First Financial Northwest, Inc.
Form 10-Q
August 07, 2013

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 June 30, 2013

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 (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

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 August 2, 2013, 17,190,621 shares of the issuer's common stock, $0.01 par value per share, were outstanding.

FIRST FINANCIAL NORTHWEST, INC.
FORM 10-Q
TABLE OF CONTENTS

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

Part 1. Financial Information

Item 1. Financial Statements

Assets	June 30, 2013	December 31, 2012
Cash on hand and in banks	$5,682	$4,289
Interest-bearing deposits	27,837	83,452
Investments available-for-sale, at fair value	152,664	152,262
Loans receivable, net of allowance of $12,313 and $12,542	653,757	650,468
Premises and equipment, net	17,679	18,073
Federal Home Loan Bank ("FHLB") stock, at cost	7,149	7,281
Accrued interest receivable	3,633	3,484
Deferred tax assets, net	14,870	1,000
Other real estate owned ("OREO")	14,226	17,347
Prepaid expenses and other assets	4,718	4,999
Total assets	$902,215	$942,655
Liabilities and Stockholders' Equity		
Interest-bearing deposits	$622,889	$659,643
Noninterest-bearing deposits	7,948	6,154
Advances from the FHLB	74,000	83,066
Advance payments from borrowers for taxes and insurance	3,135	2,186
Accrued interest payable	59	179
Investment transactions payable	2,676	—
Other liabilities	4,433	4,310
Total liabilities	715,140	755,538
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 17,190,621 and 18,805,168 shares at June 30, 2013 and December 31, 2012, respectively	172	188
Additional paid-in capital	175,279	190,534
Retained earnings, substantially restricted	23,912	6,650
Accumulated other comprehensive income (loss), net of tax	(1,849)	748
Unearned Employee Stock Ownership Plan ("ESOP") shares	(10,439)	(11,003)
Total stockholders' equity	187,075	187,117
Total liabilities and stockholders' equity	$902,215	$942,655

See accompanying selected notes to consolidated financial statements.

3

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Interest income				
Loans, including fees	$9,063	$9,802	$18,107	$20,274
Investments available-for-sale	603	500	1,076	1,093
Interest-bearing deposits	18	97	39	194
Total interest income	$9,684	$10,399	$19,222	$21,561
Interest expense				
Deposits	1,763	2,627	3,656	5,568
FHLB advances	116	511	372	1,022
Total interest expense	$1,879	$3,138	$4,028	$6,590
Net interest income	7,805	7,261	15,194	14,971
Provision for loan losses	100	650	100	2,350
Net interest income after provision for loan losses	$7,705	$6,611	$15,094	$12,621
Noninterest income				
Net gain on sale of investments	1	94	1	288
Other	154	236	258	323
Total noninterest income	$155	$330	$259	$611
Noninterest expense				
Salaries and employee benefits	3,755	3,451	7,369	6,878
Occupancy and equipment	345	395	699	800
Professional fees	387	468	743	941
Data processing	176	185	338	366
Gain on sale of OREO property, net	(383)	(128)	(1,015)	(349)
OREO market value adjustments	76	235	221	545
OREO-related expenses, net	151	446	485	935
Regulatory assessments	94	314	377	411
Insurance and bond premiums	121	100	235	200
Proxy contest and related litigation	16	604	105	604
Marketing	42	61	60	113
Prepayment penalty on FHLB advances	—	—	679	—
Other general and administrative	526	438	888	746
Total noninterest expense	$5,306	$6,569	$11,184	$12,190
Income before federal income tax benefit	2,554	372	4,169	1,042
Federal income tax benefit	(13,809)	(999)	(13,751)	(951)
Net income	$16,363	$1,371	$17,920	$1,993
Basic earnings per share	$0.96	$0.08	$1.03	$0.11
Diluted earnings per share	$0.95	$0.08	$1.03	$0.11

See accompanying selected notes to consolidated financial statements.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Net income	$16,363	$1,371	$17,920	$1,993
Other comprehensive income, before tax:				
Unrealized holding gains (losses) on available-for-sale investments	(1,960)	(455)	(2,596)	(203)
Reclassification adjustment for net gain realized in income	(1)	(94)	(1)	(288)
Other comprehensive income (loss), before tax	(1,961)	(549)	(2,597)	(491)
Income tax provision related to items of other comprehensive income	—	—	—	—
Other comprehensive income (loss), net of tax	$(1,961)	$(549)	$(2,597)	$(491)
Total comprehensive income	$14,402	$822	$15,323	$1,502

See accompanying selected notes to consolidated financial statements.

FIRST FINANCIAL NORTHWEST, INC. AND SUBSIDIARIES
Consolidated Statements of Stockholders' Equity
For the Six Months Ended June 30, 2013
(Dollars in thousands)
(Unaudited)

	Shares	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss), net of tax	Unearned ESOP Shares	Total Stockholders' Equity
Balances at December 31, 2012	18,805,168	$ 188	$ 190,534	$ 6,650	$ 748	$ (11,003)	$ 187,117
Other comprehensive income	—	—	—	17,920	(2,597)	—	15,323
Cash dividend declared and paid ($0.04 per share)	—	—	—	(658)	—	—	(658)
Exercise of stock options	40,000	—	334	—	—	—	334
Purchase and retirement of common stock	(1,654,547)	(16)	(16,480)	—	—	—	(16,496)
Compensation related to stock options and restricted stock awards	—	—	970	—	—	—	970
Allocation of 56,426 ESOP shares	—	—	(79)	—	—	564	485
Balances at June 30, 2013	17,190,621	$ 172	$ 175,279	$ 23,912	$ (1,849)	$ (10,439)	$ 187,075

See accompanying selected notes to consolidated financial statements.

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

	Six Months Ended June 30,	
	2013	2012
Cash flows from operating activities:		
Net income	$17,920	$1,993
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	100	2,350
OREO market value adjustments	221	545
Gain on sale of OREO property, net	(1,015)	(349)
Depreciation of premises and equipment	410	524
Net amortization of premiums and discounts on investments	966	884
ESOP expense	485	418
Compensation expense related to stock options and restricted stock awards	970	932
Net realized gain on investments available-for-sale	(1)	(288)
Loss from disposal of premises and equipment	—	6
Deferred federal income taxes	(13,870)	(998)
Changes in operating assets and liabilities:		
Prepaid expenses and other assets	281	603
Accrued interest receivable	(149)	191
Accrued interest payable	(120)	(4)
Investment transactions payable	2,676	—
Other liabilities	123	(124)
Net cash provided by operating activities	$8,997	$6,683
Cash flows from investing activities:		
Proceeds from sales of investments	29,998	23,199
Capitalized improvements in OREO	(38)	—
Proceeds from sales of OREO properties	9,322	11,664
Principal repayments on investments	13,792	11,023
Purchases of investments	(47,754)	(36,792)
Net (increase) decrease in loans receivable	(8,758)	42,951
FHLB stock redemption	132	—
Purchases of premises and equipment	(16)	(56)
Net cash provided (used) by investing activities	$(3,322)	$51,989
Cash flows from financing activities:		
Net decrease in deposits	(34,960)	(63,802)
Advances from the FHLB	74,000	110
Repayments of advances from the FHLB	(83,066)	(110)
Net increase in advance payments from borrowers for taxes and insurance	949	366
Proceeds from exercise of stock options	334	—
Repurchase and retirement of common stock	(16,496)	—
Cash dividends paid	(658)	—
Net cash used by financing activities	$(59,897)	$(63,436)

Continued

7

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

Continued

	Six Months Ended June 30, 2013	2012
Net decrease in cash and cash equivalents	$(54,222)	$(4,764)
Cash and cash equivalents:		
Beginning of period	87,741	164,761
End of period	$33,519	$159,997
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	$4,148	$6,594
Federal income taxes	15	60
Noncash transactions:		
Loans, net of deferred loan fees and allowance for loan and lease losses ("ALLL"), transferred to OREO	$5,369	$8,022

See accompanying selected 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”), 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. Our current business strategy emphasizes one-to-four family residential, multifamily and commercial real estate lending.

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

During April 2013, the Memorandum of Understanding ("MOU") by and between the Bank and the FDIC and the DFI (originally effective March 27, 2012) was terminated. Also in April 2013, the MOU by and between First Financial Northwest and the FRB (originally effective April 14, 2010) was terminated. As a result, the Company is no longer required to obtain the approval of the FRB prior to the repurchase of its common stock and for the payment of any cash dividends. The FDIC, DFI and FRB have also terminated the Bank's and First Financial Northwest's "troubled condition" status.

Note 3 - Basis of Presentation

The accompanying unaudited interim consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission ("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, 2012, 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 six months ended June 30, 2013 are not necessarily indicative of the results that may be expected for the year ending December 31, 2013. 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 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 with no effect on income or stockholders' equity.

Note 4 - Recently Issued Accounting Pronouncements

In December 2011, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2011-11, Disclosures about Offsetting Assets and Liabilities. The ASU 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.

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

The 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. This ASU is effective for annual and interim reporting periods beginning on or after January 1, 2013. The adoption of this ASU did not have a material impact on the Company's consolidated financial statements.

In July 2012, the FASB issued ASU No. 2012-2, Intangibles-Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment. This ASU states that an entity has the option to first assess qualitative factors to determine whether the existence of events and circumstances indicates that it is more likely than not that the indefinite-lived intangible asset is impaired. If, after assessing the totality of events and circumstances, an entity concludes that it is not more likely than not that the indefinite-lived intangible asset is impaired, then the entity is not required to take further action. However, if an entity concludes otherwise, it is required to determine the fair value of the indefinite-lived intangible asset and perform the quantitative impairment test by comparing the fair value with the carrying amount, in accordance with Codification Subtopic 350-30, Intangibles-Goodwill and Other, General Intangibles Other than Goodwill. Under guidance in this ASU an entity also has the option to bypass the qualitative assessment for any indefinite-lived intangible asset in any period and proceed directly to performing the quantitative impairment test. An entity will be able to resume performing the qualitative assessment in any subsequent period. This ASU is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. The adoption of this ASU did not have a material impact on the Company's consolidated financial statements.

In February 2013, the FASB issued ASU 2013-02, Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income. This ASU requires an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component and to present either on the face of the statement where net income is presented or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income, but only if the amount reclassified is required to be reclassified to net income in its entirety in the same reporting period. The amendments were effective prospectively for annual and interim reporting periods beginning on or after December 15, 2012. The adoption of this ASU did not have a material impact on the Company's consolidated financial statements.

In April 2013, the FASB issued ASU 2013-11, Income Taxes (Topic 740). This ASU requires an entity to present in the financial statements an unrecognized tax benefit as a liability and the unrecognized tax benefit should not be combined with deferred tax assets to the extent that a net operating loss carryforward, tax loss or tax credit carryforward is also not available at the reporting date. The amendment is to be applied prospectively to all unrecognized tax benefits and is effective for annual and interim reporting periods beginning after December 15, 2013. The Company does not expect this ASU to have a material impact on the Company's consolidated financial statements.

Note 5 - Investments

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

	June 30, 2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands)			
Mortgage-backed investments:				
Fannie Mae	$49,136	$563	$(528)	$49,171
Freddie Mac	21,470	237	(178)	21,529
Ginnie Mae	29,143	15	(334)	28,824
Municipal bonds	2,045	6	(200)	1,851
U.S. Government agencies	39,357	210	(466)	39,101

Corporate bonds	12,573	21	(406)	12,188
Total	$153,724	$1,052	$(2,112)	$152,664

10

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

	December 31, 2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands)			
Mortgage-backed investments:				
Fannie Mae	$35,039	$1,131	$(2)	$36,168
Freddie Mac	15,368	403	(8)	15,763
Ginnie Mae	31,193	84	(131)	31,146
Municipal bonds	2,048	7	(166)	1,889
U.S. Government agencies	67,077	223	(4)	67,296
Total	$150,725	$1,848	$(311)	$152,262

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:

	June 30, 2013					
	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	$30,152	$(528)	$—	$—	$30,152	$(528)
Freddie Mac	10,751	(178)	—	—	10,751	(178)
Ginnie Mae	21,572	(327)	1,502	(7)	23,074	(334)
Municipal bonds	—	—	1,203	(200)	1,203	(200)
U.S. Government agencies	22,301	(362)	9,896	(104)	32,197	(466)
Corporate bonds	10,667	(406)	—	—	10,667	(406)
Total	$95,443	$(1,801)	$12,601	$(311)	$108,044	$(2,112)

	December 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	$4,603	$(2)	$—	$—	$4,603	$(2)
Freddie Mac	2,952	(8)	—	—	2,952	(8)
Ginnie Mae	18,238	(131)	—	—	18,238	(131)
Municipal bonds	—	—	1,239	(166)	1,239	(166)
U.S. Government agencies	10,508	(4)	—	—	10,508	(4)
Total	$36,301	$(145)	$1,239	$(166)	$37,540	$(311)

At June 30, 2013, the Company had three securities with a gross unrealized loss of $311,000 with a fair value of $12.6 million that had an unrealized loss for greater than one year. At December 31, 2012, there was one security that had a gross unrealized loss of $166,000 with a fair value of $1.2 million that had an unrealized loss for greater than one year. Management reviewed the financial condition of the entities issuing these securities at June 30, 2013 and December 31, 2012, and determined that 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. The Company considers 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 the Company's Consolidated Income Statements. For debt securities, if the Company intends to sell the security or it is likely that the Company 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 the Company does not intend to sell the security and it is not likely that it will be required to sell the security but does 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 and six months ended June 30, 2013 and 2012, the Company did not have any OTTI losses on investments.

The amortized cost and estimated fair value of investments available-for-sale at June 30, 2013, 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.

	June 30, 2013	
	Amortized Cost	Fair Value
	(In thousands)	
Due after one year through five years	$26,631	$26,295
Due after five years through ten years	19,443	19,074
Due after ten years	7,901	7,771
	53,975	53,140
Mortgage-backed investments	99,749	99,524
Total	$153,724	$152,664

Under Washington state law, in order to participate in the public funds program the Company is required to pledge as collateral an amount equal to 100% of the public deposits held in the form of eligible securities. Investments with a market value of $25.1 million and $1.9 million were pledged as collateral for public deposits at June 30, 2013 and December 31, 2012, respectively, both of which exceeded the collateral requirements established by the Washington Public Deposit Protection Commission.

We sold $30.0 million of investments generating a gross gain of $10,000 and a gross loss of $9,000 during the three months ended June 30, 2013. For the three months ended June 30, 2012, we sold $12.1 million of investments resulting in a gross gain of $100,000 and a gross loss of $6,000. For the six months ended June 20, 2013 we sold $30.0 million of investments generating a gross gain of $10,000 and a gross loss of $9,000 compared to sales of $22.9 million, gross gains of $294,000 and gross losses of $6,000 for the comparable period in 2012.

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

Note 6 - Loans Receivable

Loans receivable are summarized as follows:

	June 30, 2013	December 31, 2012
	(In thousands)	
One-to-four family residential: [1]		
Permanent	$294,880	$306,851
Construction	—	177
	294,880	307,028
Multifamily:		
Permanent	103,187	105,936
Construction	8,160	5,585
	111,347	111,521
Commercial real estate:		
Permanent	221,329	207,436
Construction	13,805	12,500
Land	1,964	1,942
	237,098	221,878
Construction/land development: [2]		
One-to-four family residential	1,795	608
Multifamily	12,741	8,375
Commercial real estate	5,770	—
Land development	9,094	10,435
	29,400	19,418
Business	1,720	2,968
Consumer	9,927	11,110
Total loans	684,372	673,923
Less:		
Loans in process ("LIP")	15,873	8,856
Deferred loan fees, net	2,429	2,057
ALLL	12,313	12,542
Loans receivable, net	$653,757	$650,468

(1) Includes $129.3 million and $139.8 million of non-owner occupied loans at June 30, 2013 and December 31, 2012, respectively.

(2) Excludes construction loans that will convert to permanent loans. The Company considers 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. At June 30, 2013, the Company had $13.8 million, or 5.8% of the total commercial real estate portfolio and $8.2 million, or 7.3% of its total multifamily portfolio in these "rollover" type of loans. At December 31, 2012, the Company had $12.5 million, or 5.6% of the total commercial real estate portfolio, $5.6 million, or 5.0% of the total multifamily portfolio, and $177,000, or 0.1% of its total one-to-four family loan portfolio in these rollover type of loans. At June 30, 2013 and December 31, 2012, $2.0 million and $1.9 million, respectively, of commercial real estate loans were not included in the construction/land development category because the Company classifies raw land or buildable lots when it does not intend to finance the

construction as commercial real estate land loans.

At June 30, 2013 and December 31, 2012 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 summarize changes in the ALLL and loan portfolio by loan type and impairment method:

	At or For the Three Months Ended June 30, 2013						
	One-to-Four Family Residential	Multifamily	Commercial Real Estate	Construction/ Land Development	Business	Consumer	Total
	(In thousands)						
ALLL:							
Beginning balance	$5,444	$1,198	$4,781	$386	$32	$161	$12,002
Charge-offs	(150)	—	—	(332)	—	(55)	(537)
Recoveries	533	208	2	—	—	5	748
Provision	(857)	(106)	736	291	(11)	47	100
Ending balance	$4,970	$1,300	$5,519	$345	$21	$158	$12,313
General reserve	$3,825	$1,232	$5,035	$345	$21	$158	$10,616
Specific reserve	$1,145	$68	$484	$—	$—	$—	$1,697
Loans: (1)							
Total Loans	$294,880	$110,039	$235,812	$16,121	$1,720	$9,927	$668,499
General reserve (2)	$241,415	$108,566	$220,088	$11,752	$1,720	$9,210	$592,751
Specific reserve (3)	$53,465	$1,473	$15,724	$4,369	$—	$717	$75,748

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

	At or For the Six Months Ended June 30, 2013						
	One-to-Four Family Residential	Multifamily	Commercial Real Estate	Construction/ Land Development	Business	Consumer	Total
	(In thousands)						
ALLL:							
Beginning balance	$5,562	$1,139	$5,207	$437	$30	$167	$12,542
Charge-offs	(309)	(346)	(98)	(332)	—	(71)	(1,156)
Recoveries	533	208	3	70	—	13	827
Provision	(816)	299	407	170	(9)	49	100
Ending balance	$4,970	$1,300	$5,519	$345	$21	$158	$12,313
General reserve	$3,825	$1,232	$5,035	$345	$21	$158	$10,616
Specific reserve	$1,145	$68	$484	$—	$—	$—	$1,697
Loans: (1)							
Total Loans	$294,880	$110,039	$235,812	$16,121	$1,720	$9,927	$668,499
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Specific reserve (3)	$53,465	$1,473	$15,724	$4,369	$—	$717	$75,748

(1) Net of LIP.
(2) Loans collectively evaluated for impairment.

(3) Loans individually evaluated for impairment.

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

	At or For the Three Months Ended June 30, 2012						
	One-to-Four Family Residential	Multifamily	Commercial Real Estate	Construction/ Land Development	Business	Consumer	Total
	(In thousands)						
ALLL:							
Beginning balance	$5,813	$2,357	$5,675	$724	$35	$228	$14,832
Charge-offs	(619)	(153)	(482)	(95)	—	—	(1,349)
Recoveries	12	—	301	2	—	2	317
Provision	760	(180)	140	(64)	—	(6)	650
Ending balance	$5,966	$2,024	$5,634	$567	$35	$224	$14,450
General reserve	$5,349	$2,024	$5,430	$567	$35	$224	$13,629
Specific reserve	$617	$—	$204	$—	$—	$—	$821
Loans: (1)							
Total Loans	$318,377	$104,431	$210,698	$17,670	$3,627	$11,328	$666,131
General reserve (2)	$259,572	$101,145	$196,414	$8,939	$3,627	$11,046	$580,743
Specific reserve (3)	$58,805	$3,286	$14,284	$8,731	$—	$282	$85,388

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

	At or For the Six Months Ended June 30, 2012						
	One-to-Four Family Residential	Multifamily	Commercial Real Estate	Construction/ Land Development	Business	Consumer	Total
	(In thousands)						
ALLL:							
Beginning balance	$5,756	$950	$6,846	$2,503	$154	$350	$16,559
Charge-offs	(1,337)	(153)	(3,096)	(169)	—	(293)	(5,048)
Recoveries	12	—	472	102	—	3	589
Provision	1,535	1,227	1,412	(1,869)	(119)	164	2,350
Ending balance	$5,966	$2,024	$5,634	$567	$35	$224	$14,450
General reserve	$5,349	$2,024	$5,430	$567	$35	$224	$13,629
Specific reserve	$617	$—	$204	$—	$—	$—	$821
Loans: (1)							
Total Loans	$318,377	$104,431	$210,698	$17,670	$3,627	$11,328	$666,131

General reserve (2)	$259,572	$101,145	$196,414	$8,939	$3,627	$11,046	$580,743
Specific reserve (3)	$58,805	$3,286	$14,284	$8,731	$—	$282	$85,388

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

Nonperforming loans, net of LIP, were $14.6 million and $22.8 million at June 30, 2013 and December 31, 2012, respectively. Foregone interest on nonperforming loans for the quarter ended June 30, 2013 was $259,000, compared to $365,000 for the same quarter in 2012. Foregone interest for the six months ended June 30, 2013 was $553,000 compared to $776,000 for the six months ended June 30, 2012.

There were no funds committed to be advanced in connection with impaired loans at either June 30, 2013 or December 31, 2012.

We continually monitor our loan portfolio for delinquent loans and changes in the financial condition of each borrower. When an issue is identified with one of our borrowers and it is determined that the loan needs to be classified as nonperforming and/or impaired, an evaluation of the collateral is performed and, if necessary, an appraisal is ordered in accordance with our appraisal policy guidelines. Based on this evaluation, any additional provision for loan loss or charge-offs that may be needed is recorded prior to the end of the financial reporting period.

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. When 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. We obtain annual updated appraisals for impaired collateral dependent loans that exceed $1.0 million and loans that have been transferred to OREO. In addition, we may order appraisals on properties not included within these guidelines when there are extenuating circumstances where we are not otherwise able to determine the fair value of the property.

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

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

	June 30, 2013		
	Recorded Investment [1]	Unpaid Principal Balance [2]	Related Allowance
	(In thousands)		
Loans with no related allowance:			
One-to-four family residential:			
Owner occupied	$4,874	$5,475	$—
Non-owner occupied	28,737	28,817	—
Multifamily	244	266	—
Commercial real estate	7,663	8,492	—
Construction/land development	4,369	8,813	—
Consumer	717	798	—
Total	46,604	52,661	—
Loans with an allowance:			
One-to-four family residential:			
Owner occupied	4,762	4,960	322
Non-owner occupied	15,092	15,343	823
Multifamily	1,229	1,229	68
Commercial real estate	8,061	8,061	484
Total	29,144	29,593	1,697
Total impaired loans:			
One-to-four family residential:			
Owner occupied	9,636	10,435	322
Non-owner occupied	43,829	44,160	823
Multifamily	1,473	1,495	68
Commercial real estate	15,724	16,553	484
Construction/land development	4,369	8,813	—
Consumer	717	798	—
Total	$75,748	$82,254	$1,697

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

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

	December 31, 2012 Recorded Investment [1] (In thousands)	Unpaid Principal Balance [2]	Related Allowance
Loans with no related allowance:			
One-to-four family residential:			
Owner occupied	$4,741	$5,569	$—
Non-owner occupied	34,318	34,442	—
Multifamily	5,950	6,131	—
Commercial real estate	10,126	12,502	—
Construction/land development	4,767	8,813	—
Consumer	759	798	—
Total	60,661	68,255	—
Loans with an allowance:			
One-to-four family residential:			
Owner occupied	5,897	6,073	361
Non-owner occupied	13,936	14,150	890
Commercial real estate	8,113	8,113	352
Total	27,946	28,336	1,603
Total impaired loans:			
One-to-four family residential:			
Owner occupied	10,638	11,642	361
Non-owner occupied	48,254	48,592	890
Multifamily	5,950	6,131	—
Commercial real estate	18,239	20,615	352
Construction/land development	4,767	8,813	—
Consumer	759	798	—
Total	$88,607	$96,591	$1,603

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

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

	Three Months Ended June 30, 2013		Six Months Ended June 30, 2013	
	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	$5,136	$28	$5,004	$58
Non-owner occupied	29,161	419	30,880	849
Multifamily	2,050	—	3,350	—
Commercial real estate	8,355	69	8,946	135
Construction/land development	4,558	—	4,628	—
Consumer	725	—	736	—
Total	49,985	516	53,544	1,042
Loans with an allowance:				
One-to-four family residential:				
Owner occupied	4,990	54	5,292	112
Non-owner occupied	16,571	135	15,693	361
Multifamily	614	20	410	40
Commercial real estate	8,074	91	8,086	208
Total	30,249	300	29,481	721
Total impaired loans:				
One-to-four family residential:				
Owner occupied	10,126	82	10,296	170
Non-owner occupied	45,732	554	46,573	1,210
Multifamily	2,664	20	3,760	40
Commercial real estate	16,429	160	17,032	343
Construction/land development	4,558	—	4,628	—
Consumer	725	—	736	—
Total	$80,234	$816	$83,025	$1,763

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

	Three Months Ended June 30, 2012		Six Months Ended June 30, 2012	
	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	$ 8,405	$ 63	$ 8,272	$ 112
Non-owner occupied	37,603	526	38,537	1,057
Multifamily	3,366	49	3,395	91
Commercial real estate	12,597	23	12,666	180
Construction/land development	8,861	—	8,974	—
Consumer	258	1	195	2
Total	71,090	662	72,039	1,442
Loans with an allowance:				
One-to-four family residential:				
Owner occupied	4,251	45	4,363	90
Non-owner occupied	9,310	99	9,399	212
Commercial real estate	4,012	69	3,280	139
Total	17,573	213	17,042	441
Total impaired loans:				
One-to-four family residential:				
Owner occupied	12,656	108	12,635	202
Non-owner occupied	46,913	625	47,936	1,269
Multifamily	3,366	49	3,395	91
Commercial real estate	16,609	92	15,946	319
Construction/land development	8,861	—	8,974	—
Consumer	258	1	195	2
Total	$ 88,663	$ 875	$ 89,081	$ 1,883

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

Certain loan modifications or restructurings are accounted for as troubled debt restructured loans ("TDRs"). In general, the modification or restructuring of a debt is considered a TDR if, for economic or legal reasons related to the borrower's financial difficulties, a concession is granted to the borrower that the Company would not otherwise consider. Once the loan is restructured, a current, well-documented credit evaluation of the borrower's financial condition and prospects for repayment are performed to assess the likelihood that all principal and interest payments required under the terms of the modified agreement will be collected in full. A loan that is determined to be classified as a TDR is generally reported as a TDR until the loan is paid in full or otherwise settled, sold or charged-off. The following is a summary of information pertaining to nonperforming assets and TDRs:

	June 30, 2013	December 31, 2012
	(In thousands)	
Nonperforming assets: [1]		
Nonaccrual loans	$11,655	$18,231
Nonaccrual TDRs	2,904	4,528
Total nonperforming loans	14,559	22,759
OREO	14,226	17,347
Total nonperforming assets	$28,785	$40,106
Performing TDRs	$61,189	$65,848
Nonaccrual TDRs	2,904	4,528
Total TDRs	$64,093	$70,376

[1] There were no loans 90 days or more past due and still accruing interest at June 30, 2013 or December 31, 2012. All loans are reported net of LIP.

The accrual status of a loan may change after it has been classified as a TDR. Management considers the following in determining the accrual status of restructured loans: (1) if the loan was on accrual status prior to the restructuring, the borrower has demonstrated performance under the previous terms, and a credit evaluation shows the borrower's capacity to continue to perform under the restructured terms (both principal and interest payments), the loan will remain on accrual at the time of the restructuring; (2) if the loan was on nonaccrual status before the restructuring, and the Company's credit evaluation shows the borrower's capacity to meet the restructured terms, the loan would remain as nonaccrual for a minimum of six months after restructuring until the borrower has demonstrated a reasonable period of sustained repayment performance (thereby providing reasonable assurance as to the ultimate collection of principal and interest in full under the modified terms).

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.

In order to return a nonaccrual loan to accrual status, each loan is evaluated on a case-by-case basis. The Company evaluates the borrower's financial condition to ensure that future loan payments are reasonably assured. The Company also takes into consideration the borrower's willingness and ability to make the loan payments and historical repayment performance. The Company requires the borrower to make loan payments consistently for a period of at least six months as agreed to under the terms of the loan agreement before the Company will consider reclassifying the loan to accrual status.

21

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

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

	June 30, 2013	December 31, 2012
	(In thousands)	
One-to-four family residential	$5,709	$6,248
Multifamily	244	4,711
Commercial real estate	3,520	6,274
Construction/land development	4,369	4,767
Consumer	717	759
Total nonaccrual loans	$14,559	$22,759

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

	Loans Past Due as of June 30, 2013					
	30-59 Days	60-89 Days	90 Days and Greater	Total	Current	Total Loans (1) (2)
	(In thousands)					
Real estate:						
One-to-four family residential:						
Owner occupied	$415	$1,188	$1,755	$3,358	$162,259	$165,617
Non-owner occupied	384	—	371	755	128,508	129,263
Multifamily	—	—	—	—	110,039	110,039
Commercial real estate	—	—	3,406	3,406	232,406	235,812
Construction/land development	—	—	473	473	15,648	16,121
Total real estate	799	1,188	6,005	7,992	648,860	656,852
Business	—	—	—	—	1,720	1,720
Consumer	79	47	—	126	9,801	9,927
Total	$878	$1,235	$6,005	$8,118	$660,381	$668,499

(1) There were no loans 90 days past due and still accruing interest at June 30, 2013.
(2) Net of LIP.

	Loans Past Due as of December 31, 2012					
	30-59 Days	60-89 Days	90 Days and Greater	Total	Current	Total Loans (1) (2)
	(In thousands)					
Real estate:						
One-to-four family residential:						
Owner occupied	$1,974	$1,374	$2,653	$6,001	$161,100	$167,101
Non-owner occupied	1,276	49	1,019	2,344	137,488	139,832
Multifamily	—	—	4,711	4,711	104,935	109,646
Commercial real estate	1,795	—	4,479	6,274	215,604	221,878
Construction/land development	—	—	805	805	11,727	12,532
Total real estate	5,045	1,423	13,667	20,135	630,854	650,989
Business	—	—	—	—	2,968	2,968
Consumer	20	47	690	757	10,353	11,110
Total	$5,065	$1,470	$14,357	$20,892	$644,175	$665,067

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

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

Credit Quality Indicators. The Company utilizes a nine-point risk rating system and assigns 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 the Company's 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 Company 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 the Company 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 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 Company. There were no loans classified as doubtful or loss at June 30, 2013 and December 31, 2012.

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

	June 30, 2013						
	One-to-Four Family Residential	Multifamily	Commercial Real Estate	Construction/ Land Development	Business	Consumer	Total (1)
	(In thousands)						
Risk Rating:							
Pass	$275,622	$107,345	$219,343	$11,752	$1,706	$8,987	$624,755
Special mention	9,834	1,221	10,739	—	14	1	21,809
Substandard	9,424	1,473	5,730	4,369	—	939	21,935
Total	$294,880	$110,039	$235,812	$16,121	$1,720	$9,927	$668,499

(1) Net of LIP.

	December 31, 2012						
	One-to-Four Family Residential	Multifamily	Commercial Real Estate	Construction / Land Development	Business	Consumer	Total (1)
	(In thousands)						
Risk Rating:							
Pass	$286,674	$103,696	$202,407	$7,600	$2,968	$10,129	$613,474
Special mention	10,433	—	11,666	165	—	—	22,264
Substandard	9,826	5,950	7,805	4,767	—	981	29,329
Total	$306,933	$109,646	$221,878	$12,532	$2,968	$11,110	$665,067

(1) Net of LIP.

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

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

	June 30, 2013						
	One-to-Four Family Residential	Multifamily	Commercial Real Estate	Construction / Land Development	Business	Consumer	Total [(1)]
	(In thousands)						
Performing [(2)]	$289,171	$109,795	$232,292	$11,752	$1,720	$9,210	$653,940
Nonperforming [(3)]	5,709	244	3,520	4,369	—	717	14,559
Total	$294,880	$110,039	$235,812	$16,121	$1,720	$9,927	$668,499

(1) Net of LIP.
(2) There were $161.6 million of owner-occupied one-to-four family residential loans and $127.6 million of non-owner occupied one-to-four family residential loans classified as performing.
(3) There were $4.0 million of owner-occupied one-to-four family residential loans and $1.7 million of non-owner occupied one-to-four family residential loans classified as nonperforming.

	December 31, 2012						
	One-to-Four Family Residential	Multifamily	Commercial Real Estate	Construction/ Land Development	Business	Consumer	Total [(1)]
	(In thousands)						
Performing [(2)]	$300,685	$104,935	$215,604	$7,765	$2,968	$10,351	$642,308
Nonperforming [(3)]	6,248	4,711	6,274	4,767	—	759	22,759
Total	$306,933	$109,646	$221,878	$12,532	$2,968	$11,110	$665,067

(1) Net of LIP.
(2) There were $163.1 million of owner-occupied one-to-four family residential loans and $137.6 million of non-owner occupied one-to-four family residential loans classified as performing.
(3) There were $4.0 million of owner-occupied one-to-four family residential loans and $2.2 million of non-owner occupied one-to-four family residential loans classified as nonperforming.

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

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

	Three Months Ended June 30, 2013			Six Months Ended June 30, 2013		
	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	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:						
Interest-only payments with no interest rate concession	2	$ 682	$ 685	2	$ 682	$ 685
Principal and interest with interest rate concession	2	1,620	1,590	2	1,620	1,590
Advancement of maturity date	1	311	307	1	311	307
Commercial real estate:						
Principal and interest reamortized with no interest rate concession	—	—	—	1	335	333
Interest-only payments with interest rate concession	2	3,484	3,484	2	3,484	3,484
Total	7	$ 6,097	$ 6,066	8	$ 6,432	$ 6,399

	Three Months Ended June 30, 2012			Six Months Ended June 30, 2012		
	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	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	$ 213
Commercial real estate:						
Principal and interest reamortized with no interest rate concession	1	1,415	1,409	1	1,415	1,409
Interest-only payments with interest rate concession	1	2,012	2,012	2	2,508	2,508
Total	2	$ 3,427	$ 3,421	4	$ 4,137	$ 4,130

At June 30, 2013, December 31, 2012 and June 30, 2012, the Company had no 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 and six months ended June 30, 2013 and 2012 were primarily a result of granting the borrower interest rate concessions and/or interest-only payments for a period of time ranging from one to three years. The impaired portion of the loan with an interest rate concession and/or interest-only payments for a specific period of time are calculated based on the present value of expected future cash flows discounted at the loan’s effective interest rate. The effective interest rate

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

is the rate of 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 charge-offs to the ALLL of $85,000 and $390,000 for the three months ended June 30, 2013 and 2012, respectively, and $89,000 and $644,000 for the six months ended June 30, 2013 and 2012, respectively.

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 and six months ended June 30, 2013 and 2012:

	Types of Modification					
	Three Months Ended June 30, 2013			Six Months Ended June 30, 2013		
	Number of Loans	Interest Only Payments	Interest Rate Concession	Number of Loans	Interest Only Payments	Interest Rate Concession
	(Dollars in thousands)					
TDRs that Subsequently Defaulted:						
One-to-four family residential	—	$—	$—	1	$—	$70
Commercial real estate	1	—	333	2	940	333
Total	1	$—	$333	3	$940	$403

	Types of Modification					
	Three Months Ended June 30, 2012			Six Months Ended June 30, 2012		
	Number of Loans	Interest Only Payments	Interest Rate Concession	Number of Loans	Interest Only Payments	Interest Rate Concession
	(Dollars in thousands)					
TDRs that Subsequently Defaulted:						
One-to-four family residential	1	$274	$—	1	$274	$—
Commercial real estate	1	1,409	—	1	1,409	—
Total	2	$1,683	$—	2	$1,683	$—

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 June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
	(In thousands)			
Balance at beginning of period	$16,310	$22,448	$17,347	$26,044
Loans transferred to OREO	1,993	6,176	5,369	8,022
Capitalized improvements	5	—	38	—
Dispositions of OREO, net	(4,006)	(6,183)	(8,307)	(11,315)
Market value adjustments	(76)	(235)	(221)	(545)

Balance at end of period	$14,226	$22,206	$14,226	$22,206

26

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

OREO includes properties acquired by the Company through foreclosure and deed in lieu of foreclosure. OREO at June 30, 2013 consisted of $2.7 million in one-to-four family residential homes, $1.1 million in construction/land development projects and $10.4 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.

The Company determines the fair values of its 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 its estimate 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 the Company's 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.

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):

	Fair Value Measurements at June 30, 2013			
	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	$49,171	$—	$49,171	$—
Freddie Mac	21,529	—	21,529	—
Ginnie Mae	28,824	—	28,824	—
Municipal bonds	1,851	—	1,851	—
U.S. Government agencies	39,101	—	39,101	—
Corporate bonds	12,188	—	12,188	—

$152,664	$—	$152,664	$—

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

	Fair Value Measurements at December 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	$36,168	$—	$36,168	$—
Freddie Mac	15,763	—	15,763	—
Ginnie Mae	31,146	—	31,146	—
Municipal bonds	1,889	—	1,889	—
U.S. Government agencies	67,296	—	67,296	—
	$152,262	$—	$152,262	$—

The estimated fair value of Level 2 investments is based on quoted prices for similar investments in active markets, identical or similar investments in markets that are not active and model-derived valuations whose inputs are observable.

The tables below present the balances of assets and liabilities measured at fair value on a nonrecurring basis.

	Fair Value Measurements at June 30, 2013				
	Fair Value Measurements	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Losses
	(In thousands)				
Impaired loans (included in loans receivable, net) (1)	$74,051	$—	$—	$74,051	$1,697
OREO (2)	14,226	—	—	14,226	76
Total	$88,277	$—	$—	$88,277	$1,773

(1) The loss represents the specific reserve against loans that were considered impaired at June 30, 2013.
(2) The loss represents OREO market value adjustments for the quarter ended June 30, 2013.

	Fair Value Measurements at December 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)	Total Losses
	(In thousands)				
Impaired loans (included in loans receivable, net) (1)	$87,004	$—	$—	$87,004	$1,603

OREO [2]	17,347	—	—	17,347	2,046
Total	$104,351	$—	$—	$104,351	$3,649

(1) The loss represents the specific reserve against loans that were considered impaired at December 31, 2012.
(2) The loss represents OREO market value adjustments for the year ended December 31, 2012.

The fair value of impaired loans is calculated using the collateral value method or on a discounted cash flow basis. Inputs used in the collateral value method include appraised values, estimates of certain completion costs and closing and selling costs.

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

Some of these inputs may not be observable in the marketplace. Appraised values may be discounted based on management's historical knowledge, changes in market conditions from the time of valuation and/or management's expertise and knowledge of the borrower.

OREO properties are measured at the lower of their carrying amount or fair value, less costs to sell. Fair values are generally based on third party appraisals of the property, resulting in a Level 3 classification. In cases where the carrying amount exceeds the fair value, less costs to sell, an impairment loss is recognized.

The following table presents quantitative information about Level 3 fair value measurements for financial instruments measured at fair value on a nonrecurring basis.

	June 30, 2013			
	Fair Value	Valuation Technique(s)	Unobservable Input(s)	Range (Weighted Average)
	(Dollars in thousands)			
Impaired Loans	$ 74,051	Market approach	Adjusted for differences between comparable sales	0% - 41% (1.1%)
OREO	$ 14,226	Market approach	Adjusted for differences between comparable sales	19% - 26% (0.6%)

The carrying amounts and estimated fair values of financial instruments were as follows:

	June 30, 2013				
		Estimated	Fair Value Measurements Using:		
	Carrying Value	Fair Value	Level 1	Level 2	Level 3
	(In thousands)				
Financial Assets:					
Cash on hand and in banks	$5,682	$5,682	$5,682	$—	$—
Interest-bearing deposits	27,837	27,837	27,837	—	—
Investments available-for-sale	152,664	152,664	—	152,664	—
Loans receivable, net	653,757	683,566	—	—	683,566
FHLB stock	7,149	7,149	7,149	—	—
Accrued interest receivable	3,633	3,633	—	3,633	—
Financial Liabilities:					
Deposits	191,123	191,123	191,123	—	—
Certificates of deposit	439,714	443,000	—	443,000	—
Advances from the FHLB	74,000	73,382	—	73,382	—
Accrued interest payable	59	59	—	59	—
Investment transactions payable	2,676	2,676	—	2,676	—

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

	December 31, 2012				
		Estimated	Fair Value Measurements Using:		
	Carrying Value	Fair Value	Level 1	Level 2	Level 3
	(In thousands)				
Financial Assets:					
Cash on hand and in banks	$4,289	$4,289	$4,289	$—	$—
Interest-bearing deposits	83,452	83,452	83,452	—	—
Investments available-for-sale	152,262	152,262	—	152,262	—
Loans receivable, net	650,468	689,708	—	—	689,708
FHLB stock	7,281	7,281	7,281	—	—
Accrued interest receivable	3,484	3,484	—	3,484	—
Financial Liabilities:					
Deposits	202,090	202,090	202,090	—	—
Certificates of deposit	463,707	467,126	—	467,126	—
Advances from the FHLB	83,066	83,659	—	83,659	—
Accrued interest payable	179	179	—	179	—

Fair value estimates, methods, and assumptions are set forth below for the Company's financial instruments:

- Financial instruments with book value equal to fair value: The fair value of financial instruments that are short-term or reprice frequently and that have little or no risk are considered to have a fair value equal to book value. These instruments include cash on hand and in banks, interest-bearing deposits, FHLB stock, accrued interest receivable, accrued interest payable and investment transactions payable. FHLB stock is not publicly-traded, however it may be redeemed on a dollar-for-dollar basis, for any amount the Bank is not required to hold, subject to the FHLB's discretion. The fair value is therefore equal to the book value.

- Investments available-for-sale: The fair value of all investments excluding FHLB stock was based upon quoted market prices for similar investments in active markets, identical or similar investments in markets that are not active and model-derived valuations whose inputs are observable.

- Loans receivable: For variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. The fair value of fixed-rate loans is estimated using discounted cash flow analysis, utilizing interest rates that would be offered for loans with similar terms to borrowers of similar credit quality. As a result of current market conditions, cash flow estimates have been further discounted to include a credit factor. The fair value of nonperforming loans is estimated using the fair value of the underlying collateral.

- Liabilities: The f