First Financial Northwest, Inc.
Form 10-Q
August 07, 2017

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, 2017

or

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

For the transition period from ____________ to ____________

Commission File Number: 001-33652

FIRST FINANCIAL NORTHWEST, INC.
(Exact name of registrant as specified in its charter)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES X NO

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

YES X NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, 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 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 3, 2017, 11,039,665 shares of the issuer’s common stock, $0.01 par value per share, were outstanding.

FIRST FINANCIAL NORTHWEST, INC.
FORM 10-Q
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FIRST FINANCIAL NORTHWEST, INC. AND SUBSIDIARIES
Consolidated Balance Sheets
(Dollars in thousands, except share data)

Part 1. Financial Information

Item 1. Financial Statements

Assets	June 30, 2017 (Unaudited)	December 31, 2016
Cash on hand and in banks	$7,418	$5,779
Interest-earning deposits with banks	10,996	25,573
Investments available-for-sale, at fair value	133,951	129,260
Loans receivable, net of allowance of $11,285 and $10,951	861,672	815,043
Federal Home Loan Bank ("FHLB") stock, at cost	8,902	8,031
Accrued interest receivable	3,165	3,147
Deferred tax assets, net	2,620	3,142
Other real estate owned ("OREO")	1,825	2,331
Premises and equipment, net	19,501	18,461
Bank owned life insurance ("BOLI"), net	28,721	24,153
Prepaid expenses and other assets	2,937	2,664
Total assets	$1,081,708	$1,037,584
Liabilities and Stockholders' Equity		
Deposits:		
Noninterest-bearing deposits	$35,126	$33,422
Interest-bearing deposits	700,449	684,054
Total deposits	735,575	717,476
FHLB Advances	191,500	171,500
Advance payments from borrowers for taxes and insurance	2,183	2,259
Accrued interest payable	286	231
Other liabilities	8,650	7,993
Total liabilities	938,194	899,459
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 11,041,865 shares at June 30, 2017, and 10,938,251 shares at December 31, 2016	110	109
Additional paid-in capital	98,469	96,852
Retained earnings, substantially restricted	51,844	48,981
Accumulated other comprehensive loss, net of tax	(984)	(1,328)
Unearned Employee Stock Ownership Plan ("ESOP") shares	(5,925)	(6,489)
Total stockholders' equity	143,514	138,125
Total liabilities and stockholders' equity	$1,081,708	$1,037,584

See accompanying selected notes to consolidated financial statements.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Interest income				
Loans, including fees	$10,352	$ 9,048	$20,379	$ 17,775
Investments available-for-sale	887	757	1,732	1,432
Interest-earning deposits with banks	42	47	86	160
Dividends on FHLB stock	62	44	144	91
Total interest income	11,343	9,896	22,341	19,458
Interest expense				
Deposits	1,776	1,441	3,467	2,924
FHLB advances and other borrowings	570	272	1,015	570
Total interest expense	2,346	1,713	4,482	3,494
Net interest income	8,997	8,183	17,859	15,964
Provision for loan losses	100	600	300	500
Net interest income after provision for loan losses	8,897	7,583	17,559	15,464
Noninterest income				
Net gain on sale of investments	56	—	56	—
BOLI income	116	225	317	391
Wealth management revenue	307	281	447	491
Other	252	202	446	306
Total noninterest income	731	708	1,266	1,188
Noninterest expense				
Salaries and employee benefits	4,409	3,841	8,694	7,615
Occupancy and equipment	579	488	1,059	996
Professional fees	482	561	921	1,029
Data processing	519	251	759	441
(Gain) loss on sale of OREO property, net	(5)	89	(5)	87
OREO market value adjustments	—	—	50	257
OREO related reimbursements, net	(15)	(14)	(25)	(34)
Regulatory assessments	112	117	208	237
Insurance and bond premiums	98	86	197	174
Marketing	52	40	100	78
Other general and administrative	605	613	946	965
Total noninterest expense	6,836	6,072	12,904	11,845
Income before federal income tax provision	2,792	2,219	5,921	4,807
Federal income tax provision	924	779	1,709	1,542
Net income	$1,868	$ 1,440	$4,212	$ 3,265
Basic earnings per common share	$0.18	$ 0.12	$0.41	$ 0.26
Diluted earnings per common share	$0.18	$ 0.11	$0.40	$ 0.26
Basic weighted average number of common shares outstanding	10,363,345	12,390,234	10,341,654	12,567,464
Diluted weighted average number of common shares outstanding	10,500,829	12,530,720	10,503,023	12,718,155

See accompanying selected notes to consolidated financial statements.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Net income	$1,868	$1,440	$4,212	$3,265
Other comprehensive income, before tax:				
Gross unrealized holding gains on investments available-for-sale	453	866	829	2,308
Tax provision	(159)	(303)	(290)	(808)
Reclassification adjustment for net gains realized in income	(56)	—	(56)	—
Tax benefit	20	—	20	—
Loss on cash flow hedge	(306)	—	$(243)	$—
Tax benefit	107	—	$84	$—
Other comprehensive income, net of tax	59	563	$344	$1,500
Total comprehensive income	$1,927	$2,003	$4,556	$4,765

See accompanying selected notes to consolidated financial statements.

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

	Shares	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive (Loss) Income, net of tax	Unearned ESOP Shares	Total Stockholders’ Equity
Balances at December 31, 2015	13,768,814	$ 138	$ 136,338	$ 42,892	$ (1,077)	$ (7,618)	$ 170,673
Net income	—	—	—	3,265	—	—	3,265
Other comprehensive income	—	—	—	—	1,500	—	1,500
Exercise of stock options	55,673	—	244	—	—	—	244
Issuance of common stock - restricted stock awards	14,052	—	—	—	—	—	—
Compensation related to stock options and restricted stock awards	—	—	383	—	—	—	383
Allocation of 56,426 ESOP shares	—	—	189	—	—	565	754
Repurchase and retirement of common stock	(436,154)	(4)	(5,843)	—	—	—	(5,847)
Canceled common stock - restricted stock awards	(74,478)	(1)	1	—	—	—	—
Cash dividend declared and paid ($0.12 per share)	—	—	—	(1,517)	—	—	(1,517)
Balances at June 30, 2016	13,327,907	$ 133	$ 131,312	$ 44,640	$ 423	$ (7,053)	$ 169,455

	Shares	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive (Loss) Income, net of tax	Unearned ESOP Shares	Total Stockholders' Equity
Balances at December 31, 2016	10,938,251	$ 109	$ 96,852	$ 48,981	$ (1,328)	$ (6,489)	$ 138,125
Net income	—	—	—	4,212	—	—	4,212
Other comprehensive income	—	—	—	—	344	—	344
Exercise of stock options	115,880	1	1,132	—	—	—	1,133
Issuance of common stock - restricted stock awards, net	10,434	—	—	—	—	—	—
Compensation related to stock options and restricted stock awards	—	—	401	—	—	—	401
Allocation of 56,428 ESOP shares	—	—	446	—	—	564	1,010
Repurchase and retirement of common stock	(22,700)	—	(362)	—	—	—	(362)
Cash dividend declared and paid ($0.13 per share)	—	—	—	(1,349)	—	—	(1,349)
Balances at June 30, 2017	11,041,865	$ 110	$ 98,469	$ 51,844	$ (984)	$ (5,925)	$ 143,514

See accompanying selected notes to consolidated financial statements.

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

	Six Months Ended June 30,	
	2017	2016
Cash flows from operating activities:		
Net income	$4,212	$3,265
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	300	500
OREO market value adjustments	50	257
(Gain) loss on sale of OREO property, net	(5)	87
Gain on sale of investments available-for-sale	(56)	—
Loss on sale of premises and equipment	23	—
Depreciation of premises and equipment	536	524
Amortization of premiums and discounts on investments available-for-sale, net	331	498
Deferred federal income taxes	336	309
Allocation of ESOP shares	1,010	754
Stock compensation expense	401	383
Increase in cash surrender value of BOLI	(317)	(391)
Changes in operating assets and liabilities:		
(Increase) decrease in prepaid expenses and other assets	(516)	32
Net (decrease) increase in advance payments from borrowers for taxes and insurance	(76)	350
Increase in accrued interest receivable	(18)	(190)
Increase (decrease) in accrued interest payable	55	(21)
Increase (decrease) in other liabilities	657	(591)
Net cash provided by operating activities	6,923	5,766
Cash flows from investing activities:		
Proceeds from sales of OREO properties	461	988
Proceeds from calls and sales of investments available-for-sale	4,742	430
Principal repayments on investments available-for-sale	5,253	8,203
Purchases of investments available-for-sale	(14,188)	(13,285)
Net increase in loans receivable	(46,929)	(81,474)
Purchase of FHLB stock	(871)	(1,494)
Purchases of premises and equipment	(1,599)	(1,023)
Surrender of BOLI	—	10,182
Purchase of BOLI	(4,251)	(10,182)
Net cash used by investing activities	(57,382)	(87,655)
Cash flows from financing activities:		
Net increase (decrease) in deposits	18,099	(15,197)
Advances from the FHLB	40,000	160,000
Repayments of advances from the FHLB	(20,000)	(124,000)
Proceeds from stock options exercises	1,133	244
Repurchase and retirement of common stock	(362)	(5,847)
Dividends paid	(1,349)	(1,517)
Net cash provided by financing activities	37,521	13,683

Continued

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

	Six Months Ended June 30,	
	2017	2016
Net decrease in cash and cash equivalents	$(12,938)	$(68,206)
Cash and cash equivalents at beginning of period	31,352	105,711
Cash and cash equivalents at end of period	$18,414	$37,505
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest paid	$4,427	$3,515
Federal income taxes paid	1,900	1,175
Noncash items:		
Change in unrealized loss on investments available-for-sale	$773	$2,308
Change in gain on cash flow hedge	(243)	—

See accompanying selected notes to consolidated financial statements.

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

Note 1 - Description of Business

First Financial Northwest, Inc. (“First Financial Northwest”), a Washington corporation, was formed on June 1, 2007 for the purpose of becoming the holding company for First Financial Northwest Bank (“the Bank”) in connection with the conversion from a mutual holding company structure to a stock holding company structure completed on October 9, 2007. First Financial Northwest’s business activities generally are limited to passive investment activities and oversight of its investment in First Financial Northwest Bank. Accordingly, the information presented in the consolidated financial statements and accompanying data, relates primarily to First Financial Northwest Bank. First Financial Northwest is a bank holding company, having converted from a savings and loan holding company on March 31, 2015, and as a bank holding company is subject to regulation by the Federal Reserve Bank of San Francisco. First Financial Northwest Bank is regulated by the Federal Deposit Insurance Corporation (“FDIC”) and the Washington State Department of Financial Institutions (“DFI”).

First Financial Northwest Bank is headquartered in Renton, Washington, where it has a full-service retail branch as well as a smaller branch located in a commercial development known as the “Landing”. Three additional, smaller branches are located in Mill Creek and Edmonds, both in Snohomish County, Washington and the community of Crossroads in Bellevue, in King County, Washington. The Bank has received regulatory approval to open a new branch in Bothell, also in King County, Washington, which is expected to open in the fourth quarter of 2017. The Bank’s primary market area consists of King, Snohomish, Pierce and Kitsap counties, Washington. In addition to these de novo branches, the Bank has received FDIC, DFI and California Department of Business Oversight approvals on the acquisition of four Washington branches located in the Clearview area in Snohomish, the Smokey Point area in Arlington, and Lake Stevens, all in Snohomish County, and Woodinville, in King County. The acquisition is scheduled to close during the third quarter of 2017, subject to customary closing conditions.

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

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

Note 2 - Basis of Presentation

The accompanying unaudited interim consolidated financial statements have been prepared pursuant to the rules and regulations of the U.S. Securities and Exchange Commission ("SEC"). Accordingly, they do not include all of the information and footnotes required by U.S. Generally Accepted Accounting Principles (“GAAP”) for complete financial statements. These unaudited interim consolidated financial statements should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2016, as filed with the SEC. In our opinion, all adjustments (consisting only of normal recurring adjustments) considered necessary for a fair presentation of the unaudited interim consolidated financial statements in accordance with GAAP have been included. All significant intercompany balances and transactions between the Company and its subsidiaries have been eliminated in consolidation. Operating results for the six months ended June 30, 2017, are not necessarily indicative of the results that may be expected for the year ending December 31, 2017. In preparing the unaudited consolidated financial statements, we are required to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Actual results could differ from those estimates. Material estimates that are particularly

susceptible to significant change relate to the allowance for loan and lease losses ("ALLL"), the valuation of other real estate owned ("OREO") and the underlying collateral of impaired loans, deferred tax assets, and the fair value of financial instruments.

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

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

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

Note 3 - Recently Issued Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers (Topic 606). In August 2015, FASB issued ASU No. 2015-14, Revenue from Contracts with Customers (Topic 606) which postponed the effective date of 2014-09. Subsequently, in March 2016, the FASB issued ASU 2016-08, Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations. This amendment clarifies that an entity should determine if it is the principal or the agent for each specified good or service promised in a contract with a customer. In April 2016, the FASB issued ASU No. 2016-10, Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing. The core principle of Topic 606 is that an entity must recognize revenue when it has satisfied a performance obligation of transferring promised goods or services to a customer. The standard is effective for public entities for interim and annual periods beginning after December 15, 2017; early adoption is not permitted. The standard allows for full retrospective adoption for all periods presented or modified retrospective adoption to only the most current period presented in the financial statements. The cumulative effect of initially applying the standard is recognized at the date of the initial application. Our primary source of revenue is interest income, which is recognized as it is earned and is deemed to be in compliance with this ASU. With respect to noninterest income, the Company is in its preliminary stages of identifying and evaluating the revenue streams and underlying revenue contracts within the scope of the guidance. The Company is expecting to begin developing processes and procedures during 2017 to ensure it is fully compliant with these amendments. To date, the Company has not yet identified any significant changes in the timing of revenue recognition when considering the amended accounting guidance; however, the Company’s implementation efforts are ongoing and such assessments may change prior to the January 1, 2018 implementation date. Accordingly, the Company does not expect implementation of this standard to have a material impact on our consolidated financial statements.

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

In February 2016, FASB issued ASU No. 2016-02, Leases (Topic 842). ASU No. 2016-02 requires lessees to recognize on the balance sheet the assets and liabilities arising from operating leases. A lessee should recognize a liability to make lease payments and a right-of-use asset representing its right to use the underlying asset for the lease term. A lessee should include payments to be made in an optional period only if the lessee is reasonably certain to exercise an option to extend the lease or not to exercise an option to terminate the lease. For a finance lease, interest payments should be recognized separately from amortization of the right-of-use asset in the statement of

comprehensive income. For operating leases, the lease cost should be allocated over the lease term on a generally straight-line basis. The amendments in ASU 2016-02 are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early application of the amendments in the ASU is permitted. The effect of the adoption will depend on leases at the time of adoption. Once adopted, we expect to report higher assets and liabilities as a result of including right-of-use assets and lease liabilities related to certain banking offices and certain equipment under noncancelable operating lease agreements, however, based on current leases, the adoption is expected to increase our consolidated balance sheets by less than 5% and not to have a material impact on our regulatory capital ratios.

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

sale securities will bifurcate the fair value mark and establish an allowance for credit losses through the income statement for the credit portion of that mark. The interest portion will continue to be recognized through accumulated other comprehensive income or loss. The change in allowance recognized as a result of adoption will occur through a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which the ASU is adopted. The amendments in this ASU are effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years, with early adoption permitted for fiscal years beginning after December 15, 2018. The Company is evaluating our current expected loss methodology of our loan and investment portfolios to identify the necessary modifications in accordance with this standard and expects a change in the processes and procedures to calculate the ALLL, including changes in assumptions and estimates to consider expected credit losses over the life of the loan versus the current accounting practice that utilizes the incurred loss model. A valuation adjustment to our ALLL or investment portfolio that is identified in this process will be reflected as a one-time adjustment in equity rather than earnings. We are evaluating the potential impact adoption of this standard will have on our consolidated financial statements and expect to shortly begin developing and implementing processes and procedures to ensure we are fully compliant with the amendments at the adoption date. Once adopted, we expect our allowance for loan losses to increase, however, until our evaluation is complete the magnitude of the increase will be unknown.

In August 2016, FASB issued ASU No. 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments. This ASU was to address the appropriate classification of eight specific cash flow issues on the cash flow statement. Debt prepayment costs should be classified as an outflow for financing activities. Settlement of zero-coupon debt instruments divides the interest portion as an outflow for operating activities and the principal portion as an outflow for financing activities. Contingent consideration payments made after a business combination should be classified as outflows for financing and operating activities. Proceeds from the settlement of bank-owned life insurance policies should be classified as inflows from investing activities. Other specific areas are identified in the ASU as to the appropriate classification of the cash inflows or outflows. The amendments in this ASU are effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. Early adoption is permitted and must be applied using a retrospective transition method to each period presented. The Company is evaluating our current cash flow statement classifications in accordance with the standard. Adoption of ASU 2016-15 is not expected to have a material impact on the Company’s consolidated financial statements.

In January 2017, FASB issued ASU 2017-01, Business Combinations (Topic 805). This ASU clarifies the definition of a business to assist in determining whether transactions should be accounted for as acquisitions (or disposals) or assets or businesses. The amendments in this ASU provide a screen to determine when a set of assets and activities is not a business, thereby reducing the number of transactions requiring further evaluation. If the screen is not met, the amendments in this ASU further provide a framework to evaluate if the criteria is present to qualify for a business. This ASU is effective for annual periods beginning after December 15, 2017 and should be applied prospectively on or after the effective date. Adoption of ASU 2017-01 is not expected to have a material impact on the Company’s consolidated financial statements.

In January 2017, FASB issued ASU 2017-03, Accounting Changes and Error Corrections (Topic 250) and Investments-Equity Method and Joint Ventures (Topic 323). The ASU amends the Codification for SEC staff announcements made at recent Emerging Issues Task Force (EITF) meetings. The SEC guidance that specifically relates to the Company’s consolidated financial statements was from the September 2016 meeting, where the SEC staff expressed their expectations about the extent of disclosures registrants should make about the effects of the new FASB guidance as well as any amendments issued prior to adoption, in particular on revenue (ASU 2014-09), leases (ASU 2016-02) and credit losses on financial instruments (ASU 2016-13) in accordance with Staff Accounting Bulletin

Topic 11.M. Registrants are required to disclose the effect that recently issued accounting standards will have on their financial statements when adopted in a future period. In cases where a registrant cannot reasonably estimate the impact of the adoption, then additional qualitative disclosures should be considered. The ASU incorporates these SEC staff views into Topic 250 and adds references to that guidance in the transition paragraphs of each of the three new standards. The Company has adopted the amendments in this ASU and appropriate disclosures have been included in this Note for each recently issued accounting standard.

In January 2017, FASB issued ASU No. 2017-04, Intangibles--Goodwill and Other (Topic 350). This ASU simplifies the impairment calculation for subsequent measurement of goodwill by eliminating the step of comparing the implied fair value of a reporting unit's goodwill with the carrying amount of that goodwill. Under the amendments in this ASU, an entity will evaluate the carrying amount of a reporting unit to its fair value, as if the reporting unit had been acquired in a business combination. An impairment charge should be recognized for the amount that the carrying amount exceeds the fair value, not to exceed the amount of goodwill. The income tax effect should be considered for any tax deductible goodwill when measuring the impairment loss. While the Company does not have any goodwill to recognize from any previous transaction, this ASU will apply to the impairment analysis of goodwill recognized in future transactions. The amendments in this ASU are effective for goodwill impairment tests

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

in fiscal years beginning after December 15, 2019. Early adoption is permitted for reporting periods after January 1, 2017. Adoption of ASU 2017-04 is not expected to have a material impact on the Company’s consolidated financial statements.

In March 2017, FASB issued ASU No. 2017-08, Receivables - Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities. The ASU shortens the amortization period for certain callable debt securities held at a premium. The standard will take effect for SEC filers for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. The adoption of ASU No. 2017-08 is not expected to have a material impact on the Company's consolidated financial statements.

In May 2017, FASB issued ASU No. 2017-09, Compensation--Stock Compensation (Topic 718): Scope of Modification Accounting. The ASU was issued to provide clarity as to when to apply modification accounting when there is a change in the terms or conditions of a share-based payment award. According to this ASU, an entity should account for the effects of a modification unless the fair value, vesting conditions, and balance sheet classification of the award is the same after the modification as compared to the original award prior to the modification. The standard is effective for reporting periods beginning after December 15, 2017, with early adoption permitted. The adoption of ASU No. 2017-09 is not expected to have a material impact on the Company’s consolidated financial statements.

Note 4 - Investments

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

	June 30, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands)			
Mortgage-backed investments:				
Fannie Mae	$46,664	$ 164	$ (625)	$46,203
Freddie Mac	15,865	87	(72)	15,880
Ginnie Mae	18,425	28	(559)	17,894
Municipal bonds	14,137	210	(29)	14,318
U.S. Government agencies	15,175	90	(127)	15,138
Corporate bonds	24,504	412	(398)	24,518
Total	$134,770	$ 991	$ (1,810)	$133,951

	December 31, 2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands)			
Mortgage-backed investments:				
Fannie Mae	$42,060	$ 126	$ (854)	$41,332
Freddie Mac	18,013	95	(99)	18,009
Ginnie Mae	19,133	41	(540)	18,634
Municipal bonds	13,203	11	(107)	13,107
U.S. Government agencies	15,937	75	(155)	15,857
Corporate bonds	22,506	241	(426)	22,321

Total	$130,852	$ 589	$ (2,181)	$129,260

The tables below summarize the aggregate fair value and gross unrealized loss by length of time those investment securities have been continuously in an unrealized loss position at the dates indicated:

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	June 30, 2017					
	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss
	(In thousands)					
Mortgage-backed investments:						
Fannie Mae	$35,902	$ (625)	$—	$ —	$35,902	$ (625)
Freddie Mac	10,039	(72)	—	—	10,039	(72)
Ginnie Mae	16,285	(559)	—	—	16,285	(559)
Municipal bonds	2,844	(29)	—	—	2,844	(29)
U.S. Government agencies	8,447	(127)	—	—	8,447	(127)
Corporate bonds	1,499	(2)	7,103	(396)	8,602	(398)
Total	$75,016	$ (1,414)	$7,103	$ (396)	$82,119	$ (1,810)

	December 31, 2016					
	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss	Fair Value	Gross Unrealized Loss
	(In thousands)					
Mortgage-backed investments:						
Fannie Mae	$34,763	$ (854)	$—	$ —	$34,763	$ (854)
Freddie Mac	8,343	(99)	—	—	8,343	(99)
Ginnie Mae	16,734	(540)	—	—	16,734	(540)
Municipal bonds	8,815	(107)	—	—	8,815	(107)
U.S. Government agencies	9,000	(153)	1,426	(2)	10,426	(155)
Corporate bonds	3,880	(119)	4,693	(307)	8,573	(426)
Total	$81,535	$ (1,872)	$6,119	$ (309)	$87,654	$ (2,181)

On a quarterly basis, management makes an assessment to determine whether there have been any events or economic circumstances to indicate that a security on which there is an unrealized loss is impaired on an other-than-temporary basis. The Company considers many factors including the severity and duration of the impairment, recent events specific to the issuer or industry, and for debt securities, external credit ratings and recent downgrades. Securities on which there is an unrealized loss that is deemed to be an other-than-temporary impairment ("OTTI") are written down to fair value. If the Company intends to sell a debt security, or it is likely that the Company will be required to sell the debt security before recovering its cost basis, the entire impairment loss would be recognized in earnings as an OTTI. If the Company does not intend to sell the debt security and it is not likely that it will be required to sell the debt security but does not expect to recover the entire amortized cost basis of the debt security, only the portion of the impairment loss representing credit losses would be recognized in earnings. The credit loss on a debt security is measured as the difference between the amortized cost basis and the present value of the cash flows expected to be collected. Projected cash flows are discounted by the original or current effective interest rate depending on the nature of the debt security being measured for potential OTTI. The remaining impairment related to all other factors, the difference between the present value of the cash flows expected to be collected and fair value, is recognized as a charge to other comprehensive income ("OCI"). Impairment losses related to all other factors are presented as separate

categories within OCI. At June 30, 2017 and December 31, 2016, the Company had 46 securities and 53 securities in an unrealized loss position, respectively. At June 30, 2017 and December 31, 2016, the Company had five securities and four securities, respectively, in an unrealized loss position for 12 months or more. Management reviewed the financial condition of the entities issuing municipal or corporate bonds at June 30, 2017 and December 31, 2016, and determined that an OTTI charge was not warranted.

The amortized cost and estimated fair value of investments available-for-sale at June 30, 2017, 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.

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	June 30, 2017	
	Amortized Cost	Fair Value
	(In thousands)	
Due within one year	$5,506	$5,521
Due after one year through five years	4,915	4,918
Due after five years through ten years	24,652	24,739
Due after ten years	18,743	18,796
	53,816	53,974
Mortgage-backed investments	80,954	79,977
Total	$134,770	$133,951

Under Washington state law, in order to participate in the public funds program the Company is required to pledge eligible securities as collateral in an amount equal to 50% of the public deposits held less the FDIC insured amount. Investment securities with market values of $21.7 million and $22.6 million were pledged as collateral for public deposits at June 30, 2017 and December 31, 2016, respectively, both of which exceeded the collateral requirements established by the Washington Public Deposit Protection Commission.

For the three and six months ended June 30, 2017, we had calls and sales on investment securities of $4.7 million generating a net gain of $56,000. For the three and six months ended June 30, 2016, we had calls on investment securities of $385,000, and $430,000, respectively, with no gain or loss. There were no sales of investments during the six months ended June 30, 2016.

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Note 5 - Loans Receivable

Loans receivable are summarized as follows at the dates indicated:

	June 30, 2017	December 31, 2016
	(In thousands)	
One-to-four family residential:		
Permanent owner occupied	$137,816	$ 137,834
Permanent non-owner occupied	118,816	111,601
	256,632	249,435
Multifamily	125,884	123,250
Commercial real estate	317,218	303,694
Construction/land:		
One-to-four family residential	76,404	67,842
Multifamily	123,497	111,051
Commercial	1,100	—
Land	39,012	30,055
	240,013	208,948
Business	15,206	7,938
Consumer	9,031	6,922
Total loans	963,984	900,187
Less:		
Loans in process ("LIP")	88,475	72,026
Deferred loan fees, net	2,552	2,167
Allowance for loan and lease losses ("ALLL")	11,285	10,951
Loans receivable, net	$861,672	$ 815,043

At June 30, 2017, loans totaling $448.2 million were pledged to secure borrowings from the FHLB of Des Moines compared to $472.1 million at December 31, 2016.

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

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

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	At or For the Three Months Ended June 30, 2017						
	One-to-Four Family Residential	Multifamily	Commercial Real Estate	Construction/ Land	Business	Consumer	Total
	(In thousands)						
ALLL:							
Beginning balance	$2,542	$ 1,188	$ 4,027	$ 2,791	$311	$ 299	$11,158
Charge-offs	—	—	—	—	—	—	—
Recoveries	27	—	—	—	—	—	27
Provision (recapture)	58	43	(294)	151	146	(4)	100
Ending balance	$2,627	$ 1,231	$ 3,733	$ 2,942	$457	$ 295	$11,285

	At or For the Six Months Ended June 30, 2017						
	One-to-Four Family Residential	Multifamily	Commercial Real Estate	Construction/ Land	Business	Consumer	Total
	(In thousands)						
ALLL:							
Beginning balance	$2,551	$ 1,199	$ 3,893	$ 2,792	$237	$ 279	$10,951
Charge-offs	—	—	—	—	—	—	—
Recoveries	33	—	—	—	—	1	34
Provision (recapture)	43	32	(160)	150	220	15	300
Ending balance	$2,627	$ 1,231	$ 3,733	$ 2,942	$457	$ 295	$11,285
ALLL by category:							
General reserve	$2,446	$ 1,231	$ 3,710	$ 2,942	$457	$ 295	$11,081
Specific reserve	181	—	23	—	—	—	204
Loans: [(1)]							
Total loans	$256,632	$ 125,884	$ 316,675	$ 152,082	$15,206	$ 9,031	$875,510
Loans collectively evaluated for impairment [(2)]	236,951	124,738	313,015	152,082	15,206	8,933	850,925
Loans individually evaluated for impairment [(3)]	19,681	1,146	3,660	—	—	98	24,585

(1) Net of LIP.
(2) Loans collectively evaluated for general reserves.
(3) Loans individually evaluated for specific reserves.

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	At or For the Three Months Ended June 30, 2016						
	One-to-Four Family Residential	Multifamily	Commercial Real Estate	Construction/ Land	Business	Consumer	Total
	(In thousands)						
ALLL:							
Beginning balance	$2,840	$ 1,184	$ 3,497	$ 1,392	$ 197	$ 361	$9,471
Charge-offs	—	—	—	—	—	—	—
Recoveries	63	—	—	—	—	—	63
Provision (recapture)	(156)	10	274	488	20	(36)	600
Ending balance	$2,747	$ 1,194	$ 3,771	$ 1,880	$ 217	$ 325	$10,134

	At or For the Six Months Ended June 30, 2016						
	One-to-Four Family Residential	Multifamily	Commercial Real Estate	Construction/ Land	Business	Consumer	Total
	(In thousands)						
ALLL:							
Beginning balance	$3,028	$ 1,193	$ 3,395	$ 1,193	$ 229	$ 425	$9,463
Charge-offs	—	—	—	—	—	(19)	(19)
Recoveries	85	—	104	—	—	1	190
Provision (recapture)	(366)	1	272	687	(12)	(82)	500
Ending balance	$2,747	$ 1,194	$ 3,771	$ 1,880	$ 217	$ 325	$10,134
ALLL by category:							
General reserve	$2,346	$ 1,194	$ 3,664	$ 1,824	$ 217	$ 325	$9,570
Specific reserve	401	—	107	56	—	—	564
Loans: [1]							
Total loans	$251,732	$ 132,189	$ 285,449	$ 95,209	$7,208	$ 6,333	$778,120
Loans collectively evaluated for impairment [2]	220,597	130,610	281,002	94,715	7,208	6,226	740,358
Loans individually evaluated for impairment [3]	31,135	1,579	4,447	494	—	107	37,762

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(1) Net of LIP.
(2) Loans collectively evaluated for general reserves.
(3) Loans individually evaluated for specific reserves.

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Past Due Loans. Loans are considered past due if a scheduled principal or interest payment is due and unpaid for 30 days or more. At June 30, 2017, past due loans were 0.01% of total loans receivable, net of LIP. In comparison, past due loans were 0.06% of total loans receivable, net of LIP at December 31, 2016. The following tables represent a summary of the aging of loans by type at the dates indicated:

	Loans Past Due as of June 30, 2017					
	30-59 Days	60-89 Days	90 Days and Greater	Total Past Due	Current	Total [1] [2]
	(In thousands)					
Real estate:						
One-to-four family residential:						
Owner occupied	$85	$ —	$ —	$ 85	$137,731	$137,816
Non-owner occupied	—	—	—	—	118,816	118,816
Multifamily	—	—	—	—	125,884	125,884
Commercial real estate	—	—	—	—	316,675	316,675
Construction/land	—	—	—	—	152,082	152,082
Total real estate	85	—	—	85	851,188	851,273
Business	—	—	—	—	15,206	15,206
Consumer	—	—	—	—	9,031	9,031
Total loans	$85	$ —	$ —	$ 85	$875,425	$875,510

(1) There were no loans 90 days and greater past due and still accruing interest at June 30, 2017.
(2) Net of LIP.

	Loans Past Due as of December 31, 2016					
	30-59 Days	60-89 Days	90 Days and Greater	Total Past Due	Current	Total [1] [2]
	(In thousands)					
Real estate:						
One-to-four family residential:						
Owner occupied	$304	$ —	$ 169	$473	$137,361	$137,834
Non-owner occupied	—	—	—	—	111,601	111,601
Multifamily	—	—	—	—	123,250	123,250
Commercial real estate	—	—	—	—	303,694	303,694
Construction/land	—	—	—	—	136,922	136,922
Total real estate	304	—	169	473	812,828	813,301
Business	—	—	—	—	7,938	7,938
Consumer	—	—	—	—	6,922	6,922

Total loans	$304	$ —	$ 169	$473	$827,688	$828,161

(1) There were no loans 90 days and greater past due and still accruing interest at December 31, 2016.
(2) Net of LIP.

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Nonaccrual Loans. The following table is a summary of nonaccrual loans by loan type at the dates indicated:

	June 30, 2017	December 31, 2016
	(In thousands)	
One-to-four family residential	$528	$ 798
Consumer	55	60
Total nonaccrual loans	$583	$ 858

During the three and six months ended June 30, 2017, interest income that would have been recognized had these nonaccrual loans been performing in accordance with their original terms was $9,000 and $18,000, respectively. For the three and six months ended June 30, 2016, foregone interest on nonaccrual loans was $13,000 and $27,000, respectively.

The following tables summarize the loan portfolio by type and payment status at the dates indicated:

	June 30, 2017						
	One-to-Four Family Residential	Multifamily	Commercial Real Estate	Construction / Land	Business	Consumer	Total [1]
	(In thousands)						
Performing [2]	$256,104	$ 125,884	$ 316,675	$ 152,082	$15,206	$ 8,976	$874,927
Nonperforming [3]	528	—	—	—	—	55	583
Total loans	$256,632	$ 125,884	$ 316,675	$ 152,082	$15,206	$ 9,031	$875,510

[1] Net of LIP.
[2] There were $137.3 million of owner-occupied one-to-four family residential loans and $118.8 million of non-owner occupied one-to-four family residential loans classified as performing.
[3] The $528,000 of one-to-four family residential loans classified as nonperforming are all owner-occupied.

	December 31, 2016						
	One-to-Four Family Residential	Multifamily	Commercial Real Estate	Construction/ Land	Business	Consumer	Total [1]
	(In thousands)						
Performing [2]	$248,637	$ 123,250	$ 303,694	$ 136,922	$ 7,938	$ 6,862	$827,303
Nonperforming [3]	798	—	—	—	—	60	858
Total loans	$249,435	$ 123,250	$ 303,694	$ 136,922	$ 7,938	$ 6,922	$828,161

[1] Net of LIP.

(2) There were $137.0 million of owner-occupied one-to-four family residential loans and $111.6 million of non-owner occupied one-to-four family residential loans classified as performing.
(3) The $798,000 of one-to-four family residential loans classified as nonperforming are all owner-occupied.

Impaired Loans. 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 original loan document. There were no funds committed to be advanced in connection with impaired loans at either June 30, 2017, or December 31, 2016.

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

	June 30, 2017		
	Recorded Investment [(1)]	Unpaid Principal Balance [(2)]	Related Allowance
	(In thousands)		
Loans with no related allowance:			
One-to-four family residential:			
Owner occupied	$1,982	$2,265	$ —
Non-owner occupied	12,664	12,679	—
Multifamily	1,146	1,146	—
Commercial real estate	2,913	2,990	—
Consumer	98	145	—
Total	18,803	19,225	—
Loans with an allowance:			
One-to-four family residential:			
Owner occupied	1,673	1,720	45
Non-owner occupied	3,362	3,383	136
Commercial real estate	747	747	23
Total	5,782	5,850	204
Total impaired loans:			
One-to-four family residential:			
Owner occupied	3,655	3,985	45
Non-owner occupied	16,026	16,062	136
Multifamily	1,146	1,146	—
Commercial real estate	3,660	3,737	23
Consumer	98	145	—
Total	$24,585	$25,075	$ 204

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

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	December 31, 2016		
	Recorded Investment [1]	Unpaid Principal Balance [2]	Related Allowance
	(In thousands)		
Loans with no related allowance:			
One-to-four family residential:			
Owner occupied	$2,216	$ 2,475	$ —
Non-owner occupied	16,634	16,652	—
Multifamily	1,564	1,564	—
Commercial real estate	2,952	3,012	—
Consumer	103	148	—
Total	23,469	23,851	—
Loans with an allowance:			
One-to-four family residential:			
Owner occupied	1,896	1,965	51
Non-owner occupied	4,326	4,347	151
Commercial real estate	755	755	26
Construction/land	495	495	81
Total	7,472	7,562	309
Total impaired loans:			
One-to-four family residential:			
Owner occupied	4,112	4,440	51
Non-owner occupied	20,960	20,999	151
Multifamily	1,564	1,564	—
Commercial real estate	3,707	3,767	26
Construction/land	495	495	81
Consumer	103	148	—
Total	$30,941	$ 31,413	$ 309

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[1] Represents the loan balance less charge-offs.
[2] Contractual loan principal balance.

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The following table presents the average recorded investment in loans individually evaluated for impairment and the interest income recognized for the three and six months ended June 30, 2017 and 2016:

	Three Months Ended June 30, 2017		Six Months Ended June 30, 2017	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
	(In thousands)			
Loans with no related allowance:				
One-to-four family residential:				
Owner occupied	$1,997	$ 30	$2,070	$ 61
Non-owner occupied	13,510	181	14,551	374
Multifamily	1,149	19	1,287	37
Commercial real estate	2,923	48	2,932	101
Consumer	99	2	100	4
Total	19,678	280	20,940	577
Loans with an allowance:				
One-to-four family residential:				
Owner occupied	1,781	20	1,819	43
Non-owner occupied	3,721	39	3,922	81
Commercial real estate	749	10	751	21
Construction/land	—	—	165	—
Total	6,251	69	6,657	145
Total impaired loans:				
One-to-four family residential:				
Owner occupied	3,778	50	3,889	104
Non-owner occupied	17,231	220	18,473	455
Multifamily	1,149	19	1,287	37
Commercial real estate	3,672	58	3,683	122
Construction/land	—	—	165	—
Consumer	99	2	100	4
Total	$25,929	$ 349	$27,597	$ 722

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	Three Months Ended June 30, 2016		Six Months Ended June 30, 2016	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
	(In thousands)			
Loans with no related allowance:				
One-to-four family residential:				
Owner occupied	$2,516	$ 17	$2,733	$ 66
Non-owner occupied	22,084	286	22,484	605
Multifamily	1,584	26	1,194	53
Commercial real estate	2,251	35	2,392	76
Consumer	110	1	117	3
Total	28,545	365	28,920	803
Loans with an allowance:				
One-to-four family residential:				
Owner occupied	2,107	27	2,111	56
Non-owner occupied	5,496	62	6,171	139
Multifamily	—	—	393	—
Commercial real estate	2,207	34	2,211	70
Construction/land	495	5	495	9
Consumer	38	—	50	—
Total	10,343	128	11,431	274
Total impaired loans:				
One-to-four family residential:				
Owner occupied	4,623	44	4,844	122
Non-owner occupied	27,580	348	28,655	744
Multifamily	1,584	26	1,587	53
Commercial real estate	4,458	69	4,603	146
Construction/land	495	5	495	9
Consumer	148	1	167	3
Total	$38,888	$ 493	$40,351	$ 1,077

Troubled Debt Restructurings. Certain loan modifications are accounted for as troubled debt restructured loans ("TDRs"). At June 30, 2017, the TDR portfolio totaled $24.1 million, of which one loan of $106,000 was on nonaccrual status because it had previously not performed in accordance with the terms of its restructure. As of June 30, 2017, it was current, however it will remain on nonaccrual status until it has performed for six months and is expected to continue to perform. At December 31, 2016, the TDR portfolio totaled $30.3 million, of which one loan of $174,000 was not performing in accordance with the terms of its restructure and was on nonaccrual status.

The following tables present loans that were modified as TDRs during the periods indicated and their recorded investment both before and after the modification:

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	Three Months Ended June 30, 2017			Six Months Ended June 30, 2017		
	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
	(Dollars in thousands)			(Dollars in thousands)		
One-to-four family residential:						
Principal and interest with interest rate concession and advancement of maturity date	7	1,968	1,968	7	1,968	1,968
Total	7	1,968	1,968	7	1,968	1,968

	Three Months Ended June 30, 2016			Six Months Ended June 30, 2016		
	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
	(Dollars in thousands)					
One-to-four family residential:						
Principal and interest with interest rate concession	16	$ 3,155	$ 3,155	17	$ 3,711	$ 3,711
Commercial real estate:						
Interest-only payments with interest rate concession and advancement of maturity date	—	—	—	1	495	495
Total	16	$ 3,155	$ 3,155	18	$ 4,206	$ 4,206

At June 30, 2017, the Company had no commitments to extend additional credit to borrowers whose loan terms have been modified in TDRs. All TDRs are also classified as impaired loans and are included in the loans individually evaluated for impairment as part of the calculation of the ALLL.

The TDRs that occurred during the three and six months ended June 30, 2017 and June 30, 2016, were all on existing TDRs and included extensions of existing interest rate concessions and advancing maturity dates for a period of time ranging from one to three years. No loans accounted for as TDRs were charged-off to the ALLL for the three and six months ended June 30, 2017 and 2016.

TDRs that default after they have been modified are typically evaluated individually on a collateral basis. Any additional impairment is charged to the ALLL. For the three and six months ended June 30, 2017, and June 30, 2016, no loans that had been modified in the previous 12 months defaulted.

Credit Quality Indicators. The Company utilizes a nine-category risk rating system and assigns a risk rating for all credit exposures. The risk rating system is designed to define the basic characteristics and identify risk elements of each credit extension. Credits risk rated 1 through 5 are considered to be “pass” credits. Pass credits include assets, such as cash secured loans with funds on deposit with the Bank, where there is virtually no credit risk. Pass credits also include credits that are on the Company’s watch list, where the borrower exhibits potential weaknesses, which may, if not checked or corrected, negatively affect the borrower’s financial capacity and threaten their ability to fulfill debt

obligations in the future. Credits classified as special mention are risk rated 6 and possess weaknesses that deserve management's close attention. Special mention assets do not expose the Company to sufficient risk to warrant adverse classification in the substandard, doubtful or loss categories. Substandard credits are risk rated

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7. An asset is considered substandard if it is inadequately protected by the current net worth and payment capacity of the borrower or of any collateral pledged.

Substandard assets include those characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected. Assets classified as doubtful are risk rated 8 and have all the weaknesses inherent in those credits classified as substandard with the added characteristic that the weaknesses present make collection or liquidation in full highly questionable and improbable, on the basis of currently existing facts, conditions, and values. Assets classified as loss are risk rated 9 and are considered uncollectible and cannot be justified as a viable asset for the Company. There were no loans classified as doubtful or loss at June 30, 2017 and December 31, 2016.

The following tables represent a summary of loans by type and risk category at the dates indicated:

	June 30, 2017						
	One-to-Four Family Residential	Multifamily	Commercial Real Estate	Construction/ Land	Business	Consumer	Total [1]
	(In thousands)						
Risk Rating:							
Pass	$253,095	$ 125,884	$ 313,856	$ 152,082	$15,206	$ 8,788	$868,911
Special mention	2,460	—	2,819	—	—	188	5,467
Substandard	1,077	—	—	—	—	55	1,132
Total loans	$256,632	$ 125,884	$ 316,675	$ 152,082	$15,206	$ 9,031	$875,510

[1] Net of LIP.

	December 31, 2016						
	One-to-Four Family Residential	Multifamily	Commercial Real Estate	Construction / Land	Business	Consumer	Total [1]
	(In thousands)						
Risk Rating:							
Pass	$245,237	$ 123,250	$ 300,655	$ 136,427	$ 7,938	$ 6,674	$820,181
Special mention	2,847	—	3,039	—	—	188	6,074
Substandard	1,351	—	—	495	—	60	1,906
Total loans	$249,435	$ 123,250	$ 303,694	$ 136,922	$ 7,938	$ 6,922	$828,161

[1] Net of LIP.

Note 6 - Other Real Estate Owned

OREO includes properties acquired by the Company through foreclosure and deed in lieu of foreclosure. The following table is a summary of OREO activity during the periods shown:

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	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
	(In thousands)			
Balance at beginning of period	$2,281	$3,405	$2,331	$3,663
Gross proceeds from sale of OREO	(461)	(985)	(461)	(988)
Gain on sale of OREO	5	(89)	5	(87)
Market value adjustments	—	—	(50)	(257)
Balance at end of period	$1,825	$2,331	$1,825	$2,331

During the three and six months ended June 30, 2017, one OREO property sold for $461,000, generating a gain on sale of $5,000. For the three months ended June 30, 2017, there were no market value adjustments taken on OREO properties. However, during the three months ended March 31, 2017, a $50,000 market value adjustment was recognized on the property that was subsequently sold during the second quarter of 2017. OREO at June 30, 2017 consisted of $1.8 million in commercial real estate properties. At June 30, 2017, there were no loans secured by residential real estate properties for which formal foreclosure proceedings were in process.

Note 7 - Fair Value

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

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

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

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

- Level 1 - Quoted prices for identical instruments in active markets.

- Level 2 - Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations whose inputs are observable.

- Level 3 - Instruments whose significant value drivers are unobservable.

The tables below present the balances of assets measured at fair value on a recurring basis (there were no transfers between Level 1, Level 2 and Level 3 recurring measurements) at June 30, 2017 and December 31, 2016:

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	Fair Value Measurements at June 30, 2017			
	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)			
Investments available-for-sale:				
Mortgage-backed investments:				
Fannie Mae	$46,203	$ —	$ 46,203	$ —
Freddie Mac	15,880	—	15,880	—
Ginnie Mae	17,894	—	17,894	—
Municipal bonds	14,318	—	14,318	—
U.S. Government agencies	15,138	—	15,138	—
Corporate bonds	24,518	—	24,518	—
Total available-for-sale investments	133,951	—	133,951	—
Derivative fair value asset	1,090	—	1,090	—
	$135,041	$ —	$ 135,041	$ —

	Fair Value Measurements at December 31, 2016			
	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)			
Investments available-for-sale:				
Mortgage-backed investments:				
Fannie Mae	$41,332	$ —	$ 41,332	$ —
Freddie Mac	18,009	—	18,009	—
Ginnie Mae	18,634	—	18,634	—
Municipal bonds	13,107	—	13,107	—
U.S. Government agencies	15,857	—	15,857	—
Corporate bonds	22,321	—	22,321	—
Total available-for-sale investments	129,260	—	129,260	—
Derivative fair value asset	1,333	—	1,333	—
	$130,593	$ —	$ 130,593	$ —

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 measured at fair value on a nonrecurring basis at June 30, 2017 and December 31, 2016:

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	Fair Value Measurements at June 30, 2017			
	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)			
Impaired loans (included in loans receivable, net) [1]	$24,381	$ —	$ —	$ 24,381
OREO	1,825	—	—	1,825
Total	$26,206	$ —	$ —	$ 26,206

[1] Total fair value of impaired loans is net of $204,000 of specific reserves on performing TDRs.

	Fair Value Measurements at December 31, 2016			
	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)			
Impaired loans (included in loans receivable, net) [1]	$30,632	$ —	$ —	$ 30,632
OREO	2,331	—	—	2,331
Total	$32,963	$ —	$ —	$ 32,963

[1] Total fair value of impaired loans is net of $309,000 of specific reserves on performing TDRs.

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, less estimated costs to sell. Some of these inputs may not be observable in the marketplace. Appraised values may be discounted based on management’s knowledge of the marketplace, subsequent changes in market conditions, or management’s knowledge of the borrower.

OREO properties are measured at the lower of their carrying amount or fair value, less estimated 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 estimated costs to sell, an impairment loss is recognized.

The following tables present quantitative information about Level 3 fair value measurements for financial instruments measured at fair value on a nonrecurring basis at June 30, 2017 and December 31, 2016:

	June 30, 2017			
	Fair Value	Valuation Technique	Unobservable Input(s)	Range (Weighted Average)
	(Dollars in thousands)			
Impaired Loans	$24,381	Market approach	Appraised value discounted by market or borrower conditions	0.0% (0.0%)
OREO	$1,825	Market approach	Appraised value less selling costs	0.0% (0.0%)

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FIRST FINANCIAL NORTHWEST, INC. AND SUBSIDIARIES
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	December 31, 2016			
	Fair Value	Valuation Technique	Unobservable Input(s)	Range (Weighted Average)
	(Dollars in thousands)			
Impaired Loans	$30,632	Market approach	Appraised value discounted by market or borrower conditions	0.0% (0.0%)
OREO	$2,331	Market approach	Appraised value less selling costs	0.0% (0.0%)

The carrying amounts and estimated fair values of financial instruments were as follows at the dates indicated:

	June 30, 2017				
		Estimated	Fair Value Measurements Using:		
	Carrying Value	Fair Value	Level 1	Level 2	Level 3
	(In thousands)				
Financial Assets:					
Cash on hand and in banks	$7,418	$ 7,418	$ 7,418	$ —	$ —
Interest-earning deposits with banks	10,996	10,996	10,996	—	—
Investments available-for-sale	133,951	133,951	—	133,951	—
Loans receivable, net	861,672	864,725	—	—	864,725
FHLB stock	8,902	8,902	—	8,902	—
Accrued interest receivable	3,165	3,165	—	3,165	—
Derivative fair value asset	1,090	1,090	—	1,090	—
Financial Liabilities:					
Deposits	315,059	315,059	315,059	—	—
Certificates of deposit, retail	345,028	345,058	—	345,058	—
Certificates of deposit, brokered	75,488	75,644	—	75,644	—
Advances from the FHLB	191,500	188,939	—	188,939	—
Accrued interest payable	286	286	—	286	—

FIRST FINANCIAL NORTHWEST, INC. AND SUBSIDIARIES
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	December 31, 2016				
		Estimated	Fair Value Measurements Using:		
	Carrying Value	Fair Value	Level 1	Level 2	Level 3
	(In thousands)				
Financial Assets:					
Cash on hand and in banks	$5,779	$ 5,779	$ 5,779	$ —	$ —
Interest-earning deposits with banks	25,573	25,573	25,573	—	—
Investments available-for-sale	129,260	129,260	—	129,260	—
Loans receivable, net	815,043	818,054	—	—	818,054
FHLB stock	8,031	8,031	—	8,031	—
Accrued interest receivable	3,147	3,147	—	3,147	—
Derivative fair value asset	1,333	1,333	—	1,333	—
Financial Liabilities:					
Deposits	285,335	285,335	285,335	—	—
Certificates of deposit, retail	356,653	356,723	—	356,723	—
Certificates of deposit, brokered	75,488	75,431	—	75,431	—
Advances from the FHLB	171,500	170,221	—	170,221	—
Accrued interest payable	231	231	—	231	—

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

- Financial instruments with book value equal to fair value: The fair value of financial instruments that are short-term or reprice frequently and that have little or no risk are considered to have a fair value equal to book value. These instruments include cash on hand and in banks, interest-earning deposits with banks, 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. The fair value is therefore equal to the book value.

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

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

- Derivatives: The fair value of derivatives is based on dealer quotes, pricing models, discounted cash flow methodologies or similar techniques for which the determination of fair value may require significant management judgment or estimation.

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Liabilities: The fair value of deposits with no stated maturity, such as statement savings, interest-bearing checking 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 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 8 - Derivatives

The Company uses a derivative financial instrument, which qualifies as a cash flow hedge, to manage the risk of changes in future cash flows due to interest rate fluctuations. The hedge instrument is a $50.0 million three-month FHLB advance that will be renewed every three months at the fixed interest rate at that time. The agreement has a five-year term and stipulates that the counterparty will pay the Company interest at three-month LIBOR and the Company will pay fixed interest of 1.34% on the $50.0 million notional amount. The Company pays or receives the net interest amount quarterly and includes this amount as part of interest expense on the Consolidated Income Statement.

Quarterly, the effectiveness evaluation is based upon the fluctuation of the interest the Company pays to the FHLB for the hedge instrument as compared to the three-month LIBOR interest received from the counterparty. At June 30, 2017, the fair value of the cash flow hedge of $1.1 million was reported with other assets. The tax effected amount of $709,000 was included in Other Comprehensive Income. There were no amounts recorded in the Consolidated Income Statement for the quarters ended June 30, 2017 or 2016 related to ineffectiveness.

Fair value for this derivative instrument, which generally changes as a result of changes in the level of market interest rates, is estimated based on dealer quotes and secondary market sources.

The following table presents the fair value of this derivative instrument as of June 30, 2017 and December 31, 2016:

	Balance Sheet Location	Fair Value at June 30, 2017	Fair Value at December 31, 2016
	(In thousands)		
Interest rate swap on FHLB debt designated as cash flow hedge	Other Assets	$1,090	$ 1,333
Total derivatives		$1,090	$ 1,333

The following table presents the effect of this derivative instrument on the Consolidated Statement of Comprehensive Income for the quarters ended June 30, 2017 and December 31, 2016:

	Balance Sheet Location	Amount Recognized in OCI at June 30,	Amount Recognized in OCI at December

		2017	31, 2016
	(In thousands)		
Interest rate swap on FHLB debt designated as cash flow hedge	Other assets	$ 707	$ 866

Note 9 - Stock-Based Compensation

In June 2016, First Financial Northwest's shareholders approved the First Financial Northwest, Inc. 2016 Equity Incentive Plan ("2016 Plan"). This plan provides for the granting of incentive stock options ("ISO"), non-qualified stock options ("NQSO"), restricted stock and restricted stock units until June 2026. The 2016 Plan established 1,400,000 shares available to grant with a maximum of 400,000 of these shares available to grant as restricted stock awards. Each share issued as a restricted stock award counts as two shares towards the total shares available to award.

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Under the 2016 Plan, the vesting date for each option award or restricted stock award is determined by an award committee and specified in the award agreement. In the case of restricted stock awards granted in lieu of cash payments of directors' fees, the grant date is used as the vesting date unless the award agreement provides otherwise.

As a result of the approval of the 2016 Plan, the First Financial Northwest, Inc. 2008 Equity Incentive Plan ("2008 Plan") was frozen and no additional awards will be made. As of June 30, 2016, there were 611,756 available stock options and 74,478 available restricted stock awards that are no longer available to be awarded under the 2008 Plan. Restricted stock awards and stock options that were granted under the 2008 Plan will continue to vest and be available for exercise, subject to the 2008 Plan provisions. At June 30, 2017, there were 1,351,028 total shares available for grant under the 2016 Plan, including 375,514 shares available to be granted as restricted stock.

For the three months ended June 30, 2017 and 2016, total compensation expense for the Plan was $291,000 and $290,000, respectively, and the related income tax benefit was $102,000 and $101,500, respectively.

For the six months ended June 30, 2017 and 2016, total compensation expense for the Plan was $401,000, and $383,000, respectively, and the related income tax benefit was $141,000 and $134,000, respectively.

Included in the above compensation for the three and six months ended June 30, 2017 and 2016, directors' compensation of $180,000 was recognized as a result of the awarding and vesting of restricted shares in lieu of cash payments of directors' fees, with a related income tax benefit of $63,000.

Stock Options

Under the 2008 Plan, stock option awards were granted with an exercise price equal to the market price of First Financial Northwest's common stock at the grant date. 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 10 years. Any unexercised stock options expires 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 and the Bank.

Under the 2016 Plan, the exercise price and vesting period for stock options are determined by the award committee and specified in the award agreement, however, the exercise price shall not be less than the fair market value of a share as of the grant date. Any unexercised stock option will expire 10 years after the award date or sooner in the event of the award recipient's death, disability, retirement, or termination of service.

The fair value of each option award is estimated on the grant date 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. The historical volatility of the Company's stock price over a specified period of time is used for the expected volatility assumption. First Financial Northwest bases the risk-free interest rate on the U.S. Treasury Constant Maturity Indices in effect on the date of the grant. First Financial Northwest 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.

Under certain conditions, a cashless exercise of vested stock options may occur by the option holder surrendering the number of options valued at the current stock price at the time of exercise to cover the total cost to exercise. The surrendered options are canceled and are unavailable for reissue.

A summary of the Company’s stock option plan awards and activity for the three and six months ended June 30, 2017, follows:

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	For the Three Months Ended June 30, 2017			
	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term in Years	Aggregate Intrinsic Value
Outstanding at April 1, 2017	506,280	$ 10.27		
Granted	—			
Exercised	(18,340)	9.78		
Outstanding at June 30, 2017	487,940	10.29	5.14	2,851,319
Vested and expected to vest assuming a 3% forfeiture rate over the vesting term	482,870	10.28	5.12	2,826,214
Exercisable at June 30, 2017	318,940	9.81	4.14	2,014,489

	For the Six Months Ended June 30, 2017			
	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term in Years	Aggregate Intrinsic Value
Outstanding at January 1, 2017	603,820	$ 10.19		
Granted	—			
Exercised	(115,880)	9.78		
Outstanding at June 30, 2017	487,940	10.29	5.14	2,851,319
Vested and expected to vest assuming a 3% forfeiture rate over the vesting term	482,870	10.28	5.12	2,826,214
Exercisable at June 30, 2017	318,940	9.81	4.14	2,014,489

As of June 30, 2017, there was $458,000 of total unrecognized compensation cost related to nonvested stock options granted under the 2008 Plan. The cost is expected to be recognized over the remaining weighted-average vesting period of 2.41 years. There were no stock options granted during the three and six months ended June 30, 2017 under either the 2008 Plan or 2016 Plan.

Restricted Stock Awards

The 2008 Plan authorized the grant of restricted stock awards to 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 grant date. The restricted stock awards' fair value is equal to the stock price on the grant date. Shares awarded under this plan 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.

The 2016 Plan authorizes the grant of restricted stock awards subject to vesting periods or terms as defined by the award committee and specified in the award agreement. Restricted stock awards granted in lieu of cash payments for directors' fees are subject to immediate vesting on the grant date unless the award agreement provides otherwise.

A summary of changes in nonvested restricted stock awards for the three and six months ended June 30, 2017, follows:

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(Unaudited)

	For the Three Months Ended June 30, 2017	
	Shares	Weighted-Average Grant Date Fair Value
Nonvested at April 1, 2017	26,400	$ 9.13
Granted	10,434	
Vested	(10,434)	17.25
Nonvested at June 30, 2017	26,400	9.13
Expected to vest assuming a 3% forfeiture rate over the vesting term	25,608	

	For the Six Months Ended June 30, 2017	
	Shares	Weighted-Average Grant Date Fair Value
Nonvested at January 1, 2017	26,400	$ 9.13
Granted	10,434	
Vested	(10,434)	17.25
Nonvested at June 30, 2017	26,400	9.13
Expected to vest assuming a 3% forfeiture rate over the vesting term	25,608	

As of June 30, 2017, there was $87,000 of total unrecognized compensation costs related to nonvested shares granted as restricted stock awards. The cost is expected to be recognized over the remaining weighted-average vesting period of 0.75 years.

Note 10 - Earnings Per Share

Per the provisions of FASB ASC 260, Earnings Per Share, nonvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents are participating securities and are included in the computation of EPS pursuant to the two-class method. The two-class method is an earnings allocation formula that determines earnings per share for each class of common stock and participating security according to dividends declared (or accumulated) and participation rights in undistributed earnings. ESOP shares are considered outstanding for basic and diluted earnings per share when the shares are committed to be released. Certain of the Company’s nonvested restricted stock awards qualify as participating securities.

Net income is allocated between the common stock and participating securities pursuant to the two-class method, based on their rights to receive dividends, participate in earnings, or absorb losses. Basic earnings per common shares is computed by dividing net earnings available to common shareholders by the weighted-average number of common shares outstanding during the period, excluding participating nonvested restricted shares.

The following table presents a reconciliation of the components used to compute basic and diluted earnings per share for the periods indicated:

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(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
	(Dollars in thousands, except share data)			
Net income	$1,868	$ 1,440	$4,212	$ 3,265
Less: Earnings allocated to participating securities	(4)	(5)	$(10)	$ (11)
Earnings allocated to common shareholders	$1,864	$ 1,435	$4,202	$ 3,254
Basic weighted average common shares outstanding	10,363,345	12,390,234	10,341,654	12,567,464
Dilutive stock options	122,192	120,704	147,147	132,619
Dilutive restricted stock grants	15,292	19,782	14,222	18,072
Diluted weighted average common shares outstanding	10,500,829	12,530,720	10,503,023	12,718,155
Basic earnings per share	$0.18	$ 0.12	$0.41	$ 0.26
Diluted earnings per share	$0.18	$ 0.11	$0.40	$ 0.26

Potential dilutive shares are excluded from the computation of earnings per share if their effect is anti-dilutive. For the three months ended June 30, 2017, there were 20,000 options to purchase shares of common stock that were omitted from the computation of diluted earnings per share because their effect would be anti-dilutive. For the six months ended June 30, 2017, there were no anti-dilutive shares omitted from the computation. For the three and six months ended June 30, 2016, options to purchase an additional 60,000 shares of common stock, respectively, were excluded as their effect would be anti-dilutive.

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

Forward-Looking Statements

Certain matters discussed in this Quarterly Report on Form 10-Q 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 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

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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; computer systems on which we depend could fail or experience a security breach; our ability to retain key members of our senior management team; costs and effects of litigation, including settlements and judgments; our ability to implement our 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, including our pending branch purchase; 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 (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 our filings with the U.S. Securities and Exchange Commission ("SEC"), including our Annual Report on Form 10-K for the year ended December 31, 2016 ("2016 Form 10-K"). Any of the forward-looking statements that we make in this Form 10-Q 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.

Overview

First Financial Northwest Bank ("the Bank") is a wholly-owned subsidiary of First Financial Northwest, Inc. ("the Company") and, as such, comprises substantially all of the activity for the Company. First Financial Northwest Bank was a community-based savings bank until February 4, 2016, when the Bank converted to a Washington chartered commercial bank reflecting the commercial banking services it now provides to its customers. The Bank primarily serves King, Pierce, Snohomish, and Kitsap counties, Washington, through its full-service banking office and smaller branch in Renton, Washington, and additional branches located in Mill Creek, Edmonds, and the community of Crossroads in Bellevue, Washington. The addition of branch locations, together with improved technology from the conversion to a new core data processor in 2015 have allowed the Bank to better meet the needs of our customers and broaden the demographics of our customer base. The Bank has received regulatory approval to open a new branch office at The Junction, a new, mixed use development in Bothell, Washington in the fourth quarter of 2017. In addition, the Bank has received FDIC, DFI and California Department of Business Oversight approvals for the acquisition of four Washington branches located in the Clearview area in Snohomish, the Smokey Point area in Arlington, Lake Stevens, and Woodinville, Washington. The acquisition is scheduled to close during the third quarter of 2017, subject to customary closing conditions.

The Bank's business consists predominantly of attracting deposits from the general public, combined with borrowing from the Federal Home Loan Bank of Des Moines ("FHLB") and raising funds in the wholesale market, then utilizing these funds to originate one-to-four family residential, multifamily, commercial real estate, construction/land, business, and consumer loans. Our current business strategy emphasizes commercial real estate, construction, one-to-four family residential, and multifamily lending. With the current low interest rate environment, we are not

aggressively pursuing longer term assets, but rather are focused on financing shorter term loans, in particular construction/land loans. Recently, improvements in the economy, employment rates, stronger real estate prices, and a general lack of new housing inventory in certain areas in the Puget Sound region have resulted in our significantly increasing originations of construction loans for properties located in our market area. We anticipate that construction/land lending will continue to be a strong element of our total loan portfolio in future periods. We will continue to take a disciplined approach in our construction/land lending by concentrating our efforts on one-to-four family residential loans to builders known to us. On a limited basis, we also will provide multifamily loans to developers with proven success in this type of construction. In addition, we have geographically expanded our loan portfolio through loan purchases or loan participations of commercial and multifamily real estate loans that are outside of our primary market area. We have a loan officer with extensive experience in California to further support our efforts to geographically diversify our loan portfolio through direct loan originations, loan participations, or loan purchases.

In support of our strategic growth plan, the Bank has developed a national line of business to originate and service aircraft loans. These loans are collateralized by new or used, single-engine piston aircraft to light jets for business or personal use which have demonstrated an acceptable valuation history under industry accepted valuation resources. As we grow our aircraft loan portfolio, we anticipate these loans will range in size from $250,000 to $8.0 million with underwriting guidelines primarily based on the asset value of the collateral with secondary emphasis placed on the ability of the borrower to repay the loan. However, the underwriting importance of the asset value compared to the borrowers' financial condition may fluctuate, based on the relative strengths or weaknesses of each of these underwriting components. We began originating aircraft loans in the fourth quarter of 2016. At June 30, 2017, our business loans included $6.2 million in fixed and adjustable rate aircraft loans.

Our primary source of revenue is interest income, which is the income that we earn on our loans and investments. Interest expense is the interest that we pay on our deposits and borrowings. Net interest income is the difference between interest income and interest expense. Changes in levels of interest rates affect interest income and interest expense differently and, thus, impacts our net interest income.

An offset to net interest income is the provision for loan losses which is required to establish the allowance for loan and lease losses ("ALLL") at a level that adequately provides for probable losses inherent in our loan portfolio. As our loan portfolio increases, or due to an increase for probable losses inherent in our loan portfolio, our ALLL may increase, resulting in a decrease to net interest income. Improvements in loan risk ratings, increases in property values, or receipt of recoveries of amounts previously charged off may partially or fully offset any increase to ALLL due to loan growth or an increase in probable loan losses.

Noninterest income is generated from various loan or deposit fees, increases in the cash surrender value of bank owned life insurance ("BOLI"), and revenue earned on our wealth management brokerage services. This income is increased or partially offset by any net gain or loss on sales of investment securities.

Our noninterest expenses consist primarily of salaries and employee benefits, professional fees, regulatory assessments, occupancy and equipment, and other general and administrative expenses. Salaries and employee benefits consist primarily of the salaries and wages paid to our employees, payroll taxes, expenses for retirement, and other employee benefits. OREO-related expenses consist primarily of maintenance and costs of utilities for the OREO inventory, market valuation adjustments, build-out expenses, gains and losses from OREO sales, legal fees, real estate taxes, and insurance related to the properties included in the OREO inventory. Professional fees include legal services, auditing and accounting services, computer support services, and other professional services in support of strategic plans. Occupancy and equipment expenses, which are the fixed and variable costs of buildings and equipment, consist primarily of real estate taxes, depreciation expenses, maintenance, and costs of utilities. Also included in noninterest expense are changes to the Company's unfunded commitment reserve which are reflected in general and administrative expenses. This unfunded commitment reserve expense can vary significantly each quarter, based on the amount believed by management to be sufficient to absorb estimated probable losses related to unfunded credit facilities, and reflects changes in the amounts that the Company has committed to fund but has not yet disbursed.

Critical Accounting Policies

Our significant accounting policies are fundamental to understanding our results of operations and financial condition because they require that we use estimates and assumptions that may affect the value of our assets or liabilities and our financial results. These policies are critical because they require management to make difficult, subjective, and complex judgments about matters that are inherently uncertain and because it is likely that materially different amounts would be reported under different conditions or by using different assumptions. These policies govern the ALLL, the valuation of OREO, and the calculation of deferred taxes, fair values, and other-than-temporary impairments on the market value of investments and derivatives. These policies and estimates are described in further detail in Part II, Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations and

Note 1, Summary of Significant Accounting Policies with the 2016 Form 10-K. There have not been any material changes in the Company's critical accounting policies and estimates as compared to the disclosure contained in the 2016 Form 10-K.

Comparison of Financial Condition at June 30, 2017 and December 31, 2016

Total assets were $1.1 billion at June 30, 2017, an increase of 4.3%, from $1.0 billion at December 31, 2016. The following table details the $44.1 million net change in the composition of our assets at June 30, 2017 from December 31, 2016.

	Balance at June 30, 2017	Change from December 31, 2016	Percent Change
	(Dollars in thousands)		
Cash on hand and in banks	$7,418	$ 1,639	28.4 %
Interest-earning deposits with banks	10,996	(14,577)	(57.0)
Investments available-for-sale, at fair value	133,951	4,691	3.6
Loans receivable, net	861,672	46,629	5.7
Premises and equipment, net	19,501	1,040	5.6
FHLB stock, at cost	8,902	871	10.8
Accrued interest receivable	3,165	18	0.6
Deferred tax assets, net	2,620	(522)	(16.6)
OREO	1,825	(506)	(21.7)
BOLI, net	28,721	4,568	18.9
Prepaid expenses and other assets	2,937	273	10.2
Total assets	$1,081,708	$ 44,124	4.3 %

Interest-earning deposits with banks. Our interest-earning deposits with banks, consisting primarily of funds held at the Federal Reserve Bank of San Francisco, decreased by $14.6 million from December 31, 2016 to June 30, 2017. Loan payoffs received late in the fourth quarter of 2016 were temporarily held in our Federal Reserve Bank account, then partially used to fund new loan originations in the six months ended June 30, 2017.

Investments available-for-sale. Our investments available-for-sale portfolio increased by $4.7 million during the first six months of 2017. During this period, we purchased $14.2 million of securities which included four mortgage-backed securities, two subordinated debt securities, and one tax-exempt municipal bond. We also sold $4.7 million of securities which included two mortgage-backed securities and a portion of a subordinated debt security. The mortgage-backed securities were sold in favor of a collateralized mortgage obligation security which met our investment objectives while the portion of the subordinated debt security was sold in order to allow us the ability to diversify our holdings of bank subordinated debt notes through reinvestment of the proceeds received in other issuers. In addition, the Bank had partial calls of $5,000 on a taxable municipal security and $21,000 on a U.S. government agency security. At June 30, 2017, corporate bonds issued by financial institutions represented $24.5 million, or 18.3% of our investments available-for-sale and municipal bonds represented $14.1 million, or 10.7% of our investments available-for-sale.

The net unrealized loss of our investments available-for-sale had a pre-tax decrease of $829,000 during the six months ended June 30, 2017 as a result of a net improvement in the market value of the underlying securities in our portfolio.

The effective duration of the investments available-for-sale at June 30, 2017, was 3.5% as compared to 4.0% at December 31, 2016. Effective duration is a measure that attempts to quantify the anticipated percentage change in the value of an investment security (or portfolio) in the event of a 100 basis point change in market yields. Since the Bank's portfolio includes securities with embedded options (including call options on bonds and prepayment options on mortgage-backed securities), management believes that effective duration is an appropriate metric to use as a tool when analyzing the Bank's investment securities portfolio, as effective duration incorporates assumptions relating to such embedded options, including changes in cash flow assumptions as interest rates change.

Loans receivable. Net loans receivable increased $46.6 million during the first six months of 2017 to $861.7 million at June 30, 2017. While the concentrations of our commercial and construction loans have increased, we routinely monitor these levels in support of our strategic plan to maintain compliance with internally established concentration guidelines. The Bank has set aggregate concentration guidelines that total commercial real estate, including

residential, non-residential, and construction, should not exceed 550% of total risk-based capital. Our guidelines for construction/land loans are 100% of total risk-based capital. At June 30, 2017, the Bank's concentrations were 443.0% for total commercial real estate loans and 115.3% for total construction/land loans. The concentration of construction/land loans is calculated using the funded balance of these loans and consequently can fluctuate based on the timing of construction draws and loan payoffs. Management reviews estimated construction draws and loan payoffs and adjusts loan originations based on these estimates to achieve compliance with our construction guidelines. Our commercial and multifamily real estate and construction/land loan portfolios are subject to ongoing credit reviews performed by both independent loan review staff, as well as an external third-party review firm to assist with

identifying potential adverse trends and risks in the portfolio allowing management to initiate timely corrective action, as necessary. Such reviews also assist with ensuring loan risk grades are accurately assigned and thereby properly accounted for in the ALLL. The review places emphasis on large borrowing relationships, stress testing, compliance with loan covenants, as well as other risk factors warranting enhanced review. The following table presents a breakdown of our loan portfolio by collateral type at June 30, 2017 and December 31, 2016:

	June 30, 2017	December 31, 2016
	(In thousands)	
Multifamily real estate:		
Micro-unit apartments	$5,580	$ 7,878
Other multifamily	120,304	115,372
Total multifamily	125,884	123,250
Commercial real estate:		
Office	95,256	101,688
Retail	99,482	106,294
Mobile home park	21,851	20,689
Warehouse	21,491	15,338
Storage	35,121	34,816
Other non-residential	44,017	24,869
Total commercial real estate	317,218	303,694
Construction/land:		
One-to-four family residential	76,404	67,842
Multifamily	123,497	111,051
Commercial	1,100	—
Land	39,012	30,055
Total construction/land	240,013	208,948
Total commercial, multifamily and construction/land loans	$683,115	$ 635,892

During the first six months of 2017, total construction/land loans increased by $31.1 million as compared to December 31, 2016. The LIP related to these loans increased by $16.4 million as the unfunded portion of new loan originations exceeded disbursements on existing loans. Included in total construction/land loans, net of LIP, at June 30, 2017 are $48.9 million of multifamily loans, $25,000 of commercial loans and $1.1 million of one-to-four family loans that will roll over to permanent loans at the completion of their construction period in accordance with the terms of the construction/land loan.

To assist in our strategic initiatives for loan growth, the Bank will utilize loan participations or loan purchases within Washington or in the Western United States. The Bank’s goal with respect to participations is to locate a selling bank that is unable to make an entire loan due to legal or lending concentration limitations. Sellers of these loans are reviewed for management/lending experience, financial condition, asset quality metrics, and regulatory matters. Loans acquired through participation or purchase must meet the Bank’s underwriting standards. During the six months ended June 30, 2017, the Bank purchased participation interests in seven loans in Washington and California for a total of $23.3 million.

The majority of our loan portfolio continues to be focused in our primary market area, however we are also seeking geographic diversification. Through loan purchases and by loan originations initiated by our California employee, we have acquired loans secured by collateral located in Arizona, California, Colorado, Oregon, and Utah. At June 30, 2017, total loans secured by collateral located in California represented 2.1% of our total loans, net of LIP and total loans secured by collateral located outside the states of California and Washington represented 4.8% of our total loans,

net of LIP. The following table details geographic concentrations in our loan portfolio, net of LIP:

	At June 30, 2017						
	One-to-four family residential	Multifamily	Commercial real estate	Construction/land	Business	Consumer	Total
	(In thousands)						
King County	$192,685	$78,548	$162,228	$131,287	$8,908	$7,980	$581,636
Pierce County	37,908	15,044	27,198	3,766	—	511	84,427
Snohomish County	12,177	2,189	30,215	15,151	63	214	60,009
Kitsap County	1,632	1,536	823	135	—	78	4,204
California	—	—	17,911	—	439	—	18,350
Other Washington Counties	11,648	17,078	53,082	1,743	1,361	248	85,160
Outside Washington and California	582	11,489	25,218	—	4,435	—	41,724
Total loans, net of LIP	$256,632	$125,884	$316,675	$152,082	$15,206	$9,031	$875,510

Our five largest borrowing relationships, which represent 9.9% of our net loans, increased by $7.5 million to $87.0 million at June 30, 2017 from $79.5 million at December 31, 2016. The total number of loans represented by this group of borrowers increased to 30 loans at June 30, 2017 from 23 loans at December 31, 2016. At June 30, 2017, all five borrowers were current on their loan payments. We monitor the performance of these borrowing relationships very closely due to their concentration risk in relation to the entire loan portfolio. The following table details our five largest lending relationships at June 30, 2017:

Borrower [1]	Number of Loans	One-to-Four Family Residential [2]	Multifamily	Commercial Real Estate	Construction/ Land	Consumer	Aggregate Balance of Loans [3]
	(Dollars in thousands)						
Real estate investor	2	$ 562	$ —	$ —	$ 22,000	$ —	$ 22,562
Real estate investor	17	—	17,417	832	—	—	18,249
Real estate investor	4	469	—	15,552	—	—	16,021
Real estate investor	5	461	—	14,443	—	500	15,404
Real estate investor	2	—	—	—	14,755	—	14,755
Total	30	$ 1,492	$ 17,417	$ 30,827	$ 36,755	$ 500	$ 86,991

[1] The composition of borrowers represented in the table may change between periods.

[2] $930,000 of the one-to-four family residential loans for these borrowers are for owner occupied properties while $562,000 is for non-owner occupied. The commercial real estate loans are for non-owner occupied properties.

[3] Net of LIP.

The ALLL increased to $11.3 million at June 30, 2017, from $11.0 million at December 31, 2016, and represented 1.3% of total loans receivable, net of LIP at both June 30, 2017 and December 31, 2016. The ALLL consists of two components, the general allowance and the specific reserves. The increase in the ALLL, primarily a result of growth in our loan portfolio, consisted of a $439,000 increase in the general reserve, which included $34,000 of recoveries, and a $105,000 decrease in the specific reserves. For additional information, see "Comparison of Operating Results for the Three Months Ended June 30, 2017 and 2016 - Provision for Loan Losses" discussed below.

We believe that the ALLL at June 30, 2017, was adequate to absorb the probable and inherent risks of loss in the loan portfolio at that date. While we believe the estimates and assumptions used in our determination of the adequacy of the allowance are reasonable, there can be no assurance that such estimates and assumptions will be proven correct in the future, that the actual amount of future losses 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 allowance 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 our ALLL is subject to review by bank regulators as part of the routine examination process, which 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.

As we work with our borrowers that face difficult financial circumstances, we explore various options available to minimize our risk of loss. At times, the best option for our customers and the Bank is to modify the loan for a period of time, usually one year or less. Certain loan modifications are accounted for as troubled debt restructured loans ("TDRs"). These modifications have included a reduction in interest rate on the loan for a period of time, advancing the maturity date of the loan, or allowing interest-only payments for a specific time frame. These modifications are granted only when there is a reasonable and attainable restructured loan plan that has been agreed to by the borrower and is considered to be in the Bank's best interest.

The following table presents a breakdown of our TDRs at the dates indicated:

	June 30, 2017	December 31, 2016	Six Month Change
	(Dollars in thousands)		
Nonperforming TDRs:			
One-to-four family residential	$106	$ 174	$(68)
Total nonperforming TDRs	106	174	(68)
Performing TDRs:			
One-to-four family residential	19,152	24,274	(5,122)
Multifamily	1,146	1,564	(418)
Commercial real estate	3,660	4,202	(542)
Consumer	43	43	—
Total performing TDRs	24,001	30,083	(6,082)
Total TDRs	$24,107	$ 30,257	$(6,150)
% TDRs classified as performing	99.6 %	99.4 %	

Our TDRs decreased $6.2 million at June 30, 2017, compared to December 31, 2016, as a result of principal repayments and loan payoffs. At June 30, 2017, one TDR of $106,000 was on nonaccrual status because it had previously not performed in accordance with the terms of its restructure although now current on its payments. There were no committed but undisbursed funds in connection with our TDRs and impaired loans. The largest TDR relationship at June 30, 2017, totaled $8.2 million and was comprised of $7.5 million in one-to-four family residential rental properties and $747,000 in owner occupied commercial property, all located in King County.

Loans are considered past due if a scheduled principal or interest payment is due and unpaid for 30 days or more. At June 30, 2017, total past due loans represented 0.01% of total loans receivable, as compared to 0.06% at December 31, 2016.

Nonperforming assets decreased to $2.4 million at June 30, 2017, compared to $3.2 million at December 31, 2016. The following table presents detailed information on our nonperforming assets at the dates indicated:

	June 30, 2017	December 31, 2016	Six Month Change
	(Dollars in thousands)		
Nonperforming loans:			
One-to-four family residential	$528	$ 798	$ (270)
Consumer	55	60	(5)
Total nonperforming loans	583	858	(275)
OREO	1,825	2,331	(506)
Total nonperforming assets [(1)]	$2,408	$ 3,189	$ (781)
Nonperforming assets as a percent of total assets	0.22 %	0.31 %	

(1) The difference between nonperforming assets reported above, and the totals reported by other industry sources, is due to their inclusion of all TDRs as nonperforming loans, although 99.6% of our TDRs were performing in accordance with their restructured terms at June 30, 2017. The remaining 0.4% of TDRs at June 30, 2017, that were nonperforming are reported above as nonperforming loans.

Nonaccrual loans are loans that are 90 days or more delinquent or other loans which, in management's opinion, the borrower is unable to meet scheduled payment obligations. Nonaccrual loans decreased to $583,000 at June 30, 2017, from $858,000 at December 31, 2016. During the first six months of 2017, one loan with a $62,000 balance was returned to accrual status as a result of consistent payments for a period of time and demonstration of the ability to continue making payments. Further reductions in nonperforming loans were the result of $213,000 in principal payments and payoffs of nonaccrual loans during this period. There were no charge-offs or loans added to nonaccrual status.

The three largest nonaccrual loans in the loan portfolio at June 30, 2017, included a $283,000 owner occupied single family residence in Snohomish County, a $131,000 owner occupied single family residence in Snohomish County, and a $106,000 owner occupied single family residence in King County. Each of these loans is current on its loan payments.

We continue to focus our efforts on working with borrowers to bring their loans current or converting nonaccrual loans to OREO and subsequently selling the properties. By taking ownership of these properties, we can generally convert nonearning assets into earning assets on a more timely basis than which may otherwise be the case. Our success in this area is reflected by the continued improved ratio of our nonperforming assets as a percent of total assets, which declined to 0.22% at June 30, 2017, compared to 0.31% at December 31, 2016.

OREO. OREO includes properties acquired by the Bank through foreclosure or acceptance of a deed in lieu of foreclosure. At June 30, 2017, and December 31, 2016, OREO was $1.8 million and $2.3 million, respectively. During the six months ended June 30, 2017, a $50,000 market valuation adjustment was taken on a property for which we had entered into a sale contract. The sale of this property closed in April 2017.

The three largest OREO properties at June 30, 2017, were an office building valued at $837,000 located in Pierce County, a retail building valued at $505,000 in Mason County, and undeveloped land valued at $270,000 in Pierce County.

The following table presents a breakdown of our OREO by county and number of properties at June 30, 2017:

	County				
	Pierce	Mason	Total OREO	Number of Properties	Percent of Total OREO
	(Dollars in thousands)				
OREO:					
Commercial real estate [(1)]	$1,320	$ 505	$1,825	4	100.0%
Total OREO	$1,320	$ 505	$1,825	4	100.0%

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[(1)] Of the four properties classified as commercial real estate, two are office/retail buildings and two are undeveloped lots.

Deposits. During the first six months of 2017, deposits increased $18.1 million to $735.6 million at June 30, 2017, compared to $717.5 million at December 31, 2016. Deposit accounts consisted of the following:

	June 30, 2017	Change from December 31, 2016	Percent Change
	(Dollars in thousands)		
Noninterest-bearing	$35,126	$ 1,704	5.1 %
Interest-bearing checking	21,059	2,527	13.6
Statement savings	26,668	(1,715)	(6.0)
Money market	232,206	27,208	13.3
Certificates of deposit, retail	345,028	(11,625)	(3.3)
Certificates of deposit, brokered	75,488	—	—
	$735,575	$ 18,099	2.5

The increase during the first six months of 2017 was predominantly in retail deposits reflecting our strategy to grow our core deposits. Growth occurred in both our noninterest-bearing and interest-bearing checking accounts and money market accounts as we pursue these sources of lower cost funding.

Our portfolio of brokered certificates of deposits remained at $75.5 million at June 30, 2017, unchanged from December 31, 2016. We may add to our portfolio of these brokered deposits as a source of additional funding in future periods. While brokered certificates of deposit may carry a higher cost than our retail certificates, their remaining maturity periods of 13 to 43 months, along with the enhanced call features of these deposits, assist us in our efforts to manage interest rate risk.

At June 30, 2017 and December 31, 2016, we held $23.8 million and $23.7 million in public funds, respectively, nearly all of which were retail certificates of deposit.

Advances. We use advances from the FHLB as an alternative funding source to reduce interest rate risk and to leverage our balance sheet. Total FHLB advances were $191.5 million at June 30, 2017 and $171.5 million at December 31, 2016. At June 30, 2017, the Bank held $56.5 million in borrowings that are due in less than one year and $135.0 million in borrowings that are due in one to three years. Included in our total advances at that date is a $50.0 million three-month fixed-rate advance designated as a hedge instrument in a cash flow hedge, as described below. Included in the category of advances that are due in one to three years is a $120.0 million Member Option Variable Rate advance that reprices quarterly and allows prepayment without penalties on the repricing date.

Cash Flow Hedge. To assist in managing interest rate risk, the Bank entered into a five-year, $50 million notional, pay fixed, receive floating cash flow hedge or interest rate swap with a qualified institution on October 25, 2016. Under the terms of the agreement, the Bank will pay a fixed rate of 1.34% for five years and, will in turn, receive an interest payment based on the three-month LIBOR index, which resets quarterly. Concurrently, the Bank borrowed a $50.0 million fixed rate three-month advance that will be renewed quarterly at the fixed interest rate in effect at that time. Effectiveness of the swap is evaluated quarterly with any ineffectiveness recognized as a gain or a loss on the income statement in noninterest income. A change in the fair value of the cash flow hedge is recognized as an other asset or other liability on the balance sheet with the tax-effected portion of the change included in other comprehensive income. At June 30, 2017, we recognized a $1.1 million fair value asset as a result in the increase in the market value

of the hedge agreement.

Stockholders' Equity. Total stockholders' equity increased $5.4 million during 2017 to $143.5 million at June 30, 2017, from $138.1 million at December 31, 2016. Additional paid-in capital increased $1.6 million as a result of the exercise of stock options for 115,880 shares during the six months ended June 30, 2017. Also contributing to the increase, retained earnings increased $2.9 million during the six months ended June 30, 2017, as a result of $4.2 million in net income partially offset by $1.3 million paid out in shareholder dividends.

The following table shows cash dividends paid per share and the related dividend payout ratio for the periods indicated:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Dividend declared per common share	$0.07	$0.06	$0.13	$0.12
Dividend payout ratio [1]	38.9 %	51.8 %	32.0 %	46.4 %

[1] Dividends paid per common share divided by basic earnings per common share

The Company has a share repurchase plan in effect from May 30, 2017 through November 30, 2017 authorizing the repurchase of 1,100,000 shares, or 10.0% of outstanding shares. At June 30, 2017, the Company had repurchased 22,700 shares at an average price of $15.93 per share.

Comparison of Operating Results for the Three Months Ended June 30, 2017 and 2016

General. Net income for the three months ended June 30, 2017 was $1.9 million, or $0.18 per diluted share as compared to net income of $1.4 million, or $0.11 per diluted share for the quarter ended June 30, 2016. The $428,000 increase in net income during the first quarter of 2017 was primarily a result of an increase in net interest income and a decrease in the provision for loan losses partially offset by an increase in noninterest expense.

Net Interest Income. Net interest income for the quarter ended June 30, 2017 increased $814,000 to $9.0 million, as compared to $8.2 million for the first quarter in 2016, due to the $1.4 million increase in our interest income partially offset by a $633,000 increase in interest expense. Interest income primarily increased as a result of the growth in average loans receivable. Our net interest margin was 3.60% for the quarter ended June 30, 2017, compared to 3.63% for the quarter ended June 30, 2016. The change between quarters was primarily attributed to increased costs associated with interest-bearing liabilities due to the recent increases in short term interest rates.

The following table details the change in net interest income due to changes in yield or cost, or changes in the average balance of the related asset or liability:

	Three Months Ended June 30, 2017 Compared to June 30, 2016		
	Net Change		
	Rate	Volume	Total
	(In thousands)		
Interest-earning assets:			
Loans receivable, net	$(176)	$1,480	$1,304
Investments available-for-sale	138	(8)	130
Interest-earning deposits with banks	22	(27)	(5)
FHLB stock	—	18	18
Total net change in income on interest-earning assets	(16)	1,463	1,447
Interest-bearing liabilities:			
Interest-bearing demand	13	1	14
Statement savings	(1)	(1)	(2)
Money market	125	21	146
Certificates of deposit, retail	58	76	134
Certificates of deposit, brokered	2	41	43

Advances from the FHLB	163	135	298
Total net change in expense on interest-bearing liabilities	360	273	633
Total net change in net interest income	$(376)	$1,190	$814

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The $1.3 million increase in loan interest income during the second quarter of 2017, as compared to the same period in 2016, was a result of a $118.7 million increase in the average outstanding loan balance partially offset by a decrease in the average loan yield of nine basis points. Higher yielding loans continue to be repaid while rates of new loan originations remain relatively unchanged in spite of the recent rate increases in the Federal Funds rate by the Federal Reserve Board.

During the first quarter of 2017, interest income from our investments available-for-sale increased by $130,000 as compared to the same period in 2016. The average balance of our investments available-for-sale for the three months ended June 30, 2017 decreased by $1.4 million as compared to the same period last year as sales and paydowns outpaced purchases of new investments. As a result of restructuring our available-for-sale investment portfolio through the sales of lower yielding investment securities, and utilizing the proceeds received to purchase higher yielding, long-term investment securities last year, our yield on these assets increased by 42 basis points for the three months ended June 30, 2017, as compared to the same period in 2016.

Partially offsetting the increase in interest income, interest expense increased by $633,000 for the three months ended June 30, 2017, as compared to the same period in 2016. The average balance of our interest-bearing liabilities increased $116.4 million over the last year to support the growth in our financial assets. The average balance of deposits increased by $55.1 million for the three months ended June 30, 2017 as compared to the same period in 2016, including growth in retail certificates of deposit of $26.0 million, money market accounts of $19.5 million, brokered certificates of deposit of $9.9 million, and interest-bearing checking accounts of $2.8 million. These increases were partially offset by a decrease of $3.1 million in the average balance of our statement savings accounts. The average cost of our deposits increased by 12 basis points for the three months ended June 30, 2017, as compared to the same period in 2016. In further support of our asset growth, average borrowings at the FHLB increased by $61.2 million for the three months ended June 30, 2017, and the average cost of these funds increased 35 basis points as compared to the same period in 2016. The average cost of both our deposits and FHLB borrowings increased for the three months ended June 30, 2017, as compared to the same period in 2016 in response to increases in the Federal Funds rate.

The following table compares detailed average balances, related interest income or interest expense, associated yields and rates, and the resulting net interest margin for the three months ended June 30, 2017 and 2016. Nonaccrual loans are included in the average balance of net loans receivable and are considered to carry a zero yield.

	Three Months Ended June 30,					
	2017			2016		
	Average Balance	Interest Earned / Paid	Yield / Cost	Average Balance	Interest Earned / Paid	Yield / Cost
	(Dollars in thousands)					
Assets						
Loans receivable, net	$844,853	$10,352	4.91%	$726,109	$9,048	5.00%
Investments available-for-sale	132,375	887	2.69	133,813	757	2.27
Interest-earning deposits with banks	16,831	42	1.00	39,167	47	0.48
FHLB stock	8,616	62	2.89	6,097	44	2.89
Total interest-earning assets	1,002,675	11,343	4.54	905,186	9,896	4.39
Noninterest earning assets	63,802			58,002		
Total average assets	$1,066,477			$963,188		
Liabilities and Stockholders' Equity						
Interest-bearing checking	$20,426	$19	0.37%	$17,592	$5	0.11%
Statement savings	27,366	10	0.15	30,449	12	0.16
Money market	220,241	358	0.65	200,738	212	0.42
Certificates of deposit, retail	349,401	1,075	1.23	323,390	941	1.17
Certificates of deposit, brokered	75,488	314	1.67	65,612	271	1.66
Total interest-bearing deposits	692,922	1,776	1.03	637,781	1,441	0.91
Advances from the FHLB	184,357	570	1.24	123,148	272	0.89
Total interest-bearing liabilities	877,279	2,346	1.07	760,929	1,713	0.90
Noninterest bearing liabilities	45,555			33,082		
Average equity	143,643			169,177		
Total average liabilities and equity	$1,066,477			$963,188		
Net interest income		$8,997			$8,183	
Net interest margin			3.60%			3.63%

Provision 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 reserves. The general reserve is determined by applying factors to our various groups of loans. Management considers factors such as charge-off history, the prevailing economy, 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 reserve 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 if future events differ from current estimates.

During the quarter ended June 30, 2017, management evaluated the adequacy of the ALLL and concluded that additional provision for loan losses in the amount of $100,000 was appropriate for the quarter. For the quarter ended June 30, 2016, a $600,000 provision for loan losses was recorded. For the second quarter of 2017, the provision for loan losses was primarily a result of growth in our loan receivables partially offset by payoffs and credit improvements to certain adversely classified loans. In comparison, the provision reported in the second quarter of 2016 was primarily a result of an increase in the balance of our loans receivable.

The following table summarizes selected financial data related to our ALLL and loan portfolio. All loan balances and ratios are calculated using loan balances that are net of LIP.

	At or For the Three Months Ended June 30,	
	2017	2016
	(Dollars in thousands)	
Total loans receivable, net of LIP, end of period	$875,510	$778,120
Average loans receivable during period	844,853	726,109
ALLL balance at beginning of period	11,158	9,471
Provision for loan losses	100	600
Charge-offs:		
Consumer	—	—
Total charge-offs	—	—
Recoveries:		
One-to-four family	27	63
Total recoveries	27	63
Net recovery	27	63
ALLL balance at end of period	$11,285	$10,134
ALLL as a percent of total loans, net of LIP	1.29 %	1.30 %
Ratio of net recoveries to average net loans receivable	0.01	0.03

Noninterest Income. Noninterest income increased $23,000 to $731,000 for the quarter ended June 30, 2017, from $708,000 for the quarter ended June 30, 2016. The following table provides a detailed analysis of the changes in the components of noninterest income:

	Three Months Ended June 30, 2017	Change from Three Months Ended June 30, 2016	Percent Change
	(Dollars in thousands)		
Service fees on deposit accounts	38	9	31.0 %
Loan service fees	120	39	48.1
Net gain on sale of investments	56	56	100.0
BOLI change in cash surrender value	116	(109)	(48.4)
Wealth management revenue	307	26	9.3
Other	94	2	2.2
Total noninterest income	731	23	3.2

The increase in the quarter ended June 30, 2017, compared to the quarter ended June 30, 2016, was partially the result of the $56,000 gain on sales of a portion of a corporate bond and two mortgage-backed securities during the second quarter of 2017. During the same period in 2016, we did not sell any of our investment securities. Further contributing to the increase in 2017, loan service fees increased by $39,000 as a result of increased prepayment penalties and wealth management revenue increased by $26,000 as we continue to expand our portfolio of managed accounts. These increases were partially offset by a decrease in noninterest income from our BOLI policies. During the second quarter of 2017, we purchased $4.2 million in additional policies where certain policy expenses are deducted from earnings over the first year, thereby reducing the overall noninterest income recognized from BOLI policies for the initial one year period.

Noninterest Expense. Noninterest expense increased $764,000 to $6.8 million for the quarter ended June 30, 2017 from $6.1 million for the comparable quarter in 2016.

The following table provides a detailed analysis of the changes in the components of noninterest expense:

	Three Months Ended June 30, 2017	Change from Three Months Ended June 30, 2016	Percent Change
	(Dollars in thousands)		
Salaries and employee benefits	$4,409	$ 568	14.8 %
Occupancy and equipment	579	91	18.6
Professional fees	482	(79)	(14.1)
Data processing	519	268	106.8
Gain on sale of OREO property, net	(5)	(94)	(105.6)
OREO related expenses, net	(15)	(1)	7.1
Regulatory assessments	112	(5)	(4.3)
Insurance and bond premiums	98	12	14.0
Marketing	52	12	30.0
Other general and administrative	605	(8)	(1.3)
Total noninterest expense	$6,836	$ 764	12.6 %

Expenses for salaries and employee benefits increased $568,000 for the second quarter of 2017, as compared to the same period in 2016 primarily as a result of increases in costs due to the increase in the number of employees. As a result of our new branches and the development of new products, the number of employees increased to 129 at June 30, 2017 from 118 at June 30, 2016. In addition, the change in timing of recognition of the compensation expense for directors' restricted stock awards resulted in $180,000 of additional expense for the quarter ended June 30, 2017 as compared to the same period in 2016.

As a result of our pending acquisition of four retail branches, our data processing expense increased by $268,000 for the quarter ended June 30, 2017 as compared to the same period in 2016 due primarily to the cost of data conversion of the accounts in these branches.

Partially offsetting these increases, professional fees decreased by $79,000, primarily as a result of a reduction in legal costs. During the second quarter of 2016, we incurred additional legal expenses relating to our modified Dutch auction tender offer completed in 2016. In addition, noninterest expense declined as we incurred a $5,000 gain on the sale of OREO property in the quarter ended June 30, 2017 as compared to a loss on sale of $89,000 for the quarter ended June 30, 2016.

Federal Income Tax Expense. Our statutory income tax rate is 35%. We recorded federal income tax provisions of $924,000 and $779,000 for the quarters ended June 30, 2017, and 2016, respectively, as a result of our consolidated pretax net income. Our effective tax rate for the quarter ended June 30, 2017 was 30.3%, which reflected the year-to-date impact of stock options exercised in the first quarter of 2017. In comparison, the effective tax rate for the quarter ended June 30, 2016 was 32.1%, which reflected reversal of nontaxable BOLI income and a 10% penalty on the early surrender a BOLI policy.

Comparison of Operating Results for the Six Months Ended June 30, 2017 and 2016

General. Net income for the six months ended June 30, 2017 was $4.2 million, or $0.40 per diluted share as compared to net income of $3.3 million, or $0.26 per diluted share for the six months ended June 30, 2016. Net interest income increased by $1.9 million year over year, however this was partially offset by a $1.1 million increase in noninterest expense.

Net Interest Income. Net interest income for the six months ended June 30, 2017 increased $1.9 million to $17.9 million, as compared to $16.0 million for the same period in 2016, due to the $2.9 million increase in our interest income partially offset by a $988,000 increase in interest expense. The increase in total interest income was primarily the result of the growth in average loans receivable. Our net interest margin was 3.62% for the six months ended June 30, 2017, compared to 3.54% for the six months ended June 30, 2016. The change between periods was primarily attributed to the increase in average loan balances and the increase in the average yield on interest-earning assets outpacing increased average costs associated with interest-bearing liabilities.

The following table details the change in net interest income due to changes in yield or cost, or changes in the average balance of the related asset or liability:

	Six Months Ended June 30, 2017 Compared to June 30, 2016 Net Change		
	Rate	Volume	Total
	(In thousands)		
Interest-earning assets:			
Loans receivable, net	$(628)	$3,232	$2,604
Investments available-for-sale	315	(15)	300
Interest-earning deposits with banks	35	(109)	(74)
FHLB stock	19	34	53
Total net change in income on interest-earning assets	(259)	3,142	2,883
Interest-bearing liabilities:			
Interest-bearing demand	25	1	26
Statement savings	(1)	(1)	(2)
Money market	197	19	216
Certificates of deposit, retail	135	165	300
Certificates of deposit, brokered	(91)	94	3
Advances from the FHLB	190	255	445
Total net change in expense on interest-bearing liabilities	455	533	988
Total net change in net interest income	$(714)	$2,609	$1,895

Average loans receivable increased $128.5 million for the six months ended June 30, 2017 as compared to the same period in 2016 while the average yield decreased to 4.92% from 5.07% for the six months ended June 30, 2017 and 2016, respectively as loans originated during the past year were at lower average rates than those paying off.

Interest income on our investments available-for-sale increased $300,000 for the six months ended June 30, 2017 as compared to the same period in 2016 primarily as a result of the 48 basis point increase in the yield on these assets. We have continued to restructure our portfolio of these securities to include additional longer term higher-yielding investment securities to increase earnings from our investment portfolio.

Interest income on our interest-earning deposits decreased $74,000 for the six months ended June 30, 2017 as compared to the same period in 2016, primarily as a result of the $43.3 million decrease in the average balance of these deposits as we shifted cash earning a nominal yield into higher yielding assets. Partially offsetting the impact of the decrease in average balance, the average yield earned on interest-earning deposits from the Federal Reserve Bank increased by 34 basis points year over year.

Partially offsetting the increase in interest income, our interest expense increased $988,000 for the six months ended June 30, 2017 as compared to the same period in 2016. The average cost of our deposits increased by nine basis points for the six months ended June 30, 2017, as compared to the same period in 2016. Interest expense on money market accounts increased by $216,000, year over year primarily due to an 18 basis point increase in the cost of these funds. In addition, interest expense on retail certificates of deposit increased by $300,000, primarily from a combined result of a $28.9 million increase in the average balance of these accounts and an eight basis point increase in the cost of these funds. Interest expense on our FHLB advances and other borrowings increased by $445,000 for the six months ended June 30, 2017, as compared to the same period in 2016 as a result of a $55.0 million increase in the average balance of FHLB advances and a 22 basis point increase in the cost of these funds.

The following table compares detailed average balances, associated yields and rates, and the resulting changes in interest and dividend income or expense for the six months ended June 30, 2017 and 2016. Nonaccrual loans are

included in the average balance of net loans receivable and are considered to carry a zero yield.

	Six Months Ended June 30,					
	2017			2016		
	Average Balance	Interest Earned / Paid	Yield or Cost	Average Balance	Interest Earned / Paid	Yield or Cost
	(Dollars in thousands)					
Assets						
Loans receivable, net	$835,106	$20,379	4.92%	$706,606	$17,775	5.07%
Investments available-for-sale	130,693	1,732	2.67	132,073	1,432	2.19
Interest-earning deposits with banks	20,512	86	0.85	63,774	160	0.51
FHLB stock	8,327	144	3.49	6,066	91	3.03
Total interest-earning assets	994,638	22,341	4.53	908,519	19,458	4.32
Noninterest earning assets	61,848			58,291		
Total average assets	$1,056,486			$966,810		
Liabilities and Stockholders' Equity						
Interest-bearing checking	$19,956	$35	0.35%	$17,290	$9	0.10%
Statement savings	27,717	21	0.15	28,733	23	0.16
Money market	215,071	641	0.60	205,968	425	0.42
Certificates of deposit, retail	352,391	2,147	1.23	323,524	1,847	1.15
Certificates of deposit, brokered	75,488	623	1.66	65,516	620	1.91
Total interest-bearing deposits	690,623	3,467	1.01	641,031	2,924	0.92
Advances from the FHLB	177,964	1,015	1.15	123,017	570	0.93
Total interest-bearing liabilities	868,587	4,482	1.04	764,048	3,494	0.92
Noninterest bearing liabilities	45,796			32,948		
Average equity	142,103			169,814		
Total average liabilities and equity	$1,056,486			$966,810		
Net interest income		$17,859			$15,964	
Net interest margin			3.62%			3.54%

Provision for Loan Losses. During the six months ended June 30, 2017, management evaluated the adequacy of the ALLL and concluded that additional provision for loan losses in the amount of $300,000 was appropriate for the period. The provision for the six months ended June 30, 2017 was primarily a reflection of the $46.6 million growth in net loans receivable partially offset by payoffs and credit improvements to certain adversely classified loans. For the six months ended June 30, 2016, an additional provision of $500,000 was recorded as a result of loan growth.

The following table summarizes selected financial data related to our ALLL and loan portfolio. All loan balances and ratios are calculated using loan balances that are net of LIP.

	At or For the Six Months Ended June 30,	
	2017	2016
	(Dollars in thousands)	
Total loans receivable, net of LIP, end of period	$875,510	$778,120
Average loans receivable during period	835,106	706,606
ALLL balance at beginning of period	10,951	9,463
Provision for loan losses	300	500
Charge-offs:		
Consumer	—	(19)
Total charge-offs	—	(19)
Recoveries:		
One-to-four family	33	85
Commercial real estate	—	104
Consumer	1	1
Total recoveries	34	190
Net recovery	34	171
ALLL balance at end of period	$11,285	$10,134
ALLL as a percent of total loans, net of LIP	1.29 %	1.30 %
Ratio of net recoveries to average net loans receivable (annualized)	0.01	0.05

Noninterest Income. Noninterest income increased $78,000 to $1.3 million for the six months ended June 30, 2017, from $1.2 million for the same period in 2016. The following table provides a detailed analysis of the changes in the components of noninterest income:

	Six Months Ended June 30, 2017	Change from Six Months Ended June 30, 2016	Percent Change
	(Dollars in thousands)		
Service fees on deposit accounts	$63	$ 19	43.2 %
Loan service fees	155	26	20.2
Net gain on sale of investments	56	56	n/a
BOLI change in cash surrender value	317	(73)	(18.7)
Wealth management revenue	447	(44)	(9.0)
Other	228	94	70.1
Total noninterest income	$1,266	$ 78	6.6

The largest change to our noninterest income for the six months ended June 30, 2017 as compared to the same period in 2016 was the $95,000 increase in other noninterest income. This increase was a result of an additional $77,000 of fees received during the 2017 six month period on loans where certain commercial loan customers participate in an interest rate swap with a third party broker institution and the Bank receives a fee that is recognized as other noninterest income at the time the loan is originated. In addition, sales of investment securities generated a $56,000 gain for the six months ended June 30, 2017, compared to none for the same period in 2016. Loan servicing fees, primarily from prepayment penalties, increased by $26,000 year over year. Partially offsetting these increases, BOLI noninterest income from the change in cash surrender value of our policies decreased by $74,000 during the six months ended June 30, 2017 as compared to the same period in 2016, primarily due to expenses relating to the $4.1 million in additional BOLI policies purchased during the second quarter of 2017, as discussed above. Further

offsetting our income, our wealth management revenue decreased $44,000 for the first six months of 2017 as compared to the same period in 2016 as a result of normal fluctuations in business activity.

Noninterest Expense. Noninterest expense increased $1.1 million to $12.9 million for the six months ended June 30, 2017 as compared to the same period in 2016.

The following table provides a detailed analysis of the changes in the components of noninterest expense:

	Six Months Ended June 30, 2017	Change from Six Months Ended June 30, 2016	Percent Change
	(Dollars in thousands)		
Salaries and employee benefits	$8,694	$1,079	14.2 %
Occupancy and equipment	1,059	63	6.3
Professional fees	921	(108)	(10.5)
Data processing	759	318	72.1
(Gain) loss on sales of OREO property, net	(5)	(92)	(105.7)
OREO market value adjustments	50	(207)	(80.5)
OREO-related expenses, net	(25)	9	(26.5)
Regulatory assessments	208	(29)	(12.2)
Insurance and bond premiums	197	23	13.2
Marketing	100	22	28.2
Other general and administrative	946	(19)	(2.0)
Total noninterest expense	$12,904	$1,059	8.9 %

Salaries and employee benefits expense increased $1.1 million for the first six months of 2017 as compared to the same period in 2016. The number of employees increased from June 30, 2016 to June 30, 2017, as we added employees to support our branch expansions. Data processing increased by $318,000 primarily as a result of the cost of data conversion related to our pending acquisition of four retail branches. These increases were partially offset by a $207,000 decrease in OREO market value adjustments. During the first six months of 2016, we reduced the carrying value of OREO properties by $257,000 primarily as the result of a sales contract on one property. The sale fell through in 2016, however a new sale contract was agreed on during the first six months of 2017, resulting in a $50,000 additional write-down.

Federal Income Tax Expense. Our statutory income tax rate is 35%. We recorded federal income tax provisions of $1.7 million and $1.5 million for the six months ended June 30, 2017, and 2016 as a result of our consolidated net income. Our effective tax rate for the six months ended June 30, 2017 was 30.3% partially as a result of tax benefit from the exercise of stock options earlier in 2017. In comparison, the effective tax rate for the six months ended June 30, 2016 was 32.1% as a result of the reversal of noninterest income and a tax penalty from the early surrender of BOLI policies, partially offset by a benefit from the exercise of stock options.

Liquidity

We are required to have enough cash flow in order to maintain sufficient liquidity to ensure a safe and sound operation. We maintain cash flows above the minimum level believed to be adequate to meet the requirements of normal operations, including potential deposit outflows. On a daily basis, we review and update cash flow projections to ensure that adequate liquidity is maintained.

Our primary sources of funds are customer deposits, cash flow from the loan and investment portfolios, advances from the FHLB, and to a lesser extent, brokered certificates of deposit. These funds, together with equity, are used to make loans, acquire investment securities and other assets, and fund continuing operations. At June 30, 2017, retail certificates of deposit scheduled to mature in one year or less totaled $155.3 million. Management’s practice is to maintain deposit rates at levels that are competitive with other local financial institutions. While maturities and the

scheduled amortization of loans are a predictable source of funds, deposit flows and mortgage prepayments are greatly influenced by the level of interest rates, economic conditions and competition. We measure our liquidity based on our ability to fund our assets and to meet liability obligations when they come due. Liquidity (and funding) risk occurs when funds cannot be raised at reasonable prices or in a reasonable time frame to meet our normal or unanticipated obligations. We regularly monitor the mix between our assets and our liabilities to manage effectively our liquidity and funding requirements.

When deposits are not readily available and/or cost effective to provide the funds for our assets, we use alternative funding sources. These sources include, but are not limited to: advances from the FHLB, wholesale funding, national certificates of deposit listing services, brokered deposits, federal funds purchased and dealer repurchase agreements, as well as other short-term alternatives. These funding sources are generally collateral dependent. We may also liquidate assets to meet our funding needs.

The balance of our investments available-for-sale increased $4.7 million from December 31, 2016, to $134.0 million at June 30, 2017, and represents a ready source of cash if needed. The balance of our interest-earning deposits with banks decreased by $14.6 million from December 31, 2016 to June 30, 2017, as we shifted cash into higher yielding assets. At June 30, 2017, the Bank maintained credit facilities with the FHLB totaling $370.4 million, with an outstanding balance of $191.5 million. At June 30, 2017, we also had available a total of $35.0 million credit facilities with other financial institutions, with no balance outstanding. For additional information, see the Consolidated Statements of Cash Flows in Item 1 of this Form 10-Q.

To assist in our funds acquisition and interest rate risk management efforts, management utilizes the national brokered deposit market and maintained a balance at June 30, 2017 of $75.5 million of brokered certificates of deposit. In contrast to most retail certificate of deposit offerings which provide the depositor with an option to withdraw their funds prior to maturity, subject to an early withdrawal penalty, certificates of deposit acquired in the brokered market limits the depositor ability to withdraw the funds before the end of the term (except in the case of death or adjudication of incompetence of a depositor) which greatly reduces early redemption risk associated with retail deposits. This strategy may include, but is not necessarily limited to, raising longer term deposits (with terms greater than three years) that assist the Bank in its interest rate risk management efforts. At June 30, 2017, brokered certificates of deposit had a remaining maturity of 13 to 43 months. Most of these certificates also provide the Bank the option to redeem the deposit after six months, a favorable distinction compared to retail certificate of deposit terms that are offered in our local market. With these redemption limitations and call features, the cost of these brokered deposits is generally higher than our retail certificate of deposit offerings. Consequently, as we increase our brokered deposits, our cost of funds may increase.

First Financial Northwest is a separate legal entity from the Bank and, on a stand-alone level, must provide for its own liquidity and pay its own operating expenses and cash dividends. First Financial Northwest's primary sources of funds consist of dividends from the Bank, although there are regulatory requirements related to the ability of the Bank to pay dividends. At June 30, 2017, the Company (on an unconsolidated basis) had liquid assets of $17.7 million and short-term liabilities of $153,000.

On a monthly basis, we estimate our liquidity sources and needs for the next six months. Also, we determine funding concentrations and our need for sources of funds other than deposits. This information is used by our Asset/Liability Management Committee (“ALCO”) in forecasting funding needs and investing opportunities. We believe that our current liquidity position and our expected operating results are sufficient to fund all of our existing commitments.

Commitments and Off-Balance Sheet Arrangements

We are a party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of our customers. These financial instruments include commitments to extend credit and the unused portions of lines of credit. These instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated financial statements. Commitments to extend credit and lines of credit are not recorded as an asset or liability by us until the instrument is exercised. At June 30, 2017 and December 31, 2016, we had no commitments to originate loans for sale.

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the loan agreement. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. We evaluate each customer’s creditworthiness on a case-by-case basis. The amount of the collateral obtained, if deemed necessary by us upon the extension of credit, is based on our credit evaluation of the customer. The amount and type of collateral required varies, but may include real estate and income-producing commercial properties.

The following table summarizes our outstanding commitments to advance additional amounts pursuant to outstanding lines of credit and to disburse funds related to our construction loans at June 30, 2017:

	Total Amounts Committed	Amount of Commitment Expiration			
		Through One Year	After One Through Three Years	After Three Through Five Years	After Five Years
	(In thousands)				
Unused portion of lines of credit	$24,136	$1,584	$14,746	$ 3,321	$4,485
Undisbursed portion of construction loans	88,475	37,420	51,055	—	—
Total commitments	$112,611	$39,004	$65,801	$ 3,321	$4,485

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We anticipate that we will continue to have sufficient funds and alternative funding sources to meet our current commitments.

As of June 30, 2017, the Bank had four operating leases with initial terms of five to eight years which carry minimum lease payments of $18,000 per month. All four leases offer extension periods. The Bank signed a fifth lease agreement in April 2017 for the new branch office in Bothell, Washington that is expected to open in the fourth quarter of 2017. With the pending acquisition of four retail branches, the Bank will assume the leases for the Woodinville, Lake Stevens, and Smokey Point locations when the acquisition is scheduled to close during the third quarter of 2017, subject to DFI approval and other customary closing conditions.

First Financial Northwest and its subsidiaries from time to time are involved in various claims and legal actions arising in the ordinary course of business. There are currently no matters that in the opinion of management would have a material adverse effect on First Financial Northwest's consolidated financial position, results of operation, or liquidity.

Capital

At June 30, 2017, stockholders' equity totaled $143.5 million, or 13.27% of total assets. Our book value per share of common stock was $13.00 at June 30, 2017, compared to $12.63 at December 31, 2016. Consistent with our goal to operate a sound and profitable financial organization, we actively seek to maintain a "well-capitalized" status in accordance with regulatory standards.

As of June 30, 2017, the Bank and consolidated Company exceeded all regulatory capital requirements and the Bank was considered "well capitalized" under regulatory capital guidelines of the FDIC. The following table provides our capital requirements and actual results.

	At June 30, 2017					
	Actual		For Minimum Capital Adequacy Purposes		To be Categorized as "Well Capitalized"	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
	(Dollars in thousands)					
Tier I leverage capital (to average assets)						
Bank only	$122,001	11.46%	$42,591	4.00%	$53,239	5.00 %
Consolidated	144,498	13.55	42,663	4.00	53,328	5.00
Common equity tier I ("CET1") (to risk-weighted assets)						
Bank only	122,001	13.95	39,362	4.50	56,856	6.50
Consolidated	144,498	16.48	39,460	4.50	56,998	6.50
Tier I risk-based capital (to risk-weighted assets)						
Bank only	122,001	13.95	52,483	6.00	69,977	8.00
Consolidated	144,498	16.48	52,614	6.00	70,152	8.00
Total risk-based capital (to risk-weighted assets)						
Bank only	132,944	15.20	69,977	8.00	87,471	10.00
Consolidated	155,469	17.73	70,152	8.00	87,690	10.00

In addition to the minimum CET1, Tier 1 total capital and leverage ratios, the Bank is required to maintain a capital conservation buffer consisting of additional CET1 capital above the required minimum levels in order to avoid limitations on paying dividends, engaging in share repurchases, and paying discretionary bonuses based on

percentages of eligible retained income that could be utilized for such actions. This new capital conservation buffer requirement began to be phased in starting in January 2016 at 0.625% of risk-weighted assets and will increase each year until fully implemented to an amount equal to 2.5% of risk-weighted assets in January 2019.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

General. Our Board of Directors has approved an asset/liability management policy to guide management in maximizing net interest income by managing the differences in terms between interest-earning assets and interest-bearing liabilities while maintaining acceptable levels of liquidity, capital adequacy, interest rate sensitivity, credit risk, and profitability. The policy established an ALCO, comprised of certain members of senior management and the Board of Directors. The Committee's purpose is to manage, coordinate, and communicate our asset/liability position consistent with our business plan and Board-approved policy. The ALCO meets quarterly to review various areas including:

- economic conditions;
- interest rate outlook;
- asset/liability mix;
- interest rate risk sensitivity;
- current market opportunities to promote specific products;
- historical financial results;
- projected financial results; and
- capital position.

Additionally, the Committee reviews current and projected liquidity needs. As part of its procedures, the ALCO regularly reviews our interest rate risk by modeling the impact that changes in interest rates may have on earnings, particularly net interest income. The market value of portfolio equity, which is the net present value of an institution's existing assets less its liabilities and off-balance sheet instruments, is also modeled under several scenarios of changing interest rates. In both cases, results are evaluated and compared with the maximum potential change that is authorized by the Board of Directors.

Our Risk When Interest Rates Change. The rates of interest we earn on assets and pay on liabilities generally are established contractually for a period of time. Market interest rates change over time. Our loans generally have longer maturities than our deposits. Accordingly, our results of operations, like those of other financial institutions, are impacted by changes in interest rates and the interest rate sensitivity of our assets and liabilities. The risk associated with changes in interest rates and our ability to adapt to these changes is known as interest rate risk and is our most significant market risk.

We have utilized the following strategies in our efforts to manage interest rate risk:

- we are originating shorter term higher yielding loans, whenever possible;
- we have attempted, where possible, to extend the maturities of our deposits which typically fund our long-term assets;
- we have invested in securities with relatively short average lives, generally less than eight years;
- we have added adjustable-rate loans to our loan portfolio;
- we have added brokered certificates of deposit with a call option as a new funding source; and
- we have utilized an interest rate swap to effectively fix the rate on $50.0 million of FHLB advances.

We have evaluated the use of derivative instruments to limit the impact of interest rate changes on earnings, prepayment penalties and cash flows and to lower our cost of borrowing while taking into account variable interest rate risk. On October 25, 2016, the Bank entered into a Cash Flow Hedge agreement to effectively fix the rate on $50.0 million of FHLB advances. We are using this interest rate swap as a tool to lower the cost of certain FHLB advances as compared to the fixed rates offered by the FHLB for its longer term advances. At June 30, 2017, pursuant to the Cash Flow Hedge agreement we held a $50.0 million notional pay fixed, receive floating cash flow hedge. The Bank pays a fixed rate of 1.34% for five years and in turn, will receive an interest payment based on three-month LIBOR, which resets quarterly. The hedge instrument is a $50.0 million FHLB fixed-rate three-month advance that is renewed at the fixed rate at that time. Entering into this hedge agreement has allowed the Bank to secure fixed rate

funding at a lower cost than a traditional five-year fixed rate FHLB advance. We will continue to review similar instruments and may utilize them for interest rate risk management in the future.

Interest rate contracts, however, may expose us to the risk of loss associated with variations in the spread between the interest rate contract and the hedged item. In addition, these contracts carry volatility risk that the expected uncertainty relating to the price of the underlying asset differs from what is anticipated. If any interest rate swaps we enter into prove ineffective, it could

result in volatility in our operating results, including potential losses, which could have a material adverse effect on our results of operations and cash flows.

Brokered Deposits. During the third quarter of 2014, management added the national brokered deposit market as an additional source of funds and to assist efforts in managing interest rate risk. Utilizing brokered deposits might result in increased regulatory scrutiny, as such deposits are not viewed as favorably as core retail deposits and there can be no assurance that the Bank will be allowed to include brokered deposits in its deposit mix in the future. While management will attempt to weigh the benefits of brokered deposits against the costs and risks, there can be no assurance that its conclusions will necessarily be aligned with those of the Bank's regulators.

How We Measure the Risk of Interest Rate Changes. We monitor our interest rate sensitivity on a quarterly basis to measure the change in net interest income in varying rate environments. Management uses various assumptions to evaluate the sensitivity of our operations to changes in interest rates. Although management believes these assumptions are reasonable, the interest rate sensitivity of our assets and liabilities on net interest income and the market value of portfolio equity could vary substantially if different assumptions were used or actual experience differs from these assumptions. Although certain assets and liabilities may have similar maturities or periods of repricing, they may react differently to changes in market interest rates. The interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market interest rates, while interest rates on other types of assets and liabilities lag behind changes in market interest rates. Non-uniform changes and fluctuations in market interest rates across various maturities will also affect the results presented. In addition, certain assets, such as adjustable-rate mortgage loans, have features which restrict changes in interest rates on a short-term basis and over the life of the asset. A portion of our adjustable-rate loans have interest rate floors below which the loan's contractual interest rate may not adjust. Approximately 45.3% of our total loans, net LIP, were adjustable-rate loans at June 30, 2017. At that date, $105.2 million, or 26.5% of these loans were at their floor, with a weighted-average interest rate of 4.01%.

The inability of our loans to adjust downward can contribute to increased income in periods of declining interest rates. However, when loans are at their floors, there is a risk that our interest income may not increase as rapidly as our cost of funds during periods of increasing interest rates. Furthermore, in the event of a significant change in interest rates, prepayment and early withdrawal levels would likely deviate from those assumed. Finally, the ability of many borrowers to service their debt may decrease in the event of an interest rate increase. We consider all these factors in monitoring our interest rate exposure.

The assumptions we use are based upon a combination of proprietary and market data that reflect historical results and current market conditions. These assumptions relate to interest rates, loan prepayments, deposit decay rates and the market value of certain assets under the various interest rate scenarios. We use market data to determine prepayments and maturities of loans, investments and borrowings and use our own assumptions on deposit decay rates. The exception to this is time deposits, which are modeled to reprice to market rates upon their stated maturities. We also assume that non-maturity deposits can be maintained with rate adjustments not directly proportionate to the change in market interest rates, based upon our historical deposit decay rates which are substantially lower than market decay rates. We have demonstrated in the past that the tiering structure of our deposit accounts during changing rate environments results in relatively lower volatility and less than market rate changes in our interest expense for deposits. We tier our deposit accounts by balance and rate, whereby higher balances within an account earn higher rates of interest. Therefore, deposits that are not very rate sensitive (generally, lower balance tiers) are separated from deposits that are rate sensitive (generally, higher balance tiers). When interest rates rise, we do not have to raise interest rates proportionately on less rate sensitive accounts to retain these deposits. These assumptions are based upon our analysis of our customer base, competitive factors and historical experience.

Our income simulation model examines changes in net interest income in which interest rates were assumed to remain at their base level, instantaneously increase by 100, 200 and 300 basis points or decline immediately by 100 basis points. Reductions of rates by 200 and 300 basis points were not reported due to the current low rate environment.

The following table illustrates the change in our net interest income at June 30, 2017 that would occur in the event of an instantaneous change in interest rates equally across all maturities, with no effect given to any steps that we might take to counter the effect of that interest rate movement.

Net Interest Income Change at June 30, 2017

Basis Point Change in Rates	Net Interest Income	% Change
(Dollars in thousands)		
+300	$34,345	(1.65)%
+200	34,553	(1.06)
+100	34,817	(0.30)
Base	34,922	—
(100)	34,797	(0.36)

The following table illustrates the change in our net portfolio value ("NPV") at June 30, 2017 that would occur in the event of an immediate change in interest rates equally across all maturities, with no effect given to any steps that we might take to counter the effect of that interest rate movement.

Basis Point Change in Rates	Net Portfolio Value [1]			Net Portfolio as % of Portfolio Value of Assets		Market Value of Assets [5]
	Amount	$ Change [2]	% Change	NPV Ratio [3]	% Change [4]	
	(Dollars in thousands)					
+300	$125,628	$(33,700)	(21.15)%	12.46%	(3.11)%	$1,008,238
+200	136,764	(22,564)	(14.16)	13.24	(2.08)	1,032,991
+100	149,542	(9,786)	(6.14)	14.11	(0.90)	1,060,033
Base	159,328	—	—	14.69	—	1,084,760
(100)	164,943	5,615	3.52	14.90	0.52	1,107,219

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(1) The net portfolio value is the difference between the present value of the discounted cash flows of assets and liabilities and represents the market value of the Company's equity for any given interest rate scenario. Net portfolio value is useful for determining, on a market value basis, how equity changes in response to various interest rate scenarios. Large changes in net portfolio value reflect increased interest rate sensitivity and generally more volatile earnings streams.
(2) The increase or decrease in net portfolio value at the indicated interest rates compared to the net portfolio value assuming no change in interest rates.
(3) Net portfolio value divided by the market value of assets.
(4) The increase or decrease in the net portfolio value divided by the market value of assets.
(5) The market value of assets represents the value of assets under the various interest rate scenarios and reflects the sensitivity of those assets to interest rate changes.

The net interest income and net portfolio value tables presented above are predicated upon a stable balance sheet with no growth or change in asset or liability mix. In addition, the net portfolio value is based upon the present value of discounted cash flows using our estimates of current replacement rates to discount the cash flows. The effects of changes in interest rates in the net interest income table are based upon a cash flow simulation of our existing assets and liabilities and assuming that delinquency rates would not change as a result of changes in interest rates, although there can be no assurance that this will be the case. Delinquency rates may change when interest rates change as a result of changes in the loan portfolio mix, underwriting conditions, loan terms or changes in economic conditions that have a delayed effect on the portfolio. Even if interest rates change in the designated amounts, there can be no

assurance that our assets and liabilities would perform as set forth above. Also, a change in U.S. Treasury rates in the designated amounts accompanied by a change in the shape of the Treasury yield curve would cause changes to the net portfolio value and net interest income other than those indicated above.

At June 30, 2017, other than the interest rate swap we entered into through the Cash Flow Hedge agreement, we did not have any derivative financial instruments or trading accounts for any class of financial instruments, nor have we engaged in any other hedging activities or purchased off-balance sheet derivative instruments. However, we continue to review such instruments and may utilize them for interest rate risk management in the future. Interest rate risk continues to be one of our primary risks, as other types of risks, such as foreign currency exchange risk and commodity pricing risk do not arise in the normal course of our business activities and operations.

Item 4. Controls and Procedures

The management of First Financial Northwest, Inc. is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rule 13a-15(f) of the Securities Exchange Act of 1934 ("Exchange Act"). A control procedure, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that its objectives are met. Also, because of the inherent limitations in all control procedures, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. Additionally, in designing disclosure controls and procedures, our management was required to apply its judgment in evaluating the cost-benefit relationship of possible disclosure controls and procedures. The design of any disclosure controls and procedures is also based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. As a result of these inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Furthermore, projections of any evaluation of effectiveness to future periods are subject to risk that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate.

(a) Evaluation of Disclosure Controls and Procedures: An evaluation of our disclosure controls and procedures (as defined in Rule 13a-15(e) of the Exchange Act) was carried out under the supervision and with the participation of our Chief Executive Officer, Chief Financial Officer (Principal Financial Officer) and several other members of our senior management as of the end of the period covered by this report. Our Chief Executive Officer and Chief Financial Officer concluded that, as of June 30, 2017, our disclosure controls and procedures were effective in ensuring that the information required to be disclosed by us in the reports we file or submit under the Exchange Act is (i) accumulated and communicated to our management (including the Chief Executive Officer and Chief Financial Officer) in a timely manner and (ii) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

(b) Changes in Internal Controls: In the quarter ended June 30, 2017, there was no change in our internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II

Item 1. Legal Proceedings

From time to time, we are engaged in various legal proceedings in the ordinary course of business, none of which are currently considered to have a material impact on our financial position or results of operations.

Item 1A. Risk Factors

There have been no material changes to the risk factors previously disclosed in Part I, Item 1A of our 2016 Form 10-K.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

(a) Not applicable

(b) Not applicable

(c) The following table summarizes First Financial Northwest's common stock repurchases during the second quarter of 2017, under the repurchase plan effective May 30, 2017 through November 30, 2017:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Repurchased as Part of Publicly Announced Plan	Maximum Number of Shares that May Yet Be Repurchased Under the Plan
April 1 - April 30, 2017	n/a	n/a	n/a	n/a
May 1 - May 31, 2017	—	—	—	1,100,000
June 1 - June 30, 2017	22,700	$ 15.93	22,700	1,077,300
	22,700		22,700	

On May 22, 2017, the Board of Directors authorized the repurchase of up to 1,100,000 shares of the Company's common stock, or 10% of the Company's outstanding shares. Shares are repurchased under a pre-arranged stock trading plan in accordance with guidelines specified under Rule 10b5-1 of the Securities Exchange Act of 1034, as amended.

Item 3. Defaults Upon Senior Securities

Not applicable.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

Not applicable.

Item 6. Exhibits and Financial Statement Schedules

(a) Exhibits

3.1	Articles of Incorporation of First Financial Northwest [(1)]
3.2	Amended and Restated Bylaws of First Financial Northwest [(2)]
4.0	Form of stock certificate of First Financial Northwest [(1)]
10.1	Amended Employment Agreement between First Savings Bank Northwest and Joseph W. Kiley III [(3)]
10.2	Form of Change in Control Severance Agreement for Executive Officers [(4)]
10.3	Amended Executive Supplemental Retirement Plan Participation Agreement with Joseph W. Kiley III [(5)]
10.4	2008 Equity Incentive Plan [(6)]
10.5	2016 Equity Incentive Plan [(7)]
10.6	Forms of incentive and non-qualified stock option award agreements [(8)]
10.7	Form of restricted stock award agreement [(8)]
10.8	Employment Agreement between First Savings Bank Northwest and Richard P. Jacobson [(3)]
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act
32	Certification of Chief Executive Officer and Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act
101	The following materials from First Financial Northwest's Quarterly Report on Form 10-Q for the quarter ended June 30, 2017, formatted in Extensible Business Reporting Language (XBRL): (1) Consolidated Balance Sheets; (2) Consolidated Income Statements; (3) Consolidated Statements of Comprehensive Income; (4) Consolidated Statements of Stockholders' Equity; (5) Consolidated Statements of Cash Flows; and (6) Selected Notes to Consolidated Financial Statements.

[(1)] Filed as an exhibit to First Financial Northwest's Registration Statement on Form S-1 (333-143539)
[(2)] Filed as an exhibit to First Financial Northwest's Current Report on Form 8-K dated June 15, 2017.
[(3)] Filed as an exhibit to First Financial Northwest's Current Report on Form 8-K dated December 5, 2013.
[(4)] Filed as an exhibit to First Financial Northwest's Current Report on Form 8-K dated September 9, 2014.
[(5)] Filed as an exhibit to First Financial Northwest's Current Report on Form 8-K dated July 11, 2017.
[(6)] Filed as Appendix A to First Financial Northwest's definitive proxy statement dated April 15, 2008.
[(7)] Filed as an exhibit to First Financial Northwest's Current Report on Form 8-K dated June 15, 2016.
[(8)] Filed as an exhibit to First Financial Northwest's Current Report on Form 8-K dated July 1, 2008.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

FIRST FINANCIAL NORTHWEST, INC.

Date: August 7, 2017	By:	/s/Joseph W. Kiley III
		Joseph W. Kiley III
		President and Chief Executive Officer (Principal Executive Officer)
Date: August 7, 2017	By:	/s/Richard P. Jacobson
		Richard P. Jacobson
		Executive Vice President and Chief Financial Officer (Principal Financial Officer)
Date: August 7, 2017	By:	/s/Christine A. Huestis
		Christine A. Huestis
		Vice President and Controller (Principal Accounting Officer)

Exhibit Index

Exhibit No.	Description
31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act
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