First Financial Northwest, Inc.
Form 10-Q
November 06, 2015

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2015

or

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

For the transition period from ____________ to ____________

Commission File Number: 001-33652

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

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

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

YES X NO

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

YES X NO

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

Large accelerated filer Accelerated filer X Non-accelerated filer Smaller reporting company ____

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

YES NO X

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: As of November 3, 2015, 14,107,868 shares of the issuer's common stock, $0.01 par value per share, were outstanding.

FIRST FINANCIAL NORTHWEST, INC.
FORM 10-Q
TABLE OF CONTENTS

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

Part 1. Financial Information

Item 1. Financial Statements

	September 30, 2015	December 31, 2014
Assets		
Cash on hand and in banks	$5,435	$5,920
Interest-earning deposits	116,919	98,129
Investments available-for-sale, at fair value	125,897	120,374
Loans receivable, net of allowance of $10,146 and $10,491, respectively	674,820	663,938
Federal Home Loan Bank ("FHLB") stock, at cost	6,537	6,745
Accrued interest receivable	3,072	3,265
Deferred tax assets, net	5,216	8,338
Other real estate owned ("OREO")	4,235	9,283
Premises and equipment, net	17,515	16,734
Bank owned life insurance ("BOLI"), net	23,145	2,776
Prepaid expenses and other assets	1,278	1,495
Total assets	$984,069	$936,997
Liabilities and Stockholders' Equity		
Deposits:		
Interest-bearing deposits	$634,986	$599,773
Noninterest-bearing deposits	30,081	14,354
Total deposits	665,067	614,127
Advances from the FHLB	135,500	135,500
Advance payments from borrowers for taxes and insurance	2,939	1,707
Accrued interest payable	142	142
Other liabilities	5,466	4,109
Total liabilities	809,114	755,585
Commitments and contingencies		
Stockholders' Equity		
Preferred stock, $0.01 par value; authorized 10,000,000 shares; no shares issued or outstanding	—	—
Common stock, $0.01 par value; authorized 90,000,000 shares; issued and outstanding 14,199,667 shares at September 30, 2015, and 15,167,381 shares at December 31, 2014	142	151
Additional paid-in capital	141,625	153,395
Retained earnings, substantially restricted	41,543	36,969
Accumulated other comprehensive loss, net of tax	(455)	(357)
Unearned Employee Stock Ownership Plan ("ESOP") shares	(7,900)	(8,746)
Total stockholders' equity	174,955	181,412
Total liabilities and stockholders' equity	$984,069	$936,997

See accompanying selected notes to consolidated financial statements.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Interest income				
Loans, including fees	$8,698	$9,157	$25,932	$27,270
Investments available-for-sale	578	554	1,585	1,743
Interest-earning deposits	67	23	196	65
Dividends on FHLB stock	15	2	20	5
Total interest income	$9,358	$9,736	$27,733	$29,083
Interest expense				
Deposits	1,369	1,193	4,016	3,778
FHLB advances	325	324	963	854
Total interest expense	$1,694	$1,517	$4,979	$4,632
Net interest income	7,664	8,219	22,754	24,451
Recapture of provision for loan losses	(700)	(300)	(1,300)	(900)
Net interest income after recapture of provision for loan losses	$8,364	$8,519	$24,054	$25,351
Noninterest income				
Net gain (loss) on sale of investments	85	—	85	(20)
Other	362	186	810	362
Total noninterest income	$447	$186	$895	$342
Noninterest expense				
Salaries and employee benefits	3,488	2,947	10,153	8,693
Occupancy and equipment	387	330	1,039	1,018
Professional fees	472	457	1,284	1,208
Data processing	176	147	523	469
(Gain) loss on sale of OREO property, net	—	(15)	(531)	92
OREO market value adjustments	—	60	5	348
OREO related expenses, net	24	49	17	188
Regulatory assessments	119	102	351	284
Insurance and bond premiums	89	100	270	305
Marketing	103	15	190	77
Other general and administrative	523	316	1,244	1,052
Total noninterest expense	$5,381	$4,508	$14,545	$13,734
Income before federal income tax provision	3,430	4,197	10,404	11,959
Federal income tax provision	984	1,462	3,361	4,212
Net income	$2,446	$2,735	$7,043	$7,747
Basic earnings per share	$0.18	$0.19	$0.51	$0.52
Diluted earnings per share	$0.18	$0.19	$0.51	$0.51
Weighted average number of basic shares outstanding	13,372,573	14,458,874	13,719,522	14,901,817
Weighted average number of diluted shares outstanding	13,528,322	14,585,908	13,878,549	15,040,444

See accompanying selected notes to consolidated financial statements.

4

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Net income	$2,446	$2,735	$7,043	$7,747
Other comprehensive income, before tax:				
Unrealized holding gains (losses) on investments available-for-sale (net of tax provision (benefit) of $72 and ($89) for the third quarter of 2015 and 2014, respectively, and ($22) and $678 for the first nine months of 2015 and 2014, respectively)	133	(166)	(43)	1,259
Reclassification adjustment for net losses realized in income (net of tax provision of ($30) and $0 for the third quarter of 2015 and 2014, respectively, and ($30) and $7 for the first nine months of 2015 and 2014, respectively)	$(55)	$—	$(55)	$13
Other comprehensive (loss) income, net of tax	$78	$(166)	$(98)	$1,272
Total comprehensive income	$2,524	$2,569	$6,945	$9,019

See accompanying selected notes to consolidated financial statements.

5

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

	Shares	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss), net of tax	Unearned ESOP Shares	Total Stockholders' Equity
Balances at December 31, 2013	16,392,139	$164	$166,866	$29,220	$ (2,020)	$(9,875)	$ 184,355
Other comprehensive income	—	—	—	7,747	1,272	—	9,019
Cash dividend declared and paid ($0.15 per share)	—	—	—	(2,228)	—	—	(2,228)
Exercise of stock options	340,880	4	3,331	—	—	—	3,335
Purchase and retirement of common stock	(1,266,921)	(13)	(13,812)	—	—	—	(13,825)
Compensation related to stock options and restricted stock awards	—	—	275	—	—	—	275
Allocation of 84,640 ESOP shares	—	—	50	—	—	847	897
Balances at September 30, 2014	15,466,098	$155	$156,710	$34,739	$ (748)	$(9,028)	$ 181,828

	Shares	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss), net of tax	Unearned ESOP Shares	Total Stockholders' Equity
Balances at December 31, 2014	15,167,381	$151	$153,395	$36,969	$ (357)	$(8,746)	$ 181,412
Other comprehensive income	—	—	—	7,043	(98)	—	6,945
Cash dividend declared and paid ($0.18 per share)	—	—	—	(2,469)	—	—	(2,469)
Exercise of stock options	100,000	1	690	—	—	—	691
Purchase and retirement of common stock	(1,067,714)	(10)	(12,975)	—	—	—	(12,985)
Compensation related to stock options and restricted stock awards	—	—	330	—	—	—	330
Allocation of 84,639 ESOP shares	—	—	185	—	—	846	1,031
Balances at September 30, 2015	14,199,667	$142	$141,625	$41,543	$ (455)	$(7,900)	$ 174,955

See accompanying selected notes to consolidated financial statements.

6

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

	Nine Months Ended September 30,	
	2015	2014
Cash flows from operating activities:		
Net income	$7,043	$7,747
Adjustments to reconcile net income to net cash provided by operating activities:		
Recapture of provision for loan losses	(1,300)	(900)
OREO market value adjustments	5	348
(Gain) loss on sale of OREO property, net	(531)	92
(Gain) Loss on sale of investments available-for-sale	(85)	20
Loss on sale of premises and equipment	—	11
Depreciation of premises and equipment	570	568
Amortization of premiums and discounts on investments available-for-sale, net	852	1,086
Deferred federal income taxes	3,174	4,089
Allocation of ESOP shares	1,031	897
Stock compensation expense	330	275
Change in cash surrender value of BOLI	(369)	—
Changes in operating assets and liabilities:		
Prepaid expenses and other assets	217	(634)
Net increase in advance payments from borrowers for taxes and insurance	1,232	1,101
Accrued interest receivable	193	297
Accrued interest payable	—	42
Other liabilities	1,357	1,024
Net cash provided by operating activities	$13,719	$16,063
Cash flows from investing activities:		
Capital expenditures related to OREO	—	(120)
Proceeds from sales of OREO properties	5,715	3,149
Proceeds from calls and sales of investments available-for-sale	23,771	6,380
Principal repayments on investments available-for-sale	14,463	15,942
Purchases of investments available-for-sale	(44,674)	(1,563)
Net increase in loans receivable	(9,723)	(21,936)
FHLB stock redemption	208	202
Purchases of premises and equipment	(1,351)	(147)
Purchase of BOLI	(20,000)	—
Net cash (used) provided by investing activities	$(31,591)	$1,907
Cash flows from financing activities:		
Net increase (decrease) in deposits	50,940	(21,700)
Advances from the FHLB	—	16,500
Proceeds from stock options exercises	691	3,335
Repurchase and retirement of common stock	(12,985)	(13,825)
Dividends paid	(2,469)	(2,228)
Net cash provided (used) by financing activities	$36,177	$(17,918)

Continued

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

	Nine Months Ended September 30,	
	2015	2014
Net increase in cash and cash equivalents	$18,305	$52
Cash and cash equivalents at beginning of quarter	104,049	55,575
Cash and cash equivalents at end of quarter	$122,354	$55,627
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest paid	$4,979	$4,590
Federal income taxes paid	177	284
Noncash items:		
Loans transferred to OREO, net of deferred loan fees and allowance for loan losses	$141	$1,823
Change in unrealized loss on investments available for sale	(150)	1,958

See accompanying selected notes to consolidated financial statements.

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

Note 1 - Description of Business

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

Formerly operating as First Savings Bank Northwest, First Financial Northwest Bank began operating under the new name as of August 21, 2015. First Financial Northwest Bank is headquartered in Renton, Washington, where its main, full service retail branch is located. In addition, the Bank opened a second branch in Mill Creek, Washington on September 1, 2015. Regulatory approval has been received to open a third branch in Edmonds, Washington, which is expected to open in the first quarter of 2016. The Bank's primary market area consists of King, Snohomish, Pierce, and Kitsap counties, Washington.

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

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

Note 2 - Basis of Presentation

The accompanying unaudited interim consolidated financial statements have been prepared pursuant to the rules and regulations of the U.S. Securities and Exchange Commission ("SEC"). Accordingly, they do not include all of the information and footnotes required by U.S. Generally Accepted Accounting Principles (“GAAP”) for complete financial statements. These unaudited interim consolidated financial statements should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2014, as filed with the SEC. In our opinion, all adjustments (consisting only of normal recurring adjustments) considered necessary for a fair presentation of the unaudited interim consolidated financial statements in accordance with GAAP have been included. All significant intercompany balances and transactions between the Company and its subsidiaries have been eliminated in consolidation. Operating results for the nine months ended September 30, 2015, are not necessarily indicative of the results that may be expected for the year ending December 31, 2015. In preparing the unaudited consolidated financial statements, we are required to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change relate to the allowance for loan and lease losses ("ALLL"), the valuation of other real estate owned ("OREO") and the underlying collateral of impaired loans, deferred tax assets, and the fair value of financial instruments.

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

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

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

Note 3 - Recently Issued Accounting Pronouncements

In May 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2015-07, Fair Value Measurement (Topic 820), Disclosures for Investments in Certain Entities that Calculate Net Asset Value per Share (or Its Equivalent). The ASU allows a reporting entity, as a practical expedient, to measure the fair value of certain investments using the net asset value per share of the investment. These investments should not be categorized in the fair value hierarchy, eliminating the diversity in practice resulting from the way in which investments measured at net asset value per share with future redemption dates are classified. It also ensures that all investments categorized in the fair value hierarchy are classified using a consistent approach. The amendments are effective for public entities for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. Early adoption is permitted. The adoption of ASU No. 2015-07 is not expected to have a material impact on the Company's consolidated financial statements.

In July 2015, the FASB issued ASU No. 2015-12, Plan Accounting: Defined Benefit Pensions Plans (Topic 960), Defined Contribution Pension Plans (Topic 962), and Health and Welfare Benefit Plans (Topic 965). The ASU contains three parts: I. Fully Benefit-Responsive Investment Contracts; II. Plan Investment Disclosures; and III. Measurement Date Practical Expedient. Part one of the ASU designates contract value as the only required measure for fully benefit-responsive investment contracts. Previously, plan financial statements were required to include a reconciliation between contract and fair value when these amounts differed. Part two of the ASU allows reporting of investments, and the related appreciation or depreciation, by general type, eliminating the need to disaggregate the investments in multiple ways. Part three of the ASU allows employers to measure defined benefit plan assets on a month-end date that is nearest to the employer's fiscal year-end, when the fiscal period does not coincide with a month-end. These amendments are effective for fiscal years beginning after December 15, 2015, with early adoption permitted. The Company adopted this ASU in the third quarter of 2015 with no material impact to the Company's consolidated financial statements.

In August 2015, the FASB issued ASU No. 2015-15, Interest—Imputation of Interest (Subtopic 835-30), Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements. The ASU provides guidance not previously included in ASU 2015-03 regarding debt issuance related to line-of-credit arrangements. The amendment allows an entity to present debt issuance costs as an asset and subsequently amortize the deferred debt issuance costs over the term of the line-of-credit arrangement, regardless if there are any outstanding borrowings on the line-of-credit arrangement. The amendment is effective for fiscal years beginning after December 15, 2015. The adoption of ASU No. 2015-15 is not expected to have a material impact on the Company's consolidated financial statements.

In September 2015, the FASB issued ASU No. 2015-16, Business Combinations (Topic 805). The ASU simplifies the accounting for measurement period adjustments. The amendments require that an acquirer recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period when the adjustment amounts are determined. The acquirer is required to record in the same period's financial statements the effect on earnings from changes in depreciation, amortization, or other income effects resulting from the change to provisional amounts, calculated as if the accounting had been completed at the acquisition date. The acquirer must present separately on the income statement, or disclose in the notes, the amount recorded in current-period earnings that would have been recorded in previous reporting periods if the provisional amount had been recognized at the acquisition date. For public business entities, the amendments are effective for fiscal years beginning after December 15, 2015, including interim periods within those fiscal years. The adoption of ASU No. 2015-16 is not expected to have a material impact on the Company's consolidated financial statements.

10

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

Note 4 - Investments

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

	September 30, 2015			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands)			
Mortgage-backed investments:				
Fannie Mae	$48,277	$649	$(6)	$48,920
Freddie Mac	22,966	400	(18)	23,348
Ginnie Mae	14,744	76	(81)	14,739
Municipal bonds	10,929	82	(12)	10,999
U.S. Government agencies	13,886	119	(27)	13,978
Corporate bonds	14,011	17	(115)	13,913
Total	$124,813	$1,343	$(259)	$125,897

	December 31, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(In thousands)			
Mortgage-backed investments:				
Fannie Mae	$40,083	$863	$(30)	$40,916
Freddie Mac	21,442	526	(22)	21,946
Ginnie Mae	26,049	87	(122)	26,014
Municipal bonds	642	2	—	644
U.S. Government agencies	16,863	104	(151)	16,816
Corporate bonds	14,061	39	(62)	14,038
Total	$119,140	$1,621	$(387)	$120,374

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

	September 30, 2015					
	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
	(In thousands)					
Mortgage-backed investments:						
Fannie Mae	$2,229	$(6)	$—	$—	$2,229	$(6)
Freddie Mac	3,977	(18)	—	—	3,977	(18)
Ginnie Mae	2,401	(4)	3,493	(77)	5,894	(81)
Municipal bonds	2,904	(12)	—	—	2,904	(12)
U.S. Government agencies	5,310	(27)	—	—	5,310	(27)
Corporate bonds	7,894	(115)	—	—	7,894	(115)

Total	$24,715	$(182)	$3,493	$(77)	$28,208	$(259)

11

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

	December 31, 2014					
	Less Than 12 Months		12 Months or Longer		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
	(In thousands)					
Mortgage-backed investments:						
Fannie Mae	$—	$—	$1,456	$(30)	$1,456	$(30)
Freddie Mac	—	—	1,832	(22)	1,832	(22)
Ginnie Mae	1,883	(6)	9,952	(116)	11,835	(122)
U.S. Government agencies	545	—	8,096	(151)	8,641	(151)
Corporate bonds	1,496	(4)	5,942	(58)	7,438	(62)
Total	$3,924	$(10)	$27,278	$(377)	$31,202	$(387)

On a quarterly basis, management makes an assessment to determine whether there have been any events or economic circumstances to indicate that a security on which there is an unrealized loss is impaired on an other-than-temporary basis. The Company considers many factors including the severity and duration of the impairment, recent events specific to the issuer or industry, and for debt securities, external credit ratings and recent downgrades. Securities on which there is an unrealized loss that is deemed to be an other-than-temporary impairment ("OTTI") are written down to fair value. If the Company intends to sell a debt security, or it is likely that the Company will be required to sell the debt security before recovering its cost basis, the entire impairment loss would be recognized in earnings as an OTTI. If the Company does not intend to sell the debt security and it is not likely that it will be required to sell the debt security but does not expect to recover the entire amortized cost basis of the debt security, only the portion of the impairment loss representing credit losses would be recognized in earnings. The credit loss on a debt security is measured as the difference between the amortized cost basis and the present value of the cash flows expected to be collected. Projected cash flows are discounted by the original or current effective interest rate depending on the nature of the debt security being measured for potential OTTI. The remaining impairment related to all other factors, the difference between the present value of the cash flows expected to be collected and fair value, is recognized as a charge to other comprehensive income (“OCI”). Impairment losses related to all other factors are presented as separate categories within OCI. At September 30, 2015, the Company had 20 securities in an unrealized loss position, of which three have been in an unrealized loss position for 12 months or more. Management reviewed the financial condition of the entities issuing municipal or corporate bonds at September 30, 2015 and December 31, 2014, and determined that an OTTI charge was not warranted.

The amortized cost and estimated fair value of investments available-for-sale at September 30, 2015, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Investments not due at a single maturity date, primarily mortgage-backed investments, are shown separately.

	September 30, 2015	
	Amortized Cost	Fair Value
	(In thousands)	
Due within one year	$—	$—
Due after one year through five years	9,859	9,873
Due after five years through ten years	16,244	16,210
Due after ten years	12,723	12,807

	38,826	38,890
Mortgage-backed investments	85,987	87,007
Total	$124,813	$125,897

Under Washington state law, in order to participate in the public funds program the Company is required to pledge eligible securities as collateral in an amount equal to 100% of the public deposits held. Investments with market values of $18.4 million and $16.3 million were pledged as collateral for public deposits at September 30, 2015 and December 31, 2014, respectively, both of which exceeded the collateral requirements established by the Washington Public Deposit Protection Commission.

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

For the three and nine months ended September 30, 2015, we had calls on investment securities of $127,000 and $1.7 million, respectively, with no gain or loss. During the three and nine months ended September 30, 2015, we sold $22.0 million of investment securities generating a gross gain of $429,000 and a gross loss of $344,000. For the three and nine months ended September 30, 2014, we sold $5.0 million of investment securities generating a gross loss of $20,000 and had a call of $1.4 million with no gain or loss.

During the three and nine months ended September 30, 2015, we purchased $36.7 million and $44.7 million of investment securities, respectively. During the three and nine months ended September 30, 2014, we purchased investment securities of $1.6 million.

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

Note 5 - Loans Receivable

Loans receivable are summarized as follows at the dates indicated:

	September 30, 2015	December 31, 2014
	(In thousands)	
One-to-four family residential:		
Permanent owner occupied	$148,742	$161,013
Permanent non-owner occupied	106,794	112,180
Construction non-owner occupied [1]	—	500
	255,536	273,693
Multifamily:		
Permanent	113,441	116,014
Construction [1]	21,115	4,450
	134,556	120,464
Commercial real estate:		
Permanent	245,559	239,211
Construction [1]	—	6,100
Land [2]	8,128	2,956
	253,687	248,267
Construction/land development:		
One-to-four family residential [1]	30,581	19,860
Multifamily [1]	27,596	17,902
Commercial [1]	4,300	4,300
Land development [2]	6,403	8,993
	68,880	51,055
Business	6,973	3,783
Consumer	6,655	7,130
Total loans	726,287	704,392
Less:		
Loans in process ("LIP")	38,611	27,359
Deferred loan fees, net	2,710	2,604
Allowance for loan and lease losses ("ALLL")	10,146	10,491
Loans receivable, net	$674,820	$663,938

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[1] Construction/land development 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 September 30, 2015, the Company had no one-to-four family residential or commercial real estate loans, and $21.1 million or 15.7% of its total multifamily portfolio in these rollover loans. At December 31, 2014, the Company had $6.1 million or 2.5% of the total commercial real estate portfolio and $4.5 million or 3.7% of the total multifamily portfolio, and $500,000 or 0.2% of the total one-to-four family residential portfolio in these rollover loans.

(2)At September 30, 2015, and December 31, 2014, $8.1 million and $3.0 million, respectively, of commercial real estate loans were not included in the construction/land development category because the Company classifies raw land or buildable lots (where we do not intend to finance the construction) as commercial real estate land loans.

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

At both September 30, 2015 and December 31, 2014, there were no loans classified as held for sale.

ALLL. The Company maintains an ALLL as a reserve against probable and inherent risk of losses in its loan portfolios. The ALLL is comprised of a general reserve component for loans evaluated collectively for loss and a specific reserve component for loans evaluated individually. We continually monitor our loan portfolio for delinquent loans and changes in our borrower's financial condition. When an issue is identified and it is determined that the loan needs to be classified as nonperforming and/or impaired, an evaluation of the collateral is performed and, if necessary, an appraisal is ordered in accordance with our appraisal policy guidelines. Based on this evaluation, any additional provision for loan loss or charge-offs is recorded prior to the end of the financial reporting period.

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

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

	At or For the Three Months Ended September 30, 2015						
	One-to-Four Family Residential	Multifamily	Commercial Real Estate	Construction/ Land Development	Business	Consumer	Total
	(In thousands)						
ALLL:							
Beginning balance	$3,536	$1,187	$4,436	$819	$189	$436	$10,603
Charge-offs	(2)	—	—	—	—	(20)	(22)
Recoveries	217	—	48	—	—	—	265
Provision (recapture)	(245)	15	(579)	76	21	12	(700)
Ending balance	$3,506	$1,202	$3,905	$895	$210	$428	$10,146

	At or For the Nine Months Ended September 30, 2015						
	One-to-Four Family Residential	Multifamily	Commercial Real Estate	Construction/ Land Development	Business	Consumer	Total
	(In thousands)						
ALLL:							
Beginning balance	$3,694	$1,646	$4,597	$355	$47	$152	$10,491
Charge-offs	(27)	(281)	—	—	—	(54)	(362)
Recoveries	908	—	105	—	3	301	1,317
Provision (recapture)	(1,069)	(163)	(797)	540	160	29	(1,300)
Ending balance	$3,506	$1,202	$3,905	$895	$210	$428	$10,146
ALLL by category:							
General reserve	$2,945	$1,199	$3,665	$895	$210	$388	$9,302
Specific reserve	561	3	240	—	—	40	844
Loans: (1)							
Total loans	$255,536	$123,752	$253,687	$41,073	$6,973	$6,655	$687,676
Loans with general valuation allowance (2)	217,660	120,467	245,947	41,073	6,973	6,444	638,564
Loans with specific reserves (3)	37,876	3,285	7,740	—	—	211	49,112

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

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

	At or For the Three Months Ended September 30, 2014						
	One-to-Four Family Residential	Multifamily	Commercial Real Estate	Construction/ Land Development	Business	Consumer	Total
	(In thousands)						
ALLL:							
Beginning balance	$4,377	$1,433	$5,622	$333	$11	$175	$11,951
Charge-offs	(3)	—	—	—	—	(6)	(9)
Recoveries	12	—	—	—	5	1	18
Provision (recapture)	(379)	(64)	97	49	10	(13)	(300)
Ending balance	$4,007	$1,369	$5,719	$382	$26	$157	$11,660

	At or For the Nine Months Ended September 30, 2014						
	One-to-Four Family Residential	Multifamily	Commercial Real Estate	Construction/ Land Development	Business	Consumer	Total
	(In thousands)						
ALLL:							
Beginning balance	$5,141	$1,377	$5,881	$399	$14	$182	$12,994
Charge-offs	(78)	—	(311)	(223)	—	(30)	(642)
Recoveries	46	—	151	—	6	5	208
Provision (recapture)	(1,102)	(8)	(2)	206	6	—	(900)
Ending balance	$4,007	$1,369	$5,719	$382	$26	$157	$11,660
ALLL by category:							
General reserve	$2,896	$1,340	$5,240	$382	$26	$157	$10,041
Specific reserve	1,111	29	479	—	—	—	1,619
Loans: [1]							
Total loans	279,360	123,599	260,198	25,736	2,148	7,543	698,584
Loans with general valuation allowance [2]	234,094	121,417	250,392	25,736	2,148	7,423	641,210
Loans with specific reserves [3]	45,266	2,182	9,806	—	—	120	57,374

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[1] Net of LIP.
[2] Loans collectively evaluated for general reserves.
[3] Loans individually evaluated for specific reserves.

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

Past Due Loans. Loans are considered past due if a scheduled principal or interest payment is due and unpaid for 30 days or more. At September 30, 2015, total past due loans comprised 0.51% of total loans receivable, net of LIP, as compared to 0.66% at December 31, 2014. The following tables represent a summary of the aging of loans by type at the dates indicated:

	Loans Past Due as of September 30, 2015					
	30-59 Days	60-89 Days	90 Days and Greater	Total Past Due	Current	Total [(1)] [(2)]
	(In thousands)					
Real estate:						
One-to-four family residential:						
Owner occupied	$898	$333	$172	$1,403	$147,339	$148,742
Non-owner occupied	—	—	—	—	106,794	106,794
Multifamily	—	—	1,683	1,683	122,069	123,752
Commercial real estate	320	—	—	320	253,367	253,687
Construction/land development	—	—	—	—	41,073	41,073
Total real estate	1,218	333	1,855	3,406	670,642	674,048
Business	—	—	—	—	6,973	6,973
Consumer	—	72	—	72	6,583	6,655
Total loans	$1,218	$405	$1,855	$3,478	$684,198	$687,676

(1) There were no loans 90 days and greater past due and still accruing interest at September 30, 2015.
(2) Net of LIP.

	Loans Past Due as of December 31, 2014					
	30-59 Days	60-89 Days	90 Days and Greater	Total Past Due	Current	Total [(1)] [(2)]
	(In thousands)					
Real estate:						
One-to-four family residential:						
Owner occupied	$666	$575	$666	$1,907	$159,106	$161,013
Non-owner occupied	—	—	164	164	112,388	112,552
Multifamily	1,965	—	—	1,965	118,306	120,271
Commercial real estate	—	325	11	336	247,632	247,968
Construction/land development	—	—	—	—	24,316	24,316
Total real estate	2,631	900	841	4,372	661,748	666,120
Business	—	—	—	—	3,783	3,783
Consumer	—	75	—	75	7,055	7,130
Total loans	$2,631	$975	$841	$4,447	$672,586	$677,033

(1) There were no loans 90 days and greater past due and still accruing interest at December 31, 2014.
(2) Net of LIP.

Nonaccrual Loans. Loans are placed on nonaccrual when they are 90 days delinquent or when, in management's opinion, the borrower is unable to meet scheduled payment obligations.

In order to return a nonaccrual loan to accrual status, the Company evaluates the borrower's financial condition to ensure that future loan payments are reasonably assured. The Company also takes into consideration the borrower's willingness and ability

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

to make the loan payments, as well as historical repayment performance. The Company requires the borrower to make loan payments consistently for a period of at least six months as agreed to under the terms of the loan agreement before the Company will consider reclassifying the loan to accrual status.

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

	September 30, 2015	December 31, 2014
	(In thousands)	
One-to-four family residential	$655	$830
Multifamily	1,683	—
Commercial real estate	—	434
Consumer	91	75
Total nonaccrual loans	$2,429	$1,339

During the three and nine months ended September 30, 2015, interest income that would have been recognized had these nonaccrual loans been performing in accordance with their original terms was $31,000 and $87,000, respectively. For the three and nine months ended September 30, 2014, lost interest on nonaccrual loans was $26,000 and $105,000, respectively.

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

	September 30, 2015						
	One-to-Four Family Residential	Multifamily	Commercial Real Estate	Construction / Land Development	Business	Consumer	Total (1)
	(In thousands)						
Performing (2)	$254,881	$122,069	$253,687	$41,073	$6,973	$6,564	$685,247
Nonperforming (3)	655	1,683	—	—	—	91	2,429
Total loans	$255,536	$123,752	$253,687	$41,073	$6,973	$6,655	$687,676

(1) Net of LIP.
(2) There were $148.2 million of owner-occupied one-to-four family residential loans and $106.7 million of non-owner occupied one-to-four family residential loans classified as performing.
(3) There were $581,000 of owner-occupied one-to-four family residential loans and $74,000 non-owner occupied one-to-four family residential loans classified as nonperforming.

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

	December 31, 2014						
	One-to-Four Family Residential	Multifamily	Commercial Real Estate	Construction/ Land Development	Business	Consumer	Total [1]
	(In thousands)						
Performing [2]	$272,735	$120,271	$247,534	$24,316	$3,783	$7,055	$675,694
Nonperforming [3]	830	—	434	—	—	75	1,339
Total loans	$273,565	$120,271	$247,968	$24,316	$3,783	$7,130	$677,033

[1] Net of LIP.
[2] There were $160.3 million of owner-occupied one-to-four family residential loans and $112.4 million of non-owner occupied one-to-four family residential loans classified as performing.
[3] There were $666,000 of owner-occupied one-to-four family residential loans and $164,000 of non-owner occupied one-to-four family residential loans classified as nonperforming.

Impaired Loans. A loan is considered impaired when we have determined that we may be unable to collect payments of principal or interest when due under the terms of the original loan document. When identifying loans as impaired, management takes into consideration factors which include payment history and status, collateral value, financial condition of the borrower, and the probability of collecting scheduled payments in the future. Minor payment delays and insignificant payment shortfalls typically do not result in a loan being classified as impaired. The significance of payment delays and shortfalls is considered by management on a case-by-case basis after taking into consideration the circumstances surrounding the loan and the borrower, including payment history and the amounts of any payment shortfall, length and reason for delay and the likelihood of a return to stable performance. Impairment is measured on a loan-by-loan basis for all loans in the portfolio. We obtain annual updated appraisals for impaired collateral dependent loans that exceed $1.0 million.

There were no funds committed to be advanced in connection with impaired loans at either September 30, 2015, or December 31, 2014.

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

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

	September 30, 2015 Recorded Investment (1) (In thousands)	Unpaid Principal Balance (2)	Related Allowance
Loans with no related allowance:			
One-to-four family residential:			
Owner occupied	$3,270	$3,512	$—
Non-owner occupied	24,621	24,646	—
Multifamily	2,100	2,381	—
Commercial real estate	5,013	5,264	—
Consumer	134	172	—
Total	35,138	35,975	—
Loans with an allowance:			
One-to-four family residential:			
Owner occupied	2,127	2,197	96
Non-owner occupied	7,858	7,910	465
Multifamily	1,185	1,185	3
Commercial real estate	2,727	2,727	240
Consumer	77	77	40
Total	13,974	14,096	844
Total impaired loans:			
One-to-four family residential:			
Owner occupied	5,397	5,709	96
Non-owner occupied	32,479	32,556	465
Multifamily	3,285	3,566	3
Commercial real estate	7,740	7,991	240
Consumer	211	249	40
Total	$49,112	$50,071	$844

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

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

	December 31, 2014 Recorded Investment [1] (In thousands)	Unpaid Principal Balance [2]	Related Allowance
Loans with no related allowance:			
One-to-four family residential:			
Owner occupied	$3,308	$3,661	$—
Non-owner occupied	29,224	29,266	—
Commercial real estate	4,553	4,851	—
Consumer	118	153	—
Total	37,203	37,931	—
Loans with an allowance:			
One-to-four family residential:			
Owner occupied	2,554	2,624	121
Non-owner occupied	8,652	8,704	679
Multifamily	2,172	2,172	27
Commercial real estate	4,999	4,999	329
Consumer	79	79	59
Total	18,456	18,578	1,215
Total impaired loans:			
One-to-four family residential:			
Owner occupied	5,862	6,285	121
Non-owner occupied	37,876	37,970	679
Multifamily	2,172	2,172	27
Commercial real estate	9,552	9,850	329
Consumer	197	232	59
Total	$55,659	$56,509	$1,215

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

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

The following tables present the average recorded investment in loans individually evaluated for impairment and the interest income recognized for the three and nine months ended September 30, 2015 and 2014:

	Three Months Ended September 30, 2015		Nine Months Ended September 30, 2015	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
	(In thousands)			
Loans with no related allowance:				
One-to-four family residential:				
Owner occupied	$3,114	$49	$3,215	$131
Non-owner occupied	25,142	361	26,835	1,123
Multifamily	2,101	8	1,471	23
Commercial real estate	4,757	85	4,650	269
Consumer	125	2	121	3
Total	35,239	505	36,292	1,549
Loans with an allowance:				
One-to-four family residential:				
Owner occupied	2,131	12	2,240	89
Non-owner occupied	7,772	115	8,084	345
Multifamily	1,187	19	1,677	58
Commercial real estate	3,199	41	3,883	104
Consumer	77	—	78	2
Total	14,366	187	15,962	598
Total impaired loans:				
One-to-four family residential:				
Owner occupied	5,245	61	5,455	220
Non-owner occupied	32,914	476	34,919	1,468
Multifamily	3,288	27	3,148	81
Commercial real estate	7,956	126	8,533	373
Consumer	202	2	199	5
Total	$49,605	$692	$52,254	$2,147

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

	Three Months Ended September 30, 2014		Nine Months Ended September 30, 2014	
	Average Recorded Investment	Interest Income Recognized	Average Recorded Investment	Interest Income Recognized
	(In thousands)			
Loans with no related allowance:				
One-to-four family residential:				
Owner occupied	$3,256	$45	$3,444	$115
Non-owner occupied	28,984	438	28,995	1,312
Multifamily	111	—	171	—
Commercial real estate	2,812	41	4,388	123
Construction/land development	—	—	56	—
Consumer	82	2	63	3
Total	35,245	526	37,117	1,553
Loans with an allowance:				
One-to-four family residential:				
Owner occupied	2,974	29	3,134	94
Non-owner occupied	10,792	147	11,307	447
Multifamily	2,187	36	2,196	107
Commercial real estate	7,032	101	7,054	282
Total	22,985	313	23,691	930
Total impaired loans:				
One-to-four family residential:				
Owner occupied	6,230	74	6,578	209
Non-owner occupied	39,776	585	40,302	1,759
Multifamily	2,298	36	2,367	107
Commercial real estate	9,844	142	11,442	405
Construction/land development	—	—	56	—
Consumer	82	2	63	3
Total	$58,230	$839	$60,808	$2,483

Troubled Debt Restructurings. Certain loan modifications are accounted for as troubled debt restructured loans ("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, a concession is granted to the borrower that the Company would not otherwise consider. Once the loan is restructured, a current, well-documented credit evaluation of the borrower's financial condition and prospects for repayment are performed to assess the likelihood that all principal and interest payments required under the terms of the modified agreement will be collected in full. A loan that is classified as a TDR is generally reported as a TDR until the loan is paid in full or otherwise settled, sold, or charged-off.

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

The accrual status of a loan may change after it has been classified as a TDR. Management considers the following in determining the accrual status of restructured loans: (1) if the loan was on accrual status prior to the restructuring, the borrower has demonstrated performance under the previous terms, and a credit evaluation shows the borrower's capacity to continue to perform under the restructured terms (both principal and interest payments), the loan will remain on accrual at the time of the restructuring; (2) if the loan was on nonaccrual status before the restructuring, and the Company's credit evaluation shows the borrower's capacity to meet the restructured terms, the loan would remain as nonaccrual for a minimum of six months after restructuring until the borrower has demonstrated a reasonable period of sustained repayment performance, thereby providing reasonable assurance as to the ultimate collection of principal and interest in full under the modified terms.

At September 30, 2015 and December 31, 2014, the TDR portfolio totaled $46.6 million and $54.2 million, respectively, all of which were on accrual status and performing in accordance with the terms of their restructure.

The following tables present loans that were modified as TDRs within the periods indicated, and their recorded investment both prior to and after the modification:

	Three Months Ended September 30, 2015			Nine Months Ended September 30, 2015		
	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
	(Dollars in thousands)					
One-to-four family residential:						
Interest-only payments with interest rate concession and advancement of maturity date	—	—	—	6	1,439	1,439
Principal and interest with interest rate concession and advancement of maturity date	2	426	426	2	426	426
Advancement of maturity date	—	—	—	2	248	248
Commercial real estate:						
Principal and interest with interest rate concession and advancement of maturity date	1	775	775	1	775	775
Advancement of maturity date	—	—	—	2	866	866
	—	—	—	1	496	496

Interest-only payments with interest rate concession and advancement of maturity date						
Interest-only payments with advancement of maturity date	—	—	—	1	2,004	2,004
Total	3	$ 1,201	$ 1,201	15	$ 6,254	$ 6,254

25

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

	Three Months Ended September 30, 2014			Nine Months Ended September 30, 2014		
	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment
	(Dollars in thousands)					
One-to-four family residential:						
Interest-only payments with interest rate concession	6	$ 1,439	$ 1,439	6	$ 1,439	$ 1,439
Principal and interest with interest rate concession	5	$ 953	$ 953	6	$ 1,174	$ 1,174
Advancement of maturity date	—	—	—	4	772	772
Commercial real estate:						
Interest-only payments with interest rate concession	1	1,466	1,466	2	3,470	3,470
Total	12	$ 3,858	$ 3,858	18	$ 6,855	$ 6,855

At September 30, 2015, the Company had no commitments to extend additional credit to borrowers whose loan terms have been modified in TDRs. All TDRs are also classified as impaired loans and are included in the loans individually evaluated for impairment in the calculation of the ALLL.

The TDRs that occurred during the three and nine months ended September 30, 2015 and 2014, were the result of advancing the maturity date for balloon payments on loans otherwise current on principal and interest payments, or granting the borrower interest rate concessions and/or interest-only payments and advancing the maturity date for a period of time ranging from one to three years. The impaired portion of the loan with an interest rate concession and/or interest-only payments for a specific period of time are calculated based on the present value of expected future cash flows discounted at the loan’s effective interest rate. The effective interest rate is the rate of return implicit on the original loan. This impaired amount increases the ALLL and is expensed to earnings. As loan payments are received in future periods, the impairment is amortized over the life of the concession, reducing ALLL and recapturing provision expense. TDRs resulted in no charge-offs to the ALLL for the three and nine months ended September 30, 2015 and 2014.

TDRs that default after they have been modified are typically evaluated individually on a collateral basis. Any additional impairment is charged to the ALLL. For the three and nine months ended September 30, 2015, one loan of $226,000 that had been modified with an advancement of maturity date during the previous 12 months missed one payment but subsequently became current. During the three months ended September 30, 2014, no loans defaulted that had been modified as TDRs within the previous 12 months. For the nine months ended September 30, 2014, one loan of $430,000 that was restructured with an advancement of maturity date during the previous 12 months missed a payment, but became current the subsequent quarter.

Credit Quality Indicators. The Company utilizes a nine-category risk rating system and assigns a risk rating for all credit exposures. The risk rating system is designed to define the basic characteristics and identify risk elements of each credit extension. Credits risk rated 1 through 5 are considered to be “pass” credits. Pass credits include assets, such as cash secured loans with funds on deposit with the Bank, where there is virtually no credit risk. Pass credits also include credits that are on the Company's watch list, where the borrower exhibits potential weaknesses, which may, if not checked or corrected, negatively affect the borrower’s financial capacity and threaten their ability to fulfill debt obligations in the future. Credits classified as special mention are risk rated 6 and possess weaknesses that deserve management’s close attention. Special mention assets do not expose the Company to sufficient risk to warrant adverse classification in the substandard, doubtful or loss categories. Substandard credits are risk rated 7. An asset is considered substandard if it is inadequately protected by the current net worth and payment capacity of the borrower or of any collateral pledged.

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

Substandard assets include those characterized by the distinct possibility that the Company will sustain some loss if the deficiencies are not corrected. Assets classified as doubtful are risk rated 8 and have all the weaknesses inherent in those credits classified as substandard with the added characteristic that the weaknesses present make collection or liquidation in full highly questionable and improbable, on the basis of currently existing facts, conditions, and values. Assets classified as loss are risk rated 9 and are considered uncollectible and cannot be justified as a viable asset for the Company. There were no loans classified as doubtful or loss at September 30, 2015 and December 31, 2014.

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

	September 30, 2015						
	One-to-Four Family Residential	Multifamily	Commercial Real Estate	Construction/ Land Development	Business	Consumer	Total [1]
	(In thousands)						
Risk Rating:							
Pass	$246,981	$120,671	$247,041	$41,073	$6,973	$6,376	$669,115
Special mention	5,854	1,398	5,831	—	—	188	13,271
Substandard	2,701	1,683	815	—	—	91	5,290
Total loans	$255,536	$123,752	$253,687	$41,073	$6,973	$6,655	$687,676

[1] Net of LIP.

	December 31, 2014						
	One-to-Four Family Residential	Multifamily	Commercial Real Estate	Construction / Land Development	Business	Consumer	Total [1]
	(In thousands)						
Risk Rating:							
Pass	$263,094	$116,891	$235,841	$24,316	$3,783	$6,833	$650,758
Special mention	4,157	1,416	10,529	—	—	—	16,102
Substandard	6,314	1,964	1,598	—	—	297	10,173
Total loans	$273,565	$120,271	$247,968	$24,316	$3,783	$7,130	$677,033

[1] Net of LIP.

Note 6 - Other Real Estate Owned

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
	(In thousands)			
Balance at beginning of period	$4,416	$10,114	$9,283	$11,465
Loans transferred to OREO	—	193	141	1,823
Capitalized improvements	—	68	—	120
Gross proceeds from sale of OREO	(181)	(511)	(5,715)	(3,149)
Gain (loss) on sale of OREO	—	15	531	(92)
Market value adjustments	—	(60)	(5)	(348)
Balance at end of period	$4,235	$9,819	$4,235	$9,819

We sold $181,000 of OREO during the third quarter of 2015, which consisted of one commercial real estate property, and generated no gain or loss. OREO at September 30, 2015 consisted of $3.9 million in commercial real estate properties and $355,000 in construction and land development projects.

Note 7 - Fair Value

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

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

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

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

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

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

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

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

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

	Fair Value Measurements at September 30, 2015			
	Fair Value Measurements	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	(In thousands)			
Investments available-for-sale:				
Mortgage-backed investments:				
Fannie Mae	$48,920	$—	$48,920	$—
Freddie Mac	23,348	—	23,348	—
Ginnie Mae	14,739	—	14,739	—
Municipal bonds	10,999	—	10,999	—
U.S. Government agencies	13,978	—	13,978	—
Corporate bonds	13,913	—	13,913	—
Total	$125,897	$—	$125,897	$—

	Fair Value Measurements at December 31, 2014			
	Fair Value Measurements	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	(In thousands)			
Investments available-for-sale:				
Mortgage-backed investments:				
Fannie Mae	$40,916	$—	$40,916	$—
Freddie Mac	21,946	—	21,946	—
Ginnie Mae	26,013	—	26,013	—
Municipal bonds	644	—	644	—
U.S. Government agencies	16,816	—	16,816	—
Corporate bonds	14,039	—	14,039	—
Total	$120,374	$—	$120,374	$—

The estimated fair value of Level 2 investments is based on quoted prices for similar investments in active markets, identical or similar investments in markets that are not active and model-derived valuations whose inputs are observable.

The tables below present the balances of assets measured at fair value on a nonrecurring basis at September 30, 2015 and December 31, 2014.

	Fair Value Measurements at September 30, 2015			
	Fair Value Measurements	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)

	(In thousands)			
Impaired loans (included in loans receivable, net) [1]	$48,268	$—	$—	$48,268
OREO	4,235	—	—	4,235
Total	$52,503	$—	$—	$52,503

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[1] Total fair value of impaired loans is net of $844,000 of specific reserves on performing TDRs.

29

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

	Fair Value Measurements at December 31, 2014			
	Fair Value Measurements	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
	(In thousands)			
Impaired loans (included in loans receivable, net) (1)	$54,444	$—	$—	$54,444
OREO	9,283	—	—	9,283
Total	$63,727	$—	$—	$63,727

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(1) Total fair value of impaired loans is net of $1.2 million of specific reserves on performing TDRs.

The fair value of impaired loans is calculated using the collateral value method or on a discounted cash flow basis. Inputs used in the collateral value method include appraised values, less estimated costs to sell. Some of these inputs may not be observable in the marketplace. Appraised values may be discounted based on management's knowledge of the marketplace, subsequent changes in market conditions, or management's knowledge of the borrower.

OREO properties are measured at the lower of their carrying amount or fair value, less estimated costs to sell. Fair values are generally based on third party appraisals of the property, resulting in a Level 3 classification. In cases where the carrying amount exceeds the fair value, less estimated costs to sell, an impairment loss is recognized.

The following table presents quantitative information about Level 3 fair value measurements for financial instruments measured at fair value on a nonrecurring basis at September 30, 2015 and December 31, 2014.

	September 30, 2015			
	Fair Value	Valuation Technique	Unobservable Input(s)	Range (Weighted Average)
	(Dollars in thousands)			
Impaired Loans	$48,268	Market approach	Appraised value discounted by market or borrower conditions	0.0% - 9.09% (0.6%)
OREO	$4,235	Market approach	Appraised value less selling costs	0.0% - 0.0% (0.0%)

	December 31, 2014			
	Fair Value	Valuation Technique	Unobservable Input(s)	Range (Weighted Average)
	(Dollars in thousands)			
Impaired Loans	$54,365			