BLUE LION CAPITAL

August 2, 2023

To my fellow HomeStreet Bank shareholders,

As a top ten shareholder, I wanted to weigh in on recent reports regarding the potential for asset sales by HomeStreet. It goes without saying that the company is currently in a very dangerous predicament. The stock price reflects this fact as HomeStreet currently trades at 33% of tangible book value. This valuation is one of the lowest of all 400+ publicly traded banks in the U.S. Candidly, the problems at HomeStreet are completely self-inflicted. During the past several years, HomeStreet's management assumed a great deal of interest rate risk by investing in long-duration, fixed-rate securities and loans. With the Federal Reserve's aggressive interest rate hikes, the bank and more importantly shareholders are suffering.

The values of the bank's assets have declined thereby pressuring capital levels, profitability is dangerously low and the market fully questions the bank's viability. With more potential Federal Reserve interest rate hikes coming and a likely credit cycle looming, HomeStreet needs to take aggressive action.

I believe the viability of the bank can be ensured if the Board of Directors simply does the right thing. HomeStreet is one of the few banks to possess a FNMA DUS license and **this license should be sold**. There are only 25 licenses outstanding, so there is significant scarcity value. Below is a list of the banks that hold a FNMA DUS license and those we believe would very much like to own a license:

FNMA DUS Bank Lenders		Large Banks Without DUS	
	Assets		**Assets**
JPM	$4 trillion	**BAC**	$3 trillion
CITI	$2 trillion	**GS**	$1.6 trillion
WFC	$2 trillion	**MS**	$1.2 trillion
PNC	$557 billion	**USB**	$674 billion
COF	$455 billion	**TFC**	$555 billion
MTB	$201 billion	**CFG**	$227 billion
KEY	$190 billion	**FCNCA**	$215 billion
RF	$155 billion	**FITB**	$207 billion
		HBAN	$183 billion
HMST	$9.5 billion	**NYCB**	$119 billion

As you can see, HMST is the smallest license holder by a wide margin in terms of assets and there are several large banks that do not have a license. It goes without saying that in the CRE multifamily lending business, size matters.

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So, in addition to the scarcity value, what makes the license so valuable? A holder of the license can underwrite, originate and sell multifamily loans under a loss-share arrangement with FNMA. Due to strict underwriting requirements and the FNMA guarantee on a portion of the credit, FNMA DUS loans are deemed to be very high quality and typically generate a gain on sale margin of 3%. In 2022, the FNMA Multifamily program generated more than $69 billion of loans and approximately $2 billion of gain on sale fees. In short, the FNMA DUS program is very large, there are only 25 licenses and the gain on sale fees are 2-3x larger than non-guaranteed multifamily loan sale fees.

The largest FNMA DUS lender in 2022 was Walker & Dunlop (WD) with $9.95 billion of loan sales and more than $300 million of gain on sale fees. HomeStreet was the smallest lender in 2022 with approximately $135 million of loan sales and $4 million of gain on sale fees. HomeStreet's origination and loan sales in 2022 represented less than 0.2% of the total program.

Below is a table presenting HomeStreet's FNMA DUS loan sales, gain on sale margin, revenues, operating profit and after-tax income for 2019 – 2022 and YTD 2023. This information is estimated based on bar charts used in the company's quarterly presentations. The operating profit margin is estimated using WD's margins for the same periods. Given WD's scale and best-in-class operations, we believe we are being more than generous. The after-tax income is calculated using HomeStreet's typical tax rate of 21%.

(000s)	2019	2020	2021	2022	1H 2022	1H 2023
Loan Sales	$210,000	$365,000	$270,000	$135,000	$90,000	$5,000
DUS Margin	3.38%	2.88%	3.34%	3.03%	3.32%	1.65%
DUS Revenues	$7,095	$10,495	$9,025	$4,095	$2,985	$83
Operating profit	$1,974	$3,245	$2,640	$939	$750	$12
After-Tax Income	$1,560	$2,563	$2,085	$742	$593	$9

Through the first six months of 2023, HomeStreet has originated and sold approximately $5 million of FNMA DUS loans vs approximately $90 million in 1H 2022 and generated DUS revenues of $83,000. As you might imagine, the profits in 2023 year-to-date are de-minimis best case, given the fixed costs. In short, the FNMA DUS license business has likely not been profitable for the past six quarters and is unlikely to be so in the foreseeable future. Further, the trajectory of this business has been in a meaningful decline since 2020. Despite this history, HomeStreet's management claims that this business is a core part of the bank and the license is not for sale. While I fully acknowledge that this business has been part of HomeStreet for a very long time, addressing the serious problems facing the company must take precedence - there can be no sacred cows.

Given the number of large banks that don't have a license, and prominent non-bank financials like BlackRock, Starwood, Brookfield, Dwight Capital, etc. that lack one as well, we believe this license could garner $100 – $150 million in a sale (includes the approximate $25 million of FNMA DUS servicing). In fact, in June of 2019, Dwight Capital offered up an opening bid of $60 million. Initially, HomeStreet denied ever receiving an offer from Dwight Capital. Shortly thereafter, HomeStreet acknowledged the offer but declined it without even engaging Dwight Capital, claiming the asset wasn't for sale, the license was a core part of the business and the price was too low. At the time, HomeStreet had a market cap of approximately $740 million, so they could likely have claimed the offer wasn't material as well.

Today, HomeStreet has a market cap of approximately $170 million and its problems are serious and mounting. A $100 million purchase price for the license would represent almost 60% of the company's market cap. Given the lack of profitability and the declining performance of the FNMA DUS business, why not sell this grossly under-utilized, scarce asset for 135x 2022 net income? Or, stated differently, why not sell the asset for 135 years of 2022 earnings? If you think I'm being too punitive using 2022 earnings, then 40x peak earnings generated in 2020. Further, HomeStreet could negotiate an origination agreement with the buyer to share gain on sale fees for FNMA DUS qualifying loans and thereby stay active in the business. Isn't that the best use case for this license – monetize this valuable asset while remaining involved?

The FNMA DUS license has zero basis on HomeStreet's balance sheet, so a sale for $100 million would generate a $100 million gain. With a pre-tax loss on its securities portfolio of approximately $127 million and substantial mark-to-market losses on their fixed-rate CRE portfolio, HomeStreet could sell some of these assets and realize $100 million of losses to offset the gains from the sale of the FNMA DUS license. By doing so, HomeStreet could completely transform its balance sheet. And, it could essentially re-capitalize the company without diluting shareholders or negatively impacting book value.

Based on June 20, 2023 financials, HomeStreet's pre-tax loss on its securities portfolio is 8.4% if the AOCI hit in stockholder's equity is grossed up by a 21% tax rate. So, for every $100 million of securities that are sold, $8.4 million in losses would be generated.

Further, based on discussions with wall street loan trading desks, multifamily CRE loans are currently trading at a yield of 7.0% - 7.5%. If you assume HomeStreet's multifamily CRE portfolio yield is equal to its average loan portfolio yield of 4.56% in 2Q 2023 and the loans have a 3-year average maturity, to create a loan that will yield 7.5%, the loan would need to be sold for $91. Three points of discount would be added to the 4.5% loan yield each year to achieve 7.5%. Based on these assumptions, every $100 million of multifamily CRE loan sales would generate $9 million of losses.

The following balance sheet restructuring scenario (one of many) could have an enormous impact on the company. Assuming $40 million of securities losses were realized, HomeStreet would need to sell $478 million or approximately 31% of its large securities portfolio. Assuming $60 million of multifamily CRE loan losses were realized, HomeStreet would need to sell $667 million or less than 17% of its large multifamily portfolio. Throw in the sale of $76 million of low-yielding single family MSRs and the $25 million of FNMA DUS MSRs that accompany the license and a total of $1.25 billion of assets could be sold.

While I readily admit that these numbers are rough estimates because complete information is unavailable to shareholders, the opportunity is real. The proceeds from the sales could be used to pay off $1.25 billion of the highest cost deposits and borrowings. This proposed balance sheet restructuring transaction would greatly improve liquidity, improve profitability as marginal funding costs exceed securities yields (3.82%) and loans yields (4.56%) by approximately 100bps, improve NIM, reduce non-cash earnings, allow further cost reductions, and greatly improve capital ratios. And, HomeStreet could still partner with the buyer of the license to continue to participate in the FNMA DUS program.

Candidly, the FNMA DUS license is just in the wrong hands - as evidenced by the 20-30bps share of total FNMA DUS originations by HomeStreet historically. Can you imagine how many loans BAC, USB, TFC or BlackRock could originate if they owned a license? A $100 million purchase price for the license is a very small price to pay by these potential / likely interested buyers.

Given such, to the extent you as a shareholder agree with this analysis, please contact Mark Patterson - the lead independent director and weigh in. The independent directors need to hear from shareholders. Further, if there are any errors in my analysis or other items that should be considered, please let me know.

If you are a potential interested buyer, please also contact Mark Patterson with a real offer. That would ensure the offer was presented to the Board.

As a company, HomeStreet is trying to wait out the current environment, hoping that things will improve. This is not a sound decision and hope is not a strategy. In fact, it could very well lead to the failure of the bank and introduce significant liability for directors. But, selling a scarce and grossly underutilized asset at 40x the highest annual net income ever generated and removing the prospect of failure would be a very wise decision. It would benefit all stakeholders: employees, shareholders, regulators, the FDIC, FNMA and HomeStreet customers. If done so in an expeditious manner, I would expect the stock to trade up to 80% of tangible book value or $22.

Given the current position HomeStreet put itself in, I see virtually no downside to pursuing this strategy. I appreciate your time and look forward to your feedback.

Your fellow shareholder,

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