

First Financial Northwest, Inc.  
Form 10-K  
March 10, 2017  
UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-K

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 (I.R.S. Employer Identification Number)  
organization)

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

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to submit and post such files). YES  NO

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§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.

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  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

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).

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FIRST FINANCIAL NORTHWEST, INC.  
2016 ANNUAL REPORT ON FORM 10-K  
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### 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 conditional verbs such as “may,” “will,” “should,” “would” and “could.” Forward-looking statements include statements with respect to our 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](http://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](http://www.sec.gov) or by calling the SEC at 1-800-SEC-0330.

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## 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.

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Borrower <sup>(1)</sup>	Number of Loans	One-to-Four	Commercial	Construction/Land	Aggregate Balance of Loans <sup>(2)</sup>	
		Family Residential	Real Estate (Rental Properties)			
(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

<sup>(1)</sup> The composition of borrowers represented in the table may change between periods.

<sup>(2)</sup> 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: <sup>(1)</sup>										
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)

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(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.

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

	December 31,		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	



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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 <sup>(1)</sup>		Other Washington		Total in Washington State		All Other States <sup>(2)</sup>		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	11,599.4	9.4	123,250	100.0 %