HomeStreet, Inc.®

October 5, 2012

Federal Reserve Bank
Federal Deposit Insurance Corporation
Office of the Comptroller of the Currency

Re: Comments on Basel III Capital Proposals

Ladies and Gentlemen:

We have studied the joint proposed rules to implement the Basel III requirements and are very concerned about the impact on HomeStreet and our ability to continue to serve our markets in the Pacific Northwest and Hawaii.

HomeStreet Bank is a 91-year old, $2.4 billion bank headquartered in Seattle, Washington, that provides community banking and mortgage banking services in the Pacific Northwest and Hawaii. HomeStreet is unique among Northwest community banks due to our heritage and scale as a single family mortgage originator and servicer. HomeStreet generated $1.1 billion in single family mortgage loans in second quarter 2012, second in overall market share in the 7 counties that comprise 74% (5.0 million people) of the population in Washington State. We service over $7 billion in single family mortgage loans. Given our mortgage origination volumes, and our large servicing portfolio and associated hedging program, the Basel III proposals would have a greater impact on HomeStreet Bank than a typical community bank. In addition, Basel III would negatively impact us in areas that would affect most community banks, including changes related TRuPS Securities, available for sale securities and home equity loans.

Of greatest concern to HomeStreet Bank are the many changes to capital requirements that relate to originating and servicing single family mortgages.

Mortgage servicing: Under the proposed rule, institutions are required to deduct all mortgage servicing assets (net of deferred tax liabilities) that exceed 10% of their tier 1 common equity. Our mortgage servicing asset is currently over 26% of common equity. If we are required to deduct the amount that exceeds 10%, combined with the high initial risk weight (and the extremely high 250% risk weight in 2018) our capital levels would be reduced signficantly. HomeStreet has a long and successful history as a servicer of mortgage loans. Based on the Basel III capital treatment, we may be forced to reconsider whether to remain in the mortgage servicing business, which would disrupt long-standing customer relationships that we have built over the decades. It would also reduce our fee income. We already absorb the 10% reduction in the fair market value of mortgage servicing assets for measuring current regulatory capital. We request that there be no deduction from capital for mortgage servicing rights, given the importance of effectively-managed servicing portfolios to the smooth functioning of the mortgage loan market. We also request that the proposed risk weights be reconsidered and lowered.

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Risks related to holding mortgage servicing rights are adequately addressed by the existing regulatory and accounting framework and reflected in current valuation methodologies. Requirements to hold additional capital would result in further contraction of the already-constrained mortgage industry capacity, which has already been reduced following the credit crisis.

Mortgage loans sold as securities: The requirement to apply risk weighted asset treatment to sold loans held as securities while eliminating the existing 120-day exclusion would cause significant hardship to HomeStreet Bank and would have the unintended consequence of requiring HomeStreet to significantly curtail its mortgage lending activities. For the four-month period June through September 2012, our single family sold loans pipeline totaled $1.6 billion, requiring a risk weight of 35% to 200% based on Category 1 or Category 2 and loan to value. This could result a potential reduction in our Risk based capital ratio of over four percent, assuming the most favorable risk weighting of 35% on the entire pipeline. The impact would likely be higher.

TRuPS securities: HomeStreet, Inc. has approximately $60 million of trust preferred securities. In all of their terms and conditions, except their 30-year life when issued, these securities qualify as Tier 1 capital and warrant continued treatment as such. The fact that some banks invested in TRuPS securities that subsequently defaulted is an investment risk management issue that should be addressed separately from the treatment of such securities as Tier 1 capital. Phasing out the recognition of TRuPS securities as Tier 1 capital will put an unplanned strain on the total capital of many community banks.

Available for sale securities: HomeStreet, Inc. has approximately $392 million in securities that are classified available for sale. Inclusion of the mark-to-market gains and losses in the common equity tier 1 calculation will cause significant volatility in our earnings. Like many banks, we would have no choice but to shorten the duration of our investments. The aggregate impact on the bond market of all banks shortening their investment durations would be dramatic, potentially substantially reducing demand for bonds with longer duration. This could have a significant, negative impact on the value of such bonds issued by the GSEs and local municipalities.

Home equity loans: Home equity loans are the only type of consumer loan currently offered by HomeStreet Bank. Other forms of lending, such as direct and indirect auto loans, are no longer profitable for banks due to competition from non-banks or captives of automobile manufacturers. Home equity loans are the preferred borrowing method for many of our customers. The 200 percent risk weighting proposed for higher LTV home equity loans would result in banks moving away from secured lending toward unsecured lending that has historically had higher risk, such as credit cards. This would serve to restrict the availability for credit for consumers and/or force them into unsecure credit products. We already adequately account for the risk of home equity lending in our ALLL calculation, so this risk weight change would be a double count with the ALLL.

Commercial real estate loans: The increased risk weights are redundant with the risk allocations incorporated into the ALLL and serve to double count the capital buffer. In addition, existing regulations limit commercial real estate loan concentrations as a percent of capital.

Delinquent loans: The risk weights for delinquent loans are also redundant with the ALLL risk allocations, double counting the capital buffer.

We support the goals of Basel to increase capital requirements for major institutions that had historically operated at extremely low capital levels. However, the application of the Basel III Is not appropriate for community banks such as HomeStreet.

Sincerely,

Mark K. Mason
President and CEO