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

Registration No. 333-173980

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

AMENDMENT NO. 10

TO

FORM S-1

REGISTRATION STATEMENT

UNDER

THE SECURITIES ACT OF 1933

HOMESTREET, INC.

(Exact Name of Registrant as Specified in its Charter)

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

601 Union Street, Suite 2000

Seattle, WA 98101

(206) 623-3050

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

Mark K. Mason

Chief Executive Officer

HomeStreet, Inc.

601 Union Street, Suite 2000

Seattle, WA 98101

(206) 623-3050

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

Copy to:

Marcus J. Williams	**Godfrey B. Evans**	**John C. Grosvenor**
Donna M. Cochener	**HomeStreet, Inc.**	**Matthew S. O Loughlin**
Davis Wright Tremaine LLP	**601 Union Street, Suite 2000**	**Manatt, Phelps & Phillips, LLP**
1201 Third Avenue, Suite 2200	**Seattle, WA 98101**	**695 Town Center Drive, 14th Floor**
Seattle, WA 98101	**(206) 623-3050**	**Costa Mesa, CA 92626**
(206) 622-3150	**(206) 389-7703 Facsimile**	**(714) 371-2500**
(206) 757-7700 Facsimile		**(714) 371-2550 Facsimile**

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

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

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

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

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

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

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

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

CALCULATION OF REGISTRATION FEE

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

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

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

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

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

1,590,909 Shares of Common Stock

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

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

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

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

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

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

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

(1) For a description of the compensation to be received by the underwriters in addition to discounts and commissions, see Underwriting .

We have granted an over-allotment option which will allow the underwriters to purchase up to an additional 238,636 shares of our common stock from us at the initial offering price within 30 days following the date of this prospectus solely to cover over-allotments, if any.

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

FBR Capital Markets

The date of this prospectus is , 2012

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

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

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SUMMARY

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

Our Company

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

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

Recent Developments

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

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

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

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

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

Our Business

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

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

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

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

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

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

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

Impact of Economic Downturn

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Management Changes

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

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

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

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

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

Turnaround Plan

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

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

Improve Asset Quality and Upgrade Credit Culture

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

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

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

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

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

Balance Sheet Restructuring and Core Earnings Improvement

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

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

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

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

Controlling Noninterest Expense

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

Maintain Satisfactory Regulatory Relations

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

Recapitalize the Company

Upon the successful completion of this offering, we expect to contribute approximately $44.0 million of the net proceeds of this offering to the Bank. The Bank is required by the Bank Order to maintain a Tier 1 leverage capital ratio of at least 10% and a risk-based capital ratio of at least 12%. While this offering will improve our capital position and bring the Bank closer to compliance with these requirements, we will not be able to fully satisfy the requirements of the Bank Order based on this offering alone. However, we believe that following the contribution to the Bank of at least $44.0 million in capital from this offering, and subject to the completion of an on-site examination of the Bank by our primary regulators confirming our condition, we will qualify for replacement of the Bank Order with another form of enforcement agreement between the Bank and our regulators, which we expect would include provisions for maintenance of at least an 8.5% Tier 1 capital ratio and continuing improvement in the Bank s asset quality. Management does not have any reason to believe that the risk-based capital ratio will be increased in any subsequent enforcement order. Based on guidance from the Federal Reserve, we believe that we will need to further reduce our classified assets in the future to qualify for the lifting of the Company Order. The requirements imposed by the Company Order do not include quantitative capital ratio or asset quality targets. However, if we were to take more aggressive measures, such as bulk sales, to dispose of classified assets or OREO, we may incur additional valuation adjustments or may recognize additional losses on sales of classified assets. These events would be recorded as charges against earnings, which would reduce our financial performance in the affected periods, and in some cases may require that we raise additional capital.

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

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

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

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

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

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

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

Selected Turnaround Plan Results

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

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

	Month Ended		Three Months Ended $ Thousands (Unaudited)				
	31-Jan-12(1)	**31-Dec-11 (1)**	**30-Sep-11**	**30-Jun-11**	**31-Mar-11**	**31-Dec-10**	**30-Sep-09**
Total Construction Loans	$ 171,493	$ 173,405	$ 213,001	$ 234,062	$ 271,676	$ 285,131	$ 733,394
Provision for Loan Losses			1,000	2,300		8,200	35,555
Classified Assets	191,217	188,167	225,022	276,476	298,742	363,947	737,925
Nonperforming Loans	75,379	76,484	95,094	90,912	124,118	113,210	388,663
OREO	35,533	38,572	64,368	102,697	98,863	170,455	63,321
Nonperforming Assets	110,912	115,056	159,462	193,609	222,981	283,665	451,984
Total Delinquencies and Nonaccruing Loans (2)	161,009	139,860	144,133	132,481	188,013	178,286	495,168
Total Assets	$ 2,244,249	$ 2,264,957	$2,316,839				