

First Financial Northwest, Inc.
Form 10-Q
May 07, 2010

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, 2010

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 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.

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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

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 3, 2010, 18,805,168 shares of the issuer's common stock, \$0.01 par value per share, were outstanding.

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Item 1. Financial Statements

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

Assets	March 31, 2010	December 31, 2009
Cash on hand and in banks	\$ 8,373	\$ 8,937
Interest-bearing deposits	107,326	96,033
Investments available for sale	109,593	97,383
Loans receivable, net of allowance of \$36,479 and \$33,039	1,016,896	1,039,300
Premises and equipment, net	20,453	19,585
Federal Home Loan Bank stock, at cost	7,413	7,413
Accrued interest receivable	4,716	4,880
Federal income tax receivable	12,160	9,499
Deferred tax assets, net	5,415	12,139
Other real estate owned (OREO)	20,500	11,835
Prepaid expenses and other assets	8,384	8,330
Total assets	\$ 1,321,229	\$ 1,315,334
Liabilities and Stockholders' Equity		
Deposits	\$ 962,590	\$ 939,423
Advances from the Federal Home Loan Bank	139,900	139,900
Advance payments from borrowers for taxes and insurance	4,509	2,377
Accrued interest payable	402	457
Other liabilities	3,789	4,660
Total liabilities	1,111,190	1,086,817
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 18,805,168 and 18,823,068 shares at March 31, 2010 and December 31, 2009	188	188
Additional paid-in capital	186,415	186,120
Retained earnings, substantially restricted	36,078	55,251
Accumulated other comprehensive income, net of tax	1,465	1,347
Unearned Employee Stock Ownership Plan (ESOP) shares	(14,107)	(14,389)
Total stockholders' equity	210,039	228,517
Total liabilities and stockholders' equity	\$ 1,321,229	\$ 1,315,334

See accompanying notes to consolidated financial statements.

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

	Three Months Ended March 31,	
	2010	2009
Interest income		
Loans, including fees	\$ 14,594	\$ 15,123
Investments available for sale	1,007	1,625
Federal funds sold and interest-bearing deposits with banks	61	2
Total interest income	\$ 15,662	\$ 16,750
Interest expense		
Deposits	6,571	7,329
Federal Home Loan Bank advances	1,023	1,246
Total interest expense	\$ 7,594	\$ 8,575
Net interest income	8,068	8,175
Provision for loan losses		
Net interest income (loss) after provision for loan losses	\$ (4,932)	\$ 6,631
Noninterest income		
Net gain on sale of investments	—	76
Other	46	54
Total noninterest income	\$ 46	\$ 130
Noninterest expense		
Salaries and employee benefits	3,189	3,039
Occupancy and equipment	425	350
Professional fees	459	307
Data processing	170	144
Loss on sale of OREO property, net	437	—
OREO valuation expense	2,271	—
OREO related expenses, net	702	—
FDIC/OTS assessments	580	682
Other general and administrative	634	622
Total noninterest expense	\$ 8,867	\$ 5,144
Income (loss) before provision for federal income taxes	(13,753)	1,617
Provision for federal income taxes		
Net income (loss)	\$ (17,752)	\$ 1,196
Basic earnings (loss) per share	\$ (1.02)	\$ 0.06
Diluted earnings (loss) per share	\$ (1.02)	\$ 0.06

See accompanying notes to consolidated financial statements.

FIRST FINANCIAL NORTHWEST, INC. AND SUBSIDIARIES
Consolidated Statements of Stockholders' Equity and Comprehensive Income (Loss)
For the Three Months Ended March 31, 2010
(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, 2009	18,823,068	\$188	\$186,120	\$55,251	\$1,347	\$(14,389)	\$228,517
Comprehensive loss:							
Net loss	—	—	—	(17,752)	—	—	(17,752)
Change in fair value of investments							
available for sale, net of tax \$63	—	—	—	—	118	—	118
Total comprehensive loss:							(17,634)
Cash dividend declared and paid (\$0.085 per share)	—	—	—	(1,421)	—	—	(1,421)
Purchase and retirement of common stock	(17,900)	—	(106)	—	—	—	(106)
Compensation related to stock options and restricted stock awards							
	—	—	497	—	—	—	497
Allocation of 28,213 ESOP shares	—	—	(96)	—	—	282	186
Balances at March 31, 2010	18,805,168	\$188	\$186,415	\$36,078	\$1,465	\$(14,107)	\$210,039

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,	
	2010	2009
Cash flows from operating activities:		
Net income (loss)	\$ (17,752)	\$ 1,196
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	13,000	1,544
OREO valuation expense	2,271	—
Loss on sale of OREO property, net	437	—
Depreciation and amortization of premises and equipment	254	197
Net amortization of premiums and discounts on investments	250	146
ESOP expense	186	234
Compensation expense related to stock options and restricted stock awards	497	515
Net realized gain on investments available for sale	—	(76)
Deferred federal income taxes	6,661	412
Changes in operating assets and liabilities:		
Other assets	(54)	1,370
Accrued interest receivable	164	(262)
Accrued interest payable	(55)	16
Other liabilities	(871)	596
Federal income taxes	(2,661)	(242)
Net cash provided by operating activities	\$ 2,327	\$ 5,646
Cash flows from investing activities:		
Proceeds from sales of investments	—	6,853
Proceeds from sales of OREO's	3,031	—
Principal repayments on investments available for sale	6,657	7,215
Purchases of investments available for sale	(18,936)	(4,671)
Net increase (decrease) in loans receivable	(5,000)	2,451
Purchases of premises and equipment	(1,122)	(353)
Net cash provided (used) by investing activities	\$ (15,370)	\$ 11,495
Balance, carried forward	\$ (13,043)	\$ 17,141

Continued

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

	Three Months Ended March 31,	
	2010	2009
Balance, brought forward	\$ (13,043)	\$ 17,141
Cash flows from financing activities:		
Net increase in deposits	23,167	29,703
Advances from the Federal Home Loan Bank	50,000	15,000
Repayments of advances from the Federal Home Loan Bank	(50,000)	(23,000)
Net increase in advance payments from borrowers for taxes and insurance	2,132	2,013
Repurchase and retirement of common stock	(106)	(7,533)
Dividends paid	(1,421)	(1,667)
Net cash provided by financing activities	\$ 23,772	\$ 14,516
Net increase in cash	10,729	31,657
Cash and cash equivalents:		
Beginning of period	104,970	5,756
End of period	\$ 115,699	\$ 37,413
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	\$ 7,649	\$ 8,559
Federal income taxes	\$ —	\$ 450
Noncash transactions:		
Loans, net of deferred loan fees and allowance for loan losses, transferred to OREO	\$ 14,404	\$ —

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. 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 the consolidated financial statements and related data, relates primarily to First Savings Bank. First Financial Northwest is a savings and loan holding company and is subject to regulation by the Office of Thrift Supervision (“OTS”). First Savings Bank is regulated by the Federal Deposit Insurance Corporation (“FDIC”) and the Washington State Department of Financial Institutions (“DFI”).

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 deposits to originate one-to-four family, multifamily, commercial real estate, business, consumer and to a lesser extent, construction/land development 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 (“GAAP”) 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, 2009 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 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 three months ended March 31, 2010 are not necessarily indicative of the results that may be expected for the year ended December 31, 2010. 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 losses, other real estate owned (“OREO”), deferred tax assets and the fair value of financial instruments.

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

Note 3 – Recent Accounting Pronouncements

Accounting Standards Update (“ASU”) No. 2010-06, “Fair Value Measurements and Disclosures (Topic 820) - Improving Disclosures About Fair Value Measurements.” ASU 2010-06 requires expanded disclosures related to fair value measurements including (i) the amounts of significant transfers of assets or liabilities between Levels 1 and 2 of the fair value hierarchy and the reasons for the transfers, (ii) the reasons for transfers of assets or liabilities in or out of Level 3 of the fair value hierarchy, with significant transfers disclosed separately, (iii) the policy for determining when transfers between levels of the fair value hierarchy are recognized and (iv) for recurring fair value measurements of

assets and liabilities in Level 3 of the fair value hierarchy, a gross presentation of information about purchases, sales, issuances and settlements. ASU 2010-06 further clarifies that (i) fair value measurement disclosures should be provided for each class of assets and liabilities (rather than major category), which would generally be a subset of assets or liabilities within a line item in the statement of financial position and (ii) company's should provide disclosures about the valuation techniques and inputs used to measure fair value for both recurring and nonrecurring fair value measurements for each class of assets and liabilities included in Levels 2 and 3 of the fair value hierarchy. The disclosures related to the gross presentation of

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

purchases, sales, issuances and settlements of assets and liabilities included in Level 3 of the fair value hierarchy will be required beginning January 1, 2011. The remaining disclosure requirements and clarifications made by ASU 2010-06 became effective on January 1, 2010 and did not have a significant impact on our consolidated financial statements. See Note 6 – Fair Value.

Note 4 – Investment Securities Available for Sale

Investment securities available for sale are summarized as follows:

	Amortized Cost	March 31, 2010		Fair Value
		Gross Unrealized Gains	Gross Unrealized Losses	
(In thousands)				
Mortgage-backed and related investments:				
Fannie Mae	\$ 58,736	\$ 1,403	\$ (101)	\$ 60,038
Freddie Mac	32,543	1,128	(54)	33,617
Ginnie Mae	4,809	90	—	4,899
Tax-exempt municipal bonds	4,207	45	(492)	3,760
Taxable municipal bonds	649	—	(11)	638
U.S. Government agencies	1,936	87	—	2,023
Mutual fund (1)	4,460	158	—	4,618
	\$ 107,340	\$ 2,911	\$ (658)	\$ 109,593

	Amortized Cost	December 31, 2009		Fair Value
		Gross Unrealized Gains	Gross Unrealized Losses	
(In thousands)				
Mortgage-backed and related investments:				
Fannie Mae	\$ 50,025	\$ 1,267	\$ (21)	\$ 51,271
Freddie Mac	28,924	1,020	(3)	29,941
Ginnie Mae	5,099	84	—	5,183
Tax-exempt municipal bonds	4,207	49	(484)	3,772
Taxable municipal bonds	650	—	(48)	602
U.S. Government agencies	1,946	57	—	2,003
Mutual fund (1)	4,460	151	—	4,611
	\$ 95,311	\$ 2,628	\$ (556)	\$ 97,383

(1) The majority of the fund value is invested in U.S. Government or agency securities with additional holdings of private label mortgage-backed securities.

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

Investments with unrealized losses at March 31, 2010 and December 31, 2009 by length of time that individual investments have been in a continuous loss position, are as follows:

	Less Than 12 Months		March 31, 2010 12 Months or Longer		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
	(In thousands)					
Fannie Mae	\$ 12,049	\$ (101)	\$ -	\$ -	\$ 12,049	\$ (101)
Freddie Mac	4,442	(52)	249	(2)	4,691	(54)
Tax-exempt municipal bonds	-	-	1,617	(492)	1,617	(492)
Taxable municipal bonds	-	-	639	(11)	639	(11)
	\$ 16,491	\$ (153)	\$ 2,505	\$ (505)	\$ 18,996	\$ (658)

	Less Than 12 Months		December 31, 2009 12 Months or Longer		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
	(In thousands)					
Fannie Mae	\$ 3,255	\$ (21)	\$ -	\$ -	\$ 3,255	\$ (21)
Freddie Mac	-	-	255	(3)	255	(3)
Tax-exempt municipal bonds	-	-	1,625	(484)	1,625	(484)
Taxable municipal bonds	-	-	602	(48)	602	(48)
	\$ 3,255	\$ (21)	\$ 2,482	\$ (535)	\$ 5,737	\$ (556)

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 150 securities). We have elected to maintain our investment in the mutual fund.

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, 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 (“OTTI”) are written down to fair value. For equity securities, the write-down is recorded as a realized loss in “other-than-temporary impairment loss on investments” on the income statement. For debt securities, if we intend 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 we do not intend to sell the security and it is not likely that we will be required to sell the security but we do 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 (“OCI”). Impairment losses related to all other factors are presented as separate categories within OCI. For investment securities held to maturity, this amount is accreted over the remaining life of the debt security prospectively based on the amount and timing of future estimated cash flows. The accretion of the OTTI amount recorded in OCI will increase the carrying value of the investment, and would not affect earnings. If there is an indication of additional credit losses the security is re-evaluated in

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

accordance with the procedures described above. For the quarter ended March 31, 2010, we did not have any OTTI losses on investments.

The amortized cost and estimated fair value of investments, available for sale at March 31, 2010, 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 and the mutual fund, are shown separately.

	March 31, 2010	
	Amortized Cost	Fair Value
	(In thousands)	
Due within one year	\$ -	\$ -
Due after one year through five years	1,292	1,367
Due after five years through ten years	685	693
Due after ten years	4,815	4,361
	6,792	6,421
Mortgage-backed investments	96,088	98,554
Mutual fund	4,460	4,618
	\$ 107,340	\$ 109,593

There were no sales of investments during the three months ended March 31, 2010.

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

Note 5 - Loans Receivable, Net

Loans receivable consist of the following:

	March 31, 2010		December 31, 2009	
	Amount	Percent	Amount	Percent
(Dollars in thousands)				
One-to-four family residential: (1)				
Permanent	\$ 474,210	43.65%	\$ 481,046	43.13%
Construction	14,050	1.29	15,685	1.41
	488,260	44.94	496,731	44.54
Multifamily residential:				
Permanent	133,989	12.34	128,943	11.56
Construction	18,190	1.67	17,565	1.58
	152,179	14.01	146,508	13.14
Commercial real estate:				
Permanent	250,334	23.04	251,185	22.52
Construction	31,599	2.91	31,605	2.83
Land	5,877	0.54	6,206	0.56
	287,810	26.49	288,996	25.91
Speculative construction/land development:				
One-to-four family residential	78,043	7.18	95,699	8.58
Multifamily residential	3,624	0.33	3,624	0.33
Commercial	1,125	0.10	1,129	0.10
Land development	56,179	5.17	63,501	5.69
	138,971	12.78	163,953	14.70
Business	347	0.03	353	0.03
Consumer	19,006	1.75	18,678	1.68
Total loans	\$ 1,086,573	100.00%	\$ 1,115,219	100.00%
Less:				
Loans in process	30,252		39,942	

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Deferred loan fees	2,946	2,938
Allowance for loan losses	36,479	33,039
Loans receivable, net	\$ 1,016,896	\$ 1,039,300

(1) Includes \$216.5 million and \$230.8 million of non-owner occupied loans at March 31, 2010 and December 31, 2009, respectively.

At March 31, 2010 and December 31, 2009 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, 2010 and 2009 is as follows:

	Three Months Ended March 31,	
	2010	2009
	(In thousands)	
Beginning balance, January 1, 2010	\$ 33,039	\$ 16,982
Provision for loan losses	13,000	1,544
Charge-offs	(9,682)	(4,232)
Recoveries	122	-
Ending balance, March 31, 2010	\$ 36,479	\$ 14,294

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

	March 31,	December 31,
	2010	2009
	(In thousands)	
Impaired loans without a valuation allowance	\$ 38,216	\$ 46,282
Impaired loans with a valuation allowance	130,650	109,879
Total impaired loans	\$ 168,866	\$ 156,161
Valuation allowance related to impaired loans	\$ 18,356	\$ 13,432
Average investment of impaired loans	\$ 144,696	\$ 117,644
Interest income recognized on a cash basis on impaired loans	\$ 345	\$ 2,134
Nonperforming assets		
90 days or more past due and still accruing	\$ -	\$ -
Nonaccrual loans	108,135	94,682
Nonaccrual troubled debt restructured loans	37,783	26,021
Total nonperforming loans	145,918	120,703
Other real estate owned	20,500	11,835
Total nonperforming assets	\$ 166,418	\$ 132,538
Performing troubled debt restructured loans	\$ 22,948	\$ 35,458
Nonaccrual troubled debt restructured loans	37,783	26,021
Total troubled debt restructured loans (1)	\$ 60,731	\$ 61,479

(1) Troubled debt restructured loans are also considered impaired loans and are included in the impaired category at the beginning of the table.

At March 31, 2010, the amounts committed to be advanced in connection with the impaired loans totaled \$12.6 million.

Foregone interest on nonaccrual loans for the three months ended March 31, 2010 and 2009 was \$797,000 and \$1.1 million, respectively.

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

A summary of our OREO at March 31, 2010 is as follows:

	March 31, 2010		December 31, 2009	
	Amount	Number	Amount	Number
	(Dollars in thousands)			
Beginning balance, January 1, 2010	\$ 11,835	32	\$ -	-
Additions	14,404	34	11,835	32
Market value adjustments	(2,271)	N/A	-	N/A
Sales	(3,468)	(7)	-	-
Ending balance, March 31, 2010	\$ 20,500	59	\$ 11,835	32

Note 6 – 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. ASC Topic 820 also establishes a consistent framework for measuring fair value and expands disclosure requirements about fair value measurements.

We determined the fair values of our 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 our estimates 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 our 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.

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

The tables below present the balances of assets and liabilities measured at fair value on a recurring basis:

	Fair Value Measurements at March 31, 2010			
	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)				
Available for sale investments				
Mortgage-backed investments				
Fannie Mae	\$ 60,038	\$ -	\$ 60,038	\$ -
Freddie Mac	33,617	-	33,617	-
Ginnie Mae	4,899	-	4,899	-
Tax-exempt municipal bonds	3,760	-	3,760	-
Taxable municipal bonds	638	-	638	-
U.S. Government agencies	2,023	-	2,023	-
Mutual Fund	4,618	4,618	-	-
	\$ 109,593	\$ 4,618	\$ 104,975	\$ -

	Fair Value Measurements at December 31, 2009			
	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)				
Available for sale investments				
Mortgage-backed investments				
Fannie Mae	\$ 51,271	\$ -	\$ 51,271	\$ -
Freddie Mac	29,941	-	29,941	-
Ginnie Mae	5,183	-	5,183	-
Tax-exempt municipal bonds	3,772	-	3,772	-
Taxable municipal bonds	602	-	602	-
U.S. Government agencies	2,003	-	2,003	-

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Mutual Fund			4,611		-		-	
		4,611						
	\$	97,383	\$	4,611	\$	92,772	\$	-

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FIRST FINANCIAL NORTHWEST, INC. AND SUBSIDIARIES
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 (Unaudited)

The tables below present the balances of assets and liabilities measured at fair value on a nonrecurring basis.

	Fair Value Measurements at March 31, 2010				
	Fair Value Measurements	Quoted Prices in Significant Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Losses (1)
Impaired loans including undisbursed but committed funds of \$12.6 million (included in loans receivable, net)	\$ 163,077	\$-	\$-	\$163,077	\$4,924
Other real estate owned	20,500	-	-	20,500	2,271
	\$ 183,577	\$-	\$-	\$183,577	\$7,195

(1) This represents the loss for the quarter ended March 31, 2010.

	Fair Value Measurements at December 31, 2009				
	Fair Value Measurements	Quoted Prices in Significant Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Losses (1)
Impaired loans including undisbursed but committed funds of \$10.6 million (included in loans receivable, net)	\$ 153,300	\$-	\$-	\$153,300	\$4,895
Goodwill impairment	-	-	-	-	14,206
Other real estate owned	11,835	-	-	11,835	-
	\$ 165,135	\$-	\$-	\$165,135	\$19,101

(1) This represents the loss for the year ended December 31, 2009.

Investments available for sale consist primarily of mortgage-backed securities, bank qualified tax-exempt bonds, taxable municipal bonds, a mutual fund and agency securities. The estimated fair value of Level 1 investments, which consists of a mutual fund investment, is based on quoted market prices. 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.

Loans are considered impaired when, based upon current information and events, it is probable that we will be unable to collect the scheduled payments of principal and interest when due according to the contractual terms of the loan agreement. The fair value of impaired loans is calculated using the collateral value method. Inputs include appraised values, estimates of certain completion costs and closing and selling costs. Some of these inputs may not be observable in the marketplace.

Nonrecurring adjustments to certain commercial and residential real estate properties classified as OREO are measured at the lower of carrying amount or fair value, less 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 costs to sell, an impairment loss is recognized.

FIRST FINANCIAL NORTHWEST, INC. AND SUBSIDIARIES
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The carrying amounts and estimated fair values of financial instruments were as follows:

	March 31, 2010		December 31, 2009	
	Carrying value	Estimated fair value	Carrying value	Estimated fair value
(In thousands)				
Assets:				
Cash on hand and in banks	\$ 8,373	\$ 8,373	\$ 8,937	\$ 8,937
Interest-bearing deposits	107,326	107,326	96,033	96,033
Investments available for sale	109,593	109,593	97,383	97,383
Loans receivable, net	1,016,896	982,000	1,039,300	1,001,562
Federal Home Loan Bank stock	7,413	7,413	7,413	7,413
Accrued interest receivable	4,716	4,716	4,880	4,880
OREO	20,500	20,500	11,835	11,835
Liabilities:				
Deposits	229,524	229,524	225,772	225,772
Certificates of deposit	733,066	749,288	713,651	727,250
Advances from the Federal Home Loan Bank	139,900	141,685	139,900	140,994
Accrued interest payable	402	402	457	457

Fair value estimates, methods, and assumptions are set forth below for our financial instruments.

- Financial instruments with book value equal to fair value: The fair value of financial instruments that are short-term or reprice frequently and that have little or no risk are considered to have a fair value equal to book value.
- Investments: The fair value of all investments excluding Federal Home Loan Bank of Seattle (“FHLB”) stock was based upon quoted market prices. FHLB stock is not publicly-traded, however it may be redeemed on a dollar-for-dollar basis, for any amount the Bank is not required to hold. The fair value is therefore equal to the book value.
- Loans receivable: For variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values. The fair value of fixed-rate loans is estimated using discounted cash flow analysis utilizing current interest rates that would be offered for loans with similar terms to borrowers of similar credit quality. As a result of the current market conditions, cash flow estimates have been further discounted to

include a credit factor. The fair value of nonperforming loans is estimated using the fair value of the underlying collateral.

- **Liabilities:** The fair value of deposits with no stated maturity, such as statement, NOW, and money market accounts, is equal to the amount payable on demand. The fair value of certificates of deposit is based on the discounted value of contractual cash flows. The fair value of FHLB advances is estimated based on discounting the future cash flows using current interest rates for debt with similar remaining maturities.
- **Off-balance sheet commitments:** No fair value adjustment is necessary for commitments made to extend credit, which represents commitments for loan originations or for outstanding commitments to purchase loans. These commitments are at variable rates, are for loans with terms of less than one year and have interest rates which approximate prevailing market rates, or are set at the time of loan closing.

Fair value estimates are based on existing balance sheet financial instruments without attempting to estimate the value of anticipated future business. The fair value has not been estimated for assets and liabilities that are not considered financial instruments.

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Note 7 – Federal Home Loan Bank stock

At March 31, 2010, we held \$7.4 million in shares of FHLB stock. FHLB stock is carried at par and does not have a readily determinable fair value. Ownership of FHLB stock is restricted to the FHLB and member institutions, and can only be purchased and redeemed at par. As a result of ongoing turmoil in the capital and mortgage markets, the FHLB of Seattle has a risk-based capital deficiency largely as a result of write-downs on its private label mortgage-backed securities portfolios.

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.

Under Federal Housing Finance Agency Regulations, a Federal Home Loan Bank that fails to meet any regulatory capital requirement may not declare a dividend or redeem or repurchase capital stock in excess of what is required for members' current loans. Based upon an analysis by Standard and Poors regarding the Federal Home Loan Banks they stated that the FHLB System has a special public status (organized under the Federal Home Loan Bank Act of 1932) and because of the extraordinary support offered to it by the U.S. Treasury in a crisis, (though not used), it can be considered an extension of the government. The U.S. government would almost certainly support the credit obligations of the FHLB System. We have determined there is not an other-than-temporary impairment on the FHLB stock investment as of March 31, 2010.

Note 8 - Stock-Based Compensation

In June 2008, our shareholders approved the First Financial Northwest, Inc. 2008 Equity Incentive Plan ("Plan"). The Plan provides for the grant of stock options, awards of restricted stock and stock appreciation rights.

Total compensation cost that has been charged against income for the Plan was \$497,000 and \$515,000 for the three months ended March 31, 2010 and 2009, respectively, and the related income tax benefit was \$174,000 and \$180,000 for the three months ended March 31, 2010 and 2009, respectively.

Stock Options

The Plan authorized the grant of stock options amounting to 2,285,280 shares to our directors, advisory directors, officers and employees. Option awards are granted with an exercise price equal to the market price of our common stock at the date of grant. These option awards have a vesting period of five years, with 20% vesting on the anniversary date of each grant date and a contractual life of ten years. Any unexercised stock options will expire ten years after the grant date or 90 days after employment or service ends. We have a policy of issuing new shares upon exercise. At March 31, 2010, remaining options for 861,756 shares of common stock were available for grant under the Plan.

The fair value of each option award is estimated on the date of grant using a Black-Scholes model that uses the following assumptions. The dividend yield is based on the current quarterly dividend in effect at the time of the grant. Historical employment data is used to estimate the forfeiture rate. The expected volatility is generally based on the historical volatility of our stock price over a specified period of time. Since becoming a publicly-held company in October 2007, the amount of historical stock price information is limited. As a result, we elected to use a weighted-average of our peers' historical stock prices as well as our own historical stock prices to estimate volatility. We base the risk-free interest rate on the U.S. Treasury Constant Maturity Indices in effect on the date of the grant. We elected to use the "Share-Based Payments" method permitted by the Securities and Exchange

FIRST FINANCIAL NORTHWEST, INC. AND SUBSIDIARIES
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Commission to calculate the expected term. This method uses the vesting term of an option along with the contractual term, setting the expected life at a midpoint in between. There were no options granted during the three months ended March 31, 2010.

A summary of our stock option plan awards for the three months ended March 31, 2010 follows:

	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term in Years	Aggregate Intrinsic Value
Outstanding at January 1, 2010	1,433,524	\$ 9.73	8.52	
Granted	-	-	-	
Exercised	-	-	-	
Forfeited or expired	(10,000)	9.78	8.26	
Outstanding at March 31, 2010	1,423,524	\$ 9.73	8.28	\$ -
Expected to vest assuming a 3% forfeiture				
rate over the vesting term	1,104,643	\$ 9.73	8.28	\$ -
Exercisable at March 31, 2010	284,705	\$ 9.73	8.28	\$ -

As of March 31, 2010, there was \$1.7 million of total unrecognized compensation cost related to nonvested stock options granted under the Plan. The cost is expected to be recognized over the remaining weighted-average vesting period of 3.3 years.

Restricted Stock Awards

The Plan authorized the grant of restricted stock awards amounting to 914,112 shares to our directors, advisory directors, officers and employees. Compensation expense is recognized over the vesting period of the awards based on the fair value of the stock at the date of grant. The restricted stock awards' fair value is equal to the value on the date of grant. Shares awarded as restricted stock vest ratably over a five-year period beginning at the grant date with 20% vesting on the anniversary date of each grant date. At March 31, 2010, remaining restricted awards for 159,478 shares were available to be issued. Shares that have been repurchased totaled 604,987 and are held in trust until they are vested in connection with the agreement.

A summary of changes in nonvested restricted stock awards for the three months ended March 31, 2010 follows:

Nonvested Shares	Shares	Weighted-Average Grant-Date Fair Value
Nonvested at January 1, 2010	604,987	\$ 10.22
Granted	-	-

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Vested	(6,400)		8.35
Forfeited	-		-
Nonvested at March 31, 2010	598,587	\$	10.24
Expected to vest assuming a 3% forfeiture rate over the vesting term	580,627		

FIRST FINANCIAL NORTHWEST, INC. AND SUBSIDIARIES
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As of March 31, 2010, there was \$5.1 million of total unrecognized compensation costs related to nonvested shares granted as restricted stock awards. The cost is expected to be recognized over the remaining weighted-average vesting period of 3.4 years. The total fair value of shares vested during the quarter ended March 31, 2010 and 2009 was \$53,000 and \$0, respectively.

Note 9 – Federal Taxes on Income

Deferred tax assets and liabilities are recognized for the future tax consequences attributable to temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. These calculations are based on many complex factors including estimates of the timing of reversals of temporary differences, the interpretation of federal income tax laws and a determination of the differences between the tax and the financial reporting basis of assets and liabilities. Actual results could differ significantly from the estimates and interpretations used in determining the current and deferred income tax liabilities.

Our primary deferred tax assets relate to our allowance for loan losses, our contribution to the First Financial Northwest Foundation and our impairment charge relating to our investment in the AMF Ultra Short Mortgage Fund.

Under GAAP, a valuation allowance is required to be recognized if it is “more likely than not” that a portion of the deferred tax asset will not be realized. Our policy is to evaluate our deferred tax assets on a quarterly basis and record a valuation allowance for our deferred tax asset if we do not have sufficient positive evidence indicating that it is more likely than not that some or all of the deferred tax asset will be realized. At March 31, 2010, we considered positive evidence, which includes \$5.4 million of carryback potential and negative evidence, which includes cumulative losses in the most recent three year period and uncertainty regarding short-term future earnings. We further considered that GAAP places heavy emphasis on prior earnings in determining the realizable deferred tax asset. After reviewing and weighing these various factors, we recorded a valuation allowance for the balance of the deferred tax asset in excess of the tax carryback refund potential.

Note 10 – Earnings (Loss) Per Share

The following table presents a reconciliation of the components used to compute basic and diluted earnings (loss) per share.

	Three Months Ended March 31,	
	2010	2009
(Dollars in thousands, except share data)		
Net income (loss)	\$ (17,752)	\$ 1,196
Weighted-average common shares outstanding	17,383,841	19,315,048
Basic income (loss) per share	\$ (1.02)	\$ 0.06
Diluted income (loss) per share	\$ (1.02)	\$ 0.06

All outstanding stock options were not included in computing dilutive earnings (loss) per share for the three months ended March 31, 2010 and 2009 because they were antidilutive.

Note 11 – Segment Information

Our activities are considered to be a single industry segment for financial reporting purposes. We are engaged in the business of attracting deposits from the general public and originating loans for our portfolio in our

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primary market area. Substantially all income is derived from a diverse base of commercial and residential real estate loans, consumer lending activities and investments.

Note 12 – Subsequent Events

Subsequent events are events or transactions that occur after the date of the statement of financial condition but before financial statements are issued. Recognized subsequent events are events or transactions that provide additional evidence about conditions that existed at the date of the statement of financial condition, including the estimates inherent in the process of preparing financial statements. Nonrecognized subsequent events are events that provide evidence about conditions that did not exist at the date of the statement of financial condition but arose after that date.

On April 14, 2010, in connection with the most recent examination of the holding company by the OTS, the members of the Board of Directors of First Financial Northwest entered into an informal supervisory agreement. Under the terms of the agreement, the Company has agreed, among other things, to provide notice to and obtain written non-objection from the OTS prior to the Company (a) declaring a dividend or redeeming any capital stock; and (b) incurring, issuing, renewing or repurchasing any new debt. Further, as a result of the most recent examination of the Bank by the FDIC and the Washington State DFI, the FDIC notified us that we must obtain written non-objection from the FDIC before engaging in any transaction that would materially change the balance sheet composition (including growth in total assets of five percent or more), significantly change funding sources (including using brokered deposits) or declare or pay cash dividends. In addition, both the Company and the Bank must obtain prior regulatory approval before adding any new director or senior executive officer or changing the responsibilities of any current senior executive officer or pay pursuant to or by entering into certain severance and other forms of compensation agreements.

In light of the continuing challenging operating environment, along with our elevated level of nonperforming assets, delinquencies and adversely classified assets, our recent operating results and the regulatory restrictions recently imposed on us, we expect the Bank to be requested to enter into a formal written enforcement order with the FDIC and the Washington State DFI. We expect that, under this order, the Bank will be required, among other things, to develop and implement plans to reduce concentrations in construction/land development loans; to improve asset quality and credit administration; to reduce classified assets and to improve profitability within specified time frames. See Item 1A, Risk Factors—“Certain regulatory restrictions were recently imposed on us and we expect to be subject to future additional regulatory restrictions and enforcement actions; lack of compliance could result in monetary penalties and/or additional regulatory actions.” We are actively engaged in responding to the concerns raised by our banking regulators.

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

Forward-looking statements:

Certain matters discussed in this Quarterly Report on Form 10-Q may contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements relate to, among other things, expectations of the business environment in which we operate, projections of future performance, 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 impacted 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 Office of Thrift Supervision and our bank subsidiary by the Federal Deposit Insurance Corporation, the Washington State Department of Financial Institutions, Division of Banks or other regulatory authorities, including the possibility that any such regulatory authority may initiate a formal enforcement action against the Company and/or the Bank such as an order to take corrective action and refrain from unsafe and unsound practices which also may require us, among other things, to increase our reserve for loan losses, write-down assets, change our regulatory capital position or affect our ability to borrow funds or maintain or increase deposits, which could adversely affect our liquidity and earnings; our ability to control operating costs and expenses; the use of estimates in determining the fair values 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 our branch expansion strategy; our ability to successfully integrate any assets, liabilities, customers, systems, and management personnel we have acquired or may in the future acquire into our operations and our ability to realize related revenue synergies and cost savings within expected time frames and any goodwill charges related thereto; our ability to manage loan delinquency rates; 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; the availability of resources to address changes in laws, rules, or regulations or to respond to regulatory actions; adverse changes in the securities markets; inability of key third-party providers to perform their obligations to us; changes in accounting policies and practices, as may be adopted by the financial institution regulatory agencies or the Financial Accounting Standards Board, including additional guidance and interpretation on accounting issues and details of the implementation of new accounting methods; the economic impact of war or any terrorist activities; other economic, competitive, governmental, regulatory, and technological factors affecting our operations; pricing, products and services; and other risks detailed in our reports filed with the Securities and Exchange Commission, including our Annual Report on Form 10-K for the year ended December 31, 2009. Any of the forward-looking statements that we make in this Form 10-Q and in the other public reports and statements we make may turn out to be wrong because of the inaccurate assumptions we might make, because of the factors illustrated above or because of other factors that we cannot foresee. Because of these and other uncertainties, our actual future results may be materially different from those expressed in any forward-looking statements made by or on our behalf. Therefore, these factors should be

considered in evaluating the forward-looking statements, and undue reliance should not be placed on such statements. We undertake no responsibility to update or revise any forward-looking statements.

Overview

First 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, multifamily, commercial real estate, business, consumer and to a lesser extent construction/land development loans.

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

An offset to net interest income is the provision for loan losses which represents the quarterly charge to operations which is required to adequately provide for probable losses inherent in our loan portfolio.

Noninterest expense consists primarily of salaries and employee benefits, occupancy and equipment, data processing, marketing, postage and supplies, professional services, expenses associated with OREO and deposit insurance premiums. Salaries and employee benefits consist primarily of the salaries and wages paid to our employees, payroll taxes, expenses for retirement benefits, the equity incentive plan and other employee benefits. Occupancy and equipment expenses consist primarily of real estate taxes, depreciation charges, maintenance and costs of utilities. OREO expenses consist of valuation allowances related to real estate that we own as well as maintenance costs, taxes and insurance and gains/losses resulting from the sale of these properties.

We incurred a net loss for the first quarter ended March 31, 2010 of \$17.8 million, or \$1.02 per diluted share, as compared to net income of \$1.2 million or \$0.06 per diluted share for the quarter ended March 31, 2009. The change in operating results in the first quarter of 2010 as compared to the first quarter of 2009 was primarily the result of an \$11.5 million increase in the provision for loan losses, a \$3.7 million increase in noninterest expense and an increase of \$3.6 million in federal income tax expense.

During the quarter ended March 31, 2010, our total loan portfolio decreased \$28.6 million or 2.6% from December 31, 2009. The major changes in our loan portfolio for the quarter ended March 31, 2010, were our one-to-four family residential loans decreased \$8.5 million or 1.7%, multifamily loans increased \$5.7 million or 3.9% and construction/land development loans decreased \$25.0 million or 15.2%.

Our loan policy limits the maximum amount of loans we can make to one borrower to 20% of First Savings Bank's risk-based capital. As of March 31, 2010, the maximum amount which we could lend to any one borrower was \$32.1 million based on our policy. Exceptions may be made to this policy with the prior approval of the Executive Committee and ratified by the Board of Directors if the borrower exhibits financial strength or compensating factors to sufficiently offset any weaknesses based on the loan-to-value ratio, borrower's financial condition, net worth, credit history, earnings capacity, installment obligations and current payment history.

The five largest borrowing relationships, as of March 31, 2010, in descending order were:

Borrower (1)	Aggregate Amount of Loans (2)	Number of Loans
Real estate builder	\$ 47.0 million (3)	143
Real estate builder	39.7 million (4)	144
Real estate builder	28.2 million	119
Real estate builder	19.2 million (5)	71
Real estate investor	17.6 million	3
Total	\$ 151.7 million	480

(1) The composition of borrowers represented in the table

may change from one period to the next.

(2) Net of undisbursed funds.

(3) Of this amount, \$21.9 million are considered impaired loans.

(4) Of this amount, \$21.9 million are considered impaired loans.

(5) Of this amount, \$14.8 million are considered impaired loans.

The following table details the breakdown of the types of loans to our top five largest borrowing relationships at March 31, 2010:

Borrower	Permanent One-to-Four Family Residential Loans (Rental Properties)	Permanent Multifamily Loans (Rental Properties)	Permanent Commercial Loans (Rental Properties)	Construction/ Land Development (1)	Aggregate Amount of Loans (1)
Real estate builder (2)	\$ 18.4 million	\$ -	\$ 0.3 million	\$ 28.3 million	\$ 47.0 million
Real estate builder (3)	26.8 million	-	0.8 million	12.1 million	39.7 million
Real estate builder	18.7 million	1.0 million	0.1 million	8.4 million	28.2 million
Real estate builder (4)	11.0 million	-	-	8.2 million	19.2 million
Real estate investor	-	-	17.6 million	-	17.6 million
Total	\$ 74.9 million	\$ 1.0 million	\$ 18.8 million	\$ 57.0 million	\$ 151.7 million

(1) Net of undisbursed funds.

(2) Of the \$21.9 million loans considered impaired, \$3.2 million are one-to-four family residential loans and \$18.4 million are construction/land development loans and \$0.3 million are commercial loans.

(3) Of the \$21.9 million loans considered impaired, \$10.4 million are one-to-four family residential loans and \$11.5 million are construction/land development loans.

(4) Of the \$14.8 million loans considered impaired, \$6.7 million are one-to-four family residential loans and \$8.1 million are construction/land development loans.

Some of the builders listed in the above tables, as part of their business strategy, retain a certain percentage of their finished homes in their own inventory of permanent investment properties, (i.e. one-to-four family rental properties). These properties are used to enhance the builders' liquidity through rental income and improve their equity position, long-term, through the appreciation in market value of the property. As part of our underwriting process we review the borrowers' business strategy to determine the feasibility of the project. Starting in 2008, these builders have taken more rental properties into their portfolio than originally planned as a result of the depressed housing market. For the four builders included in the table above, the total one-to-four family rental properties decreased \$800,000, or 1.1% to \$74.9 million at March 31, 2010 from \$75.7 million at December 31, 2009.

During the first quarter of 2010, we have classified all of the loans to our two largest merchant builders, excluding nearly all of their rental properties, as nonperforming. Both of these builders are current on all of their loan payments. As a result of the prolonged recession, these builders are beginning to experience cash flow

difficulties. We are currently establishing workout arrangements with these borrowers to reduce the Bank's exposure. These loans are included in the one-to-four family residential, construction/land development and commercial portfolios totaling \$12.9 million, \$29.9 million and \$300,000, respectively, at March 31, 2010.

The following table includes construction/land development loans, net of undisbursed funds, by the five counties that contain our largest loan concentrations at March 31, 2010.

County	Loan Balance (1)	Percent of Loan Balance (1)	Nonperforming Loans	Nonperforming Loans as a Percent of Loan Balance (2)
(Dollars in thousands)				
King	\$ 50,433	41.8 %	\$ 37,137	73.6 %
Pierce	20,155	16.7	9,451	46.9
Kitsap	15,815	13.1	10,366	65.5
Whatcom	11,491	9.5	11,491	100.0
Snohomish	6,767	5.6	4,339(3)	64.1
All other counties	15,974	13.3	10,232	64.1
Total	\$ 120,635	100.0 %	\$ 83,016	68.8 %

(1) Net of undisbursed funds.

(2) Represents the percent of the loan balance by county that is nonperforming.

(3) Represents one loan.

Critical Accounting Policies

Critical accounting policies are those that involve significant judgments and assumptions by management and that have, or could have, a material impact on our income or the carrying value of our assets. The following are our critical accounting policies.

Allowance for Loan Losses. Management recognizes that loan losses may occur over the life of a loan and that the allowance for loan losses 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 allowance for loan losses consists of two components: formula and specific allowances. The formula allowance is determined by applying factors to our various groups of loans. Management considers factors such as charge-off history, the prevailing economy, 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, management's experience level, our loan review and grading system, the value of underlying collateral, the level of problem loans, business conditions and credit concentrations in assessing the allowance for loan losses. The specific allowance component is created when management believes that the collectability of a specific loan, such as a construction/land development, multifamily, business or commercial real estate 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.

Our Board of Directors approves the provision for loan losses on a quarterly basis. 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.

We believe that the accounting estimate related to the allowance for loan losses is a critical accounting estimate because it is highly susceptible to change from period-to-period requiring management to make assumptions about probable losses inherent in the loan portfolio; and the impact of a sudden large loss could deplete the allowance and potentially require increased provisions to replenish the allowance, which would

negatively affect earnings. In addition, various regulatory agencies, as an integral part of their examination process, periodically review a financial institution's ALLL and carrying amounts of other real estate owned. Such agencies may require the financial institution to recognize additions to the allowance based on their judgment and information available to them at the time of their examination. For additional information see the section titled "Our provision for loan losses has increased substantially and we may be required to make further increases in our provision for loan losses and to charge-off additional loans in the future, which could adversely affect our results of operations," within the section titled "Item 1A. Risk Factors".

Valuation of OREO and Foreclosed Assets. Real estate properties acquired through foreclosure or by deed-in-lieu of foreclosure are recorded at the lower of cost or fair value less estimated costs to sell. Fair value is generally determined by management based on a number of factors, including third-party appraisals of fair value in an orderly sale. Accordingly the valuation of OREO is subject to significant external and internal judgment. Any differences between management's assessment of fair value, less estimated costs to sell, and the carrying value of the loan at the date a particular property is transferred into OREO are charged to the allowance for loan losses. Management periodically reviews OREO values to determine whether the property continues to be carried at the lower of its recorded book value or fair value, net of estimated costs to sell. Any further decreases in the value of OREO are considered valuation adjustments and trigger a corresponding charge to noninterest expense in the Consolidated Statement of Operations. Expenses from the maintenance and operations and any gains or losses from the sale of OREO are included in noninterest expense.

Deferred Taxes. Deferred tax assets arise from a variety of sources, the most significant being: a) expenses, such as our charitable contribution to the First Financial Northwest Foundation, that can be carried forward to be utilized against profits in future years; b) expenses recognized in our books but disallowed in our tax return until the associated cash flow occurs; and c) write-downs in the value of assets for book purposes that are not deductible for tax purposes until the asset is sold or deemed worthless.

We record a valuation allowance to reduce our deferred tax assets to the amount which can be recognized in line with the relevant accounting standards. The level of deferred tax asset recognition is influenced by management's assessment of our historic and future profitability profile. At each balance sheet date, existing assessments are reviewed and, if necessary, revised to reflect changed circumstances. In a situation where income is less than projected or recent losses have been incurred, the relevant accounting standards require convincing evidence that there will be sufficient future tax capacity.

Other-Than-Temporary Impairments In the Market Value of Investments. Declines in the fair value of any available for sale or held to maturity investment below their cost that is deemed to be other-than-temporary results in a reduction in the carrying amount of the investment to that of fair value. A charge to earnings and an establishment of a new cost basis for the investment is made. Unrealized investment losses are evaluated at least quarterly to determine whether such declines should be considered other-than-temporary and therefore be subject to immediate loss recognition in income. Although these evaluations involve significant judgment, an unrealized loss in the fair value of a debt security is generally deemed to be temporary when the fair value of the investment security is below the carrying value primarily due to changes in interest rates and there has not been significant deterioration in the financial condition of the issuer. An unrealized loss in the value of an equity security is generally considered temporary when the fair value of the security is below the carrying value primarily due to current market conditions and not deterioration in the financial condition of the issuer. Other factors that may be considered in determining whether a decline in the value of either a debt or an equity security is other-than-temporary include ratings by recognized rating agencies; the extent and duration of an unrealized loss position; actions of commercial banks or other lenders relative to the continued extension of credit facilities to the issuer of the security; the financial condition, capital strength and near-term prospects of the issuer and recommendations of investment advisors or market analysts. Therefore continued deterioration of market conditions could result in additional impairment losses recognized within the investment portfolio.

Comparison of Financial Condition at March 31, 2010 and December 31, 2009

General. Total assets increased \$5.9 million, or 0.5%, to \$1.3 billion at March 31, 2010 from December 31, 2009. This asset growth was a result of the increases of \$10.7 million in cash and interest-bearing deposits and \$12.2 million in investment securities. These increases were offset by a decrease in net loans receivable of \$22.4 million. Total liabilities were \$1.1 billion at March 31, 2010, an increase of \$24.4 million or 2.2% from December 31, 2009. The increase in total liabilities was the result of a \$23.2 million increase in deposits. Stockholders' equity decreased \$18.5 million, primarily due to the net loss for the quarter ended March 31, 2010 of \$17.8 million.

Assets. Total assets increased \$5.9 million or 0.5% at March 31, 2010, as compared to December 31, 2009. The following table details the changes in the composition of our assets.

	Balance at March 31, 2010	Increase/(Decrease) from December 31, 2009 (Dollars in thousands)	Percentage Increase/(Decrease)
Cash on hand and in banks	\$ 8,373	\$ (564)	(6.31)%
Interest-bearing deposits	107,326	11,293	11.76
Investments available for sale	109,593	12,210	12.54
Loans receivable, net	1,016,896	(22,404)	(2.16)
Premises and equipment, net	20,453	868	4.43
Federal Home Loan Bank stock, at cost	7,413	-	-
Accrued interest receivable	4,716		