[HomeStreet]

September 18, 2015

William A. Longbrake, Chairman
Washington State Citizen Commission for Performance Measurement of Tax Preferences
1300 Quince Street SE
P.O. Box 40910
Olympia, WA 98504-0910

Dear Chairman Longbrake:

This letter is submitted on behalf of HomeStreet Bank with concerns about the 2015 Tax Preference Performance Review, specifically regarding the recommendations to narrow the definition of eligibility for the first mortgage interest deduction.

HomeStreet was founded in Seattle in 1921 as Continental Mortgage and Loan. We are now a state chartered savings bank and a leading mortgage lender in the State of Washington with more than 90 years of expertise. We are currently the second-largest originator of residential mortgage loans in Washington, behind only Wells Fargo, and the leading lender for purchase transactions in the State.

Below are my responses to the six questions that the Commission has raised for stakeholders.

Question 1: Is there evidence that the tax preference achieved its purpose, as noted in the 2015 tax preference reports?

As noted in the report, JLARC staff has inferred that the public policy objectives for this tax preference are to stimulate Washington's residential housing market by making mortgage loans available and more affordable to home purchasers and home owners. Additionally, the report considers the Legislature's intent to narrow this preference to "community banks."

Response: We believe that the above objectives are being met. Additionally, we strongly believe that the Legislature also intended to increase the competitiveness of Washington's lenders, particularly after the Legislature retained this deduction for local lenders in 2012 while the housing market was still relatively weak.

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We firmly believe that each of these priorities are being met, and altering or eliminating this preference would negatively impact Washington lenders' ability to compete with large national lenders, and also some large credit unions who make portfolio loans.

I. This preference helps Washington lenders to remain in the cyclical residential lending market and to offer more residential home loan products at better terms than would otherwise be the case.

We believe that this preference helps encourage Washington lenders to compete in the residential home lending business, which is a very low-margin business. Removal of this preference would squeeze margins further. This, coupled with the vastly higher cost of producing a residential mortgage today, would mean many lenders would likely redirect some of their resources to other businesses, and originate fewer mortgages and restructure their portfolios to hold fewer mortgages for investment. This would have the impact of reducing the number of local entities offering home loans.

Washington's B&O tax, which is based on gross receipts, discourages narrow margin businesses such as holding mortgage loans. Washington mortgage lenders have a difficult time competing with large national lenders who enjoy much lower cost of capital and much greater scale economies. Should local lenders to lose the current tax preference, they will invariably increase the costs to consumers for mortgage loans, or simply exit the business. The likely result would be fewer local lenders serving Washington consumers.

II. Encourage all local lending institutions

The JLARC report considers the Legislative intent from the 2012 legislation was meant to narrow the deduction to "community banks." The report quotes the prime sponsor, who "described a 'community bank' as a Washington-based bank." We believe that the report is considering the term "bank" more narrowly than the legislative intent.

While the term "bank" is often used in a general sense which may often be interchanged with other terms like credit union or savings institutions, there are distinct legal differences in terms of business purpose, ownership, and governance. Specifically, under the legal definition, a bank is an institution that is engaged in the business of gathering deposits. However, this requirement is not seen in the final legislation, which broadly allows the deduction to be taken for those engaged in banking, lending, security, and other financial businesses.

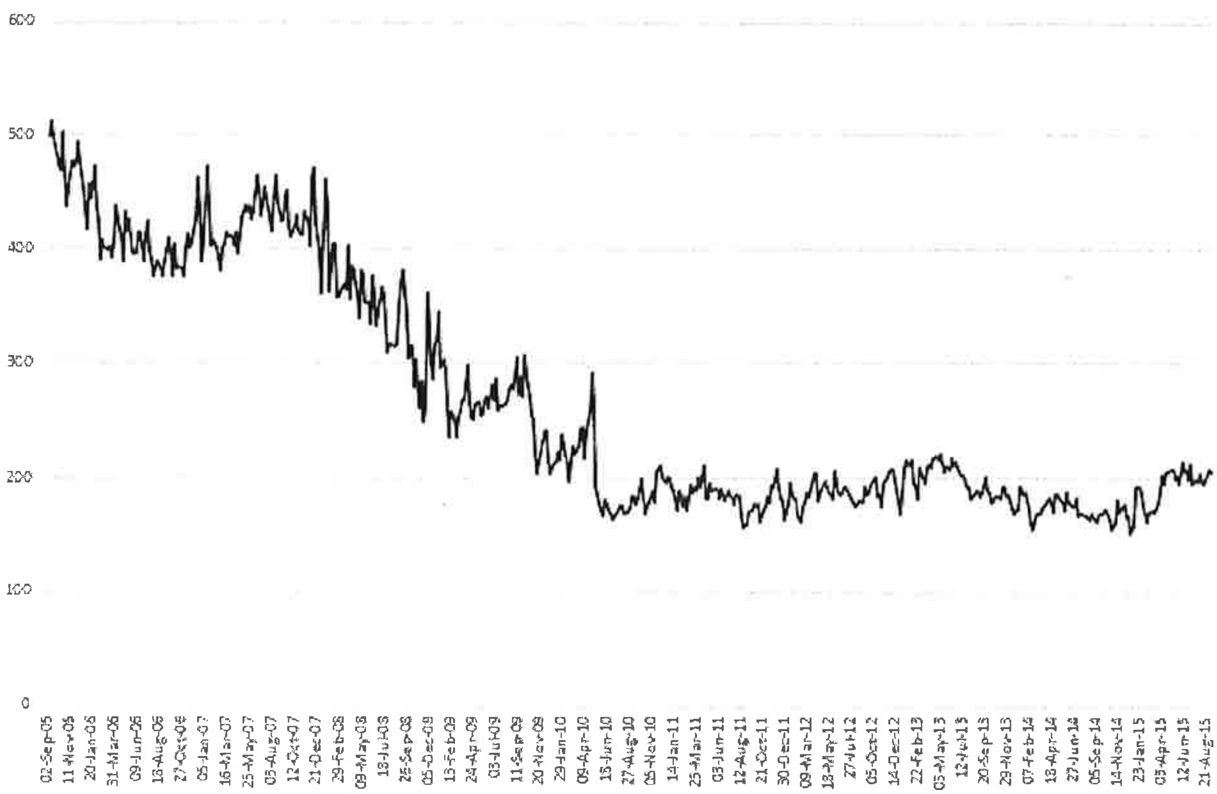
We believe that the Legislature intended to encourage a broad application of the deduction in order to stimulate the underlying residential market for all local lenders--not merely depository institutions. We believe the current definition is meeting the Legislature's underlying intent, and we ask that the Commission recommend that it remains the same.

III. Help local lenders through a fiscal crisis

The nation's and the State's financial institutions are now recovering from a severe and lengthy fiscal crisis. Regulatory and compliance burdens on institutions have increased substantially, making it difficult for smaller institutions to survive. The current preference achieves its public policy objective by helping local institutions to compete for business and add assets with a decent risk-adjusted yield.

Below is a chart on purchase mortgage application activity from 2005 to 2015. As you can see, home buyers are just beginning to apply for mortgages again, after the residential housing market was severely impacted by the recession. Washington State has a similar curve.

Purchase Mortgage Application Volume Index
(September 2005 - August 2015)



Source: Mortgage Bankers Association (2015)

At a time when the market is finally beginning to rebound, we do not believe it would be the Legislature's intent to impose a significant new tax on its local lenders. Instead, we believe the Legislature intended for this deduction to help level the playing field for smaller institutions, and encourage more lenders to compete with the national mortgage lenders.

Question 2: Does the preference provide benefits in addition to those stated in its intended or implied purpose, consistent with one or more of the six public policy objectives stated in RCW 82.32.808(2)?

Response: We believe this deduction improves industry competitiveness.

As previously discussed, the nature of Washington's gross receipts tax structure places a significant tax burden on businesses with low margins. Removing this preference would discourage local lenders from entering into the low-margin residential lending business. Large national banks enjoy lower costs of capital and scale economies that have the effect of widening their margins compared to smaller local institutions. Additionally, Basel III imposes punitive capital requirements on MSRs which make it more advantageous for large banks to hold whole loans. The result is that they can price their portfolio loans at much lower rates than can smaller institutions, making it very difficult for local lenders to compete.

Question 3: Is there a loss of tax revenue as a result of the preference; and if so, do any increased taxes from new economic activity exceed that loss?

Response: The tax preference reduces gross receipts on the loans that are made. However, we believe that the additional jobs that are created, and the additional spending that is related to home mortgage activity generates additional tax revenues to the State. The amount is difficult to estimate, but we believe that it is substantial.

HomeStreet is an example of growth and investment in this business. Since 2012 our portfolio lending business has grown from $233 million to a projected $430 million this year. Should the tax preference be lost our margins would shrink further, making it difficult to justify further growth in this business.

Question 4: Specifically, in the case of property tax preferences, what would be the impacts on taxpayers and economic activity if the preference is eliminated or modified?

Response: N/A

Question 5: Does this preference have negative consequences? For example, were other industries, workers, or the environment harmed by activities stimulated by this tax preference?

Response: N/A

Question 6: How does the overall impact of the "preference" affect the tax burden in Washington compared with similar tax burden in other states?

Response: As previously discussed, Washington State has a unique gross receipts business tax system. This tax on gross revenue puts Washington lenders at a distinct disadvantage against out of state lenders who are taxed on corporate net income. Our B&O tax is particularly hard on narrow margin businesses such as holding residential loans in portfolio. This deduction helps offset this structural disadvantage for Washington's local lenders.

In summary, we appreciate the staff's thorough analysis of this complicated tax issue. We believe the Legislature's intent is currently being met and that it serves a valid purpose, and we respectfully ask that the Commission recommend retaining this important tool for Washington's local lenders. Please keep the definition as it currently stands.

Sincerely,

Richard W.H. Bennion
Executive Vice President
HomeStreet Bank

cc Members of the Washington State Citizen Commission for Performance Measurement of Tax Preferences

Members of the Joint Legislative Audit & Review Committee
Mr. Keenan Konopaski