First Financial Northwest, Inc.
Form 10-Q
May 10, 2012
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

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

For the quarterly period ended March 31, 2012

or

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

For the transition period from _____ to _____

Commission File Number: 001-33652

FIRST FINANCIAL NORTHWEST, INC.

(Exact name of registrant as specified in its charter)

Washington	26-0610707
(State or other jurisdiction of incorporation or organization	(I.R.S. Employer Identification Number)
201 Wells Avenue South, Renton, Washington	98057
(Address of principal executive offices)	(Zip Code)
Registrant’s telephone number, including area code:	(425) 255-4400

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 whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes [X] No [ ]

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 the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

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 Exchange Act).
Yes [ ] No [X]

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: As of May 4, 2012, 18,805,168 shares of the issuer's common stock, $0.01 par value per share, were outstanding.

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Item 1. Financial Statements

FIRST FINANCIAL NORTHWEST, INC. AND SUBSIDIARIES
Consolidated Balance Sheets
(Dollars in thousands, except share data)
(Unaudited)

Assets	March 31, 2012	December 31, 2011
Cash on hand and in banks	$5,186	$4,620
Interest-bearing deposits	152,177	160,141
Investments available-for-sale, at fair value	140,676	129,002
Loans receivable, net of allowance of $14,832 and $16,559	680,737	703,288
Premises and equipment, net	18,702	18,922
Federal Home Loan Bank stock, at cost	7,413	7,413
Accrued interest receivable	3,897	3,856
Federal income tax receivable	1,058	1,060
Other real estate owned ("OREO")	22,448	26,044
Prepaid expenses and other assets	5,028	5,044
Total assets	$1,037,322	$1,059,390
Liabilities and Stockholders' Equity		
Interest-bearing deposits	$758,415	$782,652
Noninterest-bearing deposits	5,633	6,013
Advances from the Federal Home Loan Bank	83,066	83,066
Advance payments from borrowers for taxes and insurance	4,056	2,093
Accrued interest payable	196	184
Other liabilities	3,281	4,062
Total liabilities	854,647	878,070
Commitments and contingencies		
Stockholders' Equity		
Preferred stock, $0.01 par value; authorized 10,000,000 shares, no shares issued or outstanding	-	-
Common stock, $0.01 par value; authorized 90,000,000 shares; issued and outstanding 18,805,168 shares at March 31, 2012 and December 31, 2011	188	188
Additional paid-in capital	189,209	188,816
Retained earnings, substantially restricted	4,559	3,937
Accumulated other comprehensive income, net of tax	569	511
Unearned Employee Stock Ownership Plan ("ESOP") shares	(11,850)	(12,132)
Total stockholders' equity	182,675	181,320
Total liabilities and stockholders' equity	$1,037,322	$1,059,390

See accompanying notes to consolidated financial statements.

FIRST FINANCIAL NORTHWEST, INC. AND SUBSIDIARIES
Consolidated Statements of Income
(Dollars in thousands, except share data)
(Unaudited)

	Three Months Ended March 31,	
	2012	2011
Interest income		
Loans, including fees	$10,472	$12,428
Investments available-for-sale	593	1,205
Interest-bearing deposits	97	76
Total interest income	$11,162	$13,709
Interest expense		
Deposits	2,941	4,513
Federal Home Loan Bank advances	511	576
Total interest expense	$3,452	$5,089
Net interest income	7,710	8,620
Provision for loan losses	1,700	1,200
Net interest income after provision for loan losses	$6,010	$7,420
Noninterest income		
Net gain on sale of investments	194	511
Other	87	85
Total noninterest income	$281	$596
Noninterest expense		
Compensation and employee benefits	3,427	3,289
Occupancy and equipment	405	402
Professional fees	473	480
Data processing	181	209
Gain on sale of OREO property, net	(221)	(626)
OREO market value adjustments	310	628
OREO related expenses, net	489	850
Regulatory assessments	97	710
Insurance and bond premiums	100	247
Marketing	52	61
Other general and administrative	308	332
Total noninterest expense	$5,621	$6,582
Income before provision for federal income taxes	670	1,434
Provision for federal income taxes	48	-
Net income	$622	$1,434
Basic earnings per share	$0.04	$0.08
Diluted earnings per share	$0.04	$0.08

See accompanying notes to consolidated financial statements.

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FIRST FINANCIAL NORTHWEST, INC. AND SUBSIDIARIES
Consolidated Statements of Comprehensive Income
(In thousands)
(Unaudited)

	Three Months Ended March 31, 2012	Three Months Ended March 31, 2011
Net Income	$622	$1,434
Other comprehensive income, before tax:		
Unrealized holding gains on available-for-sale securities	252	66
Reclassification adjustment for net gains realized in income	(194)	(511)
Other comprehensive income (loss), before tax	58	(445)
Income tax benefit related to items of other comprehensive income	-	(430)
Other comprehensive income (loss), net of tax	58	(15)
Total comprehensive income	$680	$1,419

See accompanying notes to consolidated financial statements.

FIRST FINANCIAL NORTHWEST, INC. AND SUBSIDIARIES
Consolidated Statements of Changes in Stockholders' Equity
(Dollars in thousands, except share data)
(Unaudited)

	Shares	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income, net of tax	Unearned ESOP Shares	Total Stockholders' Equity
Balances at December 31, 2011	18,805,168	$ 188	$ 188,816	$ 3,937	$ 511	$ (12,132)	$ 181,320
Comprehensive income:							
Net income	-	-	-	622	-	-	622
Change in fair value of investments available-for-sale	-	-	-	-	58	-	58
Total comprehensive income							680
Compensation related to stock options and restricted stock awards	-	-	479	-	-	-	479
Allocation of 28,213 ESOP shares	-	-	(86)	-	-	282	196
Balances at March 31, 2012	18,805,168	$ 188	$ 189,209	$ 4,559	$ 569	$ (11,850)	$ 182,675

See accompanying notes to consolidated financial statements.

FIRST FINANCIAL NORTHWEST, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows
(In thousands)
(Unaudited)

	Three Months Ended March 31,	
	2012	2011
Cash flows from operating activities:		
Net income	$622	$1,434
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	1,700	1,200
OREO market value adjustments	310	628
Gain on sale of OREO property, net	(221)	(626)
Depreciation of premises and equipment	263	269
Net amortization of premiums and discounts on investments	452	691
ESOP expense	196	145
Compensation expense related to stock options and restricted stock awards	479	473
Net realized gain on investments available-for-sale	(194)	(511)
Deferred federal income taxes	-	430
Changes in operating assets and liabilities:		
Prepaid expenses and other assets	16	16
Accrued interest receivable	(41)	347
Accrued interest payable	12	16
Other liabilities	(781)	(10)
Federal income taxes, net	2	(430)
Net cash provided by operating activities	$2,815	$4,072
Cash flows from investing activities:		
Proceeds from sales of investments	11,000	9,701
Capitalized improvements in OREO	-	(88)
Proceeds from sales of OREO properties	5,353	9,199
Principal repayments on investments	5,592	10,350
Purchases of investments	(28,466)	(4,303)
Net decrease in loans receivable	19,005	48,625
Purchases of premises and equipment	(43)	(25)
Net cash provided by investing activities	$12,441	$73,459
Balance, carried forward	$15,256	$77,531

FIRST FINANCIAL NORTHWEST, INC. AND SUBSIDIARIES
Consolidated Statements of Cash Flows
(In thousands)
(Unaudited)

	Three Months Ended March 31,	
	2012	2011
Balance, brought forward	$15,256	$77,531
Cash flows from financing activities:		
Net decrease in deposits	(24,617)	(14,000)
Net increase in advance payments from borrowers for taxes and insurance	1,963	2,037
Net cash used by financing activities	$(22,654)	$(11,963)
Net increase (decrease) in cash	(7,398)	65,568
Cash and cash equivalents:		
Beginning of period	164,761	98,427
End of period	$157,363	$163,995
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	$3,440	$5,073
Federal income taxes	$45	$-
Noncash transactions:		
Loans, net of deferred loan fees and allowance for loan losses transferred to OREO	$1,846	$10,277

See accompanying notes to consolidated financial statements.

FIRST FINANCIAL NORTHWEST, INC. AND SUBSIDIARIES
SELECTED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1 – Description of Business

First Financial Northwest, Inc. ("First Financial Northwest" or the "Company"), 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" or "the Bank") in connection with the conversion from a mutual holding company structure to a stock holding company structure. 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 presented in the consolidated financial statements and related data, relates primarily to First Savings Bank. First Financial Northwest is a savings and loan holding company and is subject to regulation by the Federal Reserve Board ("FRB"). First Savings Bank is regulated by the Federal Deposit Insurance Corporation ("FDIC") and the Washington State Department of Financial Institutions ("DFI").

First Savings Bank is a community-based savings bank primarily serving King, and to a lesser extent, Pierce, Snohomish and Kitsap counties through our full-service banking office located in Renton, Washington. First Savings Bank's business consists of attracting deposits from the public and utilizing these deposits to originate one-to-four family residential, multifamily, commercial real estate, business, consumer and construction/land development loans.

As used throughout this report, the terms "we", "our", "us", or the "Company" refer to First Financial Northwest, Inc. and its consolidated subsidiary First Savings Bank Northwest, unless the context otherwise requires.

Note 2 – Regulatory Items

On April 14, 2010, the Office of Thrift Supervision ("OTS") and members of the Board of Directors of First Financial Northwest entered into an informal supervisory agreement or Memorandum of Understanding ("MOU"), which is now enforced by the FRB as the successor to the OTS. Under the terms of the MOU, the Company agreed, among other things, to provide notice to and obtain a written non-objection from the FRB prior to the Company (a) declaring a dividend or redeeming any capital stock and (b) incurring, issuing, renewing or repurchasing any new debt.

On March 27, 2012, the Bank's regulators, the FDIC and the DFI terminated the Consent Order ("Order") which became effective on September 24, 2010. In place of the Order, the Bank entered into an MOU, which is an informal regulatory action, with the FDIC and DFI. The Order was terminated as a result of the steps the Bank took in complying with the Order and reducing its level of classified assets, increasing earnings, augmenting management and improving the overall condition of the Bank.

The MOU with the Bank contains provisions concerning the management and directors of the Bank, interest rate risk, minimum capital levels, the allowance for loan and lease losses ("ALLL"), lending and collection policies, policies concerning the Bank and its affiliates, restrictions on paying dividends and a requirement to furnish progress reports to the FDIC and DFI. A copy of the MOU with the Bank is attached to the Form 8-K that we filed with the Securities and Exchange Commission ("SEC") on April 2, 2012.

Note 3 – Basis of Presentation

The accompanying unaudited interim consolidated financial statements have been prepared pursuant to the rules and regulations of the SEC. Accordingly, they do not include all of the information and footnotes required by U.S. Generally Accepted Accounting Principles ("GAAP") for complete financial statements. These unaudited consolidated financial statements should be read in conjunction with the Company’s Annual Report on Form 10-K for the year ended December 31, 2011, as filed with the SEC. In our opinion, all adjustments (consisting only of normal recurring adjustments) considered necessary for a fair presentation of the consolidated financial statements in accordance with GAAP have been included. All significant intercompany balances and transactions between the Company and its subsidiaries have been eliminated in consolidation. Operating results for the three months ended

FIRST FINANCIAL NORTHWEST, INC. AND SUBSIDIARIES
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(Unaudited)

March 31, 2012 are not necessarily indicative of the results that may be expected for the year ended December 31, 2012. In preparing the unaudited consolidated financial statements, we are required to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change relate to the ALLL, the valuation of other real estate owned ("OREO") and the underlying collateral of loans in the process of foreclosure, deferred tax assets and the fair value of financial instruments.

Certain amounts in the unaudited consolidated financial statements for prior periods have been reclassified to conform to the current unaudited financial statement presentation.

Note 4 – Recently Issued Accounting Pronouncements

In April 2011, the FASB issued ASU No. 2011-03, Reconsideration of Effective Control for Repurchase Agreements. The update amends existing guidance to remove from the assessment of effective control, the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed terms, even in the event of default by the transferee and, as well, the collateral maintenance implementation guidance related to that criterion. ASU No. 2011-03 is effective for the Company's reporting period beginning on or after December 15, 2011. The guidance applies prospectively to transactions or modification of existing transactions that occur on or after the effective date and early adoption is not permitted. The adoption of this ASU did not have a material impact on the Company's consolidated financial statements.

In April 2011, the FASB issued ASU No. 2011-04, Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs (International Financial Reporting Standards). The update amends existing guidance regarding the highest and best use and valuation premise by clarifying these concepts are only applicable to measuring the fair value of nonfinancial assets. The Update also clarifies that the fair value measurement of financial assets and financial liabilities which have offsetting market risks or counterparty credit risks that are managed on a portfolio basis, when several criteria are met, can be measured at the net risk position. Additional disclosures about Level 3 fair value measurements are required including a quantitative disclosure of the unobservable inputs and assumptions used in the measurement, a description of the valuation process in place, and discussion of the sensitivity of fair value changes in unobservable inputs and interrelationships about those inputs as well as disclosure of the level of the fair value of items that are not measured at fair value in the financial statements but disclosure of fair value is required. The provisions of ASU No. 2011-04 were effective for the Company's reporting period beginning after December 15, 2011 and should be applied prospectively. The adoption of this ASU did not have a material impact on the Company's consolidated financial statements.

In June 2011, the FASB issued ASU No. 2011-05, Presentation of Comprehensive Income. The update amends current guidance to allow a company the option of presenting the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The provisions do not change the items that must be reported in other comprehensive income or when an item of other comprehensive must be reclassified to net income. The amendments do not change the option for a company to present components of other comprehensive income either net of related tax effects or before related tax effects, with one amount shown for the aggregate income tax expense (benefit) related to the total of other comprehensive income items. The amendments do not affect how earnings per share is calculated or presented. The provisions of ASU No. 2011-05 were effective for the Company's reporting periods beginning after December 15, 2011 and should be applied retrospectively. Early adoption is permitted and there are no required transition disclosures. The adoption of this ASU did not have a material impact on the Company's consolidated financial statements.

In December 2011, the FASB issued ASU No. 2011-11, Disclosures about Offsetting Assets and Liabilities. The update requires an entity to offset, and present as a single net amount, a recognized eligible asset and a recognized eligible liability when it has an unconditional and legally enforceable right of setoff and intends either to settle the asset and liability on a net basis or to realize the asset and settle the liability simultaneously. The

FIRST FINANCIAL NORTHWEST, INC. AND SUBSIDIARIES
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ASU requires an entity to disclose information about offsetting and related arrangements to enable users of its financial statements to understand the effect of those arrangements on its financial position. The amendments are effective for annual and interim reporting periods beginning on or after January 1, 2013. The Company is currently in the process of evaluating the ASU but does not expect it will have a material impact on the Company's consolidated financial statements.

In December 2011, the FASB issued ASU No. 2011-12, Deferral of the Effective Date for Amendments to Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update 2011-05 ("ASU 2011-12"). This ASU defers only those changes in ASU 2011-05 that relate to the presentation of reclassification adjustments. ASU 2011-12 was issued in order to allow the FASB time to redeliberate whether to present on the face of the financial statements the effects of reclassifications out of accumulated other comprehensive income on the components of net income and other comprehensive income for all periods presented. While the FASB is considering the operational concerns about the presentation requirements for reclassification adjustments and the needs of financial statement users for additional information about reclassification adjustments, the Company will continue to report reclassifications out of accumulated other comprehensive income consistent with the presentation requirements in effect before the issuance of ASU 2011-05. ASU 2011-12 is effective for the Company's financial statements for annual and interim periods beginning after December 31, 2011, and must be applied prospectively. The adoption of this standard did not have a material impact on the Company's consolidated financial statements.

Note 5 – Investments

Investment securities available-for-sale are summarized as follows:

	March 31, 2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands)			
Mortgage-backed investments:				
Fannie Mae	$54,829	$1,109	$(14)	$55,924
Freddie Mac	12,740	451	-	13,191
Ginnie Mae	6,884	130	-	7,014
Municipal bonds	2,084	30	(251)	1,863
U.S. Government sponsored entities and agencies	62,782	21	(119)	62,684
	$139,319	$1,741	$(384)	$140,676

	December 31, 2011			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands)			
Mortgage-backed investments:				
Fannie Mae	$50,981	$1,182	$-	$52,163
Freddie Mac	19,285	560	-	19,845
Ginnie Mae	7,416	79	-	7,495
Municipal bonds	2,085	32	(270)	1,847
U.S. Government sponsored entities and agencies	47,934	2	(284)	47,652

	$127,701	$1,855	$(554)	$129,002

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FIRST FINANCIAL NORTHWEST, INC. AND SUBSIDIARIES
SELECTED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

The following table summarizes the aggregate fair value and gross unrealized loss by length of time those investments have been continuously in an unrealized loss position:

	March 31, 2012					
	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
	(In thousands)					
Mortgage-backed investments:						
Fannie Mae	$2,975	$(14)	$-	$-	$2,975	$(14)
Municipal bonds	-	-	1,156	(251)	1,156	(251)
U.S. Government sponsored entities and agencies	45,113	(119)	-	-	45,113	(119)
	$48,088	$(133)	$1,156	$(251)	$49,244	$(384)

	December 31, 2011					
	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
	(In thousands)					
Municipal bonds	$-	$-	$1,137	$(270)	$1,137	$(270)
U.S. Government sponsored entities and agencies	45,039	(284)	-	-	45,039	(284)
	$45,039	$(284)	$1,137	$(270)	$46,176	$(554)

At March 31, 2012, we had one security with a gross unrealized loss totaling $251,000 with a fair value totaling $1.2 million that had an unrealized loss for greater than one year. At December 31, 2011, this same security had a gross unrealized loss totaling $270,000 with a fair value totaling $1.1 million that had an unrealized loss for greater than one year. We reviewed the financial condition of the entity underlying this security at both March 31, 2012 and December 31, 2011, and determined an other-than-temporary impairment ("OTTI") was not warranted.

On a quarterly basis, management makes 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, 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 an OTTI are written down to fair value. For equity securities, the write-down is recorded as a realized loss in noninterest income on our Consolidated Statements of Income. For debt securities, if we intend to sell the security or it is likely that we will be required to sell the security before recovering its cost basis, the entire impairment loss would be recognized in earnings as an OTTI. If we do not intend to sell the security and it is not likely that we will be required to sell the security but we do not expect to recover the entire amortized cost basis of the security, only the portion of the impairment loss representing credit losses would be recognized in earnings. The credit loss on a security is measured as the difference between the amortized cost basis and the present value of the cash flows expected to be collected. Projected cash flows are discounted by the original or current effective interest rate depending on the nature of the security being measured for potential OTTI. The remaining impairment related to all other factors, the difference between the present value of the cash flows expected to be collected and fair value, is recognized as a charge to other comprehensive income (“OCI”). Impairment losses related to all other factors are presented as separate categories within OCI. For the three months ended March 31, 2012 and 2011, we did not have any OTTI losses on investments.

FIRST FINANCIAL NORTHWEST, INC. AND SUBSIDIARIES
SELECTED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

The amortized cost and estimated fair value of investments available-for-sale at March 31, 2012, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Investments not due at a single maturity date, primarily mortgage-backed investments, are shown separately.

	March 31, 2012	
	Amortized Cost	Fair Value
	(In thousands)	
Due after one year through five years	$ 50,053	$ 49,992
Due after five years through ten years	820	838
Due after ten years	13,993	13,717
	64,866	64,547
Mortgage-backed investments	74,453	76,129
	$ 139,319	$ 140,676

Under Washington State law, in order to participate in the public funds program we are required to pledge as collateral an amount equal to 100% of the public deposits we hold in the form of eligible securities. Investments with a market value of $29.8 million and $31.8 million were pledged as collateral for public deposits at March 31, 2012 and December 31, 2011, respectively, both of which exceeded collateral requirements established by the Washington Public Deposit Protection Commission.

We sold $10.8 million and $9.2 million of investments during the three months ended March 31, 2012 and 2011 resulting in gross gains of $194,000 and $511,000, respectively. There were no losses on sales of securities during the three months ended March 31, 2012 and 2011.

FIRST FINANCIAL NORTHWEST, INC. AND SUBSIDIARIES
SELECTED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 6 - Loans Receivable

Loans receivable are summarized as follows:

	March 31, 2012	December 31, 2011
	(In thousands)	
One-to-four family residential (1)	$ 325,316	$ 335,412
Multifamily:		
Permanent	110,319	110,148
Construction	-	3,526
	110,319	113,674
Commercial real estate:		
Permanent	213,391	218,032
Construction	12,500	12,500
Land	1,780	1,811
	227,671	232,343
Construction/land development (2):		
One-to-four family residential	1,475	6,194
Multifamily	855	855
Commercial	1,104	1,104
Land development	16,156	16,990
	19,590	25,143
Business	3,620	3,909
Consumer	11,439	12,499
Total loans	697,955	722,980
Less:		
Loans in process	598	1,372
Deferred loan fees, net	1,788	1,761
ALLL	14,832	16,559
Loans receivable, net	$ 680,737	$ 703,288

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(1) Includes $146.2 million and $147.4 million of non-owner occupied loans at March 31, 2012 and December 31, 2011, respectively.

(2) Excludes construction loans that will convert to permanent loans. We consider these loans to be "rollovers" in that one loan is originated for both the construction loan and permanent financing. These loans are classified according to the underlying collateral. As a result, at March 31, 2012, we had $12.5 million, or 5.5%, of our total commercial real estate portfolio and no one-to-four family residential or multifamily loans in these "rollover" type of loans. At December 31, 2011,

we had \$12.5 million, or 5.4%, of our total commercial real estate portfolio and \$3.5 million, or 3.1%, of our total multifamily loan portfolio and no one-to-four family residential loans in these "rollover" type of loans. At both March 31, 2012 and December 31, 2011, \$1.8 million of commercial real estate land loans were not included in the construction/land development category because we classify raw land or buildable lots where we do not intend to finance the construction as commercial real estate land loans.

At March 31, 2012 and December 31, 2011, there were no loans classified as held for sale.

FIRST FINANCIAL NORTHWEST, INC. AND SUBSIDIARIES
SELECTED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

The following tables represent a summary of our ALLL and loan portfolio by loan type and impairment method:

	At or For the Three Months Ended March 31, 2012						
	One-to-Four Family Residential	Multifamily	Commercial Real Estate	Construction/ Land Development	Business	Consumer	Total
ALLL:				(In thousands)			
Beginning balance	$ 5,756	$ 950	$ 6,846	$ 2,503	$ 154	$ 350	$ 16,559
Charge-offs	(718)	-	(2,614)	(74)	-	(293)	(3,699)
Recoveries	-	-	171	100	-	1	272
Provision	775	1,407	1,272	(1,805)	(119)	170	1,700
Ending balance	$ 5,813	$ 2,357	$ 5,675	$ 724	$ 35	$ 228	$ 14,832
General reserve	$ 5,343	$ 2,357	$ 5,576	$ 724	$ 35	$ 228	$ 14,263
Specific reserve	$ 470	$ -	$ 99	$ -	$ -	$ -	$ 569
Loans (1):							
Total Loans	$ 325,280	$ 110,081	$ 227,666	$ 19,271	$ 3,620	$ 11,439	$ 697,357
General reserve (2)	$ 264,946	$ 106,636	$ 208,731	$ 10,280	$ 3,620	$ 11,205	$ 605,418
Specific reserve (3)	$ 60,334	$ 3,445	$ 18,935	$ 8,991	$ -	$ 234	$ 91,939

(1) Net of undisbursed funds.
(2) Loans collectively evaluated for impairment.
(3) Loans individually evaluated for impairment.

	At or For the Three Months Ended March 31, 2011						
	One-to-Four Family Residential	Multifamily	Commercial Real Estate	Construction/ Land Development	Business	Consumer	Total
ALLL:							

				(In thousands)			
Beginning balance	$ 8,302	$ 1,893	$ 6,742	$ 5,151	$ 7	$ 439	$ 22,534
Charge-offs	(585)	(26)	(2,080)	(926)	-	(58)	(3,675)
Recoveries	5	-	-	185	-	1	191
Provision	34	(121)	2,613	(1,343)	6	11	1,200
Ending balance	$ 7,756	$ 1,746	$ 7,275	$ 3,067	$ 13	$ 393	$ 20,250
General reserve	$ 6,596	$ 1,684	$ 5,351	$ 1,483	$ 13	$ 298	$ 15,425
Specific reserve	$ 1,160	$ 62	$ 1,924	$ 1,584	$ -	$ 95	$ 4,825
Loans (1):							
Total Loans	$ 375,858	$ 128,678	$ 255,532	$ 40,938	$ 1,026	$ 16,767	$ 818,799
General reserve (2)	$ 307,401	$ 125,470	$ 234,006	$ 17,453	$ 1,026	$ 16,552	$ 701,908
Specific reserve (3)	$ 68,457	$ 3,208	$ 21,526	$ 23,485	$ -	$ 215	$ 116,891

(1) Net of undisbursed funds.
(2) Loans collectively evaluated for impairment.
(3) Loans individually evaluated for impairment.

Nonperforming loans, net of undisbursed funds, were $26.4 million and $23.7 million at March 31, 2012 and December 31, 2011, respectively. Foregone interest on nonaccrual loans for the three months ended March 31, 2012 was $377,000, compared to $857,000 for the same quarter in 2011.

Loans committed to be advanced in connection with impaired loans at both March 31, 2012 and December 31, 2011 were $36,000.

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The following tables present a summary of loans individually evaluated for impairment by the type of loan:

	At or For the Three Months Ended March 31, 2012		
	Recorded Investment (1)	Unpaid Principal Balance (2)	Related Allowance
		(In thousands)	
Loans with no related allowance:			
One-to-four family residential:			
Owner occupied	$ 8,679	$ 9,562	$ -
Non-owner occupied	38,253	39,379	-
Multifamily	3,445	3,570	-
Commercial real estate	16,630	21,871	-
Construction/land development	8,991	14,299	-
Consumer	234	510	-
Total	76,232	89,191	-
Loans with an allowance:			
One-to-four family residential:			
Owner occupied	4,251	4,363	181
Non-owner occupied	9,151	9,326	289
Commercial real estate	2,305	2,305	99
Total	15,707	15,994	569
Total impaired loans:			
One-to-four family residential:			
Owner occupied	12,930	13,925	181
Non-owner occupied	47,404	48,705	289
Multifamily	3,445	3,570	-
Commercial real estate	18,935	24,176	99
Construction/land development	8,991	14,299	-
Consumer	234	510	-
Total	$ 91,939	$ 105,185	$ 569

(1) Represents the loan balance less charge-offs.
(2) Contractual loan principal balance.

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	At or For the Year Ended December 31, 2011		
	Recorded Investment (1)	Unpaid Principal Balance (2)	Related Allowance
	(In thousands)		
Loans with no related allowance:			
One-to-four family residential:			
Owner occupied	$ 8,007	$ 8,931	$ -
Non-owner occupied	40,406	42,794	-
Multifamily	3,453	3,578	-
Commercial real estate	12,802	15,957	-
Construction/land development	9,199	22,776	-
Consumer	70	70	-
Total	73,937	94,106	-
Loans with an allowance:			
One-to-four family residential:			
Owner occupied	4,588	4,724	180
Non-owner occupied	9,575	9,735	325
Commercial real estate	1,817	1,817	59
Total	15,980	16,276	564
Total impaired loans:			
One-to-four family residential:			
Owner occupied	12,595	13,655	180
Non-owner occupied	49,981	52,529	325
Multifamily	3,453	3,578	-
Commercial real estate	14,619	17,774	59
Construction/land development	9,199	22,776	-
Consumer	70	70	-
Total	$ 89,917	$ 110,382	$ 564

(1) Represents the loan balance less charge-offs.
(2) Contractual loan principal balance.

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The following table presents the average recorded investment and the interest income recognized on impaired loans.

	Three Months Ended March 31,			
	2012		2011	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
	(In thousands)			
Loans with no related allowance:				
One-to-four family residential:				
Owner occupied	$8,343	$53	$8,785	$116
Non-owner occupied	39,329	545	45,700	667
Multifamily	3,449	42	2,511	42
Commercial real estate	14,716	193	12,549	164
Construction/land development	9,095	-	9,828	-
Consumer	152	1	167	1
Total	75,084	834	79,540	990
Loans with an allowance:				
One-to-four family residential:				
Owner occupied	4,420	99	4,317	-
Non-owner occupied	9,363	46	9,393	-
Multifamily	-	-	350	-
Commercial real estate	2,061	34	7,073	-
Construction/land development	-	-	18,424	-
Consumer	-	-	4	-
Total	15,844	179	39,561	-
Total impaired loans:				
One-to-four family residential:				
Owner occupied	12,763	152	13,102	116
Non-owner occupied	48,692	591	55,093	667
Multifamily	3,449	42	2,861	42
Commercial real estate	16,777	227	19,622	164
Construction/land development	9,095	-	28,252	-
Consumer	152	1	171	1
Total	$90,928	$1,013	$119,101	$990

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The following is a summary of information pertaining to nonperforming assets and troubled debt restructured loans ("TDRs"):

	March 31, 2012	December 31, 2011
	(In thousands)	
Nonperforming assets (1):		
Nonaccrual loans	$ 22,739	$ 18,613
Nonaccrual troubled debt restructured loans	3,644	5,079
Total nonperforming loans	26,383	23,692
OREO	22,448	26,044
Total nonperforming assets	$ 48,831	$ 49,736
Performing troubled debt restructured loans	$ 65,556	$ 66,225
Nonaccrual troubled debt restructured loans	3,644	5,079
Total troubled debt restructured loans	$ 69,200	$ 71,304

(1) There were no loans 90 days or more past due and still accruing interest at March 31, 2012 and December 31, 2011.

Nonaccrual and Past Due Loans. Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. Loans are placed on nonaccrual when they are 90 days delinquent or when, in management's opinion, the borrower is unable to meet scheduled payment obligations.

A loan is considered impaired when we have determined that we may be unable to collect payments of principal or interest when due under the terms of the loan. In the process of identifying loans as impaired, management takes into consideration factors which include payment history and status, collateral value, financial condition of the borrower and the probability of collecting scheduled payments in the future. Minor payment delays and insignificant payment shortfalls typically do not result in a loan being classified as impaired. The significance of payment delays and shortfalls is considered by management on a case-by-case basis, after taking into consideration the circumstances surrounding the loan and the borrower, including payment history and the amounts of any payment shortfall, length and reason for delay and the likelihood of a return to stable performance. Impairment is measured on a loan-by-loan basis for all loans in the portfolio.

The following table is a summary of nonaccrual loans by loan type:

	March 31, 2012	December 31, 2011
	(In thousands)	
One-to-four family residential	$ 8,691	$ 9,808
Multifamily	949	949

Commercial real estate		7,588		3,736
Construction/land development		8,991		9,199
Consumer		164		-
Total nonaccrual loans	$	26,383	$	23,692

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The following tables represent a summary of the aging of loans by type:

	Loans Past Due at March 31, 2012					
	30-59 Days	60-89 Days	90 Days and Greater (1)	Total	Current	Total Loans (2)
			(In thousands)			
Real estate:						
One-to-four family residential:						
Owner occupied	$ 1,918	$ 1,434	$ 4,448	$ 7,800	$ 171,282	$ 179,082
Non-owner occupied	985	70	2,159	3,214	142,984	146,198
Multifamily	2,047	-	949	2,996	107,085	110,081
Commercial real estate	2,183	-	2,149	4,332	223,334	227,666
Construction/land development	766	-	4,991	5,757	13,514	19,271
Total real estate	7,899	1,504	14,696	24,099	658,199	682,298
Business	-	-	-	-	3,620	3,620
Consumer	644	48	164	857	10,582	11,439
Total	$ 8,543	$ 1,552	$ 14,860	$ 24,956	$ 672,401	$ 697,357

(1) There were no loans 90 days past due and still accruing interest at March 31, 2012.
(2) Net of undisbursed funds.

	Loans Past Due at December 31, 2011					
	30-59 Days	60-89 Days	90 Days and Greater (1)	Total	Current	Total Loans (2)
			(In thousands)			
Real estate:						
One-to-four family residential:						
Owner occupied	$ 2,594	$ 1,318	$ 4,076	$ 7,988	$ 180,009	$ 187,997
Non-owner occupied	761	-	3,224	3,985	143,394	147,379
Multifamily	-	-	949	949	112,314	113,263
Commercial real estate	633	-	2,621	3,254	228,583	231,837
Construction/land development	-	-	9,199	9,199	15,525	24,724
Total real estate	3,988	1,318	20,069	25,375	679,825	705,200
Business	240	-	-	240	3,669	3,909
Consumer	1,133	-	-	1,133	11,366	12,499
Total	$ 5,361	$ 1,318	$ 20,069	$ 26,748	$ 694,860	$ 721,608

(1) There were no loans 90 days past due and still accruing interest at December 31, 2011.
(2) Net of undisbursed funds.

Credit Quality Indicators. We utilize a nine-point risk rating system and assign a risk rating for all credit exposures. The risk rating system is designed to define the basic characteristics and identify risk elements of each credit extension. Credits risk rated 1 through 5 are considered to be "pass" credits. Pass credits can be assets where there is virtually no credit risk, such as cash secured loans with funds on deposit with the Bank. Pass credits also include credits that are on our watch list, where the borrower exhibits potential weaknesses, which may, if not checked or corrected, negatively affect the borrower's financial capacity and threaten their ability to fulfill debt obligations in the future. Credits classified as special mention are risk rated 6 and possess weaknesses that deserve management's close attention. Special mention assets do not expose the Bank to sufficient risk to warrant adverse classification in the substandard, doubtful or loss categories. Substandard credits are risk rated 7. 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 are risk rated 8 and have all the weaknesses inherent in those credits classified as substandard with the added characteristic that the weaknesses present make collection or liquidation in full highly questionable and improbable, on the basis of

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currently existing facts, conditions and values. Assets classified as loss are risk rated 9 and are considered uncollectible and cannot be justified as a viable asset for the Bank.

The following tables represent a summary of loans by type and risk category:

	March 31, 2012						
	One-to-Four Family Residential	Multifamily	Commercial Real Estate	Construction/ Land Development	Business	Consumer	Total (1)
				(In thousands)			
Risk Rating:							
Pass	$299,706	$102,925	$200,902	$9,091	$3,620	$10,290	$626,534
Special mention	12,871	6,207	13,892	1,189	-	763	34,922
Substandard	12,703	949	12,872	8,991	-	386	35,901
Total	$325,280	$110,081	$227,666	$19,271	$3,620	$11,439	$697,357

(1) Net of undisbursed funds.

	December 31, 2011						
	One-to-Four Family Residential	Multifamily	Commercial Real Estate	Construction/ Land Development	Business	Consumer	Total (1)
				(In thousands)			
Risk Rating:							
Pass	$307,807	$106,900	$203,997	$15,101	$3,909	$11,822	$649,536
Special mention	13,193	5,414	14,256	424	-	488	33,775
Substandard	14,376	949	13,584	9,199	-	189	38,297
Total	$335,376	$113,263	$231,837	$24,724	$3,909	$12,499	$721,608

(1) Net of undisbursed funds.

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The following tables summarize the loan portfolio by type and payment activity:

	March 31, 2012						
	One-to-Four Family Residential	Multifamily	Commercial Real Estate	Construction/ Land Development	Business	Consumer	Total (3)
	(In thousands)						
Performing (1)	$316,589	$109,132	$220,078	$ 10,280	$3,620	$11,275	$670,974
Nonperforming (2)	8,691	949	7,588	8,991	-	164	26,383
Total	$325,280	$110,081	$227,666	$ 19,271	$3,620	$11,439	$697,357

(1) There were $173.7 million of owner-occupied and $142.9 million of non-owner occupied one-to-four family residential loans classified as performing.
(2) There were $5.4 million of owner-occupied and $3.3 million of non-owner occupied one-to-four family residential loans classified as nonperforming.
(3) Net of undisbursed funds.

	December 31, 2011						
	One-to-Four Family Residential	Multifamily	Commercial Real Estate	Construction/ Land Development	Business	Consumer	Total (3)
	(In thousands)						
Performing (1)	$325,568	$112,314	$228,101	$ 15,525	$3,909	$12,499	$697,916
Nonperforming (2)	9,808	949	3,736	9,199	-	-	23,692
Total	$335,376	$113,263	$231,837	$ 24,724	$3,909	$12,499	$721,608

(1) There were $183.0 million of owner-occupied and $142.6 million of non-owner occupied one-to-four family residential loans classified as performing.
(2) There were $5.0 million of owner-occupied and $4.8 million of non-owner occupied one-to-four family residential loans classified as nonperforming.
(3) Net of undisbursed funds.

The following table presents our TDRs recorded investment prior to the modification and after the modification:

	Three Months Ended March 31, 2012		
	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
	(Dollars in thousands)		
TDRs that Occurred During the Period:			

One-to-four family residential:					
Principal and interest with interest rate concession	1	$	214	$	214
Commercial:					
Interest only payments with interest rate concession	1		496		496
Total	2	$	710	$	710

At March 31, 2012, the Company had $36,000 in commitments to extend additional credit to borrowers whose loan terms have been modified in TDRs. All TDRs are also classified as impaired loans and are included in the loans individually evaluated for impairment in the calculation of the ALLL.

The TDRs that occurred during the three months ended March 31, 2012 were primarily a result of granting the borrower interest rate concessions for a period of time ranging from one to three years. The impaired portion of the loan with an interest rate concession for a specific period of time is calculated based on the present value of expected future cash flows discounted at the loan's effective interest rate. The effective interest rate is the rate of

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return implicit on the original loan. This impaired amount reduces the ALLL and a valuation allowance is established to reduce the loan balance. As loan payments are received in future periods, the ALLL entry is reversed and the valuation allowance is reduced utilizing the level yield method over the modification period. TDRs resulted in a charge to the ALLL of $569,000 for the three months ended March 31, 2012.

The following is a summary of loans that were modified as TDRs within the previous 12 months and for which there was a payment default during the three months ended March 31, 2012.

		Types of Modifications	
	Number of Loans	Interest Only Payments	Interest Rate Concession
		(Dollars in thousands)	
TDRs that Subsequently Defaulted:			
One-to-four family residential	1	$ 347	$ -

TDRs that default after they have been modified are typically evaluated individually on a collateral basis. Any additional impairment further reduces the ALLL.

Note 7 – Other Real Estate Owned

The following table is a summary of OREO:

	Three Months Ended March 31,	
	2012	2011
	(In thousands)	
Beginning balance	$ 26,044	$ 30,102
Loans transferred to OREO	1,846	10,277
Capitalized improvements	-	88
Dispositions of OREO, net	(5,132)	(8,573)
Market value adjustments	(310)	(628)
Ending balance	$ 22,448	$ 31,266

OREO includes properties acquired by the Bank through foreclosure or deed in lieu of foreclosure. OREO at March 31, 2012 consisted of $6.2 million in one-to-four family residential homes, $6.5 million in construction/land development projects and $9.7 million in commercial real estate properties.

Note 8 – Fair Value

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

We determined the fair values of our financial instruments based on the fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair values.

Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect our estimates for market assumptions.

Valuation inputs refer to the assumptions market participants would use in pricing a given asset or liability using one of the three valuation techniques. Inputs can be observable or unobservable. Observable inputs are those assumptions that market participants would use in pricing the particular asset or liability. These inputs are based on market data and are obtained from an independent source. Unobservable inputs are assumptions based on our own information or estimate of assumptions used by market participants in pricing the asset or liability. Unobservable inputs are based on the best and most current information available on the measurement date.

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All inputs, whether observable or unobservable, are ranked in accordance with a prescribed fair value hierarchy:

- Level 1 – Quoted prices for identical instruments in active markets.
- Level 2 – Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations whose inputs are observable.
- Level 3 – Instruments whose significant value drivers are unobservable.

The tables below present the balances of assets and liabilities measured at fair value on a recurring basis (there were no transfers between Level 1, Level 2 and Level 3 recurring measurements during the periods presented):

	Fair Value Measurements at March 31, 2012			
	Fair Value Measurements	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	(In thousands)			
Available-for-sale investments:				
Mortgage-backed investments:				
Fannie Mae	$55,924	$-	$55,924	$ -
Freddie Mac	13,191	-	13,191	-
Ginnie Mae	7,014	-	7,014	-
Municipal bonds	1,863	-	1,863	-
U.S. Government sponsored entities and agencies	62,684	-	62,684	-
	$140,676	$-	$140,676	$ -

Fair Value Measurements at December 31, 2011			
Fair Value Measurements	Quoted Prices in Active Markets for Identical	Significant Other Observable	Significant Unobservable