

First Financial Northwest, Inc.
Form 10-K
March 31, 2008

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, 2007 OR

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

Commission File Number: 000-33652

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

Washington
(State or other jurisdiction of incorporation or
organization)

26-0610707
(I.R.S. Employer Identification
Number)

201 Wells Avenue South,
Renton, Washington
(Address of principal executive offices)

98057
(Zip Code)

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

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

Common Stock, \$.01 par value per share
(Title of Each Class)

The Nasdaq Stock Market LLC
(Name of Each Exchange on Which
Registered)

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

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

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

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

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

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of A large accelerated filer, @ Accelerated filer@ and smaller reporting company in Rule 12b-2 of the Exchange Act (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

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

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 December 31, 2007* was \$220,924,531 (22,451,680 shares at \$9.84 per share). For purposes of this calculation, common stock held only by executive officers and directors of the Registrant is considered to be held by affiliates. As of March 26, 2008, the registrant had outstanding 22,852,800 shares of common stock.

* The Registrant was not a public company the last business day of the second quarter of its fiscal year and therefore has used December 31, 2007.

DOCUMENTS INCORPORATED BY REFERENCE

1. Portions of Registrant's Definitive Proxy Statement for the 2008 Annual Meeting of Shareholders (Part III).
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FIRST FINANCIAL NORTHWEST, INC.
2007 ANNUAL REPORT ON FORM 10-K

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Forward-Looking Statements

ASafe Harbor@ statement under the Private Securities Litigation Reform Act of 1995: This Form 10-K contains certain "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements may be identified by the use of words such as "believe," "expect," "anticipate," "should," "planned," "estimated," and "potential." These forward-looking statements relate to, among other things, expectations of the business environment in which the Company operates, projections of future performance, perceived opportunities in the market, potential future credit experience, and statements regarding the Company=s strategies. These forward-looking statements are based upon current management expectations and may, therefore, involve risks and uncertainties. The Company=s 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: interest rate fluctuations; economic conditions in the Company=s primary market area; deposit flows; demand for residential, construction/land development, commercial real estate, consumer, and other types of loans; our ability to manage our growth, levels of our non-performing assets and other loans of concern; real estate values; success of new products; competitive conditions between banks and non-bank financial service providers; regulatory and accounting changes; success of new technology; technological factors affecting operations; costs of technology; pricing of products and services; and other risks detailed from time to time in our filings with the Securities and Exchange Commission. Accordingly, these factors should be considered in evaluating forward-looking statements, and undue reliance should not be placed on such statements. The Company undertakes no responsibility to update or revise any forward-looking statements. These risks could cause our actual results beyond 2007 to differ materially from those expressed in any financial statements made by or on behalf of the Company.

As used throughout this report, the terms Awe@, Aour@, Aus@ or the ACompany@ refer to First Financial Northwest, Inc. and its consolidated subsidiaries.

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PART I

Item 1. Business

General

First Financial Northwest, Inc. ("First Financial Northwest" or ACompany@), a Washington corporation, was formed on June 1, 2007 for the purpose of becoming the holding company for First Savings Bank Northwest ("First Savings Bank") in connection with the conversion from a mutual holding company structure to a stock holding company structure. The mutual to stock conversion was completed on October 9, 2007 through the sale and issuance of 22,852,800 shares of common stock by First Financial Northwest including 1,692,800 shares contributed to our charitable foundation the First Financial Northwest Foundation, Inc. that was established in connection with the mutual to stock conversion. At December 31, 2007, we had total assets of \$1.1 billion, total deposits of \$729.5 million and total shareholders' equity of \$309.3 million. First Financial Northwest=s business activities generally are limited to passive investment activities and oversight of its investment in First Savings Bank. Accordingly, the information set forth in this report, including consolidated financial statements and related data, relates primarily to First Savings Bank.

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

First Savings Bank is examined and regulated by the Washington Department of Financial Institutions, its primary regulator, and by the Federal Deposit Insurance Corporation. First Savings Bank is required to have certain reserves set by the Board of Governors of the Federal Reserve System and is a member of the Federal Home Loan Bank of Seattle, which is one of the 12 regional banks in the Federal Home Loan Bank System.

First Savings Bank is a community-based savings bank primarily serving King and to a lesser extent, Pierce and Snohomish counties, Washington through our full-service banking office and automated teller machine. We are in the business of attracting deposits from the public and utilizing those deposits to originate loans. Our recent business strategy has included an increased emphasis on the expansion of construction/land development and commercial real estate lending. Consistent with this strategy, on December 30, 2005 we completed our acquisition of Executive House, Inc., a mortgage banking company, in a cash acquisition for approximately \$15.0 million. Prior to the acquisition, in the normal course of business, we purchased loans from Executive House for which Executive House maintained the servicing rights.

During 2006 and 2007, we continued to operate Executive House as a separate subsidiary, primarily originating loans on behalf of First Savings Bank. Effective January 1, 2008, the lending operations of Executive House were assumed by First Savings Bank, creating a commercial lending division within First Savings Bank while retaining Executive House's commercial real estate/construction lending emphasis.

A large percentage of our loans consist of construction/land development loans and to a lesser extent, commercial and multi-family loans which were originated by our subsidiary, Executive House either prior to or subsequent to our acquisition. At the time of the acquisition, Executive House had total assets of \$71.9 million, net outstanding loans of \$70.3 million and was servicing \$297.0 million of loans, including \$234.2 million owned by First Savings Bank.

At December 31, 2007, \$288.4 million or 28.82% of our total loan portfolio consisted of construction/land development loans and \$204.8 million or 20.46% of our total loan portfolio consisted of commercial real estate loans, including commercial real estate construction loans of \$15.5 million. At that date, \$76.0 million or 7.60% of our total loan portfolio consisted of multi-family residential real estate loans. There were no multi-family construction loans at December 31, 2007. Through Executive House we have established core lending relationships with real estate builders representing \$190.8 million, or 66.16% of our total construction/land development loan portfolio at December 31, 2007.

Of this amount, \$103.1 million or 35.75% in total, or \$81.0 million or 41.24%, net of loans in process, are construction/land development loans with three builders. See Item 1A., A Risk Factors B Our business is subject to various lending risks which could adversely impact our results of operations and financial condition. @ Because the acquisition was consummated on December 30, 2005, the assets and liabilities of Executive House were included in our consolidated balance sheets at December 31, 2005. However, the results of operations of Executive House have not been included in our consolidated financial statements for the periods before the completion of the acquisition.

We also originate mortgage loans secured by one- to four-family residential real estate and consumer loans. At December 31, 2007, \$424.9 million or 42.45% of our total loan portfolio was comprised of one- to four-family loans and \$6.7 million or 0.67% of our total loan portfolio were consumer loans.

The principal executive offices of First Savings Bank are located at 201 Wells Avenue South, Renton, Washington, 98057 and its telephone number is (425) 255-4400.

Recent Developments

New Chief Financial Officer. Effective February 19, 2008, the Company hired Kari A. Stenslie as its Chief Financial Officer. Ms. Stenslie is a certified public accountant having nearly 20 years of financial institution experience.

Executive Vice President of Commercial and Construction Lending. Effective January 1, 2008, David G. Kroeger was promoted from Executive Vice President of Executive House to Executive Vice President of Commercial and Construction Lending of First Savings Bank as part of the assumption of Executive House's operations by First Savings Bank.

Chief Operating Officer. Effective January 1, 2008, Roger Elmore was promoted from Senior Operations Officer to Senior Vice President and Chief Operating Officer of First Savings Bank. Mr. Elmore has been with First Savings Bank since 2004.

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

Market Area

We consider our primary market area to be the Puget Sound Region, which consists primarily of King, Snohomish and Pierce counties. The economy of the King, Snohomish and Pierce counties has performed well over the last few years, spurred on by strong growth despite the downsizing of one of its major employers, the Boeing Company during the past decade. A reduction in growth in any of these markets can adversely affect the level of our construction and commercial real estate lending. Recently, slower housing market conditions have resulted in an increase of delinquencies in our market area. For more information regarding loan delinquencies and impaired loans see "Asset Quality."

King County has the largest population of any county in the State of Washington, covers approximately 2,134 square miles, and is located on the Puget Sound. It has a population of approximately 1.8 million residents according to the U.S. Census Bureau 2006 estimates, and a median household income of approximately \$75,600 according to 2007

HUD estimates. King County has a diversified economic base with many industries including shipping and transportation, aerospace (Boeing) and computer technology and biotech industries. According to the Washington State Employment Security Department, the unemployment rate for King County decreased to 3.6% at December 31, 2007 from 4.1% at December 31, 2006. Residential housing values depreciated in the King County market by 1.1% in the year ended 2007, with a median home price of \$435,000 according to the Northwest Multiple Listing Service.

Pierce County has the second largest population of any county in the State of Washington, covers approximately 1,790 square miles and is located along western Puget Sound. It has approximately 767,000 residents according to the U.S. Census Bureau 2006 estimates, and a median household income of approximately \$61,500 according to 2007 U.S. Department of Housing and Urban Development estimates. The Pierce County economy is diversified with the presence of military related government employment (Fort Lewis Army Base and McChord Air Force Base), 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 remained unchanged at 4.9% at December 2007 from 4.9% December 2006. Residential housing values appreciated in the Pierce County market by 0.7% in the year ended 2007 with a median home price of \$277,000 according to the Northwest Multiple Listing Service.

Snohomish County has the third largest population of any county in the State of Washington, covers approximately 2,090 square miles and is located on Puget Sound touching the northern boarder of King County. It has approximately 670,000 residents according to the U.S. Census Bureau 2006 estimates, and a median household income of approximately \$75,600 according to 2007 U.S. Department of Housing and Urban Development estimates. The economy of Snohomish County is diversified with the presence of military related government employment (Everett Homeport Naval Base), aerospace related employment (Boeing) and retail trade. The unemployment rate for Snohomish County decreased to 4.2% at December 2007 from 4.4% at December 2006. Residential housing values depreciated in the Snohomish County market by 0.4% in the year ended 2007 with a median home price of \$359,000 according to the Northwest Multiple Listing Service.

For a discussion regarding the competition in our primary market area, see A-- Competition.@

Lending Activities

General. We focus our lending activities primarily on the origination of loans secured by first mortgages on owner-occupied one- to four-family residences, commercial real estate, multi-family real estate, and real-estate construction/land development loans. We offer a limited variety of consumer secured loans, including savings account loans and home equity loans, which includes lines of credit and second mortgage loans. As of December 31, 2007, the net loan portfolio totaled \$880.7 million and represented 77.19% of our total assets.

Our loan policy limits the maximum amount of loans we can make to one borrower to 20% of First Savings Bank=s risk-based capital. As of December 31, 2007, the maximum amount which we could lend to any one borrower was \$38.6 million based on our policy. Exceptions may be made to this policy with the prior approval of the board of directors if the borrower exhibits financial strength or compensating factors to sufficiently offset any weaknesses based on the loan-to-value ratio, borrower=s financial condition, net worth, credit history, earnings capacity, installment obligations, and current payment habits. The five largest borrowing relationships as of December 31, 2007 in descending order are:

Borrower	Aggregate Amount of Loans (1)	Collateral	Number of Loans
Real estate builder	\$40.5 million	residential properties	138
Real estate builder	\$40.0 million	residential properties	96
Real estate builder	\$28.0 million (2)	residential properties	89
Real estate builder	\$27.5 million	residential properties	97
Real estate builder	\$19.7 million	residential properties	128

(1) Net of loans in process at December 31, 2007.

(2) Of this amount, \$23.5 million is considered impaired loans.

All of the loans to these five builders have personal guarantees in place as an additional source of repayment including those made to partnerships and corporations. All of the properties securing these loans were in our geographic market area. Management plans to continue to originate real estate and consumer loans primarily within the market area we serve.

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Loan Portfolio Analysis. The following table sets forth the composition of First Savings Bank=s loan portfolio by type of loan at the dates indicated.

	2007		2006		At December 31, 2005		2004		2003	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
(Dollars in Thousands)										
Real Estate:										
One- to four-family residential	\$ 424,863	42.45%	\$ 373,192	48.86%	\$ 266,081	43.18%	\$ 231,553	56.87%	\$ 216,259	60.00%
Multi-family residential	76,039	7.60	79,701	10.44	68,267	11.08	61,913	15.20	55,472	15.50%
Commercial	204,798	20.46	153,924	20.15	109,300	17.73	86,558	21.26	68,300	19.20%
Construction/land development	288,378	28.82	153,401	20.08	171,246	27.79	25,265	6.20	13,880	3.90%
Total real estate	994,078	99.33	760,218	99.53	614,894	99.78	405,289	99.53	353,911	99.60%
Consumer:										
Home equity	6,368	0.64	3,038	0.40	915	0.15	932	0.23	1,074	3.00%
Savings account	127	0.01	296	0.04	209	0.03	553	0.14	326	0.90%
Other	177	0.02	203	0.03	217	0.04	419	0.10	353	1.00%
Total consumer	6,672	0.67	3,537	0.47	1,341	0.22	1,904	0.47	1,753	0.50%
Total loans	1,000,750	100.00%	763,755	100.00%	616,235	100.00%	407,193	100.00%	355,664	100.00%
Less:										
Loans in process	108,939		58,731		71,532		19,762		8,362	
Deferred loan fees	3,176		2,725		2,357		2,308		2,362	