

Edgar Filing: First Financial Northwest, Inc. - Form 10-K

First Financial Northwest, Inc.
Form 10-K
March 11, 2015
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

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

For the Fiscal Year Ended December 31, 2014

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

Commission File Number: 000-33652

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

Washington 26-0610707
(State or other jurisdiction of incorporation or (I.R.S. Employer Identification Number)
organization)

201 Wells Avenue South, Renton, Washington 98057
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: (425) 255-4400

Securities registered pursuant to Section 12(b) of the Act:

Common Stock, \$0.01 par value per share The Nasdaq Stock Market LLC
(Title of Each Class) (Name of Each Exchange on Which Registered)

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

YES NO

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

YES NO

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 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 NO

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

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company _____

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Act). YES

NO

The aggregate market value of the Common Stock outstanding held by nonaffiliates of the Registrant based on the closing sales price of the Registrant's Common Stock as quoted on The Nasdaq Stock Market LLC on June 30, 2014, was \$121,820,492 (11,207,037 shares at \$10.87 per share). For purposes of this calculation, common stock held only by executive officers, directors and beneficial owners over 5% of the Registrant is considered to be held by affiliates. As of March 9, 2015, the Registrant had outstanding 15,031,981 shares of common stock.

DOCUMENTS INCORPORATED BY REFERENCE

1. Portions of Registrant's Definitive Proxy Statement for the 2015 Annual Meeting of Shareholders (Part III).

FIRST FINANCIAL NORTHWEST, INC.
2014 ANNUAL REPORT ON FORM 10-K
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Forward-Looking Statements

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

because of the inaccurate assumptions we might make, because of the factors illustrated above or because of other factors that we cannot foresee. Because of these and other uncertainties, our actual future results may be materially different from those expressed in any forward-looking statements made by or on our behalf. Therefore, these factors should be considered in evaluating the forward-looking statements, and undue reliance should not be placed on such statements. We undertake no responsibility to update or revise any forward-looking statements.

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

Internet Website

We maintain a website with the address www.fsbnw.com. The information contained on our website is not included as a part of, or incorporated by reference into, this Annual Report on Form 10-K. Other than an investor's own Internet access charges,

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we make available free of charge through our website, our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to these reports, on our investor relations page. These reports are posted as soon as reasonably practicable after they are electronically filed with the SEC. All of our SEC filings are also available free of charge at the SEC's website at www.sec.gov or by calling the SEC at 1-800-SEC-0330.

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PART I

Item 1. Business

General

First Financial Northwest, Inc. (“First Financial Northwest” or “the Company”), a Washington corporation, was formed on June 1, 2007, for the purpose of becoming the holding company for First Savings Bank Northwest (“First Savings Bank” or the “Bank”) in connection with the conversion from a mutual holding company structure to a stock holding company structure completed on October 9, 2007. At December 31, 2014, we had total assets of \$937.0 million, net loans of \$663.9 million, deposits of \$614.1 million and stockholders’ equity of \$181.4 million. First Financial Northwest’s business activities generally are limited to passive investment activities and oversight of its investment in First Savings Bank. Accordingly, the information set forth in this report, including consolidated financial statements and related data, relates primarily to First Savings Bank.

First Savings Bank was organized in 1923 as a Washington state-chartered savings and loan association, converted to a federal mutual savings and loan association in 1935, and converted to a Washington state-chartered mutual savings bank in 1992. In 2002, First Savings Bank reorganized into a two-tier mutual holding company structure, became a stock savings bank, and became the wholly-owned subsidiary of First Financial of Renton, Inc. In connection with the conversion, First Savings Bank changed its name to “First Savings Bank Northwest.”

First Financial Northwest is a savings and loan holding company and is subject to regulation by the Federal Reserve Bank of San Francisco (“FRB”). The Company has filed an application with the FRB to convert from a savings and loan holding company to a bank holding company, consistent with First Savings Bank’s shift in focus from a traditional savings and loan association towards a full service, community bank. While we anticipate this conversion to be completed in the first calendar quarter of 2015, no assurance can be made regarding the timing. In addition, the completion of the conversion is subject to the receipt of all required regulatory approvals. First Savings Bank is examined and regulated by the Washington State Department of Financial Institutions (“DFI”) and by the Federal Deposit Insurance Corporation (“FDIC”). First Savings Bank is required to have certain reserves set by the Board of Governors of the Federal Reserve System. The Bank is a member of the Federal Home Loan Bank (“FHLB”) of Seattle, which is one of the 12 regional banks in the Federal Home Loan Bank System (“FHLB System”). On September 25, 2014, the FHLB of Seattle and the FHLB of Des Moines announced a proposed merger. If the merger is completed, we will become a member of the FHLB of Des Moines. For additional information, see “How We are Regulated - Regulation and Supervision of First Savings Bank Northwest-Federal Home Loan Bank System.”

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

At December 31, 2014, \$273.7 million, or 38.9% of our total loan portfolio was comprised of one-to-four family residential loans; multifamily loans were \$120.5 million, or 17.1%; commercial real estate loans were \$248.3 million, or 35.3%; construction/land development loans were \$51.1 million, or 7.2%; and business and consumer loans were \$3.8 million and \$7.1 million, or 0.5% and 1.0%, respectively. Included in our one-to-four family residential, multifamily, commercial real estate, and construction/land development portfolios at December 31, 2014, were \$20.8 million, \$17.5 million, \$34.3 million and \$1.6 million of total loans, respectively, to our five largest borrowing relationships.

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

Market Area

We consider our primary market area to be the Puget Sound Region that consists primarily of King and, to a lesser extent, Pierce, Snohomish and Kitsap counties. During 2014, the region experienced appreciation in market prices though the increases moderated from the gains seen in 2013, and 2012. While foreclosure and short sale activity declined closer to the historic average level of area sales, the number of homes with negative equity remains high and will impact the residential real estate market for several years. Employment continues to improve with job growth being fairly consistent throughout 2014.

King County has the largest population of any county in the state of Washington, covering approximately 2,100 square miles. It has a population of approximately 2.0 million residents and a median household income of approximately \$72,000,

according to U.S. Census estimates. King County has a diversified economic base with many nationally recognized firms including Boeing, Microsoft, PACCAR, Starbucks, Costco and Amazon. According to the Washington State Employment Security Department, the unemployment rate for King County was 4.1% at December 31, 2014, compared to 4.7% at December 31, 2013, and the national average of 5.6% at December 31, 2014. The median sales price of a residential home in King County was \$400,000 during 2014, a 7.5% increase compared to 2013, according to the Northwest Multiple Listing Service ("MLS"). Residential sales volumes decreased 1.3% in 2014 as compared to 2013 and inventory levels at December 31, 2014, are projected to be 1.4 months according to the MLS.

Pierce County has the second largest population of any county in the state of Washington, covering approximately 1,800 square miles. It has approximately 820,000 residents and a median household income of approximately \$59,000, according to U.S. Census estimates. The Pierce County economy is diversified with the presence of military-related government employment (Joint Base Lewis-McChord), transportation and shipping employment (Port of Tacoma), and aerospace-related employment (Boeing). According to the Washington State Employment Security Department, the unemployment rate for Pierce County was 7.2% in December 2014, compared to 7.3% at year-end 2013. The median sales price of a residential home in Pierce County was \$225,000 during 2014, a 6.3% increase compared to 2013, according to the MLS. Residential sales volumes increased by 2.8% in 2014 as compared to 2013 and inventory levels at December 31, 2014, are projected to be 3.0 months according to the MLS.

Snohomish County has the third largest population of any county in the state of Washington, covering approximately 2,090 square miles. It has approximately 746,000 residents and a median household income of approximately \$68,000, according to U.S. Census estimates. The economy of Snohomish County is diversified with the presence of military-related government employment (Naval Station Everett), aerospace-related employment (Boeing), and retail trade. According to the Washington State Employment Security Department, the unemployment rate for Snohomish County was 4.5% in December 2014 compared to 5.4% in December 2013. The median sales price of a residential home in Snohomish County was \$308,000 during 2014, a 10.0% increase compared to 2013, according to the MLS. Residential sales volumes increased by 0.8% in 2014 as compared to 2013, and inventory levels at December 31, 2014 are projected to be 2.2 months according to the MLS.

Kitsap County has the seventh largest population of any county in the state of Washington, covering approximately 570 square miles. It has approximately 254,000 residents and a median household income of approximately \$62,000, according to U.S. Census estimates. The Kitsap County economy is diversified with the presence of military-related government employment (Naval Base Kitsap, Puget Sound Naval Shipyard), health care, retail and education. According to the Washington State Employment Security Department, the unemployment rate for Kitsap County was 6.2% in December 2014 compared to 6.0% in December 2013. The median sales price of a residential home in Kitsap County was \$239,000 during 2014, unchanged from 2013, according to the MLS. Residential sales volumes increased by 8.7% in 2014 as compared to 2013 and inventory levels at December 31, 2014 are projected to be 2.8 months according to the MLS.

For a discussion regarding the competition in our primary market area, see “– Competition.”

Lending Activities

General. We focus our lending activities primarily on loans secured by commercial real estate, construction/land development, first mortgages on one-to-four family residences, multifamily, and to lesser extent, business lending. We offer a limited variety of consumer secured loans as an accommodation to our customers, including savings account loans and home equity loans that include lines of credit and second mortgage loans. As of December 31, 2014, our net loan portfolio totaled \$663.9 million and represented 70.9% of our total assets.

Our current loan policy generally limits the maximum amount of loans we can make to one borrower to 15% of the Bank's total risk-based capital. Exceptions may be made to this policy with the prior approval of the Board of Directors if the borrower exhibits financial strength or compensating factors exist that sufficiently offset any

exceptions that are measured based on the loan-to-value ratio, borrower's financial condition, net worth, credit history, earnings capacity, installment obligations, and current payment history. The regulatory limit of loans we can make to one borrower is 20% of total risk-based capital, or \$23.2 million, at December 31, 2014.

During 2014, we continued to decrease loan concentration levels in our five largest lending relationships. At December 31, 2014, loans to our five largest lending relationships totaled \$74.2 million compared to \$79.6 million at December 31, 2013, a decrease of \$5.4 million, or 6.8%. As of December 31, 2014, these loans represent 11.0% of our total loans, net of loans in process ("LIP"). The following table details the breakdown of the types of loans to our top five lending relationships at December 31, 2014.

Borrower ⁽¹⁾	Number of Loans	One-to-Four Family Residential (Rental Properties)	Multifamily	Commercial Real Estate (Rental Properties)	Construction/Land Development	Aggregate Balance of Loans ^{(2) (3)}
	(Dollars in thousands)					
Real estate investor	3	\$—	\$—	\$18,111	\$ —	\$18,111
Real estate builder	55	13,123	—	—	1,636	14,759
Real estate investor	2	—	—	14,484	—	14,484
Real estate investor	7	—	13,614	—	—	13,614
Real estate investor	30	7,672	3,896	1,660	—	13,228
Total	97	\$20,795	\$17,510	\$34,255	\$ 1,636	\$74,196

⁽¹⁾ The composition of borrowers represented in the table may change between periods.

⁽²⁾ Net of LIP.

⁽³⁾ None of these loans are considered impaired.

As a result of payoffs and principal repayments, the composition of the mix of loans to our five largest borrowers has changed from December 31, 2013, to December 31, 2014. Total one-to-four family rental properties decreased \$18.2 million to \$20.8 million at December 31, 2014, while multifamily real estate loans increased \$13.5 million to \$17.5 million. The real estate investors listed in the table above have been, and at December 31, 2014, were in compliance with the original terms of their respective loans.

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

	December 31, 2014		2013		2012		2011		2010	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
(Dollars in thousands)										
One-to-four family residential:										
Permanent owner occupied	\$161,013	22.9 %	\$158,797	23.0 %	\$167,019	24.8 %	\$187,997	26.0 %	\$224,808	25.2 %
Permanent non-owner occupied	112,180	15.9	121,877	17.7	139,832	20.7	147,415	20.4	168,526	18.9
Construction owner occupied	—	—	—	—	177	0.1	—	—	460	0.1
Construction non-owner occupied	500	0.1	—	—	—	—	—	—	4,896	0.5
	273,693	38.9	280,674	40.7	307,028	45.6	335,412	46.4	398,690	44.7
Multifamily:										
Permanent	116,014	16.5	106,152	15.4	105,936	15.7	110,148	15.2	140,762	15.8
Construction	4,450	0.6	12,360	1.8	5,585	0.8	3,526	0.5	4,114	0.5
	120,464	17.1	118,512	17.2	111,521	16.5	113,674	15.7	144,876	16.3
Commercial real estate:										
Permanent	239,211	34.0	227,016	32.9	207,436	30.8	218,032	30.2	237,708	26.6
Construction	6,100	0.9	19,905	2.9	12,500	1.8	12,500	1.7	28,362	3.2
Land	2,956	0.4	1,831	0.3	1,942	0.3	1,811	0.2	6,643	0.7
	248,267	35.3	248,752	36.1	221,878	32.9	232,343	32.1	272,713	30.5
Construction/land development: ⁽¹⁾										
One-to-four family residential	19,860	2.8	3,977	0.6	608	0.1	6,194	0.9	26,848	3.0
Multifamily	17,902	2.5	12,491	1.8	8,375	1.2	855	0.1	1,283	0.1
Commercial real estate	4,300	0.6	6,726	1.0	—	—	1,104	0.2	1,108	0.1
Land development	8,993	1.3	7,461	1.1	10,435	1.6	16,990	2.3	27,262	3.1
	51,055	7.2	30,655	4.5	19,418	2.9	25,143	3.5	56,501	6.3
Business	3,783	0.5	1,142	0.2	2,968	0.4	3,909	0.6	479	0.1
Consumer	7,130	1.0	9,201	1.3	11,110	1.7	12,499	1.7	19,127	2.1
Total loans	704,392	100.0 %	688,936	100.0 %	673,923	100.0 %	722,980	100.0 %	892,386	100.0 %
Less:										
LIP	27,359		10,209		8,856		1,372		10,975	
Deferred loan fees, net	2,604		2,580		2,057		1,761		2,421	
Allowance for loan and lease losses ("ALLL")	10,491		12,994		12,542		16,559		22,534	
Loans receivable, net	\$663,938		\$663,153		\$650,468		\$703,288		\$856,456	

(footnote on the following page)

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(1) Excludes construction loans that will convert to permanent loans. The Company considers these loans to be “rollovers” in that one loan is originated for both the construction loan and permanent financing. These loans are classified according to the underlying collateral. At December 31, 2014, the Company had \$6.1 million, or 2.5%, of its total commercial real estate portfolio, \$4.5 million, or 3.7%, of the total multifamily loan portfolio, and \$500,000, or 0.2%, of the total one-to-four family residential loan portfolio in these “rollover” type of loans. At December 31, 2013, the Company had \$19.9 million, or 8.0% of our total commercial real estate portfolio, and \$12.4 million, or 10.4% of our total multifamily loan portfolio in these "rollover" type of loans. At December 31, 2014 and 2013, \$3.0 million and \$1.8 million, respectively, of commercial real estate land loans were not included in the construction/land development category because the Company classifies raw land or buildable lots where it does not intend to finance the construction as commercial real estate land loans.

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

	December 31,		2013		2012		2011		2010	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
FIXED-RATE LOANS										
(Dollars in thousands)										
Real estate:										
One-to-four family residential	\$ 189,899	27.0 %	\$ 224,820	32.6 %	\$ 263,503	39.1 %	\$ 297,769	41.2 %	\$ 359,675	40.3 %
Multifamily	82,639	11.7	82,310	11.9	94,327	14.0	105,420	14.6	140,210	15.7
Commercial real estate	207,064	29.4	198,484	28.8	193,476	28.7	208,418	28.8	235,947	26.4
Construction/land development	4,300	0.6	—	—	3,962	0.6	—	—	556	0.1
Total real estate	483,902	68.7	505,614	73.3	555,268	82.4	611,607	84.6	736,388	82.5
Business	375	0.1	282	0.1	943	0.1	1,355	0.2	124	—
Consumer	689	0.1	855	0.1	1,084	0.2	1,171	0.1	3,743	0.4
Total fixed-rate loans	484,966	68.9	506,751	73.5	557,295	82.7	614,133	84.9	740,255	82.9
ADJUSTABLE-RATE LOANS										
Real estate:										
One-to-four family residential	83,794	11.9	55,854	8.1	43,525	6.5	37,643	5.2	39,015	4.4
Multifamily	37,825	5.4	36,202	5.3	17,194	2.5	8,254	1.1	4,666	0.5
Commercial real estate	41,203	5.8	50,268	7.3	28,402	4.2	23,925	3.3	36,766	4.1
Construction/land development	46,755	6.6	30,655	4.5	15,456	2.3	25,143	3.5	55,945	6.3
Total real estate	209,577	29.7	172,979	25.2	104,577	15.5	94,965	13.1	136,392	15.3
Business	3,408	0.5	860	0.1	2,025	0.3	2,554	0.4	355	0.1
Consumer	6,441	0.9	8,346	1.2	10,026	1.5	11,328	1.6	15,384	1.7
Total adjustable-rate loans	219,426	31.1	182,185	26.5	116,628	17.3	108,847	15.1	152,131	17.1
Total loans	704,392	100.0%	688,936	100.0%	673,923	100.0%	722,980	100.0%	892,386	100.0%
Less:										
LIP	27,359		10,209		8,856		1,372		10,975	
Deferred loan fees, net	2,604		2,580		2,057		1,761		2,421	
ALLL	10,491		12,994		12,542		16,559		22,534	
Loans receivable, net	\$ 663,938		\$ 663,153		\$ 650,468		\$ 703,288		\$ 856,456	

One-to-Four Family Residential Real Estate Lending. As of December 31, 2014, \$273.7 million, or 38.9% of our total loan portfolio consisted of loans secured by one-to-four family residences.

First Savings Bank is a traditional portfolio lender when it comes to financing residential home loans. In 2014, we originated \$35.8 million in one-to-four family residential loans, most of which had adjustable rates and adjustable terms. Approximately 31.8% of our one-to-four family residential loan originations in 2014 were in connection with the refinancing of existing loans. New loan originations comprised the remaining 68.2%. At December 31, 2014, \$161.0 million, or 58.8% of our one-to-four family residential portfolio consisted of owner occupied loans with \$112.7 million, or 41.2% consisting of non-owner occupied loans. In addition, at December 31, 2014, \$189.9 million, or 27.0% of our one-to-four family residential loan portfolio consisted of fixed-rate loans. Substantially all of our one-to-four family residential loans require monthly principal and interest payments.

We also originate a limited number of jumbo loans that we retain in our portfolio. Loans originated with balances greater than \$506,000 in King, Pierce and Snohomish counties are considered jumbo loans while loans outside these three counties are considered jumbo loans if originated with a balance greater than \$417,000. One-to-four family residential loans classified as jumbo loans totaled \$69.9 million and consisted of 83 loans at December 31, 2014. The loans in this portfolio have been priced essentially the same as the standard rates quoted on conventional loans. As of December 31, 2014, all of our jumbo loans were performing in accordance with their loan repayment terms. Charged-off, one-to-four family residential loans totaled \$78,000 for the year ended December 31, 2014, none of which were for jumbo loans. For the years ended December 31, 2013 and 2012, charged-off one-to-four family residential loans totaled \$456,000 and \$2.2 million, of which \$57,000 and \$553,000 were jumbo loans, respectively.

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

Our lending policy generally limits the maximum loan-to-value ratio on mortgage loans secured by owner-occupied properties to 80% of the lesser of the appraised value or the purchase price. The maximum loan-to-value ratio on one-to-four family loans secured by non-owner occupied properties is generally 75% with exceptions requiring our Chief Credit Officer's ("CCO") approval. Properties securing our one-to-four family residential loans are appraised by independent appraisers approved by us. We require the borrowers to obtain title, hazard and, if necessary, flood insurance. We generally do not require earthquake insurance because of competitive market factors.

Our construction loans to individuals to build their personal or non-owner occupied residences typically are structured to be converted to fixed-rate permanent loans at the end of the construction phase with one closing for both the construction loan and the permanent financing. Prior to making a commitment to fund a construction loan, we require an appraisal of the post construction value of the project by an independent appraiser. During the construction phase, which typically lasts 12 to 18 months, an approved inspector or our designated loan officer makes periodic inspections of the construction site and loan proceeds are disbursed directly to the contractor or borrower as construction progresses. Typically, disbursements are made in monthly draws during the construction period. Construction loans require interest-only payments during the construction phase and are structured to be converted to fixed-rate permanent loans at the end of the construction phase. At December 31, 2014, there were no owner occupied and \$500,000 in non-owner occupied construction loans in the one-to-four family residential loan balance.

Loans secured by rental properties represent a unique credit risk to us and, as a result, we adhere to more stringent underwriting guidelines. Of primary concern in non-owner occupied real estate lending is the consistency of rental income of the property. Payments on loans secured by rental properties depend primarily on the tenants continuing ability to pay rent to the property owner, the character of the borrower or, if the property owner is unable to find a tenant, the property owner's ability to repay the loan without the benefit of a rental income stream. In addition, successful operation and management of non-owner occupied properties, including property maintenance standards, may affect repayment. As a result, repayment of such loans may be subject to adverse conditions in the real estate market or the economy. We request that borrowers and loan guarantors, if any, provide annual financial statements, a budget factoring in a rental income cash flow analysis of the borrower as well as the net operating income of the property, information concerning the borrower's expertise, credit history and profitability, and the value of the underlying property. These loans are generally secured by a first mortgage on the underlying collateral property along with an assignment of rents and leases. If the borrower has multiple loans for rental properties with us, the loans are typically not cross-collateralized. At December 31, 2014, \$830,000 of our one-to-four family residential loans were in nonaccrual status.

Multifamily and Commercial Real Estate Lending. As of December 31, 2014, \$120.5 million, or 17.1% of our total loan portfolio was secured by multifamily real estate and \$248.3 million, or 35.3% of our loan portfolio was secured by commercial real estate properties. Our commercial real estate loans are typically secured by office and medical buildings, retail shopping centers, mini-storage facilities, industrial use buildings and warehouses. Substantially all of our multifamily and commercial real estate loans are secured by properties located in our primary market area. Commercial real estate and multifamily loans are subject to similar underwriting standards and processes. These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate.

Typically, multifamily and commercial real estate loans have higher balances, are more complex to evaluate and monitor, and involve a greater degree of risk than one-to-four-family residential loans. In an attempt to compensate for and mitigate this risk, these loans are generally priced at a higher rate of interest than one-to-four family residential loans and generally have a maximum loan-to-value ratio of 75% of the lesser of the appraised value or purchase price for multifamily and 70% for commercial real estate. We generally require loan guarantees from financially capable parties based upon the review of personal financial statements. If the borrower is a corporation or partnership, we generally require personal guarantees from the principals based upon a review of their personal financial statements and individual credit reports.

The average loan size in our multifamily and commercial real estate loan portfolios was \$744,000 and \$1.4 million, respectively, as of December 31, 2014. We currently target individual multifamily and commercial real estate loans between \$1.0 million and \$5.0 million; however, we can by policy originate loans to one borrower up to 15% of the Bank's total risk-based capital, not to exceed \$15.0 million. New loan originations exceeding these limits must have received prior approval from the Bank's Board of Directors. The largest multifamily loan as of December 31, 2014 was a 96-unit apartment complex with a net outstanding principal balance of \$4.5 million located in Kitsap County. As of December 31, 2014, the largest commercial real estate loan had a net outstanding balance of \$12.3 million and was secured by a self-storage facility located in King County. At that date, these two loans were performing according to their respective loan repayment terms.

We also make construction loans for commercial development projects. The projects include multifamily, retail, office/warehouse and office buildings. These loans typically have an interest-only payment phase during construction and generally convert to permanent financing when construction is complete. Disbursement of funds is at our sole discretion and is based on the progress of construction. Generally, the maximum loan-to-value ratio applicable to these loans is 75% of the actual cost of construction. At December 31, 2014, \$4.5 million, or 3.7% of our multifamily and \$6.1 million, or 2.5%, of commercial real estate loan portfolio consisted of these "rollover" construction loans.

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

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

our one-to-four family residential or consumer loan portfolios. At December 31, 2014, there were no multifamily loans past due 90 days or more or in nonaccrual status, while there were \$434,000 of commercial real estate loans in nonaccrual status, of which \$11,000 were 90 days or more past due. Commercial real estate loans totaling \$311,000 were charged-off during the year ended December 31, 2014 as compared to charge-offs of \$98,000 and \$6.1 million for the years ended December 31, 2013 and 2012, respectively. There were no multifamily real estate loans charged off in 2014, compared to charge-offs of \$346,000 and \$153,000 during the years ended December 31, 2013, and 2012, respectively.

Construction/Land Development Loans. We originate construction/land development loans primarily to residential builders for the construction of single-family residences, condominiums, townhouses, and residential developments located in our market area. Our land development loans are generally made to builders intending to develop lots. Construction/land development loans to builders generally require the borrower to have an existing relationship with us and a proven record of successful projects. At December 31, 2014, our total construction/land development loans were \$51.1 million, or 7.2% of our total loan portfolio. The

\$20.4 million or 66.5% increase in construction/land development loans over the past year reflects our decision to increase construction loan origination activity in 2014 reflecting the improvement in real estate values and in general economic conditions in our market areas, in particular King County. Current plans include continuing efforts to increase our balances of construction loans in 2015, while remaining within our guideline of 100% of risk-based capital. At December 31, 2014, our one-to-four family speculative residential construction loans were \$19.9 million, an increase of \$15.9 million or 399.4% during the year ended December 31, 2014 and our multifamily speculative real estate construction loans were \$17.9 million at December 31, 2014. There were no construction/land development loans classified as nonperforming at December 31, 2014, or 2013. Construction/land development loans totaling \$223,000 were charged-off during the year ended December 31, 2014, as compared to \$582,000 and \$630,000 for the years ended December 31, 2013, and 2012, respectively.

At the dates indicated, the composition of our total construction/land development loan portfolio and the related nonperforming loans in this portfolio were as follows:

	December 31, Total Loans		Nonperforming loans	
	2014	2013	2014	2013
	(In thousands)			
Construction speculative:				
One-to-four family residential	\$19,860	\$3,977	\$—	\$—
Multifamily	17,902	12,491	—	223
Commercial real estate	4,300	6,726	—	—
Land development	8,993	7,461	—	—
Total construction/land development ⁽¹⁾	\$51,055	\$30,655	\$—	\$223

⁽¹⁾ LIP for construction/land development loans at December 31, 2014, and 2013, were \$26.7 million and \$7.5 million, respectively. There were no LIP for nonperforming construction/land development loans at December 31, 2014, and 2013.

Construction speculative one-to-four family residential loans increased \$15.9 million from December 31, 2013, to \$19.9 million at December 31, 2014. Multifamily construction speculative loans increased \$5.4 million or 43.3%, from \$12.5 million to \$17.9 million, during the same period.

The following table includes construction/land development loans by county at December 31, 2014:

County	Loan Balance ⁽¹⁾ (Dollars in thousands)	Percent of Loan Balance	
King	\$20,015	82.3	%
Whatcom	3,428	14.1	
All other	873	3.6	
Total	\$24,316	100.0	%

⁽¹⁾ Net of LIP.

Loans to finance the construction of single-family homes and subdivisions and land development loans are generally offered to builders in our primary market areas. Many of these loans are termed "speculative" because the builder does not have, at the time of loan origination, a signed contract with a buyer for the home or lot who has a commitment for permanent financing with either us or another lender. The buyer may be identified either during or after the construction period, with the risk that the builder may have to fund the debt service on the speculative loan along with real estate taxes and other carrying costs for the project for a significant period of time after completion of the project until a buyer is identified. The maximum loan-to-value ratio applicable to these loans is generally 80% of the actual cost of construction and loan-to-completed value of no more than 75%, with approval required from the CCO for

loan-to-value ratios over 75%. In addition, a minimum of 25% verified equity is generally also required. Verified equity generally refers to cash equity invested in the project. Development plans are required from builders prior to committing to the loan. We require that builders maintain adequate title insurance and other appropriate insurance coverage, and, if applicable, an environmental data report(s) that the land is free of hazardous or toxic waste. While maturity dates for residential construction loans are largely a function of the estimated construction period of the project and generally do not exceed one year, land development loans generally are for 12 to 18 months. Substantially all of our residential construction loans have

adjustable-rates of interest based on The Wall Street Journal prime rate. During the term of construction, the accumulated interest on the loan is either added to the principal of the loan through an interest reserve or billed monthly. We have interest reserves on \$45.8 million of our total speculative construction loans, with LIP totaling \$26.7 million. When these loans exhaust their original reserves set up at origination, no additional reserves are permitted unless the loan is re-analyzed and it is determined that the additional reserves are appropriate, based on the updated analysis. Construction loan proceeds are disbursed periodically as construction progresses and as inspections by our approved inspectors warrant. Total outstanding net loan amounts for land development loans range from \$702,000 to \$3.4 million with an average individual total loan commitment at December 31, 2014, of \$2.2 million. At December 31, 2014, our three largest construction/land development loans had outstanding principal balances, net of LIP, of \$3.4 million, \$2.1 million, and \$2.1 million, of which none are impaired.

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

Business Lending. Business loans totaled \$3.8 million, or 0.5% of the loan portfolio at December 31, 2014. Business loans are generally secured by business equipment, accounts receivable, inventory or other property. Loan terms typically vary from one to five years. The interest rates on such loans are either fixed-rate or adjustable-rate. The interest rates for the adjustable-rate loans are indexed to the prime rate published in The Wall Street Journal plus a margin. Our business lending policy includes credit file documentation and requires analysis of the borrower's background, capacity to repay the loan, the adequacy of the borrower's capital and collateral, as well as an evaluation of other conditions affecting the borrower. Analysis of the borrower's past, present and future cash flows is also an important aspect of our credit analysis. We generally obtain personal guarantees on our business loans. The largest business loan had an outstanding balance of \$3.4 million at December 31, 2014 and was performing according to its repayment terms. At December 31, 2014, we did not have any business loans delinquent in excess of 90 days or in nonaccrual status.

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

Consumer Lending. We offer a limited variety of consumer loans to our customers, consisting primarily of home equity loans and savings account loans. Generally, consumer loans have shorter terms to maturity and higher interest rates than one-to-four family residential loans. Consumer loans are offered with both fixed and adjustable interest rates and with varying terms. At December 31, 2014, consumer loans were \$7.1 million, or 1.0% of the total loan portfolio.

At December 31, 2014, the largest component of the consumer loan portfolio consisted of home equity loans, primarily home equity lines of credit, that totaled \$5.0 million, or 70.7% of the total consumer loan portfolio. The home equity lines of credit include \$2.9 million of equity lines of credit in first lien position and \$2.1 million of second mortgages on residential properties. At December 31, 2014, unfunded commitments on our home equity lines of credit totaled \$4.6 million. Home equity loans are made for purposes such as the improvement of residential properties, debt consolidation and education expenses. At origination, the loan-to-value ratio is generally 90% or less, when taking into account both the balance of the home equity loans and the first mortgage loan. Second mortgage loans are originated on a fixed-rate or adjustable-rate basis. The interest rate for the adjustable-rate second mortgages is indexed to the prime rate published in The Wall Street Journal and may include a margin. Second mortgages generally have a ten year term with a balloon payment due at maturity.

Consumer loans entail greater risk than do residential mortgage loans, particularly in the case of consumer loans that are unsecured or secured by rapidly depreciating assets. In these cases, any repossessed collateral for a defaulted consumer loan may

not provide an adequate source of repayment of the outstanding loan balance as a result of the greater likelihood of damage, loss or depreciation. The remaining deficiency often does not warrant further substantial collection efforts against the borrower beyond obtaining a deficiency judgment. In addition, consumer loan collections are dependent on the borrower's continuing financial stability, and are more likely to be adversely affected by job loss, divorce, illness or personal bankruptcy. Furthermore, the application of various federal and state laws, including federal and state bankruptcy and insolvency laws, may limit the amount that can be recovered on these loans. Home equity lines of credit have greater credit risk than one-to-four family residential mortgage loans because they are generally secured by mortgages subordinated to the existing first mortgage on the property that we may or may not hold in our portfolio. We do not have private mortgage insurance coverage on these loans. Adjustable-rate loans may experience a higher rate of default in a rising interest rate environment due to the increase in payment amounts caused by the increase in interest rates as loan rates reset. If current economic conditions deteriorate for our borrowers and their home prices continue to fall, we may also experience higher credit losses from this loan portfolio. Since our home equity loans primarily consist of second mortgage loans, it is unlikely that we will be successful in recovering all, if any, portion of our loan principal amount outstanding in the event of a default. At December 31, 2014, consumer loans totaling \$75,000 were delinquent in excess of 60 days and in nonaccrual status. Consumer loans totaling \$30,000 were charged-off during the year ended December 31, 2014. Consumer loans charged-off during the years ended December 31, 2013 and 2012 totaled \$101,000 and \$491,000, respectively.

Loan Maturity and Repricing. The following table sets forth certain information at December 31, 2014 regarding the amount of loans repricing or maturing in our portfolio based on their contractual terms to maturity, but does not include prepayments. Loan balances do not include undisbursed loan funds, deferred loan fees and costs, or the ALLL.

	Within One Year	After One Year Through Three Years	After Three Years Through Five Years	After Five Years Through Ten Years	Beyond Ten Years	Total
(In thousands)						
Real Estate:						
One-to-four family residential	\$39,854	\$27,742	\$44,757	\$48,286	\$113,054	\$273,693
Multifamily	8,954	26,139	42,633	36,719	6,019	120,464
Commercial	28,719	43,542	72,968	91,830	11,208	248,267
Construction/land development	51,055	—	—	—	—	51,055
Total real estate	128,582	97,423	160,358	176,835	130,281	693,479
Business	3,408	66	309	—	—	3,783
Consumer	6,489	241	317	46	37	7,130
Total	\$138,479	\$97,730	\$160,984	\$176,881	\$130,318	\$704,392

The following table sets forth the amount of all loans due after December 31, 2015, with fixed or adjustable interest rates. Loan balances do not include undisbursed loan funds, deferred loan fees and costs, or the ALLL.

	Fixed-Rate (In thousands)	Adjustable-Rate	Total
Real Estate:			
One-to-four family residential	\$177,983	\$55,856	\$233,839
Multifamily	79,287	32,223	111,510
Commercial	187,031	32,517	219,548
Total real estate	444,301	120,596	564,897
Business	375	—	375
Consumer	641	—	641
Total	\$445,317	\$120,596	\$565,913

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

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

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

Lending Authority. The Bank's Board of Directors has the authority to approve each loan request with an aggregate relationship greater than 15% of the Bank's risk-based capital or \$15.0 million.

The Directors' Loan Committee consists of at least three members of the Board of Directors. The Directors' Loan Committee has the authority to approve:

- Aggregate borrower relationships up to and including 15% of the Bank's risk-based capital; and
- Each loan request in excess of the loan approval authorities assigned to the Chief Lending Officer ("CLO"), Senior Credit Approval Officer ("SCAO"), and CCO.

Officer Lending Authority. Individual signing authority has been delegated to three lending or executive officers. Our CLO has authority from the Board of Directors to approve loan requests for both individual loans and loans in the aggregate up to \$1.0 million. Our SCAO has authority from the Board of Directors to approve loans and loans in the aggregate up to \$2.0 million. The Board of Directors has given our CCO authority to approve individual loans up to and including \$5.0 million and aggregate relationships up to and including \$15.0 million.

Loan Originations, Servicing, Purchases, Sales and Repayments. For the years ended December 31, 2014, and 2013, our total loan originations were \$154.5 million and \$157.0 million, respectively. Total loan originations decreased as a result of increased competition in our market area during the year ended December 31, 2014.

One-to-four family residential loans are generally originated in accordance with the guidelines established by Freddie Mac and Fannie Mae, with the exception of our special community development loans originated to satisfy

compliance with the Community Reinvestment Act. Our loans are underwritten by designated real estate loan underwriters internally in accordance with standards as provided by our Board-approved loan policy. We require title insurance on all loans and fire and casualty insurance on all secured loans and home equity loans where real estate serves as collateral. Flood insurance is also required on all secured loans when the real estate is located in a flood zone.

We may sell loans from time to time on a non-recourse basis consistent with our troubled loan and asset and liability management objectives. Fixed-rate residential mortgage loans with terms of 30 years or less and adjustable-rate mortgage loans are generally held in our portfolio. During the year ended December 31, 2014, we did not sell any loans, whereas during the year ended December 31, 2013, loan sales were \$3.5 million.

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

	Year Ended December 31,		
	2014	2013	2012
	(In thousands)		
Loan Originations:			
Real estate:			
One-to-four family residential	\$35,834	\$50,884	\$24,633
Multifamily	25,417	24,521	27,331
Commercial	39,864	61,288	48,706
Construction/land development	47,157	15,400	12,697
Total real estate	148,272	152,093	113,367
Business	3,556	1,053	756
Consumer	2,669	3,866	4,660
Total loans originated	154,497	157,012	118,783
Loans purchased	12,981	2,241	136
Loans sold	—	(3,524)	(1,051)
Principal repayments	(149,557)	(132,635)	(145,210)
Charge-offs	(642)	(1,596)	(9,591)
Loans transferred to other real estate owned ("OREO")	(1,823)	(6,485)	(12,124)
Change in other items, net	(14,671)	(2,328)	(3,763)
Net increase (decrease) in loans	\$785	\$12,685	\$(52,820)

Loan Origination and Other Fees. In some instances, we receive loan origination fees on real estate-related products. Loan fees generally represent a percentage of the principal amount of the loan and are paid by the borrower. The amount of fees charged to the borrower on one-to-four family residential loans and multifamily and commercial real estate loans can range between 0% to 2%. United States generally accepted accounting principles require that certain fees received, net of certain origination costs, be deferred and amortized over the contractual life of the loan. Net deferred fees or costs associated with loans that are prepaid or sold are recognized in income at the time of prepayment or sale. We had \$2.6 million of net deferred loan fees at both December 31, 2014, and 2013.

One-to-four family residential and consumer loans are generally originated without a prepayment penalty. The majority of our multifamily and commercial real estate loans, however, have prepayment penalties associated with the loans. Most of the recent multifamily and commercial real estate loan originations with interest rates fixed for the first five years will adjust thereafter and have a prepayment penalty of 3% of the principal balance in year one, 2% in year two, 1% in year three and no penalties after year three. Longer initial fixed rate terms generally have correspondingly longer prepayment penalty periods.

Asset Quality

As of December 31, 2014, we had an aggregate of \$4.4 million, or 0.7% of total loans, net of LIP, past due 30 days or more. These loans consisted of eleven one-to-four family residential loans (ten owner-occupied and one non-owner occupied), one multifamily real estate loan, two commercial real estate loans, and one consumer loan. We generally assess late fees or penalty charges on delinquent loans of up to 5.0% of the monthly payment. The borrower is given up to a 15 day grace period from the due date to make the loan payment.

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

the collateral, if any, and whether the loan requires specific handling procedures as required by the Washington State Deed of Trust Act.

If the borrower is chronically delinquent and all reasonable means of obtaining payments have been exhausted, we will seek to foreclose on the collateral securing the loan according to the terms of the security instrument and applicable law. The following table shows our delinquent loans by the type of loan, net of LIP, and the number of days delinquent at December 31, 2014:

	Loans Delinquent						Total	
	30-59 Days		60-89 Days		90 Days and Greater		Delinquent Loans	
	Number of Loans	Principal Balance	Number of Loans	Principal Balance	Number of Loans	Principal Balance	Number of Loans	Principal Balance
(Dollars in thousands)								
Real estate:								
One-to-four family residential:								
Owner occupied	4	\$666	2	\$575	4	\$666	10	\$1,907
Non-owner occupied	—	—	—	—	1	164	1	164
Multifamily	1	1,965	—	—	—	—	1	1,965
Commercial	—	—	1	325	1	11	2	336
Total real estate	5	2,631	3	900	6	841	14	4,372
Consumer	—	—	1	75	—	—	1	75
Total	5	\$2,631	4	\$975	6	\$841	15	\$4,447

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

	December 31,					
	2014	2013	2012	2011	2010	
(Dollars in thousands)						
Loans accounted for on a nonaccrual basis:						
Real estate:						
One-to-four family residential	\$830	\$2,297	\$6,248	\$9,808	\$22,688	
Multifamily	—	233	4,711	949	—	
Commercial	434	1,198	6,274	3,736	7,306	
Construction/land development	—	223	4,767	9,199	32,885	
Consumer	75	44	759	—	57	
Total nonperforming loans	1,339	3,995	22,759	23,692	62,936	
OREO	9,283	11,465	17,347	26,044	30,102	
Total nonperforming assets	\$10,622	\$15,460	\$40,106	\$49,736	\$93,038	
TDRs:						
Nonaccrual ⁽¹⁾	\$—	\$968	\$4,528	\$5,079	\$16,299	
Performing	54,241	60,170	65,848	66,225	58,375	
Total TDRs	\$54,241	\$61,138	\$70,376	\$71,304	\$74,674	
Nonperforming loans as a percent of total loans	0.20	% 0.59	% 3.42	% 3.28	% 7.14	%
Nonperforming loans as a percent of total assets	0.14	0.43	2.41	2.24	5.27	
Nonperforming assets as a percent of total assets	1.13	1.68	4.25	4.69	7.79	
Total loans, net LIP	\$677,033	\$678,727	\$665,067	\$721,608	\$881,411	

Foregone interest on nonaccrual loans	126	650	1,399	2,178	6,069
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⁽¹⁾ These loans are also included in the appropriate loan category above under the caption: “Loans accounted for on a nonaccrual basis.”

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When a loan becomes 90 days past due, we generally place the loan on nonaccrual status unless the credit is well secured and in the process of collection. Loans may be placed on nonaccrual status prior to being 90 days past due if there is an identified problem such as an impending foreclosure or bankruptcy or if the borrower is unable to meet their scheduled payment obligations.

Our three largest nonperforming loans at December 31, 2014 were as follows:

• A commercial real estate loan with an outstanding balance of \$329,000 secured by a six unit rental vacation lodge located in Pierce County. The purpose of the loan was to purchase the real estate for an owner occupied business.

• A one-to-four family residential loan with an outstanding balance of \$236,000 secured by a condominium in King County. The purpose of the loan was to refinance a primary residence.

• A one-to-four family residential loan with an outstanding balance of \$188,000 secured by a two-story single family residence in King County. The purpose of the construction-permanent loan was a new primary residence.

We have reduced our nonperforming loans at December 31, 2014, by \$2.7 million, or 66.5% as compared to December 31, 2013. This reduction was accomplished by transferring nonperforming loans to OREO, accepting short sales, and charging off uncollectible portions of loans. Because of our structure, we believe we are able to make decisions regarding offers on OREO and the real estate underlying our nonperforming loans very quickly compared to larger institutions where decisions could take six to twelve months. This distinction has worked to our benefit in reducing our nonperforming loans and disposing of OREO.

The following tables summarize our total nonperforming loans, net of LIP and OREO, at December 31, 2014, by county and by type of loan or property:

	County				Total Nonperforming Loans	Number of Loans	Percent of Total Nonperforming Loans	
	King	Pierce	Kitsap	All Other				
(Dollars in thousands)								
Nonperforming loans:								
One-to-four family residential	\$774	\$56	\$—	\$—	\$ 830	5	62.0	%
Commercial real estate	105	329	—	—	434	3	32.4	
Consumer	75	—	—	—	75	1	5.6	
Total nonperforming loans	\$954	\$385	\$—	\$—	\$ 1,339	9	100.0	%
	County				Total OREO	Number of Properties	Percent of Total OREO	
	King	Pierce	Kitsap	All Other				
(Dollars in thousands)								
OREO:								
One-to-four family residential	\$154	\$146	\$—	\$—	\$300	2	3.2	%
Commercial real estate ⁽¹⁾	—	6,842	773	877	8,492	11	91.5	
Construction/land development	—	200	—	291	491	2	5.3	
Total OREO	\$154	\$7,188	\$773	\$1,168	\$9,283	15	100.0	%
Total nonperforming assets	\$1,108	\$7,573	\$773	\$1,168	\$10,622			

(1) Of the 11 properties classified as commercial real estate, eight are office/retail buildings and three are undeveloped lots.

Construction/land development, commercial real estate, and multifamily loans have larger individual loan amounts that have a greater single impact on our total portfolio quality in the event of delinquency or default. We continue to

monitor our loan portfolio and believe additions to nonperforming loans, charge-offs, provisions for loan losses, and/or OREO are possible in the future, particularly if the housing market and other economic conditions do not continue to improve.

Other Real Estate Owned. Real estate acquired by us as a result of foreclosure or by deed-in-lieu of foreclosure is classified as OREO until it is sold. When the property is acquired, it is recorded at the lower of its cost or the fair market value of the property, less selling costs. We had \$9.3 million and \$11.5 million of OREO at December 31, 2014 and 2013, respectively. At December 31, 2014, OREO consisted of \$300,000 in one-to-four family residential properties, \$491,000 in construction/land

development properties and \$8.5 million in commercial real estate properties. We have a special assets department whose primary focus is the prompt and effective management of our troubled, nonperforming assets, and expediting their disposition to minimize any potential losses. During 2014, we foreclosed or accepted deeds-in-lieu of foreclosure on six properties totaling \$1.8 million as compared to 15 properties totaling \$6.5 million during 2013. We anticipate continued foreclosure, deed-in-lieu of foreclosure, and short sale activity while we work with our nonperforming loan customers to minimize our loss exposure.

Troubled Debt Restructured Loans. We account for certain loan modifications or restructurings as TDRs. In general, the modification or restructuring of a debt is considered a TDR if, for economic or legal reasons related to the borrower's financial difficulties, we grant a concession to the borrower that we would not otherwise consider. These loans are all considered to be impaired loans. At December 31, 2014, we had \$54.2 million in TDRs as compared to \$61.1 million at December 31, 2013.

Prior to 2012, we utilized a strategy for a limited number of our lending relationships of establishing an "A" and "B" note structure. We created an "A" note representing a reduced principal balance expected to be fully collected and at a debt service level and loan-to-value ratio acceptable to us. The "A" note was classified as a performing TDR as long as the borrower continued to perform in accordance with the note terms. The "B" note represented the amount of the principal reduction portion of the original note and was immediately charged-off. The "B" note is held by the Bank and when the "A" note is paid off, the Bank may proceed with collection efforts on the "B" note. At December 31, 2014, 100.0% of our TDRs were classified as performing compared to 98.4% at December 31, 2013. Of the \$54.2 million of performing TDRs at December 31, 2014, \$26.1 million were related to an "A" note as a result of an "A" and "B" note workout strategy.

The largest TDR relationship at December 31, 2014 totaled \$12.4 million and was comprised of \$11.6 million in one-to-four family residential loans secured by rental properties and a \$783,000 owner occupied commercial property, all located in King County. At December 31, 2014, there were no LIP in connection with these restructured and impaired loans. For additional information regarding our TDRs, see Note 3 of the Notes to Consolidated Financial Statements contained in Item 8 of this report on Form 10-K.

The following table summarizes our total TDRs:

	December 31,	
	2014	2013
	(In thousands)	
Nonperforming TDRs:		
One-to-four family residential	\$—	\$924
Consumer	—	44
Total nonperforming TDRs	—	968
Performing TDRs:		
One-to-four family residential	42,908	45,851
Multifamily	2,172	2,208
Commercial real estate	9,118	12,111
Consumer	43	—
Total performing TDRs	54,241	60,170
Total TDRs	\$54,241	\$61,138

Classified Assets. Federal regulations provide for the classification of lower quality loans and other assets as substandard, doubtful or loss. An asset is considered substandard if it is inadequately protected by the current net worth and payment capacity of the borrower or of any collateral pledged. Substandard assets include those characterized by the distinct possibility that we will sustain some loss if the deficiencies are not corrected. Assets classified as doubtful have all the weaknesses inherent in those classified substandard with the added characteristic that the weaknesses present make collection or liquidation in full highly questionable and improbable, on the basis of

currently existing facts, conditions and values. Assets classified as loss are those considered uncollectible and of such little value that their continuance as assets without the establishment of a specific loss reserve is not warranted.

When we classify problem assets as either substandard or doubtful, we may establish a specific allowance in an amount we deem prudent. General allowances represent loss allowances that have been established to recognize the inherent risk associated with lending activities, but unlike specific allowances, have not been specifically allocated to particular problem assets. When an

insured institution classifies problem assets as a loss, it is required to charge-off those assets in the period in which they are deemed uncollectible. Our determinations as to the classification of our assets and the amount of our valuation allowances are subject to review by the FDIC and the DFI that can order the establishment of additional loss allowances or the charge-off of specific loans against established loss reserves. Assets that do not currently expose us to sufficient risk to warrant classification in one of the aforementioned categories but possess weaknesses are designated as special mention. At December 31, 2014, special mention loans totaled \$16.1 million.

In connection with the filing of periodic reports with the FDIC and in accordance with our loan policy, we regularly review the problem loans in our portfolio to determine whether any loans require classification in accordance with applicable regulations. The decrease in our classified loans during the year ended December 31, 2014 was a result of loan charge-offs, transfers to OREO, and short sales, as well as our efforts to work with our borrowers to bring their loans current when possible or restructure the loan when appropriate. During 2014, we continued our aggressive approach to reduce nonperforming assets and improve asset quality.

The aggregate amounts of our classified loans, net of LIP, consisting solely of substandard loans, at the dates indicated were as follows:

	December 31,	
	2014	2013
	(In thousands)	
One-to-four family residential	\$6,314	\$9,338
Multifamily	1,964	1,453
Commercial real estate	1,598	3,119
Construction/land development	—	223
Consumer	297	266
Total classified loans	\$10,173	\$14,399

With the exception of these classified loans, of which \$1.3 million were accounted for as nonaccrual loans at December 31, 2014, management is not aware of any loans as of December 31, 2014, where the known credit problems of the borrower would cause us to have serious doubts as to the ability of such borrowers to comply with their present loan repayment terms and which may result in the future inclusion of such loans in the nonperforming loan categories.

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

Our Board of Directors' Internal Asset Review Committee reviews and recommends approval of the allowance for loan losses on a quarterly basis and any related provision or recapture of provision for loan losses, and the full Board

of Directors approves the provision or recapture after considering the Committee's recommendation. The allowance is increased by the provision for loan losses which is charged against current period earnings and decreased by the amount of actual loan charge-offs, net of recoveries.

As a result of payoffs of larger loans and improvement in loan grades on several large loans, we recorded a \$2.1 million recapture of provision from our ALLL for the year ended December 31, 2014, as compared to a recapture of \$100,000 for the year ended December 31, 2013. The provision for loan losses was \$3.1 million for the year ended December 31, 2012. The improvement in the quality of loans was attributable to reductions in the levels of nonperforming and classified assets, charge-offs, and our

directed focus during 2014 to work with our borrowers when possible to bring their loan payments current. When this option was not feasible, we promptly initiated foreclosure or deed-in-lieu of foreclosure proceedings. We also utilized short sales as an option to liquidate properties prior to foreclosure. The focus that we placed on reducing our nonperforming assets during 2014 resulted in a reduction of \$4.8 million in nonperforming assets. The ALLL was \$10.5 million, or 1.6% of total loans at December 31, 2014 as compared to \$13.0 million, or 1.9% of total loans outstanding at December 31, 2013. The level of the ALLL is based on estimates and the ultimate losses may vary from the estimates. Management reviews the adequacy of the ALLL on a quarterly basis.

A loan is considered impaired when, based on current information and events, it is probable we will be unable to collect the scheduled payments of principal or interest when due, according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, market conditions, rent rolls, and the borrower's and guarantor's, if any, financial strength. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including length of the delay, the reasons for the delay, the borrower's prior payment record and the amounts of the shortfall in relation to the principal and interest owed. Loans are evaluated for impairment on a loan-by-loan basis. As of December 31, 2014 and 2013, impaired loans, net of LIP, were \$55.7 million and \$64.2 million, respectively.

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

	December 31, 2014			2013			2012			2011		
Loan Balance	Allowance by Loan Category	Percent of Loans to Total Loans	Loan Balance	Allowance by Loan Category	Percent of Loans to Total Loans	Loan Balance	Allowance by Loan Category	Percent of Loans to Total Loans	Loan Balance	Allowance by Loan Category	Percent of Loans to Total Loans	
(Dollars in thousands)												
Real estate:												
One-to-four family												
residential	\$273,693	\$3,694	38.9 %	\$280,674	\$5,141	40.7 %	\$307,028	\$5,562	45.6 %	\$335,412	\$5,756	
Multifamily	120,464	1,646	17.1	118,512	1,377	17.2	111,521	1,139	16.5	113,674	950	
Commercial	248,267	4,597	35.3	248,752	5,881	36.1	221,878	5,207	32.9	232,343	6,846	
Construction/land development	51,055	355	7.2	30,655	399	4.5	19,418	437	2.9	25,143	2,503	
Total real estate	693,479	10,292	98.5	678,593	12,798	98.5	659,845	12,345	97.9	706,572	16,055	
Business	3,783	47	0.5	1,142	14	0.2	2,968	30	0.4	3,909	154	
Consumer	7,130	152	1.0	9,201	182	1.3	11,110	167	1.7	12,499	350	
Total	\$704,392	\$10,491	100.0%	\$688,936	\$12,994	100.0%	\$673,923	\$12,542	100.0%	\$722,980	\$16,559	

We believe that the ALLL as of December 31, 2014 was adequate to absorb the probable and inherent losses in the loan portfolio at that date. While we believe the estimates and assumptions used in our determination of the adequacy of the ALLL are reasonable, there can be no assurance that such estimates and assumptions will be proven correct in the future, or that the actual amount of future provisions will not exceed the amount of past provisions, or that any increased provisions that may be required will not adversely impact our financial condition and results of operations. Future additions to the ALLL may become necessary based upon changing economic conditions, the level of problem loans, business conditions, credit concentrations, increased loan balances or changes in the underlying collateral of the loan portfolio. In addition, the determination of the amount of the ALLL is subject to review by bank regulators as part of the routine examination process that may result in the establishment of additional loss reserves or the charge-off of specific loans against established loss reserves based upon their judgment of information available to them at the time of their examination.

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

	At or For the Year Ended December 31,				
	2014	2013	2012	2011	2010
	(Dollars in thousands)				
ALLL at beginning of period	\$ 12,994	\$ 12,542	\$ 16,559	\$ 22,534	\$ 33,039
(Recapture of provision) provision for loan losses	(2,100)	(100)	3,050	4,700	53,100
Charge-offs:					
One-to-four family residential	(78)	(456)	(2,229)	(2,330)	(24,594)
Multifamily	—	(346)	(153)	(125)	—
Commercial real estate	(311)	(98)	(6,088)	(4,249)	(8,012)
Construction/land development	(223)	(582)	(630)	(4,058)	(32,080)
Business	—	(13)	—	—	—
Consumer	(30)	(101)	(491)	(263)	(790)
Total charge-offs	(642)	(1,596)	(9,591)	(11,025)	(65,476)
Total recoveries	239	2,148	2,524	350	1,871
Net (charge-offs) recoveries	(403)	552	(7,067)	(10,675)	(63,605)
ALLL at end of period	\$ 10,491	\$ 12,994	\$ 12,542	\$ 16,559	\$ 22,534
ALLL as a percent of total loans, net of LIP	1.55 %	1.91 %	1.89 %	2.29 %	2.56 %
Net charge-offs (recoveries) to average loans receivable, net of LIP	0.06	(0.08)	1.07	1.39	6.55
ALLL as a percent of nonperforming loans, net of LIP	783.50 %	325.26 %	55.11 %	69.89 %	35.80 %

Investment Activities

General. Under Washington State law, savings banks are permitted to invest in various types of liquid assets, including U.S. Treasury obligations, securities of various federal agencies, certain certificates of deposit of insured banks and savings institutions, banker's acceptances, repurchase agreements, federal funds, commercial paper, investment grade corporate debt securities, and obligations of states and their political sub-divisions.

The Investment, Asset/Liability Committee ("ALCO"), consisting of the Chief Executive Officer, Chief Financial Officer, and Controller of First Savings Bank, other members of management and the Board of Directors, has the authority and responsibility to administer our investment policy, monitor portfolio strategies, and recommend appropriate changes to policy and strategies to the Board of Directors. On a monthly basis, management reports to the Board a summary of investment holdings with respective market values and all purchases and sales of investment

securities. The Chief Financial Officer has the primary responsibility for the management of the investment portfolio and considers various factors when making decisions, including the marketability, maturity, liquidity, and tax consequences of proposed investments. The maturity structure of investments will be affected by various market conditions, including the current and anticipated slope of the yield curve, the level of interest rates, the trend of new deposit inflows, and the anticipated demand for funds via deposit withdrawals and loan originations and purchases.

The general objectives of the investment portfolio are to provide liquidity when loan demand is high, to assist in maintaining earnings when loan demand is low, and to maximize earnings while satisfactorily managing risk, including credit risk, reinvestment risk, liquidity risk and interest rate risk.

At December 31, 2014, our investment portfolio consisted principally of mortgage-backed securities, U.S. government agency obligations, and corporate bonds. From time to time, investment levels may increase or decrease depending upon yields available on investment opportunities and management's projected demand for funds for loan originations, deposits, and other activities. At December 31, 2014, we did not hold securities of any single issuer (other than government-sponsored entities) that exceeded 10% of our shareholders' equity.

Mortgage-Backed Securities. The mortgage-backed securities in our portfolio were comprised of Fannie Mae, Freddie Mac, and Ginnie Mae mortgage-backed securities. These issuers guarantee the timely payment of principal and interest in the event of default. The mortgage-backed securities had a weighted-average yield of 2.42% at December 31, 2014.

U.S. Government Agency Obligations. The agency securities in our portfolio were comprised of Fannie Mae, Freddie Mac, and FHLB agency securities. These issuers guarantee the timely payment of principal and interest in the event of default. At December 31, 2014, the portfolio of government agency securities had a weighted-average yield of 1.81%.

Ginnie Mae is part of a U.S. government agency and its guarantees are backed by the full faith and credit of the United States. Fannie Mae, Freddie Mac, and the Federal Home Loan Banks are U.S. government-sponsored entities. Although their guarantees are not backed by the full faith and credit of the United States, they may borrow from the U.S. Treasury, which has taken other steps to ensure these U.S. Government-sponsored entities can fulfill their financial obligations.

Corporate Bonds. The corporate bond portfolio was comprised of variable rate securities issued by various financial institutions. At December 31, 2014, the corporate bond portfolio had a weighted-average yield of 2.89%.

Municipal Bonds. The municipal bond portfolio at December 31, 2014 was comprised of two taxable revenue bonds (i.e., backed by revenues from the specific project being financed) issued by the Washington State Housing Finance Commission. The weighted-average yield on the municipal bond portfolio was 5.66% at December 31, 2014.

Federal Home Loan Bank Stock. As a member of the FHLB, we are required to own capital stock in the FHLB. The amount of stock we hold is based on guidelines specified by the FHLB. The redemption of any excess stock we hold is at the discretion of the FHLB. The carrying value of the stock totaled \$6.7 million at December 31, 2014. During the years ended December 31, 2014 and 2013, we received dividends of \$7,000 and \$3,600, respectively, from the FHLB. The FHLB repurchased shares on a pro-rata basis from its shareholders, including 2,729 shares and 2,633 shares from the Bank, at par value during 2014 and 2013, respectively.

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

We have determined there is not an other-than-temporary impairment ("OTTI") on our FHLB stock investment as of December 31, 2014.

The following table sets forth the composition of our investment portfolio at the dates indicated.

	December 31,		2013		2012	
	2014					
	Amortized	Fair	Amortized	Fair	Amortized	Fair
	Cost	Value	Cost	Value	Cost	Value
	(In thousands)					
Available-for-sale:						
Mortgage-backed securities:						
Fannie Mae	\$40,083	\$40,916	\$46,234	\$46,232	\$35,039	\$36,168
Freddie Mac	21,442	21,946	25,707	25,856	15,368	15,763
Ginnie Mae	26,049	26,013	34,403	33,873	31,193	31,146
Tax-exempt municipal bonds	—	—	1,401	1,202	1,405	1,239
Taxable municipal bonds	642	644	642	648	643	650
U.S. government agencies	16,863	16,816	23,222	22,704	67,077	67,296
Corporate bonds	14,061	14,039	14,079	13,849	—	—
Total available-for-sale	\$119,140	\$120,374	\$145,688	\$144,364	\$150,725	\$152,262

At December 31, 2014, 2013, and 2012 there were no investments held to maturity.

During the year ended December 31, 2014, gross proceeds from the call and sale of investments was \$6.4 million, with net realized losses of \$20,000.

Management reviews investment securities on an ongoing basis for the presence of OTTI or permanent impairment, taking into consideration current market conditions, fair value in relationship to cost, extent and nature of the change in fair value, issuer rating changes and trends, whether management intends to sell a security or if it is likely that we will be required to sell the security before recovery of the amortized cost basis of the investment, which may be maturity, and other factors. For debt securities, if management intends to sell the security or it is likely that we will be required to sell the security before recovering its cost basis, the entire impairment loss would be recognized in earnings as an OTTI. If management does not intend to sell the security and it is not likely that we will be required to sell the security, but management does not expect to recover the entire amortized cost basis of the security, only the portion of the impairment loss representing credit losses would be recognized in earnings. The credit loss on a security is measured as the difference between the amortized cost basis and the present value of the cash flows expected to be collected. Projected cash flows are discounted by the original or current effective interest rate, depending on the nature of the security being measured for potential OTTI. The remaining impairment related to all other factors, the difference between the present value of the cash flows expected to be collected and fair value, is recognized as a charge to other comprehensive income (loss). Impairment losses related to all other factors are presented as separate categories within other comprehensive income (loss). There were no losses related to OTTI at December 31, 2014 and 2013. For additional information regarding our investments, see Note 2 of the Notes to Consolidated Financial Statements contained in Item 8.

The table below sets forth information regarding the carrying value and weighted-average yield by contractual maturity of our investment portfolio at December 31, 2014. Mortgage-backed securities and the FHLB stock investments have no stated maturity date and are included in the totals column only.

December 31, 2014

	Within One Year		After One Year Through Five Years		After Five Through Ten Years		Thereafter		Totals	
	Carrying Value	Weighted-Average Yield	Carrying Value	Weighted-Average Yield	Carrying Value	Weighted-Average Yield	Carrying Value	Weighted-Average Yield	Carrying Value	Weighted-Average Yield
(Dollars in thousands)										
Available-for-sale:										
Mortgage-backed securities	\$—	— %	\$—	— %	\$—	— %	\$—	— %	\$88,875	1.91 %
Municipal bonds	—	—	—	—	644	5.87	—	—	644	5.87
U.S. Government agencies	—	—	4,484	1.41	9,414	1.48	2,918	1.83	16,816	1.52
Corporate bonds	—	—	9,049	1.16	4,990	1.25	—	—	14,039	1.20
Total available-for-sale	\$—	—	\$13,533	1.25	\$15,048	1.59	\$2,918	1.83	\$120,374	1.79

Deposit Activities and Other Sources of Funds

General. Deposits and loan repayments are the major sources of our funds for lending and other investment purposes. Scheduled loan repayments are a relatively stable source of funds, while deposit inflows and outflows and loan prepayments are influenced significantly by general interest rates and market conditions. Borrowings from the FHLB are used to supplement the availability of funds from other sources and also as a source of term funds to assist in the management of interest rate risk.

Our deposit composition reflects a mixture of various deposit products. We rely on marketing activities, customer service, and the availability of a broad range of products and services to attract and retain customer deposits.

Deposits. We offer a competitive range of deposit products within our market area, including noninterest bearing accounts, NOW accounts, money market deposit accounts, statement savings accounts, and certificates of deposit. Deposit account terms vary according to the minimum balance required, the time periods the funds must remain on deposit, and the interest rate, among other factors. In determining the terms of our deposit accounts, we consider the development of long-term profitable customer relationships, current market interest rates, current maturity structures, deposit mix, our customer preferences, and the profitability of acquiring customer deposits compared to alternative sources. As part of our strategy to shift our deposit mix to lower cost funds, we continued to better align our pricing with competitors in our local market to meet our goals. Beginning in the third quarter of 2014, management implemented a strategy of generating funds through national brokered certificates of deposit to supplement local deposits. This new source of funds added \$54.4 million of certificates of deposit as of December 31, 2014, with maturities ranging from four to six years. These funds cannot be withdrawn early except in the case of the death or adjudication of incompetence of the depositor. However, the Bank has a quarterly call option six months after issuance that allows the Bank to close the certificate of deposit and return the deposit to the customer if the Bank determines it is in its best interest to do so. The longer term nature of these brokered deposits, along with the enhanced features of these deposits as compared to retail certificates of deposit, assist us in our interest rate risk management efforts.

At December 31, 2014, our deposits totaled \$614.1 million. We had \$249.9 million of jumbo (greater than \$100,000) certificates of deposit, of which \$15.9 million were public funds, that represent 40.7% and 2.6%, respectively, of total deposits. Under Washington State law, in order to participate in the public funds program, we are required to pledge 100% of the public deposits held in the form of eligible securities. At December 31, 2014, we had \$54.4 million of brokered deposits, or 8.9% of total deposits.

Deposit Activities. The following table sets forth our total deposit activity for the periods indicated.

	At or For the Year Ended December 31,		
	2014	2013	2012
	(In thousands)		
Beginning balance	\$612,065	\$665,797	\$788,665
Net decrease before interest credited	(2,607) (60,254) (132,632
Interest credited	4,669	6,522	9,764
Net increase (decrease) in deposits	2,062	(53,732) (122,868
Ending balance	\$614,127	\$612,065	\$665,797

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The following table sets forth information regarding our certificates of deposit and other deposits at December 31, 2014.

Weighted-Average Interest Rate	Term	Category	Amount	Minimum Balance	Percentage of Total Deposits	
(Dollars in thousands)						
—	% N/A	Noninterest bearing demand deposits	\$14,354	\$—	2.3	%
0.11	N/A	NOW	20,752	250	3.4	
0.13	N/A	Statement savings	23,901	25	3.9	
0.22	N/A	Money market	142,532	1,000	23.2	
Certificates of deposit, retail						
0.10	3 month		1,495	1,000	0.2	
0.20	6 month		2,269	1,000	0.4	
0.35	9 month		1,224	1,000	0.2	
0.30	Variable 12 month		20	1,000	—	
0.38	12 month		24,763	1,000	4.0	
0.75	13 month		13,147	1,000	2.3	
0.83	15 month		50,854	1,000	8.3	
0.60	18 month		17,341	1,000	2.8	
0.92	23 month		12,070	1,000	2.0	
0.89	24 month		20,788	1,000	3.4	
1.01	30 month		61,267	1,000	10.0	
1.16	36 month		43,224	1,000	7.0	
1.37	48 month		90,970	1,000	14.8	
1.74	60 month		18,604	1,000	3.0	
5.15	72 month		123	1,000	—	
		Total certificates of deposit, retail	358,159		58.4	
Certificates of deposit, brokered						
1.76	48 month		18,011	1,000	2.9	
1.94	54 month		3,758	1,000	0.6	
2.04	60 month		25,924	1,000	4.2	
1.73	72 month		6,736	1,000	1.1	
		Total certificates of deposit, brokered	54,429		8.8	
		Total deposits	\$614,127		100.0	%

Certificates of Deposit. The following table sets forth the amount and maturities of certificates of deposit at December 31, 2014.

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	Within One Year	After One Year Through Two Years	After Two Years Through Three Years	After Three Years Through Four Years	Thereafter	Total
	(In thousands)					
0.00 - 1.00%	\$134,113	\$47,509	\$17,591	\$11,084	\$—	\$210,297
1.01 - 2.00%	49,936	20,665	39,609	37,831	32,757	180,798
2.01 - 3.00%	67	—	—	—	21,303	21,370
5.01 - 6.00%	—	—	123	—	—	123
Total	\$184,116	\$68,174	\$57,323	\$48,915	\$54,060	\$412,588

The following table sets forth the amount of our jumbo certificates of deposit by remaining maturity as of December 31, 2014. Jumbo certificates of deposit are certificates in amounts greater than \$100,000.

Maturity Period	Certificates of Deposit (In thousands)
Three months or less	\$43,258
Over three months through six months	34,855
Over six months through twelve months	45,340
Over twelve months	126,458
Total	\$249,911

Deposit Flow. The following table sets forth the deposit balances by the types of accounts we offered at the dates indicated.

	December 31, 2014		2013		2012			
	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total		
	(Dollars in thousands)							
Noninterest bearing	\$14,354	2.3	% \$10,619	1.7	% \$6,154	0.9	%	
NOW	20,752	3.4	25,471	4.2	15,944	2.4		
Statement savings	23,901	3.9	20,396	3.3	18,273	2.8		
Money market	142,532	23.2	145,172	23.7	161,719	24.3		
Certificates of deposit, retail:								
0.00 - 1.00%	210,297	34.3	222,508	36.4	185,010	27.8		
1.01 - 2.00%	147,672	24.1	114,542	18.7	125,010	18.8		
2.01 - 3.00%	67	—	71,504	11.7	118,020	17.7		
3.01 - 4.00%	123	—	1,737	0.3	35,108	5.3		
4.01 - 5.00%	—	—	—	—	449	—		
5.01 - 6.00%	—	—	116	—	110	—		
Total certificates of deposit, retail	358,159	58.4	410,407	67.1	463,707	69.6		
Certificates of deposit, brokered								
1.01 - 2.00%	33,126	5.3	—	—	—	—		
2.01 - 3.00%	21,303	3.5	—	—	—	—		
Total certificates of deposit, brokered	54,429	8.8	—	—	—	—		
Total	\$614,127	100.0	% \$612,065	100.0	% \$665,797	100.0	%	

Core funding is generally considered lower cost and a more stable funding source. As of December 31, 2014, our core deposits (money market, savings, NOW, noninterest demand deposits, and certificates of deposit less than or equal to \$250,000) was \$480.4 million, or 78.2% of our deposit portfolio.

Borrowings. Customer deposits are the primary source of funds for our lending and investment activities. We use advances from the FHLB to supplement our supply of lendable funds, to meet short-term deposit withdrawal requirements and to provide longer term funding to better match the duration of selected loan and investment maturities. In addition, at December 31, 2014 we had available a total of \$50.0 million lines of credit between two other financial institution as supplemental funding sources.

As a member of the FHLB, we are required to own capital stock in the FHLB and are authorized to apply for advances on the security of that stock and certain of our mortgage loans and other assets provided certain creditworthiness standards have been met. Advances are individually made under various terms pursuant to several different credit programs, each with its own interest rate and range of maturities. Depending on the program, limitations on the amount of advances are based on the financial condition of the member institution and the adequacy of collateral pledged to secure the credit. We maintain a credit facility with the FHLB that provides for immediately available advances, subject to acceptable collateral. At December 31, 2014, our FHLB credit facility was \$227.3 million and outstanding advances from the FHLB totaled \$135.5 million.

The following table sets forth information regarding FHLB advances at the end of and during the periods indicated. The table includes both long- and short-term borrowings.

	At or for the Year Ended December 31,			
	2014	2013	2012	
	(Dollars in thousands)			
Maximum amount of borrowings outstanding at any month end	\$135,500	\$119,000	\$83,066	
Average borrowings outstanding	128,839	67,796	83,067	
Weighted-average rate paid	0.91	% 1.08	% 2.47	%
Balance outstanding at end of the year	\$135,500	\$119,000	\$83,066	
Weighted-average rate paid at end of the year	0.95	% 0.86	% 2.47	%

Subsidiaries and Other Activities

First Financial Northwest, Inc. First Financial Northwest has two wholly-owned subsidiaries, First Savings Bank and First Financial Diversified Corporation. First Financial Diversified Corporation currently holds a loan portfolio of one-to-four family residential, commercial real estate, business, and consumer loans. At December 31, 2014, First Financial Diversified's net loans receivable of \$4.5 million represented less than one percent of the Company's loan portfolio.

First Savings Bank Northwest. First Savings Bank is a community-based savings bank primarily serving King and to a lesser extent, Pierce, Snohomish and Kitsap counties, Washington through our full-service banking office located in Renton, Washington. We are in the business of attracting deposits from the public and utilizing those deposits to originate loans.

Competition

We face competition in originating loans and attracting deposits within our targeted geographic market area. We compete by consistently delivering high-quality, personal service to our customers that results in a high level of customer satisfaction.

Based on the most current FDIC Deposit Market Share Report dated June 30, 2014, we ranked 15th in terms of deposits with a deposit market share of 0.92%, among the 46 FDIC-insured depository institutions located in King County. The top five banks in the market (comprised of Bank of America, Wells Fargo Bank, U.S. Bank, J.P. Morgan Chase, and Key Bank) controlled 75.0% of the King County deposit market with deposits of \$47.4 billion out of the

\$63.3 billion total deposits in King County as of June 30, 2014. Aside from these traditional competitors, credit unions, insurance companies and brokerage firms also compete for consumer deposit relationships.

Our competition for loans comes principally from commercial banks, mortgage brokers, thrift institutions, credit unions, and finance companies. Several other financial institutions, including those previously mentioned, compete with us for banking business in our targeted market area. These institutions have far more resources than we do and, as a result, are able to offer a broader range of services, such as trust departments and enhanced retail services. Among the advantages of some of these institutions are their ability to make larger loans, finance extensive advertising campaigns, access lower cost funding sources, and allocate their investable assets in regions of highest yield and demand. The challenges posed by such large competitors may impact our ability to originate loans, secure low cost deposits, and establish product pricing levels that support our net interest margin goals that may limit our future growth and earnings potential.

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Employees

At December 31, 2014, we had 101 full-time employees. Our employees are not represented by any collective bargaining group. We consider our employee relations to be good.

How We Are Regulated

The following is a brief description of certain laws and regulations that are applicable to First Financial Northwest and First Savings Bank. As a savings and loan holding company, First Financial Northwest is subject to examination and supervision by, and is required to file certain reports with, the FRB. First Financial Northwest also is subject to the rules and regulations of the SEC under the federal securities laws. First Savings Bank, as a state-chartered savings bank, is subject to regulation and oversight by the DFI, the applicable provisions of Washington law and by the regulations of the DFI adopted thereunder. First Savings Bank also is subject to regulation and examination by the FDIC, which insures its deposits to the maximum extent permitted by law.

The laws and regulations affecting depository institutions and their holding companies have changed significantly, particularly in connection with the enactment of The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act"). Among other changes, the Dodd-Frank Act established the Consumer Financial Protection Bureau ("CFPB") as an independent bureau of the FRB. The CFPB assumed responsibility for the implementation of the federal financial consumer protection and fair lending laws and regulations and has authority to impose new requirements. In addition, the regulations governing us may be amended from time to time by the respective regulators. Any such legislation or regulatory changes in the future could adversely affect us. We cannot predict whether any such changes may occur.

In connection with the 2007 conversion from a mutual holding company structure to a stock holding company structure, First Savings Bank elected, pursuant to Section 10(l) of the Home Owners' Loan Act, as amended, to be treated as a savings association. As a result, First Financial Northwest is a registered savings and loan holding company subject to regulation of the FRB. The Bank has submitted a request to the FDIC to rescind its 10(l) election. If the FDIC rescinds the 10(l) election, First Financial Northwest will convert to a bank holding company; the Bank, however, will continue to operate as a Washington-chartered savings bank.

Regulation and Supervision of First Savings Bank Northwest

General. As a state-chartered savings bank, First Savings Bank is subject to applicable provisions of Washington state law and regulations of the DFI. State law and regulations govern First Savings Bank's ability to take deposits and pay interest, to make loans on or invest in residential and other real estate, to make consumer loans, to invest in securities, to offer various banking services to its customers and to establish branch offices. Under state law, savings banks in Washington also generally have all of the powers that federal savings banks have under federal laws and regulations. First Savings Bank is subject to periodic examination and reporting requirements by and of the DFI.

Insurance of Accounts and Regulation by the FDIC. First Savings Bank's deposits are insured up to \$250,000 per deposit by the DIF of the FDIC. As insurer, the FDIC imposes deposit insurance premiums and is authorized to conduct examinations of and to require reporting by FDIC-insured institutions. It also may prohibit any FDIC-insured institution from engaging in any activity the FDIC determines by regulation or order to pose a serious risk to the insurance fund. The FDIC also has the authority to initiate enforcement actions against savings institutions and may terminate the deposit insurance if it determines that the institution has engaged in unsafe or unsound practices or is in an unsafe or unsound condition.

The Dodd-Frank Act requires the FDIC's deposit insurance assessments to be based on assets instead of deposits. The FDIC issued rules which specify that the assessment base for a bank is equal to its total average consolidated assets less average tangible equity capital. The FDIC revised assessment schedules established assessment rates range from approximately 2.5 basis points to 45 basis points, depending on applicable adjustments for unsecured debt issued by an institution and brokered deposits (and to further adjustment for institutions that hold unsecured debt of other FDIC-insured institutions), until such time as the FDIC's reserve ratio equals 1.15%. Once the FDIC's reserve ratio reaches 1.15% and the reserve ratio for the immediately prior assessment period is less than 2.0%, the applicable assessment rates may range from 1.5 basis points to 40 basis points (subject to adjustments as described above). If the reserve ratio for the prior assessment period is equal to or greater than 2.0% and less than 2.5%, the assessment rates may range from 2 basis points to 28 basis points and if reserve ratio for the prior assessment period is greater than 2.5%, the assessment rates may range from 0.5 basis point to 35 basis points (in each case subject to adjustments as described above). No institution may pay a dividend if it is in default on its federal deposit insurance assessment.

In addition, federally insured institutions are required to pay a Financing Corporation ("FICO") assessment in order to fund the interest on bonds issued to resolve thrift failures in the 1980s. At December 31, 2014, the FICO assessment equaled 0.60 basis points of the assessment base, computed on assets. These assessments, which may be revised based upon the level of DIF deposits, will continue until the bonds mature in the years 2017 through 2019. For 2014, the Bank incurred approximately \$45,000 in FICO assessments.

The FDIC may terminate the deposit insurance of any insured depository institution, including First Savings Bank, if it determines after a hearing that the institution has engaged in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations or has violated any applicable law, regulation, rule, order or condition imposed by the FDIC. It also may suspend deposit insurance temporarily during the hearing process for the permanent termination of insurance if the institution meets certain criteria. If insurance of accounts is terminated, the accounts at the institution at the time of the termination, less subsequent withdrawals, shall continue to be insured for a period of six months to two years, as determined by the FDIC. We are not aware of any practice, condition or violation that might lead to termination of First Savings Bank's deposit insurance.

A significant increase in insurance premiums would likely have an adverse effect on the operating expenses and results of operations of the Bank. There can be no prediction as to what changes in insurance assessment rates may be made in the future.

Prompt Corrective Action. Federal statutes establish a supervisory framework based on five capital categories: well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized and critically undercapitalized. An institution's category depends upon its capital levels in relation to relevant capital measures that include a risk-based capital measure, a leverage ratio capital measure and certain other factors. The federal banking agencies have adopted regulations that implement this statutory framework. Under these regulations, an institution is treated as well capitalized if its Total risk based capital ratio is 10% or more, its Tier 1 risk-based capital ratio is 6% or more, its Tier 1 leverage capital ratio is 5% or more, and it is not subject to any federal supervisory order or directive to meet a specific capital level. In order to be adequately capitalized, an institution must have a Total risk-based capital ratio of not less than 8%, a Tier 1 risk-based capital ratio of not less than 4%, and a Tier 1 leverage capital ratio of not less than 4%. An institution that is not well capitalized is subject to certain restrictions on brokered deposits, including restrictions on the rates it can offer on its deposits, generally. Any institution that is neither well capitalized nor adequately capitalized is considered undercapitalized. In connection with the new capital rules adopted by the federal banking agencies, the general structure of the prompt corrective action rules were maintained, but include a new common equity requirement for Tier 1 capital and incorporate an increased Tier 1 capital requirement into the prompt corrective action framework. See "Capital Requirements" below.

The FDIC may impose additional restrictions on institutions that are undercapitalized and generally is authorized to reclassify an institution into a lower capital category and impose the restrictions applicable to such category if the institution is engaged in unsafe or unsound practices or is in an unsafe or unsound condition. Undercapitalized institutions are also subject to certain prompt corrective action requirements, regulatory controls and restrictions that become more extensive as an institution becomes more severely undercapitalized. Failure by institutions to comply with applicable capital requirements would, if unremedied, result in progressively more severe restrictions on its activities and lead to enforcement actions, including, but not limited to, the issuance of a capital directive to ensure the maintenance of required capital levels and, ultimately, the appointment of the FDIC as receiver or conservator. Banking regulators will take prompt corrective action with respect to depository institutions that do not meet minimum capital requirements. Additionally, approval of any regulatory application filed for review by the banking agencies may be dependent on compliance with capital requirements. At December 31, 2014, the Bank was categorized as "well capitalized" under the prompt corrective action regulation of the FDIC. See "Capital Requirements" below.

Standards for Safety and Soundness. The federal banking regulatory agencies have prescribed, by regulation, guidelines for all insured depository institutions relating to: internal controls, information systems and internal audit systems, loan documentation, credit underwriting, interest rate risk exposure, asset growth, asset quality, earnings and compensation, fees and benefits, liquidity, affiliate transactions, insider transactions and interbank liabilities. The guidelines set forth the safety and soundness standards that the federal banking agencies use to identify and address problems at insured depository institutions before capital becomes impaired. Each insured depository institution must implement a comprehensive written information security program that includes administrative, technical and physical safeguards appropriate to the institution's size and complexity and the nature and scope of its activities. The information security program also must be designed to ensure the security and confidentiality of customer information, protect against any unanticipated threats or hazards to the security or integrity of such information, protect against unauthorized access to or use of such information that could result in substantial harm or inconvenience to any customer and ensure the proper disposal of customer and consumer information. Each insured depository institution must also develop and implement a risk-based response program to address incidents of unauthorized access to customer information in customer information systems. If the FDIC determines that First Savings Bank fails to meet any standard prescribed by the guidelines, it may require First Savings Bank to submit to the FDIC an acceptable plan to achieve compliance with the standard. FDIC regulations establish deadlines for the submission and review of such safety and soundness compliance plans. We are not

aware of any conditions relating to these safety and soundness standards that would require submission of a plan of compliance by First Savings Bank.

Capital Requirements. Federally insured savings institutions, such as First Savings Bank, are required to maintain a minimum level of regulatory capital.

Currently, FDIC regulations recognize two types, or tiers, of capital: core (“Tier 1”) capital and supplementary (“Tier 2”) capital. Tier 1 capital generally includes common shareholders’ equity and noncumulative perpetual preferred stock, less accumulated other comprehensive income and most intangible assets. Tier 2 capital, which is limited to 100% of Tier 1 capital, includes such items as qualifying general loan loss reserves, cumulative perpetual preferred stock, mandatory convertible debt, term subordinated debt and limited life preferred stock; however, the amount of term subordinated debt and intermediate term preferred stock (original maturity of at least 5 years but less than 20 years) that may be included in Tier 2 capital is limited to 50% of Tier 1 capital.

The FDIC currently measures an institution’s capital using a leverage limit together with certain risk-based ratios. The FDIC’s minimum leverage capital requirement specifies a minimum ratio of Tier 1 capital to average total assets. Most banks are required to maintain a minimum leverage ratio of at least 4% of total assets. At December 31, 2014, First Savings Bank had a Tier 1 leverage capital ratio of 11.79%. The FDIC retains the right to require a particular institution to maintain a higher capital level based on its particular risk profile.

FDIC regulations also establish a measure of capital adequacy based on ratios of qualifying capital to risk-weighted assets. Assets are placed in one of four categories and given a percentage weight based on the relative risk of that category. In addition, certain off-balance-sheet items are converted to balance-sheet credit equivalent amounts and each amount is then assigned to one of the four categories. Under the guidelines, the ratio of total capital (Tier 1 capital plus Tier 2 capital) to risk-weighted assets must be at least 8% and the ratio of Tier 1 capital to risk-weighted assets must be at least 4%. In evaluating the adequacy of a bank’s capital, the FDIC may also consider other factors that may affect a bank’s financial condition. Such factors may include interest rate risk exposure, liquidity, funding and market risks, the quality and level of earnings, concentrations of credit risk, risks arising from nontraditional activities, loan and investment quality, the effectiveness of loan and investment policies and management’s ability to monitor and control financial operating risks. The DFI requires that net worth equal at least 5 percent of total assets. At December 31, 2014, First Savings Bank had Tier 1 risk-based capital of 18.30%.

The table below sets forth First Savings Bank’s capital position under the prompt corrective action regulations of the FDIC at December 31, 2014 and 2013. The Bank’s Tier 1 leverage capital ratio was 11.79% and our total risk-based capital ratio was 19.56% at December 31, 2014. The ratios decreased from December 31, 2013, primarily as a result of \$70.0 million in dividends paid by the Bank to the Company during 2014.

	December 31,		2013	
	2014	Ratio	Amount	Ratio
	(Dollars in thousands)			
Bank equity capital under Generally Accepted Accounting Principles ("GAAP")	\$108,239		\$164,968	
Total risk-based capital	\$116,053	19.56 %	\$174,732	28.44 %
Total risk-based capital requirement	47,469	8.00	49,146	8.00
Excess	\$68,584	11.56 %	\$125,586	20.44 %
Tier 1 risk-based capital	\$108,596	18.30 %	\$166,988	27.18 %
Tier 1 risk-based capital requirement	23,734	4.00	24,573	4.00
Excess	\$84,862	14.30 %	\$142,415	23.18 %

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Tier 1 leverage capital	\$108,596	11.79	%	\$166,988	18.60	%
Tier 1 leverage capital requirement	36,849	4.00		35,903	4.00	
Excess	\$71,747	7.79	%	\$131,085	14.60	%

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As of December 31, 2014, and 2013, the Bank was classified as a well-capitalized institution under the criteria established by the FDIC. First Savings Bank's management believes that, under the current regulations, First Savings Bank will continue to meet its minimum capital requirements in the foreseeable future. However, events beyond the control of First Savings Bank, such as a downturn in the economy in areas where it has most of its loans, could adversely affect future earnings and, consequently, the ability of First Savings Bank to meet its capital requirements.

On July 2, 2013, the FRB approved a final rule ("Final Rule") to establish a new comprehensive regulatory capital framework for all U.S. financial institutions and their holding companies. On July 9, 2013, the Final Rule was approved as an interim final rule by the FDIC. The Final Rule implements the "Basel III" regulatory capital reforms and changes required by the Dodd-Frank Act. The final rule includes new risk-based capital and leverage ratios, which are effective January 1, 2015 (with some changes generally transitioned into full effectiveness over two to four years), and revise the definition of what constitutes "capital" for purposes of calculating those ratios.

The proposed new minimum capital level requirements applicable to the Bank will be: (i) a new common equity Tier 1 ("CET1") capital ratio of 4.5% (with CET1 consisting of qualifying Tier 1 capital less all capital components that are not considered common equity); (ii) a Tier 1 capital ratio of 6% (increased from 4%); (iii) a total capital ratio of 8% (unchanged from current rules); and (iv) a Tier 1 leverage ratio of 4% for all institutions. The rule eliminates the inclusion of certain instruments, such as trust preferred securities, from Tier 1 capital. Instruments issued prior to May 19, 2010 will be grandfathered for companies with consolidated assets of \$15 billion or less. The rule also establishes a "capital conservation buffer" of 2.5% above the new regulatory minimum capital requirements, which must consist entirely of common equity Tier 1 capital and would result in the following minimum ratios: (i) a common equity Tier 1 capital ratio of 7.0%, (ii) a Tier 1 capital ratio of 8.5%, and (iii) a total capital ratio of 10.5%. The new capital conservation buffer requirement will be phased in beginning in January 2016 at 0.625% of risk-weighted assets and would increase by that amount each year until fully implemented in January 2019. An institution would be subject to limitations on paying dividends, engaging in share repurchases, and paying discretionary bonuses if its capital level falls below the buffer amount. These limitations would establish a maximum percentage of eligible retained income that could be utilized for such actions. In addition, the Final Rules maintain the general structure of the prompt corrective action rules, but incorporate the new CETI requirement and the increased Tier 1 capital requirement into the prompt corrective action framework, as indicated above in "- Prompt Correction Action."

The FDIC may impose additional restrictions on institutions that are undercapitalized and generally is authorized to reclassify an institution into a lower capital category and impose the restrictions applicable to such category if the institution is engaged in unsafe or unsound practices or is in an unsafe or unsound condition. An institution is deemed "well capitalized" if it has at least a 5.0% Tier 1 capital ratio, a 6.0% Tier 1 risk-based capital ratio and 10.0% total risk-based capital ratio. At December 31, 2014, we believe that the Bank's current capital levels meet the fully-phased in minimum capital requirements, including the related capital conservation buffers, as required by the Final Rule.

The application of these more stringent capital requirements could, among other things, result in lower returns on invested capital, over time require the raising of additional capital, and result in regulatory actions if we were to be unable to comply with such requirements. Implementation of changes to asset risk weightings for risk based capital calculations, items included or deducted in calculating regulatory capital and/or additional capital conservation buffers could result in management modifying its business strategy and could limit our ability to make distributions, including paying out dividends or buying back shares. Furthermore, the imposition of liquidity requirements in connection with the implementation of Basel III could result in our having to lengthen the term of our funding, restructure our business models, and/or increase our holdings of liquid assets. Any additional changes in our regulation and oversight, in the form of new laws, rules and regulations could make compliance more difficult or expensive or otherwise materially adversely affect our business, financial condition or prospects.

Federal Home Loan Bank System. First Savings Bank is a member of the FHLB of Seattle, which is one of 12 regional FHLBs that administer the home financing credit function of savings institutions. The FHLBs are subject to the oversight of the FHFA and each FHLB serves as a reserve or central bank for its members within its assigned

region. The FHLBs are funded primarily from proceeds derived from the sale of consolidated obligations of the FHLB System and makes loans or advances to members in accordance with policies and procedures established by the Board of Directors of the FHLB. All advances from the FHLB are required to be fully secured by sufficient collateral as determined by the FHLB. In addition, all long-term advances are required to provide funds for residential home financing. See “Business – Deposit Activities and Other Sources of Funds – Borrowings.”

Following its announcement in July 2014 that it had entered into an exclusivity agreement for a potential merger with the FHLB of Des Moines, the FHLB of Seattle and the FHLB of Des Moines entered into a merger agreement on September 25, 2014 for the voluntary merger of the two banks. The merger agreement provides that the FHLB of Des Moines will survive the merger as the resulting bank. The merger was approved by the FHFA in December 2014 and approved by the member-owners of

the FHLB of Seattle and the FHLB of Des Moines in February 2015, with a target date of May 31, 2015 for consummation of the merger. As of December 31, 2014, the FHLB of Des Moines had \$95.5 billion in assets and served 1,156 member financial institutions in five Mid-Western states, compared to the FHLB of Seattle, which had \$35.1 billion in assets and served 316 member financial institutions in eight Western states and the U.S. territories of American Samoa and Guam and the Commonwealth of the Northern Mariana Islands. The combined FHLB will be located in Des Moines and will provide funding for over 1,500 member financial institutions in 13 states, as well as the U.S. territories of American Samoa and Guam and the Commonwealth of the Northern Mariana Islands. Upon completion of the merger, member-owners of the FHLB of Seattle will receive stock in the FHLB of Des Moines equal to the same number of shares held in the FHLB of Seattle prior to the merger. Following completion of the merger, it is anticipated that member-owners of the FHLB of Des Moines and the FHLB of Seattle will hold approximately 82% and 18%, respectively, of the issued and outstanding shares of the resulting bank.

First Savings Bank, as a member of the FHLB of Seattle, is required to purchase and maintain stock in the FHLB. At December 31, 2014, the Bank had \$6.7 million in FHLB stock that was in compliance with this requirement.

Real Estate Lending Standards. FDIC regulations require First Savings Bank to adopt and maintain written policies that establish appropriate limits and standards for real estate loans. These standards that must be consistent with safe and sound banking practices, must establish loan portfolio diversification standards, prudent underwriting standards, loan administration procedures and documentation and approval and reporting requirements. First Savings Bank is obligated to monitor conditions in its real estate markets to ensure that its standards continue to be appropriate for current market conditions. First Savings Bank's Board of Directors is required to review and approve First Savings Bank's standards at least annually. The FDIC has published guidelines for compliance with these regulations, including supervisory limitations on loan-to-value ratios for different categories of real estate loans. Under the guidelines, the aggregate amount of all loans in excess of the supervisory loan-to-value ratios should not exceed 100% of total capital and the total of all loans for commercial, agricultural, multifamily or other non-one-to-four family residential properties in excess of the supervisory loan-to-value ratios should not exceed 30% of total capital. Total capital consists of the sum of an institution's Tier 1 capital and Tier 2 capital. Loans in excess of the supervisory loan-to-value ratio limitations must be identified in First Savings Bank's records and reported at least quarterly to First Savings Bank's Board of Directors. First Savings Bank is in compliance with the record keeping and reporting requirements. At December 31, 2014, First Savings Bank's aggregate loans in excess of the supervisory loan-to-value ratio was 0.2% of total risk-based capital, consisting of one one-to-four family residential property loan.

Activities and Investments of Insured State-Chartered Financial Institutions. Federal law generally limits the activities and equity investments of FDIC-insured, state-chartered banks to those that are permissible for national banks. An insured state bank is not prohibited from, among other things, (1) acquiring or retaining a majority interest in a subsidiary, (2) investing as a limited partner in a partnership the sole purpose of which is direct or indirect investment in the acquisition, rehabilitation or new construction of a qualified housing project, provided that such limited partnership investments may not exceed 2% of the bank's total assets, (3) acquiring up to 10% of the voting stock of a company that solely provides or reinsures directors', trustees' and officers' liability insurance coverage or bankers' blanket bond group insurance coverage for insured depository institutions and (4) acquiring or retaining the voting shares of a depository institution owned by another FDIC-insured institution if certain requirements are met.

Washington state has enacted a law regarding financial institution parity. Primarily, the law affords Washington state-chartered commercial banks the same powers as Washington state-chartered savings banks. In order for a bank to exercise these powers, it must provide 30 days' notice to the Director of the DFI and the Director must authorize the requested activity. In addition, the law provides that Washington state-chartered savings banks may exercise any of the powers of Washington state-chartered commercial banks, national banks and federally-chartered savings banks, subject to the approval of the Director in certain situations. Finally, the law provides additional flexibility for Washington state-chartered commercial and savings banks with respect to interest rates on loans and other extensions of credit. Specifically, they may charge the maximum interest rate allowable for loans and other extensions of credit

by federally-chartered financial institutions to Washington residents.

Environmental Issues Associated With Real Estate Lending. The Comprehensive Environmental Response, Compensation and Liability Act (“CERCLA”) is a federal statute that generally imposes strict liability on all prior and present “owners and operators” of sites containing hazardous waste. However, Congress acted to protect secured creditors by providing that the term “owner and operator” excludes a person whose ownership is limited to protecting its security interest in the site. Since the enactment of the CERCLA, this “secured creditor exemption” has been the subject of judicial interpretations that have left open the possibility that lenders could be liable for cleanup costs on contaminated property that they hold as collateral for a loan. To the extent that legal uncertainty exists in this area, all creditors, including First Savings Bank, that have made loans secured by properties with potential hazardous waste contamination (such as petroleum contamination) could be subject to liability for cleanup costs that often are substantial and can exceed the value of the collateral property.

Federal Reserve System. The Federal Reserve requires that all depository institutions maintain reserves on transaction accounts and non-personal time deposits. These reserves may be in the form of cash or deposits with the regional Federal Reserve Bank. NOW accounts and other types of accounts that permit payments or transfers to third parties fall within the definition of transaction accounts and are subject to reserve requirements, as are any non-personal time deposits at a savings bank. As of December 31, 2014, First Savings Bank's deposits with the Federal Reserve exceeded its Regulation D reserve requirements.

Affiliate Transactions. Federal laws strictly limit the ability of banks to engage in certain transactions with their affiliates, including their bank holding companies. Transactions deemed to be a "covered transaction" under Section 23A of the Federal Reserve Act and between a subsidiary bank and its parent company or any nonbank subsidiary of the bank holding company are limited to 10% of the subsidiary bank's capital and surplus and, with respect to the parent company and all such nonbank subsidiaries, to an aggregate of 20% of the subsidiary bank's capital and surplus. Further, covered transactions that are loans and extensions of credit generally are required to be secured by eligible collateral in specified amounts. Federal law also requires that covered transactions and certain other transactions listed in Section 23B of the Federal Reserve Act between a bank and its affiliates be on terms as favorable to the bank as transactions with nonaffiliates. For additional information, see "– Regulation and Supervision of First Financial Northwest – Limitations on Transactions with Affiliates" below.

Community Reinvestment Act. Banks are subject to the provisions of the Community Reinvestment Act of 1977 ("CRA") that requires the appropriate federal bank regulatory agency to assess a bank's performance under the CRA in meeting the credit needs of the community serviced by the bank, including low and moderate income neighborhoods. The regulatory agency's assessment of the bank's record is made available to the public. Further, a bank's CRA performance must be considered in connection with a bank's application, to among other things, establish a new branch office that will accept deposits, relocate an existing office or merge or consolidate with, or acquire the assets or assume the liabilities of, a federally regulated financial institution or banks that are involved in certain acquisitions by a savings and loan holding company. First Savings Bank received a "satisfactory" rating during its most recent examination.

Dividends. The amount of dividends payable by First Savings Bank to First Financial Northwest depends upon First Savings Bank's earnings and capital position, and is limited by federal and state laws. According to Washington law, First Savings Bank may not declare or pay a cash dividend on its capital stock if it would cause its net worth to be reduced below (1) the amount required for liquidation accounts or (2) the net worth requirements, if any, imposed by the Director of the DFI. In addition, dividends may not be declared or paid if First Savings Bank is in default in payment of any assessments due to the FDIC. Dividends on First Savings Bank's capital stock may not be paid in an aggregate amount greater than the aggregate retained earnings of First Savings Bank, without the approval of the Director of the DFI.

The amount of dividends actually paid during any one period is strongly affected by First Savings Bank's policy of maintaining a strong capital position. Federal law further provides that no insured depository institution may pay a cash dividend if it would cause the institution to be "undercapitalized," as defined in the prompt corrective action regulations. Moreover, the federal bank regulatory agencies also have the general authority to limit the dividends paid by insured banks if such payments are deemed to constitute an unsafe and unsound practice.

Privacy Standards. The Gramm-Leach-Bliley Financial Services Modernization Act of 1999 ("GLBA") modernized the financial services industry by establishing a comprehensive framework to permit affiliations among commercial banks, insurance companies, securities firms and other financial service providers. First Savings Bank is subject to FDIC regulations implementing the privacy protection provisions of the GLBA. These regulations require First Savings Bank to disclose its privacy policy, including informing consumers of its information sharing practices and informing consumers of their rights to opt out of certain practices.

Qualified Thrift Lender Test. Under Section 2303 of the Economic Growth and Regulatory Paperwork Reduction Act of 1996, a savings association must comply with the Qualified Thrift Lender test by either meeting the Qualified Thrift Lender test set forth in the Home Owners' Loan Act and its implementing regulations or qualifying as a domestic building and loan association as defined in Section 7701(a)(19) of the Internal Revenue Code of 1986. A savings bank subsidiary of a savings and loan holding company that does not comply with the Qualified Thrift Lender test must comply with the following restrictions on its operations:

- the institution may not engage in any new activity or make any new investment, directly or indirectly, unless the activity or investment is permissible for a national bank;
- the branching powers of the institution are restricted to those of a national bank; and

payment of dividends by the institution are subject to the rules regarding payment of dividends by a national bank.

Upon the expiration of three years from the date the institution ceases to meet the Qualified Thrift Lender test, it must cease any activity and not retain any investment not permissible for a national bank (subject to safety and soundness considerations).

As of December 31, 2014, First Savings Bank maintained 68.9% of its portfolio assets in qualified thrift investments and, therefore, met the Qualified Thrift Lender test.

Other Consumer Protection Laws and Regulations. The Dodd-Frank Act established the CFPB and empowered it to exercise broad regulatory, supervisory and enforcement authority with respect to both new and existing consumer financial protection laws. First Savings Bank is subject to consumer protection regulations issued by the CFPB, but as financial institutions with assets of less than \$10 billion, First Savings Bank is generally subject to supervision and enforcement by the FDIC and the DFI with respect to our compliance with consumer financial protection laws and CFPB regulations.

First Savings Bank is subject to a broad array of federal and state consumer protection laws and regulations that govern almost every aspect of its business relationships with consumers. While not exhaustive, these laws and regulations include the Truth-in-Lending Act, the Truth in Savings Act, the Electronic Fund Transfer Act, the Expedited Funds Availability Act, the Equal Credit Opportunity Act, the Fair Housing Act, the Real Estate Settlement Procedures Act, the Home Mortgage Disclosure Act, the Fair Credit Reporting Act, the Fair Debt Collection Practices Act, the Right to Financial Privacy Act, the Home Ownership and Equity Protection Act, the Consumer Leasing Act, the Fair Credit Billing Act, the Homeowners Protection Act, the Check Clearing for the 21st Century Act, laws governing flood insurance, laws governing consumer protections in connection with the sale of insurance, federal and state laws prohibiting unfair and deceptive business practices and various regulations that implement some or all of the foregoing. These laws and regulations mandate certain disclosure requirements and regulate the manner in which financial institutions must deal with customers when taking deposits, making loans, collecting loans and providing other services. Failure to comply with these laws and regulations can subject First Savings Bank to various penalties, including but not limited to, enforcement actions, injunctions, fines, civil liability, criminal penalties, punitive damages and the loss of certain contractual rights.

Regulation and Supervision of First Financial Northwest

General. First Financial Northwest is a nondiversified unitary savings and loan holding company subject to the regulatory oversight of the FRB. Accordingly, First Financial Northwest is required to register and file reports with the FRB and is subject to regulation and examination by the FRB. In addition, the FRB has enforcement authority over First Financial Northwest and its non-savings institution subsidiaries that also permits the FRB to restrict or prohibit activities that are determined to present a serious risk to the subsidiary savings institution.

First Financial Northwest was organized as a savings and loan holding company under the Home Owners' Loan Act, as amended, as a result of the 10(l) election made by First Savings Bank under the Home Owners' Loan Act. The 10(l) election allows First Savings Bank to be treated as a "savings association" for purposes of Section 10 of the Home Owners' Loan Act. As a result, First Financial Northwest is registered as a savings and loan holding company with the FRB and is subject to FRB regulation, examination, and supervision. In addition, First Financial Northwest is required to file certain reports with, and otherwise comply with, the rules and regulations of the SEC. As a subsidiary of a savings and loan holding company, First Savings Bank is subject to certain restrictions in its dealings with First Financial Northwest and affiliates thereof.

Generally, companies that become savings and loan holding companies following the May 4, 1999 grandfather date in the GLBA may engage only in the activities permitted for financial institution holding companies under the law for

multiple savings and loan holding companies.

Although savings and loan holding companies are not currently subject to specific capital requirements or specific restrictions on the payment of dividends or other capital distributions, federal regulations do prescribe such restrictions on subsidiary savings institutions as described above. Because First Savings Bank is treated as a savings association subsidiary of a savings and loan holding company, it must notify the FRB 30 days before declaring any dividend to First Financial Northwest. In addition, the financial impact of a holding company on its subsidiary institution is a matter that is evaluated by the FRB and the FRB has authority to order cessation of activities or divestiture of subsidiaries deemed to pose a threat to the safety and soundness of First Savings Bank. The Bank has requested a rescission from the FDIC of its previous 10(l) election in connection with First Financial Northwest's proposed change from a savings and loan holding company to a bank holding company.

Capital Requirements for First Financial Northwest. Savings and loan holding companies, like First Financial Northwest, historically have not been subject to consolidated regulatory capital requirements. However, in July 2013, the FRB approved a new rule that implements the “Basel III” regulatory capital reforms and changes required by the Dodd-Frank Act. The final rule established consolidated capital requirements for many savings and loan holding companies, including the Company. See “– Regulation and Supervision of First Savings Bank - Capital Requirements” above.

Acquisition of Control. Under the federal Change in Bank Control Act, a notice must be submitted to the FRB if any person (including a company), or group acting in concert, seeks to acquire “control” of a savings and loan holding company or savings association. An acquisition of control can occur upon the acquisition of 10% or more of the voting stock of a savings and loan holding company or savings institution or as otherwise defined by the FRB. Under the Change in Bank Control Act, the FRB has 60 days from the filing of a complete notice to act, taking into consideration certain factors, including the financial and managerial resources of the acquirer and the anti-trust effects of the acquisition. Any company that so acquires control would then be subject to regulation as a savings and loan holding company.

Restrictions on Dividends. First Financial Northwest’s ability to declare and pay dividends may depend in part on dividends received from First Savings Bank. Under Washington State law, First Financial Northwest is prohibited from paying a dividend if, as a result of its payment, it would be unable to pay its debts as they become due in the normal course of business or if First Financial Northwest's total liabilities would exceed its total assets. For additional information, see Item 1.A. “Risk Factors – Certain regulatory restrictions are imposed on us and lack of compliance could result in monetary penalties and/or additional regulatory actions.”

Limitations on Transactions with Affiliates. Transactions between savings institutions and any affiliate are governed by Sections 23A and 23B of the FRB Act. An affiliate of a savings institution is any company or entity that controls, is controlled by or is under common control with the savings institution. In a holding company context, the holding company and any companies that are controlled by such holding companies are affiliates of the savings institution. Generally, Section 23A limits the extent to which the savings institution or its subsidiaries may engage in “covered transactions” with any one affiliate to an amount equal to 10% of the institution’s capital stock and surplus and contain an aggregate limit on all such transactions with all affiliates to an amount equal to 20% of such capital stock and surplus. Section 23B applies to “covered transactions” as well as certain other transactions and requires that all transactions be on terms substantially the same, or at least as favorable, to the savings institution as those provided to a nonaffiliate. The term “covered transaction” includes the making of loans to, purchase of assets from and issuance of a guarantee to an affiliate and similar transactions. Section 23B transactions also include the provision of services and the sale of assets by a savings institution to an affiliate. In addition to the restrictions imposed by Sections 23A and 23B, Section 11 of the Home Owners’ Loan Act prohibits a savings institution from (1) making a loan or other extension of credit to an affiliate, except for any affiliate that engages only in certain activities that are permissible for bank holding companies or (2) purchasing or investing in any stocks, bonds, debentures, notes or similar obligations of any affiliate, except for affiliates which are subsidiaries of the savings institution.

In addition, Sections 22(g) and (h) of the FRB Act place restrictions on loans to executive officers, directors and principal shareholders. Under Section 22(h), loans to a director, executive officer or greater than 10% shareholder of a savings institution and certain affiliated interests, may not exceed, together with all other outstanding loans to such person and affiliated interests, the savings institution’s loans to one borrower limit (generally equal to 15% of the institution’s unimpaired capital and surplus). Section 22(h) also requires that loans to directors, executive officers and principal shareholders be made on terms substantially the same as offered in comparable transactions to other persons unless the loans are made pursuant to a benefit or compensation program that (1) is widely available to employees of the institution and (2) does not give preference to any director, executive officer or principal shareholder, or certain affiliated interests, over other employees of the savings institution. Section 22(h) also requires prior board approval for certain loans. In addition, the aggregate amount of extensions of credit by a savings institution to all insiders

cannot exceed the institution's unimpaired capital and surplus. Furthermore, Section 22(g) places additional restrictions on loans to executive officers. At December 31, 2014, First Savings Bank was in compliance with these restrictions.

Restrictions on Acquisitions. Except under limited circumstances, savings and loan holding companies are prohibited from acquiring, without prior approval of the FRB, (1) control of any other savings institution or savings and loan holding company or substantially all the assets thereof or (2) more than 5% of the voting shares of a savings institution or holding company thereof which is not a subsidiary. Except with the prior approval of the FRB, no director or officer of a savings and loan holding company or person owning or controlling by proxy or otherwise more than 25% of such company's stock, may acquire control of any savings institution, other than a subsidiary savings institution, or of any other savings and loan holding company.

The FRB may only approve acquisitions resulting in the formation of a multiple savings and loan holding company that controls savings institutions in more than one state if: (1) the multiple savings and loan holding company involved controls a savings institution that operated a home or branch office located in the state of the institution to be acquired as of March 5, 1987;

(2) the acquirer is authorized to acquire control of the savings institution pursuant to the emergency acquisition provisions of the Federal Deposit Insurance Act or (3) the statutes of the state in which the institution to be acquired is located specifically permit institutions to be acquired by the state-chartered institutions or savings and loan holding companies located in the state where the acquiring entity is located (or by a holding company that controls such state-chartered savings institutions).

Federal Securities Laws. First Financial Northwest's common stock is registered with the SEC under Section 12(b) of the Securities Exchange Act of 1934, as amended ("Exchange Act"). We are subject to information, proxy solicitation, insider trading restrictions and other requirements under the Exchange Act.

The Dodd-Frank Act. On July 21, 2010, the Dodd-Frank Act was signed into law. The Dodd-Frank-Act imposes new restrictions and an expanded framework of regulatory oversight for financial institutions, including depository institutions and implements new capital regulations that First Financial Northwest and First Savings Bank will become subject to and that are discussed above under the section entitled “- Regulation and Supervision of First Savings Bank Northwest - Capital Requirements .”

In addition, among other changes, the Dodd-Frank Act requires public companies, like First Financial Northwest, to (i) provide their shareholders with a non-binding vote (a) at least once every three years on the compensation paid to executive officers and (b) at least once every six years on whether they should have a “say on pay” vote every one, two or three years; (ii) have a separate, non-binding shareholder vote regarding golden parachutes for named executive officers when a shareholder vote takes place on mergers, acquisitions, dispositions or other transactions that would trigger the parachute payments; (iii) provide disclosure in annual proxy materials concerning the relationship between the executive compensation paid and the financial performance of the issuer; and (iv) amend Item 402 of Regulation S-K to require companies to disclose the ratio of the Chief Executive Officer's annual total compensation to the median annual total compensation of all other employees. For certain of these changes, the implementing regulations have not been promulgated, so the full impact of the Dodd-Frank Act on public companies cannot be determined at this time.

The federal banking agencies have issued final rules to implement the provisions of Section 619 of the Dodd Frank Act commonly referred to as the Volcker Rule. The regulations contain prohibitions and restrictions on the ability of financial institutions holding companies and their affiliates to engage in proprietary trading and to hold certain interests in, or to have certain relationships with, various types of investment funds, including hedge funds and private equity funds. The regulations became effective on April 1, 2014 with full compliance being phased in over a period ending on July 21, 2015. First Financial Northwest is continuously reviewing its investment portfolio to determine if changes in its investment strategies may be required in order to comply with the various provisions of the Volcker Rule regulations.

Sarbanes-Oxley Act of 2002. As a public company that files periodic reports with the SEC under the Exchange Act, First Financial Northwest, is subject to the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley Act"), which addresses, among other issues, corporate governance, auditing and accounting, executive compensation, and enhanced and timely disclosure of corporate information. The Sarbanes-Oxley Act represents significant federal involvement in matters traditionally left to state regulatory systems, such as the regulation of the accounting profession, and to state corporate law, such as the relationship between a board of directors and management and between a board of directors and its committees. Our policies and procedures have been updated to comply with the requirements of the Sarbanes-Oxley Act.

Taxation

Federal Taxation

General. First Financial Northwest and First Savings Bank are subject to federal income taxation in the same general manner as other corporations, with some exceptions discussed below. The following discussion of federal taxation is intended only to summarize certain pertinent federal income tax matters and is not a comprehensive description of the tax rules applicable to First Financial Northwest or First Savings Bank. The tax years still open for review by the Internal Revenue Service are 2011 through 2014.

First Financial Northwest files a consolidated federal income tax return with First Savings Bank. Accordingly, any cash distributions made by First Financial Northwest to its shareholders are considered to be taxable dividends and not as a non-taxable return of capital to shareholders for federal and state tax purposes.

Method of Accounting. For federal income tax purposes, First Financial Northwest currently reports its income and expenses on the accrual method of accounting and uses a fiscal year ending on December 31 for filing its federal income tax return.

Minimum Tax. The Internal Revenue Code imposes an alternative minimum tax at a rate of 20% on a base of regular taxable income plus certain tax preferences, called alternative minimum taxable income. The alternative minimum tax is payable to the extent such alternative minimum taxable income is in excess of an exemption amount. Net operating losses can offset no more than 90% of alternative minimum taxable income. Certain payments of alternative minimum tax may be used as credits against regular tax liabilities in future years. The Company's alternative minimum tax credit carryforward at December 31, 2014 totaled \$1.9 million, with no expiration date.

Net Operating Loss Carryovers. A financial institution may carry back net operating losses to the preceding 2 taxable years and forward to the succeeding 20 taxable years. This provision applies to losses incurred in taxable years beginning after August 2009. The Company's net operating loss carryforward at December 31, 2014 was \$3.1 million and will begin to expire in 2030.

Corporate Dividends-Received Deduction. First Financial Northwest may eliminate from its income dividends received from First Savings Bank as a wholly-owned subsidiary of First Financial Northwest that files a consolidated return with First Savings Bank. The corporate dividends-received deduction is 100%, or 80%, in the case of dividends received from corporations with which a corporate recipient does not file a consolidated tax return, depending on the level of stock ownership of the payer of the dividend. Corporations that own less than 20% of the stock of a corporation distributing a dividend may deduct 70% of dividends received or accrued on their behalf.

For additional information regarding our federal income taxes, see Note 13 of the Notes to Consolidated Financial Statements contained in Item 8.

Washington State Taxation

First Financial Northwest and its subsidiaries are subject to a business and occupation tax imposed under Washington state law at the rate of 1.50% of gross receipts. In addition, various municipalities also assess business and occupation taxes at differing rates. Interest received on loans secured by first lien mortgages or deeds of trust on residential properties, rental income from properties, and certain investment securities are exempt from this tax. An audit by the Washington State Department of Revenue was completed for the years 2010 through 2013.

Executive Officers of First Financial Northwest, Inc.

The business experience for at least the past five years for the executive officers of First Financial Northwest and its primary subsidiary First Savings Bank is set forth below.

Joseph W. Kiley III, age 59, has served as President and Chief Executive Officer of First Financial Northwest and First Financial Diversified since September 2013, and served as President, Chief Executive Officer, Director of First Savings Bank since September 2012, and Director of First Financial Northwest and First Financial Diversified since December 2012. He previously served as President, Chief Executive Officer and Director of Frontier Bank, F.S.B., located in Palm Desert, California, and its holding company, Western Community Bancshares, Inc. from 2010 to 2012. From 2007 to 2010, Mr. Kiley was a Director at California General Bank. From 2009 to 2011, Mr. Kiley served as the President, Chief Executive Officer and Director of Imperial Capital Bank, located in San Diego, California and its holding company, Imperial Capital Bancorp, Inc. Mr. Kiley has over 20 years of executive experience at banks, thrifts and their holding companies that included serving as president, chief executive officer, chief financial officer, and director. Mr. Kiley holds a Bachelor of Science degree in Business Administration (Accounting) from California State University, Chico and is a former California certified public accountant. Mr. Kiley is an active member of the Renton Rotary Club and is a director with the Renton Chamber of Commerce.

Richard P. Jacobson, age 51, has served as Chief Operating Officer of the Bank since July 2013, Chief Financial Officer of First Financial Northwest, First Financial Diversified, and the Bank since August 2013, and Chief

Operating Officer of First Financial Northwest since September 2013. He was appointed as a director of First Financial Northwest and First Savings Bank effective September 2013. Mr. Jacobson served as a consultant to First Financial Northwest from April 2010 to April 2012, and from that time until July 2013, served as a mortgage loan originator in Palm Desert, California. Prior to that, he had been employed by Horizon Financial Corp. and Horizon Bank, Bellingham, Washington since 1987, and had served as President, Chief Executive Officer and a director of Horizon Financial Corp and Horizon Bank from 2008 to 2010. Mr. Jacobson also served as Chief Financial Officer of Horizon Financial Corp and Horizon Bank from March 2000 until October 2008. Between 1985 and 2008, Mr. Jacobson served in several other positions at Horizon Financial Corp. and Horizon Bank, and spent two years as a Washington State licensed real estate appraiser from 1992 to 1994. Mr. Jacobson received his Bachelor's degree in Business Administration (Finance) from the University of Washington. In addition, Mr. Jacobson graduated with honors from the American Banker Association's National

School of Banking. Mr. Jacobson is a past president of the Whatcom County North Rotary club and has served on the boards of his church, the United Way, Boys and Girls Club, and Junior Achievement.

Herman L. Robinson, age 69, is Senior Vice President and Chief Credit Officer of First Savings Bank and First Financial Diversified. Prior to joining First Savings Bank in June 2010, Mr. Robinson was Senior Vice President, Senior Credit Approval Officer at East West Bank, the successor to United Commercial Bank, from 2000 to May 2010. Mr. Robinson has over 45 years of banking experience. During his banking career, Mr. Robinson has held positions such as Chief Credit Officer, Manager of Special Credits and Senior Vice President and Manager of Commercial Lending at various banks.

Simon Soh, age 50, is Senior Vice President and Chief Lending Officer of First Savings Bank. Prior to his promotion in October 2012, Mr. Soh served as Vice President and Loan Production Manager of First Savings Bank, a position he held since August 2010. Prior to that, he was First Vice President and Commercial Lending Manager at East West Bank. In 1998, Mr. Soh was a founding member of Pacifica Bank in Bellevue, Washington that merged with United Commercial Bank in 2005, later becoming East West Bank in 2009. Mr. Soh has over 25 years of experience in commercial banking.

Ronnie J. Clariza, age 34, was appointed Chief Risk Officer and Senior Vice President of First Savings Bank in November 2013. Mr. Clariza previously served as Vice President and Risk Management Officer since May 2008, and prior to that, as Assistant Vice President and Compliance Officer, as well as serving in various other compliance and internal audit roles since he began with the Bank in 2003. Mr. Clariza is a graduate of the University of Washington where he received his Bachelor of Arts degree in Business Administration, Finance, and is a certified regulatory Compliance Officer. Mr. Clariza is a member of the Washington Bankers' Association Education Committee and has been involved with the Seattle Children's Hospital Guild Association as a Volunteer Compliance Manager.

Dalen D. Harrison, age 55, was appointed Chief Deposit Officer of First Savings Bank in March 2014 and Senior Vice President in July 2014. Ms. Harrison served as Senior Vice President and Director of Retail Banking at Peoples Bank in Bellingham, Washington from 2010 until 2014. Prior to that, she served as Vice President of Rainier Pacific Bank, Tacoma, Washington, from 1994 until 2010. Ms. Harrison received a Bachelor of Arts degree in Business Administration from St Mary's College in Moraga, California. Ms. Harrison has served on the boards of Rainier Pacific Foundation, First Place for Children, and Gig Harbor Rotary Foundation, and currently serves on the board of Renton Salvation Army.

Christine A. Huestis, age 49, is Vice President and Controller of First Financial Northwest and First Savings Bank. Prior to joining First Financial Northwest in October 2013, she was employed by Realty in Motion, LLC., a holding company for several mortgage default service companies, in Bellevue, Washington. From 1999 until joining First Financial Northwest, Ms. Huestis held key accounting positions at affiliated companies within Realty in Motion, with her most recent position being that of Controller. Ms. Huestis received a Bachelor of Science degree in Accounting from Central Washington University. She is a certified public accountant and is a member of the American Institute of Certified Public Accountants.

Item 1A. Risk Factors.

An investment in our common stock is subject to risks inherent in our business. Before making an investment decision, you should carefully consider the risks and uncertainties described below together with all of the other information included in this report and our other filings with the SEC. In addition to the risks and uncertainties described below, other risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially and adversely affect our business, financial condition, capital levels, cash flows, liquidity, results of operations and prospects. The risks discussed below also include forward-looking statements, and our actual results

may differ substantially from those discussed in these forward-looking statements. The market price of our common stock could decline significantly due to any of these identified or other risks and you could lose some or all of your investment. This report is qualified in its entirety by these risk factors.

Our business may be adversely affected by downturns in the national economy and in the economies in our market areas.

Substantially all of our loans are to businesses and individuals in the state of Washington. A decline in the economies of the four counties in which we operate, which we consider to be our primary market area, could have a material adverse effect on our business, financial condition, results of operations, and prospects.

While real estate values and unemployment rates have recently improved, a prolonged slow economic recovery or a deterioration in economic conditions in the market areas we serve could result in the following consequences, any of which could have a materially adverse impact on our business, financial condition, results of operations:

• loan delinquencies, problem assets and foreclosures may increase;

• we may increase our allowance for loan losses;

• demand for our products and services may decline resulting in a decrease in our total loans or assets;

• collateral for loans, especially real estate, may decline in value, exposing us to increased risk of loss on existing loans, reducing customers' borrowing power, and reducing the value of assets and collateral associated with existing loans;

• the net worth and liquidity of loan guarantors may decline, impairing their ability to honor commitments to us; and

• the amount of our low-cost or noninterest-bearing deposits may decrease and the composition of our deposits may be adversely affected.

A decline in local economic conditions may have a greater effect on our earnings and capital than on the earnings and capital of larger financial institutions whose real estate loan portfolios are geographically diverse. If we are required to liquidate a significant amount of collateral during a period of reduced real estate values, our financial condition and profitability could be adversely affected.

A return of recessionary conditions could result in increases in our level of non-performing loans and/or reduce demand for our products and services, which could have an adverse effect on our results of operations.

Economic conditions have improved since the end of the economic recession that officially ended in June, 2009, however, economic growth has been slow and uneven, unemployment remains high and concerns still exist over the federal deficit and government spending, which have all contributed to diminished expectations for the economy. A return of recessionary conditions and/or negative developments in the domestic and international credit markets may significantly affect the markets in which we do business, the value of our loans and investments, and our ongoing operations, costs and profitability. Declines in real estate values and sales volumes and high unemployment levels may result in higher than expected loan delinquencies and a decline in demand for our products and services. These negative events may cause us to incur losses and may adversely affect our capital, liquidity, and financial condition.

Furthermore, the Board of Governors of the Federal Reserve System, in an attempt to help the economy, has, among other things, kept interest rates low through its targeted federal funds rate and the purchase of U.S. Treasury and mortgage-backed securities. If the Federal Reserve Board increases the federal funds rate market interest rates would likely rise, which may negatively affect the housing markets and the U.S. economic recovery. In addition, deflationary pressures, while possibly lowering our operating costs, could have a significant negative effect on our borrowers, especially our business borrowers, and the values of underlying collateral securing loans, which could negatively affect our financial performance.

Our construction/land development loans are based upon estimates of costs and the value of the completed project.

We make construction/land development loans to contractors and builders primarily to finance the construction of single and multi-family homes, subdivisions, as well as commercial properties. We originate these loans whether or not the collateral property underlying the loan is under contract for sale. At December 31, 2014, construction/land development loans totaled \$51.1 million, or 7.2% of our total loan portfolio of which \$17.9 million were multifamily construction loans, \$4.3 million were commercial construction loans and \$19.9 million were one-to-four family construction loans. Land loans, which are loans made with land as security, totaled \$9.0 million, or 1.3% of our total loan portfolio at December 31, 2014. Land loans include raw land and land acquisition and development loans. In addition, at December 31, 2014, the construction/land development loan totals excluded \$11.1 million of one-to-four family residential, multifamily, and commercial real estate "rollover" construction loans because these loans are structured to convert to permanent financing when construction is complete.

Construction/land development lending generally involves additional risks because funds are advanced upon the security of the project that is of uncertain value prior to its completion. Because of the uncertainties inherent in estimating construction costs, as well as the market value of the completed project and the effects of governmental

regulation of real property, it is relatively difficult to evaluate accurately the total funds required to complete a project and the related loan-to-value ratio. In addition, potential uncertainties in the residential real estate market, property values have become more difficult to determine than they have historically been. This type of lending also typically involves higher loan principal amounts and is often concentrated with a small number of builders. A downturn in housing, or the real estate market, could increase loan delinquencies, defaults and foreclosures, and significantly impair the value of our collateral and our ability to sell the collateral upon foreclosure. Some of our builders have more than one loan outstanding with us and also have residential mortgage loans for rental properties with us. Consequently, an adverse development with respect to one loan or one credit relationship can expose us to a significantly greater risk of loss.

In addition, during the term of most of our construction loans, no payment from the borrower is required since the accumulated interest is added to the principal of the loan through an interest reserve. As a result, these loans often involve the disbursement of funds with repayment substantially dependent on the success of the ultimate project and the ability of the borrower to sell or lease the property or obtain permanent take-out financing, rather than the ability of the borrower or guarantor to repay principal and interest. These loans are also generally more difficult to monitor. In addition, speculative construction loans to a builder are often associated with homes that are not pre-sold and thus pose a greater potential risk than construction loans to individuals on their personal residences. Loans on land under development or held for future construction also pose additional risk because of the lack of income being produced by the property and the potential illiquid nature of the collateral. These risks can be significantly impacted by supply and demand conditions. At December 31, 2014, \$42.1 million of our construction/land development loans were for speculative construction loans and all of our construction/land development loans were classified as performing.

Our level of commercial and multifamily real estate loans may expose us to increased lending risks.

While commercial and multifamily real estate lending may potentially be more profitable than single-family residential lending, it is generally more sensitive to regional and local economic conditions, making loss levels more difficult to predict. Collateral evaluation and financial statement analysis in these types of loans requires a more detailed analysis at the time of loan underwriting and on an ongoing basis. At December 31, 2014, we had \$248.3 million of commercial real estate loans, representing 35.3% of our total loan portfolio and \$120.5 million of multifamily loans, representing 17.1% of our total loan portfolio. These loans typically involve higher principal amounts than other types of loans and some of our commercial borrowers have more than one loan outstanding with us. Consequently, an adverse development with respect to one loan or one credit relationship can expose us to a significantly greater risk of loss compared to an adverse development with respect to a one-to-four family residential loan. Repayment on these loans is dependent upon income generated, or expected to be generated, by the property securing the loan in amounts sufficient to cover operating expenses and debt service that may be adversely affected by changes in the economy or local market conditions. For example, if the cash flow from the borrower's project is reduced as a result of leases not being obtained or renewed, the borrower's ability to repay the loan may be impaired. Commercial and multifamily loans also expose a lender to greater credit risk than loans secured by one-to-four family residential real estate because the collateral securing these loans typically cannot be sold as easily as residential real estate. In addition, many of our commercial and multifamily real estate loans are not fully amortizing and contain large balloon payments upon maturity. Such balloon payments may require the borrower to either sell or refinance the underlying property in order to make the payment that may increase the risk of default or non-payment. Further, many of our commercial and multifamily borrowers have more than one loan with us. Consequently, an adverse development with respect to one loan or one credit relationship can expose us to a significantly greater risk of loss.

A secondary market for most types of commercial and multifamily real estate loans is not readily available, so we have less opportunity to mitigate credit risk by selling part or all of our interest in these loans. As a result of these characteristics, if we foreclose on a commercial or multifamily real estate loan, our holding period for the collateral typically is longer than for one-to-four family residential loans because there are fewer potential purchasers of the collateral. Accordingly, charge-offs on commercial real estate loans may be larger on a per loan basis than those incurred with our residential or consumer loan portfolios.

The level of our commercial real estate loan portfolio may subject us to additional regulatory scrutiny.

The FDIC, the Federal Reserve and the Office of the Comptroller of the Currency have promulgated joint guidance on sound risk management practices for financial institutions with concentrations in commercial real estate lending. Under this guidance, a financial institution that, like us, is actively involved in commercial real estate lending should perform a risk assessment to identify concentrations. A financial institution may have a concentration in commercial real estate lending if, among other factors (i) total reported loans for construction, land development, and other land represent 100% or more of total capital, or (ii) total reported loans secured by multi-family and non-farm residential

properties, loans for construction, land development and other land, and loans otherwise sensitive to the general commercial real estate market, including loans to commercial real estate related entities, represent 300% or more of total capital. The particular focus of the guidance is on exposure to commercial real estate loans that are dependent on the cash flow from the real estate held as collateral and that are likely to be at greater risk to conditions in the commercial real estate market (as opposed to real estate collateral held as a secondary source of repayment or as an abundance of caution). The purpose of the guidance is to guide banks in developing risk management practices and capital levels commensurate with the level and nature of real estate concentrations. The guidance states that management should employ heightened risk management practices including board and management oversight and strategic planning, development of underwriting standards, risk assessment and monitoring through market analysis and stress testing. We have concluded that as a result of the Bank's payment in 2014 of a \$70 million dividend to the Company, we have a concentration in commercial real estate lending under the foregoing standards because our balance in commercial real estate loans at December 31, 2014 represents more than 300% of total capital. While we believe we have implemented policies and procedures with respect to our commercial real

estate loan portfolio consistent with this guidance, bank regulators could require us to implement additional policies and procedures consistent with their interpretation of the guidance that may result in additional costs to us.

Our non-owner occupied real estate loans may expose us to increased credit risk.

At December 31, 2014, \$112.7 million, or 41.2% of our one-to-four family residential loan portfolio and 16.0% of our total loan portfolio, consisted of loans secured by non-owner occupied residential properties. At December 31, 2014, nonperforming, non-owner occupied one-to-four family residential loans amounted to \$164,000. Loans that were classified as non-owner occupied residential properties prior to foreclosure and are now classified as OREO, amounted to \$300,000 at December 31, 2014. Loans secured by non-owner occupied properties generally expose a lender to greater risk of non-payment and loss than loans secured by owner occupied properties because repayment of such loans depend primarily on the tenant's continuing ability to pay rent to the property owner, who is our borrower, or, if the property owner is unable to find a tenant, the property owner's ability to repay the loan without the benefit of a rental income stream. In addition, the physical condition of non-owner occupied properties is often below that of owner occupied properties due to lax property maintenance standards that has a negative impact on the value of the collateral properties. Furthermore, some of our non-owner occupied residential loan borrowers have more than one loan outstanding with us. At December 31, 2014, we had 47 non-owner occupied residential loan relationships, each having an outstanding balance over \$500,000, with aggregate outstanding balances of \$86.0 million. Consequently, an adverse development with respect to one credit relationship may expose us to a greater risk of loss compared to an adverse development with respect to an owner occupied residential mortgage loan.

Our business may be adversely affected by credit risk associated with residential property.

At December 31, 2014, \$273.7 million, or 38.9% of our total loan portfolio, was secured by first liens on one-to-four family residential loans. In addition, at December 31, 2014, our home equity lines of credit totaled \$5.0 million. These types of loans are generally sensitive to regional and local economic conditions that significantly impact the ability of borrowers to meet their loan payment obligations, making loss levels difficult to predict. A decline in residential real estate values resulting from a downturn in the Washington housing market may reduce the value of the real estate collateral securing these types of loans and increased our risk of loss if borrowers default on their loans. Recessionary conditions or declines in the volume of real estate sales and/or the sales prices coupled with elevated unemployment rates may result in higher than expected loan delinquencies or problem assets, and a decline in demand for our products and services. These potential negative events may cause us to incur losses, adversely affect our capital and liquidity and damage our financial condition and business operations.

High loan-to-value ratios on a portion of our residential mortgage loan portfolio exposes us to greater risk of loss.

Some of our residential mortgage loans are secured by liens on mortgage properties in which the borrowers have little or no equity because of a decline in the value of the property. Residential loans with high loan-to-value ratios will be more sensitive to declining property values than those with lower loan-to-value ratios and, therefore, may experience a higher incidence of default and severity of losses. In addition, if the borrowers sell their homes, such borrowers may be unable to repay their loans in full from the sale. As a result, these loans may experience higher rates of delinquencies, defaults and losses.

Our results of operations, liquidity and cash flows are subject to interest rate risk.

Our earnings and cash flows are largely dependent upon net interest income. Interest rates are highly sensitive to many factors that are beyond our control, including general economic conditions and policies of various governmental and regulatory agencies and, in particular, the FRB. Changes in monetary policy, including changes in interest rates, could influence not only the interest we receive on loans and investments and the amount of interest we pay on deposits and borrowings, but these changes could also affect (i) our ability to originate loans and obtain deposits, (ii) the fair value

of our financial assets and liabilities and (iii) the average duration of our mortgage-backed securities portfolio and other interest-earning assets. If the interest rates paid on deposits and other borrowings increase at a faster rate than the interest rates received on loans and other investments, our net interest income, and therefore earnings, could be adversely affected. Earnings could also be adversely affected if the interest rates received on loans and other investments fall more quickly than the interest rates paid on deposits and other borrowings.

A prolonged period of exceptionally low market interest rates, such as we are currently experiencing limits our ability to lower our interest expense, while the average yield on our loan portfolio may continue to decrease as our loans reprice or are originated at these low market rates, which could have an adverse effect on our results of operations. Furthermore, a portion of our adjustable-rate loans have interest rate floors below which the loan's contractual interest rate may not adjust. Approximately 31% of our total loans were comprised of adjustable-rate loans at December 31, 2014. At that date, \$116.6 million, or 53%, of these loans with an average interest rate of 4.4% were at their floor interest rate. The inability of our loans to adjust downward can contribute to increased income in periods of declining interest rates, although this result is subject to the risks that borrowers

may refinance these loans during periods of declining interest rates. Also, when loans are at their respective floor, there is a further risk that our interest income may not increase as rapidly as our cost of funds during periods of increasing interest rates and could have a material adverse effect on our results of operations.

We principally manage interest rate risk by managing our volume and mix of our earning assets and funding liabilities. In a changing interest rate environment, we may not be able to manage this risk effectively as our interest rate risk modeling techniques and assumptions may not fully predict or capture the impact of actual interest rate changes on our balance sheet or projected operating results. If we are unable to manage interest rate risk effectively, our business, financial condition and results of operations could be materially harmed.

Our allowance for loan losses may prove to be insufficient to absorb losses in our loan portfolio.

While conditions in the housing and real estate markets and economic conditions in our market areas have recently improved, if slow economic conditions return or real estate values and sales deteriorate, we may experience higher delinquencies and credit losses. As a result, we could be required to increase our provision for loan losses and to charge-off additional loans in the future. If charge-offs in future periods exceed the ALLL, we may need additional provisions to replenish the ALLL. In addition, bank regulatory agencies periodically review our ALLL and may require an increase in the provision for possible loan losses or the recognition of further loan charge-offs, based on judgments different than those of management.

The determination of the appropriate level of the ALLL inherently involves a high degree of subjectivity and requires us to make various assumptions and judgments about the collectability of our loan portfolio, including the creditworthiness of our borrowers and the value of the real estate and other assets serving as collateral for the repayment of many of our loans. In determining the amount of the ALLL, we review our loans and the loss and delinquency experience and evaluate economic conditions and make significant estimates of current credit risks and future trends, all of which may undergo material changes. If our estimates are incorrect, the ALLL may not be sufficient to cover losses inherent in our loan portfolio, resulting in the need for increases in our provision for loan losses. Deterioration in economic conditions, new information regarding existing loans, identification of additional problem loans or relationships, and other factors, both within and outside of our control, may increase our loan charge-offs and/or may otherwise require an increase in the ALLL. Any increases in the provision for loan losses will result in a decrease in net income and may have a material adverse effect on our financial condition, results of operations, and capital.

In addition, proposed regulatory changes relating to the ALLL, including, but not limited to, the Financial Accounting Standards Board's ("FASB") proposed Current Expected Credit Losses Model could significantly impact the calculation and timing of amounts required to be included in the ALLL to cover for expected losses over the entire life of a loan.

If our investments in other real estate owned are not properly valued and managed our earnings could be reduced.

Our nonperforming loans have decreased from \$4.0 million at December 31, 2013 to \$1.3 million at December 31, 2014, however, we continue to foreclose on loans in our portfolio. We use current property valuations in the form of appraisals when a loan has been foreclosed and the property taken in as OREO. Subsequently, an evaluation is performed by our experienced lending staff during the asset's holding period. Our net book value in the loan at the time of foreclosure and thereafter is compared to the updated market value of the foreclosed property less estimated selling costs (fair value). A charge-off is recorded for any excess in the asset's net book value over its fair value. If our valuation process is incorrect, the fair value of our investments in OREO may not be sufficient to recover our net book value in such assets, resulting in the need for additional write-downs. In addition, we may incur significant property management and legal expenses related to our OREO. Additional material write-downs or expenses relating to our OREO could have a material adverse effect on our financial condition and results of operations.

In addition, bank regulators periodically review our OREO and may require us to recognize additional write-downs. Any increase in our write-downs, as required by such regulators, may have a material adverse effect on our financial condition, results of operations, and capital.

We may incur losses on our securities portfolio as a result of changes in interest rates.

Our securities portfolio may be affected by fluctuations in market value, potentially reducing accumulated other comprehensive income and/or earnings. Fluctuations in market value may be caused by changes in market interest rates, lower market prices for securities and limited investor demand. Our securities portfolio is evaluated for other-than-temporary impairment. If this evaluation shows impairment to the actual or projected cash flows associated with one or more securities, a potential loss to earnings may occur. Changes in interest rates can also have an adverse effect on our financial condition, as our available-for-sale securities are reported at their estimated fair value, and therefore are impacted by fluctuations in interest rates. We increase or decrease our stockholders' equity by the amount of change in the estimated fair value of the available-for-sale securities, net of

taxes. There can be no assurance that the declines in market value will not result in other-than-temporary impairments of these assets, and would lead to accounting charges that could have a material adverse effect on our net income and capital levels.

If our investment in the Federal Home Loan Bank of Seattle becomes impaired, our earnings and stockholders' equity could decrease.

At December 31, 2014, we owned \$6.7 million in FHLB stock. As a condition of membership at the FHLB, we are required to purchase and hold a certain amount of FHLB stock. This requirement is based, in part, upon the outstanding principal balance of advances from the FHLB and is calculated in accordance with the Capital Plan of the FHLB. Our FHLB stock has a par value of \$100, is carried at cost, and it is subject to recoverability testing per accounting guidance for the impairment of long lived assets. We monitor on a recurring basis the financial condition of the FHLB as it relates to, among other things, the recoverability of our investment.

On September 25, 2014, the FHLB Seattle and FHLB Des Moines announced a proposed merger. Under this proposal, the Bank would become a member of FHLB Des Moines and all shares of our FHLB Seattle stock would convert to equal shares of FHLB Des Moines stock. If the merger is terminated by either the FHLB Des Moines or the FHLB Seattle, the terminating FHLB must pay \$57 million in termination fees. If the FHLB Seattle were to terminate the agreement, this could result in significant impairment to our investment in the FHLB Seattle, potentially decreasing our earnings and shareholders' equity.

Liquidity risk could impair our ability to fund operations and jeopardize our financial condition.

Liquidity is essential to our business, therefore, the inability to obtain adequate funding may negatively affect growth and, consequently, our earnings capability and capital levels. An inability to raise funds through deposits, borrowings, the sale of loans or investment securities, or other sources could have a substantial negative effect on our liquidity. Our access to funding sources in amounts adequate to finance our activities on terms that are acceptable to us could be impaired by factors that affect us specifically or the financial services industry or economy in general. Factors that could detrimentally impact our access to liquidity sources include a decrease in the level of our business activity as a result of a downturn in the Washington markets in which our loans are concentrated, negative operating results, or adverse regulatory action against us. Our ability to borrow could also be impaired by factors that are not specific to us, such as a disruption in the financial markets or negative views and expectations about the prospects for the financial services industry and the continued uncertainty in credit markets. In particular, our liquidity position could be significantly constrained if we are unable to access funds from the FHLB Seattle, the Federal Reserve Bank of San Francisco or other wholesale funding sources, or if adequate financing is not available at acceptable interest rates. Finally, if we are required to rely more heavily on more expensive funding sources, our revenues may not increase proportionately to cover our costs. In this case, our results of operations and financial condition would be negatively affected. Additionally, collateralized public funds are bank deposits of state and local municipalities. These deposits are required to be secured by certain investment grade securities to ensure repayment that, on the one hand, tends to reduce our contingent liquidity risk by making these funds somewhat less credit sensitive, but on the other hand, reduces standby liquidity by restricting the potential liquidity of the pledged collateral. Although these funds historically have been a relatively stable source of funds for us, availability depends on the individual municipality's fiscal policies and cash flow needs. At December 31, 2014 we had \$15.9 million in public funds.

Our single branch location limits our ability to attract retail deposits and as a result a large portion of our deposits are certificates of deposit, including "jumbo" certificates that may not be as stable as other types of deposits.

Our single branch location limits our ability to compete with larger institutions for noninterest bearing deposits as these institutions have a larger branch network providing greater convenience to customers. As a result, we are

dependent on more interest rate sensitive deposits. At December 31, 2014, \$412.6 million, or 67.2%, of our total deposits were certificates of deposit and, of that amount, \$249.9 million were “jumbo” certificates greater than or equal to \$100,000, with \$79.8 million of these certificates greater than or equal to \$250,000. In addition, deposit inflows are significantly influenced by general interest rates. Our money market accounts and jumbo certificates of deposit and the retention of these deposits are particularly sensitive to general interest rates, making these deposits traditionally a more volatile source of funding than other deposit accounts. In order to retain our money market accounts and jumbo certificates of deposit, we may have to pay a higher rate, resulting in an increase in our cost of funds. In a rising rate environment, we may be unwilling or unable to pay a competitive rate because of the resulting compression in our interest rate spread. To the extent that such deposits do not remain with us, they may need to be replaced with borrowings or other deposits that could increase our cost of funds and negatively impact our interest rate spread and financial condition.

Our branching strategy will cause our expenses to increase faster than revenues.

On March 6, 2015, we submitted an application with the FDIC and DFI to open a new branch office in Mill Creek, WA. We are planning one to two new branch openings within the next 12 months. Current plans include opening offices much smaller than traditional bank branch offices, utilizing the improved technology that will come with the conversion to a new core data processor in 2015 to maintain management's focus on efficiency, while working to grow the Bank's presence into new markets. The success of our expansion strategy into new markets, however, is contingent upon numerous factors, such as our ability to select suitable locations, assess each market's competitive environment, secure managerial resources, hire and retain qualified personnel and implement effective marketing strategies. The opening of new offices may not increase the volume of our loans and deposits as quickly or to the degree that we hope, and opening new offices will increase our operating expenses. On average, de novo branches do not become profitable until three to four years after opening. We currently expect to lease rather than own the additional branches. Further, the projected time line and the estimated dollar amounts involved in opening de novo branches could differ significantly from actual results. In addition, we may not successfully manage the costs and implementation risks associated with our branching strategy. Accordingly, any new branch may negatively impact our earnings for some period of time until the branch reaches certain economies of scale. Finally, there is a risk that our new branches will not be successful even after they have been established.

We may be required to raise additional capital in the future, but that capital may not be available when it is needed, or it may only be available on unacceptable terms, which could adversely affect our financial condition and results of operations.

We are required by federal and state regulatory authorities to maintain adequate levels of capital to support our operations. Our ability to raise additional capital, if needed, will depend on conditions in the capital markets at that time, which are outside of our control, and on our financial performance. Accordingly, we may not be able to raise additional capital, if needed, on terms acceptable to us. If we cannot raise additional capital when needed, our ability to further expand our operations and pursue our growth strategy could be materially impaired and our financial condition and liquidity could be materially and adversely affected. In addition, if we are unable to raise additional capital when required by our bank regulators, we may be subject to adverse regulatory action.

We operate in a highly regulated environment and may be adversely affected by changes in federal and state laws and regulations that are expected to increase our costs of operations.

As a state-chartered, federally insured savings bank, First Savings Bank is currently subject to extensive examination, supervision and comprehensive regulation by the FDIC and the DFI and as a bank holding company First Financial Northwest is subject to examination, supervision and regulation by the FRB. These regulatory authorities have extensive discretion in connection with their supervisory and enforcement activities, including the ability to impose restrictions on an institution's operations, reclassify assets, determine the adequacy of an institution's ALLL and determine the level of deposit insurance premiums assessed.

Additionally, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") has significantly changed the bank regulatory structure and will affect the lending, deposit, investment, trading and operating activities of financial institutions and their holding companies. The Dodd-Frank Act requires various federal agencies to adopt a broad range of new implementing rules and regulations, and to prepare numerous studies and reports for Congress. The federal agencies are given significant discretion in drafting the implementing rules and regulations, and consequently, many of the details and much of the impact of the Dodd-Frank Act may not be known for many months or years.

Certain provisions of the Dodd-Frank Act are expected to have a near term impact on us. For example, a provision of the Dodd-Frank Act eliminates the federal prohibitions on paying interest on demand deposits, thus allowing businesses to have interest bearing checking accounts. Depending on competitive responses, this significant change to

existing law could have an adverse impact on our interest expense.

The Dodd-Frank Act created a new Consumer Financial Protection Bureau (the “CFPB”) with broad powers to supervise and enforce consumer protection laws. The CFPB has broad rule-making authority for a wide range of consumer protection laws that apply to all banks and savings institutions, including the authority to prohibit “unfair, deceptive or abusive” acts and practices. The CFPB has examination and enforcement authority over all banks and savings institutions with more than \$10 billion in assets. Financial institutions such as First Savings Bank with \$10 billion or less in assets will continue to be examined for compliance with the consumer laws by their primary bank regulators but are subject to the rules of the CFPB.

In January of 2013, the CFPB issued several final regulations and changes to certain consumer protections under existing laws. These final rules, most of the provisions of which (including the qualified mortgage rule) became effective January 10, 2014, generally prohibit creditors from extending mortgage loans without regard for the consumer’s ability-to-repay and add

restrictions and requirements to mortgage origination and servicing practices. In addition, these rules limit prepayment penalties and require the creditor to retain evidence of compliance with the ability-to-repay requirement for three years. Compliance with these rules will likely increase our overall regulatory compliance costs and may require changes to our underwriting practices with respect to mortgage loans. Moreover, these rules may adversely affect the volume of mortgage loans that we underwrite and may subject us to increased potential liabilities related to such residential loan origination activities.

The Dodd-Frank Act requires minimum leverage (Tier 1) and risk-based capital requirements for bank holding companies and savings and loan holding companies that are no less stringent than those applicable to banks, which will limit our ability to borrow at the holding company level and invest the proceeds from such borrowings as capital in First Savings Bank, and will exclude certain instruments that previously have been eligible for inclusion by bank holding companies as Tier 1 capital, such as trust preferred securities.

It is difficult to predict at this time what specific impact the Dodd-Frank Act and the yet to be written implementing rules and regulations will have on community banks. However, it is expected that at a minimum they will increase our operating and compliance costs, which could adversely affect key operating efficiency ratios, and could increase our interest expense. See - “Business - How We are Regulated” contained in Part I, Item I of this report.

Non-compliance with the USA PATRIOT Act, Bank Secrecy Act, or other laws and regulations could result in fines or sanctions.

The USA PATRIOT and Bank Secrecy Acts require financial institutions to develop programs to prevent financial institutions from being used for money laundering and terrorist activities. If such activities are detected, financial institutions are obligated to file suspicious activity reports with the U.S. Treasury’s Office of Financial Crimes Enforcement Network. These rules require financial institutions to establish procedures for identifying and verifying the identity of customers seeking to open new financial accounts. Failure to comply with these regulations could result in fines or sanctions. During the last few years, several banking institutions have received large fines for non-compliance with these laws and regulations. While we have developed policies and procedures designed to assist in compliance with these laws and regulations, no assurance can be given that these policies and procedures will be effective in preventing violations of these laws and regulations.

New or changing tax, accounting, and regulatory rules and interpretations could significantly impact strategic initiatives, results of operations, cash flows, and financial condition.

The banking industry is extensively regulated. Federal and state banking regulations are designed primarily to protect the deposit insurance funds and consumers, not to benefit a company’s shareholders. These regulations may sometimes impose significant limitations on operations. The significant federal and state banking regulations that affect us are described in this report under the heading “Item 1. Business- How We are Regulated”. These regulations, along with the currently existing tax, accounting, securities, insurance, and monetary laws, regulations, rules, standards, policies, and interpretations control the methods by which financial institutions conduct business, implement strategic initiatives and tax compliance, and govern financial reporting and disclosures. These laws, regulations, rules, standards, policies, and interpretations are constantly evolving and may change significantly over time. Any new regulations or legislation, change in existing regulations or oversight, whether a change in regulatory policy or a change in a regulator’s interpretation of a law or regulation, could have a material impact on our operations, increase our costs of regulatory compliance and of doing business and or otherwise adversely affect us and our profitability. Further, changes in accounting standards can be both difficult to predict and involve judgment and discretion in their interpretation by us and our independent accounting firms. These changes could materially impact, potentially even retroactively, how we report our financial condition and results of our operations as could our interpretation of those changes.

Legal and regulatory proceedings and related matters could adversely affect us or the financial services industry in general.

We, and other participants in the financial services industry upon whom we rely to operate, have been and may in the future become involved in legal and regulatory proceedings. Most of the proceedings we consider to be in the normal course of our business or typical for the industry; however, it is inherently difficult to assess the outcome of these matters and there can be no assurance that anyone in particular, including us, will prevail in any proceeding or litigation. There could be substantial cost and management diversion in such litigation and proceedings, and any adverse determination could have a materially adverse effect on our business, brand or image, or our financial condition and results of our operations.

Our real estate lending also exposes us to the risk of environmental liabilities.

In the course of our business, we may foreclose and take title to real estate and could be subject to environmental liabilities with respect to these properties. We may be held liable to a governmental entity or to third parties for property damage, personal

injury, investigation and clean-up costs incurred by these parties in connection with environmental contamination, or may be required to investigate or clean up hazardous or toxic substances, or chemical releases at a property. The costs associated with investigation or remediation activities could be substantial. In addition, as the owner or former owner of a contaminated site, we may be subject to common law claims by third parties based on damages and costs resulting from environmental contamination emanating from the property. If we ever become subject to significant environmental liabilities, our business, financial condition and results of operations could be materially and adversely affected.

We are subject to certain risks in connection with our use of technology.

Our security measures may not be sufficient to mitigate the risk of a cyber-attack. Communications and information systems are essential to the conduct of our business, as we use such systems to manage our customer relationships, our general ledger and virtually all other aspects of our business. Our operations rely on the secure processing, storage, and transmission of confidential and other information in our computer systems and networks. Although we take protective measures and endeavor to modify them as circumstances warrant, the security of our computer systems, software, and networks may be vulnerable to breaches, unauthorized access, misuse, computer viruses, or other malicious code and cyber-attacks that could have a security impact. If one or more of these events occur, this could jeopardize our or our customers' confidential and other information processed and stored in, and transmitted through, our computer systems and networks, or otherwise cause interruptions or malfunctions in our operations or the operations of our customers or counterparties. We may be required to expend significant additional resources to modify our protective measures or to investigate and remediate vulnerabilities or other exposures, and we may be subject to litigation and financial losses that are either not insured against or not fully covered through any insurance maintained by us. We could also suffer significant reputational damage.

Security breaches in our internet banking activities could further expose us to possible liability and damage our reputation. Any compromise of our security also could deter customers from using our internet banking services that involve the transmission of confidential information. We rely on standard internet security systems to provide the security and authentication necessary to effect secure transmission of data. These precautions may not protect our systems from compromises or breaches of our security measures, and could result in significant legal liability and significant damage to our reputation and our business.

Our security measures may not protect us from systems failures or interruptions. While we have established policies and procedures to prevent or limit the impact of systems failures and interruptions, there can be no assurance that such events will not occur or that they will be adequately addressed if they do. In addition, we outsource certain aspects of our data processing and other operational functions to certain third-party providers. If our third-party providers encounter difficulties, or if we have difficulty in communicating with them, our ability to adequately process and account for transactions could be affected, and our business operations could be adversely impacted. Threats to information security also exist in the processing of customer information through various other vendors and their personnel.

The occurrence of any failures or interruptions may require us to identify alternative sources of such services, and we cannot assure you that we could negotiate terms that are as favorable to us, or could obtain services with similar functionality as found in our existing systems without the need to expend substantial resources, if at all. Further, the occurrence of any systems failure or interruption could damage our reputation and result in a loss of customers and business, could subject us to additional regulatory scrutiny, or could expose us to legal liability. Any of these occurrences could have a material adverse effect on our financial condition and results of operations.

Our business may be adversely affected by an increasing prevalence of fraud and other financial crimes. Our loans to businesses and individuals and our deposit relationships and related transactions are subject to exposure to the risk of loss due to fraud and other financial crimes. Nationally, reported incidents of fraud and other financial

crimes have increased. We have also experienced losses due to apparent fraud and other financial crimes. While we have policies and procedures designed to prevent such losses, there can be no assurance that such losses will not occur.

We may be adversely impacted by our decision to convert to a new core data processor in 2015.

While we are encouraged by the additional services and efficiencies that we expect subsequent to our conversion to a new core data processor in 2015, no assurances can be made that the conversion will not be disruptive to our operations or not well received by certain segments of our customer base. We anticipate the capitalized cost of the new data processor to be \$525,000.

We are dependent on key personnel and the loss of one or more of those key personnel may materially and adversely affect our prospects.

Competition for qualified employees and personnel in the banking industry is intense and there are a limited number of qualified persons with knowledge of, and experience in, the community banking industry where First Savings Bank conducts its business. The process of recruiting personnel with the combination of skills and attributes required to carry out our strategies is often lengthy. Our success depends to a significant degree upon our ability to attract and retain qualified management, loan origination, finance, administrative, marketing and technical personnel and upon the continued contributions of our management and personnel. In particular, our success has been and continues to be highly dependent upon the abilities of key executives, including our President, and certain other employees. In addition, our success has been and continues to be highly dependent upon the services of our directors, many of whom are at or nearing retirement age, and we may not be able to identify and attract suitable candidates to replace such directors.

We participate in a multiple employer defined benefit pension plan for the benefit of our employees. If we were to withdraw from this plan, or if Pentegra, the multiple employer defined benefit pension plan sponsor, requires us to make additional contributions, we could incur a substantial expense in connection with the withdrawal or the request for additional contributions.

We participate in the Pentegra Defined Benefit Plan for Financial Institutions, a multiple employer pension plan for the benefit of our employees. Effective March 31, 2013, we did not allow additional employees to participate in this plan. On March 31, 2013, we froze the future accrual of benefits under this plan with respect to those participating employees. In connection with our decision to freeze our benefit accruals under the plan, and since then, we considered withdrawing from the plan.

The actual expense that would be incurred in connection with a withdrawal from the plan is primarily dependent upon the timing of the withdrawal, the total value of the plan's assets at the time of withdrawal, general market interest rates at that time, expenses imposed on withdrawal, and other conditions imposed by Pentegra as set forth in the plan. If we choose to withdraw from the plan in the future, we could incur a substantial expense in connection with the withdrawal.

Even if we do not withdraw from the plan Pentegra, as sponsor of the plan, may request that we make an additional contribution to the plan, in addition to contributions that we are regularly required to make, or obtain a letter of credit in favor of the plan, if our financial condition worsens to the point that it triggers certain criteria set out in the plan. If we fail to make the contribution or obtain the requested letter of credit, then we may be forced to withdraw from the plan and establish a separate, single employer defined benefit plan that we anticipate would be underfunded to a similar extent as under the multiple employer plan.

Item 1B. Unresolved Staff Comments

Not applicable. First Financial Northwest has not received any written comments from the SEC regarding its periodic or current reports under the Securities Exchange Act of 1934, as amended, that are unresolved.

Item 2. Properties

At December 31, 2014, we had one full service office that we own in Renton, Washington. This site is the corporate office for First Financial Northwest and First Savings Bank and is located at 201 Wells Avenue South, Renton, Washington. The lending division operations of First Savings Bank are located at 207 Wells Avenue South. This location is also the site for the operations of First Financial Northwest's subsidiary, First Financial Diversified.

Item 3. Legal Proceedings

From time to time, we are involved as plaintiff or defendant in various legal actions arising in the normal course of business. As of December 31, 2014, we were not involved in any significant litigation and do not anticipate incurring any material liability as a result of any such litigation.

Item 4. Mine Safety Disclosures

Not applicable.

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PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Our common stock is traded on The Nasdaq Stock Market LLC's Global Select Market ("NASDAQ"), under the symbol "FFNW." As of December 31, 2014, there were 15.2 million shares of common stock issued and outstanding and we had 694 shareholders of record, excluding persons or entities who hold stock in nominee or "street name" accounts with brokers.

Dividends

First Savings Bank is a wholly-owned subsidiary of First Financial Northwest. Under federal regulations, the dollar amount of dividends First Savings Bank may pay to First Financial Northwest depends upon its capital position and recent net income. Generally, if First Savings Bank satisfies its regulatory capital requirements, it may make dividend payments up to the limits prescribed by state law and FDIC regulations. See "Item 1. Business – How We Are Regulated – Regulation and Supervision of First Financial Northwest – Dividends" and Note 12 of the Notes to Consolidated Financial Statements contained in Item 8.

There were \$2.9 million in dividends declared and paid during the year ended December 31, 2014 and there were \$1.9 million in dividends declared and paid during the year ended December 31, 2013. The price range per share of our common stock presented below represents the highest and lowest sales prices for our common stock on the NASDAQ during each quarter of the two most recent fiscal years.

	High	Low	Cash Dividend Declared and Paid
2014			
First Quarter	\$ 10.98	\$ 10.03	\$ 0.05
Second Quarter	11.25	9.99	0.05
Third Quarter	11.26	10.21	0.05
Fourth Quarter	12.39	10.00	0.05
2013			
First Quarter	\$ 8.29		