First Financial Northwest, Inc.
Form 10-Q
August 08, 2011

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, 2011

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 August 5, 2011, 18,805,168 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

Item 1. Financial Statements

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

Assets	June 30, 2011	December 31, 2010
Cash on hand and in banks	$4,364	$7,466
Interest-bearing deposits	184,448	90,961
Investments available for sale	141,832	164,603
Loans receivable, net of allowance of $16,989 and $22,534	752,634	856,456
Premises and equipment, net	19,328	19,829
Federal Home Loan Bank stock, at cost	7,413	7,413
Accrued interest receivable	4,132	4,686
Federal income tax receivable	6,346	5,916
Other real estate owned ("OREO")	25,979	30,102
Prepaid expenses and other assets	5,044	6,226
Total assets	$1,151,520	$1,193,658
Liabilities and Stockholders' Equity		
Interest-bearing deposits	$868,270	$911,526
Noninterest-bearing deposits	5,427	8,700
Advances from the Federal Home Loan Bank	93,066	93,066
Advance payments from borrowers for taxes and insurance	1,948	2,256
Accrued interest payable	217	214
Other liabilities	3,339	3,418
Total liabilities	972,267	1,019,180
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 June 30, 2011 and December 31, 2010	188	188
Additional paid-in capital	188,064	187,371
Retained earnings (accumulated deficit), substantially restricted	2,387	(305)
Accumulated other comprehensive income, net of tax	1,310	484
Unearned Employee Stock Ownership Plan ("ESOP") shares	(12,696)	(13,260)
Total stockholders' equity	179,253	174,478

Total liabilities and stockholders' equity	$1,151,520	$1,193,658

See accompanying notes to consolidated financial statements.

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

	Three Months Ended June 30, 2011	Three Months Ended June 30, 2010	Six Months Ended June 30, 2011	Six Months Ended June 30, 2010
Interest income				
Loans, including fees	$11,891	$14,245	$24,319	$28,839
Investments available for sale	1,262	1,106	2,467	2,113
Interest-bearing deposits with banks	94	73	170	134
Total interest income	$13,247	$15,424	$26,956	$31,086
Interest expense				
Deposits	4,220	6,322	8,733	12,893
Federal Home Loan Bank advances	583	1,035	1,159	2,058
Total interest expense	$4,803	$7,357	$9,892	$14,951
Net interest income	8,444	8,067	17,064	16,135
Provision for loan losses	1,600	26,000	2,800	39,000
Net interest income (loss) after provision for loan losses	$6,844	$(17,933)	$14,264	$(22,865)
Noninterest income				
Net gain on sale of investments	751	-	1,262	-
Other	75	62	160	108
Total noninterest income	$826	$62	$1,422	$108
Noninterest expense				
Compensation and employee benefits	3,214	2,892	6,503	6,081
Occupancy and equipment	395	424	797	849
Professional fees	502	487	982	946
Data processing	183	172	392	342
(Gain) loss on sale of OREO property, net	(508)	(14)	(1,134)	423
OREO market value adjustments	289	897	917	3,168
OREO related expenses, net	986	708	1,836	1,410
FDIC/OTS assessments	612	515	1,322	1,095
Insurance and bond premiums	248	150	495	299
Marketing	50	78	111	121
Other general and administrative	441	701	773	1,143
Total noninterest expense	$6,412	$7,010	$12,994	$15,877
Income (loss) before provision for federal income taxes	1,258	(24,881)	2,692	(38,634)
Provision for federal income taxes	-	-	-	3,999
Net income (loss)	$1,258	$(24,881)	$2,692	$(42,633)
Basic income (loss) per share	$0.07	$(1.43)	$0.15	$(2.45)
Diluted income (loss) per share	$0.07	$(1.43)	$0.15	$(2.45)

See accompanying notes to consolidated financial statements.

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

	Shares	Common Stock	Additional Paid-in Capital	Retained Earnings (Accumulated Deficit)	Accumulated Other Comprehensive Income (Loss), net of tax	Unearned ESOP Shares	Total Stockholders' Equity
Balances at December 31, 2010	18,805,168	$ 188	$ 187,371	$ (305)	$ 484	$ (13,260)	$ 174,478
Comprehensive income:							
Net income	-	-	-	2,692	-	-	2,692
Change in fair value of investments available for sale	-	-	-	-	826	-	826
Total comprehensive income							3,518
Compensation related to stock options and restricted stock awards	-	-	950	-	-	-	950
Allocation of 56,426 ESOP shares	-	-	(257)	-	-	564	307
Balances at June 30, 2011	18,805,168	$ 188	$ 188,064	$ 2,387	$ 1,310	$ (12,696)	$ 179,253

See accompanying notes to consolidated financial statements.

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

	Six Months Ended June 30,	
	2011	2010
Cash flows from operating activities:		
Net income (loss)	$2,692	$(42,633)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Provision for loan losses	2,800	39,000
OREO market value adjustments	917	3,168
Loss (gain) on sale of OREO property, net	(1,134)	423
Depreciation of premises and equipment	532	542
Net amortization of premiums and discounts on investments	1,275	623
ESOP expense	307	342
Compensation expense related to stock options and restricted stock awards	950	978
Net realized gain on investments available for sale	(1,262)	-
Deferred federal income taxes	430	11,538
Changes in operating assets and liabilities:		
Prepaid expenses and other assets	1,182	980
Accrued interest receivable	554	67
Accrued interest payable	3	(63)
Other liabilities	(79)	372
Federal income taxes, net	(430)	4,120
Net cash provided by operating activities	$8,737	$19,457
Cash flows from investing activities:		
Proceeds from sales of investments	31,035	-
Capitalized improvements in OREO	(90)	(286)
Proceeds from sales of OREO properties	20,380	9,703
Principal repayments on investments	17,570	14,618
Purchases of investments	(25,451)	(58,540)
Net decrease in loans receivable	85,072	10,924
Purchases of premises and equipment	(31)	(1,229)
Net cash provided (used) by investing activities	$128,485	$(24,810)
Balance, carried forward	$137,222	$(5,353)

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

	Six Months Ended June 30,	
	2011	2010
Balance, brought forward	$137,222	$(5,353)
Cash flows from financing activities:		
Net increase (decrease) in deposits	(46,529)	32,676
Advances from the Federal Home Loan Bank	-	50,000
Repayments of advances from the Federal Home Loan Bank	-	(50,000)
Net increase (decrease) in advance payments from borrowers for taxes and insurance	(308)	45
Repurchase and retirement of common stock	-	(106)
Dividends paid	-	(1,421)
Net cash provided (used) by financing activities	$(46,837)	$31,194
Net increase in cash	90,385	25,841
Cash and cash equivalents:		
Beginning of period	98,427	104,970
End of period	$188,812	$130,811
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	$9,889	$15,014
Noncash transactions:		
Loans, net of deferred loan fees and allowance for loan losses transferred to OREO	$15,950	$17,666

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"), as successor on July 24, 2011 to the powers and responsibilities of the Office of Thrift Supervision ("OTS"). 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, multifamily, commercial real estate, business, consumer and construction/land development loans.

Note 2 – Regulatory Items

On April 14, 2010, the OTS and members of the Board of Directors of First Financial Northwest entered into an informal supervisory agreement or Memorandum of Understanding ("MOU"). Under the terms of the MOU, the Company has agreed, among other things, to provide notice to and obtain a written non-objection from the OTS prior to the Company (a) declaring a dividend or redeeming any capital stock and (b) incurring, issuing, renewing or repurchasing any new debt. Further, in connection with a prior examination of the Bank by the FDIC and DFI, we must obtain a written non-objection from the FDIC before engaging in any transaction that would materially change the balance sheet composition (including growth in total assets of five percent or more), significantly change funding sources (including brokered deposits) or declare or pay cash dividends. In addition, both the Company and the Bank must obtain prior regulatory approval before adding any new director or senior executive officer or changing the responsibilities of any current senior executive officer or pay pursuant to or by entering into certain severance and other forms of compensation agreements.

The Bank entered into a Stipulation to the Issuance of a Consent Order ("Order") with the FDIC and the DFI which became effective on September 24, 2010. Under the terms of the Order, the Bank cannot declare dividends or repurchase stock without the prior written approval of the FDIC. Other material provisions of the Order require the Bank to:

- Maintain and preserve qualified management;
- Increase the Board of Directors' participation in the Bank's affairs;
- Obtain an independent study of management and the personnel structure of the Bank;
- Maintain specified Capital levels;
- Eliminate loans classified as "Loss" at its regulatory examination, and reduce the loans classified as "Doubtful" and "Substandard" as a percent of capital;
- Revise its policy with respect to the allowance for loan losses;
- Not extend additional credit to borrowers whose loan had been classified as "Loss" and is uncollected;

- Revise its lending and collection policies and practices;
- Develop a plan to reduce the amount of commercial real estate loans;
- Enhance its written funds management and liquidity policy;
- Develop a three-year strategic plan;

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

- Not solicit brokered deposits and comply with certain deposit rate restrictions;
- Eliminate and correct all violations of laws; and
- Prepare and submit progress reports to the FDIC and DFI.

The Order required that a number of items be completed over various time frames. We believe we have complied with each item set forth in the Order in advance of all required due dates and we have submitted the appropriate documentation to our regulators.

The Bank's Tier 1 capital ratio was 12.47% and our total risk-based capital ratio was 22.81% at June 30, 2011 which exceeded the requirements of the Order of 10% and 12%, respectively.

Adversely classified assets as a percent of Tier 1 capital plus the allowance for loan losses was 128% at the beginning of 2010. The Order required this ratio to be below 65% by March 2011 for the adversely classified assets identified at that exam. We achieved this target as of September 30, 2010 and remained in compliance with this requirement at June 30, 2011.

The Order also required that the Bank develop a written plan to systematically reduce the amount of loans to borrowers in the commercial real estate loan category. At March 31, 2010, the Bank's commercial real estate loans represented 334% of its risk-based capital and its construction/land development loans equaled 115% of risk-based capital. As of June 30, 2011, the Bank's concentration in commercial real estate loans has been reduced to 257% of its risk-based capital and its construction/land development loan portfolio has been reduced to 40% of risk-based capital.

A copy of the Order is attached to the Form 8-K that we filed with the Securities and Exchange Commission ("SEC") on September 27, 2010. The Order will remain in effect until modified or terminated by the FDIC and the DFI.

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, 2010, 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 six months ended June 30, 2011 are not necessarily indicative of the results that may be expected for the year ended December 31, 2011. 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 foreclosed assets, 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 January 2011, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2011-01, Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings in Update No. 2010-20. This ASU temporarily delays the effective date of the disclosures about troubled debt

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

restructurings in Update 2010-20 for public entities. The delay is intended to allow the Board time to complete its deliberations on what constitutes a troubled debt restructuring. The effective date of the new disclosures about troubled debt restructurings for public entities and the guidance for determining what constitutes a troubled debt restructuring will then be coordinated. The guidance is effective for interim and annual periods ending after September 15, 2011. The adoption of this ASU is not expected to have a material impact on the Company's consolidated financial statements.

In April 2011, the FASB issued ASU No. 2011-02, A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring. The update provides additional guidance relating to when creditors should classify loan modifications as troubled debt restructurings. The ASU also ends the deferral issued in January 2010 of the disclosures about troubled debt restructurings required by ASU No. 2010-20. The provisions of ASU No. 2011-02 and the disclosure requirements of ASU No. 2010-20 are effective for the Company's interim reporting period ending September 30, 2011. The guidance applies retrospectively to restructurings occurring on or after January 1, 2011. The adoption of this ASU is not expected to have a material impact on the Company's consolidated financial statements.

In April 2011, the FASB issued ASU No. 2011-03, Reconsideration of Effective Control for Repurchase Agreements. The update amends existing guidance to remove from the assessment of effective control, the criterion requiring the transferor to have the ability to repurchase or redeem the financial assets on substantially the agreed terms, even in the event of default by the transferee and, as well, the collateral maintenance implementation guidance related to that criterion. ASU No. 2011-03 is effective for the Company's reporting period beginning on or after December 15, 2011. The guidance applies prospectively to transactions or modification of existing transactions that occur on or after the effective date and early adoption is not permitted. The adoption of this ASU is not expected to 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. The update amends existing guidance regarding the highest and best use and valuation premise by clarifying these concepts are only applicable to measuring the fair value of nonfinancial assets. The Update also clarifies that the fair value measurement of financial assets and financial liabilities which have offsetting market risks or counterparty credit risks that are managed on a portfolio basis, when several criteria are met, can be measured at the net risk position. Additional disclosures about Level 3 fair value measurements are required including a quantitative disclosure of the unobservable inputs and assumptions used in the measurement, a description of the valuation process in place, and discussion of the sensitivity of fair value changes in unobservable inputs and interrelationships about those inputs as well as disclosure of the level of the fair value of items that are not measured at fair value in the financial statements but disclosure of fair value is required. The provisions of ASU No. 2011-04 are effective for the Company's reporting period beginning after December 15, 2011 and should be applied prospectively. The Company is currently evaluating the impact of this ASU and does not expect it to have a material impact on the Company's consolidated financial statements.

In June 2011, the FASB issued ASU No. 2011-05, Presentation of Comprehensive Income. The update amends current guidance to allow a company the option of presenting the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The provisions do not change the items that must be reported in other comprehensive income or when an item of other comprehensive must to 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 are effective for the Company's reporting periods beginning after December 15, 2011 and should be applied retrospectively. Early adoption is permitted and there are no required transition disclosures. The adoption of this ASU is not expected to 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:

	June 30, 2011			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands)			
Mortgage-backed investments:				
Fannie Mae	$ 92,125	$ 1,246	$ (10)	$ 93,361
Freddie Mac	35,147	681	(23)	35,805
Ginnie Mae	8,365	7	(51)	8,321
Municipal bonds	2,393	7	(376)	2,024
U.S. Government agencies	2,133	188	-	2,321
	$ 140,163	$ 2,129	$ (460)	$ 141,832

	December 31, 2010			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands)			
Mortgage-backed investments:				
Fannie Mae	$ 109,134	$ 1,291	$ (281)	$ 110,144
Freddie Mac	40,454	860	(165)	41,149
Ginnie Mae	9,542	-	(98)	9,444
Municipal bonds	2,395	-	(473)	1,922
U.S. Government agencies	1,805	139	-	1,944
	$ 163,330	$ 2,290	$ (1,017)	$ 164,603

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:

	June 30, 2011					
	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Mortgage-backed investments:			(In thousands)			
Fannie Mae	$ 4,059	$ (10)	$ -	$ -	$ 4,059	$ (10)
Freddie Mac	3,844	(23)	-	-	3,844	(23)
Ginnie Mae	6,446	(51)	-	-	6,446	(51)
Municipal bonds	-	-	1,333	(376)	1,333	(376)
	$ 14,349	$ (84)	$ 1,333	$ (376)	$ 15,682	$ (460)

	December 31, 2010					
	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
Mortgage-backed investments:			(In thousands)			
Fannie Mae	$ 39,801	$ (281)	$ -	$ -	$ 39,801	$ (281)
Freddie Mac	15,232	(165)	-	-	15,232	(165)
Ginnie Mae	5,193	(98)	-	-	5,193	(98)
Municipal bonds	-	-	1,885	(473)	1,885	(473)
	$ 60,226	$ (544)	$ 1,885	$ (473)	$ 62,111	$ (1,017)

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 other-than-temporary impairment (“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 Income Statement. 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 six months ended June 30, 2011, we did not have any OTTI losses on investments.

The amortized cost and estimated fair value of investments available for sale at June 30, 2011, 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, 2011	
	Amortized Cost	Fair Value
	(In thousands)	
Due within one year	$ -	$ -
Due after one year through five years	501	553
Due after five years through ten years	831	836
Due after ten years	3,194	2,956
	4,526	4,345
Mortgage-backed investments	135,637	137,487
	$ 140,163	$ 141,832

We sold $20.6 million of investments during the three months ended June 30, 2011, resulting in gross gains of $751,000. For the six months ended June 30, 2011, we sold $29.8 million of investments resulting in gross gains of $1.3 million.

Note 6 - Loans Receivable

Loans receivable are summarized as follows:

	June 30, 2011		December 31, 2010	
	Amount	Percent	Amount	Percent
	(Dollars in thousands)			
One-to-four family residential: (1)				
Permanent	$ 359,846	46.44%	$ 393,334	44.08%
Construction	-	-	5,356	0.60
	359,846	46.44	398,690	44.68
Multifamily:				
Permanent	118,012	15.23	140,762	15.77
Construction	2,249	0.29	4,114	0.46
	120,261	15.52	144,876	16.23
Commercial real estate:				
Permanent	223,630	28.86	237,708	26.64
Construction	17,800	2.30	28,362	3.18
Land	3,384	0.44	6,643	0.75
	244,814	31.60	272,713	30.57

Construction/land development:						
One-to-four family residential		13,889	1.79		26,848	3.01
Multifamily		882	0.11		1,283	0.14
Commercial		1,104	0.14		1,108	0.12
Land development		18,355	2.37		27,262	3.06
		34,230	4.41		56,501	6.33
Business		1,819	0.23		479	0.05
Consumer		13,971	1.80		19,127	2.14
Total loans		774,941	100.00%		892,386	100.00%
Less:						
Loans in process ("LIP")		3,328			10,975	
Deferred loan fees, net		1,990			2,421	
ALLL		16,989			22,534	
Loans receivable, net	$	752,634		$	856,456	

(1) Includes $158.0 million and $173.4 million of non-owner occupied loans at June 30, 2011 and December 31, 2010, respectively.

At June 30, 2011, there were no loans classified as held for sale.

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

A summary of changes in the ALLL for the three and six months ended June 30, 2011 and 2010 are as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
	(In thousands)			
Balance at the beginning of the period	$ 20,250	$ 36,479	$ 22,534	$ 33,039
Provision for loan losses	1,600	26,000	2,800	39,000
Charge-offs	(4,976)	(32,703)	(8,651)	(42,385)
Recoveries	115	82	306	204
Balance at the end of the period	$ 16,989	$ 29,858	$ 16,989	$ 29,858

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 June 30, 2011						
	One-to-Four Family Residential	Multifamily	Commercial Real Estate	Construction/ Land Development	Business	Consumer	Total
ALLL:				(In thousands)			
Beginning balance	$ 7,756	$ 1,746	$ 7,275	$ 3,067	$ 13	$ 393	$ 20,250
Charge-offs	(1,031)	(62)	(1,514)	(2,256)	-	(113)	(4,976)
Recoveries	14	-	-	101	-	-	115
Provision	(1,240)	(700)	1,518	1,981	1	40	1,600
Ending balance	$ 5,499	$ 984	$ 7,279	$ 2,893	$ 14	$ 320	$ 16,989
General reserve	$ 5,097	$ 984	$ 7,220	$ 2,893	$ 14	$ 320	$ 16,528
Specific reserve	$ 402	$ -	$ 59	$ -	$ -	$ -	$ 461
Loans (1):							
Total Loans	$ 359,810	$ 120,023	$ 243,393	$ 32,597	$ 1,819	$ 13,971	$ 771,613
General reserve (2)	$ 293,165	$ 116,865	$ 225,094	$ 16,918	$ 1,819	$ 13,856	$ 667,717
Specific reserve (3)	$ 66,645	$ 3,158	$ 18,299	$ 15,679	$ -	$ 115	$ 103,896

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

	At or For the Six Months Ended June 30, 2011						
	One-to-Four Family Residential	Multifamily	Commercial Real Estate	Construction/ Land Development	Business	Consumer	Total
ALLL:				(In thousands)			
Beginning balance	$ 8,302	$ 1,893	$ 6,742	$ 5,151	$ 7	$ 439	$ 22,534
Charge-offs	(1,616)	(88)	(3,594)	(3,182)	-	(171)	(8,651)
Recoveries	19	-	-	286	-	1	306
Provision	(1,206)	(821)	4,131	638	7	51	2,800
Ending balance	$ 5,499	$ 984	$ 7,279	$ 2,893	$ 14	$ 320	$ 16,989
General reserve	$ 5,097	$ 984	$ 7,220	$ 2,893	$ 14	$ 320	$ 16,528
Specific reserve	$ 402	$ -	$ 59	$ -	$ -	$ -	$ 461
Loans (1):							
Total Loans	$ 359,810	$ 120,023	$ 243,393	$ 32,597	$ 1,819	$ 13,971	$ 771,613
General reserve (2)	$ 293,165	$ 116,865	$ 225,094	$ 16,918	$ 1,819	$ 13,856	$ 667,717

Specific reserve (3)	$ 66,645	$ 3,158	$ 18,299	$ 15,679	$ -	$ 115	$ 103,896

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

15

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

	At or For the Year Ended December 31, 2010						
	One-to-Four Family Residential	Multifamily	Commercial Real Estate	Construction/ Land Development	Business	Consumer	Total
ALLL:				(In thousands)			
Beginning balance	$11,130	$1,896	$ 6,422	$ 13,255	$6	$330	$33,039
Charge-offs	(24,594)	-	(8,012)	(32,080)	-	(790)	(65,476)
Recoveries	176	-	823	778	-	94	1,871
Provision	21,590	(3)	7,509	23,198	1	805	53,100
Ending balance	$8,302	$1,893	$ 6,742	$ 5,151	$7	$439	$22,534
General reserve	$7,137	$1,893	$ 5,499	$ 1,819	$7	$337	$16,692
Specific reserve	$1,165	$-	$ 1,243	$ 3,332	$-	$102	$5,842
Loans (1):							
Total Loans	$398,583	$143,513	$ 266,297	$ 53,412	$479	$19,127	$881,411
General reserve (2)	$330,651	$140,998	$ 248,578	$ 20,394	$479	$19,000	$760,100
Specific reserve (3)	$67,932	$2,515	$ 17,719	$ 33,018	$-	$127	$121,311

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

Nonperforming loans, net of undisbursed funds, were $37.9 million and $62.9 million at June 30, 2011 and December 31, 2010, respectively. Foregone interest on nonaccrual loans for the three and six months ended June 30, 2011 was $674,000 and $1.9 million, respectively. Foregone interest for the same periods in 2010 was $1.9 million and $3.6 million, respectively.

Loans committed to be advanced in connection with impaired loans at June 30, 2011 and December 31, 2010 were $43,000 and $1.1 million, respectively.

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

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

	At or for the Three Months Ended June 30, 2011				
	Recorded Investment (1)	Unpaid Principal Balance (2)	Related Allowance	Average Recorded Investment	Interest Income Recognized
			(In thousands)		
Loans with no related allowance:					
One-to-four family residential:					
Owner occupied	$ 7,798	$ 9,278	$ -	$ 6,091	$ 46
Non-owner occupied	46,229	49,748	-	43,306	561
Multifamily	3,158	3,246	-	2,833	42
Commercial real estate	14,555	19,411	-	11,461	119
Construction/land development	15,679	32,176	-	14,145	-
Consumer	115	117	-	130	-
Total	87,534	113,976	-	77,966	768
Loans with an allowance:					
One-to-four family residential:					
Owner occupied	5,293	5,345	109	7,058	60
Non-owner occupied	7,325	7,377	293	11,096	93
Multifamily	-	-	-	350	-
Commercial real estate	3,744	3,744	59	8,450	38
Construction/land development	-	-	-	5,438	-
Consumer	-	-	-	35	-
Total	16,362	16,466	461	32,427	191
Total impaired loans:					
One-to-four family residential:					
Owner occupied	13,091	14,623	109	13,149	106
Non-owner occupied	53,554	57,125	293	54,402	654
Multifamily	3,158	3,246	-	3,183	42
Commercial real estate	18,299	23,155	59	19,911	157
Construction/land development	15,679	32,176	-	19,583	-
Consumer	115	117	-	165	-
Total	$ 103,896	$ 130,442	$ 461	$ 110,393	$ 959

(1) Represents the loan balance less charge-offs

(2) Contractual loan principal balance

17

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

	At or For the Six Months Ended June 30, 2011				
	Recorded Investment (1)	Unpaid Principal Balance (2)	Related Allowance	Average Recorded Investment	Interest Income Recognized
	(In thousands)				
Loans with no related allowance:					
One-to-four family residential:					
Owner occupied	$ 7,798	$ 9,278	$ -	$ 5,948	$ 86
Non-owner occupied	46,229	49,748	-	43,065	1,131
Multifamily	3,158	3,246	-	2,727	84
Commercial real estate	14,555	19,411	-	10,053	217
Construction/land development	15,679	32,176	-	11,618	-
Consumer	115	117	-	102	1
Total	87,534	113,976	-	73,513	1,519
Loans with an allowance:					
One-to-four family residential:					
Owner occupied	5,293	5,345	109	7,150	136
Non-owner occupied	7,325	7,377	293	11,515	190
Multifamily	-	-	-	233	-
Commercial real estate	3,744	3,744	59	9,128	104
Construction/land development	-	-	-	12,443	-
Consumer	-	-	-	50	-
Total	16,362	16,466	461	40,519	430
Total impaired loans:					
One-to-four family residential:					
Owner occupied	13,091	14,623	109	13,098	222
Non-owner occupied	53,554	57,125	293	54,580	1,321
Multifamily	3,158	3,246	-	2,960	84
Commercial real estate	18,299	23,155	59	19,181	321
Construction/land development	15,679	32,176	-	24,061	-
Consumer	115	117	-	152	1
Total	$ 103,896	$ 130,442	$ 461	$ 114,032	$ 1,949

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

18

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

	At or For the Year Ended December 31, 2010			
	Recorded Investment (1)(3)	Unpaid Principal Balance (2)(3)	Related Allowance	Interest Income Recognized (3)
	(In thousands)			
Loans with no related allowance:				
One-to-four family residential:				
Owner occupied	$ 5,663	$ 5,997	$ -	$ 178
Non-owner occupied	42,584	42,947	-	2,920
Multifamily	2,515	2,515	-	169
Commercial real estate	7,236	7,753	-	350
Construction/land development	6,565	8,607	-	8
Consumer	48	547	-	-
Total	64,611	68,366	-	3,625
Loans with an allowance:				
One-to-four family residential:				
Owner occupied	7,333	8,570	276	95
Non-owner occupied	12,352	16,722	889	130
Commercial real estate	10,483	14,713	1,243	281
Construction/land development	26,453	46,026	3,332	-
Consumer	79	298	102	3
Total	56,700	86,329	5,842	509
Total impaired loans:				
One-to-four family residential:				
Owner occupied	12,996	14,567	276	273
Non-owner occupied	54,936	59,669	889	3,050
Multifamily	2,515	2,515	-	169
Commercial real estate	17,719	22,466	1,243	631
Construction/land development	33,018	54,633	3,332	8
Consumer	127	845	102	3
Total	$ 121,311	$ 154,695	$ 5,842	$ 4,134

(1) Represents the loan balance less charge-offs
(2) Contractual loan principal balance
(3) Certain amounts in the table have been reclassified to conform to the current presentation.

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

The following is a summary of information pertaining to impaired, nonperforming and nonaccrual loans:

	June 30, 2011		December 31, 2010	
	(In thousands)			
Impaired loans without a valuation allowance	$	87,534	$	64,611
Impaired loans with a valuation allowance		16,362		56,700
Total impaired loans	$	103,896	$	121,311
Valuation allowance related to impaired loans	$	461	$	5,842
Nonperforming assets (1):				
Nonaccrual loans	$	31,831	$	46,637
Nonaccrual troubled debt restructured loans		6,097		16,299
Total nonperforming loans		37,928		62,936
Other real estate owned		25,979		30,102
Total nonperforming assets	$	63,907	$	93,038
Performing troubled debt restructured loans	$	65,968	$	58,375
Nonaccrual troubled debt restructured loans		6,097		16,299
Total troubled debt restructured loans (2)	$	72,065	$	74,674

(1) There were no loans 90 days or more past due and still accruing interest at June 30, 2011 and December 31, 2010.
(2) Troubled debt restructured loans are also considered impaired loans and are included in "Total impaired loans."

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

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

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, 2011	December 31, 2010
	(In thousands)	
One-to-four family residential	$ 13,684	$ 22,688
Multifamily	638	-
Commercial real estate	7,882	7,306
Construction/land development	15,679	32,885
Consumer	45	57
Total nonaccrual loans	$ 37,928	$ 62,936

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

Loans Past Due as of June 30, 2011

	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	$ 479	$ 235	$ 3,642	$ 4,356	$ 197,425	$ 201,781
Non-owner occupied	135	895	7,881	8,911	149,118	158,029
Multifamily	-	-	638	638	119,385	120,023
Commercial real estate	1,475	866	5,806	8,147	235,246	243,393
Construction/land development	729	-	14,950	15,679	16,918	32,597
Total real estate	2,818	1,996	32,917	37,731	718,092	755,823
Business	-	-	-	-	1,819	1,819
Consumer	-	49	-	49	13,922	13,971
Total	$ 2,818	$ 2,045	$ 32,917	$ 37,780	$ 733,833	$ 771,613

(1) There were no loans 90 days past due and still accruing interest at June 30, 2011.
(2) Net of undisbursed funds.

Loans Past Due as of December 31, 2010

	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	$ 2,178	$ 780	$ 5,863	$8,821	$216,392	$225,213
Non-owner occupied	800	1,996	11,801	14,597	158,773	173,370
Multifamily	-	-	-	-	143,513	143,513
Commercial real estate	2,141	836	6,948	9,925	256,372	266,297
Construction/land development	133	265	32,620	33,018	20,394	53,412
Total real estate	5,252	3,877	57,232	66,361	795,444	861,805
Business	-	-	-	-	479	479
Consumer	-	55	57	112	19,015	19,127
Total	$ 5,252	$ 3,932	$ 57,289	$66,473	$814,938	$881,411

(1) There were no loans 90 days past due and still accruing interest at December 31, 2010.
(2) Net of undisbursed funds.

21

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

Credit Quality Indicators. We utilize a nine-point risk rating system and assign a risk rating for all credit exposures. The risk rating system is designed to define the basic characteristics and identify risk elements of each credit extension. Credits risk rated 1 through 5 are considered to be “pass” credits. Pass credits can be assets where there is virtually no credit risk, such as cash secured loans with funds on deposit with the Bank. Pass credits also include credits that are on our watch list, where the borrower exhibits potential weaknesses, which may, if not checked or corrected, negatively affect the borrower’s financial capacity and threaten their ability to fulfill debt obligations in the future. Credits classified as special mention are risk rated 6 and possess weaknesses that deserve management’s close attention. Special mention assets are not adversely classified and do not expose the Bank to sufficient risk to warrant adverse classification. Substandard credits are risk rated 7. An asset is considered substandard if it is inadequately protected by the current net worth and payment capacity of the borrower or of any collateral pledged. Substandard assets include those characterized by the distinct possibility that we will sustain some loss if the deficiencies are not corrected. Assets classified as doubtful are risk rated 8 and have all the weaknesses inherent in those credits classified as substandard with the added characteristic that the weaknesses present make collection or liquidation in full highly questionable and improbable, on the basis of currently existing facts, conditions and values. Assets classified as loss are risk rated 9 and are considered uncollectible and of such little value that their continuance as assets without the establishment of a specific loss reserve is not warranted.

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

	June 30, 2011						
	One-to-Four Family Residential	Multifamily	Commercial Real Estate	Construction/ Land Development	Business	Consumer	Total (1)
				(In thousands)			
Risk Rating:							
Pass	$319,193	$113,936	$214,247	$ 16,494	$1,819	$13,704	$679,393
Special mention	22,006	5,449	10,685	-	-	222	38,362
Substandard	18,611	638	18,461	16,103	-	45	53,858
Doubtful	-	-	-	-	-	-	-
Total	$359,810	$120,023	$243,393	$ 32,597	$1,819	$13,971	$771,613

(1) Net of undisbursed funds.

	December 31, 2010						
	One-to-Four Family Residential	Multifamily	Commercial Real Estate	Construction/ Land Development	Business	Consumer	Total (1)
				(In thousands)			
Risk Rating:							
Pass	$ 360,239	$141,224	$249,576	$ 17,589	$479	$18,792	$787,899
Special mention	10,261	1,936	5,805	-	-	189	18,191
Substandard	28,083	353	10,916	35,484	-	140	74,976
Doubtful	-	-	-	339	-	6	345
Total	$ 398,583	$143,513	$266,297	$ 53,412	$479	$19,127	$881,411

(1) Net of undisbursed funds.

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, 2011						
	One-to-Four Family Residential	Multifamily	Commercial Real Estate	Construction/ Land Development	Business	Consumer	Total (3)
	(In thousands)						
Performing (1)	$ 346,126	$ 119,385	$ 235,511	$ 16,918	$ 1,819	$ 13,926	$ 733,685
Nonperforming (2)	13,684	638	7,882	15,679	-	45	37,928
Total	$ 359,810	$ 120,023	$ 243,393	$ 32,597	$ 1,819	$ 13,971	$ 771,613

(1) There were $197.1 million of owner-occupied one-to-four family loans and $149.0 million of non-owner occupied one-to-four family loans classified as performing.
(2) There were $4.7 million of owner-occupied one-to-four family loans and $9.0 million of non-owner occupied one-to-four family loans classified as nonperforming.
(3) Net of undisbursed funds.

	December 31, 2010						
	One-to-Four Family Residential	Multifamily	Commercial Real Estate	Construction/ Land Development	Business	Consumer	Total (3)
	(In thousands)						
Performing (1)	$ 375,895	$ 143,513	$ 258,991	$ 20,527	$479	$ 19,070	$ 818,475
Nonperforming (2)	22,688	-	7,306	32,885	-	57	62,936
Total	$ 398,583	$ 143,513	$ 266,297	$ 53,412	$479	$ 19,127	$ 881,411

(1) There were $217.3 million of owner-occupied one-to-four family loans and $158.6 million of non-owner occupied one-to-four family loans classified as performing.
(2) There were $8.0 million of owner-occupied one-to-four family loans and $14.7 million of non-owner occupied one-to-four family loans classified as nonperforming.
(3) Net of undisbursed funds.

Note 7 – Other Real Estate Owned

The following table is a summary of OREO:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
	(In thousands)			
Beginning Balance	$ 31,266	$ 20,500	$ 30,102	$ 11,835
Loans transferred to OREO	5,673	3,262	15,950	17,666

Capitalized improvements	2	286	90	286
Dispositions of OREO	(10,673)	(6,658)	(19,246)	(10,126)
Market value adjustments	(289)	(897)	(917)	(3,168)
Ending Balance	$ 25,979	$ 16,493	$ 25,979	$ 16,493

OREO includes properties acquired by the Bank through foreclosure or deed in lieu of foreclosure. OREO at June 30, 2011 consisted of $11.5 million in one-to-four family residential homes, $8.2 million in construction/land development projects and $6.3 million in commercial real estate buildings.

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.

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

We determined the fair values of our financial instruments based on the fair value hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair values. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect our estimates for market assumptions.

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

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

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

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

	Fair Value Measurements at June 30, 2011			
	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	$ 93,361	$ -	$ 93,361	$ -
Freddie Mac	35,805	-	35,805	-
Ginnie Mae	8,321	-	8,321	-
Municipal bonds	2,024	-	2,024	-
U.S. Government agencies	2,321	-	2,321	-
	$ 141,832	$ -	$ 141,832	$ -

	Fair Value Measurements at December 31, 2010		
	Quoted Prices in Active Markets	Significant Other	Significant

	Fair Value Measurements	for Identical Assets (Level 1)	Observable Inputs (Level 2)	Unobservable Inputs (Level 3)
		(In thousands)		
Available for sale investments:				
Mortgage-backed investments:				
Fannie Mae	$ 110,144	$ -	$ 110,144	$ -
Freddie Mac	41,149	-	41,149	-
Ginnie Mae	9,444	-	9,444	-
Municipal bonds	1,922	-	1,922	-
U.S. Government agencies	1,944	-	1,944	-
	$ 164,603	$ -	$ 164,603	$ -

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

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, 2011				
	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 including undisbursed but committed funds of $43 (included in loans receivable, net) (1)	$ 103,478	$ -	$ -	$ 103,478	$ 461
OREO (2)	25,979	-	-	25,979	289
	$ 129,457	$ -	$ -	$ 129,457	$ 750

(1) The loss represents the specific reserve against loans that were considered impaired at June 30, 2011.
(2) The loss represents OREO market value adjustments for the quarter ended June 30, 2011.

	Fair Value Measurements at December 31, 2010				
	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 including undisbursed but committed funds of $1.1 million (included in loans receivable, net) (1)	$ 116,543	$ -	$ -	$ 116,543	$ 5,842
OREO (2)	30,102	-	-	30,102	5,624
	$ 146,645	$ -	$ -	$ 146,645	$ 11,466

(1) The loss represents the specific reserve against loans that were considered impaired at December 31, 2010.
(2) The loss represents OREO market value adjustments for the year ended December 31, 2010.

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. Some of these inputs may not be observable in the marketplace.

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.

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

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

	June 30, 2011		December 31, 2010	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
		(In thousands)		
Assets:				
Cash on hand and in banks	$ 4,364	$ 4,364	$ 7,466	$ 7,466
Interest-bearing deposits	184,448	184,448	90,961	90,961
Investments available for sale	141,832	141,832	164,603	164,603
Loans receivable, net	752,634	779,191	856,456	878,737
Federal Home Loan Bank stock	7,413	7,413	7,413	7,413
Accrued interest receivable	4,132	4,132	4,686	4,686
Liabilities:				
Deposits	209,416	209,416	231,527	231,527
Certificates of deposit	664,281	672,603	688,699	701,976
Advances from the Federal Home				
Loan Bank	93,066	95,008	93,066	95,972
Accrued interest payable	217	217	214	214

Fair value estimates, methods, and assumptions are set forth below for our 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, investments available for sale, Federal Home Loan Bank of Seattle ("FHLB") stock, accrued interest receivable and accrued interest 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.

- Investments: 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 fair value of deposits with no stated maturity, such as statement, NOW, and money market accounts, is equal to the amount payable on demand. The fair value of certificates of deposit is based on the discounted value of contractual cash flows using current interest rates for certificates of deposit with similar remaining maturities. The fair value of FHLB advances is estimated based on discounting the future cash flows using current interest rates for debt with similar remaining maturities.

- Off balance sheet commitments: No fair value adjustment is necessary for commitments made to extend credit, which represents commitments for loan originations or for outstanding commitments to purchase loans. These commitments are at variable rates, are for loans with terms

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

of less than one year and have interest rates which approximate prevailing market rates, or are set at the time of loan closing.

Fair value estimates are based on existing balance sheet financial instruments without attempting to estimate the value of anticipated future business. The fair value has not been estimated for assets and liabilities that are not considered financial instruments.

Note 9 – Federal Home Loan Bank stock

At June 30, 2011, we held $7.4 million of FHLB stock. FHLB stock is carried at par and does not have a readily determinable fair value. Ownership of FHLB stock is restricted to the FHLB and member institutions, and can only be purchased and redeemed at par. As a result of ongoing turmoil in the capital and mortgage markets, the FHLB has a risk-based capital deficiency largely as a result of write-downs on its private label mortgage-backed securities portfolio.

Management evaluates FHLB stock for impairment. The determination of whether this investment is impaired is based on our assessment of the ultimate recoverability of cost rather than by recognizing temporary declines in value. The determination of whether a decline affects the ultimate recoverability of cost is influenced by criteria such as: (1) the significance of any decline in net assets of the FHLB as compared to the capital stock amount for the FHLB and the length of time this situation has persisted; (2) commitments by the FHLB to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FHLB; (3) the impact of legislative and regulatory changes on institutions and, accordingly, the customer base of the FHLB; and (4) the liquidity position of the FHLB.

On October 25, 2010, the FHLB agreed to the stipulation and issuance of a Consent Order by its primary regulator, the Federal Housing Finance Agency ("FHFA"). The Consent Order sets forth requirements for capital management, asset composition, and other operational and risk management improvements. Additionally, the FHFA and the FHLB have agreed to a Stabilization Period that ends upon the filing of the FHLB's June 30, 2011 financial statements. During this period, the FHLB's classification as undercapitalized will remain in place. Subsequently, the FHLB may begin repurchasing member stock at par and paying dividends, upon achieving and maintaining financial thresholds established by the FHFA as part of the agency's supervisory process, subject to FHFA approval.

Under FHFA regulations, a Federal Home Loan Bank that fails to meet any regulatory capital requirement may not declare a dividend or redeem or repurchase capital stock in excess of what is required for members' current loans. As such, the FHLB cannot redeem, repurchase or declare dividends on stock outstanding while the risk-based capital deficiency exists. This restriction is not expected to have a material effect on our financial position, liquidity or results of operations. We have determined there is no OTTI on the FHLB stock investment as of June 30, 2011.

Note 10 - Stock-Based Compensation

In June 2008, our shareholders approved the First Financial Northwest, Inc. 2008 Equity Incentive Plan ("Plan"). The Plan provides for the grant of stock options, awards of restricted stock and stock appreciation rights.

Total compensation expense for the Plan was $476,000 and $480,000 for the three months ended June 30, 2011 and 2010, respectively, and the related income tax benefit was $167,000 and $168,000 for the three months ended June 30, 2011 and 2010, respectively.

Total compensation expense for the Plan was $950,000 and $978,000 for the six months ended June 30, 2011 and 2010, respectively, and the related income tax benefit was $332,000 and $342,000 for the six months ended June 30, 2011 and 2010, respectively.

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

Stock Options

The Plan authorized the grant of stock options totaling 2,285,280 shares to our directors, advisory directors, officers and employees. Option awards are granted with an exercise price equal to the market price of our common stock at the date of grant. These option awards have a vesting period of five years, with 20% vesting on the anniversary date of each grant date and a contractual life of ten years. Any unexercised stock options will expire ten years after the grant date or sooner in the event of the award recipient's death, disability or termination of service with the Company or the Bank. We have a policy of issuing new shares from authorized but unissued common stock upon the exercise of stock options. At June 30, 2011, remaining options for 911,756 shares of common stock were available for grant under the Plan.

The fair value of each option award is estimated on the date of grant using a Black-Scholes model that uses the following assumptions. The dividend yield is based on the current quarterly dividend in effect at the time of the grant. Historical employment data is used to estimate the forfeiture rate. In previous periods, we elected to use a weighted-average of our peers' historical stock price information in conjunction with our own stock price history due to the limited amount of history available regarding our stock price. Now that sufficient historical stock price information is available regarding our stock, we will utilize in future periods the historical volatility of our stock price over a specified period of time for the expected volatility assumption. We base the risk-free interest rate on the U.S. Treasury Constant Maturity Indices in effect on the date of the grant. We elected to use the "Share-Based Payments" method permitted by the SEC to calculate the expected term. This method uses the vesting term of an option along with the contractual term, setting the expected life at the midpoint. There were no options granted during the second quarter ended June 30, 2011.

The following is a summary of our stock option plan awards for the six months ended June 30, 2011:

	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term in Years	Aggregate Intrinsic Value	Weighted-Average Grant Date Fair Value
	(Dollars in thousands, except share data)				
Outstanding at January 1, 2011	1,383,524	$ 9.52	7.60	$ -	$ 1.91
Granted	-	-	-	-	-
Exercised	-	-	-	-	-
Forfeited or expired	(10,000)	9.78	-	-	-
Outstanding at June 30, 2011	1,373,524	9.52	7.10	53	1.91
Expected to vest assuming a 3% forfeiture rate over the vesting term	809,082	9.45	7.12	41	-

Exercisable at June 30, 2011	539,410	9.62	7.07	11	-

As of June 30, 2011, there was $1.1 million of total unrecognized compensation cost related to non-vested stock options granted under the Plan. The cost is expected to be recognized over the remaining weighted-average vesting period of 2.1 years.

Restricted Stock Awards

The Plan authorized the grant of restricted stock awards amounting to 914,112 shares to our directors, advisory directors, officers and employees. Compensation expense is recognized over the vesting period of the awards based on the fair value of the stock at the date of grant. The restricted stock awards' fair value is equal to the value on the date of grant. Shares awarded as restricted stock vest ratably over a five-year period beginning at the grant date with 20% vesting on the anniversary date of each grant date. At June 30, 2011, remaining restricted awards for 167,078 shares were available to be issued. Shares that have been repurchased totaled 443,340 and are held in trust until they are issued in connection with the agreement.

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

The following is a summary of changes in non-vested restricted stock awards for the six months ended June 30, 2011:

Non-vested Shares	Shares	Fair Value Per Share
Non-vested at January 1, 2011	456,140	$ 9.75
Granted	-	-
Vested	(12,800)	6.19
Forfeited	-	-
Non-vested at June 30, 2011	443,340	9.85
Expected to vest assuming a 3% forfeiture rate over the vesting term	430,038	

As of June 30, 2011, there was $3.1 million of total unrecognized compensation costs related to non-vested shares granted as restricted stock awards. The cost is expected to be recognized over the remaining weighted-average vesting period of 2.3 years. The total fair value of shares that vested during the quarters ended June 30, 2011 and 2010 were $26,000 and $0, respectively.

Note 11 – Federal Taxes on Income

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. These calculations are based on many complex factors including estimates of the timing of reversals of temporary differences, the interpretation of federal income tax laws and a determination of the differences between the tax and the financial reporting basis of assets and liabilities. Actual results could differ significantly from the estimates and interpretations used in determining the current and deferred income tax assets and liabilities.

Our primary deferred tax assets relate to our ALLL, our contribution to the First Financial Northwest Foundation and an impairment charge relating to a past investment in the AMF Ultra Short Mortgage Fund.

Under GAAP, a valuation allowance is required to be recognized if it is “more likely than not” that a portion of the deferred tax asset will not be realized. Our policy is to evaluate our deferred tax assets on a quarterly basis and record a valuation allowance for our deferred tax asset if we do not have sufficient positive evidence indicating that it is more likely than not that some or all of the deferred tax asset will be realized. At June 30, 2011, we considered positive and negative evidence, which includes cumulative losses in the most recent three year period and uncertainty regarding short-term future earnings. We further considered that GAAP places heavy emphasis on prior earnings in determining the realizable deferred tax asset. After reviewing and weighing these various factors, in 2010 we recorded a valuation allowance for the balance of the deferred tax asset in excess of the tax carryback refund potential, resulting in no deferred tax asset at June 30, 2011.

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

Note 12 – Earnings/(Loss) Per Share

The following table presents a reconciliation of the components used to compute basic and diluted earnings (loss) per share:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
	(Dollars in thousands, except share data)			
Net income (loss)	$1,258	$(24,881)	$2,692	$(42,633)