First Financial Northwest, Inc.
Form 10-Q
November 09, 2012

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

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

For the quarterly period ended September 30, 2012

or

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

For the transition period from _____ to _____

Commission File Number: 001-33652

FIRST FINANCIAL NORTHWEST, INC.

(Exact name of registrant as specified in its charter)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes [X] No [ ]

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

Yes [X] No [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer [ ] Accelerated filer [X] Non-accelerated filer [ ] Smaller reporting company [ ]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes [ ] No [X]

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: As of November 2, 2012, 18,805,168 shares of the issuer's common stock, $0.01 par value per share, were outstanding.

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FORM 10-Q
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Item 1. Financial Statements

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

Assets	September 30, 2012	December 31, 2011
Cash on hand and in banks	$5,265	$4,620
Interest-bearing deposits	103,968	160,141
Investments available-for-sale, at fair value	158,959	129,002
Loans receivable, net of allowance of $14,168 and $16,559	650,348	703,288
Premises and equipment, net	18,259	18,922
Federal Home Loan Bank stock, at cost	7,347	7,413
Accrued interest receivable	3,730	3,856
Federal income tax receivable	60	1,060
Deferred tax assets	1,000	-
Other real estate owned ("OREO")	19,209	26,044
Prepaid expenses and other assets	4,908	5,044
Total assets	$973,053	$1,059,390
Liabilities and Stockholders' Equity		
Interest-bearing deposits	$689,950	$782,652
Noninterest-bearing deposits	6,147	6,013
Advances from the Federal Home Loan Bank	83,066	83,066
Advance payments from borrowers for taxes and insurance	4,164	2,093
Accrued interest payable	187	184
Other liabilities	4,577	4,062
Total liabilities	788,091	878,070
Commitments and contingencies		
Stockholders' Equity		
Preferred stock, $0.01 par value; authorized 10,000,000 shares, no shares issued or outstanding	-	-
Common stock, $0.01 par value; authorized 90,000,000 shares; issued and outstanding 18,805,168 shares at September 30, 2012 and December 31, 2011	188	188
Additional paid-in capital	190,085	188,816
Retained earnings, substantially restricted	5,139	3,937
Accumulated other comprehensive income, net of tax	835	511
Unearned Employee Stock Ownership Plan ("ESOP") shares	(11,285)	(12,132)
Total stockholders' equity	184,962	181,320
Total liabilities and stockholders' equity	$973,053	$1,059,390

See accompanying notes to consolidated financial statements.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Interest income				
Loans, including fees	$9,539	$11,397	$29,813	$35,716
Investments available-for-sale	507	926	1,600	3,393
Interest-bearing deposits with banks	111	127	305	297
Total interest income	$10,157	$12,450	$31,718	$39,406
Interest expense				
Deposits	2,429	3,981	7,997	12,714
Federal Home Loan Bank advances	517	589	1,539	1,748
Total interest expense	$2,946	$4,570	$9,536	$14,462
Net interest income	7,211	7,880	22,182	24,944
Provision for loan losses	700	1,300	3,050	4,100
Net interest income after provision for loan losses	$6,511	$6,580	$19,132	$20,844
Noninterest income				
Net gain on sale of investments	-	479	288	1,741
Other	107	77	430	237
Total noninterest income	$107	$556	$718	$1,978
Noninterest expense				
Compensation and employee benefits	3,680	3,544	10,558	10,047
Occupancy and equipment	391	370	1,191	1,167
Professional fees	460	449	1,401	1,431
Data processing	174	181	540	573
Gain on sale of OREO property, net	(78)	(293)	(427)	(1,427)
OREO market value adjustments	1,157	515	1,702	1,432
OREO related expenses, net	486	540	1,421	2,376
Regulatory assessments	298	578	709	1,900
Insurance and bond premiums	100	248	300	743
Proxy contest and related litigation	264	-	868	-
Marketing	68	43	181	154
Other general and administrative	457	338	1,203	1,111
Total noninterest expense	$7,457	$6,513	$19,647	$19,507
Income (loss) before benefit for federal income taxes	(839)	623	203	3,315
Federal income tax benefit	(48)	-	(999)	-
Net income (loss)	$(791)	$623	$1,202	$3,315
Basic income (loss) per share	$(0.04)	$0.04	$0.07	$0.19
Diluted income (loss) per share	$(0.04)	$0.04	$0.07	$0.19

See accompanying notes to consolidated financial statements.

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

	Three Months Ended September 30, 2012	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2012	Nine Months Ended September 30, 2011
Net income (loss)	$(791)	$623	$1,202	$3,315
Other comprehensive income (loss), before tax				
Unrealized holding gains on available-for-sale securities	815	402	612	2,060
Reclassification adjustment for net gains realized in income	-	(479)	(288)	(1,741)
Other comprehensive income (loss), before tax	815	(77)	324	319
Income tax benefit related to items of other comprehensive income (loss)	-	1,490	-	1,060
Other comprehensive income (loss), net of tax	$815	$(1,567)	$324	$(741)
Total comprehensive income (loss)	$24	$(944)	$1,526	$2,574

See accompanying notes to consolidated financial statements.

FIRST FINANCIAL NORTHWEST, INC. AND SUBSIDIARIES
Consolidated Statements of Stockholders' Equity
For the Nine Months Ended September 30, 2012
(Dollars in thousands, except share data)
(Unaudited)

	Shares	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income, Net of Tax	Unearned ESOP Shares	Total Stockholders' Equity
Balances at December 31, 2011	18,805,168	$188	$188,816	$3,937	$ 511	$(12,132)	$181,320
Total other comprehensive income, net of tax	-	-	-	1,202	324	-	1,526
Compensation related to stock options and restricted stock awards	-	-	1,472	-	-	-	1,472
Allocation of 84,640 ESOP shares	-	-	(203)	-	-	847	644
Balances at September 30, 2012	18,805,168	$188	$190,085	$5,139	$ 835	$(11,285)	$184,962

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

	Nine Months Ended September 30, 2012	2011
Cash flows from operating activities:		
Net income	$ 1,202	$ 3,315
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	3,050	4,100
OREO market value adjustments	1,702	1,432
Gain on sale of OREO property, net	(427)	(1,427)
Depreciation of premises and equipment	767	792
Net amortization of premiums and discounts on investments	1,260	1,835
ESOP expense	644	446
Compensation expense related to stock options and restricted stock awards	1,472	1,489
Net realized gain on investments available-for-sale	(288)	(1,741)
Loss from disposal of premises and equipment	9	-
Deferred federal income taxes	(1,000)	(1,061)
Changes in operating assets and liabilities:		
Prepaid expenses and other assets	136	1,222
Federal income taxes, net	1,000	5,916
Accrued interest receivable	126	714
Accrued interest payable	3	14
Other liabilities	515	513
Investment transactions payable	-	10,000
Net cash provided by operating activities	$ 10,171	$ 27,559
Cash flows from investing activities:		
Proceeds from sales or calls of investments	23,200	74,633
Reimbursed (capitalized) improvements on OREO	16	(181)
Proceeds from sales of OREO properties	15,067	25,814
Principal repayments on investments	15,734	24,602
Purchases of investments	(69,539)	(74,679)
Net decrease in loans receivable	40,367	104,393
FHLB stock dividend redemption	66	-
Purchases of premises and equipment	(113)	(55)
Net cash provided by investing activities	$ 24,798	$ 154,527
Balance, carried forward	$ 34,969	$ 182,086

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

	Nine Months Ended September 30, 2012	2011
Balance, brought forward	$ 34,969	$ 182,086
Cash flows from financing activities:		
Net decrease in deposits	(92,568)	(69,681)
Advances from the Federal Home Loan Bank	110	-
Repayments of advances from the Federal Home Loan Bank	(110)	-
Net increase in advance payments from borrowers for taxes and insurance	2,071	1,367
Net cash used by financing activities	$ (90,497)	$ (68,314)
Net increase (decrease) in cash	(55,528)	113,772
Cash and cash equivalents:		
Beginning of period	164,761	98,427
End of period	$ 109,233	$ 212,199
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	$ 9,533	$ 14,448
Federal income taxes	$ 60	$ -
Noncash transactions:		
Loans, net of deferred loan fees and allowance for loan losses, transferred to OREO	$ 9,523	$ 20,737

See accompanying notes to consolidated financial statements.

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

Note 1 – Description of Business

First Financial Northwest, Inc. (“First Financial Northwest” or the “Company”), a Washington corporation, was formed on June 1, 2007 for the purpose of becoming the holding company for First Savings Bank Northwest (“First Savings Bank” or “the Bank”) in connection with the conversion from a mutual holding company structure to a stock holding company structure. First Financial Northwest’s business activities generally are limited to passive investment activities and oversight of its investment in First Savings Bank. Accordingly, the information presented in the consolidated financial statements and related data, relates primarily to First Savings Bank. First Financial Northwest is a savings and loan holding company and is subject to regulation by the Federal Reserve Board (“FRB”). First Savings Bank is regulated by the Federal Deposit Insurance Corporation (“FDIC”) and the Washington State Department of Financial Institutions (“DFI”).

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

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

Note 2 – Regulatory Items

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

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

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

Note 3 – Basis of Presentation

The accompanying unaudited interim consolidated financial statements have been prepared pursuant to the rules and regulations of the SEC. Accordingly, they do not include all of the information and footnotes required by U.S.

Generally Accepted Accounting Principles ("GAAP") for complete financial statements. These unaudited consolidated financial statements should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2011, as filed with the SEC. In our opinion, all adjustments (consisting only of normal recurring adjustments) considered necessary for a fair presentation of the consolidated financial statements in accordance with GAAP have been included. All significant intercompany balances and transactions between the Company and its subsidiaries have been eliminated in consolidation. Operating results for the three and nine months ended September 30, 2012 are not necessarily indicative of the results that may be expected for the year ending December 31, 2012. In preparing the unaudited consolidated financial statements, we are required to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change relate to the ALLL, the valuation of other real estate owned ("OREO") and the underlying collateral of loans in the process of foreclosure, deferred tax assets and the fair value of financial instruments.

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

Note 4 – Recently Issued Accounting Pronouncements

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

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

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

In December 2011, the FASB issued ASU No. 2011-11, Disclosures about Offsetting Assets and Liabilities. The 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

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

to settle the asset and liability on a net basis or to realize the asset and settle the liability simultaneously. 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 Company is currently in the process of evaluating the ASU but does not expect it will have a material impact on the Company's consolidated financial statements.

In December 2011, the FASB issued ASU No. 2011-12, Deferral of the Effective Date for Amendments to Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update 2011-05 ("ASU 2011-12"). This ASU defers only those changes in ASU 2011-05 that relate to the presentation of reclassification adjustments. ASU 2011-12 was issued in order to allow the FASB time to redeliberate whether to present on the face of the financial statements the effects of reclassifications out of accumulated other comprehensive income on the components of net income and other comprehensive income for all periods presented. While the FASB is considering the operational concerns about the presentation requirements for reclassification adjustments and the needs of financial statement users for additional information about reclassification adjustments, the Company will continue to report reclassifications out of accumulated other comprehensive income consistent with the presentation requirements in effect before the issuance of ASU 2011-05. ASU 2011-12 was effective for the Company's financial statements for annual and interim periods beginning after December 31, 2011, and was applied prospectively. The adoption of this standard 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 ("ASU 2012-2"). 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. Early adoption is permitted, including for annual and interim impairment tests performed as of a date before July 27, 2012, if a public entity's financial statements for the most recent annual or interim period have not yet been issued. The Company is currently in the process of evaluating the ASU but does not expect it will have a material impact on the Company's consolidated financial statements.

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

Note 5 – Investments

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

	September 30, 2012			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands)			
Mortgage-backed investments:				
Fannie Mae	$38,253	$1,341	$(1)	$39,593
Freddie Mac	16,439	376	-	16,815
Ginnie Mae	33,199	90	(124)	33,165
Municipal bonds	2,049	11	(233)	1,827
U.S. Government sponsored entities and agencies	67,395	191	(27)	67,559
Total	$157,335	$2,009	$(385)	$158,959

	December 31, 2011			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands)			
Mortgage-backed investments:				
Fannie Mae	$50,981	$1,182	$-	$52,163
Freddie Mac	19,285	560	-	19,845
Ginnie Mae	7,416	79	-	7,495
Municipal bonds	2,085	32	(270)	1,847
U.S. Government sponsored entities and agencies	47,934	2	(284)	47,652
Total	$127,701	$1,855	$(554)	$129,002

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

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

	September 30, 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	$4,892	$(1)	$-	$-	$4,892	$(1)
Ginnie Mae	16,358	(124)	-	-	16,358	(124)
Municipal bonds	-	-	1,173	(233)	1,173	(233)
U.S Government sponsored entities and agencies	12,883	(27)	-	-	12,883	(27)
Total	$34,133	$(152)	$1,173	$(233)	$35,306	$(385)

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

At September 30, 2012, we had one security with a gross unrealized loss of $233,000 with a fair value of $1.2 million that had an unrealized loss for greater than one year. At December 31, 2011, this same security had a gross unrealized loss of $270,000 with a fair value totaling $1.1 million that had an unrealized loss for greater than one year. We reviewed the financial condition of the entity underlying this security at both September 30, 2012 and December 31, 2011, and determined an other-than-temporary impairment ("OTTI") was not warranted.

On a quarterly basis, management makes an assessment to determine whether there have been any events or economic circumstances to indicate that a security on which there is an unrealized loss is impaired on an other-than-temporary basis. We consider many factors including the severity and duration of the impairment, recent events specific to the issuer or industry, and for debt securities, external credit ratings and recent downgrades. Securities on which there is an unrealized loss that is deemed to be an OTTI are written down to fair value. For equity securities, the write-down is recorded as a realized loss in noninterest income on our Consolidated Statements of Operations. For debt securities, if we intend to sell the security or it is likely that we will be required to sell the security before recovering its cost basis, the entire impairment loss would be recognized in earnings as an OTTI. If we do not intend to sell the security and it is not likely that we will be required to sell the security but we do not expect to recover the entire amortized cost basis of the security, only the portion of the impairment loss representing credit losses would be recognized in earnings. The credit loss on a security is measured as the difference between the amortized cost basis and the present value of the cash flows expected to be collected. Projected cash flows are discounted by the original or current effective interest rate depending on the nature of the security being measured for potential OTTI. The remaining impairment related to all other factors, the difference between the present value of the cash flows expected to be collected and fair value, is recognized as a charge to other comprehensive income ("OCI"). Impairment losses related to all other factors are presented as separate categories within OCI. For the three and nine months ended September 30, 2012 and 2011, we did not have any OTTI losses on investments.

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

The amortized cost and estimated fair value of investments available-for-sale at September 30, 2012, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Investments not due at a single maturity date, primarily mortgage-backed investments, are shown separately.

	September 30, 2012	
	Amortized Cost	Fair Value
	(In thousands)	
Due after one year through five years	$ 50,053	$ 50,078
Due after five years through ten years	4,722	4,760
Due after ten years	14,669	14,548
	69,444	69,386
Mortgage-backed investments	87,891	89,573
Total	$ 157,335	$ 158,959

Under Washington state law, in order to participate in the public funds program we are required to pledge as collateral an amount equal to 100% of the public deposits we hold in the form of eligible securities. Investments with a market value of $15.9 million and $31.8 million were pledged as collateral for public deposits at September 30, 2012 and December 31, 2011, respectively, both of which exceeded the collateral requirements established by the Washington Public Deposit Protection Commission.

We did not sell any investments during the three months ended September 30, 2012. We sold $43.1 million of investments during the three months ended September 30, 2011, resulting in gross gains of $487,000. For the nine months ended September 30, 2012 and 2011, we sold $22.9 million and $72.9 million of investments, respectively, resulting in gross gains of $294,000 and $1.7 million, respectively.

There were no gross losses on the sales of investments for the three months ended September 30, 2012 and there were $8,000 of gross losses for the same period in 2011. For the nine months ended September 30, 2012 and 2011, there were gross losses on the sales of investments of $6,000 and $8,000, respectively.

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

Note 6 - Loans Receivable

Loans receivable are summarized as follows:

	September 30, 2012	December 31, 2011
	(In thousands)	
One-to-four family residential: (1)	$ 313,562	$ 335,412
Multifamily:		
Permanent	107,575	110,148
Construction	-	3,526
	107,575	113,674
Commercial real estate:		
Permanent	200,490	218,032
Construction	12,500	12,500
Land	1,947	1,811
	214,937	232,343
Construction/land development: (2)		
One-to-four family residential	1,625	6,194
Multifamily	806	855
Commercial	-	1,104
Land development	14,435	16,990
	16,866	25,143
Business	3,503	3,909
Consumer	10,778	12,499
Total loans	667,221	722,980
Less:		
Loans in process	931	1,372
Deferred loan fees, net	1,774	1,761
ALLL	14,168	16,559
Loans receivable, net	$ 650,348	$ 703,288

(1) Includes $144.5 million and $147.4 million of non-owner occupied loans at September 30, 2012 and December 31, 2011, respectively.

(2) Excludes construction loans that will convert to permanent loans. We consider these loans to be "rollovers" in that one loan is originated for both the construction loan and permanent financing. These loans are classified according to the underlying collateral. As a result, at September 30, 2012, we had $12.5 million, or 5.8% of our total commercial real estate portfolio and no multifamily loans in these "rollover" type of

loans. At December 31, 2011, we had $12.5 milllion, or 5.4% of our total commercial real estate portfolio and $3.5 million, or 3.1% of our total multifamily loan portfolio in these "rollover" type of loans. At September 30, 2012 and December 31, 2011, $1.9 million and $1.8 million, respectively, of commercial real estate land loans were not included in the construction/land development category because we classify our buildable lots where we do not intend to finance the construction as commercial real estate land loans.

At September 30, 2012 and December 31, 2011, there were no loans classified as held for sale.

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

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

	At or For the Three Months Ended September 30, 2012						
	One-to-Four Family Residential	Multifamily	Commercial Real Estate	Construction/ Land Development	Business	Consumer	Total
ALLL:				(In thousands)			
Beginning balance	$5,966	$2,024	$5,634	$567	$35	$224	$14,450
Charge-offs	(681)	-	(1,313)	(149)	-	(198)	(2,341)
Recoveries	-	-	3	1,355	-	1	1,359
Provision	863	(707)	1,623	(1,275)	-	196	700
Ending balance	$6,148	$1,317	$5,947	$498	$35	$223	$14,168
General reserve	$4,831	$1,317	$5,741	$498	$35	$223	$12,645
Specific reserve	$1,317	$-	$206	$-	$-	$-	$1,523
Loans: (1)							
Total Loans	$313,562	$107,575	$214,937	$15,935	$3,503	$10,778	$666,290
General reserve (2)	$252,649	$101,621	$201,591	$7,938	$3,503	$10,637	$577,939
Specific reserve (3)	$60,913	$5,954	$13,346	$7,997	$-	$141	$88,351

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

	At or For the Nine Months Ended September 30, 2012						
	One-to-Four Family Residential	Multifamily	Commercial Real Estate	Construction/ Land Development	Business	Consumer	Total
ALLL:	(In thousands)						
Beginning balance	$5,756	$950	$6,846	$2,503	$154	$350	$16,559
Charge-offs	(2,018)	(153)	(4,409)	(318)	-	(491)	(7,389)
Recoveries	12	-	475	1,457	-	4	1,948
Provision	2,398	520	3,035	(3,144)	(119)	360	3,050
Ending balance	$6,148	$1,317	$5,947	$498	$35	$223	$14,168
General reserve	$4,831	$1,317	$5,741	$498	$35	$223	$12,645
Specific reserve	$1,317	$-	$206	$-	$-	$-	$1,523
Loans: (1)							