First Financial Northwest, Inc.
Form 10-K
March 10, 2017
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, 2016

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

Commission File Number: 001-33652

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

Washington	26-0610707
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
201 Wells Avenue South, Renton, Washington	98057
(Address of principal executive offices)	(Zip Code)

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

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

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

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

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

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

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, 2016, was $154,007,217 (11,596,929 shares at $13.28 per share). For purposes of this calculation, common stock held only by executive officers, the employee stock ownership plan and directors of the Registrant is considered to be held by affiliates. As of March 9, 2017, the Registrant had outstanding 11,035,791 shares of common stock.

DOCUMENTS INCORPORATED BY REFERENCE

1. Portions of Registrant's Definitive Proxy Statement for the 2016 Annual Meeting of Shareholders (Part III).

FIRST FINANCIAL NORTHWEST, INC.
2016 ANNUAL REPORT ON FORM 10-K
TABLE OF CONTENTS

			Page
Forward-Looking Statements			iii
Internet Website			iii
PART I.			
	Item 1.	Business	1
		General	1
		Market Area	1
		Lending Activities	2
		Asset Quality	15
		Investment Activities	21
		Deposit Activities and Other Sources of Funds	25
		Subsidiaries and Other Activities	28
		Competition	28
		Employees	28
		How We Are Regulated	28
		Taxation	37
		Executive Officers of First Financial Northwest, Inc.	37
	Item 1A.	Risk Factors	39
	Item 1B.	Unresolved Staff Comments	48
	Item 2.	Properties	50
	Item 3.	Legal Proceedings	50
	Item 4.	Mine Safety Disclosures	48
PART II.			
	Item 5.	Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities	50
	Item 6.	Selected Financial Data	51
	Item 7.	Management's Discussion and Analysis of Financial Condition and Results of Operations	54
		Overview	54
		Business Strategy	54
		Critical Accounting Policies	56
		Comparison of Financial Condition at December 31, 2016, and December 31, 2015	56
		Comparison of Operating Results for the Years Ended December 31, 2016, and 2015	59
		Comparison of Financial Condition at December 31, 2015, and December 31, 2014	62
		Comparison of Operating Results for the Years Ended December 31, 2015, and 2014	66

	Average Balances, Interest and Average Yields/Costs	69
	Yields Earned and Rates Paid	69
	Rate/Volume Analysis	70
	Asset and Liability Management and Market Risk	71
	Liquidity	73
	Capital	74
	Commitments and Off-Balance Sheet Arrangements	74
	Impact of Inflation	75
	Recent Accounting Pronouncements	76
Item 7A.	Quantitative and Qualitative Disclosures About Market Risk	76
Item 8.	Financial Statements and Supplementary Data	76
Item 9.	Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	127
Item 9A.	Controls and Procedures	127
Item 9B.	Other Information	128

PART III.

Item 10.	Directors, Executive Officers and Corporate Governance	128
Item 11.	Executive Compensation	128
Item 12.	Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	128
Item 13.	Certain Relationships and Related Transactions and Director Independence	129
Item 14.	Principal Accounting Fees and Services	129

PART IV.

Item 15.	Exhibits and Financial Statement Schedules	130
Item 16.	Form 10-K Summary	130
	Signatures	131

Forward-Looking Statements

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

because of the inaccurate assumptions we might make, because of the factors illustrated above or because of other factors that we cannot foresee. Because of these and other uncertainties, our actual future results may be materially different from those expressed in any forward looking statements made by or on our behalf. Therefore, these factors should be considered in evaluating the forward looking statements, and undue reliance should not be placed on such statements. We undertake no responsibility to update or revise any forward-looking statements.
As used throughout this report, the terms “Company”, “we”, “our”, or “us” refer to First Financial Northwest, Inc. and its consolidated subsidiaries, including First Financial Northwest Bank and First Financial Diversified Corporation.

Internet Website

The information contained on our website, www.ffnwb.com, 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 relations page. These reports are posted as soon as reasonably practicable after they are electronically filed with the SEC. All of our SEC filings are also available free of charge at the SEC’s website at www.sec.gov or by calling the SEC at 1-800-SEC-0330.

PART I

Item 1. Business

General

First Financial Northwest, Inc. (“First Financial Northwest” or the “Company”), a Washington corporation, was formed on June 1, 2007, for the purpose of becoming the holding company for First Financial Northwest Bank (“the Bank”) in connection with the Bank’s conversion from a mutual holding company structure to a stock holding company structure which was completed on October 9, 2007. At December 31, 2016, we had total assets of $1.0 billion, net loans of $815.0 million, deposits of $717.5 million and stockholders’ equity of $138.1 million. First Financial Northwest’s business activities generally are limited to passive investment activities and oversight of its investment in First Financial Northwest Bank. Accordingly, the information set forth in this report, including consolidated financial statements and related data, relates primarily to First Financial Northwest Bank.

The 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 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 the wholly-owned subsidiary of First Financial of Renton, Inc. In connection with the 2002 conversion, First Savings Bank changed its name to First Savings Bank Northwest. Subsequently, in August 2015, the Bank changed its name to First Financial Northwest Bank to better reflect the commercial banking services it provides beyond those typically provided by a traditional savings bank. In February 2016, the Bank officially changed its charter from a Washington chartered stock savings bank to a Washington chartered commercial bank.

First Financial Northwest became a bank holding company, after converting from a savings and loan holding company on March 31, 2015, and is subject to regulation by the Board of Governors of the Federal Reserve System (the “Federal Reserve Board”) through the FRB. The change was consistent with First Financial Northwest Bank’s shift in focus from a traditional savings and loan association towards a full service, commercial bank. Additionally, First Financial Northwest Bank is examined and regulated by the DFI and by the FDIC. First Financial Northwest Bank is required to maintain reserves at a level set by the Federal Reserve Board. The Bank is a member of the Federal Home Loan Bank (“FHLB”) of Des Moines, which is one of the 11 regional banks in the Federal Home Loan Bank System (“FHLB System”). For additional information, see “How We are Regulated - Regulation and Supervision of First Financial Northwest Bank - Federal Home Loan Bank System.”

In February 2016, First Financial Northwest Bank converted its charter from a community-based savings bank to a commercial bank as a way of better serving its customer needs. The Bank’s largest concentration of customers is in King County, with additional concentrations in Snohomish, Pierce, and Kitsap counties, Washington. The Bank is headquartered in Renton, Washington where it has a full-service branch as well as a smaller branch located in a commercial development known as the “Landing”. Two additional, smaller branches are located in Mill Creek and Edmonds, both in Snohomish County, Washington. These smaller branches are focused on efficiency through the extensive use of the latest banking technology. First Financial Northwest Bank’s business consists of attracting deposits from the public and utilizing these funds to originate one-to-four family residential, multifamily, commercial real estate, construction/land, business and consumer loans.

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

Market Area

We consider our primary market area to be the Puget Sound Region that consists primarily of King and Snohomish counties, to a lesser extent, Pierce and Kitsap counties. During 2016, the region experienced appreciation in residential market prices for the fifth consecutive year and a declining supply of homes for sale as a result of strong demand.

King County has the largest population of any county in the state of Washington and covers approximately 2,100 square miles. It has a population of approximately 2.1 million residents and a median household income of approximately $75,000, according to U.S. Census estimates. King County has a diversified economic base with many nationally recognized firms including Boeing, Microsoft, Amazon, Starbucks, Nordstrom, Costco and Paccar. According to the Washington State Employment Security Department, the unemployment rate for King County was 3.4% at December 31, 2016, compared to 4.5% at December 31, 2015, and the national average of 4.7% at December 31, 2016. According to the Northwest Multiple Listing Service (“MLS”), the median sales price of a residential home in King County for 2016 was $548,000, an increase of 14.2% from 2015. Residential sales volumes increased 1.7% in 2016 compared to 2015 and inventory levels as of December 31, 2016 were at 0.7 months according to the MLS.

Snohomish County has the third largest population of any county in the state of Washington and covers approximately 2,090 square miles. It has approximately 773,000 residents and a median household income of approximately $71,000, according to U.S. Census estimates. The economy of Snohomish County is diversified with the presence of military-related government employment (Naval Station Everett), aerospace-related employment (Boeing), and retail trade. According to the Washington State Employment Security Department, the unemployment rate for Snohomish County was 3.9% in December 2016 compared to 5.0% in December 2015. The median sales price of a residential home in Snohomish County was $390,000 during 2016, a 9.9% increase compared to 2015, according to the MLS. Residential sales volumes increased by 9.8% in 2016 compared to 2015 and inventory levels as of December 31, 2016 were at 0.9 months according to the MLS.

Pierce County, covering approximately 1,800 square miles, has the second largest population of any county in the state of Washington. It has approximately 844,000 residents and a median household income of approximately $60,000, according to U.S. Census estimates. The Pierce County economy is diversified with the presence of military-related government employment (Joint Base Lewis-McChord), transportation and shipping employment (Port of Tacoma), and aerospace-related employment (Boeing). According to the Washington State Employment Security Department, the unemployment rate for Pierce County was 6.0% in December 2016, compared to 6.1% at year-end 2015. The median sales price of a residential home in Pierce County was $275,000 during 2016, a 10.0% increase compared to 2015, according to the MLS. Residential sales volumes increased by 12.7% in 2016 compared to 2015 and inventory levels as of December 31, 2016 were at 1.3 months according to the MLS.

Kitsap County has the seventh largest population of any county in the state of Washington and covers approximately 570 square miles. It has approximately 260,000 residents and a median household income of approximately $63,000, according to U.S. Census estimates. The Kitsap County economy is diversified with the presence of military-related government employment (Naval Base Kitsap, Puget Sound Naval Shipyard), health care, retail trade and education. According to the Washington State Employment Security Department, the unemployment rate for Kitsap County was 5.5% in December 2016, unchanged from December of 2015. The median sales price of a residential home in Kitsap County was $284,000 during 2016, a 9.3% increase compared to 2015, according to the MLS. Residential sales volumes increased by 11.7% in 2016 compared to 2015 and inventory levels as of December 31, 2016 were at 1.4 months according to the MLS.

For a discussion regarding competition in our primary market area, see "- Competition" later in Item 1 of this report.

Lending Activities

General. We focus our lending activities primarily on loans secured by commercial real estate, construction/land, first mortgages on one-to-four family residences, multifamily, and to lesser extent, business lending. We offer a limited variety of secured consumer loans, including savings account loans and home equity loans that include lines of credit and second mortgage term loans. As of December 31, 2016, our net loan portfolio totaled $815.0 million and represented 78.6% of our total assets.

Our current loan policy generally limits the maximum amount of loans we can make to one borrower to 15% of the Bank's total risk-based capital, which was $19.5 million at December 31, 2016. Exceptions to this policy are allowed only with the prior approval of the Board of Directors and if the borrower exhibits financial strength or sufficient, measurable compensating factors exist after consideration of the loan-to-value ratio, borrower's financial condition, net worth, credit history, earnings capacity, installment obligations, and current payment history. The regulatory limit of loans we can make to one borrower is 20% of total risk-based capital, or $26.0 million, at December 31, 2016.

During 2016, the concentration of loans to our five largest lending relationships increased. At December 31, 2016, loans to our five largest lending relationships totaled $79.5 million compared to $76.1 million at December 31, 2015,

an increase of $3.4 million, or 4.5%. Although the total of these relationships increased during 2016, their percentage of total loans, net of loans in process ("LIP") decreased to 9.6% at December 31, 2016 from 10.9% at December 31, 2015 and the total number of loans comprising these relationships decreased to 23 from 70 during 2016. The following table details the types of loans to our five largest lending relationships at December 31, 2016.

Borrower [1]	Number of Loans	One-to-Four Family Residential	Multifamily	Commercial Real Estate (Rental Properties)	Construction/Land	Aggregate Balance of Loans [2]
	(Dollars in thousands)					
Real estate investor	12	$ —	$ 17,591	$ 839	$ —	$ 18,430
Real estate investor	3	482	—	15,082	—	15,564
Real estate investor	3	—	—	8,820	6,369	15,189
Real estate investor	2	467	—	14,704	—	15,171
Real estate investor	3	—	8,752	—	6,372	15,124
Total	23	$ 949	$ 26,343	$ 39,445	$ 12,741	$ 79,478

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

The composition of loans to our five largest borrowers has changed over the last year. As of December 31, 2016, total one-to-four family properties and commercial real estate loans to this group of borrowers decreased, as compared to December 31, 2015, by $12.6 million and $20.5 million, respectively, while total multifamily loans and construction loans increased by $24.3 million and $12.3 million, respectively. At December 31, 2016, all of the loans listed in the table above were in compliance with the original repayment terms of their respective loans.

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

	December 31,									
	2016		2015		2014		2013		2012	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
	(Dollars in thousands)									
One-to-four family residential:										
Permanent owner occupied	$137,834	15.3 %	$147,229	19.6 %	$161,013	22.9 %	$158,797	23.0 %	$167,019	24.8 %
Permanent non-owner occupied	111,601	12.4	106,543	14.2	112,180	15.9	121,877	17.7	139,832	20.7
	249,435	27.7	253,772	33.8	273,193	38.8	280,674	40.7	306,851	45.5
Multifamily real estate	123,250	13.7	122,747	16.3	116,014	16.5	106,152	15.4	105,936	15.7
Commercial real estate	303,694	33.7	244,211	32.5	239,211	34.0	227,016	33.0	207,436	30.8
Construction/land: [1]										
One-to-four family residential	67,842	7.5	52,233	7.0	20,360	2.9	3,977	0.6	785	0.1
Multifamily	111,051	12.4	46,666	6.2	22,352	3.1	24,851	3.5	13,960	2.1
Commercial real estate	—	—	—	—	10,400	1.5	26,631	3.9	12,500	1.9
Land	30,055	3.3	17,058	2.3	11,949	1.7	9,292	1.4	12,377	1.8
	208,948	23.2	115,957	15.5	65,061	9.2	64,751	9.4	39,622	5.9
Business	7,938	0.9	7,604	1.0	3,783	0.5	1,142	0.2	2,968	0.4
Consumer	6,922	0.8	6,979	0.9	7,130	1.0	9,201	1.3	11,110	1.7
Total loans	900,187	100.0%	751,270	100.0%	704,392	100.0%	688,936	100.0%	673,923	100.0%
Less:										
Loans in process (“LIP”)	72,026		53,854		27,359		10,209		8,856	
Deferred loan fees, net	2,167		2,881		2,604		2,580		2,057	
Allowance for loan and lease losses (“ALLL”)	10,951		9,463		10,491		12,994		12,542	
Loans receivable, net	$815,043		$685,072		$663,938		$663,153		$650,468	

(footnote on the following page)

4

---

(1) We previously excluded from the construction/land category "rollover" loans, which are loans that will convert upon completion of the construction period to permanent loans. These loans were classified according to the underlying collateral categories instead of being included in the construction/land category. In addition, we previously classified raw land or buildable lots where the Company does not intend to finance the construction as commercial real estate land loans and have now included these loans in the construction/land category. At December 31, 2016, we reclassified $62.9 million of multifamily loans and $26.9 million of commercial real estate loans, and $2.6 million of one-to-four family residential loans as construction/land loans to facilitate the review of the composition of our loan portfolio. Prior periods have been reclassified consistent with this change in presentation.

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

	December 31,									
	2016		2015		2014		2013		2012	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
FIXED-RATE LOANS	(Dollars in thousands)									
Real estate:										
One-to-four family residential	$169,523	18.8 %	$172,951	23.0 %	$189,399	26.9 %	$224,820	32.6 %	$263,503	39.1 %
Multifamily	72,593	8.1	82,767	11.0	82,639	11.7	82,310	11.9	94,327	14.0
Commercial real estate	211,054	23.4	199,101	26.5	206,395	29.3	197,624	28.7	192,029	28.5
Construction/land	50,431	5.6	12,158	1.6	5,469	0.8	860	0.1	5,409	0.8
Total real estate	503,601	55.9	466,977	62.1	483,902	68.7	505,614	73.3	555,268	82.4
Business	640	0.1	243	—	375	0.1	282	0.1	943	0.1
Consumer	432	0.1	558	0.1	689	0.1	855	0.1	1,084	0.2
Total fixed-rate loans	504,673	56.1	467,778	62.2	484,966	68.9	506,751	73.5	557,295	82.7
ADJUSTABLE-RATE LOANS										
Real estate:										
One-to-four family residential	79,912	8.9	80,821	10.8	83,794	11.9	55,854	8.1	43,347	6.4
Multifamily	50,657	5.6	39,980	5.3	33,375	4.7	23,842	3.5	11,609	1.7
Commercial real estate	92,640	10.3	45,110	6.0	32,816	4.6	29,392	4.3	15,406	2.3
Construction/land	158,517	17.6	103,799	13.8	59,592	8.5	63,891	9.3	34,215	5.1
Total real estate	381,726	42.4	269,710	35.9	209,577	29.7	172,979	25.2	104,577	15.5
Business	7,298	0.8	7,361	1.0	3,408	0.5	860	0.1	2,025	0.3
Consumer	6,490	0.7	6,421	0.9	6,441	0.9	8,346	1.2	10,026	1.5
Total adjustable-rate loans	395,514	43.9	283,492	37.8	219,426	31.1	182,185	26.5	116,628	17.3
Total loans	900,187	100.0%	751,270	100.0%	704,392	100.0%	688,936	100.0%	673,923	100.0%
Less:										
LIP	72,026		53,854		27,359		10,209		8,856	
Deferred loan fees, net	2,167		2,881		2,604		2,580		2,057	
ALLL	10,951		9,463		10,491		12,994		12,542	
Loans receivable, net	$815,043		$685,072		$663,938		$663,153		$650,468	

Geographic Distribution of our Loans. The following table shows at December 31, 2016 the geographic distribution of our loan portfolio in dollar amounts and percentages.

	Puget Sound Region [1]		Other Washington		Total in Washington State		All Other States [2]		Total	
	Amount	% of Total in Category	Amount	% of Total in Category	Amount	% of Total in Category	Amount	% of Total in Category	Amount	% of Total in Category
Real estate:	(Dollars in thousands)									
One-to-four family residential	$236,880	95.0 %	$12,434	5.0 %	$249,314	100.0 %	$121	— %	$249,435	100.0 %
Multifamily	95,060	77.1	16,591	13.5	111,651	90.6	11,599	9.4	123,250	100.0 %
Commercial	221,576	73.0	50,999	16.8	272,575	89.8	31,119	10.2	303,694	100.0 %
Construction/land	134,627	98.3	2,295	1.7	136,922	100.0	—	—	136,922	100.0 %
Total real estate	688,143	84.6	82,319	10.1	770,462	94.7	42,839	5.3	813,301	100.0 %
Business	7,572	95.4	—	—	7,572	95.4	366	4.6	7,938	100.0 %
Consumer	6,922	100.0	—	—	6,922	100.0	—	—	6,922	100.0 %
Total Loans	702,637	84.8 %	82,319	9.9 %	784,956	94.8 %	43,205	5.2 %	828,161	100.0 %

____

[1] Includes King, Snohomish, Pierce and Kitsap counties.

[2] Includes loans located in the states of Arizona, California, Colorado, Indiana, Oregon and Utah.

One-to-Four Family Residential Lending. As of December 31, 2016, $249.4 million, or 27.7% of our total loan portfolio consisted of loans secured by one-to-four family residences.

First Financial Northwest Bank is a traditional portfolio lender when it comes to financing residential home loans. In 2016, we originated and purchased $66.6 million in one-to-four family residential loans. At December 31, 2016, $137.8 million, or 55.3% of our one-to-four family residential portfolio consisted of owner occupied loans with the remaining $111.6 million, or 44.7% consisting of non-owner occupied loans. In addition, at December 31, 2016, $169.5 million, or 68.0% of our one-to-four family residential loan portfolio consisted of fixed-rate loans. Substantially all of our one-to-four family residential loans require monthly principal and interest payments.

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

Our lending policy generally limits the maximum loan-to-value ratio on mortgage loans secured by one-to-four family residential properties to 85% of the lesser of the appraised value or the purchase price. Properties securing our one-to-four family residential loans are appraised by independent appraisers approved by us. We require the borrowers to obtain title insurance and if necessary, flood insurance. We generally do not require earthquake insurance because of competitive market factors.

Loans secured by rental properties represent higher risk and, as a result, we adhere to more stringent underwriting guidelines. Of primary concern in non-owner occupied real estate lending is the consistency of rental income of the property. Payments on loans secured by rental properties depend primarily on the tenants' continuing ability to pay rent to the property owner, the character of the borrower or, if the property owner is unable to find a tenant, the property owner's ability to repay the loan without the benefit of a rental income stream. In addition, successful operation and management of non-owner occupied properties, including property maintenance standards, may affect repayment. As a result, repayment of such loans may be subject to adverse conditions in the real estate market or the economy. We request that borrowers and loan guarantors, if any, provide annual financial statements, a budget factoring in a rental income cash flow analysis of the borrower as well as the net operating income of the property, information concerning the borrower's expertise, credit history and profitability, and the value of the underlying property. These loans are generally secured by a first mortgage on the underlying collateral property along with an assignment of rents and leases. If the borrower has multiple rental property loans with us, the loans are typically not cross collateralized. At December 31, 2016, $798,000 of one-to-four family residential loans were in nonaccrual status, however, all of our one-to-four family non-owner occupied loans were performing.

Multifamily and Commercial Real Estate Lending. As of December 31, 2016, $123.3 million, or 13.7% of our total loan portfolio was secured by multifamily and $303.7 million, or 33.7% of our loan portfolio was secured by commercial real estate properties. Our commercial real estate loans are typically secured by office and medical buildings, retail shopping centers, mini-storage facilities, industrial use buildings and warehouses. Commercial real estate and multifamily loans are subject to similar underwriting standards and processes. These loans are viewed primarily as cash flow loans and secondarily as loans secured by real estate.

Typically, multifamily and commercial real estate loans have higher balances, are more complex to evaluate and monitor, and involve a greater degree of risk than one-to-four-family residential loans. In an attempt to compensate for

and mitigate this risk, these loans are generally priced at higher interest rates than one-to-four family residential loans and generally have a maximum loan-to-value ratio of 80% of the lesser of the appraised value or purchase price. We generally require loan guarantees by any parties with a property ownership interest of 20% or more. If the borrower is a corporation or partnership, we generally require personal guarantees from the principals based upon a review of their personal financial statements and individual credit reports.

The following table presents a breakdown of our multifamily and commercial real estate loan portfolio at December 31, 2016, and 2015:

	December 31, 2016		December 31, 2015	
	Amount	% of Total in Portfolio	Amount	% of Total in Portfolio
	(Dollars in thousands)			
Multifamily real estate:				
Micro-unit apartments	$7,878	6.4 %	$18,339	14.9 %
Other multifamily	115,372	93.6	104,408	85.1
Total multifamily	$123,250	100.0 %	$122,747	100.0 %
Commercial real estate:				
Office	$101,688	33.5 %	$78,297	32.1 %
Retail	106,294	35.0	76,813	31.4
Storage	34,816	11.5	40,238	16.5
Mobile home park	20,689	6.8	23,630	9.7
Warehouse	15,338	5.0	17,845	7.3
Other non-residential	24,869	8.2	7,388	3.0
Total non-residential	$303,694	100.0 %	$244,211	100.0 %

The average loan size in our multifamily and commercial real estate loan portfolios was $770,000 and $1.9 million, respectively, as of December 31, 2016. At this date, $28.2 million, or 22.9%, of our multifamily loans and $82.1 million, or 27.0%, of our commercial real estate loans were from outside of our primary market area. We currently target individual, multifamily, and commercial real estate loans between $1.0 million and $5.0 million. The largest multifamily loan as of December 31, 2016 was a 161-unit apartment complex with a net outstanding principal balance of $7.8 million located in Franklin County, Washington. As of December 31, 2016, the largest commercial real estate loan had a net outstanding balance of $12.5 million and was secured by a self-storage facility located in King County, Washington. Both of these loans were performing according to their respective loan repayment terms as of December 31, 2016.

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

If we foreclose on a multifamily or commercial real estate loan, our holding period for the collateral typically is longer than for one-to-four family residential mortgage loan foreclosures because there are fewer potential purchasers of the collateral. Our multifamily and commercial real estate loans generally have relatively large balances to single borrowers or related groups of borrowers. Accordingly, if we make any errors in judgment in the collectability of our multifamily or commercial real estate loans, any resulting charge-offs may be larger on a per loan basis than those incurred in our one-to-four family residential or consumer loan portfolios. At December 31, 2016, there were no multifamily or commercial real estate loans past due 90 days or more or in nonaccrual status. There were no commercial real estate loans charged-off during both of the years ended December 31, 2016 and 2015, as compared to charge-offs of $311,000 for the year ended December 31, 2014. For multifamily loans, there were no charge-offs

during 2016, as compared to $281,000 charged off in 2015 and no charge-offs in 2014.

Construction/Land Loans. We originate construction/land loans primarily to residential builders for the construction of single-family residences, condominiums, townhouses, multifamily properties and residential developments located in our market area. Land loans include land non-development loans for the purchase or refinance of unimproved land held for future residential development, improved residential lots held for speculative investment purposes or lines of credit secured by land, and land development loans. Construction/land loans to builders generally require the borrower to have an existing relationship with us and a proven record of successful projects. At December 31, 2016, our total construction/land loans were $208.9 million, or 23.2%

of our total loan portfolio. The $93.0 million or 80.2% increase in construction/land loans over the past year reflects our strategic decision to continue our focus on increasing construction loan origination activity in 2016 as real estate values and general economic conditions in our market areas continued to improve. The lending policy sets forth the guideline that the net balance of our acquisition, development, and construction loans not exceed 100% of risk-based capital. Management intends to maintain levels near this guideline. At December 31, 2016, net loans in this category totaled $136.9 million while total risk-based capital was $130.1 million. There were no construction/land loans classified as nonaccrual at either December 31, 2016 or 2015. There were no construction/land loan charge-offs during the years ended December 31, 2016 and 2015, as compared to $223,000 for the year ended December 31, 2014.

Following is the composition of our total construction/land loan portfolio at the dates indicated. All of the loans represented were performing:

	December 31,	
	2016	2015
	(In thousands)	
Construction speculative:		
One-to-four family residential	$65,272	$51,613
Multifamily	10,157	12,403
Total construction speculative	75,429	64,016
Construction permanent: [1]		
One-to-four family residential	2,570	620
Multifamily	100,894	34,263
Total construction permanent	103,464	34,883
Land:		
Land development	3,134	8,768
Land non-development	26,921	8,290
Total land	30,055	17,058
Total construction/land loans [2]	$208,948	$115,957

(1) Includes loans where the builder does not intend to sell the property after the construction phase is completed.
(2) LIP for construction/land loans at December 31, 2016, and 2015, was $72.0 million and $53.9 million, respectively.

The following table includes construction/land loans by county, net of LIP, at December 31, 2016:

County	Loan Balance	Percent of Construction/Land Loan Balance	
	(Dollars in thousands)		
King	$120,389	88.0	%
Snohomish	12,828	9.4	
Pierce	1,293	0.9	
Kitsap	118	0.1	
Whatcom	2,268	1.6	
All other	26	—	
Total	$136,922	100.0	%

Loans to finance the construction of single-family homes and subdivisions and land loans are generally offered to builders in our primary market areas. Loans that are termed “speculative” are those where the builder does not have, at the time of loan origination, a signed contract with a buyer for the home or lot who has a commitment for permanent financing with either us or another lender. The buyer may be identified either during or after the construction period, with the risk that the builder may have to fund the debt service on the speculative loan along with real estate taxes and

other carrying costs for the project for a significant period of time after completion of the project until a buyer is identified. The maximum loan-to-value ratio applicable to these loans is generally 100% of the actual cost of construction, provided that the loan-to-completed value does not exceed 80%, with approval required from the Chief Credit Officer ("CCO") for loan-to-value ratios over 80%. In addition, a minimum of 20%

verified equity is generally also required. Verified equity refers to cash equity invested in the project. Development plans are required from builders prior to committing to the loan. We require that builders maintain adequate title insurance and other appropriate insurance coverage, and, if applicable, appropriate environmental data report(s) that the land is free of hazardous or toxic waste. While maturity dates for residential construction loans are largely a function of the estimated construction period of the project and typically do not exceed one year, land loans generally are for 12 to 18 months. Substantially all of our residential construction loans have adjustable-rates of interest based on The Wall Street Journal prime rate. During the term of construction, the accumulated interest on the loan is either added to the principal of the loan through an interest reserve or billed monthly. At December 31, 2016, the LIP balance on construction/land loans was $72.0 million, including $5.0 million set aside for interest reserves. When these loans exhaust their original reserves set up at origination, no additional reserves are permitted unless the loan is re-analyzed and it is determined that the additional reserves are appropriate, based on the updated analysis. Construction loan proceeds are disbursed periodically as construction progresses and as inspections by our approved inspectors warrant. At December 31, 2016, our three largest construction/land loans, net of LIP, consisted of an $11.0 million line of credit, secured by land, for development activities in King County, a $7.9 million bridge loan on 11 lots to be developed in King County, and a $7.1 million loan for the purchase and rehabilitation of a multifamily apartment complex in Snohomish County.

Our residential construction loans to individuals to build their personal or non-owner occupied residences typically are structured to be converted to fixed-rate permanent loans at the end of the construction phase with one closing for both the construction loan and the permanent financing. Prior to making a commitment to fund a construction loan, we require an appraisal of the post construction value of the project by an independent appraiser. During the construction phase, which typically lasts 12 to 18 months, an approved inspector or designated Bank employee makes periodic inspections of the construction site to certify construction has reached the stated percentage of completion. Typically, disbursements are made in monthly draws and interest-only payments are required. These loans are converted to fixed-rate permanent loans at the end of the construction phase. At December 31, 2016, there was one non-owner occupied construction loan of $2.6 million that will convert to a permanent non-owner occupied one to four family loan in 2018.

We also make construction loans for commercial development projects. The projects include multifamily, retail, office/warehouse and office buildings. These loans typically have an interest-only payment phase during construction and generally convert to permanent financing when construction is complete. Disbursement of funds is at our sole discretion and is based on the progress of construction. The Bank uses an independent third party or Bank employee to conduct monthly inspections to certify that construction has reached the stated percentage of completion and that previous disbursements are reflected in the degree of work performed to date. Generally, the maximum loan-to-value ratio applicable to these loans is 90% of the actual cost of construction or 80% of the prospective value at completion. At December 31, 2016, $62.9 million of our multifamily construction loans will rollover to permanent loans with the Bank at the end of their construction period. The remaining $38.0 million of construction permanent loans represents loans which we anticipate that the builder will either refinance with us or with another lender. At December 31, 2016, we had $10.2 million of speculative multifamily loans where the builder intends to sell the property after the construction phase is completed.

Land development loans are generally made to builders for preparation of a building site and does not include the construction of buildings on the property. The maximum loan-to-value ratio for these loans is 75%. Land non-development loans are generally for raw land where we do not finance the cost of preparing the site for building and are subject to a maximum loan to value ratio of 65%.

Our construction/land loans are based upon estimates of costs in relation to values associated with the completed project. Construction/land lending involves additional risks when compared with permanent residential lending because funds are advanced upon the collateral for the project based on an estimate of costs that will produce a future value at completion. Because of the uncertainties inherent in estimating construction costs, as well as the market value

of the completed project and the effects of governmental regulation on real property, it is relatively difficult to evaluate accurately the total funds required to complete a project and the completed project loan-to-value ratio. Changes in the demand, such as for new housing and higher than anticipated building costs may cause actual results to vary significantly from those estimated. For these reasons, this type of lending also typically involves higher loan principal amounts and is often concentrated with a small number of builders. These loans often involve the disbursement of funds with repayment substantially dependent on the success of the ultimate project and the ability of the borrower to sell or lease the property or obtain permanent take-out financing, rather than the ability of the borrower or guarantor to repay principal and interest. If our appraisal of the value of a completed project proves to be overstated, we may have inadequate security for the repayment of the loan upon completion of construction of the project and may incur a loss. Because construction loans require active monitoring of the building process, including cost comparisons and on-site inspections, these loans are more difficult and costly to monitor. Increases in market rates of interest may have a more pronounced effect on construction loans by rapidly increasing the end-purchasers' borrowing costs, thereby reducing the overall demand for the project. Properties under construction are often difficult to sell and typically must be completed in order to be successfully sold which also complicates the process of working out problem construction loans. This may require us to advance additional funds and/or contract

with another builder to complete construction. Furthermore, in the case of speculative construction loans, there is the added risk associated with identifying an end-purchaser for the finished project. Land loans also pose additional risk because of the lack of income being produced by the property and the potential illiquid nature of the collateral. These risks can also be significantly influenced by supply and demand conditions.

Business Lending. Business loans totaled $7.9 million, or 0.9% of the loan portfolio at December 31, 2016. Business loans are generally secured by business equipment, accounts receivable, inventory or other property. Loan terms typically vary from one to five years. The interest rates on such loans are either fixed-rate or adjustable-rate. The interest rates for the adjustable rate loans are indexed to the prime rate published in The Wall Street Journal plus a margin. Our business lending policy includes credit file documentation and requires analysis of the borrower's background, capacity to repay the loan, the adequacy of the borrower's capital and collateral, as well as an evaluation of other conditions affecting the borrower. Analysis of the borrower's past, present and future cash flows is also an important aspect of our credit analysis. We generally obtain personal guarantees on our business loans. The largest business loan had an outstanding balance of $7.1 million at December 31, 2016 and was performing according to its repayment terms. At December 31, 2016, we did not have any business loans delinquent in excess of 90 days or in nonaccrual status.

Beginning in 2016, we began a new line of business to originate aircraft loans directly and indirectly through the Aircraft Owners and Pilots Association Aviation Finance Company. We intend to significantly grow this portfolio over the next several years. These loans are to be collateralized by new or used, single-engine piston aircraft to light jets for business or personal use. We anticipate that our aircraft loans will initially range in size from $250,000 to $3.0 million with the primary focus of our underwriting guidelines on the asset value of the collateral rather than the ability of the borrower to repay the loan. At December 31, 2016, the Bank had an outstanding balance of $366,000 in aircraft loans.

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

Consumer Lending. We offer a limited variety of consumer loans to our customers, consisting primarily of home equity loans and savings account loans. Generally, consumer loans have shorter terms to maturity and higher interest rates than one to four family residential loans. Consumer loans are offered with both fixed and adjustable interest rates and with varying terms. At December 31, 2016, consumer loans were $6.9 million, or 0.8% of the total loan portfolio.

At December 31, 2016, the largest component of the consumer loan portfolio consisted of home equity loans, primarily home equity lines of credit that totaled $5.4 million, or 78% of the total consumer loan portfolio. The home equity lines of credit include $3.6 million of equity lines of credit in first lien position and $1.8 million of second liens on residential properties. At December 31, 2016, unfunded commitments on our home equity lines of credit totaled $6.6 million. Home equity loans are made for purposes such as the improvement of residential properties, debt consolidation and education expenses. At origination, the loan-to-value ratio is generally 90% or less, when taking into account both the balance of the home equity loans and the first mortgage loan. Home equity loans are originated on a fixed-rate or adjustable-rate basis. The interest rate for the adjustable-rate second lien loans is indexed to the prime rate published in The Wall Street Journal and may include a margin. Home equity loans generally have a ten year term and either convert to principal and interest payments with no further draws or require a balloon payment due at maturity.

Consumer loans entail greater risk than one-to-four family residential mortgage loans, particularly in the case of consumer loans that are unsecured or secured by rapidly depreciating assets. In these cases, any repossessed collateral for a defaulted consumer loan may not provide an adequate source of repayment of the outstanding loan balance as a result of the greater likelihood of damage, loss or depreciation. The remaining deficiency often does not warrant further collection efforts against the borrower beyond obtaining a deficiency judgment. In addition, consumer loan collections are dependent on the borrower's continuing financial stability, and are more likely to be adversely affected by job loss, divorce, illness or personal bankruptcy. Furthermore, the application of various federal and state laws, including federal and state bankruptcy and insolvency laws, may limit the amount that can be recovered on these loans. Home equity lines of credit have greater credit risk than one-to-four family residential mortgage loans because they are generally secured by mortgages subordinated to the existing first mortgage on the property that we may or may not hold in our portfolio. We do not have private mortgage insurance coverage on these loans. Adjustable-rate loans may experience a higher rate of default in a rising interest rate environment due to the increase in payment amounts when

interest rates reset higher. If current economic conditions deteriorate for our borrowers and their home prices fall, we may also experience higher credit losses from this loan portfolio. Since our home equity loans primarily consist of second lien loans, it is unlikely that we will be successful in recovering our entire loan principal outstanding in the event of a default. At December 31, 2016, consumer loans totaling $60,000 were in nonaccrual status, however, no consumer loans were delinquent more than 30 days. Consumer loan charge-offs totaled $83,000 during the year ended December 31, 2016 compared with charge offs of $54,000 and $30,000 during the years ended December 31, 2015 and 2014.

Loan Maturity and Repricing. The following table sets forth certain information at December 31, 2016 regarding the amount of loans in our portfolio based on their contractual terms to maturity, not including prepayments. Loan balances are not net of LIP, deferred loan fees and costs, or the ALLL.

	Within One Year	After One Year Through Three Years	After Three Years Through Five Years	After Five Years Through Ten Years	Beyond Ten Years	Total
	(In thousands)					
Real estate:						
One-to-four family residential	$15,982	$16,966	$23,188	$8,829	$184,470	$249,435
Multifamily	1,653	26,706	9,006	79,576	6,309	123,250
Commercial	18,434	51,665	50,669	156,805	26,121	303,694
Construction/land	113,419	47,887	16,298	31,344	—	208,948
Total real estate	149,488	143,224	99,161	276,554	216,900	885,327
Business	109	7,463	366	—	—	7,938
Consumer	535	3,432	140	33	2,782	6,922
Total	$150,132	$154,119	$99,667	$276,587	$219,682	$900,187

The following table sets forth the amount of all loans due after December 31, 2017, with fixed or adjustable interest rates. Loan balances are not net of LIP, deferred loan fees and costs, or the ALLL.

	Fixed-Rate	Adjustable-Rate	Total
	(In thousands)		
Real estate:			
One-to-four family residential	$158,913	$ 74,540	$233,453
Multifamily	72,187	49,410	121,597
Commercial	198,856	86,404	285,260
Construction/land	50,278	45,251	95,529
Total real estate	480,234	255,605	735,839
Business	641	7,188	7,829
Consumer	285	6,102	6,387
Total	$481,160	$ 268,895	$750,055

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

Upon receipt of a loan application from a prospective borrower, we obtain a credit report and other data to verify specific information relating to the loan applicant's employment, income, and credit standing. All real estate loans

requiring an appraisal are done by an independent third-party appraiser. All appraisers are approved by us, and their credentials are reviewed annually, as is the quality of their appraisals.

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

Lending Authority. The Directors' Loan Committee consists of at least three members of the Board of Directors. The Directors' Loan Committee recommends for approval by the Board of Directors exceptions to the aggregate loan limit to one borrower of 15% of total risk-based capital, or $19.5 million at December 31, 2016. The Board of Directors approves exceptions to such aggregate loan limit to one borrower up to 20% of total risk-based capital, or $26.0 million at December 31, 2016.

Officer Lending Authority. Individual signing authority has been delegated to three lending or executive officers. Our Chief Lending Officer ("CLO") has authority from the Board of Directors to approve loan requests for both individual loans and aggregate relationships up to and including $1.0 million. Our Senior Credit Approval Officer ("SCAO") has authority from the Board of Directors to approve loans and aggregate relationships up to and including $2.5 million. The Board of Directors has given our Chief Credit Officer ("CCO") authority to approve credit to one borrower not to exceed 15% of total risk-based capital. Aircraft loan requests up to and including $5.0 million must be approved by any two of the SCAO, CLO and CCO.

Loan Originations, Servicing, Purchases, Sales and Repayments. For the years ended December 31, 2016 and 2015, our total loan originations and purchases were $420.8 million and $231.3 million, respectively.

One-to-four family residential loans are generally originated in accordance with the guidelines established by Freddie Mac and Fannie Mae, with the exception of our special community development loans originated to satisfy compliance with the Community Reinvestment Act. Our loans are underwritten by designated real estate loan underwriters internally in accordance with standards as provided by our Board-approved loan policy. We require title insurance on all loans and fire and casualty insurance on all secured loans and home equity loans where real estate serves as collateral. Flood insurance is also required on all secured loans when the real estate is located in a flood zone.

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

	Year Ended December 31,		
	2016	2015	2014
	(In thousands)		
Loan originations:			
Real estate:			
One-to-four family residential	$59,222	$37,808	$35,834
Multifamily	22,914	44,579	25,417
Commercial	92,495	64,046	39,864
Construction/land	165,363	68,637	47,157
Total real estate	339,994	215,070	148,272
Business	13,998	11,050	3,556
Consumer	5,674	3,660	2,669
Total loans originated	359,666	229,780	154,497
Loans purchased:			
One-to-four family residential	7,352	1,368	10,513
Multifamily	11,761	195	2,468
Commercial	41,990	—	—
Total loans purchased	61,103	1,563	12,981
Principal repayments	(271,768)	(183,962)	(149,557)
Charge-offs	(83)	(362)	(642)
Loans transferred to other real estate owned ("OREO")	—	(141)	(1,823)
Change in LIP, net deferred fees, and ALLL	(18,947)	(25,744)	(14,671)
Net increase in loans	$129,971	$21,134	$785

Loan Origination and Other Fees. In some instances, we receive loan origination fees on real estate-related products. Loan fees generally represent a percentage of the principal amount of the loan and are paid by the borrower. The amount of fees charged to the borrower on one-to-four family residential loans and multifamily and commercial real estate loans can range from 0% to 2%. United States generally accepted accounting principles require that certain fees received, net of certain origination

costs, be deferred and amortized over the contractual life of the loan. Net deferred fees or costs associated with loans that are prepaid or sold are recognized in income at the time of prepayment or sale. We had $2.2 million and $2.9 million of net deferred loan fees at December 31, 2016, and 2015, respectively.

One-to-four family residential and consumer loans are generally originated without a prepayment penalty. The majority of our multifamily and commercial real estate loans, however, have prepayment penalties associated with the loans. Most of the multifamily and commercial real estate loan originations with interest rates fixed for the first five years will adjust thereafter and have a prepayment penalty of 2 - 3% of the principal balance in year one, with decreasing penalties in subsequent years. Longer initial fixed rate terms generally have correspondingly longer prepayment penalty periods.

Asset Quality

As of December 31, 2016, we had $473,000 of loans past due 30 days or more. These loans represented 0.1% of total loans, net of LIP, and consisted of two one-to-four family residential loans (all owner-occupied). We generally assess late fees or penalty charges on delinquent loans of up to 5.0% of the monthly payment. The borrower is given up to a 15 day grace period from the due date to make the loan payment.

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

If the borrower is chronically delinquent and all reasonable means of obtaining payments have been exhausted, we will seek to foreclose on the collateral securing the loan according to the terms of the security instrument and applicable law. The following table shows our delinquent loans by the type of loan, net of LIP, and the number of days delinquent at December 31, 2016:

	Loans Delinquent						Total	
	30-59 Days		60-89 Days		90 Days and Greater		Delinquent Loans	
	Number of Loans	Principal Balance	Number of Loans	Principal Balance	Number of Loans	Principal Balance	Number of Loans	Principal Balance
	(Dollars in thousands)							
Real estate:								
One-to-four family residential:								
Owner occupied	1	$ 304	—	$ —	1	$ 169	2	$ 473
Total	1	$ 304	—	$ —	1	$ 169	2	$ 473

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

	December 31,				
	2016	2015	2014	2013	2012
	(Dollars in thousands)				
Loans accounted for on a nonaccrual basis:					
Real estate:					
One-to-four family residential	$798	$996	$830	$2,297	$6,248
Multifamily	—	—	—	233	4,711
Commercial	—	—	434	1,198	6,274
Construction/land	—	—	—	223	4,767
Consumer	60	89	75	44	759
Total loans accounted for on a nonaccrual basis	858	1,085	1,339	3,995	22,759
Total nonperforming loans	858	1,085	1,339	3,995	22,759
OREO	2,331	3,663	9,283	11,465	17,347
Total nonperforming assets	$3,189	$4,748	$10,622	$15,460	$40,106
TDRs:					
Nonaccrual [(1)]	$174	$131	$—	$968	$4,528
Performing	30,083	42,128	54,241	60,170	65,848
Total TDRs	$30,257	$42,259	$54,241	$61,138	$70,376
Nonperforming loans as a percent of total loans, net of LIP	0.10 %	0.16 %	0.20 %	0.59 %	3.42 %
Nonperforming loans as a percent of total assets	0.08	0.11	0.14	0.43	2.41
Nonperforming assets as a percent of total assets	0.31	0.48	1.13	1.68	4.25
Total loans, net of LIP	$828,161	$697,416	$677,033	$678,727	$665,067
Foregone interest on nonaccrual loans	51	103	126	650	1,399

(1) These loans are also included in the appropriate loan category above under the caption: "Loans accounted for on a nonaccrual basis."

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

Our three largest nonperforming loans at December 31, 2016 were as follows:

- A one-to-four family residential loan with an outstanding balance of $304,000 secured by an owner-occupied single family residence in Snohomish County. The purpose of this loan was to refinance an existing lien with improved terms.
- A one-to-four family residential loan with an outstanding balance of $169,000 secured by an owner-occupied single family residence in King County. The purpose of this loan was to refinance an existing lien with improved terms.
- A one-to-four family residential loan with an outstanding balance of $137,000 secured by an owner-occupied single family residence in Snohomish County. The purpose of this loan was to purchase a primary residence.

We have reduced our nonperforming assets by $1.6 million during 2016, including a $1.4 million or 36.4% reduction in OREO and a $227,000 or 20.9% reduction in nonperforming loans at December 31, 2016, as compared to December 31, 2015. This reduction in nonperforming loans was accomplished through payoffs or principal payments of $308,000, and $72,000 in charge offs of uncollectible portions of loans partially offset by $153,000 of new additions to nonperforming loans. Because of our structure, we believe we are able to make decisions regarding offers on OREO and the real estate underlying our nonperforming loans very quickly compared to larger institutions where

decisions could take six to twelve months. This distinction has worked to our benefit in reducing our nonperforming assets and disposing of OREO.

The following tables summarize our total nonperforming loans, net of LIP and OREO, at December 31, 2016, by county and by type of loan or property:

	County							
	King	Snohomish	Pierce	Kitsap	All Other	Total Nonperforming Loans	Number of Loans	Percent of Total Nonperforming Loans
	(Dollars in thousands)							
Nonperforming loans:								
One-to-four family residential	$357	$ 441	$ —	$ —	$ —	$ 798	6	93.0 %
Consumer	60	—	—	—	—	60	1	7.0
Total nonperforming loans	$417	$ 441	$ —	$ —	$ —	$ 858	7	100.0 %

	County							
	King	Snohomish	Pierce	Kitsap	All Other	Total OREO	Number of Properties	Percent of Total OREO
	(Dollars in thousands)							
OREO:								
Commercial real estate [1]	$—	$ —	$1,320	$ 506	$ 505	$2,331	5	100.0%
Total OREO	$—	$ —	$1,320	$ 506	$ 505	$2,331	5	100.0%
Total nonperforming assets	$417	$ 441	$1,320	$ 506	$ 505	$3,189		

[1] Of the five properties classified as commercial real estate, two are office/retail buildings and three are undeveloped lots.

Construction/land, commercial real estate, and multifamily loans have larger individual loan amounts that have a greater single impact on asset quality in the event of delinquency or default. We continue to monitor our loan portfolio and believe additions to nonperforming loans, charge-offs, provisions for loan losses, and/or OREO are possible in the future, particularly if the housing market and other economic conditions do not continue to improve.

Other Real Estate Owned. Real estate acquired by us as a result of foreclosure or by deed-in-lieu of foreclosure is classified as OREO until it is sold. When the property is acquired, it is recorded at the lower of its cost or the fair market value of the property, less selling costs. We had $2.3 million and $3.7 million of OREO at December 31, 2016 and 2015, respectively. At December 31, 2016, OREO consisted of five commercial real estate properties. Our special assets department's primary focus is the prompt and effective management of our troubled, nonperforming assets, and expediting their disposition to minimize any potential losses. During 2016, we did not foreclose or accept deeds-in-lieu of foreclosure on any loans, while during 2015, we foreclosed on one $141,000 property. We anticipate continued foreclosure, deed-in-lieu of foreclosure, and short sale activity while we work with our nonperforming loan customers to minimize our loss exposure.

Troubled Debt Restructured Loans. We account for certain loan modifications or restructurings as TDRs. In general, the modification or restructuring of a debt is considered a TDR if, for economic or legal reasons related to the borrower's financial difficulties, we grant a concession to the borrower that we would not otherwise consider. These loans are all considered to be impaired loans. At December 31, 2016, we had $30.3 million in TDRs as compared to $42.3 million at December 31, 2015.

Prior to 2012, we utilized a strategy for a limited number of our lending relationships of establishing an "A" and "B" note structure. We created an "A" note representing a reduced principal balance expected to be fully collected and at a debt service level and loan-to-value ratio acceptable to us. The "A" note was classified as a performing TDR as long as the

borrower continued to perform in accordance with the note terms. The "B" note represented the amount of the principal reduction portion of the original note and was immediately charged-off. The "B" note is held by the Bank and when the "A" note is paid off, the Bank may proceed with collection efforts on the "B" note. At December 31, 2016, 99.4% of our TDRs were classified as performing compared to 99.7% at December 31, 2015. Of the $30.1 million of performing TDRs at December 31, 2016, $13.2 million were related to an "A" note as a result of an "A" and "B" note workout strategy.

The largest TDR relationship at December 31, 2016 totaled $9.2 million and was comprised of $8.5 million in one to four family residential loans secured by rental properties and a $754,000 owner occupied commercial property, all located in King County. At December 31, 2016, there was no LIP in connection with our TDRs. For additional information regarding our TDRs, see Note 3 of the Notes to Consolidated Financial Statements contained in Item 8 of this report.

The following table summarizes our total TDRs:

	December 31,	
	2016	2015
	(In thousands)	
Nonperforming TDRs:		
One-to-four family residential	$174	$131
Total nonperforming TDRs	174	131
Performing TDRs:		
One-to-four family residential	24,274	35,099
Multifamily	1,564	1,594
Commercial real estate	4,202	5,392
Consumer	43	43
Total performing TDRs	30,083	42,128
Total TDRs	$30,257	$42,259

Classified Assets. Federal regulations provide for the classification of lower quality loans and other assets as substandard, doubtful or loss. An asset is considered substandard if it is inadequately protected by the current net worth and payment capacity of the borrower or of any collateral pledged. Substandard assets include those characterized by the distinct possibility that we will sustain some loss if the deficiencies are not corrected. Assets classified as doubtful have all the weaknesses inherent in those classified substandard with the added characteristic that the weaknesses present make collection or liquidation in full highly questionable and improbable, on the basis of currently existing facts, conditions and values. Assets classified as loss are those considered uncollectible and of such little value that their continuance as assets without the establishment of a specific loss reserve is not warranted.

When we classify problem assets as either substandard or doubtful, we may establish a specific allowance in an amount we deem prudent. General allowances represent loss allowances that have been established to recognize the inherent risk associated with lending activities, but unlike specific allowances, have not been specifically allocated to particular problem assets. When an insured institution classifies problem assets as a loss, it is required to charge-off those assets in the period in which they are deemed uncollectible. Our determinations as to the classification of our assets and the amount of our valuation allowances are subject to review by the FDIC and the DFI that can order the establishment of additional loss allowances or the charge-off of specific loans against established loss reserves. Assets that do not currently expose us to sufficient risk to warrant classification in one of the aforementioned categories but possess weaknesses are designated as special mention. At December 31, 2016, special mention loans totaled $6.1 million.

In connection with the filing of periodic reports with the FDIC and in accordance with our loan policy, we regularly review the problem loans in our portfolio to determine whether any loans require classification in accordance with applicable regulations. The decrease in our classified loans during the year ended December 31, 2016 was a result of loan charge-offs, loans transferred to OREO, and short sales, as well as our efforts to work with our borrowers to bring their loans current when possible or restructure the loan when appropriate. During 2016, we continued our aggressive approach to reduce nonperforming assets and improve asset quality.

Classified loans, net of LIP, consisting solely of substandard loans, were as follows at the dates indicated:

	December 31,	
	2016	2015
	(In thousands)	
One-to-four family residential	$1,351	$2,693
Multifamily	—	—
Commercial real estate	—	496
Construction/land	495	—
Consumer	60	89
Total classified loans	$1,906	$3,278

With the exception of these classified loans, of which $858,000 were accounted for as nonaccrual loans at December 31, 2016, management is not aware of any loans as of December 31, 2016, where the known credit problems of the borrower would cause us to have serious doubts as to the ability of such borrowers to comply with their present loan repayment terms and which may result in the future inclusion of such loans in the nonperforming loan categories.

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

Quarterly, our Board of Directors' Internal Asset Review Committee reviews and recommends approval of the allowance for loan losses and any provision or recapture of provision for loan losses, and the full Board of Directors approves the provision or recapture after considering the Committee's recommendation. The allowance is increased by the provision for loan losses which is charged against current period earnings. If the analysis of our loan portfolio indicates the risk of loss is less than the balance of the ALLL, a recapture of provision of loan loss is added to current period earnings.

For the year ended December 31, 2016, we recorded a $1.3 million loan loss provision to our ALLL, as compared to recaptures of $2.2 million and $2.1 million for the years ended December 31, 2015 and 2014, respectively. The provision for loan losses in 2016 was primarily a result of the $129.9 million growth in net loans receivable. The quality of our loan portfolio continued to improve, as reflected in reductions in the levels of nonperforming loans, classified assets, and charge-offs, due primarily to our efforts working with our borrowers to bring their loan payments current when possible. When this option was not feasible, we promptly initiated foreclosure or deed-in-lieu of foreclosure proceedings. The ALLL was $11.0 million, or 1.3% of total loans net of LIP at December 31, 2016 as compared to $9.5 million, or 1.4% at December 31, 2015. The level of the ALLL is based on estimates and the ultimate losses may vary from the estimates. Management reviews the adequacy of the ALLL on a quarterly basis.

A loan is considered impaired when, based on current information and events, it is probable we will be unable to collect the scheduled payments of principal or interest when due, according to the contractual terms of the loan

agreement. Factors considered by management in determining impairment include payment status, collateral value, market conditions, rent rolls, and the borrower's and guarantor's, if any, financial strength. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and shortfalls on a case by case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including length of the delay, the reasons for the delay, the borrower's prior payment record and the amounts of the shortfall in relation to the principal and interest owed. Loans are evaluated for impairment on a loan-by-loan basis. As of December 31, 2016 and 2015, impaired loans were $30.9 million and $43.3 million, respectively. At December 31, 2016, there was no LIP in connection with our impaired loans.

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

	December 31,											
	2016			2015			2014			2013		
	Loan Balance	Allowance by Loan Category	Percent of Loans to Total Loans	Loan Balance	Allowance by Loan Category	Percent of Loans to Total Loans	Loan Balance	Allowance by Loan Category	Percent of Loans to Total Loans	Loan Balance	Allowance by Loan Category	Pe of Lo to Lo
Real estate:	(Dollars in thousands)											
One-to-four family residential	$249,435	$2,551	27.7 %	$253,772	$3,028	33.8 %	$273,193	$3,691	38.8 %	$280,674	$5,141	40
Multifamily	123,250	1,199	13.7	122,747	1,193	16.4	116,014	1,606	16.5	106,152	1,269	15
Commercial real estate	303,694	3,893	33.7	244,211	3,395	32.5	239,211	4,476	34.0	227,016	5,101	33
Construction/land	208,948	2,792	23.2	115,957	1,193	15.4	65,061	519	9.2	64,751	1,287	9.4
Total real estate	885,327	10,435	98.3	736,687	8,809	98.1	693,479	10,292	98.5	678,593	12,798	98
Business	7,938	237	0.9	7,604	229	1.0	3,783	47	0.5	1,142	14	0.2
Consumer	6,922	279	0.8	6,979	425	0.9	7,130	152	1.0	9,201	182	1.3
Total	$900,187	$10,951	100.0%	$751,270	$9,463	100.0%	$704,392	$10,491	100.0%	$688,936	$12,994	10

We believe that the ALLL as of December 31, 2016 was adequate to absorb the probable and inherent losses in the loan portfolio at that date. While we believe the estimates and assumptions used in our determination of the adequacy of the ALLL are reasonable, there can be no assurance that such estimates and assumptions will be proven correct in the future, or that the actual amount of future provisions will not exceed the amount of past provisions, or that any increased provisions that may be required will not adversely impact our financial condition and results of operations. Future additions to the ALLL may become necessary based upon changing economic conditions, the level of problem loans, business conditions, credit concentrations, increased loan balances or changes in the underlying collateral of the loan portfolio. In addition, the determination of the amount of the ALLL is subject to review by bank regulators as part of the routine examination process that may result in the establishment of additional loss reserves or the charge-off of specific loans against established loss reserves based upon their judgment of information available to them at the time of their examination.

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

	At or For the Year Ended December 31,				
	2016	2015	2014	2013	2012
	(Dollars in thousands)				
ALLL at beginning of period	$9,463	$10,491	$12,994	$12,542	$16,559
Provision (recapture of provision) for loan losses	1,300	(2,200)	(2,100)	(100)	3,050
Charge-offs:					
One-to-four family residential	—	(27)	(78)	(456)	(2,229)
Multifamily	—	(281)	—	(346)	(153)
Commercial real estate	—	—	(311)	(98)	(6,088)
Construction/land	—	—	(223)	(582)	(630)
Business	—	—	—	(13)	—
Consumer	(83)	(54)	(30)	(101)	(491)
Total charge-offs	(83)	(362)	(642)	(1,596)	(9,591)
Total recoveries	271	1,534	239	2,148	2,524
Net recoveries (charge-offs)	188	1,172	(403)	552	(7,067)
ALLL at end of period	$10,951	$9,463	$10,491	$12,994	$12,542
ALLL as a percent of total loans, net of LIP	1.32%	1.36%	1.55%	1.91%	1.89%
Net recoveries (charge-offs) to average loans receivable, net of LIP	0.02	0.18	(0.06)	0.08	(1.07)
ALLL as a percent of nonperforming loans, net of LIP	1,276.34%	872.17%	783.50%	325.26%	55.11%

Investment Activities

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

The Investment, Asset/Liability Committee ("ALCO"), consisting of the Chief Executive Officer, Chief Financial Officer, and Controller of First Financial Northwest Bank, other members of management and the Board of Directors, has the authority and responsibility to administer our investment policy, monitor portfolio strategies, and recommend appropriate changes to policy and strategies to the Board of Directors. On a monthly basis, management reports to the Board a summary of investment holdings with respective market values and all purchases and sales of investment securities. The Chief Financial Officer has the primary responsibility for the management of the investment portfolio and considers various factors when making decisions, including the marketability, maturity, liquidity, and tax consequences of proposed investments. The maturity structure of investments will be affected by various market

conditions, including the current and anticipated slope of the yield curve, the level of interest rates, the trend of new deposit inflows, and the anticipated demand for funds via deposit withdrawals and loan originations and purchases.

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

At December 31, 2016, our investment portfolio consisted principally of mortgage-backed securities, municipal bonds, U.S. government agency obligations, and corporate bonds. From time to time, investment levels may increase or decrease depending upon yields available on investment opportunities and management's projected demand for funds for loan originations, net deposit flows, and other activities. At December 31, 2016, we did not hold securities of any single issuer (other than government-sponsored entities) that exceeded 10% of our shareholders' equity.

Other than our utilization of interest rate swaps, we do not currently participate in other hedging programs, stand-alone contracts for interest rate caps or floors or other activities involving the use of off-balance sheet derivative financial instruments, and have no present intention to do so. As of December 31, 2016, we had invested in interest rate swaps with an aggregate notional amount of $50.0 million. At December 31, 2016, the fair value of our interest rate swaps was $1.3 million. For additional information, see Item 1A. Risk Factors -"If interest rate swaps we entered into prove ineffective, it could result in volatility in our operating results, including potential loses, which could have a material adverse effect on our results of operations and cash flows, Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations - Asset and Liability Management" and Note 10 of the Notes to Consolidated Financial Statements contained in Item 8. of this report.

Mortgage-Backed Securities. The mortgage-backed securities in our portfolio were comprised of Fannie Mae, Freddie Mac, and Ginnie Mae mortgage-backed securities. These issuers guarantee the timely payment of principal and interest in the event of default. The mortgage-backed securities had a weighted-average yield of 2.12% at December 31, 2016.

U.S. Government Agency Obligations. The agency securities in our portfolio were comprised of Fannie Mae, Freddie Mac, and FHLB agency securities. These issuers guarantee the timely payment of principal and interest in the event of default. At December 31, 2016, the portfolio of government agency securities had a weighted-average yield of 1.87%.

Ginnie Mae is part of a U.S. government agency and its guarantees are backed by the full faith and credit of the United States. Fannie Mae, Freddie Mac, and the Federal Home Loan Banks are U.S. government-sponsored entities. Although their guarantees are not backed by the full faith and credit of the United States, they may borrow from the U.S. Treasury, which has taken other steps to ensure these U.S. government-sponsored entities can fulfill their financial obligations.
Corporate Bonds. The corporate bond portfolio was primarily comprised of variable rate securities issued by various financial institutions. At December 31, 2016, the corporate bond portfolio had a weighted-average yield of 4.33%.
Municipal Bonds. The municipal bond portfolio is comprised of both taxable and tax-exempt municipal bonds. The pre-tax weighted-average yield on the municipal bond portfolio was 2.70% at December 31, 2016.
Federal Home Loan Bank Stock. As a member of the FHLB Des Moines, we are required to own capital stock. The required amount of capital stock is based on a percentage of our previous year-end assets and our outstanding FHLB advances. The redemption of any excess stock we hold is at the discretion of the FHLB Des Moines. During 2016, our FHLB stock holdings increased by $1.9 million primarily as a result of the $46.0 million increase in our FHLB advances during 2016. The carrying value of our FHLB stock totaled $8.0 million at December 31, 2016. During the years ended December 31, 2016 and 2015, we received FHLB cash dividends of $202,000 and $69,000, respectively.

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

	December 31,					
	2016		2015		2014	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value	Amortized Cost	Fair Value
	(In thousands)					
Available-for-sale:						
Mortgage-backed securities:						
Fannie Mae	$42,060	$41,332	$50,288	$50,321	$40,083	$40,916
Freddie Mac	18,013	18,009	26,011	26,137	21,442	21,946
Ginnie Mae	19,133	18,634	13,802	13,732	26,049	26,013
Tax-exempt municipal bonds	13,083	12,987	11,231	11,507	—	—
Taxable municipal bonds	120	120	556	557	642	644
U.S. government agencies	15,937	15,857	13,541	13,542	16,863	16,816
Corporate bonds	22,506	22,321	14,010	13,769	14,061	14,039
Total available-for-sale	$130,852	$129,260	$129,439	$129,565	$119,140	$120,374

At December 31, 2016, 2015, and 2014 there were no investments held to maturity.

During the year ended December 31, 2016, gross proceeds from the call and sale of investments was $26.4 million, with net realized gains of $50,000.

Management reviews investment securities on an ongoing basis for the presence of other than temporary impairment ("OTTI") or permanent impairment, taking into consideration current market conditions, fair value in relationship to cost, extent and nature of the change in fair value, issuer rating changes and trends, whether management intends to sell a security or if it is likely that we will be required to sell the security before recovery of the amortized cost basis of the investment, which may be maturity, and other factors. For debt securities, if management intends to sell the security or it is likely that we will be required to sell the security before recovering its cost basis, the entire impairment loss would be recognized in earnings as an OTTI. If management does not intend to sell the security and it is not likely that we will be required to sell the security, but management does not expect to recover the entire amortized cost basis of the security, only the portion of the impairment loss representing credit losses would be recognized in earnings. The credit loss on a security is measured as the difference between the amortized cost basis and the present value of the cash flows expected to be collected. Projected cash flows are discounted by the original or current effective interest rate, depending on the nature of the security being measured for potential OTTI. The remaining impairment related to all other factors, the difference between the present value of the cash flows expected to be collected and fair value, is recognized as a charge to other comprehensive income (loss). Impairment losses related to all other factors are presented as separate categories within other comprehensive income (loss). There were no losses related to OTTI at December 31, 2016 and 2015. For additional information regarding our investments, see Note 2 of the Notes to Consolidated Financial Statements contained in Item 8 of this report.

The table below sets forth information regarding the carrying value and weighted-average yield by contractual maturity of our investment portfolio at December 31, 2016. Mortgage-backed securities have no stated maturity date and are included in the totals column only.

	December 31, 2016									
	Within One Year		After One Year Through Five Years		After Five Through Ten Years		Thereafter		Totals	
	Carrying Value	Weighted-Average Yield	Carrying Value	Weighted-Average Yield	Carrying Value	Weighted-Average Yield	Carrying Value	Weighted-Average Yield	Carrying Value	Weighted-Average Yield
	(Dollars in thousands)									
Available-for-sale:										
Mortgage-backed securities	$—	— %	$—	— %	$—	— %	$—	— %	$77,975	2.12 %
Municipal bonds	—	—	—	—	2,130	2.14	10,977	3.05	13,107	2.70
U.S. Government agencies	510	0.86	3,837	1.37	5,535	2.01	5,975	2.15	15,857	1.87
Corporate bonds	—	—	5,018	1.75	15,940	5.17	1,363	4.00	22,321	4.33
Total available-for-sale	$510	0.86 %	$8,855	1.59 %	$23,605	4.18 %	$18,315	2.83 %	$129,260	2.53 %

Deposit Activities and Other Sources of Funds

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

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

Deposits. We offer a competitive range of deposit products within our market area, including noninterest bearing accounts, interest-bearing demand accounts, money market deposit accounts, statement savings accounts, and certificates of deposit. Deposit account terms vary according to the minimum balance required, the time periods the funds must remain on deposit, and the interest rate, among other factors. In determining the terms of our deposit accounts, we consider the development of long-term profitable customer relationships, current market interest rates, current maturity structures, deposit mix, our customer preferences, and the profitability of acquiring customer deposits compared to alternative funding sources. As part of our strategy to shift our deposit mix to lower cost funds, we continued to better align our pricing with competitors in our local market to meet our goals. To supplement local deposits, funds are also generated through national brokered certificates of deposit. At December 31, 2016, $75.5 million, or 10.5% of total deposits were brokered certificates of deposit, with remaining maturities ranging from 1.5 to four years. These funds cannot be withdrawn early except in the case of the death or adjudication of incompetence of the depositor. However, the Bank has a quarterly call option six months after issuance on $56.4 million of these brokered deposits that allows the Bank to close the certificate of deposit and return the deposit to the customer if the Bank determines it is in its best interest to do so. The longer term nature of these brokered deposits, along with the enhanced features of these deposits as compared to retail certificates of deposit, assists us in our interest rate risk management efforts.

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

	Year Ended December 31,		
	2016	2015	2014
	(In thousands)		
Total deposits, beginning balance	$675,407	$614,127	$612,065
Increase (decrease) in retail deposits	32,732	49,558	(52,367)
Increase in brokered funds	9,337	11,722	54,429
Net increase in deposits	42,069	61,280	2,062
Total deposits, ending balance	$717,476	$675,407	$614,127

At December 31, 2016, deposits totaled $717.5 million. We had $265.2 million of jumbo (greater than or equal to $100,000) certificates of deposit, which were 37.0% of total deposits at December 31, 2016. Of these jumbo deposits, $91.2 million were greater than or equal to $250,000. At that date, included in the jumbo certificates of deposit, were public funds totaling $23.7 million, or 3.3% of total deposits, of which $22.9 million was in excess of the $250,000 standard FDIC insurance coverage. Under Washington State law, in order to participate in the public funds program, we are required to pledge eligible securities of a minimum of 50% of the public deposits in excess of $250,000.

The following table sets forth information regarding our certificates of deposit and other deposits at December 31, 2016.

Weighted-Average Interest Rate	Term	Category	Amount	Percentage of Total Deposits
(Dollars in thousands)				
— %	N/A	Noninterest bearing demand deposits	$33,422	4.7 %
0.32	N/A	Interest-bearing demand	18,532	2.6
0.16	N/A	Statement savings	28,383	4.0
0.50	N/A	Money market [1]	204,998	28.6
		Certificates of deposit, retail		
0.10	Three months or less		619	0.1
0.43	Over three through six months		2,725	0.4
0.69	Over six through twelve months		31,663	4.4
1.26	Over twelve months		321,646	44.7
1.20		Total certificates of deposit, retail	356,653	49.6
1.49	Over twelve months	Certificates of deposit, brokered	75,488	10.5
		Total deposits	$717,476	100.0 %

[1] Money market funds include $8.5 million of developer construction accounts that are part of the EB-5 Immigrant Investor Program with the balance expected to be withdrawn during 2017. For more information see “If limitations arise in our ability to utilize the national brokered deposit market or to replace short-term deposits, our ability to replace maturing deposits on acceptable terms could be adversely impacted” and “Non-compliance with the USA PATRIOT Act, Bank Secrecy Act, or other laws and regulations could result in fines or sanctions” in Item 1.A. Risk Factors contained in this report.

Certificates of Deposit. The following table sets forth the amount and maturities of certificates of deposit at December 31, 2016.

	Within One Year	After One Year Through Two Years	After Two Years Through Three Years	After Three Years Through Four Years	Thereafter	Total
	(In thousands)					
0.00 - 1.00%	$94,299	$27,297	$3,113	$1,039	$ —	$125,748
1.01 - 2.00%	71,579	77,951	104,869	27,320	20,753	302,472
2.01 - 3.00%	—	—	—	641	3,144	3,785
5.01 - 6.00%	136	—	—	—	—	136
Total	$166,014	$105,248	$107,982	$29,000	$ 23,897	$432,141

The following table sets forth the amount of our jumbo certificates of deposit by remaining maturity as of December 31, 2016.

Maturity Period	Certificates of Deposit (In thousands)

Three months or less	$ 31,688
Over three months through six months	27,836
Over six months through twelve months	61,260
Over twelve months	144,423
Total	$ 265,207

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

	December 31,					
	2016		2015		2014	
	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Total
	(Dollars in thousands)					
Noninterest bearing	$33,422	4.7 %	$29,392	4.4 %	$14,354	2.3 %
Interest-bearing demand	18,532	2.5	16,261	2.4	20,752	3.4
Statement savings	28,383	4.0	28,327	4.2	23,901	3.9
Money market [1]	204,998	28.6	211,436	31.3	142,532	23.2
Certificates of deposit, retail:						
0.00 - 1.00%	124,710	17.4	154,011	22.8	210,297	34.3
1.01 - 2.00%	228,458	31.8	169,494	25.1	147,672	24.1
2.01 - 3.00%	3,349	0.5	206	—	67	—
3.01 - 4.00%	—	—	—	—	123	—
5.01 - 6.00%	136	—	129	—	—	—
Total certificates of deposit, retail	356,653	49.7	323,840	47.9	358,159	58.4
Certificates of deposit, brokered						
0.00 - 1.00%	1,038	0.1	—	—	—	—
1.01 - 2.00%	74,014	10.3	65,715	9.7	33,126	5.3
2.01 - 3.00%	436	0.1	436	0.1	21,303	3.5
Total certificates of deposit, brokered	75,488	10.5	66,151	9.8	54,429	8.8
Total deposits	$717,476	100.0%	$675,407	100.0%	$614,127	100.0%

[1] Money market funds include $8.5 million of developer construction accounts that are part of the EB-5 Immigrant investor Program with the balance expected to be withdrawn during 2017. For more information see “If limitations arise in our ability to utilize the national brokered deposit market or to replace short-term deposits, our ability to replace maturing deposits on acceptable terms could be adversely impacted” and “Non-compliance with the USA PATRIOT Act, Bank Secrecy Act, or other laws and regulations could result in fines or sanctions” in Item 1.A. Risk Factors contained in this report.

Borrowings. Customer deposits are the primary source of funds for our lending and investment activities. We use advances from the FHLB to supplement our supply of lendable funds, to meet short-term deposit withdrawal requirements and to provide longer term funding to better match the duration of selected loan and investment maturities. In addition, at December 31, 2016 we had available a total of $35.0 million lines of credit between two other financial institutions as supplemental funding sources.

As a member of the FHLB, we are required to own capital stock in the FHLB and are authorized to apply for advances on the security of that stock and certain of our mortgage loans, provided that certain creditworthiness standards have been met. Advances are individually made under various terms pursuant to several different credit programs, each with its own interest rate and range of maturities. Depending on the program, limitations on the amount of advances are based on the financial condition of the member institution and the adequacy of collateral pledged to secure the credit. We maintain a credit facility with the FHLB that provides for immediately available advances, subject to acceptable collateral. At December 31, 2016, our remaining FHLB credit capacity was $203.6 million and outstanding advances from the FHLB totaled $171.5 million.

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

	At or for the Year Ended December 31,		
	2016	2015	2014
	(Dollars in thousands)		
Maximum amount of borrowings outstanding at any month end	$251,500	$135,500	$135,500
Average borrowings outstanding	163,893	133,527	128,839
Weighted-average rate paid	0.87 %	0.94 %	0.91 %
Balance outstanding at end of the year	$171,500	$125,500	$135,500
Weighted-average rate paid at end of the year	0.87 %	0.97 %	0.95 %

Subsidiaries and Other Activities

First Financial Northwest, Inc. First Financial Northwest has two wholly-owned subsidiaries, First Financial Northwest Bank and First Financial Diversified Corporation. First Financial Diversified Corporation currently holds a loan portfolio of one to-four family residential, commercial real estate, business, and consumer loans. At December 31, 2016, First Financial Diversified's net loans receivable of $2.4 million represented less than one percent of the Company's loan portfolio.

First Financial Northwest Bank. First Financial Northwest Bank is a community-based commercial bank. The Bank primarily serves the greater Puget Sound region of King and to a lesser extent, Pierce, Snohomish and Kitsap Counties, Washington through our full-service banking office and one branch located in Renton, Washington and additional branch offices in Mill Creek and Edmonds, Washington. We are in the business of attracting deposits from the public and utilizing those deposits to originate loans.

Competition

We face competition in originating loans and attracting deposits within our geographic market area. We compete by consistently delivering high-quality personal service to our customers that results in a high level of customer satisfaction.
Based on the most current FDIC market share data dated June 30, 2016, the Bank ranked 16th in terms of deposits in King County with a market share of 0.91% among the 42 FDIC insured depository institutions located in King County that accept deposits. The top five banks in the market (comprised of Bank of America, Wells Fargo Bank, JP Morgan Chase, US Bank and KeyBank) controlled 74.5% of the King County deposit market with deposits of $56.9 billion out of the $76.4 billion total for the county. Recently the Bank opened two branches in Snohomish County. At June 30, 2016, the Bank ranked 24th in total deposits in Snohomish County with a market share of 0.17% with a ranking of 24th out of 24 FDIC institutions operating in the county. The top five commercial banks in the market (comprised of Bank of America, JP Morgan Chase, Wells Fargo, US Bancorp and Mitsubishi FFJ Financial) controlled 60.9% of the Snohomish County deposit market with deposits of $6.6 billion out of the $10.8 billion total for the county. In addition to the FDIC insured competitors, credit unions, insurance companies and brokerage firms also compete for consumer deposit relationships.
Our competition for loans comes principally from commercial banks, mortgage brokers, thrift institutions, credit unions and finance companies. Several other financial institutions, including those previously mentioned, compete with us for banking business in our market area. These institutions may have substantially more resources than the Bank and, as a result, be able to offer a broader range of services, such as trust departments and enhanced retail services. Among the advantages of some of these institutions are their ability to make larger loans, initiate extensive advertising campaigns, access lower cost funding sources, and allocate their investable assets in regions of highest yield and demand. The challenges posed by such large competitors may impact our ability to originate loans, secure low cost deposits and establish product pricing levels that support our net interest margin goals and may limit our

future growth and earnings potential. In addition, for aircraft financings, we also expect to compete with specialty leasing companies, including aircraft leasing companies.

Employees

At December 31, 2016, we had 121 full-time employees. Our employees are not represented by any collective bargaining group. We consider our employee relations to be good.

How We Are Regulated

The following is a brief description of certain laws and regulations that are applicable to First Financial Northwest and First Financial Northwest Bank. On March 31, 2015, First Financial Northwest rescinded the 10(1) election made by First Financial Northwest Bank and converted from a registered savings and loan holding company to a bank holding company. As a bank holding company, First Financial Northwest is subject to examination and supervision by, and is required to file certain reports with, the FRB. First Financial Northwest also is subject to the rules and regulations of the SEC under the federal securities laws. First Financial Northwest Bank, which changed its charter from a Washington-chartered savings bank to a Washington-chartered commercial bank effective on February 11, 2016, is subject to regulation and oversight by the DFI, the applicable provisions of Washington law and by the regulations of the DFI adopted thereunder. First Financial Northwest Bank also is subject to regulation and examination by the FDIC, which insures its deposits to the maximum extent permitted by law.

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

Regulation and Supervision of First Financial Northwest Bank

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

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

The Dodd-Frank Act requires the FDIC's deposit insurance assessments to be based on assets instead of deposits. The FDIC has issued rules which specify that the assessment base for a bank is equal to its total average consolidated assets less average tangible equity capital. As of June 30, 2016, the FDIC reserve ratio reached 1.15%, thereby reducing the initial base assessment rates from 5 to 35 basis points to 3 to 30 basis points. The assessment rates are subject to adjustment for unsecured debt, however the previous brokered deposit adjustment has been eliminated. The new pricing system for small institutions replaced the use of risk categories with the Financial Ratios Method to determine assessment rates. This method is based on statistical modeling that estimates the probability of failure over three years. No institution may pay a dividend if it is in default on its federal deposit insurance assessment.

In addition, federally insured institutions are required to pay a Financing Corporation (“FICO”) assessment in order to fund the interest on bonds issued to resolve thrift failures in the 1980s. At December 31, 2016, the FICO assessment equaled 0.56 basis points of the assessment base, computed on assets. These assessments will continue until the bonds mature in the years 2017 through 2019. For 2016, the Bank incurred approximately $420,000 in FDIC and FICO assessments.

The FDIC may terminate the deposit insurance of any insured depository institution, including First Financial Northwest Bank, if it determines after a hearing that the institution has engaged or is engaging in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations or has violated any applicable law, regulation, rule, order or any condition imposed by an agreement with the FDIC. It also may suspend deposit insurance temporarily during the hearing process for the permanent termination of insurance if the institution has no tangible capital. If insurance of accounts is terminated, the accounts at the institution at the time of the termination, less subsequent withdrawals, shall continue to be insured for a period of six months to two years, as determined by the FDIC. We are not aware of any practice, condition or violation that might lead to termination of First Financial Northwest Bank’s deposit insurance.

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

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

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

Effective January 1, 2015 (with some changes transitioned into full effectiveness over two to four years), First Financial Northwest Bank became subject to new capital regulations adopted by the FRB and the FDIC, which create a new required ratio for common equity Tier 1 ("CET1") capital, increase the minimum leverage and Tier 1 capital ratios, change the risk-weightings of certain assets for purposes of the risk-based capital ratios, create an additional capital conservation buffer over the required capital ratios, and change what qualifies as capital for purposes of meeting the capital requirements. These regulations implement the regulatory capital reforms required by the Dodd-Frank Act and the "Basel III" requirements.

Under the new capital regulations, the minimum capital ratios are: (1) a CET1 capital ratio of 4.5% of risk-weighted assets; (2) a Tier 1 capital ratio of 6.0% of risk-weighted assets; (3) a total risk-based capital ratio of 8.0% of risk-weighted assets; and (4) a leverage ratio (the ratio of Tier 1 capital to average total adjusted assets) of 4.0%. CET1 generally consists of common stock, retained earnings, accumulated other comprehensive income ("AOCI") unless an institution elects to exclude AOCI from regulatory capital, and certain minority interests, all subject to applicable regulatory adjustments and deductions. Tier 1 capital generally consists of CET1 and noncumulative perpetual preferred stock. Tier 2 capital generally consists of other preferred stock and subordinated debt meeting certain conditions plus an amount of the allowance for loan and lease losses up to 1.25% of assets. Total capital is the sum of Tier 1 and Tier 2 capital.

There are a number of changes in what constitutes regulatory capital compared to the rules in effect prior to January 1, 2015, some of which are subject to transition periods. These changes include the phasing-out of certain instruments as qualifying capital and eliminate or significantly reduce the use of hybrid capital instruments, especially trust preferred securities, as regulatory capital. Mortgage servicing assets and deferred tax assets over designated percentages of CET1 will be deducted from capital. In addition, Tier 1 capital includes AOCI, which includes all unrealized gains and losses on available for sale debt and equity securities. However, because of our asset size, we are eligible for the one-time option of permanently opting out of the inclusion of unrealized gains and losses on available for sale debt

and equity securities in our capital calculations. We elected this option in the first quarter of 2015.

For purposes of determining risk-based capital, assets and certain off-balance sheet items are risk-weighted from 0% to 1,250%, depending on the risk characteristics of the asset or item. The new regulations make certain changes in the risk-weighting of assets to better reflect credit risk and other risk exposure compared to the earlier capital rules. These include a 150% risk weight (up from 100%) for certain high volatility commercial real estate acquisition, development and construction loans and for non residential mortgage loans that are 90 days past due or otherwise in nonaccrual status; a 20% (up from 0%) credit conversion factor for the unused portion of a commitment with an original maturity of one year or less that is not unconditionally cancellable (currently set at 0%); and a 250% risk weight (up from 100%) for mortgage servicing and deferred tax assets that are not deducted from capital.

In addition to the minimum CET1, Tier 1, leverage ratio and total capital ratios, First Financial Northwest Bank must maintain a capital conservation buffer consisting of additional CET1 capital above the required minimum levels in order to avoid

limitations on paying dividends, repurchasing shares, and paying discretionary bonuses. This new capital conservation buffer requirement began to be phased in starting in January 2016 at 0.625% of risk-weighted assets and will increase each year until fully implemented to an amount equal to 2.5% of risk-weighted assets in January 2019.

To be consider "well capitalized," a depository institution must have a Tier 1 risk-based capital ratio of at least 8%, a total risk-based capital ratio of at least 10%, a CET1 capital ratio of at least 5% and a leverage ratio of at least 5% and not be subject to an individualized order, directive or agreement under which its primary federal banking regulator requires it to maintain a specific capital level. As of December 31, 2016, First Financial Northwest Bank met the requirements to be "well capitalized" and met the fully phased-in capital conservation buffer requirement.

The table below sets forth First Financial Northwest Bank's capital position at December 31, 2016 and 2015, based on FDIC thresholds to be well-capitalized.

	December 31,			
	2016		2015	
	Amount	Ratio	Amount	Ratio
	(Dollars in thousands)			
Bank equity capital under U.S. Generally Accepted Accounting Principles ("GAAP")	$118,346		$112,404	
Tier 1 leverage capital	$119,652	11.17%	$112,613	11.61%
Tier 1 leverage capital requirement	53,558	5.00	48,484	5.00
Excess	$66,094	6.17 %	$64,129	6.61 %
Common equity tier 1	$119,652	14.36%	$112,613	16.36%
Common equity tier 1 capital requirement	54,163	6.50	44,735	6.50
Excess	$65,489	7.86 %	$67,878	9.86 %
Tier 1 risk-based capital	$119,652	14.36%	$112,613	16.36%
Tier 1 risk-based capital requirement	$66,662	8.00 %	$55,058	8.00 %
Excess	$52,990	6.36 %		