

First Financial Northwest, Inc.  
Form 10-Q  
May 11, 2009

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-Q

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

For the quarterly period ended March 31, 2009

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  
I.D. 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  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

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  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 May 6, 2009, 20,363,120 shares of the issuer's common stock, \$0.01 par value per share, were outstanding.

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## Item 1. Consolidated Financial Statements (Unaudited)

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

Assets	March 31, 2009	December 31, 2008
Cash on hand and in banks	\$ 2,532	\$ 3,366
Interest-bearing deposits	31,776	600
Federal funds sold	3,105	1,790
Investments available for sale	140,644	149,323
Loans receivable, net of allowance of \$14,294 and \$16,982	1,031,186	1,035,181
Premises and equipment, net	13,182	13,026
Federal Home Loan Bank stock, at cost	7,413	7,413
Accrued interest receivable	5,794	5,532
Deferred tax assets, net	8,577	9,266
Goodwill	14,206	14,206
Prepaid expenses and other assets	3,367	4,737
Total assets	\$ 1,261,782	\$ 1,244,440
Liabilities and Stockholders' Equity		
Deposits	\$ 821,186	\$ 791,483
Advances from the Federal Home Loan Bank	148,150	156,150
Advance payments from borrowers for taxes and insurance	4,758	2,745
Accrued interest payable	494	478
Federal income tax payable	94	336
Other liabilities	3,736	3,140
Total liabilities	978,418	954,332
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 20,363,120 and 21,293,368 shares at March 31, 2009 and December 31, 2008	204	213
Additional paid-in capital	195,110	202,167
Retained earnings, substantially restricted	101,887	102,358
Accumulated other comprehensive income, net of tax	1,398	887
	(15,235)	(15,517)

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Unearned Employee Stock Ownership Plan (ESOP)  
shares

Total stockholders' equity		283,364		290,108
Total liabilities and stockholders' equity	\$	1,261,782	\$	1,244,440

See accompanying notes to consolidated financial statements.

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

	Three Months Ended March 31,		
	2009		2008
Interest income			
Loans, including fees	\$	15,123	\$ 15,069
Investments available for sale		1,625	1,653
Federal funds sold and interest-bearing deposits with banks		2	536
Dividends on Federal Home Loan Bank stock		—	11
Total interest income	\$	16,750	\$ 17,269
Interest expense			
Deposits		7,329	8,079
Federal Home Loan Bank advances		1,246	1,029
Total interest expense	\$	8,575	\$ 9,108
		8,175	8,161
Net interest income		8,175	8,161
Provision for loan losses		1,544	—
Net interest income after provision for loan losses	\$	6,631	\$ 8,161
Noninterest income			
Net gain on sale of investments		76	1,373
Other		54	(10)
Total noninterest income	\$	130	\$ 1,363
Noninterest expense			
Salaries and employee benefits		3,039	1,761
Occupancy and equipment		350	294
Professional fees		307	295
Data processing		144	113
FDIC/OTS assessments		682	30
Other general and administrative		622	393
Total noninterest expense	\$	5,144	\$ 2,886
		1,617	6,638
Income before provision for federal income taxes		1,617	6,638
Provision for federal income taxes		421	2,166
Net income	\$	1,196	\$ 4,472
Basic earnings per share	\$	0.06	\$ 0.21
Diluted earnings per share	\$	0.06	\$ 0.21

See accompanying notes to consolidated financial statements.





FIRST FINANCIAL NORTHWEST, INC.  
AND SUBSIDIARIES  
Consolidated Statements of Stockholders' Equity and Comprehensive Income  
For the Three Months Ended March 31, 2009  
(Dollars in thousands, except share data)  
(Unaudited)

	Shares	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income, net of tax	Unearned ESOP Shares	Total Stockholders' Equity
Balances at December 31, 2008	21,293,368	\$ 213	\$ 202,167	\$ 102,358	\$ 887	\$(15,517)	\$ 290,108
Comprehensive income:							
Net income	—	—	—	1,196	—	—	1,196
Change in fair value of investments available for sale, net of tax of \$276	—	—	—	—	511	—	511
Total comprehensive income							1,707
Cash dividend declared and paid (\$0.085 per share)	—	—	—	(1,667)	—	—	(1,667)
Purchase and retirement of common stock	(930,248)	(9)	(7,524)	—	—	—	(7,533)
Compensation related to stock options and restricted stock awards	—	—	515	—	—	—	515
Allocation of 28,212 ESOP shares	—	—	(48)	—	—	282	234
Balances at March 31, 2009	20,363,120	\$ 204	\$ 195,110	\$ 101,887	\$ 1,398	\$(15,235)	\$ 283,364

See accompanying notes to consolidated financial statements.

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

	Three months ended March 31,	
	2009	2008
Cash flows from operating activities:		
Net income	\$ 1,196	\$ 4,472
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	1,544	—
Depreciation and amortization of premises and equipment	197	183
Net amortization of premiums and discounts on investments	146	157
ESOP expense	234	188
Compensation expense related to stock options and restricted stock awards	515	—
Net realized gain on investments available for sale	(76)	(1,373)
Mutual fund dividends	—	(69)
Loss from disposal of equipment	—	22
Deferred federal income taxes	412	178
Changes in operating assets and liabilities:		
Other assets	1,370	(500)
Accrued interest receivable	(262)	279
Accrued interest payable	16	(48)
Other liabilities	596	1,670
Federal income taxes	(242)	1,088
Net cash provided by operating activities	\$ 5,646	\$ 6,247
Cash flows from investing activities:		
Proceeds from sales of investments	6,853	62,551
Principal repayments on investments available for sale	7,215	8,868
Purchases of investments available for sale	(4,671)	(14,113)
Net increase (decrease) in loans receivable	2,451	(42,929)
Purchases of Federal Home Loan Bank stock	—	(179)
Purchases of premises and equipment	(353)	(22)
Net cash provided by investing activities	\$ 11,495	\$ 14,176
Balance, carried forward	\$ 17,141	\$ 20,423

Continued



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

	Three months ended March 31,	
	2009	2008
Balance, brought forward	\$ 17,141	\$ 20,423
Cash flows from financing activities:		
Net increase in deposits	29,703	35,771
Advances from the Federal Home Loan Bank	15,000	102,000
Repayments of advances from the Federal Home Loan Bank	(23,000)	(88,000)
Net increase in advance payments from borrowers for taxes and insurance	2,013	3,436
Repurchase and retirement of common stock	(7,533)	—
Dividends paid	(1,667)	—
Net cash provided by financing activities	\$ 14,516	\$ 53,207
Net increase in cash	31,657	73,630
Cash and cash equivalents:		
Beginning of period	5,756	11,577
End of period	\$ 37,413	\$ 85,207
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	\$ 8,559	\$ 9,155
Federal income taxes	\$ 450	\$ 900
Noncash transactions:		
Transfer from investments held to maturity to investments available for sale	\$ —	\$ 80,410

See accompanying notes to consolidated financial statements.

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

Note 1 – Description of Business

First Financial Northwest, Inc. (“First Financial Northwest” or “the Company”), a Washington corporation, was formed on June 1, 2007 for the purpose of becoming the holding company for First Savings Bank Northwest (“First Savings Bank” or the “Bank”) in connection with the conversion from a mutual holding company structure to a stock holding company structure. The mutual to stock conversion was completed on October 9, 2007 through the sale and issuance of 22,852,800 shares of common stock by First Financial Northwest including 1,692,800 shares contributed to our charitable foundation, the First Financial Northwest Foundation, Inc. that was established in connection with the mutual to stock conversion. First Financial Northwest’s business activities generally are limited to passive investment activities and oversight of its investment in First Savings Bank. Accordingly, the information presented in this Form 10-Q, including the consolidated unaudited 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 mutual to stock conversion in 2007, First Savings Bank changed its name to 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. Our business strategy has included an emphasis on one-to-four family residential mortgage and commercial real estate lending. First Savings Bank’s business consists of attracting deposits from the public and utilizing these deposits to originate one-to-four family, multifamily, construction/land development, commercial real estate and consumer loans.

Note 2 – Basis of Presentation

The accompanying unaudited interim consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. These unaudited consolidated financial statements should be read in conjunction with the Company’s Annual Report on Form 10-K for the year ended December 31, 2008 as filed with the Securities and Exchange Commission. In our opinion, all adjustments (consisting only of normal recurring adjustments) considered necessary for a fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America (“GAAP”) have been included. All significant inter-company balances and transactions among the Company and its subsidiaries have been eliminated in consolidation. Operating results for the three months ended March 31, 2009 are not necessarily indicative of the results that may be expected for the year ended December 31, 2009. 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 expense. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change relate to the determination of the allowance for losses on loans, valuation of real estate acquired in connection with foreclosures or in satisfaction of loans and goodwill.

Certain amounts in the unaudited consolidated financial statements for prior periods have been reclassified to conform to the current unaudited financial statement presentation.

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

Note 3 – Plan of Reorganization

On November 15, 2006, and as subsequently amended on April 18, 2007, July 18, 2007, and July 31, 2007, the Board of Directors of First Financial Holdings, MHC approved a plan of conversion and reorganization pursuant to which First Financial Holdings, MHC would convert from a mutual holding company to a stock holding company. The conversion to a stock holding company was approved by the depositors and borrowers of First Savings Bank, the Office of Thrift Supervision (OTS) and the Washington State Department of Financial Institutions and included the filing of a registration statement with the Securities and Exchange Commission. Upon the completion of the conversion and reorganization on October 9, 2007, First Financial Holdings, MHC and First Financial of Renton, Inc. ceased to exist as separate legal entities and First Financial Northwest, Inc. became the holding company for First Savings Bank. At the time of the conversion, First Savings Bank of Renton changed its name to First Savings Bank Northwest. First Savings Bank along with First Financial Diversified Corporation. became wholly owned subsidiaries of First Financial Northwest, Inc. On October 9, 2007, the Company also issued and sold shares of capital stock to eligible depositors and borrowers of First Savings Bank.

As part of the conversion and reorganization, First Savings Bank elected to be treated as a savings association rather than as a bank for holding company purposes. First Financial Northwest, Inc. is subject to regulation by the OTS. First Savings Bank is also regulated by the Federal Deposit Insurance Corporation (“FDIC”) and the Washington State Department of Financial Institutions.

Additionally, in accordance with OTS regulations, at the time of the conversion from a mutual holding company to a stock holding company, First Savings Bank substantially restricted its retained earnings by establishing a liquidation account. The liquidation account is maintained for the benefit of eligible account holders and supplemental eligible account holders who continue to maintain their accounts at First Savings Bank subsequent to the conversion. The liquidation account is reduced annually to the extent that eligible account holders and supplemental eligible account holders have reduced their qualifying deposits. Subsequent increases will not restore an eligible account holder’s or supplemental eligible account holder’s interest in the liquidation account. In the event of a complete liquidation of First Savings Bank, and only in such event, each account holder will be entitled to receive a distribution from the liquidation account in an amount proportionate to the adjusted qualifying account balances then held. First Savings Bank may not pay dividends if those dividends would reduce equity capital below the required liquidation account amount.

The Board of Directors also approved the establishment of a charitable foundation which was funded with authorized but unissued shares equal to 8% of the common stock outstanding after the offering and the establishment of an ESOP.

Note 4 – Newly Issued But Not Yet Effective Accounting Standards

In April 2009, the Financial Accounting Standards Board (“FASB”) issued the following three FASB Staff Positions (“FSP”) intended to provide additional application guidance and enhance disclosures regarding fair value measurements and impairments of securities:

FSP Statement of Financial Accounting Standards (“SFAS”) 157-4, “Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not

Orderly,” provides additional guidance for estimating fair value in accordance with SFAS No. 157 when the volume and level of activity for the asset or liability have decreased significantly. FSP SFAS 157-4 also provides guidance on identifying circumstances that indicate a transaction is not orderly. The provisions of FSP SFAS 157-4 are effective for the interim period ending on June 30, 2009. Management is currently evaluating the



FIRST FINANCIAL NORTHWEST, INC. AND SUBSIDIARIES  
 SELECTED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
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effect that the provisions of FSP SFAS 157-4 may have on our consolidated balance sheets and statements of income.

FSP SFAS 107-1 and Accounting Principals Board (“APB”) 28-1, “Interim Disclosures about Fair Value of Financial Instruments,” requires disclosures about fair value of financial instruments in interim reporting periods of publicly traded companies that were previously only required to be disclosed in annual financial statements. The provisions of FSP SFAS 107-1 and APB 28-1 are effective for the interim period ending on June 30, 2009. As FSP SFAS 107-1 and APB 28-1 amends only the disclosure requirements about fair value of financial instruments in interim periods, the adoption of FSP SFAS 107-1 and APB 28-1 is not expected to affect our consolidated balance sheets and statements of income.

FSP SFAS 115-2 and SFAS 124-2, “Recognition and Presentation of Other-Than-Temporary Impairments,” amends current other-than-temporary impairment guidance in GAAP for debt securities to make the guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments on debt and equity securities in the financial statements. This FSP does not amend existing recognition and measurement guidance related to other-than-temporary impairments of equity securities. The provisions of FSP SFAS 115-2 and SFAS 124-2 are effective for the interim period ending on June 30, 2009. Management is currently evaluating the effect that the provisions of FSP SFAS 115-2 and SFAS 124-2 may have on our consolidated balance sheets and statements of income.

Note 5 – Investment Securities Available for Sale

Investment securities available for sale are summarized as follows:

	Amortized Cost	March 31, 2009		Fair Value
		Gross Unrealized Gains	Gross Unrealized Losses	
(In thousands)				
Mortgage-backed and related investments:				
Fannie Mae	\$ 58,587	\$ 1,233	\$ (9)	\$ 59,811
Freddie Mac	55,812	1,266	(2)	57,076
Ginnie Mae	7,256	35	(17)	7,274
Tax exempt municipal bonds	4,206	24	(454)	3,776
Taxable municipal bonds	652	—	(44)	608
U.S. Government agencies	7,367	298	—	7,665
Mutual fund (1)	4,611	—	(177)	4,434
	\$ 138,491	\$ 2,856	\$ (703)	\$ 140,644

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

	December 31, 2008				
	Amortized	Gross	Gross		Fair Value
	Cost	Unrealized	Unrealized		
		Gains	Losses		
		(In thousands)			
Mortgage-backed and related investments:					
Fannie Mae	\$ 65,991	\$ 799	\$ (47)	\$	66,743
Freddie Mac	59,296	844	(28)		60,112
Ginnie Mae	7,858	11	(177)		7,692
Tax exempt municipal bonds	4,206	16	(523)		3,699
Taxable municipal bonds	652	—	(41)		611
U.S. Government agencies	5,344	511	—		5,855
Mutual fund (1)	4,611	—	—		4,611
	\$ 147,958	\$ 2,181	\$ (816)	\$	149,323

(1) The majority of the fund value is invested in U.S. Government or agency securities with additional holdings of private label securities backed by or representing interest in mortgages or domestic residential housing or manufactured housing.

In May 2008, the Board of Trustees of the AMF Ultra Short Mortgage Fund (“Fund”) (a mutual fund) decided to activate the Fund’s redemption-in-kind provision because of the uncertainty in the mortgage-backed securities market. The activation of this provision has limited the options available to the shareholders of the Fund with respect to liquidating their investments. Only the Fund may repurchase the shares in accordance with the terms of the Fund. The Fund is currently closed to new investors, which means that no new investors may buy shares in the Fund. Existing participants are allowed to redeem and receive up to \$250,000 in cash per quarter or may receive 100% of their investment in “like kind” securities equal to their proportional ownership in the Fund (i.e. ownership percentage in the Fund times the market value of each of the approximately 120 securities). Based on the quality of the collateral, its performance and the approximate one-year duration of the underlying assets of the Fund as well as the Fund’s performance for the three months ended March 31, 2009, we have classified the decrease in the value of the Fund as temporary. This decrease is included in our other comprehensive income for the first quarter of 2009.

On a quarterly basis, management makes an assessment to determine whether there have been any events or economic circumstances to indicate that a security on which there is an unrealized loss is impaired on an other-than-temporary basis. We consider many factors including the severity and duration of the impairment, our intent and ability to hold the security for a period of time sufficient for a recovery in value, 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 other-than-temporary are written down to fair value with the write-down recorded as a realized loss in “other-than-temporary loss on investments” on the income statement. Gross unrealized losses of \$703,000 during the three months ended March 31, 2009, were primarily due to interest rate changes, there has not been significant deterioration in the financial condition of the issuer and we have the intent and ability to hold the investment for a

sufficient time to recover the carrying value. We have reviewed these securities in accordance with our accounting policy for other-than-temporary impairment and concluded that the \$177,000 pre-tax decline in the market value of the AMF Ultra Short Mortgage Fund, during the quarter ended March 31, 2009, was considered temporary due to the current uncertainty in the marketplace. We do not consider any securities to be other-than-temporarily impaired.

During April 2009, additional guidance from the FASB was issued regarding other-than-temporary impairment which we will adopt in the second quarter of 2009. The impact on our consolidated balance sheets and statements of income has not been determined at this time.

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

The amortized cost and estimated fair value of investments available for sale at March 31, 2009, 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.

	March 31, 2009	
	Amortized	Fair Value
	Cost	
	(In thousands)	
Due within one year	\$ 6,606	\$ 6,457
Due after one year through five years	5,784	5,875
Due after five years through ten years	39,555	40,471
Due after ten years	86,546	87,841
	\$ 138,491	\$ 140,644

Gross proceeds from the sales of investments available for sale during the three months ended March 31, 2009 were \$6.9 million with gross gains of \$76,000. In January 2008, the Company elected to transfer its entire investments held to maturity portfolio to its investments available for sale portfolio. Subsequently, a portion of the tax-exempt municipal bond portfolio was sold. Gross proceeds from the sales were \$62.6 million with gross gains of \$1.4 million and gross losses of \$56,000.

Note 6 - Loans Receivable, Net

Loans receivable consist of the following:

	March 31,	December
	2009	31, 2008
	(In thousands)	
One-to-four family residential (1)	\$ 504,663	\$ 512,446
Multifamily residential	103,886	100,940
Commercial real estate	259,925	260,727
Construction/land development	240,813	250,512
Home equity	12,698	12,566
Savings account	159	205
Other	216	156
	\$ 1,122,360	\$ 1,137,552
Less:		
Loans in process	74,175	82,541
Deferred loan fees	2,705	2,848
Allowance for loan losses	14,294	16,982
	\$ 1,031,186	\$ 1,035,181

(1) Includes \$216.4 million of non-owner occupied loans.

At March 31, 2009 and December 31, 2008 there were no loans classified as held for sale.

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

A summary of changes in the allowance for loan losses for the three months ended March 31, 2009 and 2008 is as follows:

	Three Months Ended March 31,	
	2009	2008
	(In thousands)	
Balance at beginning of period	\$ 16,982	\$ 7,971
Provision for loan losses	1,544	—
Charge-offs	(4,232)	—
Balance at end of period	\$ 14,294	\$ 7,971

Nonaccrual, impaired and troubled debt restructured loans are as follows:

March 31,                  December 31,