First Financial Northwest, Inc.
Form 10-K
March 10, 2009

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Fiscal Year Ended December 31, 2008

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission File Number: 000-33652

FIRST FINANCIAL NORTHWEST, INC.
(Exact name of registrant as specified in its charter)

Washington (State or other jurisdiction of incorporation or organization)	26-0610707 (I.R.S. Employer Identification Number)
201 Wells Avenue South, Renton, Washington (Address of principal executive offices)	98057 (Zip Code)

Registrant's telephone number, including area code: (425) 255-4400

Securities registered pursuant to Section 12(b) of the Act:

Common Stock, $.01 par value per share (Title of Each Class)	The Nasdaq Stock Market LLC (Name of Each Exchange on Which Registered)

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
YES NO X

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
YES NO X

Indicate by check mark whether the Registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES

X NO ____

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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 definitions of Alarge accelerated filer,@ Aaccelerated filer@ and smaller reporting company in Rule 12b-2 of the Exchange Act (Check one):

Large accelerated filer	Accelerated filer X	Non-accelerated filer	Smaller reporting company ____

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Act).
YES NO X

The aggregate market value of the Common Stock outstanding held by nonaffiliates of the Registrant based on the closing sales price of the Registrant=s Common Stock as quoted on The Nasdaq Stock Market LLC on June 30, 2008 was $223,411,604 (22,498,651) shares at $9.93 per share). For purposes of this calculation, common stock held only by executive officers and directors of the Registrant is considered to be held by affiliates. As of March 3, 2009, the Registrant had outstanding 20,542,520 shares of common stock.

DOCUMENTS INCORPORATED BY REFERENCE

1. Portions of Registrant's Definitive Proxy Statement for the 2009 Annual Meeting of Shareholders (Part III).

FIRST FINANCIAL NORTHWEST, INC.
2008 ANNUAL REPORT ON FORM 10-K

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Forward-Looking Statements

"Safe Harbor" statement under the Private Securities Litigation Reform Act of 1995: This Form 10-K contains certain "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements may be identified by the use of words such as "believe," "expect," "anticipate," "should," "planned," "estimated," and "potential." These forward-looking statements relate to, among other things, expectations of the business environment in which we operate, projections of future performance, perceived opportunities in the market, potential future credit experience, and statements regarding our strategies. These forward-looking statements are based upon current management expectations and may, therefore, involve risks and uncertainties. Our actual results, performance, or achievements may differ materially from those suggested, expressed, or implied by forward-looking statements as a result of a wide variety or range of factors including, but not limited to: the credit risks of lending activities, including changes in the level and trend of loan delinquencies and write-offs that may be impacted by deterioration in the housing and commercial real estate markets and may lead to increased losses and nonperforming assets in our loan portfolio, and may result in our allowance for loan losses not being adequate to cover actual losses, and require us to materially increase our reserves; changes in general economic conditions, either nationally or in our market areas; changes in the levels of general interest rates, and the relative differences between short and long term interest rates, deposit interest rates, our net interest margin and funding sources; fluctuations in the demand for loans, the number of unsold homes and other properties and fluctuations in real estate values in our market areas; results of examinations of us by the Office of Thrift Supervision and our bank subsidiary by the Federal Deposit Insurance Corporation, the Washington State Department of Financial Institutions, Division of Banks or other regulatory authorities, including the possibility that any such regulatory authority may, among other things, require us to increase our reserve for loan losses, write-down assets, change our regulatory capital position or affect our ability to borrow funds or maintain or increase deposits, which could adversely affect our liquidity and earnings; our ability to control operating costs and expenses; the use of estimates in determining fair value of certain of our assets, which estimates may prove to be incorrect and result in significant declines in valuation; difficulties in reducing risk associated with the loans on our balance sheet; staffing fluctuations in response to product demand or the implementation of corporate strategies that affect our work force and potential associated charges; computer systems on which we depend could fail or experience a security breach; our ability to retain key members of our senior management team; costs and effects of litigation, including settlements and judgements; our ability to implement our branch expansion strategy; our ability to successfully integrate any assets, liabilities, customers, systems, and management personnel we have acquired or may in the future acquire into our operations and our ability to realize related revenue synergies and cost savings within expected time frames and any goodwill charges related thereto; our ability to manage loan delinquency rates; our ability to retain key members of our senior management team; costs and effects of litigation, including settlements and judgments; increased competitive pressures among financial services companies; changes in consumer spending, borrowing and savings habits; legislative or regulatory changes that adversely affect our business including changes in regulatory polices and principles, including the interpretation of regulatory capital or other rules; the availability of resources to address changes in laws, rules, or regulations or to respond to regulatory actions; adverse changes in the securities markets; inability of key third-party providers to perform their obligations to us; changes in accounting policies and practices, as may be adopted by the financial institution regulatory agencies or the Financial Accounting Standards Board, including additional guidance and interpretation on accounting issues and details of the implementation of new accounting methods; the economic impact of war or any terrorist activities; other economic, competitive, governmental, regulatory, and technological factors affecting our operations; pricing, products and services; and other risks detailed in our reports filed with the Securities and Exchange Commission. Any of the forward-looking statements that we make in this Form 10-K and in the other public statements we make may turn out to be wrong because of the inaccurate assumptions we might make, because of the factors illustrated above or because of other factors that we cannot foresee. Because of these and other uncertainties, our actual future results may be materially different from those expressed in any forward-looking statements made by or on our behalf. Therefore, these factors should be considered in evaluating the forward-looking statements, and undue reliance should not be placed on such statements. We undertake no responsibility to update or revise any forward-looking statements.

As used throughout this report, the terms "we", "our", or "us" refer to First Financial Northwest, Inc. and our consolidated subsidiaries.

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Internet Website

We maintain a website with the address www.fsbnw.com. The information contained on our website is not included as a part of, or incorporated by reference into, this Annual Report on Form 10-K. Other than an investor's own Internet access charges, we make available free of charge through our website, our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to these reports, on our investor information page. These reports are posted as soon as reasonably practicable after they are electronically filed with the Securities and Exchange Commission ("SEC"). All of our SEC filings are also available free of charge at the SEC's website at www.sec.gov or by calling the SEC at 1-800-SEC-0330.

PART I

Item 1. Business

General

First Financial Northwest, Inc. ("First Financial Northwest"), a Washington corporation, was formed on June 1, 2007 for the purpose of becoming the holding company for First Savings Bank Northwest ("First Savings Bank") in connection with the conversion from a mutual holding company structure to a stock holding company structure. The mutual to stock conversion was completed on October 9, 2007 through the sale and issuance of 22,852,800 shares of common stock by First Financial Northwest including 1,692,800 shares contributed to our charitable foundation the First Financial Northwest Foundation, Inc. that was established in connection with the mutual to stock conversion. At December 31, 2008, we had total assets of $1.2 billion, total deposits of $791.5 million and total stockholders' equity of $290.1 million. First Financial Northwest's business activities generally are limited to passive investment activities and oversight of its investment in First Savings Bank. Accordingly, the information set forth in this report, including consolidated financial statements and related data, relates primarily to First Savings Bank.

First Savings Bank was organized in 1923 as a Washington state chartered savings and loan association, converted to a federal mutual savings and loan association in 1935, and converted to a Washington state chartered mutual savings bank in 1992. In 2002, First Savings Bank reorganized into a two-tier mutual holding company structure, became a stock savings bank and became the wholly-owned subsidiary of First Financial of Renton. In connection with the conversion, First Savings Bank changed its name to "First Savings Bank Northwest."

First Savings Bank is examined and regulated by the Washington Department of Financial Institutions, its primary regulator, and by the Federal Deposit Insurance Corporation. First Savings Bank is required to have certain reserves set by the Board of Governors of the Federal Reserve System and is a member of the Federal Home Loan Bank of Seattle, which is one of the 12 regional banks in the Federal Home Loan Bank System.

First Savings Bank is a community-based savings bank primarily serving King and to a lesser extent, Pierce, Snohomish and Kitsap counties, Washington through our full-service banking office located in Renton, Washington. We are in the business of attracting deposits from the public and utilizing those deposits to originate one-to-four family, multifamily, construction/land development, commercial real estate and consumer loans. Our recent business strategy has included an increased emphasis on the expansion of multifamily and commercial real estate lending as well as lending to businesses. Consistent with the strategy, on December 30, 2005 we completed our acquisition of Executive House, Inc., a mortgage banking company, in a cash acquisition for approximately $15.0 million. Prior to the acquisition, in the normal course of business, we purchased loans from Executive House for which Executive House maintained the servicing rights.

During 2006 and 2007, we continued to operate Executive House as a separate subsidiary, primarily originating loans on behalf of First Savings Bank. Effective January 1, 2008, the lending operations of Executive House were assumed by First Savings Bank, creating a commercial lending division within First Savings Bank.

At December 31, 2008, $250.5 million or 22.0% of our total loan portfolio consisted of construction/land development loans and $260.7 million or 22.9% of our total loan portfolio consisted of commercial real estate loans, including commercial real estate construction loans of $28.9 million. At that date, $100.9 million or 8.9% of our total loan portfolio consisted of multifamily residential real estate loans. Included in our construction/land development and one-to-four family residential loan portfolios was $81.9 million and $75.9 million of total loans, respectively to our five largest borrowing relationships. In addition, $44 million, net of undisbursed funds of the construction/land development portfolio was classified as nonperforming. See "Item 1A. Risk Factors B Risks Related to our Business B The lack of diversification in our loan portfolio may hurt both our asset quality and profits."

We also originate mortgage loans secured by one-to-four family residential real estate and consumer loans. At December 31, 2008, $512.4 million or 45.1% of our total loan portfolio was comprised of one-to-four family loans and $12.9 million or 1.1% of our total loan portfolio were consumer loans.

The principal executive offices of First Savings Bank are located at 201 Wells Avenue South, Renton, Washington, 98057 and its telephone number is (425) 255-4400.

Market Area

We consider our primary market area to be the Puget Sound Region, which consists primarily of King, Pierce, Kitsap and Snohomish counties. The economies of King, Pierce, Kitsap and Snohomish counties performed well until late 2007 when signs of deterioration began to occur. Factors contributing to the deterioration were the loss of jobs at major employers including: JP Morgan (formerly Washington Mutual Bank), Boeing, Microsoft and Starbucks. The primary county we serve, King, is still outperforming the nation as a whole with unemployment at 5.7% in December 2008, compared with the national rate of 7.2% and a modest drop in home prices in 2008 with the median home price declining 5.5% compared to 9.3% drop nationally. The remaining counties served all have been adversely affected with unemployment ranging from 6.1% to 7.4% and a decrease in median home prices ranging from 7.0% to 8.7%. The reduction in growth in these markets has adversely affected the level of our construction/land development and commercial real estate lending. Recently, slower adverse housing market conditions and higher unemployment rates have resulted in an increase in delinquencies in our market area. For more information regarding loan delinquencies and impaired loans see "-Asset Quality."

King County has the largest population of any county in the State of Washington, covering approximately 2,134 square miles. It has a population of approximately 1.9 million residents according to the U.S. Census Bureau 2007 estimates, and a median household income of approximately $81,000 according to the 2008 U.S. Department of Housing and Urban Development estimates. King County has a diversified economic base with many industries including shipping and transportation, aerospace (Boeing) and computer technology and bio-tech industries. According to the Washington State Employment Security Department, the unemployment rate for King County increased to 5.7% at December 31, 2008 from 3.6% at December 31, 2007. Residential housing values depreciated in the King County market by 5.5% during the year ended 2008, with a median home price of $430,000 according to the Northwest Multiple Listing Service. Residential sales volumes decreased by 43% in 2008 as compared to 2007 as inventory levels are projected to be 10.5 months according to Realestats.

Pierce County has the second largest population of any county in the State of Washington, covering approximately 1,790 square miles. It has approximately 773,000 residents according to the U.S. Census Bureau 2007 estimates, and a median household income of approximately $66,000 according to the 2008 U.S. Department of Housing and Urban Development estimates. The Pierce County economy is diversified with the presence of military related government employment (Fort Lewis Army Base and McChord Air Force Base), transportation and shipping employment (Port of Tacoma), and aerospace related employment (Boeing). According to the Washington State Employment Security Department the unemployment rate for Pierce County increased to 7.4% at December 2008 from 4.7% December 2007. Residential housing values depreciated in the Pierce County market by 8.3% during the year ended 2008 with a median home price of $258,000 according to the Northwest Multiple Listing Service.

Snohomish County has the third largest population of any county in the State of Washington, covering approximately 2,090 square miles. It has approximately 677,000 residents according to the U.S. Census Bureau 2007 estimates, and a median household income of approximately $81,000 according to the 2008 U.S. Department of Housing and Urban Development estimates. The economy of Snohomish County is diversified with the presence of military related government employment (Everett Homeport Naval Base), aerospace related employment (Boeing) and retail trade. According to the Washington State Employment Security Department the unemployment rate for Snohomish County increased to 7.1% at December 2008 from 4.1% at December 2007. Residential housing values depreciated in the

Snohomish County market by 7.0% during the year ended 2008 with a median home price of $345,000 according to the Northwest Multiple Listing Service. Residential sales volumes decreased by 58% in 2008 as compared to 2007 as inventory levels are projected to be 20.4 months according to Realestas.

Kitsap County has the fifth largest population of any county in the state of Washington, covering approximately 566 square miles. It has approximately 237,000 residents according to the U.S. Census Bureau 2007 estimates, and a median household income of approximately $70,000 according to the 2008 U.S. Department of Housing and Urban Development estimates. The Kitsap County economy is diversified with the presence of military related government employment (Naval Base Kitsap, Puget Sound Naval Shipyard), health care, retail and education. According to the Washington State Employment Security Department, the unemployment rate for Kitsap County increased to 6.1% at December 2008 from 4.2% in December 2007. Residential housing values depreciated in the Kitsap County housing market by 8.7% in the year ended 2008 with a median home price of $265,000 according to Northwest Multiple Listing Service.

For a discussion regarding the competition in our primary market area, see "B Competition."

Lending Activities

General. We focus our lending activities primarily on loans secured by first mortgages on one-to-four family residences, commercial real estate, multifamily real estate, and construction/land development loans. We offer a limited variety of consumer secured loans, including savings account loans and home equity loans, which includes lines of credit and second mortgage loans. As of December 31, 2008, our net loan portfolio totaled $1.0 billion and represented 83.2% of our total assets.

Our loan policy limits the maximum amount of loans we can make to one borrower to 20% of First Savings Bank=s risk-based capital. As of December 31, 2008, the maximum amount which we could lend to any one borrower was $40.0 million based on our policy. Exceptions may be made to this policy with the prior approval of the Board of Directors if the borrower exhibits financial strength or compensating factors to sufficiently offset any weaknesses based on the loan-to-value ratio, borrower=s financial condition, net worth, credit history, earnings capacity, installment obligations, and current payment habits. The five largest borrowing relationships as of December 31, 2008 in descending order are:

Borrower	Aggregate Amount of Loans (1)(5) December 31, 2008	Number of Loans	Aggregate Amount of Loans (1) December 31, 2007	Number of Loans
Real estate builder	$ 47.3 million	131	$ 40.0 million	96
Real estate builder	37.2 million	132	40.5 million	138
Real estate builder	29.0 million	103	27.5 million	97
Real estate builder	25.2 million (2)	88	28.0 million (4)	98
Real estate builder	19.1 million (3)	100	19.7 million	128
Total	$157.8 million		$155.7 million	

(1) Net of loans in process.
(2) Of this amount, $20.8 million consisted of impaired loans.
(3) Of this amount, $7.7 million consisted of impaired loans.

(4) Of this amount, $23.5 million consisted of impaired loans.
(5) The collateral for the above loans consists of residential properties and developed land.

All of the loans to these five builders have personal guarantees in place as an additional source of repayment including those made to partnerships or corporations and First Savings Bank is in the first lien position. All of the properties securing these loans were in our geographic market area.

The following table details the breakdown of the types of loans to our top five builder relationships.

Borrower	Permanent Loans on One-to-Four Family Residential Loans (Rental Properties)	Construction/Land Development	Aggregate Amount of Loans December 31, 2008
Real estate builder	$15.9 million	$31.4 million	$ 47.3 million
Real estate builder	21.1 million	16.1 million	37.2 million
Real estate builder	18.6 million	10.4 million	29.0 million
Real estate builder	13.5 million	11.7 million	25.2 million
Real estate builder	6.8 million	12.3 million	19.1 million
Total	$75.9 million	$ 81.9 million	$157.8 million

The builders listed in the above tables, as part of their business strategy, retain a certain percentage of their finished homes in their own inventory of permanent investment properties, (i.e. one-to-four rental properties). These properties are used to enhance the builders= liquidity through rental income and improve their equity through the appreciation in market value of the property. As part of our underwriting process we review the borrowers' business strategy to determine the feasibility of the project. Although this has been included in these builders' business strategy prior to the economic crises that we are facing, these builders have taken more rental properties into their portfolio in 2008 than originally planned as a result of the sluggish housing market. In total, these five builders added 88 loans totaling $21.7 million to their rental portfolio in 2008 as compared to 82 loans with a dollar amount totaling $17.7 million in 2007. Included in the 2008 amount were eight loans that were still in the construction phase with undisbursed funds totaling $513,000, which when they were originated, the intent was to turn these into rental properties. In 2008, we had two builders with smaller borrowings not included in the table above, that we have made permanent fixed-rate one-to-four family loans to and paid-off the construction loans that we held so that the builder could rent out the homes in order to enhance their cash flow. There were five loans with a total balance of $3.9 million.

The following table includes construction/land development loans, net of loans in process, by the four counties that contain our largest loan concentrations at December 31, 2008:

County	Loan Balance (1)	Percent of Loan Balance (1)
King County	$82.9 million	44.4%
Pierce County	42.1 million	22.5
Kitsap County	19.2 million	10.3
Snohomish County	13.6 million	7.3

All other counties	29.0 million	15.5
Total	$186.8 million	100.0%

(1) Net of loans in process.

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Loan Portfolio Analysis. The following table sets forth the composition of First Savings Bank's loan portfolio by type of loan at the dates indicated.

	At December 31,								
	2008		2007		2006		2005		
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amou
	(Dollars in thousands)								
family residential	$ 512,446	45.05%	$ 424,863	42.45%	$ 373,192	48.86%	$ 266,081	43.18%	$ 231,5
residential	100,940	8.87	76,039	7.60	79,701	10.44	68,267	11.08	61,9
	260,727	22.92	204,798	20.46	153,924	20.15	109,300	17.73	86,5
/land development	250,512	22.02	288,378	28.82	153,401	20.08	171,246	27.79	25,2
	1,124,625	98.86	994,078	99.33	760,218	99.53	614,894	99.78	405,2
	12,566	1.11	6,368	0.64	3,038	0.40	915	0.15	9
	205	0.02	127	0.01	296	0.04	209	0.03	5
	156	0.01	177	0.02	203	0.03	217	0.04	4
	12,927	1.14	6,672	0.67	3,537	0.47	1,341	0.22	1,9
	1,137,552	100.00%	1,000,750	100.00%	763,755	100.00%	616,235	100.00%	407,1
	82,541		108,939		58,731		71,532		19,7
n									
	2,848		3,176		2,725		2,357		2,3
r loan losses	16,982		7,971		1,971		1,651		9
ple,									
	$ 1,035,181		$ 880,664		$ 700,328		$ 540,695		$ 384,1

The following table shows the composition of First Savings Bank's loan portfolio by fixed and adjustable rate loans at the dates indicated.

	At December 31,								
	2008		2007		2006		2005		200
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount
ATE LOANS					(Dollars in thousands)				
e:									
our family residential	$ 506,288	44.50	$ 417,820	41.75%	$ 365,868	47.90%	$ 264,790	42.97%	$ 230,222
ily residential	99,510	8.75	75,748	7.57	78,331	10.26	63,093	10.24	61,401
cial	245,447	21.58	183,922	18.38	151,557	19.84	100,730	16.34	83,857
tion/ land development	20,689	1.82	3,928	0.39	11,892	1.56	125,287	20.33	15,072
eal	871,934	76.65	681,418	68.09	607,648	79.56	553,900	89.88	390,552
:									
	3,385	0.30	2,217	0.22	2,151	0.28	915	0.15	932
	--	--	--	--	--	--	209	0.03	553
	103	0.01	177	0.02	203	0.03	217	0.04	419
	3,488	0.31	2,394	0.24	2,354	0.31	1,341	0.22	1,904
l-rate	875,422	76.96	683,812	68.33	610,002	79.87	555,241	90.10	392,456
ABLE RATE LOANS									
e:									
our family residential	6,158	0.54	7,043	0.70	7,324	0.96	1,291	0.21	1,332
ily residential	1,430	0.13	291	0.03	1,370	0.18	5,174	0.84	512
cial	15,280	1.34	20,876	2.09	2,367	0.31	8,570	1.39	2,701
tion/land development	229,823	20.20	284,450	28.42	141,509	18.53	45,959	7.46	10,192
eal	252,691	22.21	312,660	31.24	152,570	19.98	60,994	9.90	14,737
:									
	9,181	0.81	4,151	0.42	887	0.11	--	--	--
	205	0.02	127	0.01	296	0.04	--	--	--
	53	--	--	--	--	--	--	--	--
	9,439	0.83	4,278	0.43	1,183	0.15	--	--	--
stable rate loans	262,130	23.04	316,938	31.67	153,753	20.13	60,994	9.90	14,737
s	1,137,552	100.00%	1,000,750	100.00%	763,755	100.00%	616,235	100.00%	407,193

	82,541	108,939	58,731	71,532	19,762
loan	2,848	3,176	2,725	2,357	2,308
ce for loan losses	16,982	7,971	1,971	1,651	995
eivable, net	$ 1,035,181	$ 880,664	$ 700,328	$ 540,695	$ 384,128

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One-to-Four Family Residential Real Estate Lending. As of December 31, 2008, $512.4 million, or 45.1%, of our total loan portfolio consisted of permanent loans secured by one-to-four family residences.

First Savings Bank is a traditional fixed rate portfolio lender when it comes to financing residential home loans. In 2008, we originated $144.1 million in one-to-four family residential loans, most of which had fixed rates and fixed terms. Most of our residential loan originations are in connection with either the refinance of an existing loan or the conversion from a construction loan to a one-to-four family residential loan that the builder utilizes for leasing purposes as part of their operating strategy. At December 31, 2008, $300.4 million or 58.6% of our one-to-four family residential portfolio consisted of owner occupied loans with $212.1 million or 41.4% in non-owner occupied loans. In addition, at December 31, 2008 $506.3 million, or 98.8%, of our one-to-four family residential mortgage loan portfolio consisted of fixed rate loans. Substantially all of our one-to-four family residential mortgage loans require both monthly principal and interest payments.

We also originate a limited number of jumbo fixed rate loans that we retain for our portfolio. Loans originated with balances greater than $417,000 are generally considered jumbo except those originated in King, Pierce and Snohomish Counties where the threshold for purchase by Freddie Mac and Fannie Mae was increased in 2008 to $567,500. One-to-four family residential loans with outstanding balances in excess of $417,000 totaled $118.6 million which included 174 loans at December 31, 2008. The loans in this portfolio have been priced at rates of 0.50% to 1.00% higher than the standard rates quoted on conventional loans. As of December 31, 2008, $3.8 million of our jumbo loan portfolio was over 90 days past due there were no loans past due over 60 days but less then 90 days. The remaining loans in the jumbo loan portfolio were performing in accordance with their loan repayment terms.

Our fixed-rate, single family residential mortgage loans are normally originated with 15 to 30 year terms, although such loans typically remain outstanding for substantially shorter periods, particularly in a declining interest rate environment. In addition, substantially all residential mortgage loans in our loan portfolio contain due-on-sale clauses providing that we declare the unpaid amount due and payable upon the sale of the property securing the loan. Typically, we enforce these due-on-sale clauses to the extent permitted by law and as a standard course of business. The average loan maturity is a function of, among other factors, the level of purchase and sale activity in the real estate market, prevailing interest rates and the interest rates payable on outstanding loans.

Our lending policies generally limit the maximum loan-to-value ratio on mortgage loans secured by owner-occupied properties to 95% of the lesser of the appraised value or the purchase price. We usually obtain private mortgage insurance on the portion of the principal amount that exceeds 90% of the appraised value of the secured property. The maximum loan-to-value ratio on mortgage loans secured by non-owner occupied properties is generally 80% on purchases and refinances with exceptions being approved by the loan committee. Properties securing our one-to-four family loans are appraised by independent fee appraisers approved by us. We require the borrowers to obtain title, hazard, and, if necessary, flood insurance. We generally do not require earthquake insurance because of competitive market factors.

Our construction loans to individuals to build their personal residences typically are structured as construction/permanent loans permitting one closing for both the construction loan and the permanent financing. Prior to making a commitment to fund a construction loan, we require an appraisal of the post construction value of the project by an independent fee appraiser. During the construction phase, which typically lasts for eight months, an approved fee inspector or our designated loan officer makes periodic inspections of the construction site and loan proceeds are disbursed directly to the contractor or borrower as construction progresses. Typically, disbursements are made in seven draws during the construction period. Construction loans require payment of interest only during the construction phase and are structured to be converted to fixed rate permanent loans at the end of the construction phase. At December 31, 2008, our total owner-occupied construction loans to individuals amounted to $10.2 million or 2.0% of the one-to-four family residential loan balance.

Loans secured by rental properties represent a unique credit risk to us and, as a result, we adhere to prudent underwriting guidelines. Of primary concern in non-owner occupied real estate lending is the consistency of rental income of the property. Payments on loans secured by rental properties often depend on the maintenance of the property and the payment of rent by its tenants. Payments on loans secured by rental properties often depend on successful operation and management of the properties. As a result, repayment of such loans may be subject to adverse conditions in the real estate market or the economy. To monitor cash flows on rental properties, we generally require borrowers and loan guarantors, if any, to provide annual financial statements and we consider and review a rental income cash flow analysis of the borrower and consider the net operating income of the property, the borrower=s expertise, credit history and profitability, and the value of the underlying property. We generally require collateral on these loans to be a first mortgage along with an assignment of rents and leases. If the borrower has multiple loans for rental properties with us, the loans are typically not cross-collateralized.

Residential mortgage loans up to $1.5 million are approved by the loan committee which consists of any two of the following individuals: the Chief Executive Officer/President, the Chief Lending Administrative Officer, the Chief Lending Production Officer and a loan officer at an Assistant Vice President level or higher. Loans in excess of $1.5 million and up to $3.0 million are approved by the Executive Committee which is comprised of the Chief Executive Officer and two outside directors. Loans in excess of $3.0 million require the approval of the full Board of Directors. At December 31, 2008, $9.0 million of our one-to-four family residential loans were delinquent in excess of 90 days or in nonaccrual status. No one-to-four family residential loans were charged-off during the years ended December 31, 2008, 2007 and 2006.

Multifamily and Commercial Real Estate Lending. We have originated multifamily and commercial real estate loans for over 35 years and enhanced this lending sector with our acquisition of Executive House.

Multifamily and commercial real estate loans up to $3.0 million are approved by the loan committee which consists of any two of the following individuals: the Chief Executive Officer/President, the Chief Lending Administrative Officer, the Chief Lending Production Officer and loan officers as appointed by the Board of Directors. Loans in excess of $3.0 million and up to $5.0 million are approved by the Executive Committee, which consists of the Chief Executive Officer and two outside directors. Loans in excess of $5.0 million require the approval of the full Board of Directors. As of December 31, 2008, $100.9 million, or 8.9% of our total loan portfolio was secured by multifamily real estate, and $260.7 million, or 22.9% or our loan portfolio was secured by commercial real estate property. Our commercial real estate loans are typically secured by office and medical buildings, retail shopping centers, mini-storage facilities, industrial use buildings, and warehouses. Substantially all of our multifamily and commercial real estate loans are secured by properties located in our market area.

We actively pursue multifamily and commercial real estate loans. These loans generally are priced at a higher rate of interest than one-to-four family residential loans. Typically, these loans have higher loan balances, are more complex to evaluate and monitor, and involve a greater degree of risk than one-to-four family residential loans. Often payments on loans secured by multifamily or commercial properties are dependent on the successful operation and management of the property; therefore, repayment of these loans may be affected by adverse conditions in the real estate market or the economy. We generally require and obtain loan guarantees from financially capable parties based upon the review of personal financial statements. If the borrower is a corporation or partnership, we generally require and obtain personal guarantees from the principals based upon a review of their personal financial statements and individual credit reports.

The average loan size in our multifamily and commercial real estate loan portfolios was $827,000 and $988,000, respectively as of December 31, 2008. We also target individual multifamily and commercial real estate loans between $1.0 million and $5.0 million; however, we can by policy originate loans to one borrower up to 20% of First Savings Bank's risk-based capital. The largest multifamily loan as of December 31, 2008 was a 72 unit apartment complex with a net outstanding principal balance at December 31, 2008 of $5.2 million located in Pierce County. As of December 31, 2008, the largest single commercial real estate loan had a net outstanding balance of $2.5 million and was secured by a mini-storage facility located in King County. These loans were performing according to their respective loan repayment terms.

We also make construction loans to owners for commercial development projects. The projects include multifamily, apartment, retail, office/warehouse and office buildings. These loans generally have an interest-only phase during construction, and generally convert to permanent financing when construction is completed. Disbursement of funds is at our sole discretion and is based on the progress of construction. The maximum loan-to-value limit applicable to these loans is 75% of the appraised post-construction value. At December 31, 2008, construction loans amounted to $30.0 million or 8.3% of the combined multifamily and commercial real estate loan portfolio.

The credit risk related to multifamily and commercial real estate loans is considered to be greater than the risk related to one-to-four family residential or consumer loans because the repayment of multifamily and commercial real estate loans typically is dependent on the income stream of the real estate securing the loan as collateral and the successful operation of the borrower's business, which can be significantly affected by adverse conditions in the real estate markets or in the economy generally. For example, if the cash flow from the borrower=s project is reduced due to leases not being obtained or renewed, the borrower's ability to repay the loan may be impaired. In addition, many of our multifamily and commercial real estate loans are not fully amortizing and contain large balloon payments upon maturity. These balloon payments may require the borrower to either sell or refinance the underlying property in order to make the balloon payment.

If we foreclose on a multifamily or commercial real estate loan, our holding period for the collateral typically is longer than for one-to-four family residential mortgage loans because there are fewer potential purchasers of the collateral. Additionally, as a result of our increasing emphasis on this type of lending, a large portion of our multifamily and commercial real estate loan portfolio is relatively unseasoned and has not been subjected to unfavorable economic conditions. As a result we may not have enough payment history with which to judge future collectibility or to predict the future performance of this part of our loan portfolio. These loans may have delinquency or charge-off levels above our historical experience, which could adversely affect our future performance. Further, our multifamily and commercial real estate loans generally have relatively large balances to single borrowers or related groups of borrowers. Accordingly, if we make any errors in judgment in the collectibility of our commercial real estate loans, any resulting charge-offs may be larger on a per loan basis than those incurred with our one-to-four family residential or consumer loan portfolios. At December 31, 2008, no multifamily loans were delinquent in excess of 90 days or in nonaccrual status. Six commercial real estate loans totaling $3.8 million were 90 days or more delinquent or in nonaccrual status at December 31, 2008. No multifamily or commercial real estate loans were charged-off during the years ended December 31, 2008, 2007 and 2006.

Construction/Land Development Loans. Since we initially established a lending relationship in 1977 with Executive House we have been an originator of construction/land development loans to residential builders for the construction of single-family residences, condominiums, townhouses and residential developments located in our market area. Beginning in 2005 we significantly increased this lending portfolio through loans purchased from Executive House as part of our strategy to diversify our loan portfolio, ultimately leading to our decision to acquire Executive House later that year. Effective January 1, 2008, Executive House=s lending operations were assumed by First Savings Bank, creating a commercial lending division for First Savings Bank. At December 31, 2008, our one- to-four family total construction/land development loans amounted to $250.5 million, or 22.0%, of our total loan portfolio. At December 31, 2008, our residential construction lending and land development loans to builders amounted to approximately $145.3 million, and $90.5 million, respectively. The $37.9 million decrease in this portfolio from December 31, 2007 to December 31, 2008 was the result of First Savings Bank placing less emphasis on this type of lending during 2008 due to the economic environment and the desire to concentrate on existing loan customers. Our construction/land development loan portfolio has experienced the highest delinquency rate as well as has the largest amount of nonperforming loans as compared to other types of loans within our loan portfolio. Construction/land development loans over 60 days past due and classified as nonperforming totaled $44.0 million. Our land development loans are generally made to builders intending to develop lots for their own use at a later date. The remaining $14.6 million balance of our construction/land development loans consisted of multifamily residential and commercial real estate construction loans. At December 31, 2008, the unadvanced portion of construction/land development loans in process amounted to $63.7 million.

At the dates indicated, the composition of our total construction/land development loan portfolio was as follows:

	At December 31, 2008	2007
	(In thousands)	
One-to-four family residential:		
Construction speculative	$ 145,329	$ 179,167
Multifamily residential:		
Construction speculative	13,322	13,322
Commercial:		
Construction speculative	1,324	1,324
Land development loans	90,537	94,565
Total construction/land development (1)(2)	$ 250,512	$ 288,378

(1) Loans in process for construction/land development at December 31, 2008 and 2007 were $63.7 million and $92.0 million, respectively.

(2) At December 31, 2008, we had an additional $12.9 million, or 2.5% of our total one-to-four family loan portfolio in construction loans on one-to-four family properties that we anticipate will convert to permanent loans when they are finished, which are classified in the one-to-four family category. Also at that date, we had an additional $28.9 million, or 11.1% of our total commerical real estate loan portfolio in construction loans on commercial real estate that we anticipate will convert to permanent loans, which are classified as commercial real estate loans. We had one multifamily construction loan totaling $1.1 million that we anticipate will convert to a permanent loan at December 31, 2008. Loans in process for these loans at December 31, 2008 were $17.5 million.

We originate construction/land development loans to contractors and builders primarily to finance the construction of single-family homes and subdivisions, which homes typically have an average price ranging from $300,000 to $550,000. Loans to finance the construction of single-family homes and subdivisions are generally offered to builders in our primary market areas. The maximum loan-to-value limit applicable to these loans is generally 75% to 80% of the appraised market value upon completion of the project. We do not require any cash equity from the borrower if there is sufficient equity in the land being used as collateral. Development plans are required from builders prior to making the loan. We require that builders maintain adequate insurance coverage. While maturity dates for residential construction loans are largely a function of the estimated construction period of the project, and generally do not exceed one year, land development loans generally are for 18 to 24 months. Substantially all of our residential construction loans have adjustable rates of interest based on The Wall Street Journal Prime Rate. As a strategy to manage interest rate risk, during the latter part of 2008 we established interest rate floors on most construction/land development loans that were renewed. During the term of construction, the accumulated interest on the loan is either added to the principal of the loan through an interest reserve, or billed monthly. We have interest reserves on $38.4 million of our construction spec loans, with undisbursed funds totaling $15.7 million. When these loans with reserves exhaust their original reserves set up at origination, no new reserves are created for the loan unless the loan is re-analyzed and it is determined that there are funds available to fund the reserve. This may include the borrower agreeing to reduce their profit margin. Construction loan proceeds are disbursed periodically in increments as construction progresses and as inspection by our approved inspectors warrant. Total loan amounts for land development loans generally range from $500,000 to $6.0 million with an average individual loan commitment at December 31, 2008 of $2.4 million. At December 31, 2008, our largest construction/land development loan had a total principal balance of $13.2 million and was secured by a first mortgage lien. This loan was performing according to its original terms at December 31, 2008. At December 31, 2008, our three largest borrowing relationships for construction/land development loans had aggregate net outstanding loan balances of $31.4 million, $16.1 million and $14.8 million. These balances do not include other lending relationships we may have with these borrowers.

Our construction/land development loans are based upon estimates of costs and values associated with the completed project. Construction/land development lending involves additional risks when compared with permanent residential lending because funds are advanced upon the security of the project, which is of uncertain value prior to its completion. Because of the uncertainties inherent in estimating construction costs, as well as the market value of the completed project and the effects of governmental regulation of real property, it is relatively difficult to evaluate accurately the total funds required to complete a project and the related loan-to-value ratio. This type of lending also typically involves higher loan principal amounts and is often concentrated with a small number of builders. These loans often involve the disbursement of substantial funds with repayment substantially dependent on the success of the ultimate project and the ability of the borrower to sell or lease the property or obtain permanent take-out financing, rather than the ability of the borrower or guarantor to repay principal and interest. If our appraisal of the value of a completed project proves to be overstated, we may have inadequate security for the repayment of the loan upon completion of construction of the project and may incur a loss. At December 31, 2008, we had $44.0 million of construction/land development loans that were classified as nonaccrual and $35.7 million of those loans were in excess of 90 days delinquent. In addition, a total of $43.0 million construction/land development relationships to seven builders were considered impaired as of December 31, 2008. Construction/land development loans of $432,000 were charged-off during the year ended December 31, 2008, there were no charge-offs for the years ended December 31, 2007 and 2006. Further, as a result of the slowdown in the housing market during 2008, we have extended some of the construction loans to permit completion of the project or to allow the borrower additional time to market the underlying collateral. Most of these loans mature within 12 months. To the extent these loans are not further extended or the borrower cannot otherwise refinance with a third party lender our nonperforming construction loans may increase. For more information regarding loan delinquencies and impaired loans see AAsset Quality@ under Item 1.

Consumer Lending. We offer a limited variety of consumer loans to our customers, consisting primarily of home equity and savings account loans. Generally, consumer loans have shorter terms to maturity and higher interest rates than mortgage loans. Consumer loans are made with both fixed and variable interest rates and with varying terms. At December 31, 2008, consumer loans amounted to $12.9 million, or 1.1%, of the total loan portfolio.

At December 31, 2008, the largest component of the consumer loan portfolio consisted of home equity loans, primarily home equity lines of credit, which totaled $12.6 million, or 1.1%, of the total loan portfolio. Home equity loans are made for purposes such as the improvement of residential properties, debt consolidation and education expenses. The majority of these loans are secured by a first or second mortgage on residential property. The loan-to-value ratio is primarily 95% or less, when taking into account both the balance of the home equity loans and the first mortgage loan. Home equity lines of credit allow for a ten-year draw period. As of December 31, 2008 the undisbursed portion of the lines of credit totaled $6.7 million. The interest rate is tied to the prime rate as published in The Wall Street Journal, and may include a margin.

Consumer loans entail greater risk than do residential mortgage loans, particularly in the case of consumer loans that are unsecured or secured by rapidly depreciating assets such as automobiles. In these cases, any repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment of the outstanding loan balance as a result of the greater likelihood of damage, loss or depreciation. The remaining deficiency often does not warrant further substantial collection efforts against the borrower beyond obtaining a deficiency judgment. In addition, consumer loan collections are dependent on the borrower=s continuing financial stability, and are more likely to be adversely affected by job loss, divorce, illness or personal bankruptcy. Furthermore, the application of various federal and state laws, including federal and state bankruptcy and insolvency laws, may limit the amount that can be recovered on these loans. Home equity lines of credit have greater credit risk than one-to-four family residential mortgage loans because they are secured by mortgages subordinated to the existing first mortgage on the property, which we may or may not hold in our portfolio. We do not have private mortgage insurance coverage on these adjustable rate/loans. Adjustable rate loans may experience a higher rate of default in a rising interest rate environment due to the increase in payment amounts caused by the increase in interest rates as loan rates reset. If current economic conditions deteriorate for our borrowers and their home prices continue to fall, we may also experience higher credit losses from this loan portfolio. Since our home equity loans primarily consist of second mortgage loans, it is unlikely that we will be successful in recovering all, if any, portion of our

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loan principal amount outstanding in the event of a default. At December 31, 2008, no consumer loans were delinquent in excess of 90 days or in nonaccrual status. No consumer loans were charged-off during the years ended December 31, 2008, 2007 or 2006.

Loan Maturity and Repricing. The following table sets forth certain information at December 31, 2008 regarding the dollar amount of loans repricing or maturing in our portfolio based on their contractual terms to maturity, but does not include scheduled payments or potential prepayments. Loan balances do not include undisbursed loan proceeds, deferred loan fees and costs and allowance for loan losses.

	Within One Year	After One Year Through Three Years	After Three Years Through Five Years	After Five Years Through Ten Years	Beyond Ten Years	Total
			(In thousands)			
Real Estate:						
One-to-four family residential	$ 7,950	$ 35,406	$ 50,715	$ 206,671	$ 211,704	$ 512,446
Multifamily residential	1,312	7,905	29,357	57,436	4,930	100,940
Commercial	13,632	5,085	59,622	180,071	2,317	260,727
Construction/land development	223,090	27,422	--	--	--	250,512
Total real estate	245,984	75,818	139,694	444,178	218,951	1,124,625
Consumer:						
Home equity	9,896	368	35	2,222	45	12,566
Savings account	190	15	--	--	--	205
Other	97	28	31	--	--	156
Total consumer	10,183	411	66	2,222	45	12,927
Total	$ 256,167	$ 76,229	$ 139,760	$ 446,400	$ 218,996	$ 1,137,552

The following table sets forth the dollar amount of all loans due after December 31, 2009, which have fixed interest rates and have floating or adjustable interest rates.

	Fixed Rates	Floating or Adjustable Rates	Total
		(In thousands)	
Real Estate:			
One-to-four family residential	$ 502,699	$ 1,797	$ 504,496
Multifamily residential	99,347	281	99,628
Commercial	243,589	3,506	247,095
	17,490	9,932	27,422

Construction/land development						
Total real estate		863,125		15,516		878,641
Consumer:						
Home equity		2,325		345		2,670
Savings account		--		15		15
Other		59		--		59
Total consumer		2,384		360		2,744
Total	$	865,509	$	15,876	$	881,385

Loan Solicitation and Processing. The majority of our consumer and residential mortgage loan originations are generated through First Savings Bank and from time to time through outside brokers. We originate multifamily, commercial real estate and construction/land development loans primarily using First Savings Bank loan officers, with referrals coming from builders and existing customers.

Upon receipt of a loan application from a prospective borrower, we obtain a credit report and other data to verify specific information relating to the loan applicant=s employment, income, and credit standing. All real estate loans requiring an appraisal are done by an independent third-party appraiser. All appraisers are approved by us, and their credentials are reviewed annually, as is the quality of their appraisals.

We use a multi-tier lending matrix depending on the type and size of the consumer credit to be approved. We also allow for individual lending authorities, joint lending authorities, a management loan committee approval, and an executive committee (comprised of directors) approval.

We require title insurance on all real estate loans, and fire and casualty insurance on all secured loans and on home equity loans where the property serves as collateral.

Loan Originations, Servicing, Purchases, Sales and Repayments. For the years ended December 31, 2008 and 2007, our total loan originations were $296.3 million and $434.4 million, respectively. Total loan originations declined as a result of the decrease in construction/land development loan originations reflecting the current housing market.

One-to-four family home loans are generally originated in accordance with the guidelines established by Freddie Mac and Fannie Mae, with the exception of our special community development loans under the Community Reinvestment Act. We originate residential first mortgages and service them using an in-house mortgage system. Our loans are underwritten by designated real estate loan underwriters internally in accordance with standards as provided by our Board-approved loan policy.

We may sell loans from time to time consistent with our asset and liability management objectives. Fixed rate residential mortgage loans with terms of 30 years or less and adjustable rate mortgage loans are generally held in our portfolio. There were no loan sales for the year ended December 31, 2008 and $5.8 million in loan sales for the year ended December 31, 2007. Loans are generally sold on a non-recourse basis. As of December 31, 2008, our loan servicing portfolio for outside investors was $52.5 million.

The following table shows total loans originated, purchased, sold and repaid during the periods indicated.

	Years Ended December 31, 2008	2007	2006
	(In thousands)		
Loans Originated:			
Real estate:			
One-to-four family residential	$ 144,128	$ 118,554	$ 126,179
Multifamily residential	33,183	10,005	12,666
Commercial	74,780	66,313	51,855
Construction/land development	33,331	233,656	118,367
Total real estate	285,422	428,528	309,067
Consumer:			
Home equity	10,657	5,874	3,099
Savings account	114	25	721
Other	107	--	35
Total consumer	10,878	5,899	3,855
Total loans originated	296,300	434,427	312,922
Loans purchased	30	25	6,130
Total whole loans sold	--	5,796	4,245
Principal repayments	159,021	191,690	167,287
Change in other items, net	17,208	(56,630)	12,113
Net increase in loans, net	$ 154,517	$ 180,336	$ 159,633

Loan Origination and Other Fees. In some instances, we receive loan origination fees on real estate related products. Loan fees generally represent a percentage of the principal amount of the loan that is paid by the borrower. The amount of fees charged to the borrower on one-to-four family residential loans and on multifamily and commercial real estate loans can range up to 1.5%. Generally accepted accounting principles require that certain fees received, net of certain origination costs, be deferred and amortized over the contractual life of the loan. Net deferred fees or costs associated with loans that are prepaid or sold are recognized in income at the time of prepayment. We had $2.8 million and $3.2 million of net deferred loan fees as of December 31, 2008 and 2007, respectively.

One-to-four family loans are generally originated without a prepayment penalty. The majority of multifamily and commercial real estate loans, however, have prepayment penalties associated with the loans. The majority of the recent multifamily and commercial real estate loan originations have a prepayment penalty of 3% in year one, 2% in year two, 1% in year three, and no fees after year three.

Asset Quality

As of December 31, 2008, we had an aggregate of $59.7 million, or 5.3%, of total loans past due over 60 days consisting of 32 one-to-four family residential loans, six commercial real estate loans, 122 construction/land development loans and one consumer loan. We generally assess late fees or penalty charges on delinquent loans of up to 5.00% of the monthly payment. The borrower is given up to a 15 day grace period to make the loan payment.

We generally send delinquent borrowers three consecutive written notices when the loan becomes 10, 15 and 45 days past due. Late charges are incurred when the loan becomes 10 to 15 days past due depending upon the loan product. We actively attempt to collect on delinquent loans when they are past due in excess of 60 days. If the loan is not brought current, we continually try to contact the borrower in writing until the account is brought current. When the loan is 90 days past due, we attempt to interview the borrower to determine the cause of the delinquency, and to obtain a mutually satisfactory arrangement to bring the loan current.

If the borrower is chronically delinquent and all reasonable means of obtaining payments have been exhausted, we will seek to recover the collateral securing the loan according to the terms of the security instrument and applicable law. The following table shows our delinquent loans by the type of loan, net of undisbursed funds, and number of days delinquent as of December 31, 2008:

	Loans Delinquent For: 61-90 Days		Over 90 Days		Total Delinquent Loans	
	Number of Loans	Principal Balance	Number of Loans	Principal Balance	Number of Loans	Principal Balance
			(Dollars in thousands)			
Real estate:						
One-to-four family residential	9	$ 2,450	23	$ 9,043	32	$ 11,493
Multifamily residential	--	--	--	--	--	--
Commercial	--	--	6	3,762	6	3,762
Construction/land development	11	8,674	108	35,739	119	44,413
Total real estate	20	11,124	137	48,544	157	59,668
Consumer:						
Home equity	1	50	--	--	1	50
Savings account	--	--	--	--	--	--
Other	--	--	--	--	--	--
Total consumer	1	50	--	--	1	50
Total	21	$ 11,174	137	$ 48,544	158	$ 59,718

Nonperforming Assets. The following table sets forth information with respect to our nonperforming assets and troubled debt restructured loans for the periods indicated.

	At December 31,				
	2008	2007	2006	2005	2004
	(Dollars in thousands)				
Loans accounted for on a nonaccrual basis:					
Real estate:					
One-to-four family residential	$ 9,630	$ 526	$ 154	$ 300	$ 265
Commercial	2,865	--	--	--	--
Construction/land development (1)	44,043	24,516	--	--	--
Total loans accounted for on a nonaccrual basis	$ 56,538	$ 25,042	$ 154	$ 300	$ 265
Accruing loans which are contractually due 90 days or more:					
One-to-four family residential	$ 1,207	$ --	$ --	$ --	$ --
Commercial real estate	897	--	--	--	--
Total accrual loans which are contractually due 90 days or more	$ 2,104	$ --	$ --	$ --	$ --
Repossessed assets	$ --	$ --	$ --	$ --	$ --
Real estate owned	--	--	--	--	--
Total nonperforming assets	$ 58,642	$ 25,042	$ 154	$ 300	$ 265
Troubled debt restructured loans	$ 23,044	$ --	$ --	$ --	$ --
Nonaccrual loans and loans 90 days or more past due as a percentage of total loans net of undisbursed funds	5.56%	2.81%	0.02%	0.05%	0.07%
Nonaccrual loans and loans 90 days or more past due net of undisbursed funds as a percentage of total assets	4.71%	2.19%	0.02%	0.03%	0.03%
Nonperforming assets net of undisbursed funds as a percentage of total assets	4.71%	2.19%	0.02%	0.03%	0.03%

Total loans net of undisbursed funds	$ 1,055,011	$ 891,811	$ 705,024	$ 544,703	$ 387,431
Nonaccrued interest (2)	$ 2,090	$ 391	$ 4	$ 4	$ 11
Total assets	$ 1,244,440	$ 1,140,888	$ 1,004,711	$ 879,650	$ 776,363

(1) Balances represent loans net of undisbursed funds.
(2) Represents foregone interest on nonaccural loans.

When a loan becomes 90 days delinquent, we generally place the loan on nonaccrual status unless the credit is well secured and is in the process of collection. Loans may be placed on nonaccrual status prior to being 90 days delinquent if there is an identified problem. As of December 31, 2008, nonaccrual loans and loans 90 days or more past due were $58.6 million, net of undisbursed funds, which represents 5.6% of total loans, net of undisbursed funds, and 4.7% of total assets. Of our nonperforming loans $44.0 million are to nine residential builders for projects secured by real estate in Washington. The undisbursed funds related to these loans totaled $14.5 million. Of the $44.0 million in construction/land development nonaccrual loans, $11.7 million is attributable to one builder of entry-level homes. The remaining $32.3 million of these loans is comprised of eight builders with the next largest nonperforming loan amount totaling $7.7 million. The real estate securing these loans is predominately located in

King and Pierce counties, Washington. We intend to work with our builders to reach acceptable payment plans while protecting our interests in the existing collateral. In the event an acceptable arrangement cannot be reached we may have to acquire these properties through foreclosure or other means and subsequently sell, develop or liquidate these properties.

The following table summarizes First Savings Bank=s total nonperforming assets at December 31, 2008 by county and by type of loan:

Nonperforming Assets By Type of Loan (Dollars in thousands)	King County	Pierce County	Kitsap County	Snohomish County	All Other Counties	Total Nonperforming Loans	Percent of Total Nonperforming Loans
One-to-four family residential	$ 1,544	$ 9,293	$ --	$ --	$ --	$ 10,837	18.48%
Commercial real estate	3,026	736	--	--	--	3,762	6.42
Construction/land development	26,435	5,732	396	6,864	4,616	44,043	75.10
Total nonperforming assets	$ 31,005	$ 15,761	$ 396	$ 6,864	$ 4,616	$ 58,642	100.00%

Construction/land development, commercial real estate and multifamily real estate loans have larger individual loan amounts, which have a greater single impact on the total portfolio quality in the event of delinquency or default. Further, we are closely watching our construction/land development loan portfolio, and believe there is a potential for significant additions to nonperforming loans, charge-offs, provisions for loan losses, and/or real estate owned in the future if the housing market conditions do not improve.

Real Estate Owned and Other Repossessed Assets. Real estate acquired by us as a result of foreclosure or by deed-in-lieu of foreclosure is classified as real estate owned until it is sold. When the property is acquired, it is recorded at the lower of its cost, which is the unpaid principal balance of the related loan plus foreclosure costs, or the fair market value of the property less selling costs. We had no real estate owned or repossessed assets as of December 31, 2008 and 2007.

Troubled Debt Restructured Loans. According to generally accepted accounting principles, we are required to account for certain loan modifications or restructuring as a Atroubled debt restructuring.@ In general, the modification or restructuring of a debt is considered a troubled debt restructuring if we, for economic or legal reasons related to the borrower=s financial difficulties, grant a concession to the borrowers that we would not otherwise consider. At December 31, 2008 we had $23.0 million in troubled debt restructured loans as compared to zero at the end of 2007. There are three relationships that are included in this classification. The largest relationship was $20.8 million and included both construction/land development loans as well as one-to-four family residential rental properties located in King and Pierce counties. At December 31, 2008, the amount of undisbursed funds to that builder in connection with the restructured and impaired loans totaled $5.3 million. We also had six residential loans that were classified as troubled debt restructured loans at December 31, 2008.

Classified Assets. Federal regulations provide for the classification of lower quality loans and other assets, as substandard, doubtful or loss. An asset is considered substandard if it is inadequately protected by the current net worth and payment capacity of the borrower or of any collateral pledged. Substandard assets include those characterized by the distinct possibility that we will sustain some loss if the deficiencies are not corrected. Assets classified as doubtful have all the weaknesses inherent in those classified substandard with the added characteristic that the weaknesses present make collection or liquidation in full highly questionable and improbable, on the basis of currently existing facts, conditions and values. Assets classified as loss are those considered uncollectible and of such little value that their continuance as assets without the establishment of a specific loss reserve is not warranted.

When we classify problem assets as either substandard or doubtful, we may establish a specific allowance in an amount we deem prudent. General allowances represent loss allowances which have been established to recognize the inherent risk associated with lending activities, but which, unlike specific allowances, have not been specifically allocated to particular problem assets. When an insured institution classifies problem assets as a loss, it is required to charge-off those assets in the period in which they are deemed uncollectible. Our determination as to the classification of our assets and the amount of our valuation allowances is subject to review by the FDIC and the Washington State Department of Financial Institutions, which can order the establishment of additional loss allowances or the charge-off of specific loans against established loss reserves. Assets which do not currently expose us to sufficient risk to warrant classification in one of the aforementioned categories but possess weaknesses are designated by us as special mention.

In connection with the filing of periodic reports with the FDIC and in accordance with our loan policy, we regularly review the problem loans in our portfolio to determine whether any loans require classification in accordance with applicable regulations. On the basis of our review of our loans, as of December 31, 2008, we classified $63.2 million of our loans as substandard of which $44.0 million was construction/land development, $3.8 million were commercial and $15.4 million were one-to-four family. No loans were classified as loss, or doubtful and $37.2 million were classified as special mention which included $16.1 million of construction/land development, $857,000 of commercial real estate and $20.2 million of one-to-four family loans. With the exception of these classified loans, management is not aware of any loans as of December 31, 2008, where the known credit problems of the borrower would cause us to have serious doubts as to the ability of such borrowers to comply with their present loan repayment terms.

The aggregate amounts of our classified assets, net of undisbursed funds, at the dates indicated were as follows:

	At December 31,		
	2008	2007	2006
	(In thousands)		
Classified Assets:			
Loss	$ --	$ --	$ --
Doubtful	--	--	--
Substandard	63,235	28,328	448
Special mention	37,211	--	3,119
Total	$ 100,446	$ 28,328	$ 3,567

Allowance for Loan Losses. Management recognizes that loan losses may occur over the life of a loan and that the allowance for loan losses must be maintained at a level necessary to absorb specific losses on impaired loans and probable losses inherent in the loan portfolio. Our methodology for analyzing the allowance for loan losses consists of two components: formula and specific allowances. The formula allowance is determined by applying factors to our various groups of loans. Management considers factors such as charge-off history, the prevailing economy, borrower=s ability to repay, the regulatory environment, competition, geographic and loan type concentrations, policy and underwriting standards, nature and volume of the loan portfolio, managements= experience level, our loan review system and the value of underlying collateral in assessing the allowance for loan losses. The specific allowance component is created when management believes that the collectibility of a specific loan, such as a real estate, multifamily or commercial real estate loan, has been impaired and a loss is probable. The specific reserves are computed using current appraisals (if available), listed sales prices and other available information less costs to complete, if any, and sell the property. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available or as future events differ from predictions.

Our Board of Directors approves the provision for loan losses on a quarterly basis. The allowance is increased by the provision for loan losses, which is charged against current period earnings and decreased by the amount of actual loan charge-offs, net of recoveries.

We believe that the accounting estimate related to the allowance for loan losses is a critical accounting estimate because it is highly susceptible to change from period to period requiring management to make assumptions about probable losses inherent in the loan portfolio. The impact of a sudden large loss could deplete the allowance and potentially require increased provisions to replenish the allowance, which would negatively affect earnings.

The provision for loan losses was $9.4 million, $6.0 million and $320,000 for the years ended December 31, 2008, 2007 and 2006, respectively. The additional increase in the loss provision was primarily the result of our increased nonperforming construction/land development loans. The allowance for loan losses was $17.0 million or 1.6% of total loans at December 31, 2008 as compared to $8.0 million, or 0.9% of total loans outstanding at December 31, 2007. The level of the allowance is based on estimates, and the ultimate losses may vary from the estimates. Management will continue to review the adequacy of the allowance for loan losses on a quarterly basis.

A loan is considered impaired when, based on current information and events, it is probable we will be unable to collect the scheduled payments of principal or interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loans and the borrowers, including length of the delay, the reasons for the delay, the borrower=s prior payment record and the amounts of the shortfall in relation to the principal and interest owed. Smaller homogeneous loans are collectively evaluated for impairment while impairment is measured on a loan-by-loan basis for commercial and construction/land development loans.

As of December 31, 2008, 2007 and 2006, we had $66.3 million, $30.7 million and $0, respectively, of total loans considered as impaired. Impaired loans, net of loans in process, were $52.5 million, $23.5 million and $0, respectively, for the same periods.

The following table summarizes the distribution of the allowance for loan losses by loan category.

	At December 31,								
	2008			2007			2006		
	Loan Balance	Allowance by Loan Category	Percent of Loans to Total Loans	Loan Balance	Allowance by Loan Category	Percent of Loans to Total Loans	Loan Balance	Allowance by Loan Category	Percen of Loans to Total Loans
Real estate:									(Dollars i
One-to-four family residential	$ 512,446	$ 3,924	45.05%	$ 424,863	$ 1,508	42.45%	$ 373,192	$ 302	48.8
Multifamily residential	100,940	243	8.87	76,039	151	7.60	79,701	38	10.4
Commercial	260,727	2,140	22.92	204,798	1,066	20.46	153,924	515	20.1
Construction/land development	250,512	10,634	22.02	288,378	5,128	28.82	153,401	1,094	20.0
Total real estate	1,124,625	16,941	98.86	994,078	7,853	99.33	760,218	1,949	99.5
Consumer:									
Home equity	12,566	41	1.11	6,368	118	0.64	3,038	22	0.4
Savings account	205	--	0.02	127	--	0.01	296	--	0.0
Other	156	--	0.01	177	--	0.02	203	--	0.0
Total consumer	12,927	41	1.14	6,672	118	0.67	3,537	22	0.4
Unallocated	--	--	--	--	--	--	--	--	-
Total	$ 1,137,552	$ 16,982	100.00%	$ 1,000,750	$ 7,971	100.00%	$ 763,755	$ 1,971	100.0

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Management believes that it uses the best information available to determine the allowance for loan losses. However, unforeseen market conditions could result in adjustments to the allowance for loan losses and net income could be significantly affected, if circumstances differ substantially from the assumptions used in determining the allowance.

The following table sets forth an analysis of our allowance for loan losses at the dates and for the periods indicated.

	Years Ended December 31,				
	2008	2007	2006	2005	2004
	(Dollars in thousands)				
Allowance at beginning of period	$ 7,971	$ 1,971	$ 1,651	$ 995	$ 995
Provision for loan losses	9,443	6,000	320	137	--
Charge-offs:					
One-to-four family	--	--	--	--	--
Construction/land development	432	--	--	--	--
Consumer	--	--	--	27	--
Total charge-offs	432	--	--	27	--
Total recoveries	--	--	--	--	--
Net charge-offs	432	--	--	27	--
Acquisition of Executive House	--	--	--	546	--
Balance at end of period	$ 16,982	$ 7,971	$ 1,971	$ 1,651	$ 995
Allowance for loan losses as a percentage of total loans outstanding at the end of the period net of undisbursed funds	1.61%	0.89%	0.28%	0.30%	0.26%
Net charge-offs to average loans receivable, net	0.04%	--	--	0.01%	--
Allowance for loan losses as a percentage of nonperforming loans at end of period net of undisbursed funds	28.96%	31.83%	1,279.87%	550.33%	375.47%

Investment Activities

General. Under Washington law, savings banks are permitted to invest in various types of liquid assets, including U.S. Treasury obligations, securities of various federal agencies, certain certificates of deposit of insured banks and savings institutions, banker=s acceptances, repurchase agreements, federal funds, commercial paper, investment grade corporate debt securities, and obligations of states and their political sub-divisions.

The investment committee, consisting of the Chief Executive Officer, Chief Financial Officer and Controller of First Savings Bank, has the authority and responsibility to administer our investment policy, monitor portfolio strategies, and recommend appropriate changes to policy and strategies to the Board of Directors. On a monthly basis, our management reports to the Board a summary of investment holdings with respective market values, and all purchases and sales of investment securities. The Chief Financial Officer has the primary responsibility for the management of the investment portfolio. The Chief Financial Officer considers various factors when making decisions, including the marketability, maturity and tax consequences of proposed investments. The maturity structure of investments will be affected by various market conditions, including the current and anticipated slope of the yield curve, the level of interest rates, the trend of new deposit inflows and the anticipated demand for funds via deposit withdrawals and loan originations and purchases.

The general objectives of the investment portfolio are to provide liquidity when loan demand is high, to assist in maintaining earnings when loan demand is low and to maximize earnings while satisfactorily managing risk, including credit risk, reinvestment risk, liquidity risk and interest rate risk.

At December 31, 2008, our investment portfolio consisted principally of mortgage-backed securities, U.S. Government Agency obligations, municipal bonds and a mutual fund consisting primarily of mortgage-backed securities. From time to time, investment levels may increase or decrease depending upon yields available on investment opportunities and management=s projected demand for funds for loan originations, deposits and other activities.

In January 2008, we elected to transfer our entire investments held to maturity portfolio to our investments available for sale portfolio. At December 31, 2008 there were no investments held to maturity.

Mortgage-Backed Securities. The mortgage-backed securities in our portfolio were comprised of Freddie Mac, Fannie Mae, and Ginnie Mae mortgage-backed securities. The principal on these securities is backed by the U.S. agency issuing the security. The mortgage-backed securities held in the available for sale category had a weighted-average yield of 4.58% at December 31, 2008.

U.S. Government Agency Obligations. At December 31, 2008, the portfolio had a weighted-average yield of 5.06% in the available for sale category.

Municipal Bonds. The tax exempt and taxable municipal bond portfolios were comprised of general obligation bonds (i.e., backed by the general credit of the issuer) and revenue bonds (i.e., backed by revenues from the specific project being financed) issued by various municipal corporations. All bonds are from issuers located within the State of Washington. The weighted-average yield on the tax exempt bonds (on a tax equivalent basis) was 6.48% at December 31, 2008, while the weighted-average yield on the taxable municipal bonds was 5.62% for the same period.

Federal Home Loan Bank Stock. As a member of the Federal Home Loan Bank system, we are required to own capital stock in the Federal Home Loan Bank of Seattle. The amount of stock we hold is based on guidelines specified by the Federal Home Loan Bank of Seattle. The redemption of any excess stock we hold is at the discretion of the Federal Home Loan Bank of Seattle. The carrying value of the stock totaled $7.4 million and had a weighted-average yield of 0.85% for the year ended December 31, 2008. As of December 31, 2008, the FHLB of Seattle was considered to be undercapitalized. Under Federal Housing Finance Agency regulations, a FHLB that fails to meet any regulatory capital requirement may not declare a dividend or redeem or repurchase capital stock. As such, the Federal Home Loan Bank of Seattle will not be able to redeem, repurchase or declare dividends on stock outstanding while the risk-based capital deficiency exits. As a consequence, we did not receive a dividend for the fourth quarter of 2008. The dividend received for the third quarter of 2008 was $17,000.

The following table sets forth the composition of our investment portfolio at the dates indicated. The amortized cost of the available for sale investments is their net book value before the mark-to-market fair value adjustment.

	At December 31,					
	2008		2007		2006	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(Dollars in thousands)					
Available for sale:						
U.S. Government agencies	$ 5,344	$ 5,855	$ 2,001	$ 2,004	$ 2,016	$ 2,009
Tax exempt municipal bonds	4,206	3,699	--	--	--	--
Taxable municipal bonds	652	611	--	--	--	--
Mortgage-backed securities:						
Freddie Mac	59,296	60,112	36,794	36,190	45,815	44,505
Fannie Mae	65,991	66,743	66,594	65,638	85,195	82,775
Ginnie Mae	7,858	7,692	10,116	10,057	14,315	14,091
Mutual fund (1)	4,611	4,611	6,120	5,948	5,819	5,671
Total available for sale	$ 147,958	$ 149,323	$ 121,625	$ 119,837	$ 153,160	$ 149,051
Held to maturity:						
U.S. Government agencies	$ --	$ --	$ 3,931	$ 3,976	$ 3,443	$ 3,402
Tax exempt municipal bonds	--	--	73,912	75,019	78,598	79,661
Taxable municipal bonds	--	--	1,659	1,656	1,677	1,660
Mortgage-backed securities:						
Fannie Mae	--	--	907	893	3,067	3,000
Other securities	--	--	1	1	1	1
Total held to maturity	$ --	$ --	$ 80,410	$ 81,545	$ 86,786	$ 87,724

(1) The fund invests primarily in private label securities backed by or representing an interest in mortgages or domestic residential housing or manufactured housing with additional investments in U.S. Government or agency securities.

During the year ended December 31, 2008, gross proceeds from sales of investments were $84.4 million with gross gains of $1.7 million and gross losses of $109,000.

In May 2008 the Board of Trustees of the AMF Ultra Short Mortgage Fund (AFund@) (a mutual fund) decided to activate the Fund=s redemptionBin-kind provision because of the uncertainty in the mortgage-backed securities market. The activation of this provision has limited the options available to the shareholders of the Fund with respect to liquidating their investments. Only the Fund may repurchase the shares in accordance with the terms of the mutual fund. The Fund is currently closed to any new investors, which means no new investors may buy shares in the Fund. Existing participants are allowed to redeem and receive up to $250,000 in cash per quarter or may receive 100% of their investment in Alike kind@ securities equal to their proportional ownership in the Fund (i.e., ownership percentage in the fund times the market value of each of the approximately 120 securities). For the year ended December 31, 2008, we recognized a $1.6 million pre-tax charge for the other-than-temporary decline in fair value. As required by Statement of Financial Accounting Standards No. 115, Accounting for Certain Investments in Debt and Equity Securities, when a decline in fair value below cost is deemed to be other-than-temporary the unrealized loss must be recognized as a charge to earnings.

On a quarterly basis, we make an assessment to determine whether there have been any events or economic circumstances to indicate that a security on which there is an unrealized loss is impaired on an other-than-temporary basis. We consider many factors including the severity and duration of the impairment, our intent and our ability to hold the security for a period of time sufficient for a recovery in value, recent events specific to the issuer or industry, and for debt securities, external credit ratings and recent downgrades. Securities on which there is an unrealized loss that is deemed to be other-than-temporary are written down to fair value with the write-down recorded as a realized loss. Gross unrealized losses at December 31, 2008, are primarily caused by interest rate changes. We have reviewed our securities in accordance with our accounting policy for other-than-temporary impairment discussed above and concluded that the $1.6 million pre-tax decline in the market value of the AMF Ultra Short Mortgage Fund during the year ended December 31, 2008 was considered an other-than-temporary loss. We do not consider any other securities to be other-than-temporarily impaired. We may, however, have additional other-than-temporary impairments in the future if market liquidity does not improve and if spreads do not return to levels that reflect underlying credit characteristics.

The table below sets forth information regarding the carrying value, weighted average yields and maturities or call dates of our investment portfolio at December 31, 2008. The mutual fund and the Federal Home Loan Bank stock have no stated maturity and are included in the total column only.

	At December 31, 2008 Amount Due or Repricing within:						
	Within One Year		After One Year to Five Years		After Five Years to Ten Years		Th
	Carrying Value	Weighted-Average Yield	Carrying Value	Weighted-Average Yield	Carrying Value	Weighted-Average Yield	Carryin Value
					(Dollars in thousands)		
Available for sale:							
U.S. Government agencies	$ 2,036	4.57%	$ --	--%	$ 786	5.63%	$ 3,03
Tax exempt municipal bonds (1)	--	--	683	5.81	--	--	3,01
Taxable municipal bonds	--	--	--	--	--	--	61
Mortgage-backed securities	29	3.16	6,926	4.04	43,507	4.37	84,08
Mutual fund	--	--	--	--	--	--	
Total available for sale	$ 2,065	4.55%	$ 7,609	4.20%	$ 44,293	4.39%	$ 90,74
Federal Home Loan Bank stock	$ --	--%	$ --	--%	$ --	--%	$

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(1) Yields on tax exempt obligations are computed on a tax equivalent basis.

In January 2008, we elected to transfer our entire investments held to maturity portfolio to our investments available for sale portfolio.

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Deposit Activities and Other Sources of Funds

General. Deposits and loan repayments are the major sources of our funds for lending and other investment purposes. Scheduled loan repayments are a relatively stable source of funds, while deposit inflows and outflows and loan prepayments are influenced significantly by general interest rates and market conditions. Borrowings from the Federal Home Loan Bank of Seattle are used to supplement the availability of funds from other sources and also as a source of term funds to assist in the management of interest rate risk.

Our deposit composition reflects a mixture of noninterest bearing accounts, NOW accounts, statement savings accounts, money market accounts and certificates of deposit. We rely on marketing activities, convenience, customer service and the availability of a broad range of deposit products and services to attract and retain customer deposits.

Deposits. Deposits are attracted from within our market area through the offering of a broad selection of deposit instruments, including checking accounts, money market deposit accounts, statement savings accounts and certificates of deposit with a variety of rates. Deposit account terms vary according to the minimum balance required, the time periods the funds must remain on deposit and the interest rate, among other factors. In determining the terms of our deposit accounts, we consider the development of long term profitable customer relationships, current market interest rates, current maturity structure and deposit mix, our customer preferences and the profitability of acquiring customer deposits compared to alternative sources.

At December 31, 2008, our deposits totaled $791.5 million. We had $421.2 million of jumbo ($100,000 or more) certificates of deposit of which $81.7 million were public funds, which represent 53.2% and 10.3%, respectively, of total deposits. There were no brokered deposits at December 31, 2008.

Deposit Activities. The following table sets forth our total deposit activities for the periods indicated.

	Years Ended December 31,		
	2008	2007	2006
	(In thousands)		
Beginning balance	$ 729,494	$ 750,710	$ 689,502
Net balance before interest credited	32,000	(54,687)	31,789
Interest credited	29,989	33,471	29,419
Net increase (decrease) in deposits	61,989	(21,216)	61,208
Ending balance	$ 791,483	$ 729,494	$ 750,710

The following table sets forth information concerning our certificates of deposit and other deposits at December 31, 2008.

Weighted - Average Interest Rate	Term	Category	Amount	Minimum Balance	Percentage of Total Deposits
			(In thousands)		
B%	N/A	Non-interest bearing accounts	$ 2,407	N/A	0.30%
0.68	N/A	NOW accounts	9,859	N/A	1.25
1.75	N/A	Statement savings accounts	12,605	N/A	1.59
1.98	N/A	Money market accounts	121,164	N/A	15.31
		Certificates of deposit			
3.03	3 month		4,719	$1,000	0.60
3.28	6 month		23,625	1,000	2.99
3.37	9 month		942	1,000	0.12
3.98	12 month		286,891	1,000	36.25
3.99	18 month		85,704	1,000	10.83
4.39	24 month		25,362	1,000	3.20
4.53	30 month		41,114	1,000	5.19
4.31	36 month		29,033	1,000	3.67
4.93	48 month		142,505	1,000	18.00
4.41	60 month		5,453	1,000	0.69
5.15	72 month		100	1,000	0.01
		Total certificates of deposit	645,448		81.55
		TOTAL	$791,483		100.00%

Certificates of Deposit. The following table sets forth the amount and maturities of certificates of deposit at December 31, 2008.

	Amount Due					
	Within One Year	After One Year Through Two Years	After Two Years Through Three Years	After Three Years Through Four Years	Thereafter	Total
	(In thousands)					
2.01% - 3.00%	$ 6,492	$ 106	$ --	$ --	$ --	$ 6,598
3.01% - 4.00%	246,569	22,261	13,384	9,052	244	291,510

4.01% - 5.00%	136,072	97,213	11,363	10,687	220	255,555
5.01% - 6.00%	21,897	25,162	30,834	13,792	100	91,785
Total	$411,030	$144,742	$55,581	$33,531	$564	$645,448

The following table indicates the amount of our jumbo certificates of deposit by time remaining until maturity as of December 31, 2008. Jumbo certificates of deposit are certificates in amounts of $100,000 or more.

Maturity Period	Certificates of Deposit (In thousands)
Three months or less	$ 70,045
Over three months through six months	59,595
Over six months through twelve months	131,018
Over twelve months	160,534
Total	$ 421,192

Deposit Flow. The following table sets forth the balances of deposits in the various types of accounts we offered at the dates indicated.

	At December 31,					
	2008		2007		2006	
	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total
	(Dollars in thousands)					
Noninterest-bearing accounts	$ 2,407	0.30%	$ 1,652	0.23%	$ 3,737	0.50%
NOW accounts	9,859	1.25	12,428	1.70	10,104	1.34
Statement savings accounts	12,605	1.59	11,591	1.59	14,280	1.90
Money market accounts	121,164	15.31	161,433	22.13	198,178	26.40
Certificates of deposit:						
1.01 - 2.00%	--	--	3	--	--	--
2.01 - 3.00%	6,598	0.83	--	--	2,446	0.33
3.01 - 4.00%	291,510	36.83	7,295	1.00	46,760	6.23
4.01 - 5.00%	255,555	32.29	175,920	24.12	219,413	29.23
5.01 - 6.00%	91,785	11.60	359,172	49.23	255,792	34.07
Total certificates of deposit	645,448	81.55	542,390	74.35	524,411	69.86
Total	$791,483	100.00%	$729,494	100.00%	$750,710	100.00%

Borrowings. Customer deposits are the primary source of funds for our lending and investment activities. We use advances from the Federal Home Loan Bank of Seattle to supplement our supply of lendable funds to meet short-term deposit withdrawal requirements and also to provide longer term funding to better match the duration of selected loan and investment maturities.

As one of our capital management strategies, we have used advances from the Federal Home Loan Bank of Seattle to fund loan originations in order to increase our net interest income. We will continue to utilize leverage strategies within applicable regulatory requirements or restrictions. Such borrowings would be expected to primarily consist of Federal Home Loan Bank of Seattle advances.

As a member of the Federal Home Loan Bank of Seattle, we are required to own capital stock in the Federal Home Loan Bank of Seattle and are authorized to apply for advances on the security of that stock and certain of our mortgage loans and other assets provided certain creditworthiness standards have been met. Advances are individually made under various terms pursuant to several different credit programs, each with its own interest rate and range of maturities. Depending on the program, limitations on the amount of advances are based on the financial condition of the member institution and the adequacy of collateral pledged to secure the credit. We maintain a committed credit facility with the Federal Home Loan Bank of Seattle that provides for immediately available advances, which at December 31, 2008 was $424.8 million. At December 31, 2008, outstanding advances to First Savings Bank from the Federal Home Loan Bank of Seattle totaled $156.2 million.

The following table sets forth information regarding Federal Home Loan Bank of Seattle advances by us at the end of and during the periods indicated. The table includes both long- and short-term borrowings.

	At or for the Years Ended December 31,		
	2008	2007	2006
	(Dollars in thousands)		
Maximum amount of borrowings outstanding at any month end	$ 157,500	$ 224,000	$ 147,000
Average borrowings outstanding	$ 123,886	$ 149,365	$ 119,966
Weighted-average rate paid	3.51%	5.37%	5.22%
Balance outstanding at end of the year	$ 156,150	$ 96,000	$ 147,000
Weighted-average rate paid at end of the year	3.25%	4.32%	5.52%

Subsidiaries and Other Activities

First Financial Northwest. First Financial Northwest has two wholly-owned subsidiaries, First Savings Bank and First Financial Diversified. First Financial Diversified primarily provides escrow services to First Savings Bank, other area lenders and some private individuals. First Financial Diversified also offers limited consumer loans to First Savings Bank=s customers, which consist of short-term unsecured loans, second mortgages and, to a lesser extent, home equity loans. At December 31, 2008, loans from First Financial Diversified represented less than one percent of our loan portfolio.

First Savings Bank. First Savings Bank is a community-based savings bank primarily serving King and to a lesser extent, Pierce, Kitsap and Snohomish counties, Washington through our full-service banking office. We are in the business of attracting deposits from the public and utilizing those deposits to originate loans. Our recent business strategy has included an increased emphasis on the expansion of multifamily and commercial real estate lending and business lending.

Effective January 1, 2008, the lending operations of Executive House were assumed by First Savings Bank, creating a commercial lending division within First Savings Bank.

Competition

We face intense competition in originating loans and in attracting deposits within our targeted geographic market. We compete by consistently delivering high-quality, personal service to our customers that results in a high level of customer satisfaction.

Based on the most current FDIC Deposit Market Share Report dated June 30, 2008, we rank eighth in terms of deposits with a deposit market share of 1.6%, among the 60 federally insured depository institutions in King County, our primary market area. Our key competitors are Banner Bank, Columbia State Bank, Frontier Bank, US Bank and

Washington Mutual, a subsidiary of JP Morgan Chase. These competitors control 27.1% of the King County deposit market with deposits of $14.7 billion, of the $54.1 billion total deposits in King County as of June 30, 2008. Aside from these traditional competitors, credit unions, insurance companies and brokerage firms are an increasingly competing challenge for consumer deposit relationships.

Our competition for loans comes principally from commercial banks, mortgage brokers, thrift institutions, credit unions and finance companies. Several other financial institutions, including those previously mentioned, have greater resources than we do and compete with us for banking business in our targeted market area. These institutions have far more resources than we do and as a result are able to offer a broader range of services such as trust departments, business lending, merchant banking and enhanced retail services. Among the advantages of some of these institutions are their ability to make larger loans, finance extensive advertising campaigns, access lower cost funding sources and allocate their investment assets to regions of highest yield and demand. The challenges posed by such large competitors may impact our ability to originate loans, secure low cost deposits and establish product pricing levels that support our net interest margin goals, which may limit our future growth and earnings prospects.

Employees

At December 31, 2008, we had 99 full-time employees and two part-time employees. Our employees are not represented by any collective bargaining group. We consider our employee relations to be good.

How We Are Regulated

The following is a brief description of certain laws and regulations which are applicable to First Financial Northwest and First Savings Bank. Legislation is introduced from time to time in the United States Congress that may affect the operations of First Financial Northwest and First Savings Bank. In addition, the regulations governing us may be amended from time to time by the respective regulators. Any such legislation or regulatory changes in the future could adversely affect us. We cannot predict whether any such changes may occur.

As part of the conversion and reorganization, First Savings Bank elected, pursuant to Section 10(l) of the Home Owners= Loan Act, as amended, to be treated as a savings association. As a result, First Financial Northwest is a registered savings and loan holding company subject to regulation of the Office of Thrift Supervision. First Savings Bank continues to be regulated by the Washington State Department of Financial Institutions and the Federal Deposit Insurance Corporation.

Regulation and Supervision of First Savings Bank

General. As a state-chartered savings bank, First Savings Bank is subject to applicable provisions of Washington law and regulations of the Washington State Department of Financial Institutions. State law and regulations govern First Savings Bank=s ability to take deposits and pay interest, to make loans on or invest in residential and other real estate, to make consumer loans, to invest in securities, to offer various banking services to its customers, and to establish branch offices. Under state law, savings banks in Washington State also generally have all of the powers that federal savings banks have under federal laws and regulations. First Savings Bank is subject to periodic examination and reporting requirements by and of the Washington State Department of Financial Institutions.

Insurance of Accounts and Regulation by the Federal Deposit Insurance Corporation. First Savings Bank is a member of the Federal Deposit Insurance Corporation. The Federal Deposit Insurance Corporation insures deposits up to the applicable limits and imposes deposit insurance premiums. The Federal Deposit Insurance Corporation is also First Savings Bank=s principal federal regulator. As such, the Federal Deposit Insurance Corporation is authorized to conduct examinations of and to require reporting by First Savings Bank. The Federal Deposit Insurance Corporation may prohibit First Savings Bank from engaging in any activity determined by law, regulation or order to pose a serious risk to the institution, and may take a variety of enforcement actions in the event First Savings Bank violates a law, regulation or order, engages in an unsafe or unsound practice, or under certain other circumstances. The Federal Deposit Insurance Corporation also has the authority to seize First Savings Bank or to terminate First Savings Bank=s deposit insurance if it were to determine that First Savings Bank has engaged in unsafe or unsound practices or is in an unsafe or unsound condition.

Under regulations effective January 1, 2007, the Federal Deposit Insurance Corporation adopted a new risk-based premium system that provides for quarterly assessments based on an insured institution=s ranking in one of four risk categories based upon supervisory and capital evaluations. Institutions are assessed at annual rates ranging from five to 43 basis points, respectively, depending on each institution=s risk of default as measured by regulatory capital ratios and other supervisory measures. The Federal Deposit Insurance Corporation approved and modified on February 27, 2009, the Deposit Insurance Fund restoration plan first proposed October 16, 2008. The plan amends the way the Federal Deposit Insurance Corporation differentiates for risk in the risk-based assessment system and revises deposit insurance assessment rates, including increases in base assessment rates. Also on February 27, 2009, the Federal Deposit Insurance Corporation adopted an interim rule, subject to a 30 day comment period, imposing a 20 basis point emergency special assessment on the deposits of Federal Deposit Insurance Corporation insured institutions as of June 30, 2009. The assessment is to be collected on September 30, 2009. The interim rule would also permit the FDIC to impose an additional emergency special assessment after June 30, 2009, of up to 10 basis points if necessary to maintain public confidence in federal deposit insurance.

On December 16, 2008, the Federal Deposit Insurance Corporation issued a final rule increasing the annual base assessment range from 12 to 50 basis points for the first quarter of 2009. The Deposit Insurance Fund restoration plan starting with the second quarter of 2009 further increases the assessment rates for banks in all risk categories and adjusts premiums for new factors, including use of brokered deposits, and secured liabilities including Federal Home Loan Bank advances. The table below provides the range of new assessments and adjustments in basis points for the four risk categories identified by the Federal Deposit Insurance Corporation as a result of the adoption of the Deposit Insurance Fund restoration plan.

	Risk Category I	Risk Category II	Risk Category III	Risk Category IV
Initial base assessment rate	12 - 16	22	32	45
Unsecured debt adjustment	(5) - 0	(5) - 0	(5) - 0	(5) - 0
Secured liability adjustment	0 - 8.0	0 - 11.0	0 - 16.0	0 - 22.5
Brokered deposit adjustment	N/A	0 - 10	0 - 10	0 - 10
Total base assessment rate	7 - 24.0	17 - 43.0	27 - 58.0	40 - 77.5

The Federal Deposit Insurance Corporation in adoption of the Deposit Insurance Fund restoration plan extended to seven years, the horizon to raise the Deposit Insurance Fund reserve ratio to its required ratio of 1.15% of insured deposits. The ratio as of December 31, 2008, was 0.40%.

Federal Deposit Insurance Corporation-insured institutions are required to pay a Financing Corporation assessment, in order to fund the interest on bonds issued to resolve thrift failures in the 1980s. The Financing Corporation=s assessment rate for 2008 was approximately 1.11 basis points for each $100 in domestic deposits. These assessments, which may be revised based upon the level of DIF deposits, will continue until the bonds mature in the years 2017 through 2019.

The Federal Deposit Insurance Corporation may terminate the deposit insurance of any insured depository institution, including First Savings Bank, if it determines after a hearing that the institution has engaged or is engaging in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, order or any condition imposed by an agreement with the Federal Deposit Insurance Corporation. It also may suspend deposit insurance temporarily during the hearing process for the permanent termination of insurance, if the institution has no tangible capital. If insurance of accounts is terminated, the accounts at the institution at the time of the termination, less subsequent withdrawals, shall continue to be insured for a period of six months to two years, as determined by the Federal Deposit Insurance Corporation.

Capital Requirements. Federally insured savings institutions, such as First Savings Bank, are required to maintain a minimum level of regulatory capital. Federal Deposit Insurance Corporation regulations recognize two types, or tiers, of capital: core (ATier 1@) capital and supplementary (ATier 2@) capital. Tier 1 capital generally includes common shareholders= equity and noncumulative perpetual preferred stock, less most intangible assets. Tier 2 capital, which is recognized up to 100% of Tier 1 capital for risk-based capital purposes (after any deductions for disallowed intangibles and disallowed deferred tax assets), includes such items as qualifying general loan loss reserves (up to 1.25% of risk-weighted assets), cumulative perpetual preferred stock, long-term preferred stock (original maturity of at least 20 years), certain perpetual preferred stock, hybrid capital instruments including mandatory convertible debt, term subordinated debt, intermediate-term preferred stock (original average maturity of at least five years), and net unrealized holding gains on equity securities (subject to certain limitations); provided, however, the amount of term subordinated debt and intermediate term preferred stock that may be included in Tier 2 capital for risk-based capital purposes is limited to 50.0% of Tier 1 capital.

The Federal Deposit Insurance Corporation currently measures a bank=s capital using the total risk-based capital ratio, the Tier 1 risk-based capital ratio, and the leverage ratio. In order to be Awell capitalized,@ a bank must have a total risk-based capital ratio of at least 10.0%, a Tier 1 risk-based capital ratio of at least 6.0%, and a leverage ratio of at least 5.0%. In order to be Aadequately capitalized,@ a bank must have a total risk-based capital ratio of at least 8.0%, a Tier 1 risk-based capital ratio of at least 4.0%, and a leverage ratio of at least 4.0% (or, a leverage ratio of at least 3.0%, but a composite CAMELS rating of 1 at the last examination, and not be experiencing or anticipating any significant growth). At December 31, 2008, First Savings Bank had a total risk-based capital ratio of 24.30%, a Tier 1 risk-based capital ratio of 23.04%, and a leverage ratio of 15.61%. The Federal Deposit Insurance Corporation retains the right to require a depository institution to maintain a higher capital level based on its particular risk profile.

The Federal Deposit Insurance Corporation regulations establish a measure of capital adequacy based on ratios of qualifying capital to risk-weighted assets. Assets are placed in one of five categories and given a percentage weight based on the relative risk of that category. In addition, certain off-balance-sheet items are converted to balance-sheet credit equivalent amounts, and each amount is then assigned to one of the five categories. In evaluating the adequacy of a bank=s capital, the Federal Deposit Insurance Corporation may also consider other factors that may affect the bank=s financial condition, such as interest rate risk exposure, liquidity, funding and market risks, the quality and level of earnings, concentration of credit risk, risks arising from nontraditional activities, loan and investment quality, the effectiveness of loan and investment policies, and management=s ability to monitor and control financial operating risks.

The Washington State Department of Financial Institutions requires that net worth equal at least five percent of total assets.

The table below sets forth First Savings Bank's capital position relative to its FDIC capital requirements at December 31, 2008 and 2007. The definitions of the terms used in the table are those provided in the capital regulations issued by the Federal Deposit Insurance Corporation, and First Savings Bank has not been notified by the Federal Deposit Insurance Corporation of any higher capital requirements specifically applicable to it.

	At December 31,			
	2008		2007	
	Amount	Percent of Assets (1)	Amount	Percent of Assets
	(Dollars in thousands)			
Bank equity capital under GAAP	$ 204,744		$ 198,095	
Total risk-based capital	$ 199,940	24.30%	$ 192,784	25.91%
Total risk-based capital requirement	65,831	8.00	59,522	8.00
Excess	$ 134,109	16.30%	$ 133,262	17.91%
Tier 1 (leverage) capital (2)	$ 189,572	23.04%	$ 184,843	24.84%
Tier 1 (leverage) capital requirement	32,915	4.00	29,761	4.00
Excess	$ 156,657	19.04%	$ 155,082	20.84%

Tier 1 risk adjusted capital	$	189,572	15.61%	$	184,843	16.62%
Tier 1 risk adjusted capital requirement		48,585	4.00		44,498	4.00
Excess	$	140,987	11.61%	$	140,345	12.62%

(footnotes on the following page)

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(1) For the Tier 1 (leverage) capital and Washington regulatory capital calculations, percent of total average assets of $1.2 billion. For the Tier 1 risk-based capital and total risk-based capital calculations, percent of total risk-weighted assets of $822.9 million.
(2) As a Washington-chartered savings bank, First Savings Bank is subject to the capital requirements of the Federal Deposit Insurance Corporation and the Division. The Federal Deposit Insurance Corporation requires state-chartered savings banks, including First Savings Bank, to have a minimum leverage ratio of Tier 1 capital to total assets of at least 4%, provided, however, that all institutions, other than those (i) receiving the highest rating during the examination process and (ii) not anticipating any significant growth, are required to maintain a ratio of 1% to 2% above the stated minimum, with an absolute total capital to risk-weighted assets of at least 8%.

First Savings Bank=s management believes that, under the current regulations, First Savings Bank will continue to meet its minimum capital requirements in the foreseeable future. However, events beyond the control of First Savings Bank, such as a downturn in the economy in areas where it has most of its loans, could adversely affect future earnings and, consequently, the ability of First Savings Bank to meet its capital requirements.

Emergency Economic Stabilization Act of 2008. In October 2008, the EESA was enacted. The EESA authorizes the Treasury Department to purchase from financial institutions and their holding companies up to $700 billion in mortgage loans, mortgage-related securities and certain other financial instruments, including debt and equity securities issued by financial institutions and their holding companies in a troubled asset relief program (ATARP@). The purpose of TARP is to restore confidence and stability to the U.S. banking system and to encourage financial institutions to increase their lending to customers and to each other. The Treasury Department has allocated $250 billion towards the TARP Capital Purchase Program (ACPP@). Under the CPP, the Treasury will purchase debt or equity securities from participating institutions. The TARP also will include direct purchases or guarantees of troubled assets of financial institutions. Participants in the CPP are subject to executive compensation limits and are encouraged to expand their lending and mortgage loan modifications. Because of the additional capital raised in the conversion, First Financial Northwest has determined not to submit an application for participation in TARP.

EESA also increased Federal Deposit Insurance Corporation deposit insurance on most accounts from $100,000 to $250,000. This increase expires at the end of 2009 and is not covered by deposit insurance premiums paid by the banking industry.

The American Recovery and Reinvestment Act of 2009. On February 17, 2009, President Obama signed The American Recovery and Reinvestment Act of 2009 (AStimulus Bill@) into law. The Stimulus Bill is intended to revive the US economy by creating millions of new jobs and stemming home foreclosures. For financial institutions that have received or will receive financial assistance under TARP or related programs, the Stimulus Bill significantly rewrites the original executive compensation and corporate governance provisions of Section 111 of the EESA. Among the most important changes instituted by the Stimulus Bill are new limits on the ability of TARP recipients to pay incentive compensation to up to 20 of the next most highly-compensated employees in addition to the Asenior executive officers,@ a restriction on termination of employment payments to senior executive officers and the five next most highly-compensated employees and a requirement that TARP recipients implement Asay on pay@ shareholder votes. Further legislation is anticipated to be passed with respect to the economic recovery. However, the executive compensation limitations contained in the Stimulus Bill will not have an effect on First Financial Northwest, since it elected not to participate in TARP.

The Administration also announced in February its Financial Stability Plan (AFSP@) and Homeowners Affordability and Stability Plan (AHASP@). Many details have yet to be finalized. FSP is the second phase of TARP, to be administrated by the Treasury. Its four key elements include: 1) a development of a Public/Private investment fund essentially structured as a government sponsored enterprise with the mission to purchase troubled assets from banks with an initial capitalization from government funds; 2) the continuation of the Capital Assistance Program with the Treasury purchasing additional bank capital available only for banks that have undergone a new stress test given by their regulator; 3) an expansion of the Federal Reserve=s term asset-backed liquidity facility to support the purchase of up to $1 trillion in AAABrated asset backed securities backed by consumer and small business loans; and 4) the establishment of a mortgage loan modification program with $50 billion in federal funds further detailed in the HASP.

The HASP is a voluntary program aimed to help seven to nine million families restructure their mortgages to avoid foreclosure with $275 billion in government funding commitments. The plan also develops uniform guidance for loan modifications nationwide. However, it is mandatory for recipients of FSP financial assistance. HASP provides programs and funding for eligible refinancing of loans owned or guaranteed by Fannie Mae or Freddie Mac, along with incentives to lenders, mortgage servicers, and borrowers to modify mortgages of Aresponsible@ homeowners who are at risk of defaulting on their mortgage. The goals of HASP are to assist in the prevention of home foreclosures and to help stabilize falling home prices.

These programs are not expected to have any direct impact on First Financial Northwest since it has determined not to participate in TARP and these related programs. First Financial Northwest will benefit from these programs if they help stabilize the national banking system and aid in the recovery in the housing market.

Standards for Safety and Soundness. The federal banking regulatory agencies have prescribed, by regulation, guidelines for all insured depository institutions relating to: internal controls, information systems and internal audit systems; loan documentation; credit underwriting; interest rate risk exposure; asset growth; asset quality; earnings and compensation, fees and benefits. The guidelines set forth the safety and soundness standards that the federal banking agencies use to identify and address problems at insured depository institutions before capital becomes impaired. Each insured depository institution must implement a comprehensive written information security program that includes administrative, technical, and physical safeguards appropriate to the institution=s size and complexity and the nature and scope of its activities. The information security program also must be designed to ensure the security and confidentiality of customer information, protect against any unanticipated threats or hazards to the security or integrity of such information, protect against unauthorized access to or use of such information that could result in substantial harm or inconvenience to any customer, and ensure the proper disposal of customer and consumer information. Each insured depository institution must also develop and implement a risk-based response program to address incidents of unauthorized access to customer information in customer information systems. If the Federal Deposit Insurance Corporation determines that First Savings Bank fails to meet any standard prescribed by the guidelines, it may require First Savings Bank to submit an acceptable plan to achieve compliance with the standard.

Real Estate Lending Standards. Federal Deposit Insurance Corporation regulations require First Savings Bank to adopt and maintain written policies that establish appropriate limits and standards for real estate loans. These standards, which must be consistent with safe and sound banking practices, must establish loan portfolio diversification standards, prudent underwriting standards, loan administration procedures and documentation, and approval and reporting requirements. First Savings Bank is obligated to monitor conditions in its real estate markets to ensure that its standards continue to be appropriate for current market conditions. First Savings Bank=s Board of Directors is required to review and approve First Savings Bank=s standards at least annually. The Federal Deposit Insurance Corporation has published guidelines for compliance with these regulations, including supervisory limitations on loan-to-value ratios for different categories of real estate loans. Under the guidelines, the aggregate amount of all loans in excess of the supervisory loan to value ratios should not exceed 100% of total capital, and the total of all loans for commercial, agricultural, multifamily or other non-one-to-four family residential properties should not exceed 30% of total capital. Loans in excess of the supervisory loan to value ratio limitations must be identified in First Savings Bank=s records and reported at least quarterly to First Savings Bank=s Board of Directors. First Savings Bank is in compliance with the record and reporting requirements. As of December 31, 2008, First Savings Bank=s aggregate loans in excess of the supervisory loan to value ratios were 18.2% of total capital and First Savings Bank=s loans on commercial, multifamily or other non-one-to-four family residential properties in excess of the supervisory loan to value ratios were 2.0% of total capital.

Initiatives Prompted by the Subprime Mortgage Crisis. In response to the recent subprime mortgage crisis, federal and state regulatory agencies have focused attention on subprime and nontraditional mortgage products both with an aim toward enhancing the regulation of such loans and providing relief to adversely affected borrowers.

Guidance on Subprime Mortgage Lending. On June 29, 2007, the federal banking agencies issued guidance on subprime mortgage lending to address issues related to certain mortgage products marketed to subprime borrowers, particularly adjustable rate mortgage products that can involve Apayment shock@ and other risky characteristics. Although the guidance focuses on subprime borrowers, the banking agencies note that institutions should look to the principles contained in the guidance when offering such adjustable rate mortgages to non-subprime borrowers. The guidance prohibits predatory lending programs; provides that institutions should underwrite a mortgage loan on the borrower=s ability to repay the debt by its final maturity at the fully-indexed rate, assuming a fully amortizing repayment schedule; encourages reasonable workout arrangements with borrowers who are in default; mandates clear and balanced advertisements and other communications; encourages arrangements for the escrowing of real estate taxes and insurance; and states that institutions should develop strong control and monitoring systems. The guidance recommends that institutions refer to the Real Estate Lending Standards (discussed above) which provide underwriting standards for all real estate loans.

The federal banking agencies announced their intention to carefully review the risk management and consumer compliance processes, policies and procedures of their supervised financial institutions and their intention is to take action against institutions that engage in predatory lending practices, violate consumer protection laws or fair lending laws, engage in unfair or deceptive acts or practices, or otherwise engage in unsafe or unsound lending practices.

Guidance on Loss Mitigation Strategies for Servicers of Residential Mortgages. On September 5, 2007, the federal banking agencies issued a statement encouraging regulated institutions and state-supervised entities that service residential mortgages to pursue strategies to mitigate losses while preserving homeownership to the extent possible and appropriate. The guidance recognizes that many mortgage loans, including subprime loans, have been transferred into securitization trusts and servicing for such loans is governed by contract documents. The guidance advises servicers to review governing documentation to determine the full extent of their authority to restructure loans that are delinquent or are in default or are in imminent risk of default.

The guidance encourages that servicers take proactive steps to preserve homeownership in situations where there are heightened risks to homeowners losing their homes to foreclosures. Such steps may include loan modification; deferral of payments; extensions of loan maturities; conversion of adjustable rate mortgages into fixed rate or fully indexed, fully amortizing adjustable rate mortgages; capitalization of delinquent amounts; or any combination of these actions. Servicers are instructed to consider the borrower=s ability to repay the modified obligation to final maturity according to its terms, taking into account the borrower=s total monthly housing-related payments as a percentage of the borrower=s gross monthly income, the borrower=s other obligations, and any additional tax liabilities that may result from loan modifications. Where appropriate, servicers are encouraged to refer borrowers to qualified non-profit and other homeownership counseling services and/or to government programs that are able to work with all parties and avoid unnecessary foreclosures. The guidance states that servicers are expected to treat consumers fairly and to adhere to all applicable legal requirements.

Consumer Relief Initiative for Borrowers. In October 2007, the Treasury Secretary announced the Homeowner Assistance Initiative to encourage mortgage servicers, mortgage counselors, government officials and non-profit groups to coordinate their efforts to help struggling borrowers restructure their mortgage payments and stay in their homes. The initiative, called HOPE NOW, is aimed at coordinating and improving outreach to borrowers, developing best practices for mortgage counselors across the country and ensuring that groups able to help homeowners work out new loan arrangements with lenders have adequate resources to carry out this mission.

Economic Stimulus Act of 2008 and Housing and Economic Recovery Act of 2008. President Bush signed the Economic Stimulus Act of 2008 into law on February 13, 2008. While the main thrust of the act is to stimulate the economy, the act also temporarily increased the maximum size of mortgage loans (the conforming loan limit) that

Fannie Mae and Freddie Mac may purchase from the current \$417,000 cap to a maximum of \$729,750 for certain loans made during the July 1, 2007 - December 31, 2008 period. The cap on the Federal Housing

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Administration's conforming loan limit for mortgage loans was raised from $362,000 to $729,750 for certain loans made on or before December 31, 2008. These changes were intended, among other purposes, to provide more liquidity and stability for the jumbo loan market. The Housing and Economic Recovery Act of 2008, signed by President Bush on July 30, 2008, was designed to address a variety of issues relating to the subprime mortgage crises. This act established a new maximum conforming loan limit for Fannie Mae and Freddie Mac in high cost areas to 150% of the conforming loan limit of $417,000, to take effect after the limits established by the Economic Stimulus Act of 2008 expire. The FHA=s maximum conforming loan limit has been increased from 95% to 110% of the area median home price up to 150% of the Fannie Mae/Freddie Mac conforming loan limit, to take effect at the same time. Among other things, the Housing and Economic Recovery Act of 2008 enhanced the regulation of Fannie Mae, Freddie Mac and Federal Housing Administration loans; established a new Federal Housing Finance Agency to replace the prior Federal Housing Finance Board and Office of Federal Housing Enterprise Oversight; will require enhanced mortgage disclosures; and will require a comprehensive licensing, supervisory, and tracking system for mortgage originators. Using its new powers, on September 7, 2008 the Federal Housing Finance Agency announced that it had put Fannie Mae and Freddie Mac under conservatorship. The Housing and Economic Recovery Act of 2008 also establishes the HOPE for Homeowners program, which is a new, temporary, voluntary program to back Federal Housing Administration-insured mortgages to distressed borrowers. The new mortgages offered by Federal Housing Administration-approved lenders will refinance distressed loans at a significant discount for owner-occupants at risk of losing their homes to foreclosure.

New Regulations Establishing Protections for Consumers in the Residential Mortgage Market. The Federal Reserve Board has issued new regulations under the federal Truth-in-Lending Act and the Home Ownership and Equity Protection Act. For mortgage loans governed by the Home Ownership and Equity Protection Act, the new regulations further restrict prepayment penalties, and enhance the standards relating to the consumer=s ability to repay. For a new category of closed-end Ahigher-priced@ mortgage loans, the new regulations restrict prepayment penalties, and require escrows for property taxes and property-related insurance for most first lien mortgage loans. For all closed-end loans secured by a principal dwelling, the new regulations prohibit the coercion of appraisers; require the prompt crediting of payments; prohibit the pyramiding of late fees; require prompt responses to requests for payoff figures; and require the delivery of transaction-specific Truth in Lending Act disclosures within three business days following the receipt of an application for a closed-end home loan. The new regulations also impose new restrictions on mortgage loan advertising for both open-end and closed-end products. In general, the new regulations are effective October 10, 2009, but the rules governing escrows for higher-priced mortgages are effective on April 1, 2010, and for higher-priced mortgage loans secured by manufactured housing, on October 1, 2010.

Pending Legislation and Regulatory Proposals. As a result of the credit crisis, federal and state legislative agencies are considering a broad variety of legislative and regulatory proposals covering lending products, loan terms and underwriting standards, risk management practices, supervision and consumer protection. It is unclear which, if any, of these initiatives will be adopted, what effect they will have on First Financial Northwest or First Savings Bank and whether any of these initiatives will change the competitive landscape in the banking industry.

Guidance on Nontraditional Mortgage Product Risks. On September 29, 2006, the federal banking agencies issued guidance to address the risks posed by nontraditional residential mortgage products, that is, mortgage products that allow borrowers to defer repayment of principal or interest. The guidance instructs institutions to ensure that loan terms and underwriting standards are consistent with prudent lending practices, including consideration of a borrower=s ability to repay the debt by final maturity at the fully indexed rate and assuming a fully amortizing repayment schedule; requires institutions to recognize, for higher risk loans, the necessity of verifying the borrower=s income, assets and liabilities; requires institutions to address the risks associated with simultaneous second-lien loans, introductory interest rates, lending to subprime borrowers, nonowner occupied investor loans, and reduced documentation loans; requires institutions to recognize that nontraditional mortgages, particularly those with risk-layering features, are untested in a stressed environment; requires institutions to recognize that nontraditional mortgage products warrant strong controls and risk management standards, capital levels commensurate with that risk, and allowances for loan and lease losses that reflect the collectibility of the portfolio; and ensure that consumers have sufficient information to clearly understand loan terms and associated risks prior to making product and payment choices. The guidance recommends practices for addressing the risks raised by nontraditional mortgages, including enhanced communications with consumers, beginning when the consumer is first shopping for a mortgage; promotional materials and other product descriptions that provide information about the costs, terms, features and risks of nontraditional mortgages, including with respect to payment shock, negative amortization, prepayment penalties, and the cost of reduced documentation loans; more informative monthly statements for payment option adjustable rate mortgages; and specified practices to avoid. Subsequently, the federal banking agencies produced model disclosures that are designed to provide information about the costs, terms, features and risks of nontraditional mortgages.

Guidance on Real Estate Concentrations. On December 6, 2006, the federal banking agencies issued a guidance on sound risk management practices for concentrations in commercial real estate lending. The particular focus is on exposure to commercial real estate loans that are dependent on the cash flow from the real estate held as collateral and that are likely to be sensitive to conditions in the commercial real estate market (as opposed to real estate collateral held as a secondary source of repayment or as an abundance of caution). The purpose of the guidance is not to limit a bank=s commercial real estate lending but to guide banks in developing risk management practices and capital levels commensurate with the level and nature of real estate concentrations. The Federal Deposit Insurance Corporation and other bank regulatory agencies will be focusing their supervisory resources on institutions that may have significant commercial real estate loan concentration risk. A bank that has experienced rapid growth in commercial real estate lending, has notable exposure to a specific type of commercial real estate loan, or is approaching or exceeding the following supervisory criteria may be identified for further supervisory analysis with respect to real estate concentration risk:

$ Total reported loans for construction, land development and other land represent 100% or more of the bank=s capital; or

$ Total commercial real estate loans (as defined in the guidance) represent 300% or more of the bank=s total capital and the outstanding balance of the bank=s commercial real estate loan portfolio has increased 50% or more during the prior 36 months.

The strength of an institution=s lending and risk management practices with respect to such concentrations will be taken into account in supervisory evaluation of capital adequacy.

On March 17, 2008, the Federal Deposit Insurance Corporation issued a release to re-emphasize the importance of strong capital and loan loss allowance levels and robust credit risk management practices for institutions with concentrated commercial real estate exposures. The Federal Deposit Insurance Corporation suggested that institutions with significant construction/land development and commercial real estate loan concentrations increase or maintain strong capital levels; ensure that loan loss allowances are appropriately strong; manage construction and development and commercial real estate loan portfolios closely; maintain updated financial and analytical information on their borrowers and collateral; and bolster the loan workout infrastructure.

Temporary Liquidity Guaranty Program. Following a systemic risk determination, the Federal Deposit Insurance Corporation established a Temporary Liquidity Guarantee Program (ATLGP@) on October 14, 2008. The TLGP includes the Transaction Account Guarantee Program, which provides unlimited deposit insurance coverage through December 31, 2009 for noninterest-bearing transaction accounts (typically business checking accounts) and certain funds swept into noninterest-bearing savings accounts (ATAGP@). Institutions participating in the TAGP pay a 10 basis points fee (annualized) on the balance of each covered account in excess of $250,000, while the extra deposit insurance is in place. The TLGP also includes the Debt Guarantee Program (ADGP@), under which the Federal Deposit Insurance Corporation guarantees certain senior unsecured debt of Federal Deposit Insurance Corporation-insured institutions and their holding companies. The unsecured debt must be issued on or after October 14, 2008 and not later than June 30, 2009, and the guarantee is effective through the earlier of the maturity date or June 30, 2012. The DGP coverage limit is generally 125% of the eligible entity=s eligible debt outstanding on September 30, 2008 and scheduled to mature on or before June 30, 2009 or, for certain insured institutions, 2% of their liabilities as of September 30, 2008. Depending on the term of the debt maturity, the nonrefundable DGP fee ranges from 50 to 100 basis points (annualized) for covered debt outstanding until the earlier of maturity or June 30, 2012. The TAGP and DGP are in effect for all eligible entities, unless the entity opted out on or before December 5, 2008. First Financial Northwest did not opt out of the program.

Activities and Investments of Insured State-Chartered Financial Institutions. Federal law generally limits the activities and equity investments of Federal Deposit Insurance Corporation-insured, state-chartered banks to those that are permissible for national banks. An insured state bank is not prohibited from, among other things, (1) acquiring or retaining a majority interest in a subsidiary, (2) investing as a limited partner in a partnership the sole purpose of which is direct or indirect investment in the acquisition, rehabilitation or new construction of a qualified housing project, provided that such limited partnership investments may not exceed 2% of the bank=s total assets, (3) acquiring up to 10% of the voting stock of a company that solely provides or reinsures directors=, trustees= and officers= liability insurance coverage or bankers= blanket bond group insurance coverage for insured depository institutions, and (4) acquiring or retaining the voting shares of a depository institution if certain requirements are met.

Washington State has enacted a law regarding financial institution parity. Primarily, the law affords Washington-chartered commercial banks the same powers as Washington-chartered savings banks. In order for a bank to exercise these powers, it must provide 30 days notice to the Director of Financial Institutions and the Director must authorize the requested activity. The law also provides that Washington-chartered savings banks may exercise any of the powers of Washington-chartered commercial banks, national banks and federally-chartered savings banks, subject to the approval of the Director in certain situations. Finally, the law provides additional flexibility for Washington-chartered commercial and savings banks with respect to interest rates on loans and other extensions of credit. Specifically, they may charge the maximum interest rate allowable for loans and other extensions of credit by federally-chartered financial institutions to Washington residents.

Environmental Issues Associated With Real Estate Lending. The Comprehensive Environmental Response, Compensation and Liability Act (ACERCLA@) is a federal statute that generally imposes strict liability on, all prior and present Aowners and operators@ of sites containing hazardous waste. However, Congress asked to protect secured creditors by providing that the term Aowner and operator@ excludes a person whose ownership is limited to protecting its security interest in the site. Since the enactment of the CERCLA, this Asecured creditor exemption@ has been the subject of judicial interpretations which have left open the possibility that lenders could be liable for cleanup costs on contaminated property that they hold as collateral for a loan. To the extent that legal uncertainty exists in this area, all creditors, including First Savings Bank, that have made loans secured by properties with potential hazardous waste contamination (such as petroleum contamination) could be subject to liability for cleanup costs, which costs often substantially exceed the value of the collateral property.

Federal Reserve System. The Federal Reserve Board requires that all depository institutions maintain reserves on transaction accounts or non-personal time deposits. These reserves may be in the form of cash or non interest-bearing deposits with the regional Federal Reserve Bank. Negotiable order of withdrawal, or NOW, accounts and other types of accounts that permit payments or transfers to third parties fall within the definition of transaction accounts and are subject to the reserve requirements, as are any non-personal time deposits at a savings bank. As of December 31, 2008, First Savings Bank=s deposit with the Federal Reserve Bank and vault cash exceeded its reserve requirements.

Federal Home Loan Bank System. The Federal Home Loan Bank system consists of twelve regional Federal Home Loan Banks. Among other benefits, each Federal Home Loan Bank serves as a reserve or central bank for its members within its assigned region. Each Federal Home Loan Bank is financed primarily from the sale of consolidated obligations of the Federal Home Loan Bank system. Each Federal Home Loan Bank makes available loans or advances to its members in compliance with the policies and procedures established by the board of directors of the individual Federal Home Loan Bank. First Savings Bank is a member of the Federal Home Loan Bank of Seattle. Each member of the Federal Home Loan Bank of Seattle is required to own stock in an amount equal to the greater of (i) a membership stock requirement equal to the greater of $500, or one-half of one percent of the member=s home mortgage loans, as of the most recent calendar year-end, or (ii) an activity based stock requirement (based on percentage of outstanding products and services provided).

Impact of Monetary Policies. The earnings and growth of First Savings Bank are largely dependent on its ability to maintain a favorable differential or spread between the yield on its interest-earning assets and the rates paid on its deposits and other interest-bearing liabilities. As a result, First Savings Bank=s performance is influenced by general economic conditions, both domestic and foreign, the monetary and fiscal policies of the federal government, and the policies of the regulatory agencies. The Federal Reserve Board implements national monetary policies (such as policies seeking to curb inflation and combat recession) by its open-market operations in U.S. Government securities, by adjusting the required level of reserves for financial institutions subject to its reserve requirements, by varying the discount rate applicable to borrowings by banks from the Federal Reserve Banks, and in a variety of other ways. The actions of the Federal Reserve Board in these areas influence the growth of bank loans, investments, and deposits and also affect interest rates charged on loans and deposits. The nature and impact of any future changes in monetary policies cannot be predicted.

Affiliate Transactions. Federal laws strictly limit the ability of banks to engage in certain transactions with their affiliates, including their bank holding companies. Transactions deemed to be a Acovered transaction@ under Section 23A of the Federal Reserve Act and between a subsidiary bank and its parent company or the nonbank subsidiaries of the bank holding company are limited to 10% of the bank subsidiary=s capital and surplus and, with respect to the parent company and all such nonbank subsidiaries, to an aggregate of 20% of the bank subsidiary=s capital and surplus. Further, covered transactions that are loans and extensions of credit generally are required to be secured by eligible collateral in specified amounts. Federal law also requires that covered transactions and certain other transactions listed in Section 23B of the Federal Reserve Act between a bank and its affiliates be on terms as favorable to the bank as transactions with nonaffiliates.

Community Reinvestment Act. Banks are also subject to the provisions of the Community Reinvestment Act of 1977, which requires the appropriate federal bank regulatory agency to assess a bank=s record in meeting the credit needs of the community serviced by the bank, including low and moderate income neighborhoods. The regulatory agency=s assessment of the bank=s record is made available to the public. Further, an assessment is required of any bank which has applied to establish a new branch office that will accept deposits, relocate an existing office or merge or consolidate with, or acquire the assets or assume the liabilities of, a federally regulated financial institution or banks that are involved in certain acquisitions by a savings and loan holding company. First Savings Bank received a Asatisfactory@ rating during its most recent examination.

Dividends. The amount of dividends payable by First Savings Bank to First Financial Northwest depends upon First Savings Bank=s earnings and capital position, and is limited by federal and state laws. According to Washington law, First Savings Bank may not declare or pay a cash dividend on its capital stock if it would cause its net worth to be reduced below (1) the amount required for liquidation accounts or (2) the net worth requirements, if any, imposed by the Director of the Washington Department of Financial Institutions. Dividends on First Savings Bank=s capital stock may not be paid in an aggregate amount greater than the aggregate retained earnings of First Savings Bank, without the approval of the Director of the Washington Department of Financial Institutions.

The amount of dividends actually paid during any one period is strongly affected by First Savings Bank=s policy of maintaining a strong capital position. Federal law further provides that no insured depository institution may pay a cash dividend if it would cause the institution to be Aundercapitalized,@ as defined in the prompt corrective action regulations. Moreover, the federal bank regulatory agencies also have the general authority to limit the dividends paid by insured banks if such payments are deemed to constitute an unsafe and unsound practice.

Privacy Standards. The Gramm-Leach-Bliley Act modernized the financial services industry by establishing a comprehensive framework to permit affiliations among commercial banks, insurance companies, securities firms and other financial service providers. First Savings Bank is subject to Federal Deposit Insurance Corporation regulations implementing the privacy protection provisions of the Gramm-Leach-Bliley Act. These regulations require First Savings Bank to disclose its privacy policy, including identifying with whom it shares Anonpublic personal information,@ to customers at the time of establishing the customer relationship and annually thereafter.

The privacy policy must be provided to consumers before nonpublic personal information is shared with a nonaffiliated third party. Customers and certain consumers must be provided the right to opt out of the sharing of certain information by First Savings Bank with both affiliates and nonaffiliated third parties. Federal Deposit Insurance Corporation regulations that became mandatory on October 1, 2008 limit the right of an affiliate of First

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Savings Bank to use consumer information obtained from First Savings Bank for marketing purposes, unless the consumer is provided with a clear and conspicuous notice of his/her right to opt out from that use and the consumer has not opted out. First Savings Bank is also subject to state privacy laws, which may impose more stringent information sharing requirements.

Anti-Money Laundering and Customer Identification. Congress enacted the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (the AUSA Patriot Act@) on October 26, 2001 in response to the terrorist events of September 11, 2001. The USA Patriot Act gives the federal government new powers to address terrorist threats through enhanced domestic security measures, expanded surveillance powers, increased information sharing and broadened anti-money laundering requirements. Since its enactment, Congress has ratified certain expiring provisions of the USA Patriot Act.

Regulation and Supervision of First Financial Northwest

General. First Financial Northwest is subject to regulation as a savings and loan holding company under the Home Owners= Loan Act, as amended, instead of being subject to regulation as a bank holding company under the Bank Holding Company Act of 1956 because First Savings Bank made an election under Section 10(l) of the Home Owners= Loan Act, in connection with the mutual to stock conversion, to be treated as a Asavings association@ for purposes of Section 10 of the Home Owners= Loan Act. As a result, First Financial Northwest registered with the Office of Thrift Supervision and is subject to Office of Thrift Supervision regulations, examinations, supervision and reporting requirements relating to savings and loan holding companies. First Financial Northwest is also required to file certain reports with, and otherwise comply with the rules and regulations of the Securities and Exchange Commission. As a subsidiary of a savings and loan holding company, First Savings Bank is subject to certain restrictions in its dealings with First Financial Northwest and affiliates thereof.

First Financial Northwest is a nondiversified unitary savings and loan holding company within the meaning of federal law. Generally, companies that become savings and loan holding companies following the May 4, 1999 grandfather date in the Gramm-Leach-Bliley Act of 1999 may engage only in the activities permitted for financial institution holding companies under the law for multiple savings and loan holding companies.

Although savings and loan holding companies are not currently subject to specific capital requirements or specific restrictions on the payment of dividends or other capital distributions. Federal regulations do prescribe such restrictions on subsidiary savings institutions as described above. Because First Savings Bank is treated as a savings association subsidiary of a savings and loan holding company, it must notify the Office of Thrift Supervision 30 days before declaring any dividend to First Financial Northwest. In addition, the financial impact of a holding company on its subsidiary institution is a matter that is evaluated by the Office of Thrift Supervision and the Office of Thrift Supervision has authority to order cessation of activities or divestiture of subsidiaries deemed to pose a threat to the safety and soundness of First Savings Bank.

Acquisition of Control. Under the federal Change in Bank Control Act, a notice must be submitted to the Office of Thrift Supervision if any person (including a company), or group acting in concert, seeks to acquire Acontrol@ of a savings and loan holding company or savings association. An acquisition of control can occur upon the acquisition of 10% or more of the voting stock of a savings and loan holding company or savings institution or as otherwise defined by the Office of Thrift Supervision. Under the Change in Bank Control Act, the Office of Thrift Supervision has 60 days from the filing of a complete notice to act, taking into consideration certain factors, including the financial and managerial resources of the acquiror and the anti-trust effects of the acquisition. Any company that so acquires control would then be subject to regulation as a savings and loan holding company.

Qualified Thrift Lender Test. Under Section 2303 of the Economic Growth and Regulatory Paperwork Reduction Act of 1996, a savings association can comply with the Qualified Thrift Lender test by either meeting the Qualified Thrift Lender test set forth in the Home Owners= Loan Act and implementing regulations or qualifying as a domestic building and loan association as defined in Section 7701(a)(19) of the Internal Revenue Code of 1986. A savings bank subsidiary of a savings and loan holding company that does not comply with the Qualified Thrift Lender test must comply with the following restrictions on its operations:

$ the institution may not engage in any new activity or make any new investment, directly or indirectly, unless the activity or investment is permissible for a national bank;

$ the branching powers of the institution are restricted to those of a national bank; and

$ payment of dividends by the institution are subject to the rules regarding payment of dividends by a national bank.

Upon the expiration of three years from the date the institution ceases to meet the Qualified Thrift Lender test, it must cease any activity and not retain any investment not permissible for a national bank (subject to safety and soundness considerations).

As of December 31, 2008, First Savings Bank maintained 80.4% of its portfolio assets in qualified thrift investments and, therefore, met the Qualified Thrift Lender test.

Limitations on Transactions with Affiliates. Transactions between savings institutions and any affiliate are governed by Sections 23A and 23B of the Federal Reserve Act. An affiliate of a savings institution is any company or entity which controls, is controlled by or is under common control with the savings institution. In a holding company context, the holding company and any companies which are controlled by such holding companies are affiliates of the savings institution. Generally, Section 23A limits the extent to which the savings institution or its subsidiaries may engage in Acovered transactions@ with any one affiliate to an amount equal to 10% of the institution=s capital stock and surplus, and contain an aggregate limit on all such transactions with all affiliates to an amount equal to 20% of such capital stock and surplus. Section 23B applies to Acovered transactions@ as well as certain other transactions and requires that all transactions be on terms substantially the same, or at least as favorable, to the savings institution as those provided to a nonaffiliate. The term Acovered transaction@ includes the making of loans to, purchase of assets from and issuance of a guarantee to an affiliate and similar transactions. Section 23B transactions also include the provision of services and the sale of assets by a savings institution to an affiliate. In addition to the restrictions imposed by Sections 23A and 23B, Section 11 of the Home Owners= Loan Act prohibits a savings institution from (1) making a loan or other extension of credit to an affiliate, except for any affiliate which engages only in certain activities which are permissible for bank holding companies or (2) purchasing or investing in any stocks, bonds, debentures, notes or similar obligations of any affiliate, except for affiliates which are subsidiaries of the savings institution.

In addition, Sections 22(g) and (h) of the Federal Reserve Act place restrictions on loans to executive officers, directors and principal shareholders. Under Section 22(h), loans to a director, executive officer or greater than 10% shareholder of a savings institution, and certain affiliated interests, may not exceed, together with all other outstanding loans to such person and affiliated interests, the savings institution=s loans to one borrower limit (generally equal to 15% of the institution=s unimpaired capital and surplus). Section 22(h) also requires that loans to directors, executive officers and principal shareholders be made on terms substantially the same as offered in comparable transactions to other persons unless the loans are made pursuant to a benefit or compensation program that (1) is widely available to employees of the institution, and (2) does not give preference to any director, executive officer or principal shareholder, or certain affiliated interests, over other employees of the savings institution. Section 22(h) also requires prior board approval for certain loans. In addition, the aggregate amount of extensions of credit by a savings institution to all insiders cannot exceed the institution=s unimpaired capital and surplus. Furthermore, Section 22(g) places additional restrictions on loans to executive officers. At December 31, 2008, First Savings Bank was in compliance with these restrictions.

Restrictions on Acquisitions. Except under limited circumstances, savings and loan holding companies are prohibited from acquiring, without prior approval of the Director of the Office of Thrift Supervision, (1) control of any other savings institution or savings and loan holding company or substantially all the assets thereof, or (2) more than 5% of the voting shares of a savings institution or holding company thereof which is not a subsidiary. Except with the prior approval of the Director of the Office of Thrift Supervision, no director or officer of a savings and loan holding company or person owning or controlling by proxy or otherwise more than 25% of such company=s

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stock, may acquire control of any savings institution, other than a subsidiary savings institution, or of any other savings and loan holding company.

The Director of the Office of Thrift Supervision may only approve acquisitions resulting in the formation of a multiple savings and loan holding company which controls savings institutions in more than one state if: (1) the multiple savings and loan holding company involved controls a savings institution which operated a home or branch office located in the state of the institution to be acquired as of March 5, 1987; (2) the acquiror is authorized to acquire control of the savings institution pursuant to the emergency acquisition provisions of the Federal Deposit Insurance Act; or (3) the statutes of the state in which the institution to be acquired is located specifically permit institutions to be acquired by the state-chartered institutions or savings and loan holding companies located in the state where the acquiring entity is located (or by a holding company that controls such state-chartered savings institutions).

Federal Securities Laws. First Financial Northwest=s common stock is registered with the Securities and Exchange Commission under Section 12(b) of the Securities Exchange Act of 1934, as amended. We are subject to information, proxy solicitation, insider trading restrictions and other requirements under the Securities Exchange Act of 1934.

Sarbanes-Oxley Act of 2002. First Financial Northwest, as a public company, is subject to the Sarbanes-Oxley Act of 2002, which implements a broad range of corporate governance and accounting measures for public companies designed to promote honesty and transparency in corporate America and better protect investors from corporate wrongdoing. The Sarbanes-Oxley Act of 2002 was signed into law by President Bush on July 30, 2002 in response to public concerns regarding corporate accountability in connection with several accounting scandals. The stated goals of the Sarbanes-Oxley Act are to increase corporate responsibility, to provide for enhanced penalties for accounting and auditing improprieties at publicly traded companies and to protect investors by improving the accuracy and reliability of corporate disclosures pursuant to the securities laws.

The Sarbanes-Oxley Act includes very specific additional disclosure requirements and new corporate governance rules, requires the Securities and Exchange Commission and securities exchanges to adopt extensive additional disclosure, corporate governance and other related rules and mandates further studies of certain issues by the Securities and Exchange Commission and the Comptroller General.

Taxation

Federal Taxation

General. First Financial Northwest and First Savings Bank are subject to federal income taxation in the same general manner as other corporations, with some exceptions discussed below. The following discussion of federal taxation is intended only to summarize certain pertinent federal income tax matters and is not a comprehensive description of the tax rules applicable to First Financial Northwest or First Savings Bank. The tax years still open for review by the Internal Revenue Service are 2005-2007.

Beginning in 2007, First Financial Northwest files a consolidated federal income tax return with First Savings Bank. Accordingly, any cash distributions made by First Financial Northwest to its shareholders are considered to be taxable dividends and not as a non-taxable return of capital to shareholders for federal and state tax purposes.

Method of Accounting. For federal income tax purposes, First Financial Northwest currently reports its income and expenses on the accrual method of accounting and uses a fiscal year ending on December 31 for filing its federal income tax return.

Minimum Tax. The Internal Revenue Code imposes an alternative minimum tax at a rate of 20% on a base of regular taxable income plus certain tax preferences, called alternative minimum taxable income. The alternative minimum tax is payable to the extent such alternative minimum taxable income is in excess of an

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exemption amount. Net operating losses can offset no more than 90% of alternative minimum taxable income. Certain payments of alternative minimum tax may be used as credits against regular tax liabilities in future years. First Savings Bank has not been subject to the alternative minimum tax, nor does it have any such amounts available as credits for carryover.

Net Operating Loss Carryovers. A financial institution may carry back net operating losses to the pre- ceding two taxable years and forward to the succeeding 20 taxable years. This provision applies to losses incurred in taxable years beginning after August 6, 1997.

Charitable Contribution Carryovers. We may carryforward charitable contributions to the succeeding five taxable years. The utilization of the charitable contribution carryforward may not exceed 10% of taxable income as defined by the federal taxation laws. At December 31, 2008, First Financial Northwest had a charitable contribution carryforward for federal income tax purposes of $13.3 million. This carryforward was generated from our creation of the First Financial Northwest Foundation to which we contributed a block of stock in connection with the mutual to stock conversion, having a market value of $16.9 million. During the year ended December 31, 2008, we recorded a valuation allowance of $603,000 which relates to our charitable contribution carryforward. This amount represents the tax effect of the estimated amount of the First Financial Northwest=s charitable contribution carryforward that management believes will not be utilized in the next four years. Management fully expects to utilize the benefit of the remaining carryforward amount over the next four years.

Corporate Dividends-Received Deduction. First Financial Northwest may eliminate from its income dividends received from First Savings Bank as a wholly-owned subsidiary of First Financial Northwest which files a consolidated return with First Savings Bank. The corporate dividends-received deduction is 100%, or 80%, in the case of dividends received from corporations with which a corporate recipient does not file a consolidated tax return, depending on the level of stock ownership of the payor of the dividend. Corporations which own less than 20% of the stock of a corporation distributing a dividend may deduct 70% of dividends received or accrued on their behalf.

Washington State Taxation

The Company and its subsidiaries are subject to a business and occupation tax imposed under Washington state law at the rate of 1.50% of gross receipts. In addition, various municipalities also assess business and occupation taxes at differing rates. Interest received on loans secured by first lien mortgages or deeds of trust on residential properties, rental income from properties, and certain investment securities are exempt from this tax.

Executive Officers of the Company

The following table sets forth certain information with respect to the executive officers of First Financial Northwest and First Savings Bank.

The current executive officers of First Financial Northwest consist of the same individuals who are executive officers of First Savings Bank. The business experience for at least the past five years for the executive officers of First Financial Northwest or First Savings Bank is set forth below.

Victor Karpiak, age 54, is Chairman of the Board, President and Chief Executive Officer of First Financial Northwest and First Savings Bank. Prior to his appointment as President of First Savings Bank in 1999, he served as Executive Vice President and Chief Financial Officer. Mr. Karpiak has served as President and Chief Financial Officer of First Financial Holdings, MHC and First Financial of Renton, predecessors of the Company, since they were established in 2002. In January 2005, he was appointed Chairman of the Board and Chief Executive Officer of First Financial Holdings, MHC, First Financial of Renton and First Savings Bank. He has been with First Savings Bank for 31 years.

Kari A. Stenslie, age 44, is Vice President and Chief Financial Officer of First Financial Northwest and First Savings Bank. Prior to joining First Financial Northwest on February 19, 2008, she was employed by First Mutual Bancshares, Inc. Bellevue, Washington and its subsidiary, First Mutual Bank, from 1988 to 2008 in accounting related positions. From 1999 until its acquisition in February 2008 she was First Mutual's Senior Vice President and Controller. Ms. Stenslie is a certified public accountant with 20 years of financial institution experience. She received her Bachelor of Arts in Business from Seattle University. Ms. Stenslie's professional affiliations include the American Institute of Certified Public Accountants, Washington State Society of Certified Public Accountants and the Institute of Management Accountants.

David G. Kroeger, age 63, is Executive Vice President and Chief Lending Production Officer of First Savings Bank. Prior to that, Mr. Kroeger had served as Executive Vice President of Executive House since February 2006. Before that, Mr. Kroeger was Director of the Division of Banks of the Washington State Department of Financial Institutions from 1999 until 2006. Prior to 1999, Mr. Kroeger held a number of senior positions at the Federal Deposit Insurance Corporation. Mr. Kroeger also serves on the board of directors of the Bank of Fairfield, Fairfield, Washington.

M. Scott Gaspard, age 55, is Senior Vice President, Strategic Development of First Financial Northwest and First Savings Bank. Prior to joining First Financial Northwest on January 1, 2009, he was Senior Vice President, Manager Government and Industry Relations at Washington Mutual, Inc. from 2003 until December 31, 2008. Before that, Mr. Gaspard served as an officer of the Washington Financial League from 1979 to 2003, becoming President in 1981. Mr. Gaspard received his Bachelor of Science, Business Administration from the University of Puget Sound.

Robert H. Gagnier, age 61, is Vice President of First Financial Northwest and Senior Vice President and Chief Lending Administrative Officer of First Savings Bank. Mr. Gagnier has held his current position at First Financial Northwest since 2007, and at First Savings Bank since 2001. Prior to serving in his current position, Mr. Gagnier had served as Vice President, Loan Officer and Compliance Officer of First Savings Bank since 1986.

Roger Elmore, age 42, is Vice President of First Financial Northwest and Senior Vice President and Chief Operating Officer of First Savings Bank as of January 1, 2008. Prior to his promotion Mr. Elmore served as Vice President and Senior Operations Officer of First Savings Bank, a position he had held since 2004. Before that Mr. Elmore was Vice President Risk Operations Division Manager at Washington Mutual Bank from 2001 though 2004. Prior to 2001, Mr. Elmore held numerous management positions at Washington Mutual Bank.

Item 1A. Risk Factors.

An investment in our common stock is subject to risks inherent in our business. Before making an investment decision, you should carefully consider the risks and uncertainties described below together with all of the other information included in this report. In addition to the risks and uncertainties described below, other risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially and adversely affect our business, financial condition and results of operations. The value or market price of our common stock could decline due to any of these identified or other risks, and you could lose all or part of your investment.

Risks Related to the U.S. Financial Industry

Difficult market conditions have adversely affected our industry.

We are particularly exposed to downturns in the U.S. housing market. Dramatic declines in the housing market over the past year, with falling home prices and increasing foreclosures, unemployment and under-employment, have negatively impacted the credit performance of mortgage loans and resulted in significant write-downs of asset values by financial institutions, including government-sponsored entities, major commercial and investment banks, and regional financial institutions such as our Company. Reflecting concern about the stability of the financial markets generally and the strength of counterparties, many lenders and institutional investors have reduced or ceased providing funding to borrowers, including to other financial institutions. This market turmoil and tightening of credit have led to an increased level of commercial and consumer delinquencies, lack of consumer confidence, increased market volatility and widespread reduction of business activity generally. The resulting economic pressure on consumers and lack of confidence in the financial markets have adversely affected our business, financial condition and results of operations. We do not expect that the difficult conditions in the financial markets are likely to improve in the near future. A worsening of these conditions would likely exacerbate the adverse effects of these difficult market conditions on us and others in the financial institutions industry. In particular, we may face the following risks in connection with these events:

$ We potentially face increased regulation of our industry. Compliance with such regulation may increase our costs and limit our ability to pursue business opportunities.

$ Our ability to assess the creditworthiness of our customers may be impaired if the models and approaches we use to select, manage and underwrite our customers become less predictive of future behaviors.

$ The process we use to estimate losses inherent in our credit exposure requires difficult, subjective and complex judgments, including forecasts of economic conditions and how these economic conditions might impair the ability of our borrowers to repay their loans. The level of uncertainty concerning economic conditions may adversely affect the accuracy of our estimates which may, in turn, impact the reliability of the process.

$ Competition in our industry could intensify as a result of the increasing consolidation of financial services companies in connection with current market conditions.

$ We will be required to pay significantly higher Federal Deposit Insurance Corporation premiums because market developments have significantly depleted the insurance fund of the Federal Deposit Insurance Corporation and reduced the ratio of reserves to insured deposits.

There can be no assurance that recently enacted legislation and other measures undertaken by the Treasury, the Federal Reserve and other governmental agencies will help stabilize the U.S. financial system or improve the housing market.

Emergency Economic Stabilization Act of 2008. On October 3, 2008, President Bush signed into law the Emergency Economic Stabilization Act of 2008, or the EESA, which, among other measures, authorized the Treasury Secretary to establish the Troubled Asset Relief Program, or TARP. The EESA gives broad authority to the Treasury to purchase, manage, modify, sell and insure the troubled mortgage related assets that triggered the current economic crisis as well as other Atroubled assets.@ The EESA includes additional provisions directed at bolstering the economy, including:

$ Authority for the Federal Reserve to pay interest on depository institution balances;

$ Mortgage loss mitigation and homeowner protection;

$ Temporary increase in Federal Deposit Insurance Corporation insurance coverage from $100,000 to $250,000 through December 31, 2009; and

$ Authority to the SEC to suspend mark-to-market accounting requirements for any issuer or class of category of transactions.

Pursuant to the TARP, the Treasury has the authority to, among other things, purchase up to $700 billion of mortgages, mortgage-backed securities and certain other financial instruments from financial institutions for the purpose of stabilizing and providing liquidity to the U.S. financial markets. On November 12, 2008, the Treasury Secretary announced that the Treasury was no longer pursuing a broad plan to purchase illiquid mortgage-related assets, but would continue to examine whether targeted forms of asset purchases can play a useful role.

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Shortly following the enactment of the EESA, the Treasury announced the creation of a capital purchase program, or CPP, pursuant to which it proposes to provide access to capital to financial institutions through a standardized program to acquire preferred stock from eligible financial institutions that will serve as Tier I capital. Because of the additional capital raised in the conversion, First Financial Northwest has determined not to submit an application for participation in TARP.

The EESA also contains a number of significant employee benefit and executive compensation provisions, some of which apply to employee benefit plans generally, and others of which impose on financial institutions that participate in the TARP program restrictions on executive compensation.

The EESA followed, and has been followed by, numerous actions by the Federal Reserve, Congress, Treasury, the SEC and others to address the current liquidity and credit crisis that has followed the subprime meltdown that commenced in 2007. These measures include homeowner relief that encourages loan restructuring and modification; the establishment of significant liquidity and credit facilities for financial institutions and investment banks; the repeated lowering of the federal funds rate; emergency action against short selling practices; a temporary guaranty program for money market funds; the establishment of a commercial paper funding facility to provide back-stop liquidity to commercial paper issuers; coordinated international efforts to address illiquidity and other weaknesses in the banking sector.

Moreover, on October 14, 2008, the Federal Deposit Insurance Corporation announced the establishment of a Temporary Liquidity Guarantee Program, or TLGP, to provide full deposit insurance for all noninterest-bearing transaction accounts and guarantees of certain newly issued senior unsecured debt issued by Federal Deposit Insurance Corporation-insured institutions and their holding companies. Insured institutions are automatically covered by this program for the period commencing October 14, 2008 and will continue to be covered as long as they did not opt out of the program by December 5, 2008. First Financial Northwest did not opt out of the program. Under the program, the Federal Deposit Insurance Corporation will guarantee timely payment of newly issued senior unsecured debt issued on or before June 30, 2009. The debt includes all newly issued unsecured senior debt (e.g., promissory notes, commercial paper and inter-bank funding). The aggregate coverage for an institution may not exceed 125% of its debt outstanding on September 30, 2008 that was scheduled to mature before June 30, 2009, or, for certain insured institutions, 2% of liabilities as of September 30, 2008. The guarantee will extend to June 30, 2012 even if the maturity of the debt is after that date.

There can be no assurance as to the actual impact that the EESA and such related measures undertaken to alleviate the credit crisis will have generally on the financial markets, including the extreme levels of volatility and limited credit availability currently being experienced. The failure of such measures to help stabilize the financial markets and a continuation or worsening of current financial market conditions could materially and adversely affect our business, financial condition, results of operations, access to credit or the trading price of First Financial Northwest=s common stock.

Finally, there can be no assurance regarding the specific impact that such measures may have on usCor whether (or to what extent) we will be able to benefit from such programs.

The American Recovery and Reinvestment Act of 2009. On February 17, 2009, President Obama signed The American Recovery and Reinvestment Act of 2009, or Stimulus Bill, into law. The Stimulus Bill is intended to revive the US economy by creating millions of new jobs and stemming home foreclosures. In addition, the Stimulus Bill significantly rewrites the original executive compensation and corporate governance provisions of Section 111 of the EESA, which pertains to financial institutions that have received or will receive financial assistance under TARP or related programs. This legislation is not expected to have any effect on First Financial Northwest since it determined not to participate in TARP.

The Administration also announced in February 2008 its Financial Stability Plan (FSP) and Homeowners Affordability & Stability Plan (HASP). Many details have yet to be finalized. FSP is the second phase of TARP, to be administrated by the Treasury. Its four key elements include:

$ a development of a Public/Private investment fund essentially structured as a government sponsored enterprise with the mission to purchase troubled assets from banks with an initial capitalization from government funds;
$ Continuation of the Capital Assistance Program with the Treasury purchasing additional bank capital available only for banks that have undergone a new stress test given by their regulator;
$ An expansion of the Federal Reserve=s term asset-backed liquidity facility to support the purchase of up to $1 trillion in AAA-rated asset backed securities backed by consumer and small business loans; and
$ Establishment of a mortgage loan modification program with $50 billion in federal funds further detailed in the HASP.

The HASP is a voluntary program aimed to help seven to nine million families restructure their mortgages to avoid foreclosure with $275 billion in government funding commitments. The plan also develops uniform guidance for loan modifications nationwide. However, it is mandatory for recipients of FSP financial assistance. HASP provides programs and funding for eligible refinancing of loans owned or guaranteed by Fannie Mae or Freddie Mac, along with incentives to lenders, mortgage servicers, and borrowers to modify mortgages of Aresponsible@ homeowners who are at a risk of defaulting on their mortgage. The goals of HASP are to assist in the prevention of home foreclosures and to help stabilize falling home prices.

These plans are not expected to have any direct impact on First Financial Northwest since it has determined not to participate. To the degree that the plans help stabilize the national banking system and aid in the recovery in the housing market, First Financial Northwest will be a beneficiary.

Current levels of market volatility are unprecedented.

The capital and credit markets have been experiencing volatility and disruption for more than a year. In recent months, the volatility and disruption has reached unprecedented levels. In some cases, the markets have produced downward pressure on stock prices and credit availability for certain issuers without regard to those issuers= underlying financial strength. If current levels of market disruption and volatility continue or worsen, there can be no assurance that we will not experience an adverse effect, which may be material, on our ability to access capital and on our business, financial condition and results of operations.

Risks Related to our Business

Adverse economic conditions, particularly in Washington State, have caused and could continue to cause us to incur losses.

Our business is directly affected by market conditions, trends in industry and finance, legislative and regulatory changes, and changes in governmental monetary and fiscal policies and inflation, all of which are beyond our control. In 2007, the housing and real estate sectors experienced an economic slowdown that has continued into 2008 and 2009. Further deterioration in economic conditions, in particular within our primary market area in King, Pierce, Kitsap and Snohomish counties, Washington, real estate markets are having and may continue to have a material adverse impact on the quality of our loan portfolio and the demand for our products and services. In particular the economic slowdown in our market areas is resulting in many of the following conditions, which could continue to hurt our business materially:

$ an increase in loan delinquencies;

$ an increase in problem assets and foreclosures;

$ a decline in the demand for our products and services; and

$ a decrease in the value of loan collateral, especially real estate, which, in turn have reduced customers= borrowing power and reduced the value of assets and collateral securing our loans.

Downturns in the real estate markets in our primary market area have hurt our business.

Our business activities and credit exposure are primarily concentrated in King, Pierce, Kitsap and Snohomish counties, Washington. Our construction/land development loan portfolio, our commercial and multifamily loan portfolios and certain of our other loans have been affected by the downturn in the residential real estate market. We anticipate that further declines in the estate markets in our primary market area will hurt our business. As of December 31, 2008, substantially all of our loan portfolio consisted of loans secured by real estate. If real estate values continue to decline the collateral for our loans will provide less security. As a result, our ability to recover on defaulted loans by selling the underlying real estate will be diminished, and we would be more likely to suffer losses on defaulted loans. The events and conditions described in this risk factor could therefore have a material adverse effect on our business, results of operations and financial condition.

The lack of diversification in our loan portfolio may hurt both our asset quality and profits.

With substantially all of our loans secured by real property and concentrated in the State of Washington, and specifically, 57.5%, 23.7%, 4.2% and 5.2% of our total loan portfolio concentrated in King, Pierce, Kitsap and Snohomish counties, Washington, respectively, declines in local economic conditions have adversely affected the values of our real estate collateral. Consequently, declines in local economic conditions may have a greater effect on our earnings and capital than on the earnings and capital of larger financial institutions whose real estate loan portfolios are geographically diverse.

While one-to-four family first mortgages remain the largest portion of our loan portfolio, our operating strategy includes an increased emphasis on the expansion of construction/land development, commercial and multifamily real estate lending and lending to businesses while decreasing our overall percentage of one-to-four family loans in our loan portfolio. In addition, although these loans are intended to enhance the average yield of our earning assets, they do involve a different, and possibly higher, level of risk of delinquency or collection than generally associated with loan portfolios of more traditional community banks because, among other factors, these loans involve larger balances to a single borrower or groups of related borrowers. In this regard, at December 31, 2008, approximately $81.9 million or 7.8% of our total loan portfolio, net of loans in process, consisted of construction/land development loans to five real estate builders and their affiliates. As a result of this lending concentration, and since construction/land development loans generally have large balances, if we make any errors in judgment in the collectibility of these loans, we may need to significantly increase our provision for loan losses since any resulting charge-offs will be larger on a per loan basis. Consequently, this could materially adversely affect our future earnings. Further, if we lost our relationship with one or more of these large borrowers our liquidity would substantially increase and our future earnings could be adversely affected.

If our allowance for loan losses is not sufficient to cover actual loan losses, our earnings could be reduced.

We make various assumptions and judgments about the collectibility of our loan portfolio, including the creditworthiness of our borrowers and the value of the real estate and other assets serving as collateral for the repayment of many of our loans. In determining the amount of the allowance for loan losses, we review our loans and our loss and delinquency experience, and evaluate economic conditions including the level of problem loans, business conditions and credit concentrations. Management recognizes that significant new growth in loan portfolios, new loan products and the refinancing of existing loans can result in portfolios comprised of unseasoned loans that may not perform in a historical or projected manner. If our assumptions are incorrect, our allowance for loan losses may not be sufficient to cover actual losses, resulting in additions to our allowance. Material additions to our allowance could materially decrease our net income. Our allowance for loan losses was 1.6% of total loans, and 29.0% of nonperforming loans, net of loans in process, at December 31, 2008. In addition, bank regulators periodically review our allowance for loan losses and may require us to increase our provision for loan losses or recognize additional loan charge-offs. Any increase in our allowance for loan losses or loan charge-offs as required by these regulatory authorities could have a material adverse effect on our financial condition and results of operations.

We may be required to make further increases in our provisions for loan losses and to charge-off additional loans in the future, which could adversely affect our results of operations.

For the year ended December 31, 2008 we recorded a provision for loan losses of $9.4 million compared to $6.0 million for the year ended December 31, 2007. Loan charge-offs for the year ended December 31, 2008 and 2007 were $432,000 and $0, respectively. We are experiencing increasing loan delinquencies. Generally, our nonperforming loans and assets reflect operating difficulties of individual borrowers resulting from weakness in the economy. In addition, slowing sales have been a contributing factor to the increase in nonperforming loans as well as the increase in delinquencies. At December 31, 2008 our total nonperforming loans, net of undisbursed funds, had increased to $58.6 million compared to $25.0 million at December 31, 2007. In that regard, our portfolio includes construction/land development loans and commercial loans, all of which have a higher risk of loss than residential mortgage loans. While loans related to the construction/land development portfolio represented 22.0% of our gross loan portfolio at December 31, 2008 they represented 75.1% of our nonperforming assets at that date. If current trends in the housing and real estate markets continue, we expect that we will continue to experience increased delinquencies and credit losses. Moreover, if the recession worsens we expect that it would further negatively impact economic conditions in our market areas and that we could experience significantly higher delinquencies and credit losses. An increase in our credit losses or our provision for loan losses would adversely affect our financial condition and results of operations.

Our loan portfolio is concentrated in loans with a higher risk of loss.

We originate construction/land development, commercial, multifamily, consumer, and one-to-four family residential mortgage loans primarily within our market areas. Generally, these types of loans, other than the one-to-four family residential mortgage loans, have a higher risk of loss. We had approximately $625.1 million outstanding in these types of higher risk loans at December 31, 2008. These loans have greater credit risk than one-to-four family residential real estate loans for a number of reasons, including those described below:

Construction /Land Development Loans. This type of lending contains the inherent difficulty in estimating both a property=s value at completion of the project and the estimated cost (including interest) of the project. If the estimate of construction cost proves to be inaccurate, we may be required to advance funds beyond the amount originally committed to permit completion of the project. If the estimate of value upon completion proves to be inaccurate, we may be confronted at, or prior to, the maturity of the loan with a project the value of which is insufficient to assure full repayment. In addition, speculative construction loans to a builder are often associated with homes that are not pre-sold, and thus pose a greater potential risk to us than construction loans to individuals on their personal residences. Loans on land under development or held for future construction also pose additional risk because of the lack of income being produced by the property and the potential illiquid nature of the collateral. These risks can be significantly impacted by supply and demand conditions. As a result, this type of lending often involves the disbursement of substantial funds with repayment dependent on the success of the ultimate project and the ability of the borrower to sell or lease the property, rather than the ability of the borrower or guarantor themselves to repay principal and interest. At December 31, 2008, we had $250.5 million or 22.0% of gross loans in construction/land development loans.

Our construction/land development loans are based upon estimates of costs and values associated with the completed project. These estimates may be inaccurate. Construction/land development lending involves additional risks when compared with permanent residential lending because funds are advanced upon the security of the project, which is of uncertain value prior to its completion. Because of the uncertainties inherent in estimating construction costs, as well as the market value of the completed project and the effects of governmental regulation of real property, it is relatively difficult to evaluate accurately the total funds required to complete a project and the related loan-to-value ratio. This type of lending also typically involves higher loan principal amounts and is often concentrated with a small number of builders. In addition, generally during the term of a construction/land development loan, no payment from the borrower is generally required since the accumulated interest is added to the principal of the loan through an interest reserve. These loans often involve the disbursement of substantial funds with repayment substantially dependent on the success of the ultimate project and the ability of the borrower to sell or lease the property or obtain permanent take-out financing, rather than the ability of the borrower or guarantor to repay principal and interest. If our appraisal of the value of a completed project proves to be overstated, we may have inadequate security for the repayment of the loan upon completion of construction of the project and may incur a loss. Further, as a result of the slowdown in the housing market, we have extended construction loans to permit completion of the project or the borrower additional time to market the underlying collateral. Most of these loans mature within 12 months. To the extent these loans are not further extended or the borrower cannot otherwise refinance with a third party lender our nonperforming construction loans may increase.

Commercial Real Estate and Multifamily Residential Loans. These loans typically involve higher principal amounts than other types of loans, and repayment is dependent upon income generated, or expected to be generated, by the property securing the loan in amounts sufficient to cover operating expenses and debt service, which may be adversely affected by changes in the economy or local market conditions. Commercial real estate and multifamily residential loans also expose a lender to greater credit risk than loans secured by one-to-four family residential real estate because the collateral securing these loans typically cannot be sold as easily as one-to-four family residential real estate. In addition, many of our commercial and multifamily real estate loans are not fully amortizing and contain large balloon payments upon maturity. Such balloon payments may require the borrower to either sell or refinance the underlying property in order to make the payment, which may increase the risk of default or non-payment. At December 31, 2008, we had $361.7 million or 31.8% of gross loans in commercial real estate and multifamily residential loans.

If we foreclose on a commercial real estate loan, our holding period for the collateral typically is longer than for one-to-four family residential mortgage loans because there are fewer potential purchasers of the collateral. Additionally, as a result of our increasing emphasis on this type of lending, a large portion of our commercial real estate loan portfolio is relatively unseasoned and has not been subjected to unfavorable economic conditions. As a result we may not have enough payment history with which to judge future collectibility or to predict the future performance of this part of our loan portfolio. These loans may have delinquency or charge-off levels above our historical experience, which could adversely affect our future performance. Further, commercial real estate loans generally have relatively large balances to single borrowers or related groups of borrowers. Accordingly, if we make any errors in judgment in the collectibility of our commercial real estate loans, any resulting charge-offs may be larger on a per loan basis than those incurred with our residential or consumer loan portfolios.

Consumer Loans. Consumer loans (such as personal lines of credit) are collateralized, if at all, with assets that may not provide an adequate source of payment of the loan due to depreciation, damage, or loss. In addition, consumer loan collections are dependent on the borrower=s financial stability, and thus are more likely to be adversely affected by job loss, divorce, illness or personal bankruptcy. Furthermore, the application of various federal and state laws, including federal and state bankruptcy and insolvency laws, may limit the amount that can be recovered on these loans. Home equity lines of credit have greater credit risk than one-to-four family residential mortgage loans because they are secured by mortgages subordinated to the existing first mortgage on the property, which we may or may not hold and do not have private mortgage insurance coverage and are adjustable rate/loans. At December 31, 2008, we had $12.9 million or 1.1% of gross loans in consumer loans.

Our concentration in non-owner occupied real estate loans may expose us to increased credit risk.

At December 31, 2008, $212.1 million, or 41.4% of our one-to-four family residential mortgage loan portfolio and 18.6% of our total loan portfolio, consisted of loans secured by non-owner occupied residential properties. Loans secured by non-owner occupied properties generally expose a lender to greater risk of non-payment and loss than loans secured by owner occupied properties because repayment of such loans depend primarily on the tenant=s continuing ability to pay rent to the property owner, who is our borrower, or, if the property owner is unable to find a tenant, the property owner=s ability to repay the loan without the benefit of a rental income stream. In addition, the physical condition of non-owner occupied properties is often below that of owner occupied properties due to lax property maintenance standards, which has a negative impact on the value of the collateral properties. Furthermore, some of our non-owner occupied residential loan borrowers have more than one loan outstanding with us. At December 31, 2008, we had 57 non-owner occupied residential loan relationships, with aggregate outstanding balances of $164.3 million and each loan relationship had an aggregate outstanding balance over $500,000. Consequently, an adverse development with respect to one credit relationship may expose us to a

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greater risk of loss compared to an adverse development with respect to an owner occupied residential mortgage loan. Our non-performing residential mortgage loans increased from $526,000 at December 31 2007 to $10.8 million at December 31, 2008, primarily due to an increase in nonperforming non-owner occupied residential mortgage loans. At December 31, 2008, nonperforming non-owner occupied residential mortgage loans totaled $10.3 million, or 4.9% of our non-owner occupied residential loan portfolio, of which $9.1 million was attributable to a single borrower. This increase in non-performing, non-owner occupied residential mortgage loans was a factor in our need to increase our allowance for loan losses through an increased provision for loan losses.

We could face an assessment to guarantee public funds in Washington State.

We accept state and local fund deposits from public treasurers in Washington State as a Qualified Public Depositary under the State=s Public Deposit Protection Act administered by the Public Deposit Protection Commission or the Commission. As of December 31, 2008 we held $81.7 million in public funds. Washington law requires qualified banks and thrifts to pledge eligible collateral into a collateral pool administered by the Commission to mutually guarantee with other members of the pool against a loss of funds suffered by a public treasurer as a result of a failure by a member of the pool. We meet the minimum standards under the law and are only required to pledge collateral at least equal to 10% of the public deposits we hold. The Commission has the authority to require up to 100% collateral for banks not meeting minimum standards. Our maximum liability should any member(s) of the collateral pool default on their uninsured public funds is limited to 10% of public funds we hold. Assessments for loss are based on a pro rata share of public funds held. Our share of total public funds on December 31, 2008 was 0.96%.

The AThrift Collateral Pool,@ which we are a member, has never had an assessment for a loss of uninsured public deposits by any member of the pool. The ABank Collateral Pool@ had its first ever assessment in the first quarter of 2009. Legislation is actively being considered to require all public depositaries to pledge 100% eligible collateral against public funds held on deposit. Should this legislation become law, each public depositary would be individually responsible for the protection of uninsured public funds they hold. The legislation would also merge the Thrift and Bank Collateral pools.

Further declines in our market value could result in an impairment of goodwill.

Recently, our common stock has been trading at a price below its book value, including goodwill and other intangible assets. Further declines in our common stock could result in an impairment of goodwill. If an impairment was deemed to exist, we would be required to write down our assets resulting in a charge to earnings.

Our business strategy may result in increased volatility of earnings.

Our business strategy is focused on reducing the size of the construction/land development portfolio and diversifying our construction loan portfolio among more builders with less concentration per builder. In addition First Savings Bank is planning expansion in multifamily, commercial real estate and business banking lending activities. These types of lending activities, while potentially more profitable than single-family lending, are generally more sensitive to regional and local economic conditions, making loss levels more difficult to predict. Collateral evaluation and financial statement analysis in these types of loans requires a more detailed analysis at the time of loan underwriting and on an ongoing basis. Economic trends in Western Washington State are further weakening and may contribute to further declines in real estate values, which would reduce the value of the real estate collateral securing our loans and increase the risk that we would incur losses if borrowers defaulted on their loans. In addition, the repayment of commercial real estate loans and multifamily loans generally are dependent, in large part, on the successful operation of the property securing the loan or the business conducted on the property securing the loan. Also, loan balances for commercial real estate and residential construction tract loans are typically larger than those for permanent single-family and consumer loans. Accordingly, when there are defaults and losses on these types of loans, they are often larger on a per loan basis than those for permanent single-family and consumer loans. A secondary market for most types of commercial real estate and construction loans is not readily liquid, so we have less opportunity to mitigate credit risk by selling part or all of our interest in these loans.

Our business strategy includes plans for growth, and our financial condition and results of operations could be negatively affected if we fail to grow or fail to manage our growth effectively.

We expect to experience growth in the amount of our assets, the level of our deposits and the scale of our operations. Achieving our growth targets requires us to attract customers that currently bank with other financial institutions in our market, thereby increasing our share of the market. In addition, to the extent we expand our lending beyond our current market area, we could incur additional risk related to those new market areas. Our ability to successfully grow will depend on a variety of factors, including our ability to attract and retain experienced bankers, the continued availability of desirable business opportunities, the competitive responses from other financial institutions in our market area and our ability to manage our growth. While we believe we have the management resources and internal systems in place to successfully manage our future growth, there can be no assurance growth opportunities will be available or that we will successfully manage our growth. If we do not manage our growth effectively, we may not be able to achieve our business plan, and our business and prospects could be harmed.

The loss of our current Chairman, President and Chief Executive Officer may hurt First Financial Northwest=s and First Savings Bank=s operations because it may be difficult to hire qualified replacements.

The loss of our Chairman, President, and Chief Executive Officer, Victor Karpiak, could have a material adverse impact on the operations of First Savings Bank since he has been instrumental in managing the business affairs of First Savings Bank. Other officers within First Savings Bank do not have the experience and expertise to readily replace Mr. Karpiak. If First Savings Bank were to lose Mr. Karpiak, the board of directors would most likely have to search outside of First Savings Bank for a qualified, permanent replacement. This search may be prolonged and we cannot assure you that First Savings Bank would be able to locate and hire a qualified replacement without interruption of, or loss of momentum in, our operations.

Mr. Karpiak has a significant amount of responsibility for the operations of First Savings Bank. As a result we face unique operational and internal control challenges because of our reliance on him, which also makes risk management and general supervisory oversight more difficult. We believe we have adequate risk management procedures and internal control systems in place, however, there can be no assurance that errors will not occur or that we will be able to maintain effective internal controls in the future. Any future failure to maintain effective internal controls could impair the reliability of our financial statements which in turn could harm our business, impair investor confidence and subject us to regulatory penalties.

We may suffer losses in our loan portfolio despite our underwriting practices.

We seek to mitigate the risks inherent in our loan portfolio by adhering to specific underwriting practices. Although we believe that our underwriting criteria are appropriate for the various kinds of loans we make, we may incur losses on loans that meet our underwriting criteria, and these losses may exceed the amounts set aside as reserves in our allowance for loan losses.

Liquidity risk could impair our ability to fund operations and jeopardize our financial condition.

Liquidity is essential to our business. An inability to raise funds through deposits, borrowings, the sale of loans and other sources could have a substantial negative effect on our liquidity. Our access to funding sources in amounts adequate to finance our activities or the terms of which are acceptable to us could be impaired by factors that affect us specifically or the financial services industry or economy in general. Factors that could detrimentally impact our access to liquidity sources include a decrease in the level of our business activity as a result of a downturn in the markets in which our loans are concentrated or adverse regulatory action against us. Our ability to borrow could also be impaired by factors that are not specific to us, such as a disruption in the financial markets or negative views and expectations about the prospects for the financial services industry in light of the recent turmoil faced by banking organizations and the continued deterioration in credit markets.

We could see declines in our uninsured deposits which would reduce the funds we have available for lending and other funding purposes.

The Federal Deposit Insurance Corporation in the fourth quarter of 2008 increased the federal insurance of deposit accounts from $100,000 to $250,000 and provided 100% insurance coverage for noninterest-bearing transaction accounts for participating members including First Savings Bank. These increases of coverage, with the exception of IRA and certain retirement accounts are set to expire at the end of 2009. Congress is considering the extension of the deposit insurance increases. With the increase of bank failures, depositors are reviewing deposit relationships to maximize federal deposit insurance coverage. We may see outflows of uninsured deposits as customers restructure their banking relationships in setting up multiple accounts in multiple banks to maximize federal deposit insurance coverage.

If external funds were not available, this could adversely impact our growth and prospects.

We rely on deposits and advances from the Federal Home Loan Bank of Seattle and other borrowings to fund our operations. Although we have historically been able to replace maturing deposits and advances as necessary, we might not be able to replace such funds in the future if, among other things, our results of operations or financial condition or the results of operations or financial condition of the Federal Home Loan Bank of Seattle or market conditions were to change. Although we consider such sources of funds adequate for our liquidity needs, there can be no assurance in this regard and we may be compelled or elect to seek additional sources of financing in the future. Likewise, we may seek additional debt in the future to achieve our long-term business objectives, in connection with future acquisitions or for other reasons. There can be no assurance additional borrowings, if sought, would be available to us or, if available, would be on favorable terms. If additional financing sources are unavailable or not available on reasonable terms, our financial condition, results of operations and future prospects could be materially adversely affected.

If we fail to maintain an effective system of internal control over financial reporting, we may not be able to accurately report our financial results or prevent fraud, and, as a result, investors and depositors could lose confidence in our financial reporting, which could materially adversely affect our business, the trading price of our common stock and our ability to attract additional deposits.

In connection with the enactment of the Sarbanes-Oxley Act of 2002 (AAct@) and the implementation of the rules and regulations promulgated by the SEC, we document and evaluate our internal control over financial reporting in order to satisfy the requirements of Section 404 of the Act. This requires us to prepare an annual management report on our internal control over financial reporting, including among other matters, management=s assessment of the effectiveness of internal control over financial reporting and an attestation report by our independent auditors addressing these assessments. If we fail to identify and correct any deficiencies in the design or operating effectiveness of our internal control over financial reporting or fail to prevent fraud, current and potential shareholders and depositors could lose confidence in our internal controls and financial reporting, which could materially adversely affect our business, financial condition and results of operations, the trading price of our common stock and our ability to attract additional deposits.

Our deposit insurance assessments will increase substantially, which will adversely affect our profits.

Our assessment for federal deposit insurance from the Federal Deposit Insurance Corporation for the year ended December 31, 2008 was $470,000 at an assessment rate of seven basis points for deposits. Assessments for federal deposit insurance are expected to increase significantly for 2009 as the Federal Deposit Insurance Corporation implements its Deposit Insurance Fund restoration plan that it adopted on February 27, 2009 by interim rule. The restoration plan increases the base assessment rates for banks of all risk categories, adjusts premiums for new risk factors, and imposes an emergency special assessment of 20 basis points payable on September 30, 2009 based on deposits as of June 30, 2009. The special assessment was adopted by interim rule and subject to a 30 day comment period and may change. While we do not know the exact cost of our special assessment, based on our deposits as of December 31, 2008 of $867.8 million our estimated special assessment cost would be $1.7 million. The new total base assessment rates issued by the Federal Deposit Insurance Corporation in the Deposit Insurance Fund restoration plan range from seven basis points to 77.5 basis points spread over four risk categories. We expect our base assessment to increase in 2009 as compared to 2008. The interim rule would also permit the Federal Deposit Insurance Corporation to impose an additional emergency special assessment after June 30, 2009, of up to ten basis points if necessary to maintain public confidence in federal deposit insurance.

Our ability to foreclose on single family home loans may be restricted.

New legislation proposed by Congress may give bankruptcy judges the power to reduce the increasing number of home foreclosures. Bankruptcy judges would be given the authority to restructure mortgages and reduce a borrower=s payments. Property owners would be allowed to keep their property while working out their debts. This legislation may restrict our collection efforts on one-to-four family loans. Separately, the administration has announced a voluntary program under the TARP law which provides for government subsidies for reducing a borrower=s interest rate, which a lender would have to match with its own money.

Fluctuations in interest rates could reduce our profitability and affect the value of our assets.

Like other financial institutions, we are subject to interest rate risk. Our primary source of income is net interest income, which is the difference between interest earned on loans and investments and the interest paid on deposits and borrowings. We expect that we will periodically experience imbalances in the interest rate sensitivities of our assets and liabilities and the relationships of various interest rates to each other. Over any defined period of time, our interest-earning assets may be more sensitive to changes in market interest rates than our interest-bearing liabilities, or vice versa. In addition, the individual market interest rates underlying our loan and deposit products (e.g., prime) may not change to the same degree over a given time period. In any event, if market interest rates should move contrary to our position, our earnings may be negatively affected. In addition, loan volume and quality and deposit volume and mix can be affected by market interest rates. Changes in levels of market interest rates could materially affect our net interest spread, asset quality, origination volume, and overall profitability.

We principally manage interest rate risk by managing our volume and mix of our earning assets and funding liabilities. In a changing interest rate environment, we may not be able to manage this risk effectively. If we are unable to manage interest rate risk effectively, our business, financial condition and results of operations could be materially harmed.

Changes in the level of interest rates also may negatively affect our ability to originate real estate loans, the value of our assets and our ability to realize gains from the sale of our assets, all of which ultimately affect our earnings. At December 31, 2008, we had $865.5 million in loans due after one year with fixed rates of interest, representing 76.1% of our total loan portfolio and 69.6% of our total assets. Our most recent Arate shock@ analysis indicates that our net portfolio value would be more adversely affected by an increase in interest rates than by a decrease. See AItem 7, Management=s Discussion and Analysis of Financial Condition and Results of Operations B Asset and Liability Management and Market Risk.@

Our single branch location limits our ability to attract retail deposits and as a result a large portion of our deposits are certificates of deposit, including AJumbo@ certificates which may not be as stable as other types of deposits.

Our single branch location limits our ability to compete with larger institutions for noninterest bearing deposits as these institutions have a larger branch network providing greater convenience to customers. As a result, we are dependent on more interest rate sensitive deposits. At December 31, 2008, $645.4 million, or 81.6%, of our total deposits were certificates of deposit, and of that amount $421.2 million, or 65.3%, of the certificates of deposit were Ajumbo@ certificates of $100,000 or more. In addition, at that date our high yield money market accounts totaled $121.2 million or 15.3% of our total deposits. Deposit inflows are significantly influenced by general interest rates. Our money market accounts and jumbo certificates of deposit and the retention of these deposits are particularly sensitive to general interest rates, making these deposits traditionally a more volatile source of funding than other deposit accounts. In order to retain our money market accounts and jumbo certificates of deposit, we may have to pay a higher rate, resulting in an increase in our cost of funds. In a rising rate environment, we may be unwilling or unable to pay a competitive rate because of the resulting compression in our interest rate spread. To the extent that such deposits do not remain with us, they may need to be replaced with borrowings or other deposits which could increase our cost of funds and negatively impact our interest rate spread and our financial condition.

We face strong competition from other financial institutions, financial service companies and other organizations offering services similar to those offered by us, which could limit our growth and profitability.

We face direct competition from a significant number of financial institutions, many with a state-wide or regional presence, and in some cases a national presence, in both originating loans and attracting deposits. Competition in originating loans comes primarily from other banks, mortgage companies and consumer finance institutions that make loans in our primary market areas. We also face substantial competition in attracting deposits from other banking institutions, money market and mutual funds, credit unions and other investment vehicles.

In addition, banks with larger capitalization and non-bank financial institutions that are not governed by bank regulatory restrictions have large lending limits and are better able to serve the needs of larger customers. Many of these financial institutions are also significantly larger and have greater financial resources than us, have been in business for a longer period of time and have established customer bases and name recognition.

We compete for loans principally on the basis of interest rates and loan fees, the types of loans we originate and the quality of service we provide to borrowers. Our ability to attract and retain deposits requires that we provide customers with competitive investment opportunities with respect to rate of return, liquidity, risk and other factors. To effectively compete, we may have to pay higher rates of interest to attract deposits, resulting in reduced profitability. If we are not able to effectively compete in our market area, our profitability may be negatively affected, potentially limiting our ability to pay dividends. The greater resources and deposit and loan products offered by some of our competitors may also limit our ability to increase our interest-earning assets. See Item 1., ABusiness B Competition.@

Item 1B. Unresolved Staff Comments

Not applicable. First Financial Northwest has not received any written comments from the SEC regarding its periodic or current reports under the Securities Exchange Act of 1934, as amended that are unresolved.

Item 2. Properties

At December 31, 2008, we had one full service office, which we own in Renton, Washington. This site is the corporate office for First Financial Northwest and First Savings Bank and is located at 201 Wells Avenue South. This location is also the site for the operations of First Financial Northwest=s subsidiary, First Financial Diversified, at the address of 208 Williams Avenue South. The commercial lending division operations of First Savings Bank, is located at 207 Wells Avenue South. The net book value of our investment in premises, equipment, and leaseholds, excluding computer equipment and construction in process, was $12.6 million at December 31, 2008.

During 2009, we plan to remodel our facility at 207 Wells Avenue South. The purpose of this remodel is to increase the square footage of the building in order to accommodate our increase in staff. During 2008 we have focused on improving the depth and quality of our staff and our overall infrastructure. The project is expected to take nine to 12 months at a cost of approximately $10.0 million.

Item 3. Legal Proceedings

From time to time, we are involved as plaintiff or defendant in various legal actions arising in the normal course of business. As of December 31, 2008, we were not involved in any significant litigation and do not anticipate incurring any material liability as a result of any such litigation.

Item 4. Submission of Matters to a Vote of Security Holders

No matters were submitted to a vote of security holders during the fourth quarter of the fiscal year ended December 31, 2008.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Our common stock is traded on The Nasdaq Stock Market LLC=s Global Select Market, under the symbol AFFNW.@ As of December 31, 2008, there were 21,293,368 shares of common stock issued and outstanding and we had approximately 998 shareholders of record, excluding persons or entities who hold stock in nominee or Astreet name@ accounts with brokers.

Dividends

Under federal regulations, the dollar amount of dividends First Savings Bank may pay to First Financial Northwest, Inc. depends upon its capital position and recent net income. Generally, if First Savings Bank satisfies its regulatory capital requirements, it may make dividend payments up to the limits prescribed in the state law and Federal Deposit Insurance Corporation regulations. However, institutions that have converted to a stock form of ownership may not declare or pay a dividend on, or repurchase any of, its common stock if it would cause the regulatory capital of the institution to be reduced below the amount required for the liquidation account which was established in connection with the conversion. Under Washington law, First Financial Northwest is prohibited from paying a dividend if, as a result of its payment, it would be unable to pay its debts as they become due in the normal course of business, or if First Financial Northwest's total liabilities would exceed its total assets. See AItem 1. Business B How We Are Regulated B Regulation and Supervision of First Financial Northwest B Dividends.@

The following table sets forth the market price range of, and dividends paid on, the Company's common stock for the years ended December 31, 2008 and 2007. The following information was provided by The Nasdaq Stock Market LLC.

	High	Low	Dividends
Fiscal 2008			
First Quarter	$10.00	$8.78	$ --
Second Quarter	10.60	9.22	0.075
Third Quarter	11.02	9.00	0.080
Fourth Quarter	10.40	7.06	0.085
Fiscal 2007			
October 10 - December 31 (1)	$11.95	$9.80	N/A

(1) First Financial Northwest=s common stock began trading on The Nasdaq Stock Market LLC on October 10, 2007.

Stock Repurchases

On June 23, 2008, First Financial Northwest announced a plan to repurchase 914,112 shares, or 4%, of the Company's outstanding common stock. This was First Financial Northwest=s first stock repurchase plan, which was undertaken for the purpose of repurchasing shares of its common stock to fund the 2008 Equity Incentive Plan which are held in trust for the recipients. The completion of this repurchase program occurred on October 29, 2008. On November 5, 2008, First Financial Northwest announced a plan to repurchase and retire 2,285,280 shares, or approximately 10% of our outstanding common stock. As of December 31, 2008, we had repurchased 1,559,432 shares of our common stock under this plan. Cumulatively through December 31, 2008, we have repurchased 2,473,544 shares at an average price of $9.20 per share. This represents 10.8% of the 22,852,800 shares that were issued when First Financial

Northwest went public in October 2007. Subsequent to December 31, 2008 we repurchased the balance of the remaining shares under the plan and amended the plan to repurchase an additional 2,056,752 shares or approximately 10% of our outstanding common stock.

The following table sets forth First Financial Northwest=s repurchases of its outstanding common stock for the year ended December 31, 2008.

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans	Maximum Number of Shares to Be Purchased Under the Plans
August 2008	483,987	$ 9.99	483,987	430,125
September 2008	402,983	10.52	402,983	27,142
October 2008 .	27,142	8.14	27,142	--
November 2008	1,060,854	8.45	1,060,854	1,224,426
December 2008	498,578	9.00	498,578	725,848
Total shares repurchased as of December 31, 2008	2,473,544	$ 9.20	2,473,544	725,848

Subsequent to December 31, 2008, we repurchased the remaining 725,848 shares under the repurchase plan announced on November 5, 2008 at an average price per share of $8.28. Subsequent to December 31, 2008, the plan was amended to repurchase an additional 2,056,752 shares or approximately 10% of our outstanding common stock. As of February 27, 2009, 25,000 shares had been repurchased under the amended plan at an average price of $7.55.

Equity Compensation Plan Information

The equity compensation plan information presented under subparagraph (d) in Part III, Item 12 of this report is incorporated herein by reference.

Performance Graph. The following graph compares the cumulative total shareholder return on the Company=s Common Stock with the cumulative total return on the Russell 2000 Index, the Nasdaq Bank Index, and the SNL Thrift Index, a peer group index. The graph assumes that total return includes the reinvestment of all dividends, and that the value of the investment in First Financial Northwest=s common stock and each index was $100 on October 10, 2007, and is the base amount used in the graph. The closing price of First Financial Northwest=s common stock on December 31, 2008 was $9.34.

	Period Ended					
Index	10/10/07	12/31/07	03/31/08	06/30/08	09/30/08	12/31/08
First Financial Northwest, Inc.	100.00	83.89	80.14	85.31	89.36	81.63
NASDAQ Bank Index	100.00	85.52	81.85	65.86	77.90	65.06
Russell 2000	100.00	90.92	81.92	82.40	81.48	60.20
SNL Thrift Index	100.00	69.46	66.25	54.79	50.96	44.21

Item 6. Selected Financial Data

The following table sets forth certain information concerning our consolidated financial position and results of operations at and for the dates indicated and have been derived from our audited consolidated financial statements. The information below is qualified in its entirety by the detailed information included elsewhere herein and should be read along with AItem 7. Management's Discussion and Analysis of Financial Condition and Results of Operations@ and AItem 8. Financial Statements and Supplementary Data.@

	At December 31,				
	2008	2007(3)	2006	2005(4)	2004
FINANCIAL CONDITION DATA:	(In thousands, except share data)				
Total assets	$1,244,440	$1,140,888	$1,004,711	$879,650	$776,363
Investments available for sale	149,323	119,837	149,051	184,279	265,557
Investments held to maturity	--	80,410	86,786	86,663	88,512
Loans receivable, net (1)	1,035,181	880,664	700,328	540,695	384,128
Goodwill	14,206	14,206	14,206	13,754	--
Deposits	791,483	729,494	750,710	689,502	666,271
Advances from the Federal Home Loan Bank	156,150	96,000	147,000	90,000	17,000
Stockholders= equity	290,108	309,286	104,042	96,353	90,238
Book value per common share (2)	13.62	13.53	N/A	N/A	N/A

	Years Ended December 31,				
OPERATING DATA:	2008	2007	2006	2005	2004
	(In thousands, except share data)				
Interest income	$68,601	$66,569	$55,260	$40,285	$36,464
Interest expense	35,978	42,848	37,248	23,668	19,335
Net interest income	32,623	23,721	18,012	16,617	17,129
Provision for loan losses	9,443	6,000	320	137	--
Net interest income after provision for loan losses	23,180	17,721	17,692	16,480	17,129
Noninterest income (expense)	200	589	(92)	354	400
Noninterest expense	14,687	25,969	8,384	4,739	3,782

Income before provision/(benefit) for federal income taxes	8,693	(7,659)	9,216	12,095	13,747
Provision for federal income tax expense (benefit)	4,033	(3,675)	2,128	3,021	3,692
Net income (loss)	$4,660	$ (3,984)	$ 7,088	$ 9,074	$10,055
Basic earnings (loss) per share (2)	$0.22	($0.51)	N/A	N/A	N/A
Diluted earnings (loss) per share (2)	$0.22	($0.51)	N/A	N/A	N/A

(1) Net of allowances for loan losses, loans in process and deferred loan fees and costs.

(2) First Financial Northwest completed the offering in connection with the mutual to stock conversion on October 9, 2007.

(3) Loss per share is calculated for the period from October 9, 2007 to December 31, 2007 the period for which First Financial Northwest was publicly-owned.

(4) Our acquisition of Executive House was consummated on December 30, 2005 and the assets and liabilities of Executive House are included on our consolidated balance sheet at December 31, 2005. Results of operations of Executive House are not included in our consolidated financial statements for prior periods.

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OTHER DATA:	At December 31, 2008	2007	2006	2005	2004
Number of:					
Loans outstanding	3,362	3,015	2,558	2,209	1,886
Deposit accounts	15,719	15,548	15,836	14,522	13,668
Full-service offices	1	1	1	1	1

KEY FINANCIAL RATIOS:	At or For the Years Ended December 31, 2008	2007	2006	2005	2004
Performance Ratios:					
Return (loss) on assets (1)(3)	0.39%	(0.37)%	0.75%	1.14%	1.35%
Return (loss) on equity (2)(3)	1.50	(2.59)	6.86	9.55	11.82
Equity to asset ratio (4)	25.70	14.37	10.89	11.94	11.40
Interest rate spread (5)	1.84	1.75	1.76	1.87	2.05
Net interest margin (6)	2.81	2.30	2.01	2.18	2.34
Tangible equity to tangible assets (7)	22.43	26.19	9.07	9.54	11.62
Average interest-earning assets to average interest-bearing liabilities	131.20	113.48	106.05	109.94	111.38
Efficiency ratio (8)(9)	44.75	106.82	46.79	27.92	21.58
Noninterest expense as a percent of average total assets (9)	1.22	2.42	0.88	0.60	0.51
Capital Ratios (10):					
Tier I leverage	15.61	16.62	8.61	9.70	10.94
Tier I risk-based	23.04	24.84	14.23	15.70	23.72
Total risk-based	24.30	25.91	14.56	16.03	24.00
Asset Quality Ratios (11):					
Nonaccrual and 90 days or more past due loans as a percent of total loans	5.56	2.81	0.02	0.05	0.07
Nonperforming assets as a percent of total assets	4.71	2.19	0.02	0.03	0.03

Allowance for loan losses as a percent of total loans	1.61	0.89	0.28	0.30	0.26
Allowance for loan losses as a percent of nonperforming loans	28.96	31.83	1279.87	550.33	375.47
Net charge-offs to average loans receivable, net	0.04	--	--	0.01	--

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(1) Net income divided by average total assets.
(2) Net income divided by average equity.
(3) Noninterest expense in 2007 included a one-time expense for the establishment of the First Financial Northwest Foundation of $16.9 million. Without this one-time expense, the return on assets for the year ended December 31, 2007 would have been 1.21% and return on equity for the same period would have been 8.41%.
(4) Average equity divided by average total assets.
(5) Difference between weighted-average yield on interest-earning assets and weighted-average cost on interest-bearing liabilities.
(6) Net interest margin is calculated as net interest income divided by average interest-earning assets.
(7) Tangible equity is equity less goodwill and other intangible assets.
(8) The efficiency ratio represents the ratio of noninterest expense divided by the sum of net interest income and noninterest income.
(9) Noninterest expense in 2007 included a one-time expense for the establishment of the First Financial Northwest Foundation of $16.9 million. Without this one-time expense, the efficiency ratio for the year ended December 31, 2007 would have been 37.19% and noninterest expense as a percent of average total assets for this same period would have been 0.84%.
(10) Capital ratios are for First Savings Bank only.
(11) Nonaccrual and nonperforming loans/assets and total loans are calculated net of undisbursed funds.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

This discussion and analysis reviews our consolidated financial statements and other relevant statistical data and is intended to enhance your understanding of our financial conditions and results of operations. The information in this section has been derived from the Consolidated Financial Statements and footnotes thereto, which appear in Item 8 of this Form 10-K. You should read the information in this section in conjunction with the business and financial information regarding First Savings Bank as provided in this Form 10-K. Unless otherwise indicated, the financial information presented in this section reflects the consolidated financial condition and results of operations of First Financial Northwest and its subsidiaries.

Overview

First Savings Bank is a community-based savings bank primarily serving King and to a lesser extent, Pierce, Kitsap and Snohomish counties, Washington through our full-service banking office. We are in the business of attracting deposits from the public through our office and utilizing those deposits to originate loans. Historically, we have been a traditional fixed rate portfolio lender originating residential home loans. Our business strategy centers on the continued transition to commercial banking activities in order to expand our net interest margin. Since December 31, 2004 we have increased the amount of our construction/land development loans from 6.2% to 22.0% of our total loan portfolio at December 31, 2008 while reducing our one-to-four family residential loans from 56.9% to 45.1% over the same period. At December 31, 2008 our construction/land development loans totaled $250.5 million or 22.0% of our loan portfolio, substantially all which are short-term adjustable rate loans. In contrast, our residential mortgage loans, commercial real estate and multifamily loans are generally long term fixed rate loans. We have not actively participated in traditional one-to-four family adjustable rate mortgages, which totaled $6.2 million at December 31, 2008. Included in this portfolio are construction permanent loans which adjust based on prime during the construction phase but convert to a fixed rate loan upon completion, along with a limited number of seasoned residential loans. We consider this an insignificant portion of our loan portfolio and do not promote this type of loan product, nor do we generally offer Ateaser@ rates. Our loss history for this type of lending has been immaterial.

Prior to the latter half of 2007, real estate and home values increased substantially, as a result of the generally strong national economy, speculative investing, and aggressive lending practices that provided loans to marginal borrowers (generally termed as Asubprime@ loans). The strong economy also resulted in strong increases in residential and commercial real estate values and commercial and residential construction. The national residential lending market has since experienced worsening conditions in the last year as loan delinquencies and foreclosure rates have risen to unprecedented volumes. The national delinquency rate for one-to-four family residential loans 30 days or more delinquent was 7.0% and the percentage of loans on which foreclosure actions were started based on annualized third quarter of 2008 data was 4.3%, according to the National Delinquency Survey published by the Mortgage Bankers Association. In addition, according to the Survey the national percentage of subprime mortgage loans in foreclosure was 12.6%. Nationally, foreclosures and delinquencies are also being driven by investor speculation in the states of Arizona, California, Florida and Nevada, while job losses and depressed economic conditions in Indiana, Michigan and Ohio have resulted in the highest level of seriously delinquent loans. Louisiana and Mississippi also have high residential loan delinquencies as a result of hurricane Katrina-related economic factors.

Our primary source of pre-tax income is net interest income. Net interest income is the difference between interest income, which is the income that we earn on our loans and investments, and interest expense, which is the interest that we pay on our deposits and borrowings. Changes in levels of interest rates affect our net interest income. Since First Savings Bank is liability-sensitive meaning its liabilities reprice at a faster rate than its interest-earning assets, the lower interest rate environment that we are currently experiencing has contributed to an improvement in our net interest rate spread and net interest margin.

Although historically our loan losses have been low, during 2008 our provision for loan losses totaled $9.4 million. Of this amount, $4.5 million related to impaired loans in our residential construction/land development and one-to-four family loan portfolios related to specific borrowing relationships. The balance of the provision was attributable to the change in the mix of our loan portfolio, the uncertain economy, and the increase in delinquencies among other factors. We will continue to monitor our loan portfolio and make adjustments to our allowance for loan losses as we deem necessary.

Our operating expenses consist primarily of compensation and benefits, occupancy and equipment, data processing, marketing, postage and supplies, professional services and deposit insurance premiums. Compensation and benefits consist primarily of the salaries and wages paid to our employees, payroll taxes and expenses for retirement and other employee benefits. Occupancy and equipment expenses, which are the fixed and variable costs of building and equipment, consist primarily of real estate taxes, depreciation charges, maintenance and costs of utilities.

Our employee stock ownership plan acquired 1,692,800 shares of First Financial Northwest common stock with a $16.9 million loan from First Financial Northwest that will be be repaid over 15 years, resulting in an annual pre-tax increase in compensation expense of approximately $1.1 million (assuming that the common stock maintains a value of $10.00 per share). Our operating expense has increased as a result of this increase in compensation expenses associated with the allocation of employee stock ownership plan shares to employees. The actual expense that will be recorded for the employee stock ownership plan will be determined by the market value of the shares of common stock as they are released to employees over the term of the loan. Accordingly, increases in the stock price above $10.00 per share will increase the total employee stock ownership plan expense. For the year ended December 31, 2008, we recorded additional pre-tax operating expense of $1.2 million as a result of increased compensation costs with respect to the implementation of our employee stock ownership plan.

In June 2008, after receiving shareholder approval, we implemented our stock-based incentive plans, which resulted in an increase in operating expenses. In July 2008, stock options to purchase approximately 1.4 million shares of our common stock were issued to directors and employees of the Company at a weighted-average price of $9.78 per share. The fair value of each option award was estimated on the date of grant using a Black-Scholes model using an annual dividend yield of 3.27%, expected volatility of 23.74%, a risk-free interest rate of 3.51% and an expected term of 6.5 years. As a result, the corresponding annual pre-tax expenses associated with the stock option plan was $263,000. In addition, under our stock-based incentive plan we awarded approximately 748,000 shares of restricted stock to eligible participants at a weighted-average price of $10.34 per share, which vest over a five-year period beginning at the grant date, and which will be expensed as the awards vest over the five year period. For further information, see the AEmployee Benefit Plans@ note in the Notes to Consolidated Financial Statements included in Item 8 of this report on Form 10-K.

Our noninterest expenses decreased $11.3 million during the year ended December 31, 2008 as compared to 2007. During 2007, a one-time contribution was made to the First Financial Northwest Foundation totaling $16.9 million. Absent this one-time contribution, noninterest expenses for 2008 increased $5.6 million as compared to 2007. During 2008, management focused on the development of the First Financial Northwest=s infrastructure as it related to staffing and systems. This resulted in the additions of several key personnel during the year which included a new Chief Financial Officer, a Business Banking Manager, a Financial Analyst, and additional support staff. Management believes these additions will position us for future growth. Effective January 1, 2009 we also hired a Senior Vice President, Strategic Development to develop and execute a strategic plan for First Savings Bank.

Business Strategy

We are a community-oriented savings bank whose focus for the past several years has been primarily to gather deposits to fund a diversified mix of residential mortgage loans, commercial and multifamily real estate loans and construction/land development loans.

Our business strategy is to operate and grow First Savings Bank as a well-capitalized and profitable community bank, offering primarily one-to-four family mortgage loans, commercial and multifamily real estate loans and construction/land development loans along with a diversified array of deposits and other products and services to individuals and businesses in our market areas. We intend to accomplish this strategy by leveraging our established name and franchise, capital strength and mortgage production capability by:

$ Capitalizing on our intimate knowledge of our local communities to serve the convenience and needs of customers, delivering a consistent and high-quality level of professional service;

$ Offering competitive deposit rates and developing customer relationships to expand our core deposits, diversify the deposit mix by growing lower cost deposits, attracting new customers and expanding the Company=s footprint in the geographical area it serves;

$ Manage our loan portfolio to minimize concentrations and diversify the types of loans within the portfolio;

$ Managing credit risk to minimize the risk of loss to the Bank, and interest rate risk to optimize our net interest margin; and

$ Improving our overall efficiency and profitability.

Critical Accounting Policies

Critical accounting policies are those that involve significant judgments and assumptions by management and that have, or could have, a material impact on our income or the carrying value of our assets. Our critical accounting policies are those related to our allowance for loan losses and deferred taxes.

Allowance for Loan Losses

Management recognizes that loan losses may occur over the life of a loan and that the allowance for loan losses must be maintained at a level necessary to absorb specific losses on impaired loans and probable losses inherent in the loan portfolio. Our methodology for analyzing the allowance for loan losses consists of two components: formula and specific allowances. The formula allowance is determined by applying factors to our various groups of loans. Management considers factors such as charge-off history, the prevailing economy, borrower=s ability to repay, the regulatory environment, competition, geographic and loan type concentrations, policy and underwriting standards, nature and volume of the loan portfolio, management=s experience level, our loan review system, the value of underlying collateral, the level of problem loans, business conditions and credit concentrations in assessing the allowance for loan losses. The specific allowance component is created when management believes that the collectibility of a specific loan, such as a real estate, multifamily or commercial real estate loan, has been impaired and a loss is probable. The specific reserves are computed using current appraisals, listed sales prices and other available information less costs to complete, if any, and sell the property. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available or as future events differ from predictions.

Our Board of Directors approves the provision for loan losses on a quarterly basis. The allowance is increased by the provision for loan losses, which is charged against current period earnings and decreased by the amount of actual loan charge-offs, net of recoveries.

We believe that the accounting estimate related to the allowance for loan losses is a critical accounting estimate because it is highly susceptible to change from period-to-period requiring management to make assumptions about probable losses inherent in the loan portfolio; and the impact of a sudden large loss could deplete the allowance and potentially require increased provisions to replenish the allowance, which would negatively affect earnings. For additional information see the section titled AWe may be required to make further increases in our provision for loan losses and to charge-off additional loans in the future, which could adversely affect our results of operations,@ within the section titled ARisks related to our Business.@

Goodwill

Goodwill represents the costs in excess of net assets acquired arising from the purchases of Executive House, Inc. in December 2005. Goodwill is not amortized, but is reviewed for impairment and written down and charged to expense during the periods in which the recorded value is more than its fair value. We evaluate any potential impairment of goodwill on an annual basis, or more frequently if events or changes in circumstances indicate that goodwill might be impaired at the First Financial Northwest level. If First Financial Northwest's market capitalization (total common shares outstanding multiplied by the current stock price) exceeds the common book value, absent other indicators of impairments, goodwill is not considered impaired and no additional analysis is necessary. Despite negative values in the above tests goodwill might not be considered impaired due to current market volatility and control purchase premiums in the banking industry. However, an impairment may be recorded in the future if market capitalization continues to decrease. Any potential non-cash goodwill impairment expense would not affect First Financial Northwest's regulatory capital ratios since goodwill is not included in the calculation.

Deferred Taxes

Deferred tax assets arise from a variety of sources, the most significant being: a) expenses, such as our charitable contribution to the First Financial Northwest Foundation, that can be carried forward to be utilized against profits in future years; b) expenses recognized in the books but disallowed in the tax return until the associated cash flow occurs; and c) writedowns in the value of assets for book purposes that are not deductible for tax until the asset is sold or deemed worthless.

We record a valuation allowance to reduce our deferred tax assets to the amount which can be recognized in line with the relevant accounting standards. The level of deferred tax asset recognition is influenced by management=s assessment of our historic and future profitability profile. At each balance sheet date, existing assessments are reviewed and, if necessary, revised to reflect changed circumstances. In a situation where income is less than projected or recent losses have been incurred, the relevant accounting standards require convincing evidence that there will be sufficient future tax capacity. See Federal Taxes on Income footnote included in the Notes to Consolidated Financial Statements.

Other-Than-Temporary Impairments In the Market Value of Investments

Declines in the fair value of any available for sale or held to maturity investment below their cost that is deemed to be other-than-temporary results in a reduction in the carrying amount of the investment to that of fair value. A charge to earnings and an establishment of a new cost basis for the investment is made. Unrealized investment losses are evaluated at least quarterly to determine whether such declines should be considered other-than-temporary and therefore be subject to immediate loss recognition in income. Although these evaluations involve significant judgment, an unrealized loss in the fair value of a debt security is generally deemed to be temporary when the fair value of the investment security is below the carrying value primarily due to changes in interest rates, there has not been significant deterioration in the financial condition of the issuer, and First Financial Northwest has the intent and ability to hold the investment for a sufficient time to recover the carrying value. An unrealized loss in the value of an equity security is generally considered temporary when the fair value of the security is below the carrying value primarily due to current market conditions and not deterioration in the financial condition of the issuer. Other factors that may be considered in determining whether a decline in the value of either a debt or an equity security is other-than-temporary include ratings by recognized rating agencies; the extent and duration of an unrealized loss position; actions of commercial banks or other lenders relative to the continued extension of credit facilities to the issuer of the security; the financial condition, capital strength and near-term prospects of the issuer and recommendations of investment advisors or market analysts. Therefore continued deterioration of market conditions could result in additional impairment losses recognized within the investment portfolio.

Comparison of Financial Condition at December 31, 2008 and December 31, 2007

General. Our total assets increased $103.6 million, or 9.1%, to $1.2 billion at December 31, 2008 from $1.1 billion at December 31, 2007. The asset growth resulted mainly from an increase in net loans receivable of $154.5 million. In January 2008, we elected to transfer our entire investments held to maturity portfolio to our investments available for sale portfolio. The investments available for sale portfolio decreased $50.9 million or 25.4% as a result of the proceeds from the sale of $84.4 million of investments, principal repayments of $33.5 million and a $1.6 million charge taken for an other-than-temporary loss related to our AMF mutual fund investment. Total liabilities increased $122.7 million or 14.8% to $954.3 million at December 31, 2008 from $831.6

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million at December 31, 2007 primarily as a result of increases in deposits of $62.0 million and advances from the Federal Home Loan Bank of Seattle of $60.2 million. Stockholders= equity decreased $19.2 million or 6.2%.

Assets. Total assets increased $103.6 million or 9.1% during the year ended December 31, 2008. The following table details the changes in the composition of our assets from December 31, 2007 to December 31, 2008.

	Balance at December 31, 2008	Increase/(Decrease) from December 31, 2007	Percentage Increase/(Decrease)
		(Dollars in Thousands)	
Cash on hand and in banks	$ 3,366	$ (309)	(8.41)%
Interest-bearing deposits	600	(187)	(23.76)
Federal funds sold	1,790	(5,325)	(74.84)
Investments available for sale	149,323	29,486	24.61
Investments held to maturity	--	(80,410)	(100.00)
Loans receivable, net	1,035,181	154,517	17.55
Premises and equipment, net	13,026	(313)	(2.35)
Federal Home Loan Bank stock, at cost	7,413	2,742	58.70
Accrued interest receivable	5,532	338	6.51
Deferred tax assets, net	9,266	2,173	30.64
Goodwill	14,206	--	--
Prepaid expenses and other assets	4,737	840	21.56
Total assets	$ 1,244,440	$ 103,552	9.08%

Cash on hand and in banks, interest-bearing deposits, and federal funds sold decreased $309,000, $187,000, and $5.3 million, respectively, from December 31, 2007, as these funds were used to fund the loan growth during the year ended December 31, 2008.

Loans receivable, net increased $154.5 million to $1.0 billion at December 31, 2008 from $880.7 million at December 31, 2007. During the year ended December 31, 2008, we originated $144.1 million in one-to-four family mortgage loans. We also originated $74.8 million and $33.2 million in commercial real estate and multifamily mortgages and $10.9 million in consumer loans. Our construction/land development loan originations during the year were $33.3 million principally with the same builders we have done business with in the past. Our loan growth during the year ended December 31, 2008 was partially offset by $159.0 million in principal repayments received during the year.

The combined portfolios of our investments available for sale and investments held to maturity, as noted above, decreased $50.9 million or 25.4% to $149.3 million at December 31, 2008 from $200.2 million at December 31, 2007. In January 2008, we elected to transfer our entire investments held to maturity portfolio to our investments available for sale portfolio. During the year ended December 31, 2008, we sold $82.8 million of investments. Gross proceeds from the sales were $84.4 million with net gains of $1.6 million. We recorded an other-than-temporary impairment charge during fiscal 2008 reducing the investment portfolio by $1.6 million. For the year ended December 31, 2008, we purchased $64.4 million of Fannie Mae and Freddie Mac mortgage-backed securities and a Housing and Urban Development bond.

Our nonperforming loans increased to $58.6 million at December 31, 2008 from $25.0 million at December 31, 2007. Of our nonperforming loans, $44.0 million are to nine residential builders for projects secured by real estate. The undisbursed funds related to these loans totaled $14.5 million. Of the $44.0 million in construction/land development nonperforming loans, $11.7 million is attributable to one builder of entry-level homes. The remaining

$32.3 million of these loans is comprised of loans to eight builders with the next largest nonperforming loan amount totaling $7.7 million. The real estate securing these loans is predominately located in King and Pierce counties, Washington. Nonperforming one-to-four family residential loans totaled $10.8 million at December 31, 2008.

These loans were primarily related to the same builders discussed above. In addition, we also had $3.8 million in commercial real estate loans that were nonperforming, comprised of two office buildings and a warehouse which due to vacancies are experiencing cash flow issues. The foregone interest during the year ended December 31, 2008 relating to all nonperforming loans, totaled $2.1 million. We intend to work with our builders to reach acceptable payment plans while protecting our interests in the existing collateral. In the event an acceptable arrangement cannot be reached, we may have to acquire these properties through foreclosure or other means and subsequently sell, develop, or liquidate them.

Management performs an impairment analysis on a loan when it determines it is probable that all contractual amounts of principal and interest will not be paid as scheduled. The analysis usually occurs when a loan has been negatively classified or placed on nonaccrual status. If the current value, collateral value less costs to sell, of the impaired loan is less than the recorded investment in the loan, impairment is recognized by establishing a specific allocation of the allowance for loan losses for the loan or by adjusting an existing allocation. Our analysis of the $44.0 million in nonperforming construction/land development loans resulted in a specific allocation of the allowance. Based on our analysis of these loans, which included the review of either existing or updated appraisals as well as adjustments to those appraisals for deteriorating market conditions, we established an $8.5 million specific allowance for these loans. We did not have any real estate owned at December 31, 2008 or 2007.

Deposits. During the year ended December 31, 2008, deposits increased $62.0 million to $791.5 million at December 31, 2008. The increase in deposits was the result of the current economic environment combined with our practice of competitively pricing our deposit products. Increases in certificate of deposit accounts of $103.1 million, savings accounts of $1.0 million and non-interest bearing accounts of $755,000 were partially offset by decreases in money market accounts of $40.3 million, and NOW accounts of $2.6 million. The majority of the decrease in money market accounts was the result of transfers to certificate of deposit accounts within First Savings Bank Northwest. First Savings Bank does not have any brokered deposits.

Advances. We use advances from the Federal Home Loan Bank of Seattle as an alternative funding source to deposits to manage funding costs and reduce interest rate risk and to leverage our balance sheet. The net effect was to fund increases in total interest-earning assets, thereby incrementally increasing our net interest income. Total advances at December 31, 2008 were $156.2 million, an increase of $60.2 million, or 62.7%, from December 31, 2007. The increase in advances was used to fund loan production.

Stockholders= Equity. Total stockholders= equity decreased $19.2 million, or 6.2%, to $290.1 million at December 31, 2008 from $309.3 million at December 31, 2007. The decrease was primarily a result of the repurchase of stock to fund the restricted stock portion of the equity incentive plan of $9.3 million and $13.5 million related to the repurchase and retirement of 1,559,432 shares of common stock. The payment of cash dividends for the year ended December 31, 2008 totaled $5.1 million which was offset by net income of $4.7 million, the $2.1 million increase in accumulated other comprehensive income (loss), net and the decrease in unearned ESOP shares of $1.2 million.

Comparison of Operating Results for the Year Ended December 31, 2008 and December 31, 2007

General. Our net income for the year ended December 31, 2008 was $4.7 million, compared to a net loss of $4.0 million for the prior year. The $8.7 million increase in our net income was the result of an $8.9 million increase in net interest income, a $3.4 million increase in the provision for loan losses, a $389,000 decrease in total noninterest income, a decrease of $11.3 million in noninterest expense and an increase in the provision for federal income taxes of $7.7 million.

Net Interest Income. Our net interest income increased $8.9 million for the year ended December 31, 2008 to $32.6 million, compared to $23.7 million for the year ended December 31, 2007 primarily as a result of the $167.5 million increase in our average loans receivable partially offset by a 79 basis point decrease in our average yield on our loan portfolio. Total average interest-bearing liabilities decreased $22.7 million with the related average cost of funds decreasing 65 basis points for the year ended December 31, 2008 from the same period in

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2007. During the year, our average yield on interest-earning assets and our average cost of funds decreased 56 and 65 basis points, respectively, resulting in a nine basis point increase in our interest rate spread.

Interest Income. Total interest income increased $2.0 million to $68.6 million for the year ended December 31, 2008 from $66.6 million for the year ended December 31, 2007. The following table compares detailed average interest-earning asset balances, associated yields and resulting changes in interest income for the year ended December 31, 2008 and 2007:

	Years Ended December 31,				
	2008		2007		Increase/ (Decrease) in Interest and Dividend Income
	Average Balance	Yield	Average Balance	Yield	
	(Dollars in thousands)				
Loans receivable, net	$ 962,152	6.27%	$ 794,610	7.06%	$ 4,195
Investments available for sale	158,667	4.68	132,217	4.50	1,476
Investments held to maturity	3,760	--	85,661	4.45	(3,808)
Federal funds sold and interest-bearing deposits	30,409	2.66	12,451	5.30	150
Federal Home Loan Bank stock	5,539	0.85	4,671	0.60	19
Total interest-earning assets	$ 1,160,527	5.91%	$ 1,029,610	6.47%	$ 2,032

Interest income from loans increased $4.2 million during the year ended December 31, 2008 as compared to the prior year, principally as a result of a net increase in our loan portfolio. Average net loans receivable at December 31, 2008 totaled $962.2 million as compared to $794.6 million at December 31, 2007. During the year ended December 31, 2008, we also sold a portion of our investment portfolio, which generated $84.4 million in gross proceeds and contributed to the decline in interest income from investments. We intend to continue to utilize excess liquidity to fund loan growth and purchase investments. In addition, the yield on interest-earning assets declined 56 basis points to 5.91% for the year ended December 31, 2008 from 6.47% for the year ended December 31, 2007. The decrease was a result of a general decline in interest rates for the year.

Interest Expense. Total interest expense for the year ended December 31, 2008 was $36.0 million, a decrease of $6.9 million from the prior year. The following table details average balances, cost of funds and the resulting increase in interest expense for the years ended December 31, 2008 and 2007:

	Years Ended December 31,				
	2008		2007		Increase/ (Decrease) in Interest Expense
	Average Balance	Cost	Average Balance	Cost	
	(Dollars in thousands)				
NOW accounts	$ 10,353	0.71%	$ 33,780	0.95%	$ (247)

Statement savings accounts	11,685	1.75	14,217	1.75	(44)
Money market accounts	129,486	2.09	188,805	4.18	(5,177)
Certificates of deposit	609,152	4.70	521,126	5.06	2,275
Advances from the Federal Home Loan Bank	123,886	3.51	149,365	5.37	(3,677)
Total interest-bearing liabilities	$ 884,562	4.07%	$ 907,293	4.72%	$ (6,870)

The average balance of total interest-bearing liabilities decreased to $884.6 million at December 31, 2008 compared to $907.3 million at December 31, 2007, a decrease of $22.7 million. The average balance of advances from the Federal Home Loan Bank decreased $25.5 million at December 31, 2008 compared to December 31, 2007.

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The average cost of advances and the related interest expense decreased 186 basis points and $3.7 million, respectively. Our average balance in advances from the Federal Home Loan Bank decreased primarily because our loan volume for the year ended December 31, 2008 was $296.3 million as compared to $434.4 million for the year ended December 31, 2007. Deposit interest expense decreased $3.2 million for the year ended December 31, 2008 as compared to the year ended December 31, 2007. The average balance of money market accounts decreased $59.3 million to $129.5 million at December 31, 2008 compared to $188.8 million at December 31, 2007. The average balance of certificates of deposit increased $88.0 million at December 31, 2008 to $609.2 million from $521.1 million at December 31, 2007. The average cost of certificates of deposit decreased 36 basis points reflecting the lower interest rate environment during the year. The majority of the decrease in money market accounts was transfers to certificate of deposit accounts within First Savings Bank because our certificate of deposit products were priced higher than our money market products. The remaining growth in our certificates of deposit was the result of higher interest rates offered relative to other investment products in the current interest rate environment.

Provision for Loan Losses. Management recognizes that loan losses may occur over the life of a loan and that the allowance for loan losses must be maintained at a level necessary to absorb specific losses on impaired loans and probable losses inherent in the loan portfolio. Our methodology for analyzing the allowance for loan losses consists of two components: formula and specific allowances. The formula allowance is determined by applying factors to our various groups of loans. Management considers factors such as charge-off history, the prevailing economy, borrower=s ability to repay, the regulatory environment, competition, geographic and loan type concentrations, policy and underwriting standards, nature and volume of the loan portfolio, managements= experience level, our loan review system and the value of underlying collateral in assessing the allowance for loan losses. The specific allowance component is created when management believes that the collectibility of a specific loan, such as a real estate, multifamily or commercial real estate loan, has been impaired and a loss is probable. The specific reserves are computed using current appraisals, listed sales prices and other available information less costs to complete, if any, and sell the property. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available or as future events differ from predictions.

The allowance for loan losses was $17.0 million or 1.6% of total loans outstanding, net of undisbursed funds at December 31, 2008 as compared to $8.0 million or 0.9% of total loans outstanding, net of undisbursed funds at December 31, 2007.

A provision for loan losses of $9.4 million was recorded for the year ended December 31, 2008. The comparable provision for loan losses for the year ended December 31, 2007 totaled $6.0 million. As of December 31, 2008 nonperforming loans, net of undisbursed funds, totaled $58.6 million as compared to $25.0 million at December 31, 2007. Of our nonperforming assets, $44.0 million related to the construction/land development loan portfolio, primarily located in King and Pierce Counties and $3.8 million relate to the commercial real estate loan portfolio. The construction/land development loans are to homebuilders whose sales have been affected by the current credit tightening. The builder that was identified in the fourth quarter of 2007 who was experiencing financial difficulties continues to make progress in advancing on his projects as well as making some housing sales. The outstanding loan balance net of undisbursed funds for this relationship totaled $25.2 million at December 31, 2008. The Bank believes by working with these builders it can minimize the loss exposure.

Although we believe that we used the best information available to establish the allowance for loan losses, future additions to the allowance may be necessary based on estimates that are susceptible to change as a result of changes in economic conditions and other factors. In addition, unforeseen market conditions could result in adjustments to the allowance for loan losses and net income could be significantly affected, if circumstance differ substantially from the assumptions used in determining the allowance.

We believe that the allowance for loan losses as of December 31, 2008 was adequate to absorb the probable and inherent risks of loss in the loan portfolio at that date. While we believe the estimates and assumptions used in our determination of the adequacy of the allowance are reasonable, there can be no assurance that such estimates and assumptions will not be proven incorrect in the future, or that the actual amount of future provisions will not exceed the amount of past provisions or that any increased provisions that may be required will not adversely impact our financial condition and results of operations. Future additions to the allowance may become necessary based upon changing economic conditions, the level of problem loans, business conditions, credit concentrations, increased loan balances, or changes in the underlying collateral of the loan portfolio. In addition, the determination of the amount of First Savings Bank=s allowance for loan losses is subject to review by bank regulators as part of the routine examination process, which may result in the establishment of additional loss reserves or the charge-off of specific loans against established loss reserves based upon their judgment of information available to them at the time of their examination.

	At or For the Years Ended December 31, 2008	2007
	(Dollars in thousands)	
Provision for loan losses	$ 9,443	$ 6,000
Net charge-offs	$ 432	$ --
Allowance for loan losses	$ 16,982	$ 7,971
Allowance for loan losses as a percentage of total loans outstanding at the end of the year, net of undisbursed funds	1.61%	0.89%
Allowance for loan losses as a percentage of nonperforming loans at the end of the year, net of undisbursed funds	28.96%	31.83%
Total nonaccrual loans and loans 90 days or more past due net of undisbursed funds	58,642	25,042
Nonaccrual loans and loans 90 days or more past due as a percentage of total loans net of undisbursed funds	5.56%	2.81%
Total loans receivable net of undisbursed funds	$ 1,055,011	$ 891,811
Total loans originated	$ 296,300	$ 434,427

Noninterest Income. Noninterest income decreased $389,000 or 66.0% to $200,000 for the year ended December 31, 2008 from the year ended December 31, 2007. The following table provides a detailed analysis of the changes in the components of noninterest income:

	Year Ended December 31, 2008	Increase/(Decrease) from December 31, 2007	Percentage Increase/(Decrease)
		(Dollars in thousands)	
Service fees on deposit accounts	$ 84	$ 6	7.69%
Loan service fees	269	(70)	(20.65)
Gain on sale of investments	1,606	1,606	100.00
Other-than-temporary impairment			

on investments		(1,640)		(1,640)	100.00
Mortgage servicing rights, net		(238)		93	28.10
Other		119		(384)	(76.34)
Total noninterest income	$	200	$	(389)	(66.04)%

The decrease in noninterest income for the year ended December 31, 2008 was primarily a result of other noninterest income decreasing $384,000 for the year ended December 31, 2008 from the year ended December 31, 2007. The difference was primarily attributable to proceeds of $374,000 on a one-time payment due from an insurance policy First Savings Bank owned on one of its former officers which was received in 2007.

Noninterest Expense. Noninterest expense decreased $11.3 million during the year ended December 31, 2008 to $14.7 million, from $26.0 million for the year ended December 31, 2007. A one-time charge for our contribution totaling $16.9 million to the First Financial Northwest Foundation was made as part of our conversion to a stock-owned company in 2007; and no such contribution was made in 2008. The following table provides a detailed analysis of the changes in the components of noninterest expense:

	Year Ended December 31, 2008	Increase/(Decrease) from December 31, 2007	Percentage Increase/(Decrease)
	(Dollars in thousands)		
Compensation and benefits	$ 9,208	$ 3,825	71.06%
Occupancy and equipment	1,188	128	12.08
Professional fees	1,477	858	138.61
Data processing	486	18	3.85
Marketing	243	(31)	(11.31)
First Financial Northwest Foundation contribution	--	(16,928)	(100.00)
Office supplies and postage	183	(11)	(5.67)
Regulatory fees and deposit insurance premiums			