First Financial Northwest, Inc.
Form 10-K
March 16, 2011

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

FORM 10-K

[X]	ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934	
	For the Fiscal Year Ended December 31, 2010	OR
[ ]	TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934	

Commission File Number: 000-33652

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

Washington (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
Securities registered pursuant to Section 12(b) of the Act:	
Common Stock, $.01 par value per share (Title of Each Class)	The Nasdaq Stock Market LLC (Name of Each Exchange on Which Registered)
Securities registered pursuant to Section 12(g) of the Act:	None

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
YES NO X

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
YES NO X

Indicate by check mark whether the Registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES X NO ___

Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files) YES NO __

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

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

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

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Act).
YES NO X

The aggregate market value of the Common Stock outstanding held by nonaffiliates of the Registrant based on the closing sales price of the Registrant’s Common Stock as quoted on The Nasdaq Stock Market LLC on June 30, 2010 was $72,544,250 (18,319,255) shares at $3.96 per share). For purposes of this calculation, common stock held only by executive officers and directors of the Registrant is considered to be held by affiliates. As of March 5, 2011, the Registrant had outstanding 18,805,168 shares of common stock.

DOCUMENTS INCORPORATED BY REFERENCE

1. Portions of Registrant's Definitive Proxy Statement for the 2011 Annual Meeting of Shareholders (Part III).

FIRST FINANCIAL NORTHWEST, INC.
2010 ANNUAL REPORT ON FORM 10-K
TABLE OF CONTENTS

(Table of Contents continued on following page)

Forward-Looking Statements

Certain matters in this Form 10-K constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements relate to our financial condition, results of operations, plans, objectives, future performance or business. Forward-looking statements are not statements of historical fact, are based on certain assumptions and are generally identified by use of the words “believes,” “expects,” “anticipates,” “estimates,” “forecasts,” “intends,” “plans,” “targets,” “potentially,” “probably,” “projects,” “outlook” or similar expressions or future or co verbs such as “may,” “will,” “should,” “would” and “could.” Forward-looking statements include statements with respect to o beliefs, plans, objectives, goals, expectations, assumptions and statements about, among other things, expectations of the business environment in which we operate, projections of future performance or financial items, perceived opportunities in the market, potential future credit experience, and statements regarding our mission and vision. These forward-looking statements are based upon current management expectations and may, therefore, involve risks and uncertainties. Our actual results, performance, or achievements may differ materially from those suggested, expressed, or implied by forward-looking statements as a result of a wide variety or range of factors including, but not limited to: the credit risks of lending activities, including changes in the level and trend of loan delinquencies and write-offs that may be 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 (“OTS”) and our bank subsidiary by the Federal Deposit Insurance Corporation (“FDIC”), the Washington State Department of Financial Institutions, Division of Banks (“DFI”) or other regulatory authorities, including the possibility that any such regulatory authority may initiate additional enforcement actions against the Company or the Bank to take additional 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, add officers or directors, borrow funds or maintain or increase deposits, which could adversely affect our liquidity and earnings; our compliance with regulatory enforcement actions, including; the requirements and restrictions that have been imposed upon the Company under the memoranda of understanding with the OTS and the consent order the Bank entered into with the FDIC and the DFI and the possibility that the Company and the Bank will be unable to fully comply with these enforcement actions which could result in the imposition of additional requirements or restrictions; our ability to pay dividends on our common stock; our ability to attract and retain deposits; further increases in premiums for deposit insurance; 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 to 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; our ability to retain key members of our senior management team; costs and effects of litigation, including settlements and judgments; increased competitive pressures among financial services companies; changes in consumer spending, borrowing and savings habits; legislative or regulatory changes that adversely affect our business including changes in regulatory policies and principles, including the interpretation of regulatory capital or other rules; the impact of the Dodd-Frank Wall Street Reform and Consumer Protection Act and the implementing regulations; the availability of resources to address changes in laws, rules, or regulations or to respond to regulatory actions; adverse changes in the securities markets; inability of key third-party providers to perform their obligations to us; changes in accounting policies and practices, as may be adopted by the financial institution regulatory agencies or the Financial Accounting Standards Board, including additional guidance and interpretation on accounting issues and details of the implementation of new accounting methods; the economic impact of war or any terrorist activities; other economic, competitive, governmental, regulatory, and technological factors affecting our operations; pricing, products and services; and other risks detailed in our reports filed with the U.S. Securities and Exchange Commission. Any of the forward-looking statements that we make in this Form 10-K and in the other public reports and statements we make may turn out to be wrong because of the inaccurate assumptions we might make, because of the factors illustrated above or because of other factors that we cannot foresee. Because of these and other uncertainties, our actual future results may be materially different from those expressed in any forward-looking statements made by or on our behalf. Therefore, these factors should be considered in evaluating the forward-looking statements, and undue reliance should not be placed on such statements. We undertake no responsibility to update or revise any forward-looking statements.

As used throughout this report, the terms “we”, “our”, or “us” refer to First Financial Northwest, Inc. and our consolidated subsidiaries, including First Savings Bank Northwest.

Internet Website

We maintain a website with the address www.fsbnw.com. The information contained on our website is not included as a part of, or incorporated by reference into, this Annual Report on Form 10-K. Other than an investor's own Internet access charges, we make available free of charge through our website, our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to these reports, on our investor information page. These reports are posted as soon as reasonably practicable after they are electronically filed with the Securities and Exchange Commission (“SEC”). All of our SEC filings are also available free of charge at the SEC's website at www.sec.gov or by calling the SEC at 1-800-SEC-0330.

PART I

Item 1. Business

General

First Financial Northwest, Inc. ("First Financial Northwest"), a Washington corporation, was formed on June 1, 2007 for the purpose of becoming the holding company for First Savings Bank Northwest ("First Savings Bank" or "the Bank") in connection with the conversion from a mutual holding company structure to a stock holding company structure completed on October 9, 2007. At December 31, 2010, we had total assets of $1.2 billion, total deposits of $920.2 million and total stockholders' equity of $174.5 million. First Financial Northwest's business activities generally are limited to passive investment activities and oversight of its investment in First Savings Bank. Accordingly, the information set forth in this report, including consolidated financial statements and related data, relates primarily to First Savings Bank.

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

First Financial Northwest, Inc. is a savings and loan holding company and is subject to retulation by the Office of Thrift Supervision ("OTS"). First Savings Bank is examined and regulated by the Washington State Department of Financial Institutions ("DFI") and by the Federal Deposit Insurance Corporation ("FDIC"). First Savings Bank is required to have certain reserves set by the Board of Governors of the Federal Reserve System and is a member of the Federal Home Loan Bank of Seattle ("FHLB"), which is one of the 12 regional banks in the Federal Home Loan Bank System ("FHLB System").

First Savings Bank is a community-based savings bank primarily serving King and, to a lesser extent, Pierce, Snohomish and Kitsap counties, Washington through our full-service banking office located in Renton, Washington. First Savings Banks 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 current business strategy includes an emphasis on one-to-four family residential, multifamily and commercial real estate lending. Until recently, we had also included construction/land development lending in our business strategy. We have deemphasized this type of lending over the past three years as a result of market conditions. These types of loans represented 6.3% of our loan portfolio at December 31, 2010 from 28.8% at December 31, 2007.

At December 31, 2010, $398.7 million or 44.7% of our total loan portfolio was comprised of one-to-four family loans; commercial real estate loans were $272.7 million or 30.6%; multifamily loans were $144.9 million or 16.2%; construction/land development loans were $56.5 million or 6.3%; and consumer and business loans were $19.1 million and $479,000, or 2.1% and 0.1%, respectively. Included in our construction/land development and one-to-four family residential loan portfolios at December 31, 2010, were $27.7 million and $65.7 million of total loans, respectively, to our five largest borrowing relationships. In addition, $32.9 million, net of undisbursed funds, of the construction/land development portfolio was classified as nonperforming at December 31, 2010.

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

Recent Developments

The Bank entered into a Stipulation to the Issuance of a Consent Order ("Order") with the FDIC and the DFI, which became effective on September 24, 2010. Under the terms of the Order, the Bank cannot declare dividends or repurchase stock without the prior written approval of the FDIC. Other material provisions of the Order require the Bank to:

1

- Maintain and preserve qualified management;
- Increase the Board of Directors' participation in the Bank's affairs;
- Obtain an independent study of management and the personnel structure of the Bank;
- Maintain specified capital levels;
- Eliminate loans classified as "Loss" at its regulatory examination and reduce the loans classified as "Doubtful" and "Substandard" as a percent of capital;
- Revise its policy with respect to the allowance for loan losses;
- Not extend additional credit to borrowers whose loan had been classified as "Loss" and is uncollected;
- Revise its lending and collection policies and practices;
- Develop a plan to reduce the amount of commercial real estate loans;
- Enhance its written funds management and liquidity policy;
- Develop a three-year strategic plan;
- Not solicit brokered deposits and comply with certain deposit rate restrictions;
- Eliminate and correct all violations of laws; and
- Prepare and submit progress reports to the FDIC and DFI.

The Bank has implemented a comprehensive plan to achieve full compliance with the Order. The Order contains target dates to achieve the items listed above including that the Bank's Tier 1 capital ratio and total risk-based capital ratio be at least 10% and 12%, respectively within 30 days of the date of the Order. At December 31, 2010, the Bank's Tier 1 capital ratio was 11.7% and the total risk-based capital ratio was 19.7%, which exceeded the Order requirements. The Order also requires assets classified as substandard as a percentage of Tier 1 capital plus the allowance for loan losses ("ALLL"), at the time of the most recent examination, be below 65% by March 2011. As of December 31, 2010, the Bank has met this requirement and continues to reduce these adversely classified assets. In addition, on April 14, 2010, in connection with our most recent examination by the OTS, the members of the Board of Directors of First Financial Northwest entered into an informal supervisory agreement (a memorandum of understanding, or ("MOU"). Under the terms of the MOU, First Financial Northwest agreed, among other things, to provide notice to and obtain written non-objection from the OTS prior to (a) declaring a dividend or redeeming any capital stock; and (b) incurring, issuing, renewing or repurchasing any new debt. 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. For additional information, see Item 1.A. "Risk Factors- Certain regulatory restrictions were recently imposed on us; lack of compliance could result in monetary penalties and/or additional regulatory actions."

A copy of the Order is attached to the Form 8-K that was filed with the Securities and Exchange Commission ("SEC") on September 27, 2010. The Order will remain in effect until modified or terminated by the FDIC and the DFI. For more information about the Order and its impact on First Financial Northwest and the Bank see "Item 1A. Risk Factors- Certain regulatory restrictions were recently imposed on us; lack of compliance could result in monetary penalties and/or additional regulatory actions."

Market Area

We consider our primary market area to be the Puget Sound Region, which consists primarily of King and, to a lesser extent, Pierce, Snohomish and Kitsap counties. The economies of King, Pierce, Kitsap and Snohomish counties continued to experience economic challenges during 2010. Home prices continued to experience downward pressure caused by increased foreclosure and short sale activity throughout 2010.

King County has the largest population of any county in the state of Washington, covering approximately 2,100 square miles. It has a population of approximately 1.9 million residents according to the U.S. Census Bureau 2009 estimates, and a median family income of approximately $86,000 according to the 2010 U.S. Department of Housing and Urban Development estimates. King County has a diversified economic base with many nationally recognized firms including Boeing, Microsoft, Paccar, Starbucks, Costco and Amazon. According to the Washington State Employment Security Department, the unemployment rate for King County was 8.4% at

December 31, 2010, unchanged from year end 2009 and lower than the national average of 9.1%. Residential housing values depreciated in the King County market by 2.2% during the year ended 2010 with a median home price of $342,000. Residential sales volumes decreased by 1.1% in December 2010 as compared to December 2009 and inventory levels are projected to be 5.3 months according to the Northwest Multiple Listing Service.

Pierce County has the second largest population of any county in the state of Washington, covering approximately 1,800 square miles. It has approximately 797,000 residents according to the U.S. Census Bureau 2009 estimates and a median family income of approximately $70,000 according to the 2010 U.S. Department of Housing and Urban Development estimates. The Pierce County economy is diversified with the presence of military related government employment (Joint base Lewis-McChord), transportation and shipping employment (Port of Tacoma) and aerospace related employment (Boeing). According to the Washington State Employment Security Department the unemployment rate for Pierce County decreased to 9.2% in December 2010 from 9.5% in December 2009. Residential housing values were unchanged from a year earlier in Pierce County with a median home price of $215,000 according to the Northwest Multiple Listing Service. Residential sales volumes decreased by 10.8% in December 2010 as compared to December 2009 and inventory levels are projected to be 7.3 months according to the Northwest Multiple Listing Service.

Snohomish County has the third largest population of any county in the state of Washington, covering approximately 2,090 square miles. It has approximately 695,000 residents according to the U.S. Census Bureau 2009 estimates and a median family income of approximately $86,000 according to the 2010 U.S. Department of Housing and Urban Development estimates. The economy of Snohomish County is diversified with the presence of military related government employment (Everett Homeport Naval Base), aerospace related employment (Boeing) and retail trade. According to the Washington State Employment Security Department, the unemployment rate for Snohomish County decreased to 9.8% in December 2010 from 10.1% in December 2009. Residential housing values depreciated in the Snohomish County market by 12.3% during the year ended December 31, 2010 with a median home price of $246,000. Residential sales volumes decreased by 12.2% in 2010 as compared to 2009, as inventory levels are projected to be 6.6 months according to the Northwest Multiple Listing Service.

Kitsap County has the seventh largest population of any county in the state of Washington, covering approximately 570 square miles. It has approximately 241,000 residents according to the U.S. Census Bureau 2009 estimates and a median family income of approximately $72,000 according to the 2010 U.S. Department of Housing and Urban Development estimates. The Kitsap County economy is diversified with the presence of military related government employment (Naval Base Kitsap, Puget Sound Naval Shipyard), health care, retail and education. According to the Washington State Employment Security Department, the unemployment rate for Kitsap County decreased to 7.3% in December 2010 from 7.4% in December 2009. Residential housing values declined in the Kitsap County housing market by 2.0% in 2010 as compared to 2009 with a median home price of $235,000 according to Northwest Multiple Listing Service. Residential sales volumes decreased by 2.4% in December 2010 as compared to December 2009 and inventory levels are projected to be 6.3 months according to the Northwest Multiple Listing Service.

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

Lending Activities

General. We focus our lending activities primarily on loans secured by first mortgages on one-to-four family residences, commercial and multifamily real estate and to a lesser extent construction/land development lending. Over the past three years we have deemphasized construction/land development lending as a result of market conditions. We offer a limited variety of consumer secured loans, including savings account loans and home equity loans, which include lines of credit and second mortgage loans. As of December 31, 2010, our net loan portfolio totaled $856.5 million and represented 71.8% of our total assets.

Our current loan policy limits the maximum amount of loans we can make to one borrower to 15% of the Bank's risk-based capital. As of December 31, 2010, the maximum amount which we could lend to any one borrower was $22.8 million based on our policy. Exceptions may be made to this policy with the prior approval of the Board of Directors if the borrower exhibits financial strength or compensating factors 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 December 31, 2010 in descending order are:

Borrower (1)	Aggregate Balance of Loans at December 31, 2010 (2)	Number of Loans
Real estate builder	$ 32.5 million(3)	126
Real estate builder	28.4 million	110
Real estate builder	25.4 million(4)	118
Real estate investor	17.7 million	3
Real estate investor	17.1 million	41
Total	$121.1 million	398

(1) The composition of borrowers represented in the table may change between periods.
(2) Net of undisbursed funds.
(3) Of this amount, $31.2 million are considered impaired loans of which $13.5 million are performing and $17.7 million are nonperforming.
(4) Of this amount, $24.6 million are considered impaired loans of which $13.2 million are performing and $11.4 million are nonperforming.

The following table details the breakdown of the types of loans to our top five borrower relationships at December 31, 2010.

Borrower	One-to-Four Family Residential (Rental Properties)	Multifamily	Commercial (Rental Properties)	Construction/Land Development (1)	Aggregate Balance of Loans (1)
Real estate builder (2)	$16.3 million	$ --	$1.7 million	$14.5 million	$32.5 million
Real estate builder	17.9 million	1.0 million	0.1 million	9.4 million	28.4 million
Real estate builder (3)	20.5 million	--	1.1 million	3.8 million	25.4 million
Real estate investor	--	--	17.7 million	--	17.7 million
Real estate investor	11.0 million	5.1 million	1.0 million	--	17.1 million
Total	$65.7 million	$6.1 million	$21.6 million	$27.7 million	$121.1 million

(1) Net of undisbursed funds.

(2) Of the $31.2 million loans considered impaired, $15.0 million are one-to-four family residential loans, $14.5 million are construction/land development loans and $1.7 million are commercial loans.

(3) Of the $24.6 million loans considered impaired, $19.7 million are one-to-four family residential loans, $3.8 million are construction/land development loans and $1.1 million are commercial real estate loans.

Some of the builders listed in the above tables, as part of their previous business strategy, retained a certain percentage of their finished homes in their own inventory of permanent investment properties, (i.e. one-to-four family rental properties). In the past, these properties were used to enhance the builders' liquidity through rental income and improve their long-term equity position through the appreciation in market value of the properties. Due to the continued, prolonged depressed housing market and the challenging local economy, this business strategy was not sustainable for these builders. As a result, we have incurred losses related to these builders and have significantly reduced our exposure to these builders over the past year. We are continuing to work with these builders to further reduce our exposure through a revised workout plan established during 2010. For the three builders included in the previous table, the total one-to-four family rental properties decreased $9.8 million, or 15.2% to $54.7 million at December 31, 2010 from $64.5 million at December 31, 2009.

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

	At December 31,									
	2010		2009		2008		2007		2006	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
	(Dollars in thousands)									
One-to-four family residential: (1)										
Permanent	$393,334	44.08 %	$481,046	43.13 %	$499,562	43.92 %	$410,028	40.97 %	$356,064	46.62 %
Construction	5,356	0.60	15,685	1.41	12,884	1.13	14,835	1.48	17,128	2.24
	398,690	44.68	496,731	44.54	512,446	45.05	424,863	42.45	373,192	48.86
Multifamily:										
Permanent	140,762	15.77	128,943	11.56	99,790	8.77	76,039	7.60	74,540	9.76
Construction	4,114	0.46	17,565	1.58	1,150	0.10	--	--	5,161	0.68
	144,876	16.23	146,508	13.14	100,940	8.87	76,039	7.60	79,701	10.44
Commercial real estate:										
Permanent	237,708	26.64	251,185	22.52	223,360	19.63	182,334	18.22	133,870	17.53
Construction	28,362	3.18	31,605	2.83	28,876	2.54	15,489	1.55	19,342	2.53
Land	6,643	0.75	6,206	0.56	8,491	0.75	6,975	0.69	712	0.09
	272,713	30.57	288,996	25.91	260,727	22.92	204,798	20.46	153,924	20.15
Construction/land development (2):										