |
| Diluted earnings per share | $1.45 | $2.66 | $4.35 | $1.62 |

(1) Excluded from the computation of diluted earnings per share for the three and nine months ended September 30, 2012 were certain options (due to their antidilutive effect) and unvested restricted stock issued to key senior management personnel and directors of the Company. The aggregate number of common stock equivalents from such options and unvested restricted shares was 50,978 at September 30, 2012. There were no outstanding common stock equivalents during the three and nine months ended September 30, 2011 excluded from the computation of diluted earnings per share.

NOTE 14–BUSINESS SEGMENTS:

The Company has four business lines for the purposes of management reporting: Community Banking; Single Family Lending; Income Property Lending; and Residential Construction Lending. The results for these lines of business are based on a management accounting process that assigns income statement items to each responsible operating segment. This process is dynamic and, unlike financial accounting, there is no comprehensive, authoritative guidance for management accounting equivalent to GAAP. Our approach has focused, in the years presented, on managing revenues and expenses by segment and in total. The management accounting process measures the performance of the operating segments based on the Company's management structure and is based on management's view of the Company's operations and is not necessarily comparable with similar information for other financial services companies. The Company defines its operating segments by product type and customer segment. If the management structure and/or the allocation process changes, allocations, transfers and assignments may change.

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

Single Family Lending originates single family residential mortgage loans directly, and indirectly through our relationship with Windermere Mortgage Services Series LLC for sale into the secondary market. This segment also originates loans for our portfolio on a selective basis, including home equity loans, and services loans for others and for our portfolio.

Income Property Lending originates commercial real estate loans with a focus on multifamily lending through its Fannie Mae DUS business. These loans are sold to or securitized by Fannie Mae, and we generally continue to service them after the sale. We also originate commercial construction loans, bridge loans and permanent loans for our portfolio.

Residential Construction Lending originates and services residential construction loans for our portfolio, focusing on single family home construction that is short duration in nature. Generally, we do not lend on land development projects or raw land.

The All Other category includes corporate items not specific to an operating segment and elimination of certain items that are included in more than one business segment, including: (1) asset/liability management which includes interest rate risk, liquidity position and capital. Asset/liability management responsibilities involve managing the Company's portfolio of investment securities and providing oversight and direction across the enterprise over matters impacting the Company's balance sheet and off-balance sheet risk. Such activities include determining the optimal production composition and concentration of loans in the loan portfolio, the appropriate mix of funding sources at any point in time and the allocation of capital to the operating segments; (2) general corporate overhead costs associated with the Company's facilities, legal, accounting and finance functions, human resources, and technology services; and (3) the residual impact of our cost allocation processes.

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

- a funds transfer pricing ("FTP") system, which allocates interest income credits and funding charges between the segments and the Treasury division within the All Other category, which then assigns 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.

Effective January 1, 2012 management updated the FTP methodology it uses for reviewing segment results and managing the Company’s lines of business. Under the previous FTP methodology, we computed the cost of funds from our current period’s financial results and then allocated a portion of that cost of funds to each respective operating segment. This approach was based on internal financial results and updated for current period information, thereby providing an updated funding cost applied to certain assets or liabilities originated in prior periods.

The updated methodology is based on external market factors and more closely aligns the expected weighted-average life of the financial asset or liability to external economic data, such as the U.S. Dollar LIBOR/Swap curve, and provides a more consistent basis for determining the cost of funds to be allocated to each operating segment. The updated approach is also more consistent with FTP measurement techniques employed by other industry participants. We have reclassified all prior period amounts to conform to the current period’s methodology and presentation.

In general, the impact of the FTP change resulted in a lower cost of funds as compared with the previous method as the Company’s funding costs have generally been higher than market prices due to the historical structure of the deposit portfolio and wholesale borrowings.

Financial highlights by operating segment were as follows.

| | Three Months Ended September 30, 2012 | | | | | |
|---|---|---|---|---|---|---|
| (in thousands) | Community Banking | Single Family Lending | Income Property | Residential Construction | All Other | Total |
| Condensed income statement: | | | | | | |
| Net interest income [1] | $3,075 | $ 7,025 | $2,142 | $324 | $3,725 | $16,291 |
| Provision for loan losses | (150) | (2,982) | (1,666) | (647) | (55) | (5,500) |
| Noninterest income | 1,367 | 64,884 | 1,463 | 3 | 416 | 68,133 |
| Noninterest expense | (5,900) | (27,525) | (1,046) | (760) | (10,588) | (45,819) |
| Inter-segment revenue (expense) | (3,328) | (6,564) | (968) | (502) | 11,362 | — |
| Income (loss) before income taxes | (4,936) | 34,838 | (75) | (1,582) | 4,860 | 33,105 |
| Income tax (benefit) expense | (2,273) | 13,400 | 120 | (1,231) | 1,746 | 11,762 |
| Net income (loss) | $(2,663) | $ 21,438 | $(195) | $(351) | $3,114 | $21,343 |

| | Three Months Ended September 30, 2011 | | | | | |
|---|---|---|---|---|---|---|
| (in thousands) | Community Banking | Single Family Lending | Income Property | Residential Construction | All Other | Total |
| Condensed income statement: | | | | | | |
| Net interest income (expense) [1] | $1,817 | $ 3,332 | $2,036 | $(173) | $4,958 | $11,970 |
| Provision for loan losses | (81) | (437) | (233) | (249) | — | (1,000) |
| Noninterest income | 1,085 | 34,245 | 1,305 | 2 | 342 | 36,979 |
| Noninterest expense | (5,345) | (10,179) | (682) | (8,958) | (7,165) | (32,329) |
| Inter-segment revenue (expense) | (1,898) | (3,200) | (809) | (937) | 6,844 | — |
| Income (loss) before income taxes | (4,422) | 23,761 | 1,617 | (10,315) | 4,979 | 15,620 |
| Income tax (benefit) expense | (691) | 1,364 | 247 | (1,123) | 565 | 362 |
| Net income (loss) | $(3,731) | $ 22,397 | $1,370 | $(9,192) | $4,414 | $15,258 |

| | Nine Months Ended September 30, 2012 | | | | | |
|---|---|---|---|---|---|---|
| (in thousands) | Community Banking | Single Family Lending | Income Property | Residential Construction | All Other | Total |
| Condensed income statement: | | | | | | |
| Net interest income [1] | $8,012 | $ 17,032 | $6,998 | $1,015 | $10,837 | $43,894 |
| Provision for loan losses | (650) | (3,982) | (2,166) | (647) | (55) | (7,500) |
| Noninterest income | 3,883 | 154,064 | 4,251 | 59 | 488 | 162,745 |
| Noninterest expense | (17,505) | (68,504) | (5,574) | (7,048) | (28,721) | (127,352) |
| Inter-segment revenue (expense) | (8,059) | (15,976) | (2,650) | (1,442) | 28,127 | — |
| Income (loss) before income taxes | (14,319) | 82,634 | 859 | (8,063) | 10,676 | 71,787 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Income tax (benefit) expense | (2,671) | 15,421 | 160 | (1,505) | 1,992 | 13,397 |
| Net income (loss) | $(11,648) | $ 67,213 | $699 | $(6,558) | $8,684 | $58,390 |

| | Nine Months Ended September 30, 2011 | | | | | |
|---|---|---|---|---|---|---|
| (in thousands) | Community Banking | Single Family Lending | Income Property | Residential Construction | All Other | Total |
| Condensed income statement: | | | | | | |
| Net interest income [(1)] | $4,837 | $ 11,161 | $7,191 | $936 | $11,349 | $35,474 |
| Provision for loan losses | (193) | (1,902) | (431) | (774) | — | (3,300) |
| Noninterest income | 3,281 | 60,086 | 4,010 | 98 | 2,422 | 69,897 |
| Noninterest expense | (17,643) | (27,320) | (2,958) | (23,863) | (20,806) | (92,590) |
| Inter-segment revenue (expense) | (5,980) | (9,610) | (2,195) | (2,214) | 19,999 | — |
| Income (loss) before income taxes | (15,698) | 32,415 | 5,617 | (25,817) | 12,964 | 9,481 |
| Income tax (benefit) expense | (643) | 1,327 | 230 | (1,057) | 531 | 388 |
| Net income (loss) | $(15,055) | $ 31,088 | $5,387 | $(24,760) | $12,433 | $9,093 |

(1) Net interest income is the difference between interest earned on assets and the cost of liabilities to fund those assets. Interest earned includes actual interest earned on segment assets and, if the segment has excess liabilities, interest credits for providing funding to other segments. The cost of liabilities includes interest expense on segment liabilities and, if the segment does not have enough liabilities to fund its assets, a funding charge based on the cost of excess liabilities from another segment or category.

NOTE 15–SUBSEQUENT EVENTS:

On October 24, 2012, the Board of Directors approved a two-for-one forward split of the Company's common stock. As of the November 5, 2012 effective date, the total number of shares of common stock outstanding increased from approximately 7.2 million to approximately14.4 million and the total authorized stock increased from 80 million shares to 160 million shares. The issuance of additional shares to shareholders of record as of the effective date was made on November 7, 2012. Shares outstanding and per share information in this Form 10-Q have been adjusted to reflect the stock split.

We have evaluated all material events that occurred subsequent to September 30, 2012 and have determined that there are no other subsequent events that require disclosure.

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

FORWARD-LOOKING STATEMENTS

This Form 10-Q and the documents incorporated by reference contain, in addition to historical information, “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended (the “Securities Act”) and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). These statements relate to our future plans, objectives, expectations, intentions and financial performance, and assumptions that underlie these statements. All statements other than statements of historical fact are “forward-looking statements” for the purposes of these provisions, including:

- the factors referenced in this Form 10-Q including, but not limited to, those listed under Item 1A “Risk Factors” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and elsewhere in this Form 10-Q.;
- our ability to manage the credit risks of our lending activities, including potential increases in loan delinquencies, nonperforming assets and write offs, decreased collateral values, inadequate loan reserve amounts and the effectiveness of our hedging strategies;
- general economic conditions, either nationally or in our market area, including a continuation or worsening of the decline in the housing market, employment trends, business contraction, consumer confidence, real estate values and other recessionary pressures;
- changes in the levels of general interest rates, deposit interest rates, our net interest margin and funding sources;
- potential changes in interest rates which may affect demand for our products as well as the success of our interest rate risk management strategies;
- compliance with regulatory requirements, including new laws and regulations such as the Dodd-Frank Act as well as restrictions that may be imposed by the FDIC, the DFI, the Federal Reserve or other regulatory authorities pursuant to the Company cease and desist order, the Bank's memorandum of understanding with its regulators, or other discretionary enhanced supervision which could adversely affect our capital, liquidity and earnings;
- compliance with requirements of investors and/or government-owned or sponsored entities, including Fannie Mae, Freddie Mac, Ginnie Mae, FHA/HUD and VA;
- our ability to control costs while meeting operational needs and retaining key members of our senior management team and other key managers and business producers;
- the possibility of a significant reduction in our mortgage banking profitability if we are not able to or are limited in our ability to resell mortgages;
- increased competition in our industry due in part to consolidation;
- any projections of revenues, estimated operating expenses or other financial items;
- any statements of the plans and objectives of management for future operations or programs;
- any statements regarding future operations, plans, or regulatory approvals;
- any statements concerning proposed new products or services;
- any statements regarding pending or future mergers or acquisitions; and
- any statement regarding future economic conditions or performance, and any statement of assumption underlying any of the foregoing.

When used in this Form 10-Q, terms such as “anticipates,” “believes,” “continue,” “could,” “estimates,” “expects,” “intends,” “ “plans,” “potential,” “predicts,” “should,” or “will” or the negative of those terms or other comparable terms are intended to identify such forward-looking statements. These statements involve known and unknown risks, uncertainties and other factors that may cause industry trends or actual results, level of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by these statements. Our actual results may differ significantly from the results discussed in such forward-looking statements.

We do not intend to update any of the forward-looking statements after the date of this Form 10-Q 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-Q.

You may review a copy of this quarterly report on Form 10-Q, including exhibits and any schedule filed therewith, and obtain copies of such materials at prescribed rates, at the Securities and Exchange Commission's Public Reference Room in Room 1580, 100 F Street, NE, Washington, D.C. 20549-0102. You may obtain information on the operation of the Public Reference Room by calling the Securities and Exchange Commission at 1-800-SEC-0330. The Securities and Exchange Commission maintains a website (http://www.sec.gov) that contains reports, proxy and information statements and other information regarding registrants, such as HomeStreet, Inc., that file electronically with the Securities and Exchange Commission.

Summary Financial Data

| | Quarter ended | | | | | Nine months ended | |
|---|---|---|---|---|---|---|---|
| (in thousands, except share data) | Sept. 30, 2012 | Jun. 30, 2012 | Mar. 31, 2012 | Dec. 31, 2011 | Sept. 30, 2011 | Sept. 30, 2012 | Sept. 30, 2011 |
| Operations Data (for the period ended): | | | | | | | |
| Net interest income | $16,291 | $14,698 | $12,905 | $12,866 | $11,970 | $43,894 | $35,474 |
| Provision for loan losses | 5,500 | 2,000 | — | — | 1,000 | 7,500 | 3,300 |
| Noninterest income | 68,133 | 55,502 | 39,111 | 27,461 | 36,979 | 162,745 | 69,897 |
| Noninterest expense | 45,819 | 46,847 | 34,687 | 33,903 | 32,329 | 127,352 | 92,590 |
| Net income before taxes | 33,105 | 21,353 | 17,329 | 6,424 | 15,620 | 71,787 | 9,481 |
| Income taxes | 11,762 | 3,357 | (1,721) | (602) | 362 | 13,397 | 388 |
| Net income | $21,343 | $17,996 | $19,050 | $7,026 | $15,258 | $58,390 | $9,093 |
| Basic earnings per common share [(1)] | $1.49 | $1.26 | $1.85 | $1.30 | $2.82 | $4.51 | $1.68 |
| Diluted earnings per common share [(1)] | $1.45 | $1.21 | $1.78 | $1.21 | $2.66 | $4.35 | $1.62 |
| Weighted average common shares | | | | | | | |
| Basic | 14,335,950 | 14,252,120 | 10,292,566 | 5,403,498 | 5,403,498 | 12,960,212 | 5,403,498 |
| Diluted | 14,699,032 | 14,824,064 | 10,720,330 | 5,797,170 | 5,745,432 | 13,414,476 | 5,608,104 |
| Shareholders' equity per share | $16.67 | $14.94 | $13.35 | $15.99 | $14.87 | $16.67 | $14.87 |
| Common shares outstanding [(1)] | 14,354,972 | 14,325,214 | 14,325,214 | 5,403,498 | 5,403,498 | 14,354,972 | 5,403,498 |
| | | | | | | | |
| Financial position (at period end): | | | | | | | |
| Cash and cash equivalents | $22,051 | $75,063 | $92,953 | $263,302 | $138,429 | $22,051 | $138,429 |
| Investment securities available for sale | 414,050 | 415,610 | 446,198 | 329,047 | 339,453 | 414,050 | 339,453 |
| Loans held for sale | 532,580 | 412,933 | 290,954 | 150,409 | 226,590 | 532,580 | 226,590 |
| Loans held for investment, net | 1,268,703 | 1,235,253 | 1,295,471 | 1,300,873 | 1,360,219 | 1,268,703 | 1,360,219 |
| Mortgage servicing rights | 81,512 | 78,240 | 86,801 | 77,281 | 74,083 | 81,512 | 74,083 |
| Other real estate owned | 17,003 | 40,618 | 31,640 | 38,572 | 64,368 | 17,003 | 64,368 |
| Total assets | 2,507,941 | 2,424,947 | 2,367,497 | 2,264,957 | 2,316,839 | 2,507,941 | 2,316,839 |
| Deposits | 1,981,814 | 1,904,749 | 2,000,633 | 2,009,755 | 2,056,977 | 1,981,814 | 2,056,977 |
| FHLB advances | 131,597 | 65,590 | 57,919 | 57,919 | 67,919 | 131,597 | 67,919 |
| Repurchase agreements | — | 100,000 | — | — | — | — | — |
| Shareholders' equity | 239,260 | 214,023 | 191,230 | 86,407 | 80,336 | 239,260 | 80,336 |
| | | | | | | | |
| Financial position (averages): | | | | | | | |
| Investment securities available for sale | $411,916 | $431,875 | $381,129 | $338,933 | $272,294 | $408,320 | $295,988 |
| Loans held for investment | 1,270,652 | 1,304,740 | 1,338,552 | 1,385,037 | 1,427,763 | 1,304,526 | 1,509,296 |
| Total interest earning assets | 2,184,791 | 2,142,451 | 2,090,180 | 2,078,506 | 2,019,243 | 2,139,310 | 2,066,943 |
| Total interest bearing deposits | 1,625,437 | 1,640,159 | 1,705,371 | 1,745,493 | 1,787,388 | 1,656,874 | 1,837,708 |
| FHLB advances | 112,839 | 79,490 | 57,919 | 59,169 | 72,267 | 83,523 | 105,410 |
| Repurchase agreements | 18,478 | 52,369 | — | — | — | 23,597 | — |
| Total interest bearing liabilities | 1,818,611 | 1,833,875 | 1,825,146 | 1,866,519 | 1,921,512 | 1,825,851 | 2,005,843 |
| Shareholders' equity | 229,762 | 206,428 | 140,784 | 84,038 | 73,499 | 192,778 | 62,958 |

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Summary Financial Data (continued)

| (in thousands, except share data) | Quarter ended Sept. 30, 2012 | | Jun. 30, 2012 | | Mar. 31, 2012 | | Dec. 31, 2011 | | Sept. 30, 2011 | | Nine months ended Sept. 30, 2012 | | Sept. 30, 2011 | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Financial performance: | | | | | | | | | | | | | | |
| Return on average common shareholders' equity [2] | 37.16 | % | 34.87 | % | 54.13 | % | 33.44 | % | 83.04 | % | 40.38 | % | 19.26 | % |
| Return on average assets | 3.50 | % | 3.04 | % | 3.30 | % | 1.23 | % | 2.67 | % | 3.29 | % | 0.53 | % |
| Net interest margin [3] | 3.08 | % | 2.83 | % | 2.53 | % | 2.50 | % | 2.38 | % | 2.82 | % | 2.30 | % |
| Efficiency ratio [4] | 54.27 | % | 66.73 | % | 66.69 | % | 84.07 | % | 66.05 | % | 61.63 | % | 87.87 | % |
| Operating efficiency ratio [6] | 53.86 | % | 58.12 | % | 61.84 | % | 74.78 | % | 47.43 | % | 57.32 | % | 62.69 | % |
| Credit quality: | | | | | | | | | | | | | | |
| Allowance for credit losses | $27,627 | | $27,125 | | $35,402 | | $42,800 | | $53,386 | | $27,627 | | $53,386 | |
| Allowance for credit losses/total loans | 2.12 | % | 2.13 | % | 2.64 | % | 3.18 | % | 3.76 | % | 2.12 | % | 3.76 | % |
| Allowance for credit losses/nonaccrual loans | 71.80 | % | 81.28 | % | 46.58 | % | 55.81 | % | 55.91 | % | 71.80 | % | 55.91 | % |
| Total classified assets | $102,385 | | $137,165 | | $208,792 | | $188,167 | | $225,022 | | $102,385 | | $225,022 | |
| Classified assets/total assets | 4.08 | % | 5.66 | % | 8.82 | % | 8.31 | % | 9.71 | % | 4.08 | % | 9.71 | % |
| Total nonaccrual loans [5] | $38,247 | | $33,107 | | $75,575 | | $76,484 | | $95,094 | | $38,247 | | $95,094 | |
| Nonaccrual loans/total loans | 2.94 | % | 2.62 | % | 5.66 | % | 5.69 | % | 6.73 | % | 2.94 | % | 6.73 | % |
| Other real estate owned | $17,003 | | $40,618 | | $31,640 | | $38,572 | | $64,368 | | $17,003 | | $64,368 | |
| Total nonperforming assets | $55,250 | | $73,725 | | $107,215 | | $115,056 | | $159,462 | | $55,250 | | $159,462 | |
| Nonperforming assets/total assets | 2.20 | % | 3.04 | % | 4.53 | % | 5.08 | % | 6.88 | % | 2.20 | % | 6.88 | % |
| Net charge-offs | $4,998 | | $10,277 | | $7,398 | | $10,586 | | $7,673 | | $22,673 | | $14,480 | |
| Regulatory capital ratios for the Bank: | | | | | | | | | | | | | | |
| Tier 1 capital to total assets (leverage) | 10.77 | % | 10.14 | % | 9.29 | % | 6.04 | % | 5.64 | % | 10.77 | % | 5.64 | % |
| Tier 1 risk-based capital | 16.65 | % | 15.75 | % | 14.18 | % | 9.88 | % | 8.51 | % | 16.65 | % | 8.51 | % |
| Total risk-based capital | 17.90 | % | 17.01 | % | 15.45 | % | 11.15 | % | 9.79 | % | 17.90 | % | 9.79 | % |
| Other data: | | | | | | | | | | | | | | |
| Full-time equivalent employees (ending) | 998 | | 913 | | 821 | | 613 | | 598 | | 998 | | 598 | |

(1) Per share data shown after giving effect to the 2-for-1 forward stock splits effective on November 5, 2012 and on March 6, 2012, as well as the 1-for-2.5 reverse stock split effective on July 19, 2011.
(2) Net earnings (loss) available to common shareholders divided by average common shareholders' equity.
(3) Net interest income divided by total interest earning assets on a tax equivalent basis.
(4) The efficiency ratio is noninterest expense divided by total revenue (net interest income and noninterest income).
(5) Generally, loans are placed on nonaccrual status when they are 90 or more days past due.
(6)

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

| | Quarter ended | | | | | | | | | | Nine months ended | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Sept. 30, 2012 | | Jun. 30, 2012 | | Mar. 31, 2012 | | Dec. 31, 2011 | | Sept. 30, 2011 | | Sept. 30, 2012 | | Sept. 30, 2011 | |
| Efficiency ratio | 54.27 | % | 66.73 | % | 66.69 | % | 84.07 | % | 66.05 | % | 61.63 | % | 87.87 | % |
| Less impact of OREO expenses | 0.41 | % | 8.61 | % | 4.85 | % | 9.29 | % | 18.62 | % | 4.31 | % | 25.18 | % |
| Operating efficiency ratio | 53.86 | % | 58.12 | % | 61.84 | % | 74.78 | % | 47.43 | % | 57.32 | % | 62.69 | % |

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Summary Financial Data (continued)

| (in thousands) | Quarter ended Sept. 30, 2012 | Jun. 30, 2012 | Mar. 31, 2012 | Dec. 31, 2011 | Sept. 30, 2011 | Nine months ended Sept. 30, 2012 | Sept. 30, 2011 |
|---|---|---|---|---|---|---|---|
| SUPPLEMENTAL DATA: | | | | | | | |
| Loans serviced for others | | | | | | | |
| Single family residential | $8,109,669 | $7,468,982 | $6,947,278 | $6,885,285 | $6,649,546 | $8,109,669 | $6,649,546 |
| Multifamily | 760,820 | 772,473 | 766,433 | 758,535 | 770,401 | 760,820 | 770,401 |
| Other | 53,617 | 56,840 | 59,370 | 56,785 | 57,151 | 53,617 | 57,151 |
| Total loans serviced for others | $8,924,106 | $8,298,295 | $7,773,081 | $7,700,605 | $7,477,098 | $8,924,106 | $7,477,098 |
| Loan production volumes: | | | | | | | |
| Single family mortgage closed loans [1] | $1,368,238 | $1,068,656 | $712,302 | $624,111 | $478,024 | $3,149,196 | $1,077,497 |
| Single family mortgage interest rate lock commitments | 1,313,182 | 1,303,390 | 915,141 | 543,164 | 630,919 | 3,531,713 | 1,229,453 |
| Single family mortgage loans sold | 1,238,879 | 962,704 | 534,310 | 710,706 | 370,250 | 2,735,893 | 1,028,514 |
| Multifamily mortgage originations | 20,209 | 35,908 | 15,713 | 49,071 | 26,125 | 71,830 | 76,605 |
| Multifamily mortgage loans sold | 26,515 | 27,178 | 31,423 | 33,461 | 25,144 | 85,116 | 86,016 |

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

This report contains forward-looking statements. For a discussion about such statements, including the risks and uncertainties inherent therein, see "Forward-Looking Statements." Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with the Consolidated Financial Statements and Notes presented elsewhere in this report and in HomeStreet, Inc's 2011 annual report on Form 10-K.

Management's Overview of Third Quarter 2012 Financial Performance

We are a 91-year-old diversified financial services company headquartered in Seattle, Washington, serving consumers and businesses in the Pacific Northwest and Hawaii. Our primary subsidiaries are HomeStreet Bank (the "Bank") and HomeStreet Capital Corporation. HomeStreet Bank is a Washington state-chartered savings bank that provides deposit and investment products and cash management services. HomeStreet Bank also provides loans for single family homes, commercial real estate, construction and commercial businesses. HomeStreet Capital Corporation, a Washington corporation, originates, sells and services multifamily mortgage loans under the Fannie Mae Delegated Underwriting and Servicing Program ("DUS®"), in conjunction with HomeStreet Bank. We also provide insurance products and services for consumers and businesses as HomeStreet Insurance and loans for single family homes through an affiliated business arrangement, Windermere Mortgage Services Series LLC ("WMS LLC").

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

At September 30, 2012, we had total assets of $2.51 billion, net loans held for investment of $1.27 billion, deposits of $1.98 billion and shareholders' equity of $239.3 million.

Our reported net income for the third quarter of 2012 represents our sixth consecutive quarter of profitability reflecting substantial progress in the execution of our plan to address the negative impact of the economic downturn on the Company's financial condition, results of operations and risk profile. As discussed below, during the first nine months of 2012 we improved or expanded major components of our business, including recapitalizing the Company, upgrading the Bank's regulatory standing, expanding our mortgage origination capacity, improving the quality of our deposits, bolstering our processing, compliance and risk management capabilities, and recognizing significantly improved results of operations.

On October 24, 2012, the Board of Directors approved a two-for-one forward split of the Company's common stock. Shares outstanding and per share information have been adjusted to reflect the stock split, which was effective on November 5, 2012.

Financial Performance

For the third quarter of 2012, net income was $21.3 million, or $1.45 per diluted share, compared with $15.3 million, or $2.66 per diluted share a year ago. For the first nine months of 2012, net income was $58.4 million, or $4.35 per diluted share, compared with $9.1 million, or $1.62 per diluted share, for the same period a year ago. Return on equity for the first nine months of 2012 (on an annualized basis) was 40.38%, compared to 19.26% for the same period last year, while return on average assets for the first nine months of 2012 (on an annualized basis) was 3.29%, compared to 0.53% for the same period a year ago.

Our financial performance for the third quarter of 2012 was driven by a $35.5 million increase in net revenue as compared to the same quarter last year, and for the first nine months of 2012 was driven by a $101.3 million increase in net revenue as compared to the first nine months of 2011. Our strong revenue growth in 2012 primarily reflects the continued growth in mortgage loan origination and sale activities that has been driven by high mortgage production volume, record low mortgage interest rates and strong secondary market profit margins that began to increase in the third quarter of 2011. We also continue to expand our mortgage production capacity, which included increasing mortgage origination and support personnel by 14% from the prior quarter and 123% since the beginning of the year.

Net interest income, on a tax equivalent basis, increased $4.8 million, or 39.9%, in third quarter 2012 and increased $9.5 million, or 26.7%, in the first nine months of 2012 as compared to the same periods last year. Our net interest margin for the third quarter of 2012 improved to 3.08% from 2.38% in the third quarter of 2011 and for the first nine months of 2012 improved to 2.82% from 2.30% in the same period in the prior year. The improvement in our net interest income and net interest margin

[1] DUS® is a registered trademark of Fannie Mae 52

over these periods in large part reflects the execution of our deposit product and pricing strategy, increased average balances of loans held for sale and the investment of proceeds from our initial public offering, thereby increasing the average balance of interest earning assets for the first nine months of 2012.

Provision for credit losses was $5.5 million for third quarter 2012, and $7.5 million the first nine months of 2012, compared to $1.0 million and $3.3 million for the same periods in the prior year. Asset quality trends continue to improve as nonaccrual loans declined to $38.2 million at September 30, 2012, a decrease of $38.2 million or 50.0%, from $76.5 million at December 31, 2011. Loan delinquencies also decreased, with total loans past due decreasing to 7.37% of loans held for investment at September 30, 2012, compared to 10.38% at December 31, 2011. Overall, the allowance for credit losses decreased to 2.12% of loans held for investment at September 30, 2012, down from 3.18% of total loans held for investment at December 31, 2011.

Noninterest income was $68.1 million in the third quarter 2012, an increase of $31.2 million, or 84.2%, from $37.0 million in the third quarter 2011. For the first nine months of 2012, noninterest income was $162.7 million, an increase of $92.8 million, or 132.8%, from $69.9 million for the first nine months of the prior year. Our noninterest income is heavily dependent upon our single family mortgage banking activities, which are comprised of mortgage origination and sale activities and mortgage servicing activities. The increase in noninterest income is predominantly due to higher net gain on mortgage loan origination and sale activities, which increased $48.6 million for third quarter of 2012 and $108.7 million for the first nine months of 2012 as compared to the same periods in 2011, totaling $64.4 million for third quarter 2012 and $138.4 million for the first nine months of 2012, compared with $15.8 million and $29.7 million for the same periods in the prior year.

Noninterest expense was $45.8 million for third quarter 2012, an increase of $13.5 million, or 41.7%, from $32.3 million a year ago. Noninterest expense was $127.4 million for the first nine months of 2012, an increase of $34.8 million, or 37.5%, from $92.6 million for the same period in the prior year. Noninterest expense increased primarily due to salary and related costs, which increased $18.4 million for third quarter 2012 and $44.1 million for the first nine months of 2012 as compared to the same periods a year ago, reflecting higher commissions and incentive compensation expenses and an increase in employees as we expanded our mortgage origination and support personnel and added lending and support personnel in our other lending lines of business, partially offset by lower OREO expenses, as valuation losses decreased compared with the same periods a year ago.

Income tax expense increased $11.4 million for third quarter 2012 and $13.0 million for the first nine months of 2012 as compared to the same periods a year ago. In the second quarter of 2012 we determined we had sufficient objective positive evidence to reverse the remaining valuation allowance with respect to our net deferred tax asset, which was based on our assessment of our ability to realize deferred tax assets in the future.

Credit Quality

Management believes that the Company's 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 improved since December 31, 2011 as illustrated by the credit trends below.

For the third quarter of 2012, net charge-offs totaled $5.0 million, compared with $7.7 million for the prior year. For the first nine months of 2012, net charge-offs totaled $22.7 million, compared with $14.5 million for the same period in 2011.

We recorded a $5.5 million provision for loan losses in the third quarter of 2012, compared to $2.0 million in the preceding quarter and $1.0 million in the third quarter of 2011. The allowance for loan losses (which excludes the allowance for unfunded commitments) decreased to $27.5 million at September 30, 2012, or 2.11% of loans held for investment, compared with $42.7 million, or 3.17% of total loans held for investment, as of December 31, 2011. The decrease in the allowance for loan losses since December 31, 2011 primarily relates to reductions in specific reserves from charge-offs related to the resolution of certain nonaccrual loans as they are transferred to other real estate owned ("OREO"). Additionally, the overall level of loans in default continues to improve as seen in the improvement in nonaccrual loans and total loan delinquencies. Nonperforming assets decreased to $55.3 million at September 30, 2012, from $115.1 million at December 31, 2011. Nonaccrual loans declined to $38.2 million at September 30, 2012, compared with $76.5 million at December 31, 2011. Past due loans totaled $95.7 million, or 7.37% of total loans, at September 30, 2012, compared with $139.9 million, or 10.38% of total loans, at year end. OREO balances decreased to $17.0 million at September 30, 2012, compared with $38.6 million at December 31, 2011. In April 2012, bankruptcy courts affirmed the Company's settlement of collection litigation related to two nonperforming construction/land development loans with aggregate carrying values of $26.6 million. As a result, during the first nine months of 2012 we charged-off $11.8 million on both loans and transferred the estimated net recovery value of $18.8 million to OREO and subsequently sold the properties.

Expansion of Mortgage Banking Operations

During the first nine months of 2012, we expanded our mortgage origination capacity, accelerating our strategic plan to increase mortgage origination market share and volume by hiring approximately 326 mortgage origination and support personnel, a significant portion of whom were previously employed in Washington and Idaho by MetLife Home Loans, including MetLife's Pacific Northwest regional sales manager and its regional builder services manager, as well as regional and branch managers, loan officers and related production support staff. In the third quarter we continued to hire additional mortgage origination personnel, adding 70 loan officers and support staff. In 2012, we have opened or are in the process of opening 15 new stand-alone mortgage lending centers in Washington, Oregon and Idaho to accommodate the expansion of these operations.

Regulatory Matters

We improved our Bank regulatory capital ratios during the first nine months of 2012, increasing our Tier 1 leverage and total risk-based capital ratios to 10.8% and 17.9%, compared with 6.0% and 11.2% as of December 31, 2011, respectively. This improvement reflects the completion of our initial public offering of common stock as well as earnings for the first nine months of 2012.

On February 15, 2012, we completed our initial public offering of 8,723,632 shares of common stock for an initial offering price of $11.00 per share (after giving effect to the 2-for-1 forward stock split effective March 6, 2012 and the 2-for-1 forward stock split effective November 5, 2012). The net increase in HomeStreet's capital was $86.4 million, of which $55.0 million was contributed to the Bank on February 24, 2012 with an additional $10.0 million contributed on April 26, 2012.

On March 26, 2012 the Federal Deposit Insurance Corporation (“FDIC”) and the Washington State Department of Financial Institutions (“DFI”) terminated the cease and desist order for the Bank (“Bank Order”), dated May 8, 2009. The Bank Order was replaced with a memorandum of understanding that requires, among other things, the maintenance of a minimum Tier 1 leverage ratio of 9.0%, pre-approval of dividends and the continued reduction of classified assets. The Bank is no longer classified as a “troubled institution” and is now considered “well-capitalized” within the meaning of the FDIC’s prompt corrective action rules. The Company remains under a cease and desist order (the “Company Order”) supervised by the Federal Reserve.

The termination of the Bank Order provides several benefits, including a reduction in our FDIC assessment and examination fees; resumption of portfolio lending for certain lending products; the ability to open or re-locate retail deposit branches; access to federal funds lines from correspondent banks; the re-opening of certain correspondent lending channels that had previously been restricted; and the ability to increase the amount of trading partner relationships used for hedging purposes. Additionally, as a result of the termination of the Bank Order and the related impact on certain rating agency metrics, the Bank now fully complies with the seller servicer requirements of government-sponsored entities such as Fannie Mae and Freddie Mac. We believe that the termination of the Bank Order also improves the reputation of the Bank in our markets, removing any stigma associated with the Bank's prior status as a troubled institution and improving the Bank's attractiveness to current and prospective customers and employees.

In recognition of the significant improvement in the Bank's financial condition, results of operations and risk profile, on July 10, 2012 the Federal Reserve Bank granted full access to all Federal Reserve Bank lending and depository services.

On June 12, 2012, the three federal banking regulators (including the Federal Reserve and the FDIC) jointly announced that they were seeking comment on three sets of proposed regulations relating to capital (the “Proposed Rules”). The Proposed Rules would apply to certain depository institutions (including the Bank) and their holding companies. Although parts of the Proposed Rules would apply only to large, complex financial institutions, a substantial portion of the Proposed Rules would apply to the Bank and the Company. The Proposed Rules include requirements contemplated by the Dodd-Frank Act as well as certain standards adopted by the Basel Committee on Banking Supervision (“BCBS”) in December 2010, which standards are commonly referred to as “Basel III.” For further discussion, see Liquidity Risk and Capital Resources - New Proposed Capital Rules within Management's Discussion and Analysis of this Form 10-Q.

Recent Developments

On July 26, 2012, the Company announced the appointment of Cory Stewart, age 40, as the Company's Executive Vice President and Chief Accounting Officer, effective upon receipt of approval by or non-objection from the Federal Reserve and upon the expiration, without objection, of a 30-day period after written notice is given to the FDIC and the DFI. On October 15, 2012, having received the necessary regulatory approvals, the appointment of Cory Stewart as Executive Vice President and Chief Accounting Officer of HomeStreet, Inc. became effective. Mr. Stewart joined the Company in March 2012 as Senior Vice President and Controller of the Company; Senior Vice President and Finance Director of the Bank.

On July 26, 2012, the Company also announced the appointment of Darrell van Amen, age 46, as the Company's Executive Vice President and Chief Investment Officer, effective upon receipt of approval by or non-objection from the Federal Reserve and upon the expiration, without objection, of a 30-day period after written notice is given to the FDIC and the DFI. The appointment of Darrell van Amen as the Company's Executive Vice President and Chief Investment Officer became effective in the third quarter of 2012 due to the receipt of regulatory approval. Mr. van Amen formerly served as Senior Vice President and continues to serve as Treasurer of the Company; Asset/Liability Manager and Treasurer of the Bank. Mr. van Amen joined the Company in 2003.

On October 15, 2012, in connection with Mr. Stewart and Mr. van Amen assuming their respective positions with the Company, Mark K. Mason relinquished his role as acting Chief Financial Officer and Principal Accounting Officer of the Company. Mr. Mason will continue to serve as the Company's Vice Chairman, President and Chief Executive Officer.

Critical Accounting Policies and Estimates

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

- Allowance for Loan Losses
- Other Real Estate Owned
- Fair Value Measurements of Mortgage Servicing Rights
- Fair Value Measurements of Investment Securities
- Derivatives and Hedging Activities
- Income Taxes

These policies and estimates are described in further detail in Part II, Item 7 Management’s Discussion and Analysis of Financial Condition and Results of Operations and Note 1, Summary of Significant Accounting Policies to Financial Statements in our 2011 Annual Report on Form 10-K.

Results of Operations

| (in thousands, except per share data and ratios) | At or for the three months ended September 30, 2012 | 2011 | % Change 2012 vs. 2011 | At or for the nine months ended September 30, 2012 | 2011 | Change 2012 vs. 2011 |
|---|---|---|---|---|---|---|
| Selected statement of operations data | | | | | | |
| Total net revenue | $84,424 | $48,949 | 72 % | $206,639 | $105,371 | 96 % |
| Total noninterest expense | 68,133 | 32,329 | 111 | 127,352 | 92,590 | 38 |
| Provision for credit losses | 5,500 | 1,000 | 450 | 7,500 | 3,300 | 127 |
| Income tax expense | 11,762 | 362 | NM | 13,397 | 388 | NM |
| Net income | 21,343 | 15,258 | 40 | 58,390 | 9,093 | 542 |
| Financial performance | | | | | | |
| Diluted earnings per common share | $1.45 | $2.66 | (45 )% | $4.35 | $1.62 | 169 % |
| Return on average common shareholders’ equity | 37.16 % | 83.04 % | NM | 40.38 % | 19.26 % | NM |
| Return on average assets | 3.50 % | 2.67 % | NM | 3.29 % | 0.53 % | NM |
| Net interest margin | 3.08 % | 2.38 % | NM | 2.82 % | 2.30 % | NM |
| Capital ratios (Bank only) | | | | | | |
| Tier 1 leverage | 10.8 % | 5.6 % | NM | 10.8 % | 5.6 % | NM |
| Total risk-based capital | 17.9 % | 9.8 % | NM | 17.9 % | 9.8 % | NM |

NM = Not meaningful

Per share information reflects the initial public offering of 8,723,632 shares of common stock completed on February 15, 2012 and is shown giving effect to the 1-for-2.5 reverse stock split effective July 19, 2011, the 2-for-1 forward stock split effective March 6, 2012 and the 2-for-1 forward stock split effective November 5, 2012.

Average Balances and Rates

Average balances, together with the total dollar amounts of interest income and expense, on a tax-equivalent basis related to such balances and the weighted-average rates, for the three and nine months ended September 30, 2012 and 2011 were as follows.

| | Three Months Ended September 30, | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2012 | | | | 2011 | | | |
| (in thousands) | Average Balance | Interest | Average Yield/Cost | | Average Balance | Interest | Average Yield/Cost | |
| Assets: | | | | | | | | |
| Interest-earning assets [1]: | | | | | | | | |
| Cash & cash equivalents | $50,056 | $24 | 0.15 | % | $192,323 | $114 | 0.23 | % |
| Investment securities | 411,916 | 3,013 | 2.93 | % | 272,294 | 1,444 | 2.14 | % |
| Loans held for sale | 452,167 | 3,854 | 3.41 | % | 126,863 | 1,362 | 4.33 | % |
| Loans held for investment | 1,270,652 | 14,464 | 4.54 | % | 1,427,763 | 16,268 | 4.54 | % |
| Total interest-earning assets | 2,184,791 | 21,355 | 3.90 | % | 2,019,243 | 19,188 | 3.79 | % |
| Noninterest-earning assets [2] | 256,631 | | | | 265,216 | | | |
| Total assets | $2,441,422 | | | | $2,284,459 | | | |
| Liabilities and Shareholders' Equity: | | | | | | | | |
| Deposits: | | | | | | | | |
| Interest-bearing demand accounts | $155,947 | 128 | 0.33 | % | $133,006 | 140 | 0.42 | % |
| Savings accounts | 98,711 | 114 | 0.46 | % | 58,043 | 73 | 0.50 | % |
| Money market accounts | 655,123 | 857 | 0.52 | % | 461,278 | 715 | 0.62 | % |
| Certificate accounts | 715,656 | 2,809 | 1.56 | % | 1,135,061 | 4,920 | 1.72 | % |
| Total interest-bearing deposits | 1,625,437 | 3,908 | 0.96 | % | 1,787,388 | 5,848 | 1.30 | % |
| FHLB advances | 112,839 | 297 | 1.19 | % | 72,267 | 855 | 4.69 | % |
| Securities sold under agreements to repurchase | 18,478 | 19 | 0.14 | % | — | — | — | % |
| Long-term debt | 61,857 | 305 | 1.97 | % | 61,857 | 459 | 2.97 | % |
| Other borrowings | — | 4 | — | | — | — | — | |
| Total interest-bearing liabilities | 1,818,611 | 4,533 | 0.99 | % | 1,921,512 | 7,162 | 1.48 | % |
| Other noninterest-bearing liabilities | 393,049 | | | | 289,448 | | | |
| Total liabilities | 2,211,660 | | | | 2,210,960 | | | |
| Shareholders' equity | 229,762 | | | | 73,499 | | | |
| Total liabilities and shareholders' equity | $2,441,422 | | | | $2,284,459 | | | |
| Net interest income [3] | | $16,822 | | | | $12,026 | | |
| Net interest spread | | | 2.91 | % | | | 2.31 | % |
| Impact of noninterest-bearing sources | | | 0.17 | % | | | 0.07 | % |
| Net interest margin | | | 3.08 | % | | | 2.38 | % |

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

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

(3) Includes taxable-equivalent adjustments, which is a non-GAAP measure, primarily related to tax-exempt income on certain loans and securities of $531 thousand for the three months ended September 30, 2012 and $56 thousand for the three months ended September 30, 2011, respectively. The Company's estimated marginal tax rate was 36% for the periods presented.

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| | Nine Months Ended September 30, | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2012 | | | | 2011 | | | |
| (in thousands) | Average Balance | Interest | Average Yield/Cost | | Average Balance | Interest | Average Yield/Cost | |
| Assets: | | | | | | | | |
| Interest-earning assets [1]: | | | | | | | | |
| Cash & cash equivalents | $116,789 | $208 | 0.24 | % | $151,763 | $265 | 0.23 | % |
| Investment securities | 408,320 | 8,383 | 2.74 | % | 295,988 | 5,215 | 2.35 | % |
| Loans held for sale | 309,675 | 8,289 | 3.57 | % | 109,896 | 3,566 | 4.33 | % |
| Loans held for investment | 1,304,526 | 43,906 | 4.49 | % | 1,509,296 | 50,756 | 4.49 | % |
| Total interest-earning assets | 2,139,310 | 60,786 | 3.79 | % | 2,066,943 | 59,802 | 3.86 | % |
| Noninterest-earning assets [2] | 223,816 | | | | 241,181 | | | |
| Total assets | $2,363,126 | | | | $2,308,124 | | | |
| Liabilities and Shareholders' Equity: | | | | | | | | |
| Deposits: | | | | | | | | |
| Interest-bearing demand accounts | $148,288 | 368 | 0.33 | % | $126,769 | 458 | 0.48 | % |
| Savings accounts | 85,376 | 290 | 0.45 | % | 55,367 | 257 | 0.62 | % |
| Money market accounts | 592,195 | 2,390 | 0.54 | % | 438,922 | 2,297 | 0.70 | % |
| Certificate accounts | 831,015 | 9,937 | 1.60 | % | 1,216,650 | 16,415 | 1.80 | % |
| Total interest-bearing deposits | 1,656,874 | 12,985 | 1.05 | % | 1,837,708 | 19,427 | 1.41 | % |
| FHLB advances | 83,523 | 1,506 | 2.40 | % | 105,410 | 3,122 | 3.95 | % |
| Securities sold under agreements to repurchase | 23,597 | 69 | 0.39 | % | — | — | — | % |
| Long-term debt | 61,857 | 1,041 | 2.24 | % | 62,725 | 1,586 | 3.37 | % |
| Other borrowings | — | 12 | — | | — | 1 | — | |
| Total interest-bearing liabilities | 1,825,851 | 15,613 | 1.14 | % | 2,005,843 | 24,136 | 1.61 | % |
| Other noninterest-bearing liabilities | 344,497 | | | | 239,323 | | | |
| Total liabilities | 2,170,348 | | | | 2,245,166 | | | |
| Shareholders' equity | 192,778 | | | | 62,958 | | | |
| Total liabilities and shareholders' equity | $2,363,126 | | | | $2,308,124 | | | |
| Net interest income [3] | | $45,173 | | | | $35,666 | | |
| Net interest spread | | | 2.65 | % | | | 2.25 | % |
| Impact of noninterest-bearing sources | | | 0.17 | % | | | 0.05 | % |
| Net interest margin | | | 2.82 | % | | | 2.30 | % |

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

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

(3) Includes taxable-equivalent adjustments, which is a non-GAAP measure, primarily related to tax-exempt income on certain loans and securities of $1.3 million for the nine months ended September 30, 2012 and $192 thousand for the nine months ended September 30, 2011, respectively. The Company's estimated marginal tax rate was 36.0% for the periods presented.

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We do not include interest collected on nonaccrual loans in interest income. When we place a loan on nonaccrual status, we reverse the accrued unpaid interest receivable against interest income and amortization of any net deferred fees is suspended. Additionally, if a nonaccrual loan is placed back on accrual status or paid off, the accumulated interest collected on the loan is recognized at the time the loan is removed from nonaccrual status. The net increase/(decrease) to interest income due to adjustments made for nonaccrual loans, including the effect of additional interest income that would have been recorded during the period if the loans had been accruing, was $95 thousand and $(1.1) million for the three months ended September 30, 2012 and 2011 and $(1.0) million and $(4.0) million for the nine months ended September 30, 2012 and 2011, respectively.

Net Interest Income

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

Net interest income, on a tax equivalent basis, for third quarter 2012 increased $4.8 million or 39.9%, to $16.8 million from $12.0 million a year ago. For the first nine months of 2012 net interest income increased $9.5 million or 26.7%, to $45.2 million from $35.7 million in the same period last year. Our net interest margin for the third quarter of 2012 improved to 3.08% from 2.38% in the prior year, and for the first nine months of 2012 was 2.82% from 2.30% for the same period in 2011. The improvement in our net interest income in large part reflects the execution of our deposit product and pricing strategy, increased average balances of our loans held for sale and the investment of proceeds from our initial public offering, thereby increasing the average balance of investment securities for the first nine months of 2012. We also continued our balance sheet restructuring activities such as prepaying or allowing higher cost FHLB advances to mature without renewal. During the first nine months of 2012, the Company prepaid $25.5 million of long-term FHLB advances.

Total interest income, on a tax equivalent basis, for the third quarter of 2012 increased $2.2 million or 11.3% to $21.4 million, from $19.2 million a year ago. This increase reflects a higher average balance of loans held for sale, which increased by $325.3 million or 256.4% for the third quarter of 2012 as compared to third quarter 2011, due primarily to increased closed loan volume. The increase in interest income also reflects a higher average balance of investment securities, which increased $139.6 million or 51.3% for the same periods. In addition, we invested proceeds from the sale of loans and our initial public offering in investment securities with a shift towards higher yielding municipal securities, resulting in an increase in yield on investment securities of 79 basis points. These increases were partially offset by a decrease in the average balance of loans held for investment in the third quarter of 2012, which decreased $157.1 million or 11.0% as compared to the prior year and a lower interest yield on loans held for sale, which decreased 92 basis points as mortgage interest rates declined. For the first nine months of 2012 interest income was relatively flat, increasing $1.0 million or 1.6%, to $60.8 million from $59.8 million in the same period last year due to an increase in the average balance of loans held for sale, which increased $199.8 million or 181.8%, and investments securities, which increased $112.3 million or 38.0%, largely offset by a decline in the average balance of loans held for investment, which decreased by $204.8 million or 13.6%.

Total interest expense for the third quarter of 2012 decreased $2.6 million or 36.7% to $4.5 million, from $7.2 million a year ago. This decrease was primarily due to a $419.4 million, or 36.9%, decline in the average balance of higher cost certificates of deposit, partially offset by an increase in transaction and savings deposits. Also contributing to the decrease in interest expense was the restructuring of FHLB advances, prepaying certain long term advances and using short-term FHLB advances to meet short term mortgage origination and sales funding needs, which contributed to a 350 basis point decline in interest cost on FHLB advances. For the first nine months of 2012 net interest expense decreased $8.5 million or 35.3%, to $15.6 million from $24.1 million in the same period in the prior year, primarily driven by a $385.6 million, or 31.7%, decline in the average balance of certificates of deposit and a $21.9 million, or 20.8%, decline in the average balance of FHLB advances along with a 155 basis point decrease in interest cost on FHLB advances.

Provision for Loan Losses

Our provision for loan losses for the three and nine months ended September 30, 2012 was $5.5 million and $7.5 million, an increase from $1.0 million and $3.3 million for the same periods in 2011, respectively. Asset quality trends continue to improve as nonaccrual loans declined to $38.2 million at September 30, 2012, a decrease of $56.8 million or 59.8%, from $95.1 million a year ago, and past due loans declined to $95.7 million at September 30, 2012, a decrease of $48.4 million or 33.6%, from $144.1 million a year ago.

Net charge-offs of $5.0 million for third quarter 2012 decreased from $7.7 million in the third quarter of 2011, while for the first nine months of 2012 net charge-offs were $22.7 million compared with $14.5 million for the same period in the prior year. Net charge-offs during the first nine months of 2012 included a $11.8 million charge-off related to the settlement of collection litigation and resolution of certain related nonperforming construction/land development loans with aggregate carrying values of $26.6 million. For a more detailed discussion on our allowance for loan losses and related provision for loan losses see Credit Risk Management within Management's Discussion and Analysis of Financial Condition and Results of Operation in this Form 10-Q.

Noninterest Income

Noninterest income was $68.1 million in third quarter 2012, an increase of $31.2 million, or 84.2%, from $37.0 million in third quarter 2011. For the first nine months of 2012, noninterest income was $162.7 million, an increase of $92.8 million, or 132.8%, from $69.9 million for the first nine months of the prior year. Our noninterest income is heavily dependent upon our single family mortgage banking activities which are comprised of mortgage origination and sale activities and mortgage servicing activities. The level of our mortgage banking activity fluctuates and is influenced by mortgage interest rates, the economy, employment and housing affordability, among other factors. The increase in noninterest income is predominately due to higher net gain on mortgage loan origination and sale activities as detailed in the tables below.

Noninterest income consisted of the following.

| | Three Months Ended September 30, | | Dollar Change | Nine Months Ended September 30, | | Dollar Change |
|---|---|---|---|---|---|---|
| (in thousands) | 2012 | 2011 | 2012 vs. 2011 | 2012 | 2011 | 2012 vs. 2011 |
| Noninterest income | | | | | | |
| Net gain on mortgage loan origination and sale activities | $64,390 | $15,766 | $ 48,624 | $138,386 | $29,702 | $ 108,684 |
| Mortgage servicing income | 506 | 18,532 | (18,026) | 15,470 | 32,093 | (16,623) |
| Income from Windermere Mortgage Services Series LLC | 1,188 | 902 | 286 | 3,748 | 1,380 | 2,368 |
| Gain (loss) on debt extinguishment | — | — | — | (939) | 2,000 | (2,939) |
| Depositor and other retail banking fees | 756 | 778 | (22) | 2,262 | 2,313 | (51) |
| Insurance commissions | 192 | 103 | 89 | 550 | 724 | (174) |
| Gain on sale of investment securities available for sale | 397 | 642 | (245) | 1,349 | 643 | 706 |
| Other | 704 | 256 | 448 | 1,919 | 1,042 | 877 |
| Total noninterest income | $68,133 | $36,979 | 31,154 | $162,745 | $69,897 | 92,848 |

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

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

| | Three Months Ended September 30, | | Dollar Change | Nine Months Ended September 30, | | Dollar Change |
|---|---|---|---|---|---|---|
| (in thousands) | 2012 | 2011 | 2012 vs. 2011 | 2012 | 2011 | 2012 vs. 2011 |
| Secondary market gains[(1)] | $41,550 | $6,415 | $ 35,135 | $87,034 | $3,083 | $ 83,951 |
| Provision for repurchase losses[(2)] | (526) | (289) | (237) | (2,846) | (752) | (2,094) |

| | | | | | | |
|---|---|---|---|---|---|---|
| Net gain from secondary market activities | 41,024 | 6,126 | 34,898 | 84,188 | 2,331 | 81,857 |
| Mortgage servicing rights originated | 14,789 | 6,331 | 8,458 | 33,606 | 19,826 | 13,780 |
| Loan origination and funding fees | 8,577 | 3,309 | 5,268 | 20,592 | 7,545 | 13,047 |
| Net gain on mortgage loan origination and sale activities | $64,390 | $15,766 | $ 48,624 | $138,386 | $29,702 | $ 108,684 |

(1) Comprised of gains and losses on single family and Fannie Mae DUS loans, interest rate lock commitments and forward sale commitments used to economically hedge loans held for sale, less premiums paid to Windermere Mortgage Services Series LLC on loans purchased or committed to be purchased and the fair value of estimated future repurchase or indemnity losses recognized on new loan sales.
(2) Represents changes in estimated probable future repurchase losses on previously sold loans.

For the third quarter 2012, net gain on mortgage loan origination and sale activities was $64.4 million, an increase of $48.6 million, or 308.4%, from $15.8 million for third quarter 2011. For the first nine months of 2012 net gain on mortgage loan origination and sale activities was $138.4 million, an increase of $108.7 million, or 365.9%, from $29.7 million for the same period in the prior year.

The increase for the three and nine month periods of 2012 predominantly reflects the increase in single family loan production as borrowers continued to take advantage of historically low mortgage interest rates and the expansion of our mortgage lending operations in the first nine months of the year as we added approximately 326 mortgage origination and support personnel. Single family production volumes consisted of the following.

| | Three Months Ended September 30, | | Dollar Change | Nine Months Ended September 30, | | Dollar Change |
|---|---|---|---|---|---|---|
| (in thousands) | 2012 | 2011 | 2012 vs. 2011 | 2012 | 2011 | 2012 vs. 2011 |
| Production volumes: | | | | | | |
| Single family mortgage closed loan volume [(1)] | $1,368,238 | $478,024 | $890,214 | $3,149,196 | $1,077,497 | $ 2,071,699 |
| Single family mortgage interest rate lock commitments | 1,313,182 | 630,919 | 682,263 | 3,531,713 | 1,229,453 | 2,302,260 |

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

Single family closed loan production increased 186.2% for third quarter 2012 and 192.3% for the first nine months of 2012 as compared with the same periods in the prior year. Single family interest rate lock commitments increased by 108.1% for third quarter 2012 and 187.3% for the first nine months of 2012 as compared with the same periods in the prior year. Our mortgage loan origination and sale revenue growth reflects continuing strong demand for both purchase and refinance mortgage loans in our markets, including refinances through the federal government's expanded Home Affordable Refinance Program ("HARP 2.0"), driven by record low mortgage interest rates. Also contributing to the improvement in net gain on mortgage loan origination and sale activities was an increase in gross revenue per loan that began to increase in the third quarter of 2011. We continue to experience historically high margins as a result of a combination of historically low mortgage interest rates, which increased demand for mortgage loan products, coupled with consolidation within the industry, limiting the capacity of mortgage loan providers to process the elevated demand. Beginning in the fourth quarter of 2010 and continuing into the second quarter of 2011 interest rates increased and demand for single family mortgage products decreased, resulting in a reduction in overall loan volume and profit margins for the first nine months of 2011.

The Company records a provision for repurchase losses as a reduction to net gain on mortgage loan origination and sale activities, which was $526 thousand for third quarter 2012, compared with $289 thousand in the prior year. For the first nine months of 2012, the provision for repurchase losses was $2.8 million compared with $752 thousand for the same period in 2011. For further information on the Company's mortgage repurchase liability, see Note 8, Commitments, Guarantees and Contingencies to the Financial Statements in this Form 10-Q.

Mortgage servicing income consisted of the following.

| (in thousands) | Three Months Ended September 30, 2012 | | | 2011 | | | Dollar Change 2012 vs. 2011 |
|---|---|---|---|---|---|---|---|
| | Single Family | Multifamily | Total | Single Family | Multifamily | Total | Total |
| Servicing income, net: | | | | | | | |
| Servicing fees and other | $6,151 | $1,017 | $7,168 | $5,548 | $1,245 | $6,793 | $375 |
| Changes in fair value of MSRs due to modeled amortization [1] | (5,360) | n/a | (5,360) | (4,155) | n/a | (4,155) | (1,205) |
| Amortization | n/a | (598) | (598) | n/a | (455) | (455) | (143) |
| | 791 | 419 | 1,210 | 1,393 | 790 | 2,183 | (973) |
| Risk management: | | | | | | | |
| Changes in fair value of MSRs due to changes in model inputs and/or assumptions [2] | (5,565) | n/a | (5,565) | (21,986) | n/a | (21,986) | 16,421 |
| Net gain from derivatives economically hedging MSRs | 4,861 | n/a | 4,861 | 38,335 | n/a | 38,335 | (33,474) |
| | (704) | n/a | (704) | 16,349 | n/a | 16,349 | (17,053) |
| Mortgage servicing income | $87 | $419 | $506 | $17,742 | $790 | $18,532 | $(18,026) |

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

| (in thousands) | Nine Months Ended September 30, 2012 | | | 2011 | | | Dollar Change 2012 vs. 2011 |
|---|---|---|---|---|---|---|---|
| | Single Family | Multifamily | Total | Single Family | Multifamily | Total | Total |
| Servicing income, net: | | | | | | | |
| Servicing fees and other | $17,741 | $2,569 | $20,310 | $16,339 | $3,268 | $19,607 | $703 |
| Changes in fair value due to modeled amortization [1] | (14,382) | n/a | (14,382) | (10,245) | n/a | (10,245) | (4,137) |
| Amortization | n/a | (1,551) | (1,551) | n/a | (1,121) | (1,121) | (430) |
| | 3,359 | 1,018 | 4,377 | 6,094 | 2,147 | 8,241 | (3,864) |
| Risk management: | | | | | | | |
| Changes in fair value due to changes in model inputs and/or assumptions [2] | (13,507) | n/a | (13,507) | (21,669) | n/a | (21,669) | 8,162 |
| Net gain from derivatives economically hedging MSRs | 24,600 | n/a | 24,600 | 45,521 | n/a | 45,521 | (20,921) |
| | 11,093 | n/a | 11,093 | 23,852 | n/a | 23,852 | (12,759) |
| Mortgage servicing income | $14,452 | $1,018 | $15,470 | $29,946 | $2,147 | $32,093 | $(16,623) |

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

For third quarter 2012, mortgage servicing income was $506 thousand, a decrease of $18.0 million or 97.3%, from $18.5 million in the prior year. For the first nine months of 2012, mortgage servicing income was $15.5 million, a decrease of $16.6 million or 51.8%, from $32.1 million for the nine months ended September 30, 2011.

The decrease from the same periods in the prior year is primarily due to mortgage servicing rights (MSR) risk management results, which represents changes in the fair value of 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 their 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 hedging strategy. These factors may include but are not limited to the impact of changes to the housing price index, the level of home sales activity, changes to mortgage spreads, valuation discount rates, costs to service and policy changes by the U.S. government agencies.

The net performance of the MSR risk management activities for the third quarter of 2012 was a loss of $704 thousand compared to a $16.3 million gain in the third quarter of 2011, and for the first nine months of 2012 was a gain of $11.1 million compared to a gain of $23.9 million for the same period in 2011. The loss in the current quarter largely reflects a reduction in sensitivity to interest rates for the Company's MSRs, which has enabled the Company to reduce the notional amount of derivative instruments used to economically hedge MSRs. The lower notional amount of derivative instruments, along with a flatter yield curve, resulted in a lower net gain from derivatives economically hedging MSRs, which negatively impacted mortgage servicing income. In addition, MSR risk management results for the third quarter of 2012 also reflect a decline in the fair value of MSRs due to changes in model inputs and assumptions primarily related to factors not within the scope of the Company's MSR hedging strategy, including a streamlined refinance program implemented by FHA and higher expected home values, which both generally lead to higher prepayment speeds. The significant net gain from MSR risk management activities in the third quarter and first nine months of 2011 resulted from a substantial widening of mortgage interest rates versus swap interest rates and lower realized prepayments. The total loans serviced for others portfolio increased to $8.92 billion compared with $7.70 billion at December 31, 2011 and $7.48 billion at September 30, 2011.

Income from Windermere Mortgage Services Series LLC increased to $1.2 million and $3.7 million for the three and nine months ended September 30, 2012 from $902 thousand and $1.4 million for the three and nine months ended September 30, 2011. The increase for 2012 was primarily due to an increase in closed loan volume and interest rate lock commitments, which were $268.4 million and $224.1 million, respectively, for the three months ended September 30, 2012 compared with $143.8 million and $169.3 million for the same period in 2011. For the nine months ended September 30, 2012 closed loan volume and interest rate lock commitments for WMS LLC were $700.1 million and $658.2 million, respectively, compared with $357.6 million and $370.9 million for the same periods in 2011.

Depositor and other retail banking fees for the three and nine months ended September 30, 2012 were relatively consistent with 2011 results. The following table presents the composition of depositor and other retail banking fees for the periods indicated.

| | Three Months Ended September 30, | | Dollar Change | Nine Months Ended September 30, | | Dollar Change |
|---|---|---|---|---|---|---|
| (in thousands) | 2012 | 2011 | 2012 vs. 2011 | 2012 | 2011 | 2012 vs. 2011 |
| Fees: | | | | | | |
| Monthly maintenance and deposit-related fees | $387 | $414 | $ (27) | $1,157 | $1,262 | $ (105) |
| Debit Card/ATM fees | 340 | 328 | 12 | 1,030 | 947 | 83 |
| Other fees | 29 | 36 | (7) | 75 | 104 | (29) |
| Total depositor and other retail banking fees | $756 | $778 | (22) | $2,262 | $2,313 | (51) |

Gain (loss) on debt extinguishment was zero and a $939 thousand loss for the three and nine months ended September 30, 2012. The loss for the nine months ended September 30, 2012 was related to a prepayment fee paid for the early retirement of $25.5 million of long-term FHLB advances. The Company expects this prepayment to result in lower interest expense in future periods as we continue to replace high cost long-term FHLB advances with other lower cost short-term borrowings.

The Company recorded no gain or loss on debt extinguishment for the three months ended September 30, 2011, while the nine months ended September 30, 2011 included a $2.0 million gain from the early retirement of senior debt, which totaled $5.0 million and was settled for $3.0 million.

Noninterest Expense

Noninterest expense for the three and nine months ended September 30, 2012 was $45.8 million and $127.4 million, an increase of $13.5 million and $34.8 million, or 41.7% and 37.5%, from $32.3 million and $92.6 million for the three and nine months ended September 30, 2011, respectively. Noninterest expense increased for the three and nine months ended September 30, 2012 primarily due to an increase in salary and related costs of $18.4 million and $44.1 million, respectively, reflecting higher commissions and incentives paid as loan production increased period to period, and an increase in the number of employees as we expanded our mortgage production and support personnel. Lower OREO expenses partially offset these increases in noninterest expense as valuation losses related to OREO decreased in the three and nine months ended September 30, 2012 compared with the three and nine months ended September 30, 2011.

Noninterest expense consisted of the following.

| (in thousands) | Three Months Ended September 30, 2012 | Three Months Ended September 30, 2011 | Dollar Change 2012 vs. 2011 | Nine Months Ended September 30, 2012 | Nine Months Ended September 30, 2011 | Dollar Change 2012 vs. 2011 |
|---|---|---|---|---|---|---|
| Noninterest expense | | | | | | |
| Salaries and related costs | $31,573 | $13,217 | $18,356 | $81,149 | $37,056 | $44,093 |
| General and administrative | 7,033 | 4,310 | 2,723 | 19,030 | 12,307 | 6,723 |
| Legal | 312 | 983 | (671) | 1,471 | 2,286 | (815) |
| Consulting | 1,069 | 270 | 799 | 1,746 | 633 | 1,113 |
| Federal Deposit Insurance Corporation assessments | 794 | 1,264 | (470) | 2,751 | 4,278 | (1,527) |
| Occupancy | 2,279 | 1,663 | 616 | 6,160 | 5,031 | 1,129 |
| Information services | 2,411 | 1,509 | 902 | 6,129 | 4,466 | 1,663 |
| Other real estate owned expense | 348 | 9,113 | (8,765) | 8,916 | 26,533 | (17,617) |
| Total noninterest expense | $45,819 | $32,329 | 13,490 | $127,352 | $92,590 | 34,762 |

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

Salaries and related costs were $31.6 million and $81.1 million for the three and nine months ended September 30, 2012, an increase of 138.9% and 119.0% as compared to the same periods in 2011. The increase for the three and nine months ended September 30, 2012 was primarily due to an increase of $12.6 million and $27.7 million, respectively, in commissions and incentives paid as loan production increased period to period. Also contributing to the increase in salaries and related costs was an increase in full-time equivalent employees of 385, or 62.8%, since December 31, 2011.

General and administrative expense was $7.0 million and $19.0 million for the three and nine months ended September 30, 2012, an increase of 63.2% and 54.6% from $4.3 million and $12.3 million in the three and nine months ended September 30, 2011. This increase was primarily due to an increase in general and administrative expenses generally associated with the overall increase in business volume and personnel.

Other real estate owned expense was $348 thousand for the three months ended September 30, 2012, a decrease of 96.2% from $9.1 million in the third quarter of 2011. OREO downward valuation adjustments were $2.6 million in third quarter 2012 as compared with $8.2 million in third quarter 2011. For the nine months ended September 30, 2012 OREO expense was $8.9 million, a decrease of 66.4% from the same period in 2011. OREO downward valuation adjustments were $11.0 million for the first nine months of 2012 compared with $23.5 million for the same period in the prior year. Valuation adjustments to OREO balances have generally declined as the net balance of OREO properties has declined over the periods. General declines in property values have also continued to slow, mitigating the severity of losses realized. Lower balances of OREO properties also generally result in decreases in maintenance expenses.

Income Tax Expense

Income tax expense for the three and nine months ended September 30, 2012 was $11.8 million and $13.4 million, compared with $362 thousand and $388 thousand for the same periods in 2011, respectively. The Company's 2012 year-to-date income tax expense is based on a projected annual effective income tax rate plus discrete benefits recognized year to date. The Company's projected annual income tax expense includes $14.4 million related to the reversal of the beginning of year valuation allowance against net deferred tax assets. The reversal of the valuation allowance was based on the Company's assessment with respect to its ability to realize deferred tax assets in the future. For further discussion on income taxes, including information regarding the reversal of the valuation allowance, see Note 9, Income Taxes to the Financial Statements in this Form 10-Q.

As a consequence of our initial public offering in February 2012, the Company experienced a change of control within the meaning of Section 382 of the Internal Revenue Code of 1986, as amended. Section 382 substantially limits the ability of a corporate taxpayer to use recognized built-in losses and net operating loss carryforwards incurred prior to the change of control against income earned after a change of control. Based on our analysis, the change of control will not result in a loss of deferred tax benefits other than a small impact on deferred tax assets related to state income taxes in Oregon.

Review of Financial Condition – Comparison of September 30, 2012 to December 31, 2011

Total assets were $2.51 billion at September 30, 2012 and $2.26 billion at December 31, 2011. The increase in total assets was primarily due to $86.4 million of net proceeds from the completion of our initial public offering of common stock, most of which was invested in securities at September 30, 2012, as well as an increase in loans held for sale reflecting increased single family loan origination volume.

Cash and Cash Equivalents totaled $22.1 million at September 30, 2012, compared with $263.3 million as of December 31, 2011, a decrease of $241.3 million or 91.6%. The decrease was primarily due to funding growth in our securities portfolio and loans held for sale since December 31, 2011.

Investment Securities Available for Sale totaled $414.1 million at September 30, 2012, as compared with $329.0 million at December 31, 2011, an increase of $85.0 million or 25.8%. The increase was primarily due to the investment of the net proceeds from our initial public offering.

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

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

| | At September 30, 2012 | | At December 31, 2011 | |
|---|---|---|---|---|
| (in thousands) | Amortized Cost | Fair Value | Amortized Cost | Fair Value |
| Available for sale: | | | | |
| Mortgage backed securities: | | | | |
| Residential | $62,782 | $63,366 | $— | $— |
| Commercial | 13,813 | 14,532 | 13,941 | 14,483 |
| Municipal bonds (1) | 122,845 | 128,595 | 48,948 | 49,584 |
| Collateralized mortgage obligations: | | | | |
| Residential | 161,950 | 167,513 | 220,418 | 223,390 |
| Commercial | 9,055 | 9,109 | 10,081 | 10,070 |
| U.S. Treasury securities | 30,927 | 30,935 | 31,540 | 31,520 |
| Total available for sale | $401,372 | $414,050 | $324,928 | $329,047 |

(1) Comprised of general obligation bonds (i.e. backed by the general credit of the issuer) and revenue bonds (i.e. backed by revenues from the specific project being financed) issued by various municipal corporations. As of September 30, 2012 and December 31, 2011, of the bonds that were rated, no bonds were rated below "A."

Loans Held for Sale totaled $532.6 million at September 30, 2012, compared with $150.4 million at December 31, 2011, an increase of $382.2 million or 254.1%. Loans held for sale includes single family and multifamily residential loans that are intended for sale, which typically occurs within 30 days of closing the loan. The increase in loans held for sale is primarily due to increased single family residential loan production as mortgage rates have continued to decline since the end of 2011.

Loans Held for Investment, net was $1.27 billion at September 30, 2012, a decrease of $32.2 million, or 2.5%, from December 31, 2011. The decrease was primarily due to the transfer of nonaccrual construction/land development loans to OREO and scheduled and unscheduled payoffs of commercial real estate loans. Largely offsetting these decreases was an increase in single family residential loans, primarily driven by originations of mortgages that exceed conventional conforming loan limits.

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

| (in thousands) | At September 30, 2012 | | At December 31, 2011 | |
|---|---|---|---|---|
| | Amount | Percent | Amount | Percent |
| Consumer loans | | | | |
| Single family residential | $602,164 | 46.3 % | $496,934 | 36.9 % |
| Home equity | 141,343 | 10.9 % | 158,936 | 11.8 % |
| | 743,507 | 57.2 % | 655,870 | 48.7 % |
| Commercial loans | | | | |
| Commercial real estate [(1)] | 360,919 | 27.8 % | 402,139 | 29.8 % |
| Multifamily residential | 36,912 | 2.8 % | 56,379 | 4.2 % |
| Construction/land development | 77,912 | 6.0 % | 173,405 | 12.9 % |
| Commercial business | 80,056 | 6.2 % | 59,831 | 4.4 % |
| | 555,799 | 42.8 % | 691,754 | 51.3 % |
| | 1,299,306 | 100.0 % | 1,347,624 | 100.0 % |
| Net deferred loan fees and costs | (3,142) | | (4,062) | |
| | 1,296,164 | | 1,343,562 | |
| Allowance for loan losses | (27,461) | | (42,689) | |
| | $1,268,703 | | $1,300,873 | |

(1) September 30, 2012 and December 31, 2011 balances comprised of $94.5 million and $102.4 million of owner occupied loans, respectively, and $266.4 million and $299.7 million of non-owner occupied loans, respectively.

Accounts receivable and other assets was $122.3 million at September 30, 2012, as compared with $61.9 million at December 31, 2011, an increase of $60.4 million or 97.6%. This increase was primarily due to an increase in cash provided to counterparties as collateral for derivative positions used to hedge our higher level of mortgage banking activities. A receivable is recorded for the amount of cash delivered as collateral.

Other real estate owned was $17.0 million at September 30, 2012, compared with $38.6 million at December 31, 2011, a decrease of $21.6 million or 55.9%. This decrease is predominantly due to sales of OREO properties, which totaled $44.6 million for the first nine months of 2012.

Deposits were $1.98 billion at September 30, 2012, compared with $2.01 billion at December 31, 2011, a decrease of $27.9 million or 1.4%. This decrease was due to managed reductions in certificate of deposit balances, which decreased $349.2 million or 33.8% to $684.6 million at September 30, 2012 from $1.03 billion at December 31, 2011. Largely offsetting this decrease were increases in core consumer and business noninterest bearing accounts, NOW accounts, statement savings accounts and money market accounts, which increased $254.3 million or 32.8% to $1.03 billion at September 30, 2012 from $774.6 million at December 31, 2011 as a result of our deposit pricing and product strategy which seeks to attract new consumer and commercial relationship deposits and convert customers with maturing certificates of deposit to transaction and savings deposits as well as investment products sold by HomeStreet Investment Services.

Accounts payable and accrued expenses totaled $93.4 million at September 30, 2012, compared with $49.0 million at December 31, 2011, an increase of $44.4 million, or 90.6%. This increase was primarily due to payables related to general operating expenses and derivative payables.

Shareholders’ Equity

Shareholders' equity was $239.3 million at September 30, 2012 compared with $86.4 million at December 31, 2011. This increase includes total comprehensive income of $63.6 million recognized during the nine months ended September 30, 2012.

In addition, on February 15, 2012, we completed our initial public offering of 8,723,632 shares of common stock for an initial offering price of $11.00 per share (after giving effect to the 2-for-1 forward stock split effective March 6, 2012 and the 2-for-1 forward stock split effective November 5, 2012). The net increase in HomeStreet's capital was $86.4 million, which included net cash proceeds of $87.7 million received during the first nine months of 2012, less $1.4 million of issuance costs paid in 2011. The Company contributed $55.0 million to the Bank on February 24, 2012 and an additional $10.0 million on April 26, 2012.

As a result of the net income recognized over the first nine months of 2012, shareholders’ equity, on a per share basis, increased to $16.67 per share at September 30, 2012, up from $15.99 per share at December 31, 2011. Largely offsetting the impact of the Company's net income was an increase in the Company's shares from 5.40 million shares at December 31, 2011 to 14.35 million shares at September 30, 2012, which was predominantly the result of the shares issued in the initial public offering described above.

Return on Equity and Assets

The following table presents certain information regarding our returns on average equity and average total assets for the three and nine month periods ended September 30, 2012 and 2011. Return on equity ratios for the periods shown may not be comparable due to the impact and timing of the Company's initial public offering of common stock completed in February 2012 and changes in the annual effective income tax rate between periods based on the Company's assessment regarding its ability to realize deferred tax assets in the future.

| | At or for the three months ended September 30, | | At or for the nine months ended September 30, | |
|---|---|---|---|---|
| | 2012 | 2011 | 2012 | 2011 |
| Return on assets [1] | 3.50 % | 2.67 % | 3.29 % | 0.53 % |
| Return on equity [2] | 37.16 % | 83.04 % | 40.38 % | 19.26 % |
| Equity to assets ratio [3] | 9.41 % | 3.22 % | 8.16 % | 2.73 % |

(1) Net income divided by average total assets (annualized).
(2) Net income divided by average equity (annualized).
(3) Average equity divided by average total assets.

Business Segments

HomeStreet has four lines of business we report as operating segments: Community Banking, Single Family Lending, Income Property Lending and Residential Construction Lending. The results for these segments are based on a management accounting process that assigns income statement items to each responsible line of business.

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

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

- A funds transfer pricing ("FTP") method, which allocates interest income credits and funding charges between the segments and our treasury division, which then assigns to each such line of business 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 lines of business by centralized functions, such as corporate

overhead, which are generally based on each segment’s consumption patterns.

- An allocation of the Company's consolidated income taxes on the basis of the effective tax rate applied to the segment’s pretax income or loss.

Effective January 1, 2012 management updated the FTP methodology it uses for reviewing segment results and managing the Company’s lines of business. Under the previous FTP methodology, we computed the cost of funds from our current period’s financial results and then allocated a portion of that cost of funds to each respective operating segment. This approach was based on internal financial results and updated for current period information, thereby providing an updated funding cost applied to certain assets or liabilities originated in prior periods.

The updated methodology is based on external market factors and more closely aligns the expected weighted-average life of the financial asset or liability to external economic data, such as the U.S. Dollar LIBOR/Swap curve, and provides a more consistent basis for determining our cost of funds to be allocated to each operating segment. The updated approach is also more consistent with FTP measurement techniques employed by other financial institutions. We have reclassified all prior period amounts to conform to the current period’s methodology and presentation.

In general, the impact of the FTP change resulted in a lower cost of funds as compared with the previous method as the Company’s funding costs have generally been higher than market prices due to the historical structure of the deposit portfolio and wholesale borrowings.

Financial highlights by line of business were as follows.

Community Banking

We provide diversified financial products and services to our consumer and business customers, including deposit products, investment products, insurance products, cash management services and consumer and business loans. As of September 30, 2012, our bank branch network consisted of 21 branches, primarily in the Puget Sound area. Three branches are located in Hawaii. At September 30, 2012 and December 31, 2011, our transaction and savings totaled $1.03 billion and $774.6 million and our business banking loan portfolio totaled $208.5 million and $205.6 million, respectively.

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (in thousands) | 2012 | 2011 | 2012 | 2011 |
| Net interest income | $3,075 | $1,817 | $8,012 | $4,837 |
| Provision for loan losses | (150) | (81) | (650) | (193) |
| Noninterest income | 1,367 | 1,085 | 3,883 | 3,281 |
| Noninterest expense | (5,900) | (5,345) | (17,505) | (17,643) |
| Inter-segment expense | (3,328) | (1,898) | (8,059) | (5,980) |
| Loss before income taxes | (4,936) | (4,422) | (14,319) | (15,698) |
| Income tax benefit | (2,273) | (691) | (2,671) | (643) |
| Net loss | $(2,663) | $(3,731) | $(11,648) | $(15,055) |

Community banking had a net loss of $2.7 million for the third quarter of 2012, an improvement of $1.1 million from a loss of $3.7 million in the prior year, and for the first nine months of 2012 the net loss was $11.6 million, an improvement of $3.4 million from a loss of $15.1 million in the same period in the prior year. The improvement over these periods was primarily due to an increase in net interest income, which in large part reflects the execution of our deposit product and pricing strategy.

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Single Family Lending

We originate and purchase single family residential mortgage loans directly and through our affiliated business arrangement with Windermere Mortgage Services Series LLC for sale into the secondary market. This segment also originates and services loans for our portfolio on a selective basis, including home equity loans and lines of credit. The majority of our mortgage loans are sold to or securitized by Fannie Mae, Freddie Mac or Ginnie Mae, while we retain the right to service these loans. A small percentage of the loans are brokered or sold on a servicing-released basis to correspondent lenders.

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (in thousands) | 2012 | 2011 | 2012 | 2011 |
| Net interest income | $7,025 | $3,332 | $17,032 | $11,161 |
| Provision for loan losses | (2,982) | (437) | (3,982) | (1,902) |
| Noninterest income | 64,884 | 34,245 | 154,064 | 60,086 |
| Noninterest expense | (27,525) | (10,179) | (68,504) | (27,320) |
| Inter-segment expense | (6,564) | (3,200) | (15,976) | (9,610) |
| Income before income taxes | 34,838 | 23,761 | 82,634 | 32,415 |
| Income tax expense | 13,400 | 1,364 | 15,421 | 1,327 |
| Net income | $21,438 | $22,397 | $67,213 | $31,088 |

Single family lending net income was $21.4 million for the third quarter of 2012, a decrease of $1.0 million from the prior year, driven by an increase in noninterest expense and income tax expense, largely offset by an increase in noninterest income. For the first nine months of 2012 single family lending net income was $67.2 million, an increase of $36.1 million from the same periods in the prior year, primarily due to an increase in noninterest income. The increase in noninterest income and noninterest expense over these periods reflects elevated mortgage production volumes as net gain on mortgage loan origination and sale activities and salaries and related costs both increased with the expansion of single family lending operations. See — "Results of Operations, Noninterest Income—Net gain on mortgage loan origination and sale activities."

Income Property Lending

We originate commercial real estate loans with a focus on multifamily lending through our Fannie Mae DUS® business. These loans are sold to or securitized by Fannie Mae, and we generally continue to service them after the sale. At September 30, 2012, and December 31, 2011, we serviced $760.8 million and $758.5 million, respectively, of loans we had originated and sold to Fannie Mae under its DUS® program. We originate commercial construction loans, bridge loans and permanent loans for our portfolio, as well as place loans with capital markets sources and life insurance companies.

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (in thousands) | 2012 | 2011 | 2012 | 2011 |
| Net interest income | $2,142 | $2,036 | $6,998 | $7,191 |
| Provision for loan losses | (1,666) | (233) | (2,166) | (431) |
| Noninterest income | 1,463 | 1,305 | 4,251 | 4,010 |
| Noninterest expense | (1,046) | (682) | (5,574) | (2,958) |
| Inter-segment expense | (968) | (809) | (2,650) | (2,195) |
| (Loss) income before income taxes | (75) | 1,617 | 859 | 5,617 |

| | | | | |
|---|---|---|---|---|
| Income tax expense | 120 | 247 | 160 | 230 |
| Net (loss) income | $(195) | $1,370 | $699 | $5,387 |

Income property lending net loss was $195 thousand for third quarter 2012, a decrease of $1.6 million from net income of $1.4 million for the third quarter of the prior year, and for the first nine months of 2012 income property lending net income was $699 thousand, a decrease of $4.7 million from net income of $5.4 million for the same period in the prior year. The decrease in net income for these periods is due to an increase in provision for loan losses and an increase in noninterest expense due to OREO expenses related to adjustments to the valuation reserve.

Residential Construction Lending

We originate residential construction and land loans for our portfolio. Beginning in 2007 and into 2012, we substantially curtailed new originations in order to reduce our concentration in this category. We have now restarted our residential construction lending with a focus on homebuilding and single family home construction loans.

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| (in thousands) | 2012 | 2011 | 2012 | 2011 |
| Net interest income | $324 | $(173) | $1,015 | $936 |
| Provision for loan losses | (647) | (249) | (647) | (774) |
| Noninterest income | 3 | 2 | 59 | 98 |
| Noninterest expense | (760) | (8,958) | (7,048) | (23,863) |
| Inter-segment expense | (502) | (937) | (1,442) | (2,214) |
| Loss before income taxes | (1,582) | (10,315) | (8,063) | (25,817) |
| Income tax (benefit) expense | (1,231) | (1,123) | (1,505) | (1,057) |
| Net loss | $(351) | $(9,192) | $(6,558) | $(24,760) |

Residential construction lending recorded a loss of $351 thousand for the third quarter of 2012, improving by $8.8 million from a loss of $9.2 million for the same period in the prior year, and for the first nine months of 2012 residential construction recorded a net loss of $6.6 million, improving by $18.2 million from a net loss of $24.8 million for the same period in the prior year. The net loss decreased primarily due to lower noninterest expense, reflecting a decrease in OREO valuation losses. The net loss decreased for these periods primarily due to lower noninterest expense, reflecting a decrease in OREO valuation losses.

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 elements of credit risk in excess of the amount recognized in the accompanying consolidated financial statements. These transactions are designed to (1) meet the financial needs of our customers, (2) manage our credit, market or liquidity risks, (3) diversify our funding sources and/or (4) optimize capital.

For more information on off-balance sheet arrangements, including derivative counterparty credit risk, see the Off Balance Sheet Arrangements and Commitments, Guarantees and Contingencies discussions within Management's Discussion and Analysis of Financial Condition and Results of Operations in the 2011 Annual Report on Form 10-K as well as Note 13, Commitments, Guarantees and Contingencies in our 2011 Annual Report on Form 10-K and Note 8, Commitments, Guarantees and Contingencies to the Financial Statements in this Form 10-Q.

Enterprise Risk Management

All financial institutions manage and control a variety of business and financial risks that can significantly affect their financial performance. Among these risks are credit risk, market risk, which includes interest rate risk and price risk, liquidity risk and operational risk. We are also subject to risks associated with compliance/legal, strategic and reputational matters.
Senior Managers and management-level and board-level committees oversee the management of various risks. We review and assess these risks on an enterprise-wide basis periodically and as part of the annual strategic planning

process. During the period, the Company enhanced its enterprise risk management structure with the formation of a new Board Committee and hiring of a senior level Enterprise Risk Management Director.

Risk Management Committee - The risk management committee, on behalf of the board of directors, provides oversight of the Company's enterprise risk management practices. The risk management committee oversees the establishment and maintenance of the enterprise-wide risk management framework and promotion of the risk management culture within the Company and its subsidiaries; evaluates management's identification and assessment of the significant risks that the Company faces 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 following discussion highlights other risk management developments since December 31, 2011 and should be read in conjunction with the Enterprise Risk Management discussion within Management's Discussion and Analysis of Financial Condition and Results of Operations in the 2011 Annual Report on Form 10-K.

Credit Risk Management

The following discussion highlights developments since December 31, 2011 and should be read in conjunction with the Credit Risk Management section of our 2011 Annual Report on Form 10-K.

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.

Asset Quality and Nonperforming Assets

The primary markets in which we do business have been impacted by the deterioration in the U.S. housing market that began in 2007. Faced with unfavorable market conditions, more borrowers with residential and commercial loans have defaulted on their loans, thereby contributing to an increase in delinquency rates, which peaked in our loan portfolio during 2009 and continued to be higher than historical averages in 2012. We generally stopped our origination of new loans for investment in 2008 to enable us to focus on problem loan resolution and improve overall asset quality. Beginning in 2009, we tightened our lending practices and underwriting standards as we shifted to primarily originating single family loans that conform to government-sponsored enterprise parameters and Fannie Mae DUS multifamily loans, substantially all of which were designated for sale. With the successful completion of our initial public offering and the termination of the Bank Order, we have restarted all of our traditional lines of lending and have again begun to grow our loans held for investment portfolio.

Classified assets have decreased to $102.4 million, or 4.1% of total assets, as of September 30, 2012, compared with $188.2 million, or 8.3% of total assets, as of December 31, 2011. The decrease from December 31, 2011 primarily reflects the upgrades of $34.7 million of loans, mostly related to performing single family troubled debt restructurings and income property loans, $40.3 million of loan payoffs/paydowns and $44.6 million of OREO sales partially offset by loan downgrades of $64.3 million.

Nonperforming assets decreased to $55.3 million, or 2.2% of total assets, at September 30, 2012, compared to $115.1 million, or 5.1% of total assets, as of December 31, 2011. Nonaccrual loans were $38.2 million as of September 30, 2012, and $76.5 million as of December 31, 2011, and OREO balances totaled $17.0 million and $38.6 million at the respective dates. For the three and nine months ended September 30, 2012, net charge-offs totaled $5.0 million and $22.7 million, compared with $7.7 million and $14.5 million during the three and nine months ended September 30, 2011.

As problem loans are resolved and credit losses are realized, the balance of and the credit risk inherent within the loans held for investment portfolio declines. Consequently, the level of our allowance for loan losses has also declined. At September 30, 2012 our loans held for investment portfolio, excluding the allowance for loan losses, decreased $47.4 million from December 31, 2011, while the allowance for loan losses decreased to $27.5 million, or 2.12% of loans held for investment, compared with $42.7 million or 3.18% of total loans held for investment as of December 31, 2011. The decrease in the allowance for loan losses as a percentage of loans held for investment reflects, among other things, the reduction of specific reserves associated with certain related nonperforming loans resolved through acquisition of related collateral in the second quarter. In April 2012, bankruptcy courts affirmed the Company's settlement of collection litigation related to two nonperforming construction/land development loans with aggregate carrying values of $26.6 million. As a result, during the first nine months of 2012 we charged-off $11.8 million on both loans and transferred the estimated net recovery value of $18.8 million to OREO; both loans were subsequently sold.

Our provision for loan losses for the three and nine months ended September 30, 2012 was $5.5 million and $7.5 million at the respective dates, compared with $1.0 million and $3.3 million for the same periods in 2011. 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.

The allowance for credit losses represents management’s estimate of the incurred credit losses inherent within our loan portfolio. The methodology for evaluating the appropriateness of the allowance for loan losses has two basic elements: first, identification and measurement of impairment for each individually impaired loan; and second, a statistical calculation to provide for probable principal losses inherent in all other loans that have not been specifically identified as impaired. For further discussion related to credit policies and estimates see Management’s Discussion and Analysis of Financial Condition and Result of Operations, Critical Accounting Policies and Estimates — Allowance for Loan Losses” within the 2011 Annual Report on Form 10-K.

The following table presents the recorded investment, unpaid principal balance and related allowance for impaired loans, broken down by those with and those without a specific reserve, as of September 30, 2012 and December 31, 2011.

| | September 30, 2012 | | |
|---|---|---|---|
| (in thousands) | Recorded Investment | Unpaid Principal Balance | Related Allowance |
| Impaired Loans: | | | |
| Loans with no related allowance recorded | $61,163 | $73,759 | $— |
| Loans with an allowance recorded | 72,214 | 75,246 | 5,955 |
| Total | $133,377 | $149,005 | $5,955 |

| | December 31, 2011 | | |
|---|---|---|---|
| (in thousands) | Recorded Investment | Unpaid Principal Balance | Related Allowance |
| Impaired Loans: | | | |
| Loans with no related allowance recorded | $94,825 | $108,112 | $— |
| Loans with an allowance recorded | 82,540 | 87,781 | 18,717 |
| Total | $177,365 | $195,893 | $18,717 |

The Company had 163 impaired loans totaling $133.4 million at September 30, 2012 and 145 impaired loans totaling $177.4 million at December 31, 2011. The average recorded investment in these loans for the three and nine months ended September 30, 2012 was $130.8 million and $154.7 million, respectively, compared with $151.4 million and $150.9 million, respectively, for the three and nine months ended September 30, 2011. Impaired loans totaling $72.2 million and $82.5 million had a valuation allowance of $6.0 million and $18.7 million at September 30, 2012 and December 31, 2011, respectively.

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

| | September 30, 2012 | | | | | December 31, 2011 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| (in thousands) | Amount | Percent of Allowance to Total Allowance | | Loan Category as a % of Total Loans | | Amount | Percent of Allowance to Total Allowance | | Loan Category as a % of Total Loans | |
| Consumer loans | | | | | | | | | | |
| Single family | $13,552 | 49.1 | % | 46.3 | % | $10,671 | 24.9 | % | 36.9 | % |
| Home equity | 5,033 | 18.2 | % | 10.9 | % | 4,623 | 10.8 | % | 11.8 | % |
| | 18,585 | 67.3 | % | 57.2 | % | 15,294 | 35.7 | % | 48.7 | % |

| | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Commercial loans | | | | | | | | | | | |
| Commercial real estate | 3,736 | 13.5 | % | 27.8 | % | 4,321 | 10.1 | % | 29.8 | % |
| Multifamily residential | 772 | 2.8 | % | 2.8 | % | 335 | 0.8 | % | 4.2 | % |
| Construction/land development | 2,864 | 10.4 | % | 6.0 | % | 21,237 | 49.6 | % | 12.9 | % |
| Commercial business | 1,670 | 6.0 | % | 6.2 | % | 1,613 | 3.8 | % | 4.4 | % |
| | 9,042 | 32.7 | % | 42.8 | % | 27,506 | 64.3 | % | 51.3 | % |
| Total allowance for credit losses | $27,627 | 100.0 | % | 100.0 | % | $42,800 | 100.0 | % | 100.0 | % |

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

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2012 | 2011 | 2012 | 2011 |
| (in thousands) | | | | |
| Allowance at the beginning of period | $27,125 | $60,059 | $42,800 | $64,566 |
| Provision for loan losses | 5,500 | 1,000 | 7,500 | 3,300 |
| Recoveries: | | | | |
| Consumer | | | | |
| Single family residential | 22 | 163 | 455 | 163 |
| Home equity | 121 | 84 | 398 | 110 |
| | 143 | 247 | 853 | 273 |
| Commercial | | | | |
| Commercial real estate | 130 | — | 258 | — |
| Construction/land development | 193 | 5 | 835 | 6,126 |
| Commercial business | 631 | 35 | 717 | 208 |
| | 954 | 40 | 1,810 | 6,334 |
| Total recoveries | 1,097 | 287 | 2,663 | 6,607 |
| Charge-offs: | | | | |
| Consumer | | | | |
| Single family residential | 1,363 | 2,160 | 3,889 | 6,329 |
| Home equity | 1,078 | 1,199 | 3,577 | 3,572 |
| | 2,441 | 3,359 | 7,466 | 9,901 |
| Commercial | | | | |
| Commercial real estate | 1,757 | 509 | 3,474 | 578 |
| Construction/land development | 1,823 | 3,979 | 13,858 | 9,759 |
| Commercial business | 74 | 113 | 538 | 849 |
| | 3,654 | 4,601 | 17,870 | 11,186 |
| Total charge-offs | 6,095 | 7,960 | 25,336 | 21,087 |
| (Charge-offs), net of recoveries | (4,998) | (7,673) | (22,673) | (14,480) |
| Balance at end of period | $27,627 | $53,386 | $27,627 | $53,386 |

We regularly review loans in our portfolio to assess credit quality indicators and determine appropriate loan classification and grading in accordance with applicable regulations.

On the basis of the review as of September 30, 2012, management identified and graded $172.3 million of loans as Watch, $128.4 million of loans as Special Mention, $85.4 million of loans as Substandard and none of these loans as Doubtful or Loss. When referring to "adversely classified assets," such assets include loans graded as Substandard, Doubtful and Loss as well as other real estate owned. The total amount of adversely classified assets was $102.4 million and $188.2 million as of September 30, 2012 and December 31, 2011, respectively.

The following table sets forth our loans held for investment portfolio and loans graded special mention, substandard and designated as nonaccrual for the periods indicated below.

| (in thousands) | At September 30, 2012 | | | | | | |
|---|---|---|---|---|---|---|---|
| | | | Special Mention | | Substandard | | |
| Loan Category | Committed Balance (1) | Recorded Investment (2) | Committed Balance (1) | Recorded Investment (2) | Committed Balance (1)(3) | Recorded Investment (2)(3) | Nonaccrual (2) |
| Consumer loans | | | | | | | |
| Single family | $602,164 | $602,164 | $40,365 | $40,365 | $23,936 | $23,936 | $12,900 |
| Home equity | 207,191 | 141,343 | 2,724 | 2,705 | 1,126 | 1,024 | 1,024 |
| | 809,355 | 743,507 | 43,089 | 43,070 | 25,062 | 24,960 | 13,924 |
| Commercial loans | | | | | | | |
| Commercial real estate | 361,051 | 360,919 | 40,645 | 40,645 | 39,364 | 39,364 | 16,186 |
| Multifamily residential | 36,912 | 36,912 | 3,254 | 3,254 | 2,776 | 2,776 | — |
| Construction/land development | 89,005 | 77,912 | 46,263 | 41,066 | 15,064 | 15,064 | 5,848 |
| Commercial business | 109,518 | 80,056 | 1,523 | 323 | 3,218 | 3,218 | 2,289 |
| | 596,486 | 555,799 | 91,685 | 85,288 | 60,422 | 60,422 | 24,323 |
| Total | $1,405,841 | $1,299,306 | $134,774 | $128,358 | $85,484 | $85,382 | $38,247 |
| Undisbursed construction loan funds | (11,093 ) | n/a | | | | | |
| Undisbursed home equity and business banking line funds | (95,442 ) | n/a | | | | | |
| Net deferred loan fees and costs | (3,142 ) | (3,142 ) | | | | | |
| Allowance for loan and lease losses [4] | (27,461 ) | (27,461 ) | | | | | |
| Loans held for investment, net | $1,268,703 | $1,268,703 | | | | | |

(1) Includes undisbursed construction loan funds and home equity and business banking lines.
(2) Excludes undisbursed construction loan funds.
(3) Balances have been reduced by amounts of charge-offs.
(4) Allowance for loan losses includes specific allowances of $6.0 million.

| (in thousands) | At December 31, 2011 | | | | | | |
|---|---|---|---|---|---|---|---|
| | | | Special Mention | | Substandard | | |
| Loan Category | Committed Balance (1) | Recorded Investment (2) | Committed Balance (1) | Recorded Investment (2) | Committed Balance (1)(3) | Recorded Investment (2)(3) | Nonaccrual (2) |
| Consumer loans | | | | | | | |
| Single family | $496,845 | $496,934 | $45,412 | $45,412 | $12,104 | $12,104 | $12,104 |
| Home equity | 223,383 | 158,936 | 2,055 | 2,056 | 2,470 | 2,464 | 2,464 |
| | 720,228 | 655,870 | 47,467 | 47,468 | 14,574 | 14,568 | 14,568 |
| Commercial loans | | | | | | | |
| Commercial real estate | 402,457 | 402,139 | 52,466 | 52,456 | 46,788 | 46,788 | 10,184 |
| Multifamily residential | 56,448 | 56,379 | 508 | 508 | 8,004 | 7,938 | 2,394 |
| Construction/land development | 183,066 | 173,405 | 51,054 | 46,019 | 80,553 | 78,601 | 48,387 |
| Commercial business | 82,172 | 59,831 | 7,900 | 6,818 | 1,701 | 1,700 | 951 |
| | 724,143 | 691,754 | 111,928 | 105,801 | 137,046 | 135,027 | 61,916 |
| Total | $1,444,371 | $1,347,624 | $159,395 | $153,269 | $151,620 | $149,595 | $76,484 |
| Undisbursed construction loan funds | (9,661) | n/a | | | | | |
| Undisbursed home equity and business banking line funds | (87,086) | n/a | | | | | |
| Net deferred loan fees and costs | (4,062) | (4,062) | | | | | |
| Allowance for loan and lease losses (4) | (42,689) | (42,689) | | | | | |
| Loans held for investment, net | $1,300,873 | $1,300,873 | | | | | |

(1) Includes undisbursed construction loan funds and home equity and business banking lines.
(2) Excludes undisbursed construction loan funds.
(3) Balances have been reduced by amounts of charge-offs.
(4) Allowance for loan losses includes specific allowances of $18.7 million.

Loans are placed on nonaccrual when collection of principal or interest is doubtful, generally when a loan becomes 90 days or more past due. For further discussion on nonaccrual policies see Management’s Discussion and Analysis of Financial Condition and Results of Operations, Critical Accounting Policies and Estimates — Allowance for Loan Losses within our 2011 Annual Report on Form 10-K.

Loans are reported as troubled debt restructurings (“TDRs”) when the Company grants concessions that we would not otherwise consider to borrowers experiencing financial difficulty. For further discussion on TDR policies see Management’s Discussion and Analysis of Financial Condition and Results of Operations, Credit Risk Management—Troubled Debt Restructuring Policy in our 2011 Annual Report on Form 10-K.

The following table presents the composition of TDRs by accrual and nonaccrual status, for the periods indicated.

| (in thousands) | September 30, 2012 | | |
|---|---|---|---|
| | Accrual | Nonaccrual | Total |
| Consumer | | | |
| Single family residential | $60,497 | $4,288 | $64,785 |
| Home equity | 2,705 | 64 | 2,769 |
| | 63,202 | 4,352 | 67,554 |
| Commercial | | | |
| Commercial real estate | 16,540 | 7,716 | 24,256 |
| Multifamily residential | 5,521 | — | 5,521 |
| Construction/land development | 13,802 | 5,845 | 19,647 |
| Commercial business | 154 | 22 | 176 |
| | 36,017 | 13,583 | 49,600 |
| | $99,219 | $17,935 | $117,154 |