First Financial Northwest, Inc.
Form 10-K
March 13, 2019
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

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

For the Fiscal Year Ended December 31, 2018

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

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
Securities registered pursuant to Section 12(b) of the Act:	
Common Stock, $0.01 par value per share	The Nasdaq Stock Market LLC
(Title of Each Class)	(Name of Each Exchange on Which Registered)
Securities registered pursuant to Section 12(g) of the Act:	None

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
YES NO X
Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
YES NO X
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 every Interactive Data File required to be submitted 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 such files).

YES X NO

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of the Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer", "smaller reporting company", and "emerging growth company" in Rule 12b-2 of the Exchange Act:

Large accelerated filer _____ Accelerated filer X Non-accelerated filer _____

Smaller reporting company _____ Emerging growth company _____

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. _____

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Act). YES NO X

The aggregate market value of the Common Stock outstanding held by nonaffiliates of the Registrant based on the closing sales price of the Registrant's Common Stock as quoted on The Nasdaq Stock Market LLC on June 30, 2018, was $184,306,825 (9,441,948 shares at $19.52 per share). For purposes of this calculation, common stock held only by executive officers, the employee stock ownership plan and directors of the Registrant is considered to be held by affiliates. As of March 11, 2019, the Registrant had 10,509,425 shares of common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

1. Portions of Registrant's Definitive Proxy Statement for the 2018 Annual Meeting of Shareholders (Part III).

FIRST FINANCIAL NORTHWEST, INC.
2018 ANNUAL REPORT ON FORM 10-K
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Forward-Looking Statements

Certain matters discussed in this Annual Report on Form 10-K constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements relate to our financial condition, results of operations, plans, objectives, future performance or business. Forward-looking statements are not statements of historical fact, are based on certain assumptions and are generally identified by use of the words "believes," "expects," "anticipates," "estimates," "forecasts," "intends," "plans," "targets," "potentially," "probably," "projects," "outlook" or similar or future or conditional verbs such as "may," "will," "should," "would" and "could." Forward-looking statements include statements with respect to our beliefs, plans, objectives, goals, expectations, assumptions and statements about, among other things, expectations of the business environment in which we operate, projections of future performance or financial items, perceived opportunities in the market, potential future credit experience, and statements regarding our mission and vision. These forward-looking statements are based upon current management expectations and may, therefore, involve risks and uncertainties. Our actual results, performance, or achievements may differ materially from those suggested, expressed, or implied by forward-looking statements as a result of a wide variety or range of factors including, but not limited to: the credit risks of lending activities, including changes in the level and trend of loan delinquencies and write-offs, that may be affected by deterioration in the housing and commercial real estate markets, and may lead to increased losses and nonperforming assets in our loan portfolio, and may result in our allowance for loan losses not being adequate to cover actual losses, and require us to materially increase our reserves; changes in general economic conditions, either nationally or in our market areas; changes in the levels of general interest rates, and the relative differences between short and long term interest rates, deposit interest rates, our net interest margin and funding sources; fluctuations in the demand for loans, the number of unsold homes and other properties and fluctuations in real estate values in our market areas; results of examinations of us by the Federal Reserve Bank of San Francisco ("FRB") and our bank subsidiary by the Federal Deposit Insurance Corporation ("FDIC"), the Washington State Department of Financial Institutions, Division of Banks ("DFI") or other regulatory authorities, including the possibility that any such regulatory authority may initiate an enforcement action against the Company or the Bank which could require us to increase our reserve for loan losses, write-down assets, change our regulatory capital position, affect our ability to borrow funds or maintain or increase deposits, or impose additional requirements or restrictions on us, any of which could adversely affect our liquidity and earnings; our ability to pay dividends on our common stock; our ability to attract and retain deposits; increases in premiums for deposit insurance; our ability to control operating costs and expenses; the use of estimates in determining the fair value of certain of our assets, which estimates may prove to be incorrect and result in significant declines in valuation; difficulties in reducing risk associated with the loans on our balance sheet; staffing fluctuations in response to product demand or the implementation of corporate strategies that affect our work force and potential associated charges; disruptions, security breaches, or other adverse events, failures or interruptions in, or attacks on, our information technology systems or on the third-party vendors who perform several of our critical processing functions; our ability to retain key members of our senior management team; costs and effects of litigation, including settlements and judgments; our ability to implement a branch expansion strategy; our ability to successfully integrate any assets, liabilities, customers, systems, and management personnel we have acquired or may in the future acquire into our operations and our ability to realize related revenue synergies and cost savings within expected time frames and any goodwill charges related thereto; our ability to manage loan delinquency rates; costs and effects of litigation, including settlements and judgments; increased competitive pressures among financial services companies; changes in consumer spending, borrowing and savings habits; legislative or regulatory changes that adversely affect our business including changes in regulatory policies and principles, including the interpretation of regulatory capital or other rules, including as a result of Basel III; the impact of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act") and the implementing regulations; the availability of resources to address changes in laws, rules, or regulations or to respond to regulatory actions; adverse changes in the securities markets; inability of key third-party providers to perform their obligations to us; changes in accounting policies and practices, as may be adopted by the financial institution regulatory agencies or the Financial Accounting Standards Board, including additional guidance and interpretation on accounting issues and details of the implementation of new accounting methods; the economic impact of war or any terrorist activities; other economic, competitive, governmental, regulatory, and technological factors affecting our operations; pricing, products and services; and other risks detailed in this Form 10-K and our other reports filed with the U.S. Securities and Exchange

Commission ("SEC"). Any of the forward-looking statements that we make in this Form 10-K and in the other public reports and statements we make may turn out to be wrong because of the inaccurate assumptions we might make, because of the factors illustrated above or because of other factors that we cannot foresee. Because of these and other uncertainties, our actual future results may be materially different from those expressed in any forward looking statements made by or on our behalf. Therefore, these factors should be considered in evaluating the forward looking statements, and undue reliance should not be placed on such statements. We undertake no responsibility to update or revise any forward-looking statements.

As used throughout this report, the terms "Company", "we", "our", or "us" refer to First Financial Northwest, Inc. and its consolidated subsidiaries, including First Financial Northwest Bank and First Financial Diversified Corporation.

Internet Website

The information contained on our website, www.ffnwb.com, is not included as a part of, or incorporated by reference into, this Annual Report on Form 10-K. Other than an investor’s own Internet access charges, we make available free of charge through our website, our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to these reports, proxy statements and other SEC filings on our investor relations page. All of our reports, proxy statements, and other SEC filings are posted as soon as reasonably practicable after they are electronically filed with the SEC and are also available free of charge at the SEC’s website at www.sec.gov.

PART I

Item 1. Business

General

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 Financial Northwest Bank (“the Bank”) in connection with the Bank’s conversion from a mutual holding company structure to a stock holding company structure which was completed on October 9, 2007. At December 31, 2018, the Company had total assets of $1.3 billion, net loans of $1.0 billion, deposits of $939.0 million and stockholders’ equity of $153.7 million. First Financial Northwest’s business activities generally are limited to passive investment activities and oversight of its investment in First Financial Northwest Bank. Accordingly, the information set forth in this report, including consolidated financial statements and related data, relates primarily to First Financial Northwest Bank.

The Bank was organized in 1923 as a Washington state-chartered savings and loan association, converted to a federal mutual savings and loan association in 1935 and to a Washington state-chartered mutual savings bank in 1992. In 2002, First Savings Bank reorganized into a two-tier mutual holding company structure, became a stock savings bank, and the wholly-owned subsidiary of First Financial of Renton, Inc. In connection with the 2002 conversion, First Savings Bank changed its name to First Savings Bank Northwest. Subsequently, in August 2015, the Bank changed its name to First Financial Northwest Bank to better reflect the commercial banking services it provides beyond those typically provided by a traditional savings bank. In February 2016, the Bank officially changed its charter from a Washington chartered stock savings bank to a Washington chartered commercial bank.

First Financial Northwest became a bank holding company, after converting from a savings and loan holding company on March 31, 2015, and is subject to regulation by the Board of Governors of the Federal Reserve System (the “Federal Reserve Board” or “Federal Reserve”) through the FRB. The change was consistent with First Financial Northwest Bank’s shift in focus from a traditional savings and loan association towards a full service, commercial bank. Additionally, First Financial Northwest Bank is examined and regulated by the DFI and by the FDIC. First Financial Northwest Bank is required to maintain reserves at a level set by the Federal Reserve Board. The Bank is a member of the Federal Home Loan Bank (“FHLB”) of Des Moines, which is one of the 11 regional banks in the Federal Home Loan Bank System (“FHLB System”). For additional information, see “How We are Regulated - Regulation and Supervision of First Financial Northwest Bank - Federal Home Loan Bank System.”

In February 2016, First Financial Northwest Bank converted its charter from a community-based savings bank to a commercial bank as a way of better serving its customer needs. The Bank’s largest concentration of customers is in King County, with additional concentrations in Snohomish, Pierce, and Kitsap counties, Washington. The Bank is headquartered in Renton, in King County, where it has a full-service branch as well as a smaller branch located in a commercial development known as “The Landing”. The Bank has additional smaller branches in King County located in Bellevue, Woodinville, and Bothell, and opened a new branch in Kent in the first quarter of 2019. In Snohomish County, Washington, the Bank has five additional branches located in Mill Creek, Edmonds, Clearview, Smokey Point, and Lake Stevens. These smaller branches are focused on efficiency through the extensive use of the latest banking technology. First Financial Northwest Bank’s business consists of attracting deposits from the public and utilizing these funds to originate one-to-four family residential, multifamily, commercial real estate, construction/land, business and consumer loans.

The principal executive office of First Financial Northwest is located at 201 Wells Avenue South, Renton, Washington, 98057; our telephone number is (425) 255-4400.

Market Area

We consider our primary market area to be the Puget Sound Region that consists primarily of King, Snohomish and, to a lesser extent, Pierce and Kitsap counties. During 2018, the Puget Sound Region experienced strong appreciation in residential real estate prices throughout much of the year similar to trends in recent periods. However, price appreciation in more expensive areas of King County such as Seattle and Bellevue have slowed recently due to affordability issues and higher mortgage rates. List prices in Snohomish, Pierce and Kitsap counties are lower than King County and properties have continued to experience price appreciation higher than the national average.

King County has the largest population of any county in the state of Washington and covers approximately 2,100 square miles. It has a population of approximately 2.19 million residents and a median household income of approximately $83,600, according to U.S. Census estimates. King County has a diversified economic base with many nationally recognized firms including

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Boeing, Microsoft, Amazon, Starbucks, Nordstrom, Costco and Paccar. According to the Washington State Employment Security Department, the unemployment rate for King County was 3.3% at December 31, 2018, compared to 3.6% at December 31, 2017, and the national average of 3.9% at December 31, 2018. The median sales price of a residential home in King County for December 2018 was $597,000, an increase of 2.1% from 2017, according to the Northwest Multiple Listing Service ("MLS"). Residential sales volumes decreased 11.5% in 2018 compared to 2017 and inventory levels as of December 31, 2018 were at 1.7 months according to the MLS. The number of listings in King County have increased substantially from last year but remain below historical levels.

Pierce County, covering approximately 1,700 square miles, has the second largest population of any county in the state of Washington. It has approximately 877,000 residents and a median household income of approximately $63,900, according to U.S. Census estimates. The Pierce County economy is diversified with the presence of military-related government employment (Joint Base Lewis-McChord), transportation and shipping employment (Port of Tacoma), and aerospace-related employment (Boeing). According to the Washington State Employment Security Department, the unemployment rate for Pierce County was 5.3% in December 2018, compared to 5.4% in December 2017. The median sales price of a residential home in Pierce County was $339,800 for December 2018, a 7.9% increase compared to 2017, according to the MLS. Residential sales volumes declined by 5.2% in 2018 compared to 2017 and inventory levels as of December 31, 2018 were at 1.5 months according to the MLS.

Snohomish County has the third largest population of any county in the state of Washington and covers approximately 2,090 square miles. It has approximately 802,000 residents and a median household income of approximately $78,000, according to U.S. Census estimates. The economy of Snohomish County is diversified with the presence of military-related government employment (Naval Station Everett), aerospace-related employment (Boeing), and retail trade. According to the Washington State Employment Security Department, the unemployment rate for Snohomish County was 3.6% in December 2018 compared to 4.0% in December 2017. The median sales price of a residential home in Snohomish County was $454,900 for December 2018, a 7.0% increase compared to December of 2017, according to the MLS. Residential sales volumes dropped by 9.9% in 2018 compared to 2017 and inventory levels as of December 31, 2018 were at 1.5 months according to the MLS.

Kitsap County has the seventh largest population of any county in the state of Washington and covers approximately 395 square miles. It has approximately 266,000 residents and a median household income of approximately $68,300, according to U.S. Census estimates. The Kitsap County economy is diversified with the presence of military-related government employment (Naval Base Kitsap, Puget Sound Naval Shipyard), health care, retail trade and education. According to the Washington State Employment Security Department, the unemployment rate for Kitsap County was 4.9% in December 2018, compared to 5.0% in December 2017. The median sales price of a residential home was $343,000 for December 2018, an increase of 8.9% compared to December 2017, according to the MLS. Residential sales volumes declined by 7.2% in 2018 compared to 2017 and inventory levels as of December 31, 2018 were at 1.5 months according to the MLS.

For a discussion regarding competition in our primary market area, see "- Competition" later in Item 1 of this report.

Lending Activities

General. We focus our lending activities primarily on loans secured by commercial real estate, construction/land, first mortgages on one-to-four family residences, multifamily, and business lending. We offer a variety of secured consumer loans, including savings account loans and home equity loans that include lines of credit and second mortgage term loans. As of December 31, 2018, our net loan portfolio totaled $1.0 billion and represented 81.7% of our total assets.

Our current loan policy generally limits the maximum amount of loans we can make to one borrower to 15% of the Bank's total risk-based capital, or $21.0 million at December 31, 2018. Exceptions to this policy are allowed only with

the prior approval of the Board of Directors and if the borrower exhibits financial strength or sufficient, measurable compensating factors exist after consideration of the loan-to-value ratio, borrower's financial condition, net worth, credit history, earnings capacity, installment obligations, and current payment history. The regulatory limit of loans we can make to one borrower is 20% of total risk-based capital, or $28.0 million, at December 31, 2018. At this date, our single largest lending relationship, totaling $21.9 million, exceeded our internal lending guideline and was approved by the Board of Directors in accordance with our loan policy.

During 2018, the concentration of loans to our five largest lending relationships decreased. At December 31, 2018, loans to our five largest lending relationships totaled $79.9 million compared to $88.5 million at December 31, 2017, a decrease of $8.6 million, or 9.8%. Not only did the total of these relationships decrease during 2018, their percentage of total loans, net of loans in process ("LIP") also decreased to 7.7% at December 31, 2018 from 8.8% at December 31, 2017. The total number of loans comprising these relationships increased slightly to 19 at December 31, 2018 from 18 at December 31, 2017. The following table details the types of loans to our five largest lending relationships at December 31, 2018.

Borrower [1]	Number of Loans	One-to-Four Family Residential[2]	Multifamily	Commercial Real Estate[2]	Construction/Land	Business	Aggregate Balance of Loans [3]
	(Dollars in thousands)						
Real estate investor	5	$ —	$ 8,616	$ 13,255	$ —	$ —	$ 21,871
Real estate investor	3	428	—	15,021	—	—	15,449
Real estate investor	5	444	—	14,758	—	—	15,202
Real estate investor	3	—	5,079	—	8,836	—	13,915
Real estate investor	3	—	—	—	3,629	9,818	13,447
Total	19	$ 872	$ 13,695	$ 43,034	$ 12,465	$ 9,818	$ 79,884

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[1] The composition of borrowers represented in the table may change between periods.
[2] The one-to-four family residential loans for these borrowers are all owner occupied. The commercial real estate loans are for non-owner occupied, income producing properties.
[3] Net of LIP.

The composition of loans to our five largest borrowers has changed at December 31, 2018, as compared to December 31, 2017, with increases in multifamily loans and commercial real estate loans of $3.0 million and $3.9 million, respectively. Partially offsetting these increases, total construction/land development loans and business loans decreased by $14.9 million and $503,000, respectively. At December 31, 2018, all of the borrowers listed in the table above were in compliance with the original repayment terms of their respective loans.

Loan Portfolio Analysis. The following table sets forth the composition of our loan portfolio by type of loan at the dates indicated.

	December 31,									
	2018		2017		2016		2015		2014	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
	(Dollars in thousands)									
One-to-four family residential:										
Permanent owner occupied	$194,141	17.3 %	$148,304	13.6 %	$137,834	15.3 %	$147,229	19.6 %	$161,013	22.9 %
Permanent non-owner occupied	147,825	13.2	130,351	11.9	111,601	12.4	106,543	14.2	112,180	15.9
	341,966	30.5	278,655	25.5	249,435	27.7	253,772	33.8	273,193	38.8
Multifamily real estate	169,355	15.1	184,902	16.9	123,250	13.7	122,747	16.3	116,014	16.5
Commercial real estate	373,819	33.3	361,842	33.0	303,694	33.7	244,211	32.5	239,211	34.0
Construction/land: (1)										
One-to-four family residential	86,604	7.7	87,404	8.0	67,842	7.5	52,233	7.0	20,360	2.9
Multifamily	83,642	7.4	108,439	9.9	111,051	12.4	46,666	6.2	22,352	3.1
Commercial real estate	18,300	1.6	5,325	0.5	—	—	—	—	10,400	1.5
Land	6,740	0.7	36,405	3.3	30,055	3.3	17,058	2.3	11,949	1.7
	195,286	17.4	237,573	21.7	208,948	23.2	115,957	15.5	65,061	9.2
Business	30,486	2.7	23,087	2.1	7,938	0.9	7,604	1.0	3,783	0.5
Consumer	12,970	1.0	9,133	0.8	6,922	0.8	6,979	0.9	7,130	1.0
Total loans	1,123,882	100.0%	1,095,192	100.0%	900,187	100.0%	751,270	100.0%	704,392	100.0%
Less:										
Loans in process ("LIP")	86,453		92,498		72,026		53,854		27,359	
Deferred loan fees, net	1,178		1,150		2,167		2,881		2,604	
Allowance for loan and lease losses ("ALLL")	13,347		12,882		10,951		9,463		10,491	
Loans receivable, net	$1,022,904		$988,662		$815,043		$685,072		$663,938	

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(1) Included in the construction/land category are "rollover" loans, which are loans that will convert upon completion of the construction period to permanent loans. At December 31, 2018, we included rollover loans of $1.7 million of one-to-four family residential loans, $66.6 million of multifamily loans and $18.3 million of commercial real estate loans in the construction/land category. In addition, the construction/land category included $6.2 million of loans for raw land or buildable lots where the Company does not intend to finance the construction.

The following table shows the composition of our loan portfolio by fixed- and adjustable-rate loans at the dates indicated.

	December 31,									
	2018		2017		2016		2015		2014	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
FIXED-RATE LOANS	(Dollars in thousands)									
Real estate:										
One-to-four family residential	$185,755	16.6 %	$177,086	16.2 %	$169,523	18.8 %	$172,951	23.0 %	$189,399	26.9 %
Multifamily	68,737	6.1	77,824	7.1	72,593	8.1	82,767	11.0	82,639	11.7
Commercial real estate	179,838	16.0	208,898	19.1	211,054	23.4	199,101	26.5	206,395	29.3
Construction/land	51,738	4.6	55,169	5.0	50,431	5.6	12,158	1.6	5,469	0.8
Total real estate	486,068	43.3	518,977	47.4	503,601	55.9	466,977	62.1	483,902	68.7
Business	13,760	1.2	9,097	0.8	640	0.1	243	—	375	0.1
Consumer	1,018	0.1	136	—	432	0.1	558	0.1	689	0.1
Total fixed-rate loans	500,846	44.6	528,210	48.2	504,673	56.1	467,778	62.2	484,966	68.9
ADJUSTABLE-RATE LOANS										
Real estate:										
One-to-four family residential	156,211	13.9	101,569	9.3	79,912	8.9	80,821	10.8	83,794	11.9
Multifamily	100,618	9.0	107,078	9.8	50,657	5.6	39,980	5.3	33,375	4.7
Commercial real estate	193,981	17.2	152,944	14.0	92,640	10.3	45,110	6.0	32,816	4.6
Construction/land	143,548	12.8	182,404	16.6	158,517	17.6	103,799	13.8	59,592	8.5
Total real estate	594,358	52.9	543,995	49.7	381,726	42.4	269,710	35.9	209,577	29.7
Business	16,726	1.4	13,990	1.3	7,298	0.8	7,361	1.0	3,408	0.5
Consumer	11,952	1.1	8,997	0.8	6,490	0.7	6,421	0.9	6,441	0.9
Total adjustable-rate loans	623,036	55.4	566,982	51.8	395,514	43.9	283,492	37.8	219,426	31.1
Total loans	1,123,882	100.0%	1,095,192	100.0%	900,187	100.0%	751,270	100.0%	704,392	100.0%
Less:										
LIP	86,453		92,498		72,026		53,854		27,359	
Deferred loan fees, net	1,178		1,150		2,167		2,881		2,604	
ALLL	13,347		12,882		10,951		9,463		10,491	
Loans receivable, net	$1,022,904		$988,662		$815,043		$685,072		$663,938	

Geographic Distribution of our Loans. The following table shows the geographic distribution of our loan portfolio, net of LIP, in dollar amounts and percentages at December 31, 2018.

	Puget Sound Region [1]		Other Washington Counties		Total in Washington State		All Other States [2]		Total	
	Amount	% of Total in Category	Amount	% of Total in Category	Amount	% of Total in Category	Amount	% of Total in Category	Amount	% of Total in Category
Real estate:	(Dollars in thousands)									
One-to-four family residential	$330,331	96.6 %	$8,190	2.4 %	$338,521	99.0 %	$3,445	1.0 %	$341,966	100.0 %
Multifamily	110,573	65.3	24,270	14.3	134,843	79.6	34,512	20.4	169,355	100.0 %
Commercial	251,433	67.3	46,694	12.5	298,127	79.8	75,671	20.2	373,798	100.0 %
Construction/land	108,032	99.2	822	0.8	108,854	100.0	—	—	108,854	100.0 %
Total real estate	800,369	80.6	79,976	8.0	880,345	88.6	113,628	11.4	993,973	100.0 %
Business	14,485	47.6	1,295	4.2	15,780	51.8	14,706	48.2	30,486	100.0 %
Consumer	12,515	96.5	455	3.5	12,970	100.0	—	—	12,970	100.0 %
Total Loans	$827,369	79.7 %	$81,726	7.9 %	$909,095	87.6 %	$128,334	12.4 %	$1,037,429	100.0 %

[1] Includes King, Snohomish, Pierce and Kitsap counties.

[2] Includes loans in California, Utah, Arizona and Oregon and 19 other states.

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One-to-Four Family Residential Lending. As of December 31, 2018, $342.0 million, or 30.5% of our total loan portfolio consisted of loans secured by one-to-four family residences.

First Financial Northwest Bank is a traditional portfolio lender when it comes to financing residential home loans. In 2018, we originated $119.9 million and purchased $1.2 million in one-to-four family residential loans. At December 31, 2018, $194.2 million, or 56.8% of our one-to-four family residential portfolio consisted of owner occupied loans with the remaining $147.8 million, or 43.2% consisting of non-owner occupied loans. In addition, at December 31, 2018, $185.8 million, or 54.3% of our one-to-four family residential loan portfolio consisted of fixed-rate loans. Substantially all of our one-to-four family residential loans require monthly principal and interest payments.

Our fixed-rate, one-to-four family residential loans are generally originated with 15 to 30 year terms, although such loans typically remain outstanding for substantially shorter periods, particularly in the current low interest rate environment. We also originate hybrid loans with initial fixed-rate terms of five to ten years that convert to variable-rate which adjusts annually thereafter. In addition, substantially all of our one-to-four family residential loans contain due-on-sale clauses that allow us to declare the unpaid amount due and payable upon the sale of the property securing the loan. Typically, we enforce these due on sale clauses to the extent permitted by law and as a standard course of business. The average period of time a loan is outstanding is a function of, among other factors, the level of purchase and sale activity in the real estate market, prevailing interest rates, and the interest rates payable on outstanding loans.

Our lending policy generally limits the maximum loan-to-value ratio on mortgage loans secured by one-to-four family residential properties to 85% of the lesser of the appraised value or the purchase price. Properties securing our one-to-four family residential loans are appraised by independent appraisers approved by us. We require the borrowers to obtain title insurance and if necessary, flood insurance. We generally do not require earthquake insurance due to competitive market factors.

Loans secured by rental properties represent potentially higher risk and, as a result, we adhere to more stringent underwriting guidelines. Of primary concern in non-owner occupied real estate lending is the consistency of rental income of the property. Payments on loans secured by rental properties depend primarily on the tenants' continuing ability to pay rent to the property owner, the character of the borrower or, if the property owner is unable to find a tenant, the property owner's ability to repay the loan without the benefit of a rental income stream. In addition, successful operation and management of non-owner occupied properties, including property maintenance standards, may affect repayment. As a result, repayment of such loans may be subject to adverse conditions in the real estate market or the economy. We request that borrowers and loan guarantors, if any, provide annual financial statements, a budget factoring in a rental income cash flow analysis of the borrower as well as the net operating income of the property, information concerning the borrower's expertise, credit history and profitability, and the value of the underlying property. These loans are generally secured by a first mortgage on the underlying collateral property along with an assignment of rents and leases. If the borrower has multiple rental property loans with us, the loans are typically not cross collateralized. At December 31, 2018, $382,000 of one-to-four family residential loans were in nonaccrual status, although $110,000 of these loans were performing in accordance with their repayment terms at that date.

Multifamily and Commercial Real Estate Lending. As of December 31, 2018, $169.4 million, or 15.1% of our total loan portfolio was secured by multifamily and $373.8 million, or 33.3% of our loan portfolio was secured by commercial real estate properties. Our commercial real estate loans are typically secured by office and medical buildings, retail shopping centers, mini-storage facilities, industrial use buildings and warehouses. Commercial real estate and multifamily loans are subject to similar underwriting standards and processes. These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate.

Typically, multifamily and commercial real estate loans have higher balances, are more complex to evaluate and monitor, and involve a greater degree of risk than one-to-four-family residential loans. In an attempt to compensate for and mitigate this risk, these loans are generally priced at higher interest rates than one-to-four family residential loans and generally have a maximum loan-to-value ratio of 80% of the lesser of the appraised value or purchase price. We generally require loan guarantees by any parties with a property ownership interest of 20% or more. If the borrower is a corporation or partnership, we generally require personal guarantees from the principals based upon a review of their personal financial statements and individual credit reports.

The following table presents a breakdown of our multifamily and commercial real estate loan portfolio at December 31, 2018, and 2017:

	December 31, 2018			December 31, 2017		
	Amount	% of Total in Portfolio		Amount	% of Total in Portfolio	
	(Dollars in thousands)					
Multifamily real estate:						
Multifamily, general	$155,279	91.7	%	$177,882	96.2	%
Micro-unit apartments	14,076	8.3	%	7,020	3.8	
Total multifamily	$169,355	100.0	%	$184,902	100.0	%
Commercial real estate:						
Office	$100,495	26.9		$112,327	31.0	%
Retail	131,222	35.1		129,875	35.9	
Storage	32,462	8.7		32,201	8.9	
Motel	28,035	7.5		10,684	3.0	
Warehouse	25,398	6.8		22,701	6.3	
Nursing home [(1)]	16,315	4.4		16,591	4.6	
Mobile home park	16,003	4.3		19,970	5.5	
Other non-residential	23,889	6.3		17,493	4.8	
Total non-residential	$373,819	100.0	%	$361,842	100.0	%

[(1)] LIP for nursing home loans at December 31, 2018 and 2017 was $21,000 and $544,000, respectively.

The average loan size in our multifamily and commercial real estate loan portfolios was $1.0 million and $2.0 million, respectively, as of December 31, 2018. At this date, $58.8 million, or 34.7%, of our multifamily loans and $122.4 million, or 32.7%, of our commercial real estate loans were located outside of our primary market area. We currently target individual multifamily, and commercial real estate loans between $1.0 million and $5.0 million. The largest multifamily loan as of December 31, 2018, was a 105-unit apartment complex with a net outstanding principal balance of $8.7 million located in King County, Washington. As of December 31, 2018, the largest commercial real estate loan had a net outstanding balance of $13.3 million and was secured by an office building located in King County, Washington. Both of these loans were performing according to their respective loan repayment terms as of December 31, 2018.

The credit risk related to multifamily and commercial real estate loans is considered to be greater than the risk related to one-to-four family residential loans because the repayment of multifamily and commercial real estate loans typically is dependent on the income stream from the real estate securing the loan as collateral and the successful operation of the borrower’s business, that can be significantly affected by adverse conditions in the real estate markets or in the economy. For example, if the cash flow from the borrower’s project is reduced due to leases not being obtained or renewed, the borrower’s ability to repay the loan may be impaired. In addition, many of our multifamily and commercial real estate loans are not fully amortizing and contain large balloon payments upon maturity. These balloon payments generally require the borrower to either refinance or occasionally sell the underlying property in order to make the balloon payment.

If we foreclose on a multifamily or commercial real estate loan, our holding period for the collateral typically is longer than for one-to-four family residential mortgage loan foreclosures because there are fewer potential purchasers of the collateral. Our multifamily and commercial real estate loans generally have relatively large balances to single borrowers or related groups of borrowers. Accordingly, if we make any errors in judgment in the collectability of our multifamily or commercial real estate loans, any resulting charge-offs may be larger on a per loan basis than those

incurred in our one-to-four family residential or consumer loan portfolios. At December 31, 2018, there were no multifamily loans past due 90 days or more, or in nonaccrual status. There was one commercial real estate loan with an outstanding balance of $326,000 that was in nonaccrual status and in the process of foreclosure at December 31, 2018. However, this loan was subsequently paid in full in January 2019. There were no multifamily or commercial real estate loans charged-off during the years ended December 31, 2018, 2017 and 2016.

Construction/Land Loans. We originate construction/land loans primarily to residential builders for the construction of single-family residences, condominiums, townhouses, multifamily properties and residential developments located in our market area. Land loans include land non-development loans for the purchase or refinance of unimproved land held for future residential development, improved residential lots held for speculative investment purposes or lines of credit secured by land, and land development loans. Construction/land loans to builders generally require the borrower to have an existing relationship with the Bank and a proven record of successful projects. At December 31, 2018, our total construction/land loans were $195.3 million, or 17.4% of our total loan portfolio. The balance of our construction/land loans decreased from $237.6 million, or 21.7% of our total loans, at December 31, 2017 as loan payoffs exceeded loan originations. The Company's strategic plan projects an increase in construction loan origination activity in 2019 as we renew our focus on these loans. The Bank's lending policy sets forth the guideline that the balance of our acquisition, development, and construction loans, net of LIP and deferred fees and costs, not exceed 100% of the Bank's risk-based capital. Management intends to maintain levels near this guideline, however the uncertainty of the timing associated with construction loan draws occasionally results in the actual concentration exceeding the guideline. At December 31, 2018, the Bank's net acquisition, development, and construction loans totaled $114.9 million, for a concentration of 81.9%. There were no construction/land loans classified as nonaccrual at either December 31, 2018 or 2017. There were no construction/land loan charge-offs during the years ended December 31, 2018, 2017 and 2016, respectively.

Following is the composition of our total construction/land loan portfolio at the dates indicated. All of the loans represented were performing:

	December 31,	
	2018	2017
	(In thousands)	
Construction speculative:		
One-to-four family residential	$84,916	$84,834
Multifamily	17,017	9,985
Total construction speculative	101,933	94,819
Construction permanent: [1]		
One-to-four family residential	1,688	2,570
Multifamily	66,625	98,454
Commercial real estate	18,300	5,325
Total construction permanent	86,613	106,349
Land:		
Land development	500	528
Land non-development	6,240	35,877
Total land	6,740	36,405
Total construction/land loans [2]	$195,286	$237,573

[1] Includes loans where the builder does not intend to sell the property after the construction phase is completed.
[2] LIP for construction/land loans at December 31, 2018, and 2017, was $86.4 million and $92.0 million, respectively.

The following table includes construction/land loans by county, net of LIP, at December 31, 2018:

County	Loan Balance	Percent of Construction/Land Loan Balance	
	(Dollars in thousands)		
King	$94,331	86.6	%
Snohomish	1,933	1.8	
Pierce	9,145	8.4	

Kitsap	2,623	2.4	
All other	822	0.8	
Total	$108,854	100.0	%

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Loans to finance the construction of single-family homes, subdivisions and land loans are generally offered to builders in our primary market areas. Loans that are termed "speculative" are those where the builder does not have, at the time of loan origination, a signed contract with a buyer for the home or lot who has a commitment for permanent financing with either us or another lender. The buyer may be identified either during or after the construction period, with the risk that the builder may have to fund the debt service on the speculative loan along with real estate taxes and other carrying costs for the project for a significant period of time after completion of the project until a buyer is identified. The maximum loan-to-value ratio applicable to these loans is generally 100% of the actual cost of construction, provided that the loan-to-completed value does not exceed 80%, with approval required from the Chief Credit Officer ("CCO") for loan-to-value ratios over 80%. In addition, a minimum of 20% verified equity is generally also required. Verified equity refers to cash equity invested in the project. Development plans are required from builders prior to committing to the loan. We require that builders maintain adequate title insurance and other appropriate insurance coverage, and, if applicable, appropriate environmental data report(s) that the land is free of hazardous or toxic waste. While maturity dates for residential construction loans are largely a function of the estimated construction period of the project and typically do not exceed one year, land loans generally are for 12 to 18 months. Substantially all of our residential construction loans have adjustable-rates of interest based on The Wall Street Journal prime rate. During the term of construction, the accumulated interest on the loan is either added to the principal of the loan through an interest reserve or billed monthly. At December 31, 2018, the LIP balance on construction/land loans was $86.4 million, including $6.2 million set aside for interest reserves. When these loans exhaust their original reserves set up at origination, no additional reserves are permitted unless the loan is re-analyzed and it is determined that the additional reserves are appropriate, based on the updated analysis. Construction loan proceeds are disbursed periodically as construction progresses and as inspections by our approved inspectors warrant. At December 31, 2018, our three largest construction/land loans, net of LIP, consisted of an $8.9 million commercial real estate construction loan, a $6.7 million multifamily construction loan, and a $5.7 million multifamily construction loan. All three loans will rollover to a permanent loan at the completion of the construction period and all three properties are located in King County.

Our residential construction loans to borrowers for one-to-four family, non-owner occupied residences typically are structured to be converted to fixed-rate permanent loans at the end of the construction phase with one closing for both the construction loan and the permanent financing. Prior to making a commitment to fund a construction loan, we require an appraisal of the post construction value of the project by an independent appraiser. During the construction phase, which typically lasts 12 to 18 months, an approved inspector or designated Bank employee makes periodic inspections of the construction site to certify construction has reached the stated percentage of completion. Typically, disbursements are made in monthly draws and interest-only payments are required. These loans are converted to fixed-rate permanent loans at the end of the construction phase. At December 31, 2018, there was one non-owner occupied construction loan of $1.7 million that will rollover to a permanent non-owner occupied one to four family residential loan in 2020.

We also make construction loans for commercial development projects. The projects include multifamily, retail, office/warehouse and office buildings. These loans typically have an interest-only payment phase during construction and generally convert to permanent financing when construction is complete. Disbursement of funds is at our sole discretion and is based on the progress of construction. The Bank uses an independent third party or Bank employee to conduct monthly inspections to certify that construction has reached the stated percentage of completion and that previous disbursements are reflected in the degree of work performed to date. Generally, the maximum loan-to-value ratio applicable to these loans is 90% of the actual cost of construction or 80% of the prospective value at completion. At December 31, 2018, $84.9 million of multifamily and commercial real estate construction loans will rollover to permanent loans with the Bank at the end of their construction period.

Land development loans are generally made to builders for preparation of a building site and do not include the construction of buildings on the property. The maximum loan-to-value ratio for these loans is 75%. Land non-development loans are generally for raw land where we do not finance the cost of preparing the site for building

and are subject to a maximum loan to value ratio of 65%.

Our construction/land loans are based upon estimates of costs in relation to values associated with the completed project. Construction/land lending involves additional risks when compared with permanent residential lending because funds are advanced upon the collateral for the project based on an estimate of costs that will produce a future value at completion. Because of the uncertainties inherent in estimating construction costs, as well as the market value of the completed project and the effects of governmental regulation on real property, it is relatively difficult to evaluate accurately the total funds required to complete a project and the completed project loan-to-value ratio. Changes in the demand, such as for new housing and higher than anticipated building costs may cause actual results to vary significantly from those estimated. For these reasons, this type of lending also typically involves higher loan principal amounts and is often concentrated with a small number of builders. These loans often involve the disbursement of funds with repayment substantially dependent on the success of the ultimate project and the ability of the borrower to sell or lease the property or obtain permanent take-out financing, rather than the ability of the borrower or guarantor to repay principal and interest. If our appraisal of the value of a completed project proves to be overstated, we may have inadequate security for the repayment of the loan upon completion of construction of the project and may incur a loss. Because

construction loans require active monitoring of the building process, including cost comparisons and on-site inspections, these loans are more difficult and costly to monitor. Increases in market rates of interest may have a more pronounced effect on construction loans by rapidly increasing the end-purchasers' borrowing costs, thereby reducing the overall demand for the project. Properties under construction are often difficult to sell and typically must be completed in order to be successfully sold which also complicates the process of working out problem construction loans. This may require us to advance additional funds and/or contract with another builder to complete construction. Furthermore, in the case of speculative construction loans, there is the added risk associated with identifying an end-purchaser for the finished project. Land loans also pose additional risk because of the lack of income being produced by the property and the potential illiquid nature of the collateral. These risks can also be significantly influenced by supply and demand conditions.

Business Lending. Business loans totaled $30.5 million, or 2.7% of the loan portfolio at December 31, 2018. Business loans are generally secured by business equipment, accounts receivable, inventory or other property. Loan terms typically vary from one to five years. The interest rates on such loans are either fixed-rate or adjustable-rate. The interest rates for the adjustable rate loans are indexed to the prime rate published in The Wall Street Journal plus a margin. Our business lending policy includes credit file documentation and requires analysis of the borrower's background, capacity to repay the loan, the adequacy of the borrower's capital and collateral, as well as an evaluation of other conditions affecting the borrower. Analysis of the borrower's past, present and future cash flows is also an important aspect of our credit analysis. We generally obtain personal guarantees on our business loans. The largest business loan had an outstanding balance of $9.8 million at December 31, 2018 and was performing according to its repayment terms. At December 31, 2018, we did not have any business loans delinquent in excess of 90 days or in nonaccrual status.

At December 31, 2018, the Bank's aircraft loan portfolio had an outstanding balance of $11.1 million, or 36.3% of total business loans. We intend to grow this portfolio over the coming years. These loans are collateralized by new or used, single engine piston aircraft to light jets for business or personal use. We anticipate that our aircraft loans will range in size from $250,000 to $3.0 million with the primary focus of our underwriting guidelines on the asset value of the collateral rather than the ability of the borrower to repay the loan. The average loan size in our aircraft loan portfolio was $582,000 as of December 31, 2018.

Repayments of business loans are often dependent on the cash flows of the borrower, which may be unpredictable, and the collateral securing these loans may fluctuate in value. Our business loans are originated primarily based on the identified cash flow of the borrower and secondarily on the underlying collateral provided by the borrower. Credit support provided by the borrower for most of these loans and the probability of repayment is based on the liquidation of the pledged collateral and enforcement of a personal guarantee, if any. As a result, in the case of loans secured by accounts receivable, the availability of funds for the repayment of these loans may be substantially dependent on the ability of the borrower to collect amounts due from its customers. The collateral securing business loans may depreciate over time, may be difficult to appraise, or may fluctuate in value based on the success of the business.

Consumer Lending. We offer a limited variety of consumer loans to our customers, consisting primarily of home equity loans and savings account loans. Generally, consumer loans have shorter terms to maturity and higher interest rates than one to four family residential loans. Consumer loans are offered with both fixed and adjustable interest rates and with varying terms. At December 31, 2018, consumer loans were $13.0 million, or 1.0% of the total loan portfolio.

At December 31, 2018, the largest component of the consumer loan portfolio consisted of home equity loans, primarily home equity lines of credit that totaled $11.2 million, or 86.1% of the total consumer loan portfolio. The home equity lines of credit include $4.7 million of equity lines of credit in first lien position and $6.5 million of second liens on residential properties. At December 31, 2018, unfunded commitments on our home equity lines of credit totaled $17.1 million. Home equity loans are made for purposes such as the improvement of residential

properties, debt consolidation and education expenses. At origination, the loan-to-value ratio is generally 90% or less, when taking into account both the balance of the home equity loans and the first mortgage loan. Home equity loans are originated on a fixed-rate or adjustable-rate basis. The interest rate for the adjustable-rate second lien loans is indexed to the prime rate published in The Wall Street Journal and may include a margin. Home equity loans generally have a 10 to 30 year term, with a 10 year draw period, and either convert to principal and interest payments with no further draws or require a balloon payment due at maturity.

Consumer loans entail greater risk than one-to-four family residential mortgage loans, particularly in the case of consumer loans that are unsecured or secured by rapidly depreciating assets. In these cases, any repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment of the outstanding loan balance as a result of the greater likelihood of damage, loss or depreciation. The remaining deficiency often does not warrant further collection efforts against the borrower beyond obtaining a deficiency judgment. In addition, consumer loan collections are dependent on the borrower’s continuing financial stability and are more likely to be adversely affected by job loss, divorce, illness or personal bankruptcy. Furthermore, the application of various federal and state laws, including federal and state bankruptcy and insolvency laws, may limit the amount

that can be recovered on these loans. Home equity lines of credit have greater credit risk than one-to-four family residential mortgage loans because they are generally secured by mortgages subordinated to the existing first mortgage on the property that we may or may not hold in our portfolio. We do not have private mortgage insurance coverage on these loans. Adjustable-rate loans may experience a higher rate of default in a rising interest rate environment due to the increase in payment amounts when interest rates reset higher. If current economic conditions deteriorate for our borrowers and their home prices fall, we may also experience higher credit losses from this loan portfolio. For our home equity loans that are in a second lien position, it is unlikely that we will be successful in recovering our entire loan principal outstanding in the event of a default. At December 31, 2018, one consumer loan totaling $44,000 was in nonaccrual status, however, no consumer loans were delinquent more than 30 days. During the years ended December 31, 2018, and 2017, there were no consumer loans charged-off. In comparison, for the year ended December 31, 2016, consumer loans totaling $83,000 were charged off.

Loan Maturity and Repricing. The following table sets forth certain information at December 31, 2018, regarding the amount of total loans in our portfolio based on their contractual terms to maturity, not including prepayments.

	Within One Year	After One Year Through Three Years	After Three Years Through Five Years	After Five Years Through Ten Years	Beyond Ten Years	Total
	(In thousands)					
Real estate:						
One-to-four family residential	$17,207	$15,231	$3,690	$10,753	$295,085	$341,966
Multifamily	22,299	7,873	18,994	67,638	52,551	169,355
Commercial	35,611	51,350	30,680	212,793	43,385	373,819
Construction/land	88,257	35,399	30,732	23,560	17,338	195,286
Total real estate	163,374	109,853	84,096	314,744	408,359	1,080,426
Business	376	16,126	9,578	4,406	—	30,486
Consumer	2,249	1,097	290	—	9,334	12,970
Total	$165,999	$127,076	$93,964	$319,150	$417,693	$1,123,882

The following table sets forth the amount of total loans due after December 31, 2019, with fixed or adjustable interest rates.

	Fixed-Rate	Adjustable-Rate	Total
	(In thousands)		
Real estate:			
One-to-four family residential	$180,076	$ 144,683	$324,759
Multifamily	48,845	98,211	147,056
Commercial	167,807	170,401	338,208
Construction/land	44,823	62,206	107,029
Total real estate	441,551	475,501	917,052
Business	13,640	16,470	30,110
Consumer	1,010	9,711	10,721
Total	$456,201	$ 501,682	$957,883

Loan Solicitation and Processing. The majority of our consumer and residential mortgage loan originations are generated through the Bank and from time to time through outside brokers and correspondent relationships we have established with select mortgage companies or other financial institutions. We originate multifamily, commercial real estate, construction/land and business loans primarily using the Bank’s loan officers, with referrals coming from builders, brokers and existing customers.

Upon receipt of a loan application from a prospective borrower, we obtain a credit report and other data to verify specific information relating to the loan applicant's employment, income, and credit standing. All real estate loans requiring an appraisal are done by an independent third-party appraiser. All appraisers are approved by us, and their credentials are reviewed annually, as is the quality of their appraisals.

We use a multi-level approval matrix which establishes lending targets and tolerance levels depending on the loan type being approved. The matrix also sets minimum credit standards and approval limits for each of the loan types.

Lending Authority. The Directors' Loan Committee consists of at least three members of the Board of Directors. The Directors' Loan Committee recommends for approval by the Board of Directors exceptions to the aggregate loan limit to one borrower of 15% of total risk-based capital, or $21.0 million at December 31, 2018. The Board of Directors approves exceptions to such aggregate loan limit to one borrower up to 20% of total risk-based capital, or $28.0 million at December 31, 2018.

Officer Lending Authority. Individual signing authority has been delegated to two lending officers. Our Senior Credit Approval Officer ("SCAO") has authority from the Board of Directors to approve loans and aggregate relationships up to and including $3.0 million. The Board of Directors has given our Chief Credit Officer ("CCO") authority to approve credit to one borrower not to exceed our aggregate loan limit of 15% of total risk-based capital.

Loan Originations, Servicing, Purchases, Sales and Repayments. For the years ended December 31, 2018, 2017 and 2016, our total loan originations and purchases were $370.8 million, $430.7 million and $420.8 million, respectively.

One-to-four family residential loans are generally originated in accordance with the guidelines established by Freddie Mac and Fannie Mae, with the exception of our special community development loans originated to satisfy compliance with the Community Reinvestment Act. Our loans are underwritten by designated real estate loan underwriters internally in accordance with standards as provided by our Board-approved loan policy. We require title insurance on all loans and fire and casualty insurance on all secured loans and home equity loans where real estate serves as collateral. Flood insurance is also required on all secured loans when the real estate is located in a flood zone.

The following table shows total loans originated, purchased, repaid and other changes during the periods indicated.

	Year Ended December 31,		
	2018	2017	2016
	(In thousands)		
Loan originations:			
Real estate:			
One-to-four family residential	$119,946	$89,622	$59,222
Multifamily	8,363	20,612	22,914
Commercial	47,332	49,524	92,495
Construction/land	118,237	138,591	165,363
Total real estate	293,878	298,349	339,994
Business	21,361	23,438	13,998
Consumer	14,524	9,379	5,674
Total loans originated	329,763	331,166	359,666
Loan purchases and participations:			
One-to-four family residential	1,230	3,087	7,352
Multifamily	3,705	45,340	11,761
Commercial	21,546	46,802	41,990
Construction/land	4,582	1,100	—
Business	10,000	3,177	—
Total loan purchases and participations [1]	41,063	99,506	61,103
Principal repayments	(342,136)	(235,667)	(271,768)
Charge-offs	—	—	(83)
Loans transferred to other real estate owned ("OREO")	—	—	—

Change in LIP, net deferred fees, and ALLL	5,552	(21,386)	(18,947)
Net increase in loans	$34,242	$173,619	$129,971

[1] Includes $19.9 million, $76.2 million and $61.1 million in loan purchases during 2018, 2017 and 2016 respectively.

Loan Origination and Other Fees. In some instances, we receive loan origination fees on real estate-related products. Loan fees generally represent a percentage of the principal amount of the loan and are paid by the borrower. The amount of fees charged to the borrower on one-to-four family residential loans and multifamily and commercial real estate loans can range from 0% to 2%. United States generally accepted accounting principles require that certain fees received, net of certain origination costs, be deferred and amortized over the contractual life of the loan. Net deferred fees or costs associated with loans that are prepaid or sold are recognized in income at the time of prepayment or sale. We had $1.2 million of net deferred loan fees at both December 31, 2018, and 2017.

Loan purchases generally include a premium, which is deferred and amortized into interest income with net deferred fees over the contractual life of the loan. During 2018, total premiums of $630,000, or 3.2% of the purchased principal, were paid on purchased loans. In comparison, premiums of $1.8 million, or 2.3% of the purchased principal were paid on purchased loans during 2017.

One-to-four family residential and consumer loans are generally originated without a prepayment penalty. The majority of our multifamily and commercial real estate loans, however, have prepayment penalties associated with the loans. Most of the multifamily and commercial real estate loan originations with interest rates fixed for the first five years will adjust thereafter and have a prepayment penalty of 2% - 3% of the principal balance in year one, with decreasing penalties in subsequent years. Longer initial fixed rate terms generally have correspondingly longer prepayment penalty periods.

Asset Quality

As of December 31, 2018, we had two owner occupied one-to-four family residential loans totaling $495,000 and one commercial real estate loan of $326,000 past due 30 days or more. These loans represented 0.08% of total loans, net of LIP. Subsequent to December 31, 2018, the $326,000 nonperforming commercial real estate loan was paid in full. We generally assess late fees or penalty charges on delinquent loans of up to 5.0% of the monthly payment. The borrower is given up to a 15 day grace period from the due date to make the loan payment.

We handle collection procedures internally or with the assistance of outside legal counsel. Late charges are incurred when the loan exceeds 10 to 15 days past due depending upon the loan product. When a delinquent loan is identified, corrective action takes place immediately. The first course of action is to determine the cause of the delinquency and seek cooperation from the borrower in resolving the issue. Additional corrective action, if required, will vary depending on the borrower, the collateral, if any, and whether the loan requires specific handling procedures as required by the Washington State Deed of Trust Act.

If the borrower is chronically delinquent and all reasonable means of obtaining payments have been exhausted, we will seek to foreclose on the collateral securing the loan according to the terms of the security instrument and applicable law. The following table shows our delinquent loans by the type of loan, net of LIP, and the number of days delinquent at December 31, 2018:

	Loans Delinquent							
	30-59 Days		60-89 Days		90 Days and Greater		Total Delinquent Loans	
	Number of Loans	Principal Balance	Number of Loans	Principal Balance	Number of Loans	Principal Balance	Number of Loans	Principal Balance
	(Dollars in thousands)							
Real estate:								
One-to-four family residential:								
Owner occupied	1	$ 223	1	$ 272	—	$ —	2	$ 495

Commercial	—	—	1	326	—	—	1	326
Total	1	$ 223	2	$ 598	—	$ —	3	$ 821

Construction/land, commercial real estate, and multifamily loans generally have larger individual loan amounts that have a greater single impact on asset quality in the event of delinquency or default. We continue to monitor our loan portfolio and believe additions to nonperforming loans, charge-offs, provisions for loan losses, and/or OREO are possible in the future, particularly if the housing market and other economic conditions do not continue to improve.

The following table sets forth information with respect to our nonperforming assets and troubled debt restructured loans ("TDRs") for the periods indicated. All loan balances and ratios are calculated using loan balances that are net of LIP.

	December 31,				
	2018	2017	2016	2015	2014
	(Dollars in thousands)				
Loans accounted for on a nonaccrual basis:					
Real estate:					
One-to-four family residential	$382	$128	$798	$996	$830
Commercial	326	—	—	—	434
Consumer	44	51	60	89	75
Total loans accounted for on a nonaccrual basis	752	179	858	1,085	1,339
Total nonperforming loans	752	179	858	1,085	1,339
OREO	483	483	2,331	3,663	9,283
Total nonperforming assets	$1,235	$662	$3,189	$4,748	$10,622
TDRs:					
Nonaccrual [1]	$—	$—	$174	$131	$—
Performing	9,399	17,805	30,083	42,128	54,241
Total TDRs	$9,399	$17,805	$30,257	$42,259	$54,241
Nonperforming loans as a percent of total loans, net of LIP	0.07 %	0.02 %	0.10 %	0.16 %	0.20 %
Nonperforming loans as a percent of total assets	0.06	0.01	0.08	0.11	0.14
Nonperforming assets as a percent of total assets	0.10	0.05	0.31	0.48	1.13
Total loans, net of LIP	$1,037,429	$1,002,694	$828,161	$697,416	$677,033
Foregone interest on nonaccrual loans	18	26	51	103	126

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[1] These loans are also included in the appropriate loan category above under the caption: "Loans accounted for on a nonaccrual basis."

Nonperforming Loans. When a loan becomes 90 days past due, we generally place the loan on nonaccrual status unless the credit is well secured and in the process of collection. Loans may be placed on nonaccrual status prior to being 90 days past due if there is an identified problem such as an impending foreclosure or bankruptcy or if the borrower is unable to meet their scheduled payment obligations. Our nonperforming loans increased by $573,000, or 320.1%, at December 31, 2018, as compared to December 31, 2017, with the addition of two nonperforming loans during 2018. Subsequent to December 31, 2018, a $326,000 nonperforming commercial loan was paid in full. During 2018, there were no charge offs to nonperforming loans.

Other Real Estate Owned. Real estate acquired by us as a result of foreclosure or by deed-in-lieu of foreclosure is classified as OREO until it is sold. When the property is acquired, it is recorded at the lower of its cost or fair market value of the property, less selling costs. We had $483,000 of OREO at both December 31, 2018 and 2017 comprised of undeveloped lots. Our special assets department's primary focus is the prompt and effective management of our troubled, nonperforming assets, and expediting their disposition to minimize any potential losses. During 2018 and 2017, we did not foreclose or accept deeds-in-lieu of foreclosure on any loans. In the future, we may experience foreclosure, deed-in-lieu of foreclosure, and short sale activity while we work with our nonperforming loan customers to minimize our loss exposure.

Because of our structure, we believe we are able to make decisions regarding offers on OREO and the real estate underlying our nonperforming loans very quickly compared to larger institutions where decisions could take six to twelve months. This distinction has historically worked to our benefit in reducing our nonperforming assets and disposing of OREO.

Troubled Debt Restructured Loans. We account for certain loan modifications or restructurings as TDRs. In general, the modification or restructuring of a debt is considered a TDR if, for economic or legal reasons related to the borrower's financial difficulties, we grant a concession to the borrower that we would not otherwise consider. These loans are all considered to be impaired loans. At December 31, 2018, we had $9.4 million in TDRs as compared to $17.8 million at December 31, 2017.

Prior to 2012, we utilized a strategy for a limited number of our lending relationships of establishing an "A" and "B" note structure. We created an "A" note representing a reduced principal balance expected to be fully collected and at a debt service level and loan-to-value ratio acceptable to us. The "A" note was classified as a performing TDR as long as the borrower continued to perform in accordance with the note terms. The "B" note represented the amount of the principal reduction portion of the original note and was immediately charged-off. The "B" note is held by the Bank and when the "A" note is paid off, the Bank may proceed with collection efforts on the "B" note. During 2017, due to the improved financial condition of the borrowers holding "A" and "B" notes, and the increased market value of the underlying properties, the Bank issued revised notes that allowed for recovery of the "B" note principal, and in some cases, recognition of interest income as payments were made. In 2018, the remaining "B" notes on these agreements were paid off, resulting in recoveries of $4.3 million of previously charged off balances. At December 31, 2018, the balance of TDRs included $560,000 in remaining "A" notes.

The largest TDR relationship at December 31, 2018 totaled $1.4 million and was comprised of one to four family residential loans secured by rental properties located in Pierce County. At December 31, 2018, there was no LIP in connection with our TDRs. For additional information regarding our TDRs, see Note 4 of the Notes to Consolidated Financial Statements contained in Item 8 of this report.

The following table summarizes our total TDRs:

	December 31,	
	2018	2017
	(In thousands)	
Performing TDRs:		
One-to-four family residential	$6,941	$13,434
Multifamily	—	1,134
Commercial real estate	2,415	3,194
Consumer	43	43
Total performing TDRs	9,399	17,805
Total TDRs	$9,399	$17,805

Classified Assets. Federal regulations provide for the classification of lower quality loans and other assets as substandard, doubtful or loss. 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 have all the weaknesses inherent in those classified 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 those considered uncollectible and of such little value that their continuance as assets without the establishment of a specific loss reserve is not warranted.

When we classify problem assets as either substandard or doubtful, we may establish a specific allowance in an amount we deem prudent. General allowances represent loss allowances that have been established to recognize the inherent risk associated with lending activities, but unlike specific allowances, have not been specifically allocated to particular problem assets. When an insured institution classifies problem assets as a loss, it is required to charge-off those assets in the period in which they are deemed uncollectible. Our determinations as to the classification of our assets and the amount of our valuation allowances are subject to review by the FDIC and the DFI that can order the establishment of additional loss allowances or the charge-off of specific loans against established loss reserves. Assets that do not currently expose us to sufficient risk to warrant classification in one of the aforementioned categories but possess weaknesses are designated as special mention. At December 31, 2018, special mention loans totaled $2.5 million.

In connection with the filing of periodic reports with the FDIC and in accordance with our loan policy, we regularly review the problem loans in our portfolio to determine whether any loans require classification in accordance with applicable regulations. The decrease in our classified loans during the year ended December 31, 2018 was a result of loan repayments as well as our efforts to work with our borrowers to bring their loans current when possible or restructure the loan when appropriate. During 2018, we continued our aggressive approach to reduce nonperforming assets and improve asset quality.

Classified loans, net of LIP, consisting solely of substandard loans, were as follows at the dates indicated:

	December 31,	
	2018	2017
	(In thousands)	
One-to-four family residential	$919	$673
Commercial real estate	326	555
Consumer	44	52
Total classified loans	$1,289	$1,280

With the exception of these classified loans, of which $752,000 were accounted for as nonaccrual loans at December 31, 2018, management is not aware of any loans as of December 31, 2018, where the known credit problems of the borrower would cause us to have serious doubts as to the ability of such borrowers to comply with their present loan repayment terms and which may result in the future inclusion of such loans in the nonperforming loan categories.

Allowance for Loan Losses. Management recognizes that loan losses may occur over the life of a loan and that the ALLL must be maintained at a level necessary to absorb specific losses on impaired loans and probable losses inherent in the loan portfolio. Our methodology for analyzing the ALLL consists of two components: general and specific allowances. The general allowance is determined by applying factors to our various groups of loans. Management considers factors such as charge-off history, the prevailing economy, the borrower's ability to repay, the regulatory environment, competition, geographic and loan type concentrations, policy and underwriting standards, nature and volume of the loan portfolio, managements' experience level, our loan review and grading systems, the value of underlying collateral, and the level of problem loans in assessing the ALLL. The specific allowance component is created when management believes that the collectability of a specific loan has been impaired and a loss is probable. The specific reserves are computed using current appraisals, listed sales prices and other available information, less costs to complete, if any, and costs to sell the property. This evaluation is inherently subjective as it requires estimates that are susceptible to significant revision as more information becomes available or as future events differ from predictions. In addition, specific reserves may be created upon a loan's restructuring, based on a discounted cash flow analysis comparing the present value of the anticipated repayments under the restructured terms to the outstanding principal balance of the loan.

Quarterly, our Board of Directors' Internal Asset Review Committee reviews and recommends approval of the allowance for loan losses and any provision or recapture of provision for loan losses, and the full Board of Directors approves the provision or recapture after considering the Committee's recommendation. The allowance is increased by the provision for loan losses which is charged against current period earnings. If the analysis of our loan portfolio indicates the risk of loss is less than the balance of the ALLL, a recapture of provision of loan loss is added to current period earnings.

For the year ended December 31, 2018, we recorded a $4.0 million recapture of provision for loan losses to our ALLL, as compared to a $400,000 recapture of provision for loan losses for the year ended December 31, 2017, and a provision for loan losses of $1.3 million for the year ended December 31, 2016. The recapture of provision for loan losses in 2018 was primarily a result of the $4.5 million in net recoveries received on previously charged-off loans partially offset by the provision necessary to support the increase in total loans, net LIP, of $34.7 million. The quality of our loan portfolio was stable, with a significant decrease in TDRs and a small increase in delinquent and nonperforming loans, due primarily to our efforts working with our borrowers to bring their loan payments current whenever possible. The ALLL was $13.3 million, or 1.29% of total loans, net of LIP, at December 31, 2018, as compared to $12.9 million, or 1.28% at December 31, 2017. The level of the ALLL is based on estimates and the ultimate losses may vary from the estimates. Management reviews the adequacy of the ALLL on a quarterly basis.

A loan is considered impaired when, based on current information and events, it is probable we will be unable to collect the scheduled payments of principal or interest when due, according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, market conditions, rent rolls, and the borrower's and guarantor's, if any, financial strength. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and shortfalls on a case by case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including length of the delay, the reasons for the delay, the borrower's prior payment record and the amounts of the shortfall in relation to the principal and interest owed. Loans are evaluated for impairment on a loan-by-loan basis. As of December 31, 2018 and 2017, impaired loans were $10.1 million and $18.0 million, respectively. At December 31, 2018, there was no LIP in connection with our impaired loans.

The following table summarizes the distribution of the ALLL by loan category, at the dates indicated.

	December 31, 2018			2017			2016			2015	
	Loan Balance	Allowance by Loan Category	Percent of Loans to Total Loans	Loan Balance	Allowance by Loan Category	Percent of Loans to Total Loans	Loan Balance	Allowance by Loan Category	Percent of Loans to Total Loans	Loan Balance	Allowa by Loan Catego
Real estate:	(Dollars in thousands)										
One-to-four family residential	$341,966	$3,387	30.5 %	$278,655	$2,837	25.5 %	$249,435	$2,551	27.7 %	$253,772	$3,028
Multifamily	169,355	1,680	15.1	184,902	1,820	16.9	123,250	1,199	13.7	122,747	1,193
Commercial real estate	373,819	4,777	33.3	361,842	4,418	33.0	303,694	3,893	33.7	244,211	3,395
Construction/land	195,286	2,331	17.4	237,573	2,816	21.7	208,948	2,792	23.2	115,957	1,193
Total real estate	1,080,426	12,175	96.3	1,062,972	11,891	97.1	885,327	10,435	98.3	736,687	8,809
Business	30,486	936	2.7	23,087	694	2.1	7,938	237	0.9	7,604	229
Consumer	12,970	236	1.0	9,133	297	0.8	6,922	279	0.8	6,979	425
Total	$1,123,882	$13,347	100.0%	$1,095,192	$12,882	100.0%	$900,187	$10,951	100.0%	$751,270	$9,463

We believe that the ALLL as of December 31, 2018 was adequate to absorb the probable and inherent losses in the loan portfolio at that date. While we believe the estimates and assumptions used in our determination of the adequacy of the ALLL are reasonable, there can be no assurance that such estimates and assumptions will be proven correct in the future, or that the actual amount of future provisions will not exceed the amount of past provisions, or that any increased provisions that may be required will not adversely impact our financial condition and results of operations. Future additions to the ALLL may become necessary based upon changing economic conditions, the level of problem loans, business conditions, credit concentrations, increased loan balances or changes in the underlying collateral of the loan portfolio. In addition, the determination of the amount of the ALLL is subject to review by bank regulators as part of the routine examination process that may result in the establishment of additional loss reserves or the charge-off of specific loans against established loss reserves based upon their judgment of information available to them at the time of their examination.

The following table sets forth an analysis of our ALLL at the dates and for the periods indicated.

	At or For the Year Ended December 31,				
	2018	2017	2016	2015	2014
	(Dollars in thousands)				
ALLL at beginning of period	$12,882	$10,951	$9,463	$10,491	$12,994
(Recapture of provision) provision for loan losses	(4,000)	(400)	1,300	(2,200)	(2,100)
Charge-offs:					
One-to-four family residential	—	—	—	(27)	(78)