First Financial Northwest, Inc.
Form 10-Q
August 05, 2016

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, 2016

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, 2016, 13,326,616 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

			Page
PART I - FINANCIAL INFORMATION			
	Item 1.	Financial Statements	3
	Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	34
	Item 3.	Quantitative and Qualitative Disclosures About Market Risk	53
	Item 4.	Controls and Procedures	57
PART II - OTHER INFORMATION			
	Item 1.	Legal Proceedings	57
	Item 1A.	Risk Factors	57
	Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	57
	Item 3.	Defaults upon Senior Securities	58
	Item 4.	Mine Safety Disclosures	58
	Item 5.	Other Information	58
	Item 6.	Exhibits	58
SIGNATURES			60

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

Part 1. Financial Information

Item 1. Financial Statements

Assets	June 30, 2016 (Unaudited)	December 31, 2015
Cash on hand and in banks	$ 6,051	$ 5,713
Interest-earning deposits with banks	31,454	99,998
Investments available-for-sale, at fair value	136,028	129,565
Loans receivable, net of allowance of $10,134 and $9,463	766,046	685,072
Federal Home Loan Bank ("FHLB") stock, at cost	7,631	6,137
Accrued interest receivable	3,158	2,968
Deferred tax assets, net	3,438	4,556
Other real estate owned ("OREO")	2,331	3,663
Premises and equipment, net	18,206	17,707
Bank owned life insurance ("BOLI"), net	23,700	23,309
Prepaid expenses and other assets	1,193	1,225
Total assets	$ 999,236	$ 979,913
Liabilities and Stockholders' Equity		
Deposits:		
Noninterest-bearing deposits	$ 25,137	$ 29,392
Interest-bearing deposits	635,073	646,015
Total deposits	660,210	675,407
FHLB Advances	161,500	125,500
Advance payments from borrowers for taxes and insurance	2,144	1,794
Accrued interest payable	114	135
Other liabilities	5,813	6,404
Total liabilities	829,781	809,240
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 13,327,916 shares at June 30, 2016, and 13,768,814 shares at December 31, 2015	133	138
Additional paid-in capital	131,312	136,338
Retained earnings, substantially restricted	44,640	42,892
Accumulated other comprehensive gain (loss), net of tax	423	(1,077)
Unearned Employee Stock Ownership Plan ("ESOP") shares	(7,053)	(7,618)
Total stockholders' equity	169,455	170,673
Total liabilities and stockholders' equity	$ 999,236	$ 979,913

See accompanying selected notes to consolidated financial statements.

3

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
Interest income				
Loans, including fees	$9,048	$ 8,658	$17,775	$ 17,234
Investments available-for-sale	757	495	1,432	1,007
Interest-earning deposits	47	65	160	129
Dividends on FHLB stock	44	3	91	5
Total interest income	9,896	9,221	19,458	18,375
Interest expense				
Deposits	1,441	1,333	2,924	2,647
FHLB advances	272	320	570	638
Total interest expense	1,713	1,653	3,494	3,285
Net interest income	8,183	7,568	15,964	15,090
Provision (recapture of provision) for loan losses	600	(500)	500	(600)
Net interest income after provision (recapture of provision) for loan losses	7,583	8,068	15,464	15,690
Noninterest income				
BOLI income	225	136	391	156
Other	483	221	797	292
Total noninterest income	708	357	1,188	448
Noninterest expense				
Salaries and employee benefits	3,841	3,251	7,615	6,665
Occupancy and equipment	488	314	996	652
Professional fees	561	458	1,029	812
Data processing	251	188	441	348
Loss (Gain) on sale of OREO property, net	89	(2)	87	(531)
OREO market value adjustments	—	(46)	257	4
OREO related (reimbursements) expenses, net	(14)	41	(34)	(7)
Regulatory assessments	117	116	237	232
Insurance and bond premiums	86	89	174	181
Marketing	40	54	78	87
Other general and administrative	613	411	965	721
Total noninterest expense	6,072	4,874	11,845	9,164
Income before federal income tax provision	2,219	3,551	4,807	6,974
Federal income tax provision	779	1,183	1,542	2,377
Net income	$1,440	$ 2,368	$3,265	$ 4,597
Earnings per common share				
Basic	$0.12	$ 0.17	$0.26	$ 0.33
Diluted	$0.11	$ 0.17	$0.26	$ 0.33
Weighted average number of common shares outstanding				
Basic	12,390,234	13,756,336	12,567,464	13,895,872
Diluted	12,530,720	13,916,314	12,718,155	14,057,198

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,	
	2016	2015	2016	2015
Net income	$1,440	$2,368	$3,265	$4,597
Other comprehensive income, before tax:				
Gross unrealized holding gains (losses) on investments available-for-sale	866	(751)	2,308	(270)
Tax (provision) benefit	(303)	263	(808)	94
Other comprehensive income (loss), net of tax	563	(488)	$1,500	$(176)
Total comprehensive income	$2,003	$1,880	$4,765	$4,421

See accompanying selected notes to consolidated financial statements.

FIRST FINANCIAL NORTHWEST, INC. AND SUBSIDIARIES
Consolidated Statements of Stockholders' Equity
(Dollars in thousands except share data)
(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, 2014	15,167,381	$ 151	$ 153,395	$ 36,969	$ (357)	$ (8,746)	$ 181,412
Other comprehensive income	—	—	—	4,597	(176)	—	4,421
Exercise of stock options	50,000	1	489	—	—	—	490
Compensation related to stock options and restricted stock awards	—	—	219	—	—	—	219
Allocation of 56,426 ESOP shares	—	—	117	—	—	564	681
Repurchase and retirement of common stock	(665,057)	(6)	(7,980)	—	—	—	(7,986)
Cash dividend declared and paid ($0.12 per share)	—	—	—	(1,666)	—	—	(1,666)
Balances at June 30, 2015	14,552,324	$ 146	$ 146,240	$ 39,900	$ (533)	$ (8,182)	$ 177,571

	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, 2015	13,768,814	$ 138	$ 136,338	$ 42,892	$ (1,077)	$ (7,618)	$ 170,673
Net income	—	—	—	3,265	—	—	3,265
Other comprehensive income	—	—	—	—	1,500	—	1,500
Exercise of stock options	55,673	—	244	—	—	—	244
Issuance of common stock - restricted stock awards	14,052	—	—	—	—	—	—
Compensation related to stock options and restricted stock awards	—	—	383	—	—	—	383
Allocation of 56,426 ESOP shares	—	—	189	—	—	565	754
Repurchase and retirement of common stock	(436,145)	(4)	(5,843)	—	—	—	(5,847)
Shares previously reserved for restricted stock awards, no longer reserved	(74,478)	(1)	1	—	—	—	—
Cash dividend declared and paid ($0.12 per share)	—	—	—	(1,517)	—	—	(1,517)
Balances at June 30, 2016	13,327,916	$ 133	$ 131,312	$ 44,640	$ 423	$ (7,053)	$ 169,455

See accompanying selected notes to consolidated financial statements.

6

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

	Six Months Ended June 30, 2016	2015
Cash flows from operating activities:		
Net income	$3,265	$4,597
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision (recapture of provision) for loan losses	500	(600)
OREO market value adjustments	257	4
Loss (gain) on sale of OREO property, net	87	(531)
Depreciation of premises and equipment	524	364
Amortization of premiums and discounts on investments available-for-sale, net	498	586
Deferred federal income taxes	309	2,237
Allocation of ESOP shares	754	681
Stock compensation expense	383	219
Change in cash surrender value of BOLI	(391)	(156)
Changes in operating assets and liabilities:		
Prepaid expenses and other assets	32	270
Net increase (decrease) in advance payments from borrowers for taxes and insurance	350	(126)
Accrued interest receivable	(190)	232
Accrued interest payable	(21)	3
Other liabilities	(591)	1,240
Net cash provided by operating activities	5,766	9,020
Cash flows from investing activities:		
Proceeds from sales of OREO properties	988	5,535
Proceeds from calls and sales of investments available-for-sale	430	1,550
Principal repayments on investments available-for-sale	8,203	9,575
Purchases of investments available-for-sale	(13,285)	(8,520)
Investments available-for-sale transaction payable	—	578
Net (increase) decrease in loans receivable	(81,474)	5,124
(Purchase) redemption of FHLB stock	(1,494)	208
Purchases of premises and equipment	(1,023)	(564)
Surrender of BOLI	10,182	—
Purchase of BOLI	(10,182)	(20,000)
Net cash used by investing activities	(87,655)	(6,514)
Cash flows from financing activities:		
Net (decrease) increase in deposits	(15,197)	9,581
Advances from the FHLB	160,000	—
Repayments of advances from the FHLB	(124,000)	—
Proceeds from stock options exercises	244	490
Repurchase and retirement of common stock	(5,847)	(7,986)
Dividends paid	(1,517)	(1,666)
Net cash provided by financing activities	13,683	419

Continued

7

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

	Six Months Ended June 30,	
	2016	2015
Net (decrease) increase in cash and cash equivalents	$(68,206)	$2,925
Cash and cash equivalents at beginning of period	105,711	104,049
Cash and cash equivalents at end of period	$37,505	$106,974
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest paid	$3,515	$3,282
Federal income taxes paid	1,175	126
Noncash items:		
Loans transferred to OREO, net of deferred loan fees and allowance for loan losses	$—	$141
Change in unrealized loss on investments available for sale	2,308	(270)

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 Financial Northwest Bank (“the Bank”) in connection with the conversion from a mutual holding company structure to a stock holding company structure completed on October 9, 2007. First Financial Northwest's business activities generally are limited to passive investment activities and oversight of its investment in First Financial Northwest Bank. Accordingly, the information presented in the consolidated financial statements and accompanying data, relates primarily to First Financial Northwest Bank. First Financial Northwest is a bank holding company, having converted from a savings and loan holding company on March 31, 2015, and as a bank holding company is subject to regulation by the Federal Reserve Bank of San Francisco. First Financial Northwest Bank is regulated by the Federal Deposit Insurance Corporation (“FDIC”) and the Washington State Department of Financial Institutions (“DFI”).

First Financial Northwest Bank is headquartered in Renton, Washington, where its main, full service retail branch is located. In addition, the Bank opened branches in Mill Creek, Washington in the third quarter of 2015 and Edmonds, Washington in the first quarter of 2016. A fourth branch location opened in July 2016 at The Landing in Renton, Washington. The Bank's primary market area consists of King, Snohomish, Pierce and Kitsap counties, Washington.

The Bank is a portfolio lender, originating one-to-four family residential, multifamily, commercial real estate, construction/land development, business, and consumer loans. Loans are primarily funded by deposits from the general public, supplemented by borrowings from the Federal Home Loan Bank of Des Moines ("FHLB") and deposits raised in the national brokered deposit market.

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

Note 2 - Basis of Presentation

The accompanying unaudited interim consolidated financial statements have been prepared pursuant to the rules and regulations of the U.S. 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 interim consolidated financial statements should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2015, as filed with the SEC. In our opinion, all adjustments (consisting only of normal recurring adjustments) considered necessary for a fair presentation of the unaudited interim 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, 2016, are not necessarily indicative of the results that may be expected for the year ending December 31, 2016. 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 allowance for loan and lease losses ("ALLL"), the valuation of other real estate owned ("OREO") and the underlying collateral of impaired loans, deferred tax assets, and the fair value of financial instruments.

The Company's activities are considered to be a single industry segment for financial reporting purposes. The Company is engaged in the business of attracting deposits from the general public and originating and purchasing loans for its portfolio. Substantially all income is derived from a diverse base of commercial, multifamily, and residential real estate loans, consumer lending activities, and investments.

Certain amounts in the unaudited interim consolidated financial statements for prior periods have been reclassified to conform to the current unaudited financial statement presentation with no effect on consolidated net income or stockholders' equity.

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

Note 3 - Recently Issued Accounting Pronouncements

In January 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2016-01, Financial Instruments--Overall, Recognition and Measurement of Financial Assets and Financial Liabilities. ASU 2016-01 requires equity investments (except those accounted for under the equity method of accounting) to be measured at fair value with changes in fair value recognized in net income. The amendments in this ASU also require an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in instrument-specific credit risk. In addition, the ASU eliminates the requirement to disclose the method(s) and significant assumptions used to estimate the fair value that is required to be disclosed for financial instruments measured at amortized cost on the balance sheet. The ASU also clarifies that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale securities in combination with the entity's other deferred tax assets. The amendments in this ASU are effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. Early application is permitted for fiscal years or interim periods that have not yet been issued if adopted at the beginning of the fiscal year. The adoption of ASU 2016-01 is not expected to have a material impact on the Company's consolidated financial statements.

In February 2016, FASB issued ASU No. 2016-02, Leases (Topic 842). ASU No. 2016-02 requires lessees to recognize on the balance sheet the assets and liabilities arising from operating leases. A lessee should recognize a liability to make lease payments and a right-of-use asset representing its right to use the underlying asset for the lease term. A lessee should include payments to be made in an optional period only if the lessee is reasonably certain to exercise an option to extend the lease or not to exercise an option to terminate the lease. For a finance lease, interest payments should be recognized separately from amortization of the right-of-use asset in the statement of comprehensive income. For operating leases, the lease cost should be allocated over the lease term on a generally straight-line basis. The amendments in ASU 2016-02 are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early application of the amendments in the ASU is permitted. The adoption of ASU 2016-02 is not expected to have a material impact on the Company's consolidated financial statements.

In March 2016, FASB issued ASU No. 2016-06, Derivatives and Hedging (Topic 815): Contingent Put and Call Options in Debt Instruments. Topic 815 requires that embedded derivatives be separated from the host contract and accounted for separately as derivatives if certain criteria are met, including the “clearly and closely related” criterion. The amendments in this ASU clarify the requirements for assessing whether contingent call (put) options that can accelerate the payment of principal on debt instruments are clearly and closely related to their debt hosts. An entity performing the assessment under the amendments is required to assess the embedded call (put) options solely in accordance with the four-step decision sequence. The amendments in this ASU apply to all entities that are issuers of or investors in debt instruments (or hybrid financial instruments that are determined to have a debt host) with embedded call (put) options. This ASU applies to all entities that are issuers of or investors in debt instruments (or hybrid financial instruments that are determined to have a debt host) with embedded call (put) options. The ASU is effective for financial statements issued for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years. Adoption of ASU 2016-06 is not expected to have a material impact on the Company's consolidated financial statements.

In March 2016, FASB issued ASU No. 2016-09, Compensation--Stock Compensation (Topic 718). This ASU was issued as part of the FASB's Simplification Initiative and addresses accounting for share-based payment transactions, including income tax consequences and classification on the statement of cash flows. Under this ASU, all excess tax benefits and deficiencies should be recognized as income tax expense or benefit in the income statement. The tax effect of vested or exercised awards should be reported separately in the period in which they occur. In the statement of cash flows, excess tax benefits should be classified with other income tax cash flows as an operating activity. Entities have the option of accounting for forfeitures when they occur or to estimate the number of awards that are expected to vest. The amendments in this ASU are effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. Early adoption is permitted in any interim or annual period. First Financial Northwest has adopted ASU 2016-09 with no material impact on the Company's consolidated financial statements.

In June 2016, FASB issued ASU No. 2016-13, Financial Instruments--Credit Losses (Topic 326). This ASU replaces the existing incurred loss impairment methodology that recognizes credit losses when a probable loss has been incurred with new methodology where loss estimates are based upon lifetime expected credit losses. The amendments in this ASU require a financial asset that is measured at amortized cost to be presented at the net amount expected to be collected. The income statement would then reflect the measurement of credit losses for newly recognized financial assets as well as changes to the expected credit losses that have taken place during the reporting period. The measurement of expected credit losses will be based on historical information, current conditions, and reasonable and supportable forecasts that impact the collectability of the reported amount. Available-for-sale securities will bifurcate the fair value mark and establish an allowance for credit losses through the income statement for the

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

credit portion of that mark. The interest portion will continue to be recognized through accumulated other comprehensive income or loss. The change in allowance recognized as a result of adoption will occur through a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the ASU is adopted. The amendments in this ASU are effective for fiscal years beginning after December 15, 2019 with early adoption permitted after December 15, 2018. We are evaluating the impact of the adoption of ASU 2016-13.

Note 4 - Investments

Investments available-for-sale are summarized as follows at the dates indicated:

	June 30, 2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands)			
Mortgage-backed investments:				
Fannie Mae	$47,808	$ 1,076	$ (24)	$48,860
Freddie Mac	24,010	639	—	24,649
Ginnie Mae	12,194	128	(79)	12,243
Municipal bonds	12,824	778	—	13,602
U.S. Government agencies	12,749	212	(11)	12,950
Corporate bonds	24,008	55	(339)	23,724
Total	$133,593	$ 2,888	$ (453)	$136,028

	December 31, 2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands)			
Mortgage-backed investments:				
Fannie Mae	$50,288	$ 260	$ (227)	$50,321
Freddie Mac	26,011	243	(117)	26,137
Ginnie Mae	13,802	44	(114)	13,732
Municipal bonds	11,787	277	—	12,064
U.S. Government agencies	13,541	89	(88)	13,542
Corporate bonds	14,010	4	(245)	13,769
Total	$129,439	$ 917	$ (791)	$129,565

The tables below summarize the aggregate fair value and gross unrealized loss by length of time those investment securities have been continuously in an unrealized loss position at the dates indicated. At both June 30, 2016 and December 31, 2015, we had no municipal bonds in an unrealized loss position.

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

	June 30, 2016					
	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	$4,107	$ (24)	$—	$ —	$4,107	$ (24)
Freddie Mac	—	—	—	—	—	—
Ginnie Mae	982	(9)	2,859	(70)	3,841	(79)
U.S. Government agencies	1,793	(11)	—	—	1,793	(11)
Corporate bonds	8,661	(339)	—	—	8,661	(339)
Total	$15,543	$ (383)	$2,859	$ (70)	$18,402	$ (453)

	December 31, 2015					
	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	$37,593	$ (227)	$—	$ —	$37,593	$ (227)
Freddie Mac	12,115	(117)	—	—	12,115	(117)
Ginnie Mae	5,508	(29)	3,233	(85)	8,741	(114)
U.S. Government agencies	9,605	(88)	—	—	9,605	(88)
Corporate bonds	10,263	(245)	—	—	10,263	(245)
Total	$75,084	$ (706)	$3,233	$ (85)	$78,317	$ (791)

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 other-than-temporary impairment ("OTTI") are written down to fair value. If the Company intends to sell a debt security, or it is likely that the Company will be required to sell the debt 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 debt security and it is not likely that it will be required to sell the debt security but does not expect to recover the entire amortized cost basis of the debt security, only the portion of the impairment loss representing credit losses would be recognized in earnings. The credit loss on a debt 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 debt 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. At June 30, 2016 and December 31, 2015, the Company had 14 securities and 43 securities in an unrealized loss position, respectively, of which three were in an unrealized loss position for 12 months or more. Management reviewed the financial condition of the entities issuing municipal or corporate bonds at June 30, 2016 and December 31, 2015, and determined that an OTTI charge was not warranted.

The amortized cost and estimated fair value of investments available-for-sale at June 30, 2016, 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.

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

	June 30, 2016	
	Amortized Cost	Fair Value
	(In thousands)	
Due within one year	$—	$—
Due after one year through five years	9,392	9,469
Due after five years through ten years	25,709	25,712
Due after ten years	14,481	15,095
	49,582	50,276
Mortgage-backed investments	84,011	85,752
Total	$133,593	$136,028

Under Washington state law, in order to participate in the public funds program the Company is required to pledge eligible securities as collateral in an amount equal to 100% of the public deposits held. Investment securities with market values of $15.8 million and $17.4 million were pledged as collateral for public deposits at June 30, 2016 and December 31, 2015, respectively, both of which exceeded the collateral requirements established by the Washington Public Deposit Protection Commission.

For the three and six months ended June 30, 2016, we had calls on investment securities of $385,000, and $430,000, respectively, with no gain or loss. For the three and six months ended June 30, 2015, we had calls on investment securities of $1.5 million and $1.6 million, respectively, with no gain or loss. There were no sales of investment securities during the six months ended June 30, 2016 or 2015.

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

Note 5 - Loans Receivable

Loans receivable are summarized as follows at the dates indicated:

	June 30, 2016	December 31, 2015
	(In thousands)	
One-to-four family residential:		
Permanent owner occupied	$146,762	$ 147,229
Permanent non-owner occupied	104,970	106,543
	251,732	253,772
Multifamily:		
Permanent	132,189	122,747
Construction (1)	35,565	21,115
	167,754	143,862
Commercial real estate:		
Permanent	285,449	244,211
Land (2)	16,822	8,290
	302,271	252,501
Construction/land development:		
One-to-four family residential	64,312	52,233
Multifamily (1)	41,716	25,551
Land development (2)	5,773	8,768
	111,801	86,552
Business	7,208	7,604
Consumer	6,333	6,979
Total loans	847,099	751,270
Less:		
Loans in process ("LIP")	68,979	53,854
Deferred loan fees, net	1,940	2,881
Allowance for loan and lease losses ("ALLL")	10,134	9,463
Loans receivable, net	$766,046	$ 685,072

---

(1) Construction/land development 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, 2016 the Company had $35.6 million or 21.2% of its total multifamily portfolio in these rollover loans, as compared to $21.1 million or 14.7% at December 31, 2015. At June 30, 2016, and December 31, 2015, none of the Company's commercial real estate portfolio or one-to-four family residential portfolio included these rollover loans.

(2) At June 30, 2016, and December 31, 2015, $16.8 million and $8.3 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 (where we do not intend to finance the construction) as commercial real estate land loans.

At June 30, 2016, loans totaling $405.7 million were pledged to secure borrowings from the FHLB of Des Moines compared to $365.1 million at December 31, 2015.

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

The Company has issued loans to officers and directors on the same terms as comparable loans to unrelated parties. The outstanding balance of these loans was $69,000 at June 30, 2016 and $118,000 at December 31, 2015.

ALLL. The Company maintains an ALLL as a reserve against probable and inherent risk of losses in its loan portfolios. The ALLL is comprised of a general reserve component for loans evaluated collectively for loss and a specific reserve component for loans evaluated individually. When an issue is identified and it is determined that the loan needs to be classified as nonperforming and/or impaired, an evaluation of the discounted expected cash flows is done and an appraisal may be obtained on the collateral. Based on this evaluation, additional provision for loan loss or charge-offs is recorded prior to the end of the financial reporting period.

The following tables summarize changes in the ALLL and loan portfolio by loan type and impairment method at the dates and for the periods shown:

	At or For the Three Months Ended June 30, 2016						
	One-to-Four Family Residential	Multifamily	Commercial Real Estate	Construction/ Land Development	Business	Consumer	Total
	(In thousands)						
ALLL:							
Beginning balance	$2,840	$ 1,373	$ 3,719	$ 981	$ 197	$ 361	$9,471
Charge-offs	—	—	—	—	—	—	—
Recoveries	63	—	—	—	—	—	63
Provision (recapture)	(156)	48	302	422	20	(36)	600
Ending balance	$2,747						