Important disclosures can be found on pages 7 - 12 of this report.

September 7, 2016

Industry Update

Mortgage Market Continues to Shine; Raising our Origination Forecasts for 2016 to $1.9T; Setting 2017 at $1.75T

Summary and Recommendation

With continued strength in the purchase mortgage market and a healthy boost to refis in light of the low interest rate environment throughout the year, we are raising our estimate for 2016 total mortgage industry originations to $1.9 trillion from $1.65 trillion. For some time now, we have articulated our belief that the normalized origination market in the U.S. shakes out at around $1.7 trillion with the purchase market representing somewhere in the range of $900 billion to $1 trillion and the refi market accounting for the delta. With that in mind, we think that the tailwinds from lower interest rates will boost production through that level in FY16, hence our $1.9 trillion estimate. Additionally, we are introducing our 2017 estimate of $1.75 trillion, which assumes continued positive momentum in the purchase market but a decline in refi volumes from 2016.

Key Points

- **We highlight the "pure plays" and companies with large mortgage origination platforms.** At the risk of stating the obvious, we continue to point to mortgage banks that most directly benefit from stronger mortgage originations such as our FBR Alpha Generator pick, **HomeStreet (HMST – Outperform)** and **Flagstar Bancorp (FBC – Outperform)**. Both companies reported very strong 2Q16 results, which demonstrated the strong operating leverage generated in a healthy mortgage market. Our 2016 and 2017 EPS estimates for FBC and HMST are positioned above the Street, and we believe there is potential upside to our numbers if mortgage originations do in fact meet our estimates. Additionally, we point to **U.S. Bancorp (USB – Outperform)** and **Wells Fargo (WFC – Outperform)** as high-quality institutions that are highly levered to the U.S. mortgage market.
- **Trailing four-quarter purchase average jumps to $236 billion, the highest level since 1Q08.** Over the last year, average purchase originations have totaled $236 billion on a quarterly basis, which compares to $210 billion merely a year ago and post-crisis lows of $121 billion. These results continue to support our thesis that the "new normal" of $1.5 trillion in sustainable originations is already here. Ultimately, the improvement in the U.S. housing market has been gradual, but we believe purchase volumes will continue to grow and approach $1 trillion in 2017, which is more in line with what we believe to be a "normalized" level.
- **Most stable regulatory environment in years bodes well for our estimates.** Regulatory risk has consistently figured into the downside risk to our mortgage origination estimates in recent years, especially as the industry has adjusted to the definition of a qualified mortgage (QM), re-worked mortgage disclosures required by TRID, or adjusted credit boxes to avoid rep and warranty risk/specialty servicing risks. These new rules and regulations certainly continue to factor into the overall size of the origination market, but they are no longer the headwind they once were as the industry has transitioned to the "new" regulatory reality. We fully continue to expect some growing pains as regulators continue their supervisory and enforcement activities over the mortgage market. However, the lack of any large-scale new regulatory requirement in the mortgage market provides for the most stable regulatory environment in recent memory, which reinforces the confidence we have in our estimates.

Paul J. Miller, Jr., CFA
703.469.1252
pmiller@fbr.com

Tim Hayes
703.312.1819
timothyhayes@fbr.com

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Updated Mortgage Origination Estimates; Looking at $1.9 Trillion in 2016 and $1.75 Trillion in 2017

Reflecting the continued low interest rate environment and a rebound in the purchase mortgage market to more normalized levels, we are updating our 2016 industry mortgage originations estimate to $1.90 trillion from $1.65 trillion and introducing our 2017 estimate of $1.75 trillion. We have long adopted the "lower for longer" view toward interest rates, and as such, we expect the refi market should continue to be strong in 2H16 but will likely begin to taper off in 2017. We also remain committed to our view that the purchase market is below what we believe to be normalized levels and will continue to experience positive growth on a year-over-year basis, albeit at a more modest pace than from 2012 through 2016.

Quarterly Mortgage Originations – Actual and FBR Estimates

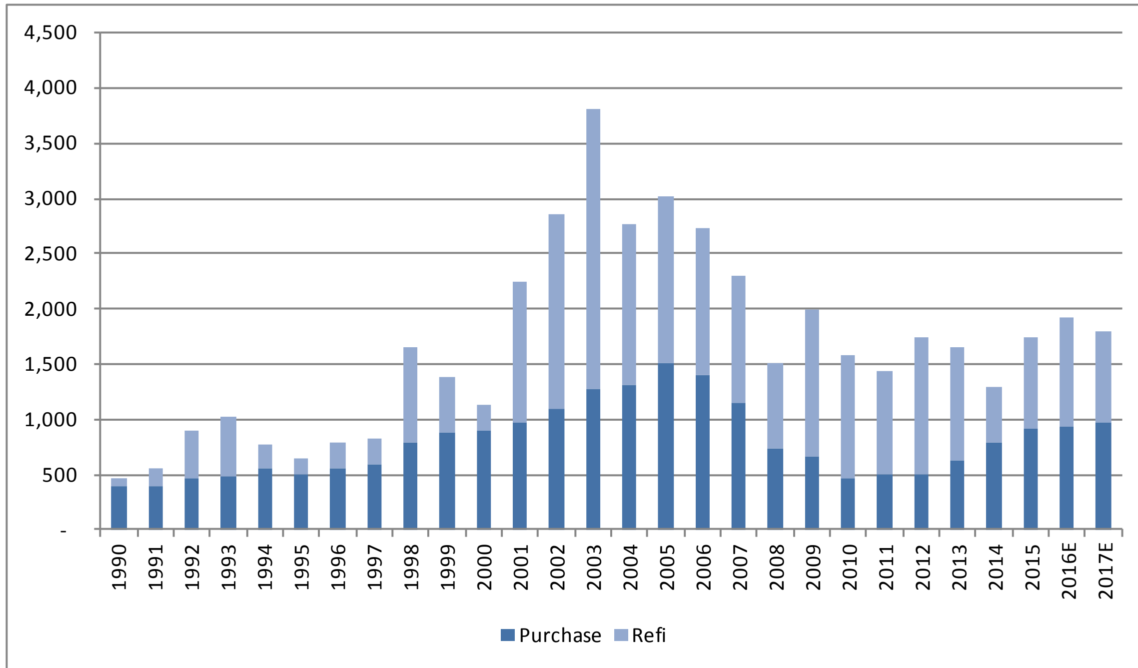
	Originations ($ billions)			QOQ Percentage Change			YOY Percentage Change		
	Purchase	Refinance	Total	Purchase	Refinance	Total	Purchase	Refinance	Total
2011	**$369**	**$1,126**	**$1,495**				**-10%**	**6%**	**-8%**
1Q12	$116	$354	**$470**	14%	-16%	-8%	-1%	40%	25%
2Q12	$159	$336	**$495**	37%	-5%	5%	20%	92%	63%
3Q12	$171	$389	**$560**	8%	16%	13%	16%	74%	56%
4Q12	$154	$441	**$595**	-10%	13%	6%	27%	38%	36%
2012	**$600**	**$1,520**	**$2,120**				**63%**	**35%**	**42%**
1Q13	$145	$403	**$560**	-6%	-9%	-6%	25%	14%	19%
2Q13	$199	$351	**$565**	37%	-13%	1%	25%	4%	14%
3Q13	$218	$225	**$460**	10%	-36%	-19%	27%	-42%	-18%
4Q13	$172	$117	**$289**	-21%	-48%	-37%	12%	-73%	-51%
2013	**$734**	**$1,096**	**$1,830**				**22%**	**-28%**	**-14%**
1Q14	$149	$108	**$245**	-13%	-8%	-15%	3%	-73%	-56%
2Q14	$212	$114	**$310**	42%	6%	27%	7%	-68%	-45%
3Q14	$232	$130	**$345**	9%	14%	11%	6%	-42%	-25%
4Q14	$190	$165	**$355**	-18%	27%	3%	10%	41%	23%
2014	**$783**	**$517**	**$1,255**				**7%**	**-53%**	**-31%**
1Q15	$165	$240	**$405**	-13%	45%	14%	11%	122%	65%
2Q15	$253	$237	**$490**	53%	-1%	21%	19%	108%	58%
3Q15	$280	$175	**$455**	11%	-26%	-7%	21%	35%	32%
4Q15	$210	$175	**$385**	-25%	0%	-15%	11%	6%	8%
2015	**$908**	**$827**	**$1,735**				**16%**	**60%**	**38%**
1Q16	$197	$197	**$380**	-6%	13%	-1%	19%	-18%	-6%
2Q16	$255	$255	**$510**	29%	29%	34%	1%	8%	4%
3Q16E	$282	$282	**$565**	11%	11%	11%	1%	61%	24%
4Q16E	$201	$246	**$448**	-29%	-13%	-21%	-4%	41%	16%
2016E	**$936**	**$981**	**$1,902**				**3%**	**19%**	**10%**
1Q17E	$197	$197	**$355**	-2%	-20%	-21%	0%	0%	-7%
2Q17E	$266	$177	**$443**	35%	-10%	25%	4%	-31%	-13%
3Q17E	$289	$237	**$526**	9%	34%	19%	2%	-16%	-7%
4Q17E	$213	$213	**$425**	-26%	-10%	-19%	6%	-14%	-5%
2017E	**$965**	**$823**	**$1,749**				**3%**	**-16%**	**-8%**

Source: Inside Mortgage Finance and FBR Research

The Purchase Market Rebounds; Approaches "Normalized" Levels

The purchase market continues to rebound from 2010 lows on a trailing-four-quarter average, supporting our 2016 and 2017 industry originations estimates of $1.9 trillion and $1.75 trillion, respectively. Over the last 12 months, purchase originations have averaged $236 billion per quarter, representing the highest level since 1Q08 and the 10th straight quarter of positive sequential growth. We believe purchase origination trends indicate strength, especially in the last year, with projected purchase volumes alone supporting a ~$1 trillion market.

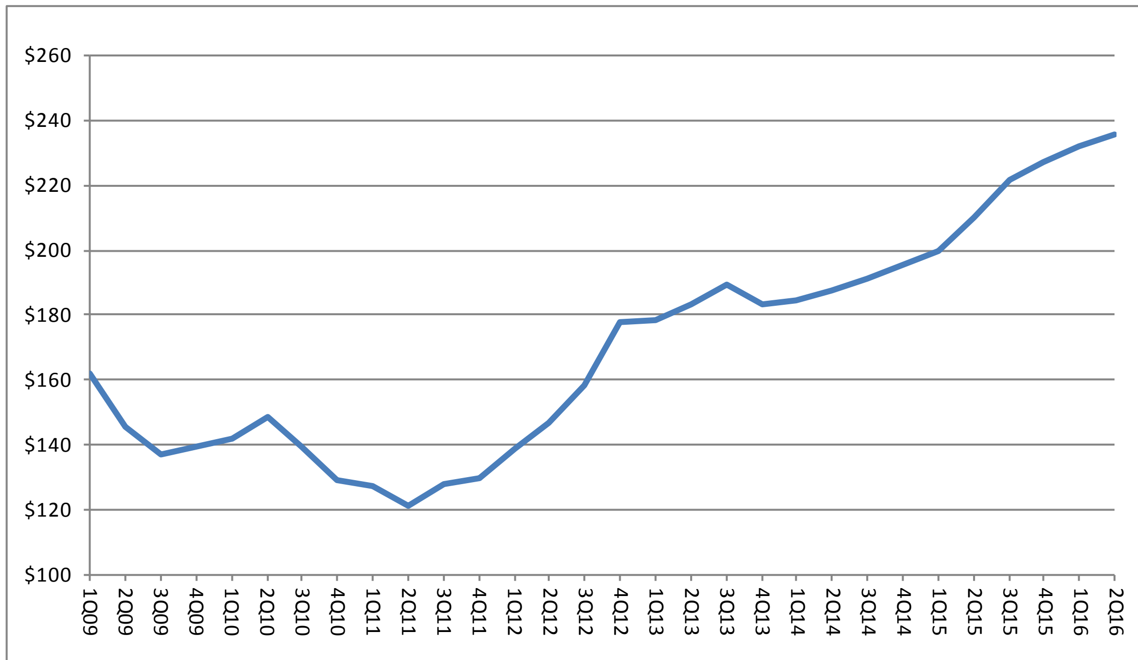
Total Mortgage Originations by Segment



$ in billions.

Source: Inside Mortgage Finance and FBR Research

Average Trailing-Four-Quarter Purchase Mortgage Originations per Quarter

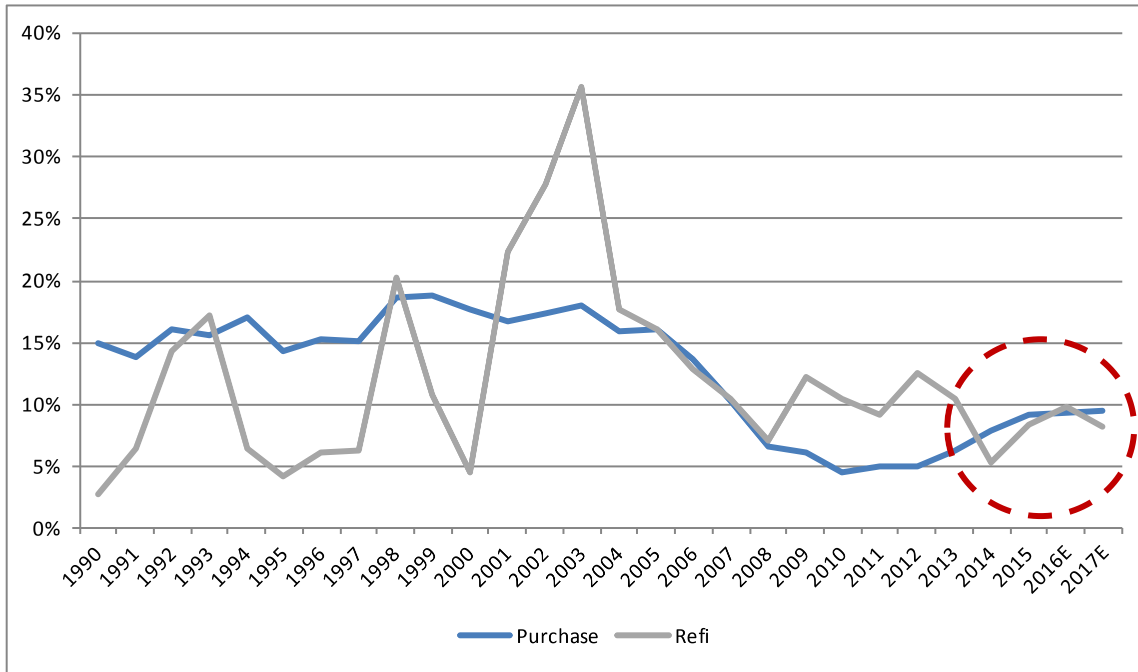


$ in billions.

Source: Inside Mortgage Finance and FBR Research

Additionally, purchase market originations have accounted for approximately 13% of total mortgage debt outstanding over the past 25 years but now stand closer to 9%. While we do not expect purchase market originations to trend in line with the historical average per se, we do think that the gap will narrow and that originations will likely hone in on the 10% level in 2017, providing a "stickier" base for the mortgage market in following years relative to a more volatile refi-heavy market.

Mortgage Market Segments As a Percentage of Total Mortgage Debt Outstanding



Source: Inside Mortgage Finance and FBR Research

Industry Risks

Forecasting the future is difficult. The pace of future economic growth and the level of interest rates in the future may turn out to be either higher or lower than the forecasts presented herein.

Commentary, predictions, and opinions expressed herein regarding the future direction of financial indicators or markets are, by nature, speculative and uncertain. Actual outcomes may differ substantially from the opinions herein expressed.

Earnings are sensitive to local economic, national, and international economic conditions. Economic recession would tend to restrict asset growth while adversely affecting credit quality, with a negative implication for future earnings and revenue growth.

Earnings and the market value of assets and liabilities are sensitive to changes in interest rates, to yield curve shifts, and to interest rate spread relationships.

Operations are subject to regulation. Compliance costs can be material and can reduce earnings or competitiveness with other financial services companies that are not regulated or are less regulated.

Legislative and regulatory agendas are subject to change at the discretion of leadership or as dictated by events.

Company-Specific Investment Risks

HomeStreet, Inc. (HMST)

Business execution risk. HomeStreet's business plan has been designed and is being implemented during a period of unpredictable market conditions, and there are no assurances that the plan can deliver anticipated results or be completed on the schedule forecasted by management.

Heavily dependent on the mortgage market. A large part of HomeStreet's revenue comes from residential mortgage, which is a market sector that has experienced significant volatility.

Asset concentration risk. The significant concentration in the bank's portfolio of real estate-secured loans might continue to have a negative impact on asset quality and profitability as a result of continued or worsening conditions in the real estate market and higher-than-normal delinquency and default rates.

Interest rate risk. HomeStreet's revenue stream is very interest rate sensitive, and earnings could differ from our estimates if the slope of the yield curve were to change.

Credit risk. HomeStreet originates residential and commercial loans that may default, especially during a recession. Depending on the health of the economy and the creditworthiness of borrowers, loans could default more rapidly than anticipated, which would translate into higher-than-expected losses at the bank.

Counter-party risk. HomeStreet engages in hedging activities that expose the company to counter-party risk, or the risk that the entity on the other end of the transaction could default on its obligation.

Macroeconomic risk. In the event of higher unemployment and further weakness in the housing market, credit losses could accelerate more quickly than expected, and there could be downside to our estimates. Conversely, if the economy stabilizes and if losses in weak markets and in commercial real estate are not as significant as expected, there could be upside to our loss estimates.

Competition. Substantial competition exists in the Pacific Northwest, HomeStreet's primary market, from state and national banks, thrifts, foreign banks, finance companies, and other firms that provide financial and ancillary services.

Regulation. Banking regulations and regulatory interpretations may change, or regulatory actions may be taken that could adversely affect HomeStreet's competitiveness or limit its business opportunities. Similarly, there is a high level of regulatory scrutiny in the banking industry.

Investor sentiment. Changes in market sentiment toward financials that are negative may pose a risk to our price target.

Flagstar Bancorp, Inc. (FBC)

Mortgage production risk. A significant amount of Flagstar Bancorp, Inc.'s revenue depends on mortgage production and, hence, interest rates. The company's loan originations, interest rate spread, and mortgage servicing rights valuation all depend directly on the level of interest rates.

Macroeconomic risk. A significant decline in economic growth could lead to higher delinquencies and defaults in the company's managed loan portfolio, which could decrease earnings.

Geographic risk. Most of the company's held-for-investment loan portfolio and servicing portfolio loans are concentrated in specific geographical regions, particularly in Michigan, California, and Florida. A weakening of the local economies may negatively affect Flagstar's earnings.

Regulation. Banking regulations and regulatory intervention may change, or regulatory actions may be taken that could adversely affect the company's competitiveness or limit its business opportunities.

Investor sentiment. Changes in market sentiment toward financials that are negative may pose a risk to our price target.

U.S. Bancorp (USB)

Local market risk. U.S. Bancorp's earnings are sensitive to local market conditions, overall economic conditions, and interest rate conditions. A significant weakening in economies local to the company's principal operations or in the U.S. economy could hinder future earnings growth.

Geographic risk. The company's operations are geographically concentrated and depend on the strength of the underlying industries.

Interest rate risk. A sustained low interest rate environment would tend to tighten net interest spreads and hurt profitability, thus creating risk to achieving our price target.

Competition. Competition in U.S. Bancorp's primary markets from state and national banks, thrift institutions, foreign banks, finance companies, and other firms that provide financial and ancillary services could impede growth opportunities for the company.

Regulation. Banking regulations and regulatory intervention may change, or regulatory actions may be taken, that could adversely affect U.S. Bancorp's competitiveness or limit its business opportunities.

Investor sentiment. Changes in market sentiment toward financials that are negative may pose a risk to our price target.

Wells Fargo & Co. (WFC)

Local market risk. Wells Fargo & Company's earnings are sensitive to local market conditions, to overall economic conditions, and to interest rate movements. A significant change in economies local to its principal operations, in the U.S. economy, or in interest rates could produce an unexpected change in future earnings growth.

Geographic risk. Lending operations depend on the strength of the underlying industries. Banking operations are geographically concentrated in the company's home state of California.

Interest rate risk. A sustained low interest rate environment would tend to tighten net interest spreads and hurt profitability, thus creating risk to achieving our price target.

Competition. Substantial competition exists in Wells Fargo's primary markets from state and national banks, thrift institutions, foreign banks, finance companies, and other firms that provide financial and ancillary services.

Credit deterioration risk. Acceleration of credit deterioration could hurt earnings at Wells Fargo, especially given the large exposure to consumer loans.

Regulation. Banking regulations and regulatory intervention may change, or regulatory actions may be taken, that could adversely affect Wells Fargo's competitiveness or limit its business opportunities.

Investor sentiment. Changes in market sentiment toward financials that are negative may pose a risk to our price target.

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Selling Covered Calls--Selling calls on long stock position. Risk is that the stock will be called away at strike, limiting investor profit to strike plus premium received.

Selling Uncovered Calls--Unlimited risk that investors may experience losses much greater than premium received.

Selling Uncovered Puts--Significant risk that investors will experience losses much greater than premium income received.

Buying Vertical Spreads (Calls--long call and short call with higher strike; Puts--long put and short put with lower strike) Same expiration month for both options. Investors may lose the entire premium paid.

Buying Calendar Spreads (different expiration months with short expiration earlier than long). Investors may lose the entire premium paid.

Selling Call or Put Vertical Spreads (Calls--short call and long call with higher strike; Puts--short put and long put with a lower strike, same expiration month for both options.) Investors risk the loss of the difference between the strike prices, reduced by the premium received.

Buying Straddle--Buying a put and a call with the same underlying strike and expiration. Investors risk loss of the entire premium paid.

Selling Straddle--Sale of call and put with the same underlying strike and expiration.) Unlimited risk that investors will experience losses much greater than the premium income received.

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HOLD [Market Perform]	33.41%	8.03%
SELL [Underperform]	2.44%	0.00%

(1) As of midnight on the business day immediately prior to the date of this publication.

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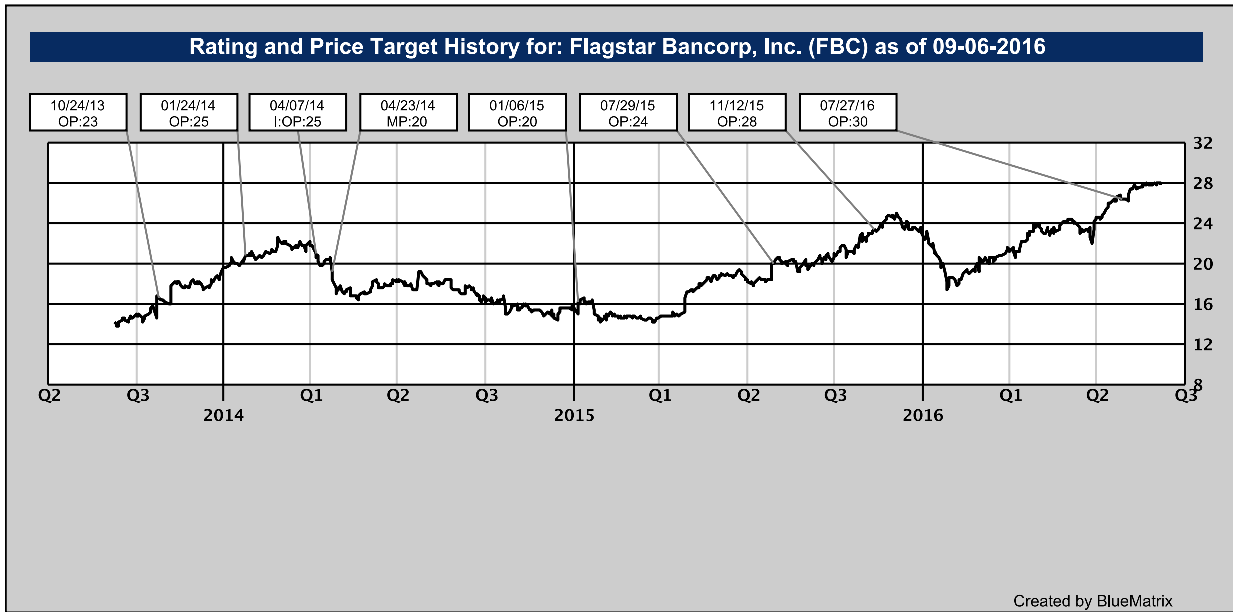
Rating and Price Target History for: Flagstar Bancorp, Inc. (FBC) as of 09-06-2016
10/24/13
OP:23
01/24/14
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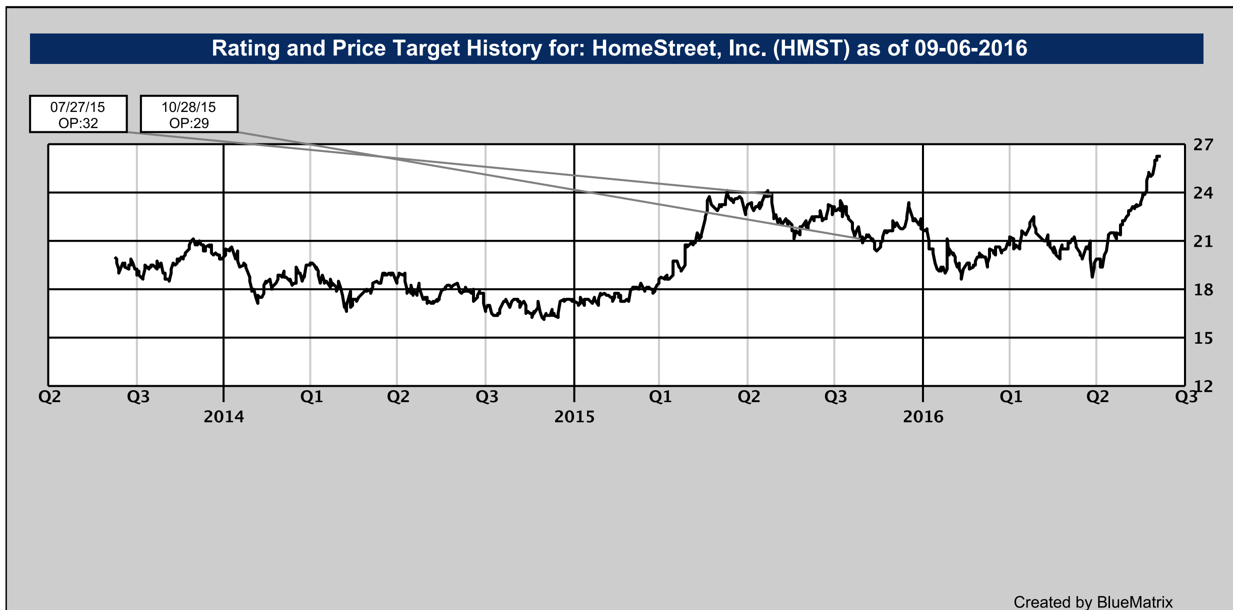
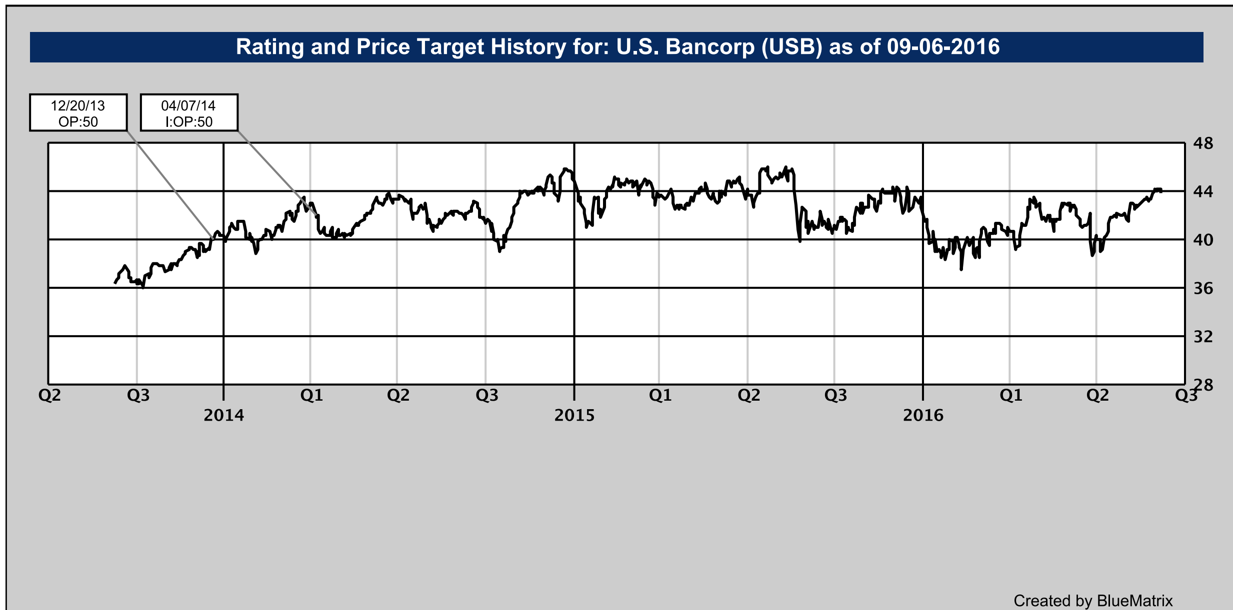
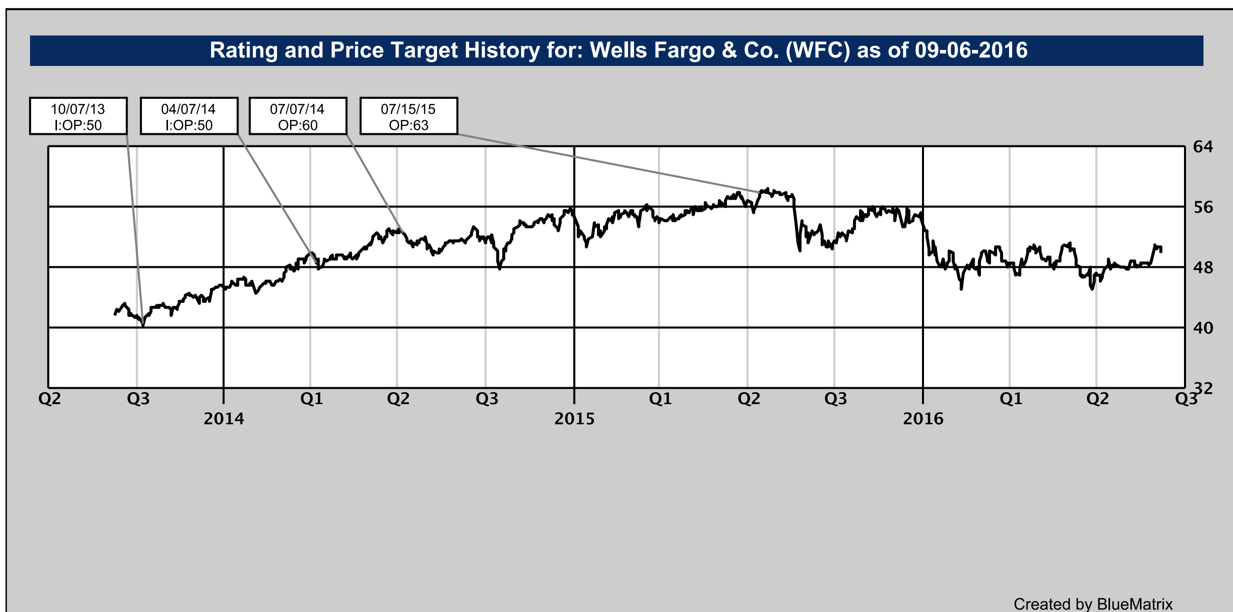
Q2
Q3
Q1
Q2
Q3
Q1
Q2
Q3
2014
2015
2016
Created by BlueMatrix


Rating and Price Target History for: HomeStreet, Inc. (HMST) as of 09-06-2016
07/27/15
OP:32
10/28/15
OP:29
27
24
21
18
15
12
Q2
Q3
Q1
Q2
Q3
Q1
Q2
Q3
Q1
Q2
Q3
2014
2015
2016
Created by BlueMatrix



Rating and Price Target History for: U.S. Bancorp (USB) as of 09-06-2016
12/20/13
OP:50
04/07/14
I:OP:50
48
44
40
36
32
28
Q2
Q3
Q1
Q2
Q3
Q1
Q2
Q3
Q1
Q2
Q3
2014
2015
2016
Created by BlueMatrix



Rating and Price Target History for: Wells Fargo & Co. (WFC) as of 09-06-2016
10/07/13
I:OP:50
04/07/14
I:OP:50
07/07/14
OP:60
07/15/15
OP:63
64
56
48
40
32
Q2
Q3
Q1
Q2
Q3
Q1
Q2
Q3
Q1
Q2
Q3
2014
2015
2016
Created by BlueMatrix