

BankFinancial CORP  
Form 10-Q  
May 08, 2013

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

FORM 10-Q

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

For the Quarterly Period ended March 31, 2013

or

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

For transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission File Number 0-51331

BANKFINANCIAL CORPORATION  
(Exact Name of Registrant as Specified in Charter)

Maryland  
(State or Other Jurisdiction  
of Incorporation)

75-3199276  
(I.R.S. Employer  
Identification No.)

15W060 North Frontage Road, Burr Ridge, Illinois 60527

(Address of Principal Executive Offices)

Registrant's telephone number, including area code: (800) 894-6900

Not Applicable

(Former name or former address, if changed since last report)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or 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. (Check one):

Large accelerated filer	<input type="checkbox"/>	Accelerated filer	<input checked="" type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/>	Smaller reporting company	<input type="checkbox"/>

Indicate the number of shares outstanding of each of the Issuer's classes of common stock as of the latest practicable date, at May 6, 2013, there were 21,072,966 shares of Common Stock, \$0.01 par value, outstanding.



BANKFINANCIAL CORPORATION

Form 10-Q

March 31, 2013

Table of Contents

	Page Number
<u>PART I</u>	
Item 1. <u>Financial Statements and Supplementary Data</u>	<u>3</u>
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>31</u>
Item 3. <u>Quantitative and Qualitative Disclosure about Market Risk</u>	<u>43</u>
Item 4. <u>Controls and Procedures</u>	<u>45</u>
<u>PART II</u>	
Item 1. <u>Legal Proceedings</u>	<u>46</u>
Item 1A. <u>Risk Factors</u>	<u>46</u>
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>46</u>
Item 3. <u>Default Upon Senior Securities</u>	<u>46</u>
Item 4. <u>Mine Safety Disclosures</u>	<u>46</u>
Item 5. <u>Other Information</u>	<u>46</u>
Item 6. <u>Exhibits and Financial Statement Schedules</u>	<u>46</u>
<u>Signatures</u>	<u>47</u>

---

Table of Contents

## BANKFINANCIAL CORPORATION

## CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

(In thousands, except share and per share data) - Unaudited

	March 31, 2013	December 31, 2012
Assets		
Cash and due from other financial institutions	\$17,742	\$20,361
Interest-bearing deposits in other financial institutions	293,386	255,403
Cash and cash equivalents	311,128	275,764
Securities, at fair value	61,273	77,832
Loans held-for-sale	55	2,166
Loans receivable, net of allowance for loan losses: March 31, 2013, \$17,453 and December 31, 2012, \$18,035	1,004,404	1,030,465
Other real estate owned, net	8,088	10,358
Stock in Federal Home Loan Bank, at cost	7,566	8,412
Premises and equipment, net	37,530	38,251
Accrued interest receivable	3,951	4,146
Core deposit intangible	2,882	3,038
Bank owned life insurance	21,715	21,645
FDIC prepaid expense	2,188	2,658
Income tax receivable	—	461
Other assets	5,355	5,996
Total assets	\$1,466,135	\$1,481,192
Liabilities:		
Deposits		
Noninterest-bearing	\$131,856	\$134,597
Interest-bearing	1,139,694	1,147,754
Total deposits	1,271,550	1,282,351
Borrowings	2,740	5,567
Advance payments by borrowers taxes and insurance	9,790	10,705
Accrued interest payable and other liabilities	8,416	9,679
Total liabilities	1,292,496	1,308,302
Commitments and contingent liabilities		
Stockholders' equity:		
Preferred Stock, \$0.01 par value, 25,000,000 shares authorized, none issued or outstanding	—	—
Common Stock, \$0.01 par value, 100,000,000 shares authorized; 21,072,966 shares issued at March 31, 2013 and December 31, 2012	211	211
Additional paid-in capital	193,544	193,590
Retained earnings (deficit)	(9,118	) (9,796 )
Unearned Employee Stock Ownership Plan shares	(11,992	) (12,233 )
Accumulated other comprehensive income	994	1,118
Total stockholders' equity	173,639	172,890
Total liabilities and stockholders' equity	\$1,466,135	\$1,481,192

See accompanying notes to the consolidated financial statements.

3

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Table of Contents

## BANKFINANCIAL CORPORATION

## CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except share and per share data) - Unaudited

	For the Three Months Ended	
	March 31,	
	2013	2012
Interest and dividend income		
Loans, including fees	\$12,278	\$16,112
Securities	250	442
Other	185	80
Total interest income	12,713	16,634
Interest expense		
Deposits	986	1,214
Borrowings	8	26
Total interest expense	994	1,240
Net interest income	11,719	15,394
Provision for loan losses	722	996
Net interest income after provision for loan losses	10,997	14,398
Noninterest income		
Deposit service charges and fees	499	557
Other fee income	375	385
Insurance commissions and annuities income	109	122
Gain on sale of loans, net	1,417	267
Loan servicing fees	123	128
Amortization and impairment of servicing assets	(33	) (82
Earnings on bank owned life insurance	70	126
Trust	181	184
Other	125	145
	2,866	1,832
Noninterest expense		
Compensation and benefits	6,752	6,679
Office occupancy and equipment	1,948	2,032
Advertising and public relations	146	106
Information technology	749	848
Supplies, telephone, and postage	461	390
Amortization of intangibles	156	163
Nonperforming asset management	694	1,240
Operations of other real estate owned	511	552
FDIC insurance premiums	492	348
Other	1,276	1,078
	13,185	13,436
Income before income taxes	678	2,794
Income tax expense	—	457
Net income	\$678	\$2,337
Basic earnings per common share	\$0.03	\$0.12
Diluted earnings per common share	\$0.03	\$0.12
Weighted average common shares outstanding	19,964,028	19,835,273
Diluted weighted average common shares outstanding	19,964,028	19,836,080

See accompanying notes to the consolidated financial statements.

4

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Table of Contents

BANKFINANCIAL CORPORATION

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands) - Unaudited

	For the Three Months Ended March 31,	
	2013	2012
Net income	\$678	\$2,337
Unrealized holding loss arising during the period, net of tax	(124	) (55
Amount reclassified from accumulated other comprehensive income	—	—
Net current period other comprehensive loss	(124	) (55
Comprehensive income	\$554	\$2,282

See accompanying notes to the consolidated financial statements.



Table of Contents

## BANKFINANCIAL CORPORATION

## CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

(In thousands, except per share data) - Unaudited

	Common Stock	Additional Paid-in Capital	Retained Earnings	Unearned Employee Stock Ownership Plan Shares	Accumulated Other Comprehen-sive Income	Total
Balance at January 1, 2012	\$211	\$193,801	\$17,946	\$(13,212 )	\$ 1,111	\$199,857
Net income	—	—	2,337	—	—	2,337
Other comprehensive income, net of tax effects	—	—	—	—	(55 )	(55 )
Nonvested stock awards-stock-based compensation expense	—	21	—	—	—	21
Cash dividends declared on common stock (\$0.01 per share)	—	—	(211 )	—	—	(211 )
ESOP shares earned	—	(82 )	—	244	—	162
Balance at March 31, 2012	\$211	\$193,740	\$20,072	\$(12,968 )	\$ 1,056	\$202,111
Balance at January 1, 2013	\$211	\$193,590	\$(9,796 )	\$(12,233 )	\$ 1,118	\$172,890
Net income	—	—	678	—	—	678
Other comprehensive income, net of tax effects	—	—	—	—	(124 )	(124 )
ESOP shares earned	—	(46 )	—	241	—	195
Balance at March 31, 2013	\$211	\$193,544	\$(9,118 )	\$(11,992 )	\$ 994	\$173,639

See accompanying notes to the consolidated financial statements.

Table of ContentsBANKFINANCIAL CORPORATION  
CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands) - Unaudited

	For the Three Months Ended March 31,	
	2013	2012
Cash flows from operating activities		
Net income	\$678	\$2,337
Adjustments to reconcile to net income to net cash from operating activities		
Provision for loan losses	722	996
ESOP shares earned	195	162
Stock-based compensation expense	—	21
Depreciation and amortization	1,111	1,154
Amortization of premiums and discounts on securities and loans	(214	) (943
Amortization of core deposit and other intangible assets	156	163
Amortization and impairment of servicing assets	33	82
Net change in net deferred loan origination costs	14	60
Net loss (gain) on sale of other real estate owned	69	(139
Net gain on sale of loans	(1,417	) (267
Loans originated for sale	(3,357	) (6,127
Proceeds from sale of loans	4,163	7,791
Other real estate owned valuation adjustments	89	389
Net change in:		
Accrued interest receivable	195	662
Earnings on bank owned life insurance	(70	) (126
Other assets	1,163	603
Accrued interest payable and other liabilities	(1,263	) (2,553
Net cash from operating activities	2,267	4,265
Cash flows from investing activities		
Securities		
Proceeds from maturities	14,626	6,455
Proceeds from principal repayments	4,938	6,209
Purchases of securities	(3,175	) (1,153
Loans receivable		
Principal payments on loans receivable	130,457	156,725
Purchases of loans	—	—
Originated for investment	(105,573	) (108,142
Proceeds from sale of loans	2,868	—
Proceeds of redemption of Federal Home Loan Bank of Chicago stock	846	5,010
Proceeds from sale of other real estate owned	2,667	2,984
Purchase of premises and equipment, net	(14	) (685
Net cash from investing activities	47,640	67,403

Continued

Table of ContentsBANKFINANCIAL CORPORATION  
CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands) - Unaudited

	For the Three Months Ended March 31,	
	2013	2012
Cash flows from financing activities		
Net change in deposits	\$(10,801	) \$(11,914
Net change in borrowings	(2,827	) (2,840
Net change in advance payments by borrowers for taxes and insurance	(915	) 673
Repurchase and retirement of common stock	—	—
Cash dividends paid on common stock	—	(211
Net cash used in financing activities	(14,543	) (14,292
Net change in cash and cash equivalents	35,364	57,376
Beginning cash and cash equivalents	275,764	120,704
Ending cash and cash equivalents	\$311,128	\$178,080
Supplemental disclosures of cash flow information:		
Interest paid	\$1,014	\$1,263
Income taxes paid	—	—
Income taxes refunded	461	—
Loans transferred to other real estate owned	555	1,127

See accompanying notes to the consolidated financial statements.

Table of Contents

BANKFINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Table amounts in thousands, except share and per share data)

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Basis of Presentation:** BankFinancial Corporation, a Maryland corporation headquartered in Burr Ridge, Illinois (the “Company”), is the owner of all of the issued and outstanding capital stock of BankFinancial, F.S.B. (the “Bank”).

**Principles of Consolidation:** The interim unaudited consolidated financial statements include the accounts of and transactions of BankFinancial Corporation, the Bank, and the Bank’s wholly-owned subsidiaries, Financial Assurance Services, Inc. and BF Asset Recovery Corporation (collectively, “the Company”), and reflect all normal and recurring adjustments that are, in the opinion of management, considered necessary for a fair presentation of the financial condition and results of operations for the periods presented. All significant intercompany accounts and transactions have been eliminated. The results of operations for the three months ended March 31, 2013, are not necessarily indicative of the results of operations that may be expected for the year ending December 31, 2013.

Certain information and note disclosures normally included in financial statements prepared in conformity with accounting principles generally accepted in the United States of America (“GAAP”) have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission.

**Use of Estimates:** To prepare financial statements in conformity with GAAP, management makes estimates and assumptions based on available information. These estimates and assumptions affect the amounts reported in the financial statements and the disclosures provided, and future results could differ. The allowance for loan losses, mortgage servicing rights, deferred tax assets, goodwill, other intangible assets, stock-based compensation, impairment of securities and fair value of financial instruments are particularly subject to change and the effect of such change could be material to the financial statements.

**Reclassifications:** Certain reclassifications have been made in the prior period’s financial statements to conform them to the current period’s presentation.

These unaudited consolidated financial statements should be read in conjunction with the Company’s Annual Report on Form 10-K for the year ended December 31, 2012, as filed with the Securities and Exchange Commission.

**Recent Accounting Pronouncements**

In February 2013, the Financial Accounting Standards Board issued an amendment to improve the reporting of reclassifications out of accumulated other comprehensive income. ASC Topic 220, “Comprehensive Income” amended prior guidance to improve the reporting of reclassifications out of accumulated other comprehensive income by requiring an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, an entity is required to present, either on the face of the statement or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income if the amount reclassified is required under GAAP. The Company adopted this new authoritative guidance on January 1, 2013, and it did not have an impact on the Company’s statements of operations and financial condition as the Company did not have any amounts reclassified during the periods ended March 31, 2013 and 2012.

Table of Contents

## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Table amounts in thousands, except share and per share data)

## NOTE 2 - EARNINGS PER SHARE

Amounts reported in earnings per share reflect earnings available to common stockholders for the period divided by the weighted average number of shares of common stock outstanding during the period, exclusive of unearned ESOP shares and unvested restricted stock shares. Stock options and restricted stock are regarded as potential common stock and are considered in the diluted earnings per share calculations to the extent that they would have a dilutive effect if converted to common stock.

	For the Three Months Ended March 31,	
	2013	2012
Net income available to common stockholders	\$678	\$2,337
Average common shares outstanding	21,072,966	21,072,966
Less:		
Unearned ESOP shares	(1,108,938	) (1,233,359
Unvested restricted stock shares	—	(4,334
Weighted average common shares outstanding	19,964,028	19,835,273
Add - Net effect of dilutive stock options and unvested restricted stock	—	807
Weighted average dilutive common shares outstanding	19,964,028	19,836,080
Basic earnings per common share	\$0.03	\$0.12
Diluted earnings per common share	\$0.03	\$0.12
Number of antidilutive stock options excluded from the diluted earnings per share calculation	—	2,055,553
Weighted average exercise price of anti-dilutive option shares	\$—	\$16.53

Table of Contents

## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Table amounts in thousands, except share and per share data)

## NOTE 3 - SECURITIES

The fair value of securities and the related gross unrealized gains and losses recognized in accumulated other comprehensive income is as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
March 31, 2013				
Certificates of deposit	\$22,281	\$—	\$—	\$22,281
Municipal securities	350	16	—	366
Equity mutual fund	500	24	—	524
Mortgage-backed securities - residential	31,026	1,614	(31	) 32,609
Collateralized mortgage obligations - residential	5,398	63	(8	) 5,453
SBA-guaranteed loan participation certificates	40	—	—	40
	\$59,595	\$1,717	\$(39	) \$61,273
December 31, 2012				
Certificates of deposit	\$33,456	\$—	\$—	\$33,456
Municipal securities	350	19	—	369
Equity mutual fund	500	28	—	528
Mortgage-backed securities - residential	32,572	1,661	—	34,233
Collateralized mortgage obligations - residential	9,111	95	(2	) 9,204
SBA-guaranteed loan participation certificates	42	—	—	42
	\$76,031	\$1,803	\$(2	) \$77,832

Mortgage-backed securities and collateralized mortgage obligations reflected in the preceding table were issued by U.S. government-sponsored entities and agencies, Freddie Mac, Fannie Mae and Ginnie Mae, and are obligations which the government has affirmed its commitment to support. All securities reflected in the preceding table were classified as available-for-sale at March 31, 2013 and December 31, 2012.

The amortized cost and fair values of securities by contractual maturity are shown below. Securities not due at a single maturity date are shown separately. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	March 31, 2013	
	Amortized Cost	Fair Value
Due in one year or less	\$22,451	\$22,455
Due after one year through five years	180	192
	22,631	22,647
Equity mutual fund	500	524
Mortgage-backed securities - residential	31,026	32,609
Collateralized mortgage obligations - residential	5,398	5,453
SBA-guaranteed loan participation certificates	40	40
	\$59,595	\$61,273



Table of Contents

## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Table amounts in thousands, except share and per share data)

## NOTE 3 - SECURITIES (continued)

Securities with unrealized losses not recognized in income are as follows:

	Less than 12 Months		12 Months or More		Total	Unrealized
	Fair	Unrealized	Fair	Unrealized	Fair	Unrealized
	Value	Loss	Value	Loss	Value	Loss
March 31, 2013						
Mortgage-backed securities - residential	\$2,673	\$(31 )	\$—	\$—	\$2,673	\$(31 )
Collateralized mortgage obligations - residential	—	—	1,142	(8 )	1,142	(8 )
	\$2,673	\$(31 )	\$1,142	\$(8 )	\$3,815	\$(39 )
December 31, 2012						
Collateralized mortgage obligations - residential	\$—	\$—	\$1,956	\$(2 )	\$1,956	\$(2 )

The Company evaluates marketable investment securities with significant declines in fair value on a quarterly basis to determine whether they should be considered other-than-temporarily impaired under current accounting guidance, which generally provides that if a marketable security is in an unrealized loss position, whether due to general market conditions or industry or issuer-specific factors, the holder of the securities must assess whether the impairment is other-than-temporary.

A collateralized mortgage obligation that the Company holds in its investment portfolio remained in an unrealized loss position at March 31, 2013, but the unrealized loss was not considered significant under the Company's impairment testing methodology. In addition, the Company does not intend to sell this security, and it is likely that the Company will not be required to sell the security before its anticipated recovery occurs.

There were no sales of securities for the three months ended March 31, 2013 and 2012.

## NOTE 4 - LOANS RECEIVABLE

Loans receivable are as follows:

	March 31, 2013	December 31, 2012
One-to-four family residential real estate loans	\$209,540	\$218,596
Multi-family mortgage loans	338,502	352,019
Nonresidential real estate loans	261,207	264,672
Construction and land loans	6,933	8,552
Commercial loans	55,362	61,388
Commercial leases	147,168	139,783
Consumer loans	2,414	2,745
Total loans	1,021,126	1,047,755
Net deferred loan origination costs	731	745
Allowance for loan losses	(17,453 )	(18,035 )
Loans, net	\$1,004,404	\$1,030,465





Table of Contents

## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Table amounts in thousands, except share and per share data)

## NOTE 4 - LOANS RECEIVABLE

The following tables present the balance in the allowance for loan losses and the loans receivable by portfolio segment and based on impairment method:

	Allowance for loan losses				Loan Balances			
	Individually evaluated for impairment	Purchased impaired loans	Collectively evaluated for impairment	Total	Individually evaluated for impairment	Purchased impaired loans	Collectively evaluated for impairment	Total
March 31, 2013								
One-to-four family residential real estate loans	\$116	\$3	\$ 4,332	\$4,451	\$4,961	\$388	\$204,191	\$209,540
Multi-family mortgage loans	747	—	3,724	4,471	11,243	—	327,259	338,502
Nonresidential real estate loans	351	24	5,386	5,761	5,883	2,554	252,770	261,207
Construction and land loans	135	74	631	840	1,576	1,021	4,336	6,933
Commercial loans	81	—	1,149	1,230	882	21	54,459	55,362
Commercial leases	—	—	604	604	—	—	147,168	147,168
Consumer loans	—	—	96	96	—	—	2,414	2,414
	\$1,430	\$101	\$ 15,922	\$17,453	\$24,545	\$3,984	\$992,597	1,021,126
Net deferred loan origination costs								731
Allowance for loan losses Loans, net								(17,453 ) \$1,004,404
	Allowance for loan losses				Loan Balances			
	Individually evaluated for impairment	Purchased impaired loans	Collectively evaluated for impairment	Total	Individually evaluated for impairment	Purchased impaired loans	Collectively evaluated for impairment	Total
December 31, 2012								
One-to-four family residential real estate loans	\$137	\$5	\$ 4,584	\$4,726	\$5,256	\$380	\$212,960	\$218,596
Multi-family mortgage loans	729	—	3,851	4,580	4,801	—	347,218	352,019
Nonresidential real estate loans	401	8	5,136	5,545	11,918	2,568	250,186	264,672
Construction and land loans	294	96	641	1,031	2,210	1,021	5,321	8,552
Commercial loans	23	1	1,300	1,324	256	20	61,112	61,388
Commercial leases	—	—	666	666	—	—	139,783	139,783
Consumer loans	—	—	163	163	—	—	2,745	2,745
	\$1,584	\$110	\$ 16,341	\$18,035	\$24,441	\$3,989	\$1,019,325	1,047,755

Net deferred loan origination costs	745
Allowance for loan losses	(18,035 )
Loans, net	\$1,030,465

Table of Contents

## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Table amounts in thousands, except share and per share data)

## NOTE 4 - LOANS RECEIVABLE (continued)

Activity in the allowance for loan losses is as follows:

	For the Three Months Ended	
	March 31,	
	2013	2012
Beginning balance	\$18,035	\$31,726
Loans charged offs:		
One-to-four family residential real estate loans	(369	) (672
Multi-family mortgage loans	(236	) (554
Nonresidential real estate loans	(79	) (433
Construction and land loans	(927	) (47
Commercial loans	(19	) (138
Consumer loans	—	(12
	(1,630	) (1,856
Recoveries:		
One-to-four family residential real estate loans	242	111
Multi-family mortgage loans	57	384
Nonresidential real estate loans	19	31
Construction and land loans	2	184
Commercial loans	5	57
Commercial leases	—	—
Consumer loans	1	5
	326	772
Net charge-off	(1,304	) (1,084
Provision for loan losses	722	996
Ending balance	\$17,453	\$31,638
Impaired loans		

Several of the following disclosures are presented by “recorded investment,” which the FASB defines as “the amount of the investment in a loan, which is not net of a valuation allowance, but which does reflect any direct write-down of the investment.” The following represents the components of recorded investment:

Loan principal balance  
 Less unapplied payments  
 Plus negative unapplied balance  
 Less escrow balance  
 Plus negative escrow balance  
 Plus unamortized net deferred loan costs  
 Less unamortized net deferred loan fees  
 Plus unamortized premium  
 Less unamortized discount  
 Less previous charge-offs  
 Plus recorded accrued interest  
 Less reserve for uncollected interest  
 = Recorded investment



Table of Contents

## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Table amounts in thousands, except share and per share data)

## NOTE 4 - LOANS RECEIVABLE (continued)

The following table presents loans individually evaluated for impairment by class of loans, excluding purchased impaired loans:

	Loan Balance	Recorded Investment	Partial Charge-off	Allowance for Loan Losses Allocated	Average Investment in Impaired Loans	Interest Income Recognized
March 31, 2013						
With no related allowance recorded:						
One-to-four family residential real estate loans	\$5,142	\$ 4,047	\$ 1,051	\$ —	\$ 2,983	\$ 15
One-to-four family residential real estate loans - non-owner occupied	810	649	139	—	1,379	7
Multi-family mortgage loans	7,651	7,379	4	—	3,417	12
Nonresidential real estate loans	4,088	3,467	251	—	5,519	2
Land loans	421	310	108	—	78	—
Commercial loans - secured	—	—	—	—	52	—
Commercial loans - unsecured	125	53	70	—	—	—
	18,237	15,905	1,623	—	13,428	36
With an allowance recorded:						
One-to-four family residential real estate loans	162	149	3	18	—	—
One-to-four family residential real estate loans - non-owner occupied	134	100	34	98	373	—
Multi-family mortgage loans	3,609	3,099	477	685	2,758	9
Wholesale commercial lending	656	647	—	62	162	7
Nonresidential real estate loans	2,628	2,404	181	351	2,511	3
Land loans	2,500	1,264	1,232	135	1,972	—
Commercial loans - secured	1,034	830	201	81	361	—
	10,723	8,493	2,128	1,430	8,137	19
Total	\$28,960	\$ 24,398	\$ 3,751	\$ 1,430	\$ 21,565	\$ 55

Table of Contents

## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Table amounts in thousands, except share and per share data)

## NOTE 4 - LOANS RECEIVABLE (continued)

	Loan Balance	Recorded Investment	Partial Charge-off	Allowance for Loan Losses Allocated	Average Investment in Impaired Loans	Interest Income Recognized
December 31, 2012						
With no related allowance recorded:						
One-to-four family residential real estate loans	\$5,250	\$ 4,216	\$ 1,027	\$ —	\$ 2,814	\$ 149
One-to-four family residential real estate loans - non-owner occupied	567	534	34	—	4,322	90
Multi-family mortgage loans	2,959	2,106	819	—	9,303	189
Nonresidential real estate loans	11,850	9,220	2,490	—	6,218	347
Land loans	—	—	—	—	409	—
Commercial loans - secured	—	—	—	—	137	—
Commercial loans - other	529	52	477	—	25	21
Non-rated commercial leases	—	—	—	—	23	3
	21,155	16,128	4,847	—	23,251	799
With an allowance recorded:						
One-to-four family residential real estate loans	—	—	—	—	2,500	—
One-to-four family residential real estate loans - non-owner occupied	626	499	128	137	1,996	13
Multi-family mortgage loans	3,182	2,645	521	729	6,562	20
Wholesale commercial lending	—	—	—	—	—	—
Nonresidential real estate loans	2,825	2,549	266	401	21,077	20
Land loans	3,812	2,210	1,602	294	2,933	113
Commercial loans - secured	386	204	182	23	1,849	—
Commercial loans - unsecured	—	—	—	—	267	—
Non-rated commercial leases	—	—	—	—	36	—
Consumer loans	—	—	—	—	2	—
	10,831	8,107	2,699	1,584	37,222	166
Total	\$31,986	\$ 24,235	\$ 7,546	\$ 1,584	\$ 60,473	\$ 965

## Purchased Impaired Loans

As a result of its acquisition of Downers Grove National Bank, the Company holds purchased loans for which there was evidence of deterioration of credit quality since origination and for which it was probable that all contractually required payments would not be collected as of the date of the acquisition. The carrying amount of these purchased impaired loans is as follows:

	March 31, 2013	December 31, 2012
One-to-four family residential real estate loans	\$388	\$380
Nonresidential real estate loans	2,554	2,568
Land loans	1,021	1,021
Commercial loans	21	20
Outstanding balance	\$3,984	\$3,989
Carrying amount, net of allowance (\$101 at March 31, 2013, \$110 at December 31, 2012)	\$3,883	\$3,879





Table of Contents

## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Table amounts in thousands, except share and per share data)

## NOTE 4 - LOANS RECEIVABLE (continued)

Accretable yield, or income expected to be collected, related to purchased impaired loans is as follows:

	For the Three Months Ended	
	March 31,	
	2013	2012
Beginning balance	\$196	\$2,270
New loans purchased	—	—
Disposals	—	127
Accretion of income	50	353
Ending balance	\$146	\$1,790

For the above purchased impaired loans, the Company decreased the allowance for loan losses by \$9,000 for the three months ended March 31, 2013 and increased the allowance for loan losses by \$337,000 for the three months ended March 31, 2012.

Purchased impaired loans for which it was probable at the date of acquisition that all contractually required payments would not be collected are as follows:

	March 31, 2013	December 31, 2012
Contractually required payments receivable of loans purchased:		
One-to-four family residential real estate loans	\$1,143	\$1,143
Nonresidential real estate loans	3,871	3,884
Land loans	1,600	1,600
Commercial loans	222	597
	\$6,836	\$7,224

At acquisition, cash flows expected to be collected were \$18.8 million, compared to the fair value of purchased impaired loans of \$15.4 million.

Table of Contents

## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Table amounts in thousands, except share and per share data)

## NOTE 4 - LOANS RECEIVABLE (continued)

## Nonaccrual loans

The following table presents the recorded investment in nonaccrual loans and loans past due over 90 days still on accrual by class of loans, excluding purchased impaired loans:

	Loan Balance	Recorded Investment	Loans Past Due Over 90 Days, Still Accruing
March 31, 2013			
One-to-four family residential real estate loans	\$6,223	\$5,122	\$—
One-to-four family residential real estate loans – non owner occupied	1,106	866	—
Multi-family mortgage loans	11,197	10,174	243
Wholesale commercial lending	656	648	—
Nonresidential real estate loans	7,125	6,182	—
Land loans	2,921	1,575	—
Commercial loans – secured	1,034	830	—
Commercial loans – unsecured	125	53	—
Consumer loans	11	11	—
	\$30,398	\$25,461	\$243
December 31, 2012			
One-to-four family residential real estate loans	\$7,286	\$6,154	\$70
One-to-four family residential real estate loans – non owner occupied	1,420	1,145	—
Multi-family mortgage loans	5,246	3,517	242
Nonresidential real estate loans	12,249	8,985	—
Land loans	3,817	2,210	—
Commercial loans – secured	386	204	—
Commercial loans – unsecured	552	52	17
	\$30,956	\$22,267	\$329

Nonaccrual loans and impaired loans are defined differently. Some loans may be included in both categories, and some may only be included in one category. Nonaccrual loans include both smaller balance homogeneous loans that are collectively evaluated for impairment and individually classified impaired loans.

The Company's reserve for uncollected loan interest was \$1.2 million and \$942,000 at March 31, 2013 and December 31, 2012, respectively. Except for purchased impaired loans, when a loan is on non-accrual status and the ultimate collectability of the total principal of an impaired loan is in doubt, all payments are applied to principal under the cost recovery method. Alternatively, when a loan is on non-accrual status but there is doubt concerning only the ultimate collectability of interest, contractual interest is credited to interest income only when received, under the cash basis method pursuant to the provisions of FASB ASC 310-10, as applicable. In all cases, the average balances are calculated based on the month-end balances of the financing receivables within the period reported pursuant to the provisions of FASB ASC 310-10, as applicable.

Table of Contents

## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Table amounts in thousands, except share and per share data)

## NOTE 4 - LOANS RECEIVABLE (continued)

## Past Due Loans

The following tables presents the aging of the recorded investment of loans at March 31, 2013 by class of loans:

	30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater Past Due	Total Past Due	Loans Not Past Due	Total
One-to-four family residential real estate loans	\$ 510	\$ 305	\$ 4,123	\$ 4,938	\$ 147,736	\$ 152,674
One-to-four family residential real estate loans - non-owner occupied	504	198	811	1,513	54,569	56,082
Multi-family mortgage loans	2,145	1,208	9,762	13,115	276,979	290,094
Wholesale commercial lending	—	—	—	—	46,592	46,592
Nonresidential real estate loans	3,159	—	5,788	8,947	247,603	256,550
Construction loans	—	—	—	—	47	47
Land loans	—	—	1,375	1,375	4,454	5,829
Commercial loans:						
Secured	142	—	830	972	18,168	19,140
Unsecured	21	—	52	73	5,549	5,622
Municipal loans	—	—	—	—	4,784	4,784
Warehouse lines	—	—	—	—	1,827	1,827
Health care	—	—	—	—	17,257	17,257
Other	—	—	—	—	6,861	6,861
Commercial leases:						
Investment rated commercial leases	303	—	—	303	107,786	108,089
Below investment grade	—	—	—	—	9,644	9,644
Non-rated	—	—	—	—	25,691	25,691
Lease pools	—	—	—	—	4,594	4,594
Consumer loans	2	1	11	14	2,410	2,424
	\$ 6,786	\$ 1,712	\$ 22,752	\$ 31,250	\$ 982,551	\$ 1,013,801
	30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater Past Due	Total Past Due	Loans Not Past Due	Total
Purchased impaired loans						
One-to-four family residential real estate loans - non-owner occupied	\$—	\$—	\$ 388	\$ 388	\$—	\$ 388
Nonresidential real estate loans	—	—	1,124	1,124	1,430	2,554
Land loans	—	—	1,021	1,021	—	1,021
Commercial loans – secured	—	—	21	21	—	21
	\$—	\$—	\$ 2,554	\$ 2,554	\$ 1,430	\$ 3,984



Table of Contents

## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Table amounts in thousands, except share and per share data)

## NOTE 4 - LOANS RECEIVABLE (continued)

The following tables presents the aging of the recorded investment of loans at December 31, 2012 by class of loans:

	30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater Past Due	Total Past Due	Loans Not Past Due	Total
One-to-four family residential real estate loans	\$1,584	\$778	\$4,463	\$6,825	\$153,279	\$160,104
One-to-four family residential real estate loans - non-owner occupied	855	579	249	1,683	55,906	57,589
Multi-family mortgage loans	5,393	3,049	3,218	11,660	291,103	302,763
Wholesale commercial lending	1,481	—	—	1,481	44,342	45,823
Nonresidential real estate loans	863	398	5,508	6,769	252,368	259,137
Land loans	702	1,220	630	2,552	4,956	7,508
Commercial loans:						
Secured	659	3	204	866	22,336	23,202
Unsecured	81	78	16	175	5,774	5,949
Municipal loans	—	—	—	—	4,752	4,752
Warehouse lines	—	—	—	—	2,989	2,989
Health care	—	—	—	—	17,601	17,601
Other	—	—	—	—	6,977	6,977
Commercial leases:						
Investment rated commercial leases	—	—	—	—	102,724	102,724
Below investment grade	—	—	—	—	9,294	9,294
Non-rated	—	—	—	—	25,657	25,657
Lease pools	—	—	—	—	3,028	3,028
Consumer loans	15	—	—	15	2,741	2,756
	\$11,633	\$6,105	\$14,288	\$32,026	\$1,005,827	\$1,037,853
	30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater Past Due	Total Past Due	Loans Not Past Due	Total
Purchased impaired loans						
One-to-four family residential real estate loans - non-owner occupied	\$327	\$—	\$53	\$380	\$—	\$380
Nonresidential real estate loans	—	—	1,125	1,125	1,443	2,568
Land loans	—	—	1,021	1,021	—	1,021
Commercial loans – secured	—	—	20	20	—	20
	\$327	\$—	\$2,219	\$2,546	\$1,443	\$3,989

## Troubled Debt Restructurings

The Company evaluates loan extensions or modifications in accordance with FASB ASC 310-40 with respect to the classification of the loan as a TDR. In general, if the Company grants a loan extension or modification to a borrower for other than an insignificant period of time that includes a below-market interest rate, principal forgiveness, payment forbearance or other concession intended to minimize the economic loss to the Company, the loan extension or loan

modification is classified as a TDR. In cases where borrowers are granted new terms that provide for a reduction of either interest or principal then due and payable, management measures any impairment on the restructured loan in the same manner as for impaired loans as noted above.

Table of Contents

## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Table amounts in thousands, except share and per share data)

## NOTE 4 - LOANS RECEIVABLE (continued)

The Company had \$5.6 million of TDRs at March 31, 2013, compared to \$11.2 million at December 31, 2012, with \$287,000 in specific valuation reserves allocated to those loans at March 31, 2013 and \$318,000 in specific valuation reserves allocated at December 31, 2012. The Company had no outstanding commitments to borrowers whose loans are classified as TDRs at either date.

The following table presents loans classified as TDRs:

	March 31, 2013	December 31, 2012
One-to-four family residential real estate	\$2,640	\$2,802
Multi-family mortgage	1,193	1,201
Nonresidential real estate	—	5,189
Troubled debt restructured loans – accrual loans	3,833	9,192
One-to-four family residential real estate	820	767
Multi-family mortgage	936	938
Nonresidential real estate	—	270
Troubled debt restructured loans – nonaccrual loans	1,756	1,975
Total troubled debt restructured loans	\$5,589	\$11,167

Periodically, the Company will restructure a note into two separate notes (A/B structure), charging off the entire B portion of the note. The A note is structured with appropriate loan-to-value and cash flow coverage ratios that provide for a high likelihood of repayment. The A note is classified as a non-performing note until the borrower has displayed a historical payment performance for a reasonable time prior to and subsequent to the restructuring. A period of sustained repayment for at least six months generally is required to return the note to accrual status provided that management has determined that the performance is reasonably expected to continue. The A note will be classified as a restructured note (either performing or nonperforming) through the calendar year of the restructuring that the historical payment performance has been established. These notes will be no longer included as a TDR above in the subsequent calendar year.

During the periods ending March 31, 2013 and 2012, the terms of certain loans were modified and classified as TDRs. The modification of the terms of such loans included one or a combination of the following: a reduction of the stated interest rate of the loan; an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk; or a permanent reduction of the recorded investment in the loan.

The following tables present TDR activity:

	Three months ended March 31, 2013		2012		Pre- Modification outstanding recorded investment	Post- Modification outstanding recorded investment
	Number of loans	Pre- Modification outstanding recorded investment	Post- Modification outstanding recorded investment	Number of loans		
One-to-four family residential real estate	1	\$ 384	\$ 384	2	\$ 392	\$ 392
Multi-family mortgage	—	—	—	1	700	503
Total	1	\$ 384	\$ 384	3	\$ 1,092	\$ 895





Table of Contents

## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Table amounts in thousands, except share and per share data)

## NOTE 4 - LOANS RECEIVABLE (continued)

	Due to reduction in interest rate	Due to extension of maturity date	Due to permanent reduction in recorded investment	Total
For the three months ended March 31, 2013				
One-to-four family residential real estate	\$—	\$384	\$—	\$384
Total	\$—	\$384	\$—	\$384
For the three months ended March 31, 2012				
One-to-four family residential real estate	\$372	\$20	\$—	\$392
Multi-family mortgage	—	—	503	503
Total	\$372	\$20	\$503	\$895

The TDRs described above had no impact on interest income, resulted in no change to the allowance for loan losses and resulted in no charge offs for the three months ended March 31, 2013. The TDR's had no impact on interest income, but increased the allowance for loan losses by \$183,000 and resulted in charge offs of \$470,000 during the three months ended March 31, 2012.

The following table presents TDRs for which there was a payment default during the three months ending March 31, 2013 and 2012 within twelve months following the modification.

	2013 Number of loans	Recorded investment	2012 Number of loans	Recorded investment
One-to-four family residential real estate	—	\$—	1	\$278
Nonresidential real estate	—	—	1	700
Total	—	\$—	2	\$978

A loan is considered to be in payment default once it is 90 days contractually past due under the modified terms. The TDRs that subsequently defaulted had no material impact on the allowance for loans losses during the three months ending March 31, 2013 and 2012.

The terms of certain other loans were modified during the quarters ending March 31, 2013 and 2012 that did not meet the definition of a TDR. These loans have a total recorded investment of \$324,000 and \$1.7 million at March 31, 2013 and 2012. The modification of these loans involved either a modification of the terms of a loan to borrowers who were not experiencing financial difficulties or a delay in a payment that was considered to be insignificant.

In order to determine whether a borrower is experiencing financial difficulty, an evaluation is performed of the probability that the borrower will be in payment default on any of its debt in the foreseeable future without the modification. This evaluation is performed under the Company's internal underwriting policy.

**Credit Quality Indicators:**

The Company categorizes loans into risk categories based on relevant information about the ability of borrowers to service their debt, including current financial information, historical payment experience, credit documentation, public information, and current economic trends, among other factors. The Company analyzes loans individually by classifying the loans based on credit risk. This analysis includes non-homogeneous loans, such as commercial and commercial real estate loans. This analysis is performed on a monthly basis. The Company uses the following definitions for risk ratings:

**Special Mention.** A Special Mention asset has potential weaknesses that deserve management's close attention. If left uncorrected, these potential weaknesses may result in deterioration of the repayment prospects for the asset or in the institution's credit position at some future date. Special Mention assets are not adversely classified and do not expose

an institution to sufficient risk to warrant adverse classification.

Substandard. Loans categorized as substandard continue to accrue interest, but exhibit a well-defined weakness or weaknesses that may jeopardize the liquidation of the debt. The loans continue to accrue interest because they are well secured and collection of principal and interest is expected within a reasonable time. The risk rating guidance published by

Table of Contents

## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Table amounts in thousands, except share and per share data)

## NOTE 4 - LOANS RECEIVABLE (continued)

the Office of the Comptroller of the Currency clarifies that a loan with a well-defined weakness does not have to present a probability of default for the loan to be rated Substandard, and that an individual loan's loss potential does not have to be distinct for the loan to be rated Substandard.

Nonaccrual. An asset classified Nonaccrual has all the weaknesses inherent in one classified substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. The loans were placed on nonaccrual status.

Loans not meeting the criteria above that are analyzed individually as part of the above described process are considered "Pass" rated loans.

As of March 31, 2013, based on the most recent analysis performed, the risk category of loans by class of loans is as follows:

	Pass	Special Mention	Substandard	Nonaccrual	Total
One-to-four family residential real estate loans	\$ 147,526	\$ 126	\$ 1,016	\$ 4,111	\$ 152,779
One-to-four family residential real estate loans non-owner occupied	52,066	1,439	1,967	1,289	56,761
Multi-family mortgage loans	254,877	14,879	11,169	10,935	291,860
Wholesale commercial lending	43,876	—	2,766	—	46,642
Nonresidential real estate loans	197,355	37,929	17,176	8,747	261,207
Construction loans	46	—	—	—	46
Land loans	2,582	—	1,707	2,598	6,887
Commercial loans:					
Secured	15,496	2,419	351	852	19,118
Unsecured	3,776	312	1,466	52	5,606
Municipal loans	4,751	—	—	—	4,751
Warehouse lines	1,812	—	—	—	1,812
Health care	17,238	—	—	—	17,238
Other	6,837	—	—	—	6,837
Commercial leases:					
Investment rated commercial leases	107,491	—	—	—	107,491
Below investment grade	9,569	—	—	—	9,569
Non-rated	25,533	—	—	—	25,533
Lease pools	4,575	—	—	—	4,575
Consumer loans	2,402	1	—	11	2,414
Total	\$ 897,808	\$ 57,105	\$ 37,618	\$ 28,595	\$ 1,021,126

Table of Contents

## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Table amounts in thousands, except share and per share data)

## NOTE 4 - LOANS RECEIVABLE (continued)

As of December 31, 2012, based on the most recent analysis performed, the risk category of loans by class of loans is as follows:

	Pass	Special Mention	Substandard	Nonaccrual	Total
One-to-four family residential real estate loans	\$152,711	\$—	\$1,428	\$6,158	\$160,297
One-to-four family residential real estate loans non-owner occupied	51,849	1,486	3,440	1,524	58,299
Multi-family mortgage loans	275,338	6,139	21,128	3,559	306,164
Wholesale commercial lending	44,074	—	1,781	—	45,855
Nonresidential real estate loans	199,802	30,898	22,345	11,627	264,672
Construction loans	—	—	—	—	—
Land loans	2,769	158	2,394	3,231	8,552
Commercial loans:					—
Secured	19,579	2,418	988	225	23,210
Unsecured	4,061	323	1,497	52	5,933
Municipal loans	4,751	—	—	—	4,751
Warehouse lines	2,971	—	—	—	2,971
Health care	17,566	—	—	—	17,566
Other	6,957	—	—	—	6,957
Commercial leases:					—
Investment rated commercial leases	102,101	—	—	—	102,101
Below investment grade	9,205	—	—	—	9,205
Non-rated	25,466	—	—	—	25,466
Lease pools	3,011	—	—	—	3,011
Consumer loans	2,742	—	3	—	2,745
Total	\$924,953	\$41,422	\$55,004	\$26,376	\$1,047,755

## NOTE 5 – FAIR VALUE

Fair value is the exchange price that would be received for an asset or paid to transfer a liability (exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. There are three levels of inputs that may be used to measure fair values:

Level 1 – Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2 – Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3 – Significant unobservable inputs that reflect a company's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The Company used the following methods and significant assumptions to estimate the fair value of each type of financial instrument:

Securities: The fair values of marketable equity securities are generally determined by quoted prices, in active markets, for each specific security (Level 1). If Level 1 measurement inputs are not available for a marketable equity security, we determine its fair value based on the quoted price of a similar security traded in an active market (Level 2). The fair values of debt securities are generally determined by matrix pricing, which is a mathematical technique

widely used in the industry to value debt securities without relying exclusively on quoted prices for the specific securities, but rather by relying on the securities' relationship to other benchmark quoted securities (Level 2).

Table of Contents

BANKFINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Table amounts in thousands, except share and per share data)

NOTE 5 - FAIR VALUE (continued)

**Loans Held for Sale:** Loans held for sale are carried at the lower of cost or fair value, which is evaluated on a pool-level basis. The fair value of loans held for sale is determined using quoted prices for similar assets, adjusted for specific attributes of that loan or other observable market data, such as outstanding commitments from third party investors (Level 2).

**Impaired Loans:** At the time a loan is considered impaired, management measures impairment in accordance with ASC Topic 310. The fair value of impaired loans is estimated using one of several methods, including collateral value, market value of similar debt, enterprise value, liquidation value and discounted cash flows. Impaired loans carried at fair value generally require a partial charge off and a specific valuation allowance for loan losses. For collateral dependent loans, fair value is commonly based on recent real estate appraisals. These real estate appraisals may include up to three approaches to value: the sales comparison approach, the income approach (for income-producing property) and the cost approach. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available, if applicable. Such adjustments may be significant and typically result in a Level 3 classification of the inputs for determining fair value. In addition, a discount is typically applied to account for sales and holding expenses. Non-real estate collateral may be valued using an appraisal, net book value per the borrower's financial statements, or aging reports, adjusted or discounted based on management's historical knowledge, changes in market conditions from the time of the valuation, and management's expertise and knowledge of the client and client's business, resulting in a Level 3 fair value classification. Impaired loans are evaluated on a quarterly basis for additional impairment and adjusted accordingly. The method utilized to estimate the fair value of loans does not necessarily represent an exit price.

**Other Real Estate Owned:** Assets acquired through foreclosure or transfers in lieu of foreclosure are initially recorded at fair value less costs to sell when acquired, establishing a new cost basis. These assets are subsequently accounted for at lower of cost or fair value less estimated costs to sell. Fair value is commonly based on recent real estate appraisals. Although the fair value of the property normally will be based on an appraisal (or other evaluation), the valuation should be consistent with the price that a market participant will pay to purchase the property at the measurement date. Circumstances may exist that indicate that the appraised value is not an accurate measurement of the property's current fair value. Examples of such circumstances include changed economic conditions since the last appraisal, stale appraisals, or imprecision and subjectivity in the appraisal process (i.e., actual sales for less than the appraised amount). Such adjustments are usually significant and typically result in a Level 3 classification of the inputs for determining fair value.

**Mortgage Servicing Rights:** On a quarterly basis, loan servicing rights are evaluated for impairment based upon the fair value of the rights as compared to carrying amount. The fair values of mortgage servicing rights are based on a valuation model that calculates the present value of estimated net servicing income. The valuation model incorporates assumptions that market participants would use in estimating future net servicing income. The Company is able to compare the valuation model inputs and results to widely available published industry data for reasonableness (Level 3).

Table of Contents

## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Table amounts in thousands, except share and per share data)

## NOTE 5 - FAIR VALUE (continued)

The following table sets forth the Company's financial assets that were accounted for at fair value and are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

	Fair Value Measurements Using			Fair Value
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
March 31, 2013				
Securities:				
Certificates of deposit	\$—	\$22,281	\$—	\$22,281
Municipal securities	—	366	—	366
Equity mutual fund	524	—	—	524
Mortgage-backed securities – residential	—	32,609	—	32,609
Collateralized mortgage obligations – residential	—	5,453	—	5,453
SBA-guaranteed loan participation certificates	—	40	—	40
	\$524	\$60,749	\$—	\$61,273
December 31, 2012				
Securities:				
Certificates of deposit	\$—	\$33,456	\$—	\$33,456
Municipal securities	—	369	—	369
Equity mutual fund	528	—	—	528
Mortgage-backed securities - residential	—	34,233	—	34,233
Collateralized mortgage obligations – residential	—	9,204	—	9,204
SBA-guaranteed loan participation certificates	—	42	—	42
	\$528	\$77,304	\$—	\$77,832

Table of Contents

## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Table amounts in thousands, except share and per share data)

## NOTE 5 - FAIR VALUE (continued)

The following table sets forth the Company's assets that were measured at fair value on a non-recurring basis:

	Fair Value Measurement Using			Fair Value
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
March 31, 2013				
Impaired loans:				
One-to-four family residential real estate loans	\$—	\$—	\$186	\$186
Multi-family mortgage loans	—	—	2,999	2,999
Nonresidential real estate loans	—	—	3,014	3,014
Construction and land loans	—	—	2,150	2,150
Commercial loans	—	—	750	750
	\$—	\$—	\$9,099	\$9,099
Other real estate owned:				
One-to-four family residential real estate	\$—	\$—	\$1,720	\$1,720
Multi-family mortgage	—	—	—	—
Nonresidential real estate	—	—	3,268	3,268
Land	—	—	3,100	3,100
	\$—	\$—	\$8,088	\$8,088
Mortgage servicing rights	\$—	\$—	\$211	\$211
December 31, 2012				
Impaired loans:				
One-to-four family residential real estate loans	\$—	\$—	\$410	\$410
Multi-family mortgage loans	—	—	1,932	1,932
Nonresidential real estate loans	—	—	3,110	3,110
Construction and land loans	—	—	2,840	2,840
Commercial loans	—	—	181	181
	\$—	\$—	\$8,473	\$8,473
Other real estate owned:				
One-to-four family residential real estate	\$—	\$—	\$2,080	\$2,080
Multi-family mortgage	—	—	720	720
Nonresidential real estate	—	—	3,966	3,966
Land	—	—	3,592	3,592
	\$—	\$—	\$10,358	\$10,358
Mortgage servicing rights	\$—	\$—	\$208	\$208

Impaired loans, which are measured for impairment using the fair value of the collateral for collateral-dependent loans, had a carrying amount of \$28.5 million, with a valuation allowance of \$1.5 million at March 31, 2013, compared to a carrying amount of \$28.4 million and a valuation allowance of \$1.7 million at December 31, 2012, resulting in a decrease in the provision for loan losses of \$163,000 for three months ended March 31, 2013.





Table of Contents

BANKFINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Table amounts in thousands, except share and per share data)

NOTE 5 - FAIR VALUE (continued)

OREO, which is carried at the lower of cost or fair value less costs to sell, had a carrying value of \$8.1 million at March 31, 2013, which included valuation adjustments of \$1.3 million, compared to \$10.4 million at December 31, 2012, which included valuation adjustments of \$1.2 million, resulting in an increase in the valuation adjustments of \$89,000, reduced by sales for the three months ended March 31, 2013.

Mortgage servicing rights, which are carried at lower of cost or fair value, had a carrying amount of \$1.0 million at March 31, 2013, of which \$757,000 related to fixed rate loans and \$256,000 related to adjustable rate loans. Mortgage servicing rights had a carrying amount of \$1.0 million at December 31, 2012, of which \$756,000 related to fixed rate loans and \$264,000 related to adjustable rate loans. A pre-tax recovery of \$26,000 on our fixed rate mortgage servicing rights portfolio was included in noninterest income for the three months ended March 31, 2013, compared to a \$13,000 provision for the same period in 2012.

Table of Contents

## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Table amounts in thousands, except share and per share data)

## NOTE 5 - FAIR VALUE (continued)

The following table presents quantitative information, based on certain empirical data with respect to Level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis at March 31, 2013:

	Fair Value	Valuation Technique(s)	Unobservable Input(s)	Range (Weighted Average)
Impaired loans:				
One-to-four family residential real estate loans	\$ 186	Sales comparison	Discount applied to valuation	6%-90% (67%)
Multi-family mortgage loans	2,999	Sales comparison	Comparison between sales and income approaches	2%-95% (47%)
		Income approach	Cap Rate	6.2% to 11.8% (7.65%)
Nonresidential real estate loans	3,014	Sales comparison	Comparison between sales and income approaches	6%-99% (63%)
		Income approach	Cap Rate	8.5%-10.3% (8.93%)
Construction and land loans	2,150	Sales comparison	Discount applied to valuation	10%-29% (28%)
Commercial loans	750	Sales comparison	Discount applied to valuation	0%-11% (58%)
Impaired loans	\$ 9,099			
Other real estate owned:				
One-to-four family residential real estate	\$ 1,720	Sales comparison	Discount applied to valuation	7%-77% (18%)
Nonresidential real estate	3,268	Sales comparison	Comparison between sales and income approaches	7%-30% (24%)
Land	3,100	Sales comparison	Discount applied to valuation	7%-21% (10%)
Other real estate owned	\$ 8,088			
Mortgage servicing rights	\$ 211	Third party valuation	Present value of future servicing income based	12.3 % - 25.7% (17.16%)

Third party valuation	on prepayment speeds Present value of future servicing income based on default rates	12%
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Table of Contents

## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Table amounts in thousands, except share and per share data)

## NOTE 5 - FAIR VALUE (continued)

The carrying amount and estimated fair value of financial instruments is as follows:

	Carrying Amount	Fair Value Measurements at March 31, 2013 Using:			Total
		Level 1	Level 2	Level 3	
Financial assets					
Cash and cash equivalents	\$311,128	\$17,742	\$293,386	\$—	\$311,128
Securities	61,273	524	60,749	—	61,273
Loans held-for-sale	55	—	55	—	55
Loans receivable, net of allowance for loan losses	1,004,404	—	964,073	9,099	973,172
FHLBC stock	7,566	—	—	—	N/A
Accrued interest receivable	3,951	—	3,951	—	3,951
Financial liabilities					
Noninterest-bearing demand deposits	\$(131,856 )	\$—	\$(131,856 )	\$—	\$(131,856 )
Savings deposits	(148,184 )	—	(148,184 )	—	(148,184 )
NOW and money market accounts	(693,650 )	—	(693,650 )	—	(693,650 )
Certificates of deposit	(297,860 )	—	(299,298 )	—	(299,298 )
Borrowings	(2,740 )	—	(2,777 )	—	(2,777 )
Accrued interest payable	(137 )	—	(137 )	—	(137 )
		Fair Value Measurements at December 31, 2012 Using:			
	Carrying Amount	Level 1	Level 2	Level 3	Total
Financial assets					
Cash and cash equivalents	\$275,764	\$20,361	\$255,403	\$—	\$275,764
Securities	77,832	528	77,304	—	77,832
Loans held-for-sale	2,166	—	2,166	—	2,166
Loans receivable, net of allowance for loan losses	1,030,465	—	999,578	8,473	1,008,051
FHLBC stock	8,412	—	—	—	N/A
Accrued interest receivable	38,251	—	38,251	—	38,251
Financial liabilities					
Noninterest-bearing demand deposits	\$(134,597 )	\$—	\$(134,597 )	\$—	\$(134,597 )
Savings deposits	(144,726 )	—	(144,726 )	—	(144,726 )
NOW and money market accounts	(697,775 )	—	(697,775 )	—	(697,775 )
Certificates of deposit	(305,253 )	—	(306,859 )	—	(306,859 )
Borrowings	(5,567 )	—	(5,608 )	—	(5,608 )
Accrued interest payable	(157 )	—	(157 )	—	(157 )

For purposes of the above, the following assumptions were used:

Cash and Cash Equivalents: The estimated fair values for cash and cash equivalents are based on their carrying value due to the short-term nature of these assets.

Loans: The estimated fair value for loans has been determined by calculating the present value of future cash flows based on the current rate the Company would charge for similar loans with similar maturities, applied for an estimated time period until the loan is assumed to be repriced or repaid. The estimated fair values of loans held-for-sale are

based on quoted market prices.

30

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Table of Contents

BANKFINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Table amounts in thousands, except share and per share data)

NOTE 5 - FAIR VALUE (continued)

FHLBC Stock: It is not practicable to determine the fair value of FHLBC stock due to the restrictions placed on its transferability.

Deposit Liabilities: The estimated fair value for certificates of deposit has been determined by calculating the present value of future cash flows based on estimates of rates the Company would pay on such deposits, applied for the time period until maturity. The estimated fair values of noninterest-bearing demand, NOW, money market, and savings deposits are assumed to approximate their carrying values as management establishes rates on these deposits at a level that approximates the local market area. Additionally, these deposits can be withdrawn on demand.

Borrowings: The estimated fair values of advances from the FHLBC and notes payable are based on current market rates for similar financing. The estimated fair value of securities sold under agreements to repurchase is assumed to equal its carrying value due to the short-term nature of the liability.

Accrued Interest: The estimated fair values of accrued interest receivable and payable are assumed to equal their carrying value.

Off-Balance-Sheet Instruments: Off-balance-sheet items consist principally of unfunded loan commitments, standby letters of credit, and unused lines of credit. The estimated fair values of unfunded loan commitments, standby letters of credit, and unused lines of credit are not material.

While the above estimates are based on management's judgment of the most appropriate factors, as of the balance sheet date, there is no assurance that the estimated fair values would have been realized if the assets were disposed of or the liabilities settled at that date, since market values may differ depending on the various circumstances. The estimated fair values would also not apply to subsequent dates.

In addition, other assets and liabilities that are not financial instruments, such as premises and equipment, are not included in the above disclosures.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Cautionary Statement Regarding Forward-Looking Information

Forward Looking Statements

This Quarterly Report on Form 10-Q contains, and other periodic and current reports, press releases and other public stockholder communications of BankFinancial Corporation may contain, forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, that involve significant risks and uncertainties. Forward-looking statements may include statements relating to our future plans, strategies and expectations, as well as our future revenues, earnings, losses, financial performance, financial condition, asset quality metrics and future prospects. Forward looking statements are generally identifiable by use of the words "believe," "may," "will," "should," "could," "expect," "estimate," "intend," "anticipate," "project," "plan," or similar expressions. Forward looking statements speak only as of the date made. They are frequently based on assumptions that may or may not materialize, and are subject to numerous uncertainties that could cause actual results to differ materially from those anticipated in the forward looking statements. We intend all forward-looking statements to be covered by the safe harbor provisions for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995, and are including this statement for the purpose of invoking these safe harbor provisions.

Factors that could cause actual results to differ materially from the results anticipated or projected and which could materially and adversely affect our operating results, financial condition or future prospects include, but are not limited to: (i) the failure of the real estate market to recover or further declines in real estate values that adversely impact the value of our loan collateral and OREO, asset dispositions and the level of borrower equity in their investments; (ii) the persistence or worsening of adverse economic conditions in general and in the Chicago metropolitan area in particular, including high or increasing unemployment levels, that could result in increased delinquencies in our loan portfolio or a decline in the value of our investment securities and the collateral for our

loans; (iii) results of supervisory monitoring or examinations by regulatory authorities, including the possibility that a regulatory authority could, among other things, require us to increase our allowance for loan losses or adversely change our loan classifications, write-down assets, reduce credit concentrations or maintain specific capital levels; (iv) interest rate movements and their impact on customer behavior and our net interest margin; (v) less than anticipated loan growth due to a lack of demand for specific loan products, competitive pressures or a dearth of borrowers who meet our underwriting standards; (vi) changes, disruptions or illiquidity in national or global financial markets; (vii) the credit risks of lending activities, including risks that could cause changes in the level and direction of loan delinquencies and charge-offs or changes in estimates relating to the computation of our allowance for loan losses; (viii) monetary and fiscal policies of the U.S. Government, including policies of the U.S. Treasury



Table of Contents

and Federal Reserve Board; (ix) factors affecting our ability to access deposits or cost-effective funding, and the impact of competitors' pricing initiatives on our deposit products; (x) the impact of new legislation or regulatory changes, including the Dodd-Frank Act, on our products, services, operations and operating expenses; (xi) higher federal deposit insurance premiums; (xii) higher than expected overhead, infrastructure and compliance costs; (xiii) changes in accounting principles, policies or guidelines; and (xiv) and our failure to achieve expected synergies and cost savings from acquisitions.

These risks and uncertainties, as well as the Risk Factors set forth in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2012, should be considered in evaluating forward-looking statements and undue reliance should not be placed on such statements. We do not undertake any obligation to update any forward-looking statement in the future, or to reflect circumstances and events that occur after the date on which the forward-looking statement was made.

Critical Accounting Policies

Critical accounting policies are defined as those that are reflective of significant judgments and uncertainties, and could potentially result in materially different results under different assumptions and conditions. We believe that the most critical accounting policies upon which our financial condition and results of operation depend, and which involve the most complex subjective decisions or assessments, are included in the discussion entitled "Critical Accounting Policies" in Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations," in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2012, and all amendments thereto, as filed with the Securities and Exchange Commission.

Overview

Continuing the trends commenced in the fourth quarter of 2012, loan origination activity improved in the first quarter of 2013, especially in the multifamily, non-residential real estate and commercial leasing categories. The net reductions in balances in multifamily and non-residential loans were due in part to continued progress in resolving Watch List, Special Mention or Substandard loans. Residential loan origination volumes were essentially constant compared to the fourth quarter of 2012. Despite a modest growth in commercial & industrial loan originations, the net balance of commercial & industrial loans decreased due to increased remittances of health-care receivables by the State of Illinois, with a corresponding decline in health care line of credit exposures, and repayments of commercial lease bridge line of credit facilities due to increased final originations of commercial leases. Continued improvement in loan origination volumes remains essential to offsetting the ongoing effects of yield compression on our net interest income.

Asset quality improved modestly in the first quarter of 2013, with the Company's classified assets to capital ratio at 46%. In addition, we continued to reduce OREO balances at an acceptable rate with minimal impact to earnings and capital during the quarter.

Beginning in the fourth quarter, 2012 and continuing in 2013, we determined that for certain performing classified and non-performing multifamily and non-residential real estate loans, the most cost-effective and expeditious resolution method was to decline to renew the loans upon maturity or to utilize other remedies provided by our loan documents to accelerate the maturity date of the loans, together with an attempt to negotiate a final resolution in the form of a deed-in-lieu of foreclosure. Of the \$10.3 million in loans placed on non-accrual in the first quarter of 2013, \$7.3 million related to affirmative steps that we took to expedite resolution. We believe this approach has the potential to further reduce classified and non-performing assets more rapidly and with lower litigation costs given current judicial foreclosure processes.

Our provision for loan losses increased in the first quarter of 2013 due principally to the receipt of an updated appraisal on land securing a loan to a local physician that we acquired in the Downers Grove National Bank transaction. Pursuant to the foregoing expedited resolution strategy, we declined to renew the loans at maturity in the fourth quarter of 2012 and obtained updated collateral valuations in the first quarter of 2013.

Non-interest income deposit fee income declined in the first quarter of 2013 due to reduced customer withdrawal activity within the check, ATM and debit card channels. The decline in activity reflects seasonal factors, the continuing impact of the Dodd-Frank Act legislation and payroll taxes on retail customer behavior, and reductions in

commercial customer account net fee income due to higher average balances. The gain on sale of newly-originated residential loans was essentially constant in the first quarter of 2013 but we noted significantly increased residential loan application activity at the beginning of the second quarter of 2013 due to new Internet marketing methods that we implemented for residential loans. The gain on sale related to our bulk sale of non-performing loans reflected improved pricing obtained in the final bidding process during first quarter of 2013.

Non-interest expense declined in the first quarter of 2013 despite seasonal effects within the compensation and benefits category as well as the recording of certain trailing legal and other expenses related to bulk sales activity. The Company's full-time equivalent employment levels declined slightly during the first quarter of 2013, reflecting the initial implementation of our updated operations review; we anticipate that our full-time employments levels will decline to a range between 305 and 315 by the end of the second quarter of 2013. These changes reflect the reductions in customer transaction volumes in branch offices, due to increased usage

Table of Contents

of electronic banking channels, completion of technology conversion projects, elimination of Downers Grove National Bank merger/acquisition integration resources, and a consolidation of resources within various operational functions.

**SELECTED FINANCIAL DATA**

The following summary information is derived from the consolidated financial statements of the Company. For additional information, reference is made to “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and the Consolidated Financial Statements of the Company and related notes included elsewhere in this Quarterly Report.

	March 31, 2013	December 31, 2012	Change
	(Dollars in thousands)		
<b>Selected Financial Condition Data:</b>			
Total assets	\$1,466,135	\$1,481,192	\$(15,057 )
Loans, net	1,004,404	1,030,465	(26,061 )
Loans held-for-sale	55	2,166	(2,111 )
Securities, at fair value	61,273	77,832	(16,559 )
Core deposit intangible	2,882	3,038	(156 )
Deposits	1,271,550	1,282,351	(10,801 )
Borrowings	2,740	5,567	(2,827 )
Equity	173,639	172,890	749
	For the Three Months Ended		
	March 31,	2012	Change
	(Dollars in thousands)		
<b>Selected Operating Data:</b>			
Interest and dividend income	\$12,713	\$16,634	\$(3,921 )
Interest expense	994	1,240	(246 )
Net interest income	11,719	15,394	(3,675 )
Provision for loan losses	722	996	(274 )
Net interest income after provision for loan losses	10,997	14,398	(3,401 )
Noninterest income	2,866	1,832	1,034
Noninterest expense	13,185	13,436	(251 )
Income before income tax expense	678	2,794	(2,116 )
Income tax expense	—	457	(457 )
Net income	\$678	\$2,337	\$(1,659 )

Table of Contents

	For the Three Months Ended March 31,		
	2013	2012	
Selected Financial Ratios and Other Data:			
Performance Ratios:			
Return on assets (ratio of net income to average total assets) <sup>(1)</sup>	0.19	% 0.61	%
Return on equity (ratio of net income to average equity) <sup>(1)</sup>	1.55	4.61	
Average equity to average assets	11.95	13.16	
Net interest rate spread <sup>(1) (2)</sup>	3.39	4.18	
Net interest margin <sup>(1) (3)</sup>	3.45	4.26	
Efficiency ratio <sup>(4)</sup>	90.40	78.00	
Noninterest expense to average total assets <sup>(1)</sup>	3.61	3.49	
Average interest-earning assets to average interest-bearing liabilities	120.81	122.46	
Dividends declared per share	\$—	\$0.01	
Dividend payout ratio	N.M.	N.M.	
	At March 31, 2013	At December 31, 2012	
Asset Quality Ratios:			
Nonperforming assets to total assets <sup>(5)</sup>	2.56	% 2.59	%
Nonperforming loans to total loans	2.89	2.67	
Allowance for loan losses to nonperforming loans	59.24	64.39	
Allowance for loan losses to total loans	1.71	1.72	
Capital Ratios:			
Equity to total assets at end of period	11.84	% 11.67	%
Tier 1 leverage ratio (Bank only)	9.77	9.60	
Other Data:			
Number of full-service offices	20	20	
Employees (full-time equivalents)	347	352	

(1) Ratios annualized.

(2) The net interest rate spread represents the difference between the yield on average interest-earning assets and the cost of average interest-bearing liabilities for the period.

(3) The net interest margin represents net interest income divided by average total interest-earning assets for the period.

(4) The efficiency ratio represents noninterest expense, divided by the sum of net interest income and noninterest income.

(5) Nonperforming assets include nonperforming loans and other real estate owned.

N.M. Not Meaningful

#### Comparison of Financial Condition at March 31, 2013 and December 31, 2012

Total assets decreased \$15.1 million, or 1.0%, to \$1.466 billion at March 31, 2013, from \$1.481 billion at December 31, 2012. The decrease in total assets was primarily due to a decrease in loans receivable and securities. The decrease was partially offset by an increase in cash and cash equivalents. Net loans decreased \$26.1 million to \$1.004 billion at March 31, 2013, from \$1.030 billion at December 31, 2012. In December 2012, we designated certain owner-occupied and investor-owned one-to-four family residential loans with a carrying value of \$7.5 million as “held for sale” in preparation for a bulk sale. The sale of the one-to-four family residential loans was completed in February 2013. Securities decreased \$16.6 million to \$61.3 million at March 31, 2013, from \$77.8 million at December 31, 2012. Net cash and cash equivalents increased by \$35.4 million to \$311.1 million at March 31, 2013,

from \$275.8 million at December 31, 2012.

Total liabilities decreased by \$15.8 million, or 1.2%, to \$1.292 billion at March 31, 2013, from \$1.308 billion at December 31, 2012. Total deposits decreased \$10.8 million, or 0.8%, to \$1.272 billion at March 31, 2013, from \$1.282 billion at December 31, 2012, primarily due to deposit pricing adjustments that we made in anticipation of additional excess liquidity resulting from loan

Table of Contents

payments and bulk sales of loans. Certificates of deposit decreased \$7.4 million, or 2.4%, to \$297.9 million at March 31, 2013, from \$305.3 million at December 31, 2012. Core deposits increased to 76.6% of total deposits at March 31, 2013, from 76.2% of total deposits at December 31, 2012. Noninterest-bearing demand deposits decreased \$2.7 million, or 2.0%, to \$131.9 million at March 31, 2013, from \$134.6 million at December 31, 2012. Savings accounts increased \$3.5 million, or 2.4%, to \$148.2 million at March 31, 2013, from \$144.7 million at December 31, 2012. Money market and interest-bearing NOW accounts decreased \$4.1 million, or 0.6%, to \$693.7 million at March 31, 2013, from \$697.8 million at December 31, 2012.

Total stockholders' equity was \$173.6 million at March 31, 2013, compared to \$172.9 million at December 31, 2012. The increase in total stockholders' equity was primarily due to the \$678,000 net income that we recorded for three months ended March 31, 2013. The unallocated shares of common stock that our ESOP owns were reflected as a \$12.0 million reduction to stockholders' equity at March 31, 2013, compared to \$12.2 million reduction at December 31, 2012.

Operating results for the three months ended March 31, 2013 and 2012

**Net Income.** We had net income of \$678,000 for three months ended March 31, 2013 compared to \$2.3 million for the three months ended March 31, 2012. Our earnings per share of common stock was \$0.03 per basic and fully diluted share, for the three months ended March 31, 2013, compared to \$0.12 per basic and fully diluted share for the three months ended March 31, 2012.

**Net Interest Income.** Net interest income was \$11.7 million for the three months ended March 31, 2013, compared to \$15.4 million for the same period in 2012. The decrease reflected a \$3.9 million decrease in interest income and a \$246,000 decrease in interest expense.

The decrease in net interest income was primarily attributable to a lower level of average interest-earning assets. Total average interest-earning assets decreased \$75.0 million, or 5.2%, to \$1.379 billion for the three months ended March 31, 2013, from \$1.454 billion for the same period in 2012. Our net interest rate spread decreased by 79 basis points to 3.39% for the three months ended March 31, 2013, from 4.18% for the same period in 2012. Our net interest margin decreased by 81 basis points to 3.45% for the three months ended March 31, 2013, from 4.26% for the same period in 2012. The decrease in the net interest spread and margin was a result of lower yields on interest earning assets, which was partially offset by a lower cost of funds. The yield on interest earning assets decreased 86 basis points to 3.74% for the three months ended March 31, 2013, from 4.60% for the same period in 2012, and the cost of interest bearing liabilities decreased seven basis points to 0.35% for the three months ended March 31, 2013, from 0.42% for the same period in 2012.

Table of Contents

## Average Balance Sheets

The following table sets forth average balance sheets, average yields and costs, and certain other information. No tax-equivalent yield adjustments were made, as the effect of these adjustments would not be material. Average balances are daily average balances. Nonaccrual loans are included in the computation of average balances, but have been reflected in the table as loans carrying a zero yield. The yields set forth below include the effect of deferred fees and expenses, discounts and premiums, purchase accounting adjustments that are amortized or accreted to interest income or expense.

	Three months ended March 31, 2013			2012			
	Average Outstanding Balance (Dollars in thousands)	Interest	Yield/Rate <sup>(1)</sup>	Average Outstanding Balance	Interest	Yield/Rate <sup>(1)</sup>	
<b>Interest-earning Assets:</b>							
Loans	\$ 1,028,907	\$ 12,278	4.84	% \$ 1,236,234	\$ 16,112	5.24	%
Securities	73,284	250	1.39	88,448	442	2.01	
Stock in FHLBC	8,026	6	0.30	13,868	4	0.12	
Other	268,939	179	0.27	115,567	76	0.26	
Total interest-earning assets	1,379,156	12,713	3.74	1,454,117	16,634	4.60	
Noninterest-earning assets	82,963			87,698			
Total assets	\$ 1,462,119			\$ 1,541,815			
<b>Interest-bearing Liabilities:</b>							
Savings deposits	\$ 145,932	37	0.10	\$ 145,544	37	0.10	
Money market accounts	345,483	313	0.37	345,339	314	0.37	
NOW accounts	346,495	105	0.12	331,459	98	0.12	
Certificates of deposit	300,528	531	0.72	355,921	765	0.86	
Total deposits	1,138,438	986	0.35	1,178,263	1,214	0.41	
Borrowings	3,187	8	1.02	9,183	26	1.14	
Total interest-bearing liabilities	1,141,625	994	0.35	1,187,446	1,240	0.42	
Noninterest-bearing deposits	128,365			131,914			
Noninterest-bearing liabilities	17,363			19,520			
Total liabilities	1,287,353			1,338,880			
Equity	174,766			202,935			
Total liabilities and equity	\$ 1,462,119			\$ 1,541,815			
Net interest income		\$ 11,719			\$ 15,394		
Net interest rate spread <sup>(2)</sup>			3.39	%		4.18	%
Net interest-earning assets <sup>(3)</sup>	\$ 237,531			\$ 266,671			
Net interest margin <sup>(4)</sup>			3.45	%		4.26	%
Ratio of interest-earning assets to interest-bearing liabilities	120.81	%		122.46	%		

(1) Annualized

(2) Net interest rate spread represents the difference between the yield on average interest-earning assets and the cost of average interest-bearing liabilities.

(3) Net interest-earning assets represents total interest-earning assets less total interest-bearing liabilities.

(4) Net interest margin represents net interest income divided by average total interest-earning assets.

36

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Table of Contents

## Provision for Loan Losses

We establish provisions for loan losses, which are charged to operations in order to maintain the allowance for loan losses at a level we consider necessary to absorb probable incurred credit losses in the loan portfolio. In determining the level of the allowance for loan losses, we consider past and current loss experience, evaluations of real estate collateral, current economic conditions, volume and type of lending, adverse situations that may affect a borrower's ability to repay a loan and the levels of nonperforming and other classified loans. The amount of the allowance is based on estimates and the ultimate losses may vary from such estimates as more information becomes available or events change. We assess the allowance for loan losses on a quarterly basis and make provisions for loan losses in order to maintain the allowance.

The provision for loan losses totaled \$722,000 for the three months ended March 31, 2013, compared to \$996,000 for the same period in 2012. The provision for loan losses is a function of the allowance for loan loss methodology we use to determine the appropriate level of the allowance for inherent loan losses after net charge-offs have been deducted. Net charge-offs were \$1.3 million for the three months ended March 31, 2013, compared to \$1.1 million for the same period in 2012. The allowance for loan losses as a percentage of nonperforming loans was 59.24% at March 31, 2013, compared to 64.39% at December 31, 2012. Loans collectively evaluated for impairment decreased \$26.7 million, or 2.6%, to \$992.6 million at March 31, 2013, compared to \$1.019 billion at December 31, 2012. The related loan loss decreased \$419,000, or 2.6%, to \$15.9 million at March 31, 2013, compared to \$16.3 million at December 31, 2012. A loan balance is classified as a loss and charged-off when it is confirmed that there is no readily apparent source of repayment for the portion of the loan that is classified as loss. Confirmation can occur upon the receipt of updated third-party appraisal valuation information indicating that there is a low probability of repayment upon sale of the collateral, the final disposition of collateral where the net proceeds are insufficient to pay the loan balance in full, our failure to obtain possession of certain consumer-loan collateral within certain time limits specified by applicable federal regulations, the conclusion of legal proceedings where the borrower's obligation to repay is legally discharged (such as a Chapter 7 bankruptcy proceeding), or when it appears that further formal collection procedures are not likely to result in net proceeds in excess of the costs to collect.

## Noninterest Income

	Three months ended March		
	31,		
	2013	2012	Change
	(Dollars in thousands)		
Deposit service charges and fees	\$499	\$557	\$(58)
Other fee income	375	385	(10)
Insurance commissions and annuities income	109	122	(13)
Gain on sale of loans, net	1,417	267	1,150
Loan servicing fees	123	128	(5)
Amortization of servicing assets	(59)	(69)	10
Recovery (impairment) of servicing assets	26	(13)	39
Earnings on bank owned life insurance	70	126	(56)
Trust income	181	184	(3)
Other	125	145	(20)
Total noninterest income	\$2,866	\$1,832	\$1,034

Noninterest income increased by \$1.0 million to \$2.9 million for the three months ended March 31, 2013, from \$1.8 million for 2012. Noninterest income for the three months ended March 31, 2013, included \$1.4 million gain on sale of loans which included recurring loan sale activity combined with the completion of the sale of the owner-occupied and investor-owned one-to-four family residential loans that we designated as held for sale at December 31, 2012. The completion of this sale resulted in pre-tax gain on sale of loans of approximately \$1.3 million.



Table of Contents

## Noninterest Expense

	Three months ended March		
	31,		
	2013	2012	Change
	(Dollars in thousands)		
Compensation and benefits	\$6,752	\$6,679	\$73
Office occupancy and equipment	1,948	2,032	(84 )
Advertising and public relations	146	106	40
Information technology	749	848	(99 )
Supplies, telephone and postage	461	390	71
Amortization of intangibles	156	163	(7 )
Nonperforming asset management	694	1,240	(546 )
Loss (gain) on sale other real estate owned	69	(139 )	208
Valuation adjustments of other real estate owned	89	389	(300 )
Operations of other real estate owned	353	302	51
FDIC insurance premiums	492	348	144
Other	1,276	1,078	198
Total noninterest expense	\$13,185	\$13,436	\$(251 )

Noninterest expense decreased by \$251,000, or 1.9%, to \$13.2 million for the three months ended March 31, 2013, from \$13.4 million for the same period in 2012. Noninterest expense for three months ended March 31, 2013 included \$1.2 million of nonperforming asset management and OREO expenses, compared to \$1.8 million for the same period in 2012. Nonperforming asset management expenses decreased \$546,000, or 44.0%, to \$694,000 for the year ended March 31, 2013, compared to \$1.2 million for the same period in 2012, primarily due to the decline in nonperforming assets and a decline in expenses relating to resolutions and accelerated dispositions of nonperforming assets. The three months ended March 31, 2013 included an \$89,000 valuation adjustment to OREO properties, compared to a \$389,000 valuation adjustment to OREO properties for the same period in 2012. Noninterest expense for the three months ended March 31, 2013 also included the payment of \$203,000 of settlements concerning two sold mortgage loans. The first settlement was based on our inclusion of an ineligible retirement plan in calculating the borrower's available liquidity, and the second involved a servicing error relating to the premature termination of private mortgage insurance.

## Income Taxes

For the three months ended March 31, 2013, we recorded no income tax expense or benefit due to the full valuation allowance we established for deferred tax assets, compared to an income tax expense of \$457,000 for three months ended March 31, 2012.

## Nonperforming Loans and Assets

We review loans on a regular basis, and generally place loans on nonaccrual status when either principal or interest is 90 days or more past due. In addition, the Company places loans on nonaccrual status when we do not expect to receive full payment of interest or principal. Interest accrued and unpaid at the time a loan is placed on nonaccrual status is reversed from interest income. Interest payments received on nonaccrual loans are recognized in accordance with our significant accounting policies. Once a loan is placed on nonaccrual status, the borrower must generally demonstrate at least six months of payment performance before the loan is eligible to return to accrual status. We may have loans classified as 90 days or more delinquent and still accruing. Generally, we do not utilize this category of loan classification unless: (1) the loan is repaid in full shortly after the period end date; (2) the loan is well secured and there are no asserted or pending legal barriers to its collection; or (3) the borrower has remitted all scheduled payments and is otherwise in substantial compliance with the terms of the loan, but the processing of loan payments actually received or the renewal of the loan has not occurred for administrative reasons. At March 31, 2013, we had one loan totaling \$243,000 in this category.

We typically obtain new third-party appraisals or collateral valuations when we place a loan on nonaccrual status, conduct impairment testing or conduct a TDR unless the existing valuation information for the collateral is sufficiently current to comply with the requirements of our Appraisal and Collateral Valuation Policy (“ACV Policy”). We also obtain new third-party appraisals or collateral valuations when the judicial foreclosure process concludes with respect to real estate collateral, and when we otherwise acquire actual or constructive title to real estate collateral. In addition to third-party appraisals, we use updated valuation information based on Multiple Listing Service data, broker opinions of value, actual sales prices of similar assets sold by us and approved sales

Table of Contents

prices in response to offers to purchase similar assets owned by us to provide interim valuation information for consolidated financial statement and management purposes. Our ACV Policy establishes the maximum useful life of a real estate appraisal at 18 months. Because appraisals and updated valuations utilize historical or “ask-side” data in reaching valuation conclusions, the appraised or updated valuation may or may not reflect the actual sales price that we will receive at the time of sale.

Real estate appraisals may include up to three approaches to value: the sales comparison approach, the income approach (for income-producing property) and the cost approach. Not all appraisals utilize all three approaches. Depending on the nature of the collateral and market conditions, we may emphasize one approach over another in determining the fair value of real estate collateral. Appraisals may also contain different estimates of value based on the level of occupancy or planned future improvements. “As-is” valuations represent an estimate of value based on current market conditions with no changes to the use or condition of the real estate collateral. “As-stabilized” or “as-completed” valuations assume the real estate collateral will be improved to a stated standard or achieve its highest and best use in terms of occupancy. “As-stabilized” or “as-completed” valuations may be subject to a present value adjustment for market conditions or the schedule of improvements.

As part of the asset classification process, we develop an exit strategy for real estate collateral or OREO by assessing overall market conditions, the current use and condition of the asset, and its highest and best use. For most income-producing real estate, we believe that investors value most highly a stable income stream from the asset; consequently, we perform a comparative evaluation to determine whether conducting a sale on an “as-is”, “as-stabilized” or “as-improved” basis is most likely to produce the highest net realizable value. If we determine that the “as-stabilized” or “as-improved” basis is appropriate, we then complete the necessary improvements or tenant stabilization tasks, with the applicable time value discount and improvement expenses incorporated into our estimates of the expected costs to sell. As of March 31, 2013, substantially all impaired real estate loan collateral and OREO were valued on an “as-is basis.” Estimates of the net realizable value of real estate collateral also include a deduction for the expected costs to sell the collateral or such other deductions from the cash flows resulting from the operation and liquidation of the asset as are appropriate. For most real estate collateral subject to the judicial foreclosure process, we apply a 10.0% deduction to the value of the asset to determine the expected costs to sell the asset. This estimate includes one year of real estate taxes, sales commissions and miscellaneous repair and closing costs. If we receive a purchase offer that requires unbudgeted repairs, or if the expected resolution period for the asset exceeds one year, we then include, on a case-by-case basis, the costs of the additional real estate taxes and repairs and any other material holding costs in the expected costs to sell the collateral. For OREO, we only apply a 7.0% deduction to determine the expected costs to sell, as expenses for real estate taxes and repairs are expensed when incurred.

Table of Contents

## Nonperforming Assets Summary

The following table below sets forth the amounts and categories of our nonperforming loans and nonperforming assets.

	March 31, 2013	December 31, 2012	Change
	(Dollars in thousands)		
Nonaccrual loans:			
One-to-four family residential	\$5,988	\$7,299	\$(1,311 )
Multi-family mortgage	10,822	3,517	7,305
Nonresidential real estate	6,182	8,985	(2,803 )
Construction and land	1,575	2,210	(635 )
Commercial	883	256	627
Consumer	11	—	11
	25,461	22,267	3,194
Loans held-for-sale	15	1,752	(1,737 )
Other real estate owned:			
One-to-four family residential	1,515	1,760	(245 )
Multi-family mortgage	—	720	(720 )
Nonresidential real estate	2,896	3,504	(608 )
Land	1,144	1,323	(179 )
	5,555	7,307	(1,752 )
Nonperforming assets (excluding purchased impaired loans and purchased other real estate owned)	31,031	31,326	(295 )
Purchased impaired loans:			
One-to-four family residential	388	380	8
Nonresidential real estate	2,554	2,568	(14 )
Construction and land	1,021	1,021	—
Commercial	21	20	1
	3,984	3,989	(5 )
Purchased other real estate owned:			
One-to-four family residential	205	320	(115 )
Nonresidential real estate	372	462	(90 )
Land	1,956	2,269	(313 )
	2,533	3,051	(518 )
Purchased impaired loans and other real estate owned	6,517	7,040	(523 )
Total nonperforming assets	\$37,548	\$38,366	\$(818 )
Ratios:			
Nonperforming loans to total loans	2.89	% 2.67	%
Nonperforming loans to total loans <sup>(1)</sup>	2.49	2.29	
Nonperforming assets to total assets	2.56	2.59	
Nonperforming assets to total assets <sup>(1)</sup>	2.12	2.11	

(1) These asset quality ratios exclude purchased impaired loans and purchased other real estate owned resulting from the Downers Grove National Bank acquisition.



Table of Contents

## Nonperforming Assets

Nonperforming assets decreased by \$818,000, to \$37.5 million at March 31, 2013, from \$38.4 million at December 31, 2012. The decrease reflected the disposition of \$2.7 million in OREO, the disposition of the \$1.7 million of one- to four family mortgage loans that we designated as held for sale in the fourth quarter of 2012, and various other nonperforming asset resolutions, including the successful restructuring (followed by a sustained period of performance) of a \$6.1 million total credit exposure that initially consisted of seven loans secured by industrial/flex suburban Chicago commercial real estate owned by a family-owned entity. These actions were partially offset by the placement of \$10.3 million of loans on nonaccrual status. In fourth quarter, 2012, we determined that for certain performing classified and non-performing multifamily or non-residential real estate loans, the most cost-effective and expeditious resolution method was to decline to renew the loans upon maturity, or to utilize other remedies provided by our loan documents to accelerate the maturity date of the loans, together with an attempt to negotiate a final resolution in the form of a deed-in-lieu of foreclosure. Of the \$10.3 million in loans placed on non-accrual in the first quarter of 2013, \$7.3 million related to affirmative expedited resolution cases. Of this amount, \$6.4 million involved multifamily loans to five unaffiliated borrowers. We are pursuing various actions to attempt to obtain title to these multifamily properties so that they can be marketed for sale.

## Other Real Estate Owned

Real estate that is acquired through foreclosure or a deed in lieu of foreclosure is classified as OREO until it is sold. When real estate is acquired through foreclosure or by deed in lieu of foreclosure, it is recorded at its fair value, less the estimated costs of disposal. If the fair value of the property is less than the loan balance, the difference is charged against the allowance for loan losses.

The following represents the rollforward of OREO and the composition of OREO properties.

	Three months ended March 31,	
	2013	2012
	(Dollars in thousands)	
Beginning balance	\$10,358	\$22,480
New foreclosed properties	555	1,127
Valuation adjustments	(89	) (573
Gain (loss) on sale of other real estate owned	(69	) 139
Proceeds from sales of other real estate owned	(2,667	) (2,984
Ending balance	\$8,088	\$20,189
	March 31,	December 31,
	2013	2012
	(Dollars in thousands)	
One-to-four family residential	\$1,515	\$1,760
Multi-family mortgage	—	720
Nonresidential real estate	2,896	3,504
Land	1,144	1,323
	5,555	7,307
Acquired other real estate owned:		
One-to-four family residential	205	320
Nonresidential real estate	372	462
Land	1,956	2,269
	2,533	3,051
Total other real estate owned	\$8,088	\$10,358

## Liquidity and Capital Resources

Liquidity. The overall objective of our liquidity management is to ensure the availability of sufficient cash funds to meet all financial commitments and to take advantage of investment opportunities. We manage liquidity in order to meet deposit withdrawals on





Table of Contents

demand or at contractual maturity, to repay borrowings as they mature, and to fund new loans and investments as opportunities arise.

Our primary sources of funds are deposits, principal and interest payments on loans and securities, and, to a lesser extent, wholesale borrowings, the proceeds from maturing securities and short-term investments, and the proceeds from the sales of loans and securities. The scheduled amortization of loans and securities, as well as proceeds from borrowings, are predictable sources of funds. Other funding sources, however, such as deposit inflows, mortgage prepayments and mortgage loan sales are greatly influenced by market interest rates, economic conditions and competition. We anticipate that we will have sufficient funds available to meet current loan commitments and lines of credit and maturing certificates of deposit that are not renewed or extended. We generally remain fully invested and utilize additional sources of funds through FHLBC advances. We had no outstanding advances at March 31, 2013. As a result of the regulatory restructuring occasioned by the Dodd-Frank Act, the Company is subject to Federal Reserve Board Supervisory Letter SR 09-4, which provides that a holding company should, among other things, notify and make a submission to the Federal Reserve Bank prior to declaring a dividend if its net income for the current quarter is not sufficient to fully fund the dividend, and consider eliminating, deferring or significantly reducing its dividends if its net income for the current quarter is not sufficient to fully fund the dividends, or if its net income for the past four quarters, net of dividends previously paid during that period, is not sufficient to fully fund the dividends. The Company will continue to consult with, and seek the prior approval of, the Federal Reserve Bank prior to declaring any dividends.

Supervisory Letter SR 09-4 also sets forth guidelines pertaining to share repurchases.

As of March 31, 2013, we were not aware of any known trends, events or uncertainties that had or were reasonably likely to have a material impact on our liquidity. As of March 31, 2013, we had no other material commitments for capital expenditures.

Capital Management

Capital Management - Bank. The overall objectives of our capital management are to ensure the availability of sufficient capital to support loan, deposit and other asset and liability growth opportunities and to maintain capital to absorb unforeseen losses or write-downs that are inherent in the business risks associated with the banking industry. We seek to balance the need for higher capital levels to address such unforeseen risks and the goal to achieve an adequate return on the capital invested by our stockholders.

The Bank is subject to regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary, actions by the Office of the Comptroller of the Currency that, if undertaken, could have a direct material effect on the Bank's financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to qualitative judgments by regulators about components, risk weightings, and other factors.

The prompt corrective action regulations provide five classifications, including well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized, although these terms are not used to represent overall financial condition. Adequately capitalized institutions require regulatory approval to accept brokered deposits. If undercapitalized, a financial institution's capital distributions, asset growth and expansion are limited, and for the submission of a capital restoration is required.

The Company and the Bank have adopted Capital Plans that require the Bank to maintain a Tier 1 leverage ratio of at least 8% and a total risk-based capital ratio of at least 12%. The minimum capital ratios set forth in the Capital Plans will be increased and other minimum capital requirements will be established if and as necessary to comply with the Basel III requirements as such requirements become applicable to the Company and the Bank. In accordance with the Capital Plans, neither the Company nor the Bank will pursue any acquisition or growth opportunity, declare any dividend or conduct any stock repurchase that would cause the Bank's total risk-based capital ratio and/or its Tier 1 leverage ratio to fall below the established minimum capital levels. In addition, the Company will continue to

maintain its ability to serve as a source of financial strength to the Bank by holding at least \$5.0 million of cash or liquid assets for that purpose.

Table of Contents

Actual capital ratios and minimum required ratios for the Bank were:

	Actual Ratio		Minimum required to be Well Capitalized Under Prompt Corrective Action Provisions		Minimum Capital Ratios Established under Capital Plans	
March 31, 2013						
Total capital (to risk-weighted assets)	15.84	%	8.00	%	12.00	%
Tier 1 (core) capital (to risk-weighted assets)	14.59		4.00		8.00	
Tier 1 (core) capital (to adjusted total assets)	9.77		4.00		8.00	
December 31, 2012						
Total capital (to risk-weighted assets)	15.32	%	8.00	%	12.00	%
Tier 1 (core) capital (to risk-weighted assets)	14.07		4.00		8.00	
Tier 1 (core) capital (to adjusted total assets)	9.60		4.00		8.00	

As of March 31, 2013 and December 31, 2012, the Bank was well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since those notifications that management believes have changed the Bank's prompt corrective action capitalization category.

Capital Management - Company Total stockholders' equity was \$173.6 million at March 31, 2013, compared to \$172.9 million at December 31, 2012. The increase in total stockholders' equity was primarily due to the \$678,000 net income that we recorded for the three months ended March 31, 2013. The unallocated shares of common stock that our ESOP owns were reflected as a \$12.0 million reduction to stockholders' equity at March 31, 2013, compared to \$12.2 million at December 31, 2012.

Quarterly Cash Dividends. Our Board of Directors declared a quarterly cash dividend of \$0.01 per share on April 11, 2013 payable on May 10, 2013 to stockholders of record on April 26, 2013. As a result of the regulatory restructuring occasioned by the Dodd-Frank Act, the Company is subject to Federal Reserve Board Supervisory Letter SR 09-4, which provides that a holding company should, among other things, notify and make a submission to the Federal Reserve Bank prior to declaring a dividend if its net income for the current quarter is not sufficient to fully fund the dividend, and consider eliminating, deferring or significantly reducing its dividends if its net income for the current quarter is not sufficient to fully fund the dividends, or if its net income for the past four quarters, net of dividends previously paid during that period, is not sufficient to fully fund the dividends. The Company will continue to consult with, and seek the prior approval of, the Federal Reserve Bank prior to declaring any dividends.

Stock Repurchase Program. Our Board of Directors had authorized the repurchase of up to 5,047,423 shares of our common stock. The repurchase authorization expired on November 15, 2012. The authorization permitted shares to be repurchased in open market or negotiated transactions, and pursuant to any trading plan that may be adopted in accordance with Rule 10b5-1 of the Securities and Exchange Commission. The authorization was utilized at management's discretion, subject to the limitations set forth in Rule 10b-18 of the Securities and Exchange Commission and other applicable legal requirements, and to price and other internal limitations established by the Board of Directors. As of March 31, 2013, the Company had repurchased 4,239,134 shares of its common stock out of the 5,047,423 shares that had been authorized for repurchase. Federal Reserve Board Supervisory Letter SR 09-4 provides that holding companies experiencing financial weaknesses such as operating losses should notify and make a submission to the Federal Reserve Bank before redeeming or repurchasing common stock. The Company has no plans to conduct such discussions with the Federal Reserve supervisory staff or engage in stock repurchases at this time.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

Qualitative Analysis. A significant form of market risk is interest rate risk. Interest rate risk results from timing differences in the maturity or repricing of our assets, liabilities and off balance sheet contracts (i.e., forward loan

commitments), the effect of loan prepayments and deposit withdrawals, the difference in the behavior of lending and funding rates arising from the use of different indices and “yield curve risk” arising from changing rate relationships across the spectrum of maturities for constant or variable credit risk investments. In addition to directly affecting net interest income, changes in market interest rates can also affect the amount of new loan originations, the ability of borrowers to repay variable rate loans, the volume of loan prepayments and refinancings, the carrying value of investment securities classified as available-for-sale and the flow and mix of deposits.

The general objective of our interest rate risk management is to determine the appropriate level of risk given our business strategy and then manage that risk in a manner that is consistent with our policy to reduce, to the extent possible, the exposure of our net

Table of Contents

interest income to changes in market interest rates. Our Asset/Liability Management Committee (“ALCO”), which consists of certain members of senior management, evaluates the interest rate risk inherent in certain assets and liabilities, our operating environment and capital and liquidity requirements, and modifies our lending, investing and deposit gathering strategies accordingly. The Board of Directors’ Asset/Liability Management Committee then reviews the ALCO’s activities and strategies, the effect of those strategies on our net interest margin, and the effect that changes in market interest rates would have on the economic value of our loan and securities portfolios as well as the intrinsic value of our deposits and borrowings, and reports to the full Board of Directors.

We actively evaluate interest rate risk in connection with our lending, investing and deposit activities. In an effort to better manage interest-rate risk, we have de-emphasized the origination of residential mortgage loans, and have increased our emphasis on the origination of nonresidential real estate loans, multi-family mortgage loans, commercial loans and commercial leases. In addition, depending on market interest rates and our capital and liquidity position, we generally sell all or a portion of our longer-term, fixed-rate residential loans, usually on a servicing-retained basis. Further, we primarily invest in shorter-duration securities, which generally have lower yields compared to longer-term investments. Shortening the average maturity of our interest-earning assets by increasing our investments in shorter-term loans and securities, as well as loans with variable rates of interest, helps to better match the maturities and interest rates of our assets and liabilities, thereby reducing the exposure of our net interest income to changes in market interest rates. Finally, we have classified all of our investment portfolio as available-for-sale so as to provide flexibility in liquidity management.

We utilize a combination of analyses to monitor the Bank’s exposure to changes in interest rates. The economic value of equity analysis is a model that estimates the change in net portfolio value (“NPV”) over a range of interest rate scenarios. NPV is the discounted present value of expected cash flows from assets, liabilities and off-balance sheet contracts. In calculating changes in NPV, we assume estimated loan prepayment rates, reinvestment rates and deposit decay rates that seem most likely based on historical experience during prior interest rate changes.

Our net interest income analysis utilizes the data derived from the dynamic GAP analysis, described below, and applies several additional elements, including actual interest rate indices and margins, contractual limitations such as interest rate floors and caps and the U.S. Treasury yield curve as of the balance sheet date. In addition, we apply consistent parallel yield curve shifts (in both directions) to determine possible changes in net interest income if the theoretical yield curve shifts occurred instantaneously. Net interest income analysis also adjusts the dynamic GAP repricing analysis based on changes in prepayment rates resulting from the parallel yield curve shifts.

Our dynamic GAP analysis determines the relative balance between the repricing of assets and liabilities over multiple periods of time (ranging from overnight to five years). Dynamic GAP analysis includes expected cash flows from loans and mortgage-backed securities, applying prepayment rates based on the differential between the current interest rate and the market interest rate for each loan and security type. This analysis identifies mismatches in the timing of asset and liability repricing but does not necessarily provide an accurate indicator of interest rate risk because it omits the factors incorporated into the net interest income analysis.

Quantitative Analysis. The following table sets forth, as of March 31, 2013, the estimated changes in the Bank’s NPV and net interest income that would result from the designated instantaneous parallel shift in the U.S. Treasury yield curve. Computations of prospective effects of hypothetical interest rate changes are based on numerous assumptions including relative levels of market interest rates, loan prepayments and deposit decay, and should not be relied upon as indicative of actual results.

Change in Interest Rates (basis points)	Estimated Increase in NPV		Decrease in Estimated Net Interest Income	
	Amount (dollars in thousands)	Percent	Amount	Percent
+400	\$1,665	1.14	% \$(712 )	(1.62 )%
+300	1,663	1.14	(405 )	(0.92 )
+200	1,535	1.05	(252 )	(0.57 )
+100	1,086	0.74	(146 )	(0.33 )

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The Company has opted not to include an estimate for a decrease in rates at March 31, 2013 as the results are not relevant given the current targeted fed funds rate of the Federal Open Market Committee. The table set forth above indicates that at March 31, 2013, in the event of an immediate 200 basis point increase in interest rates, the Bank would be expected to experience a 1.05% increase in NPV and a \$252,000 decrease in net interest income. This data does not reflect any actions that we may undertake in

44

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Table of Contents

response to changes in interest rates, such as changes in rates paid on certain deposit accounts based on local competitive factors, which could reduce the actual impact on NPV and net interest income, if any.

Certain shortcomings are inherent in the methodology used in the above interest rate risk measurements. Modeling changes in NPV and net interest income requires that we make certain assumptions that may or may not reflect the manner in which actual yields and costs respond to changes in market interest rates. The NPV and net interest income table presented above assumes that the composition of our interest-rate-sensitive assets and liabilities existing at the beginning of a period remains constant over the period being measured and, accordingly, the data does not reflect any actions that we may undertake in response to changes in interest rates, such as changes in rates paid on certain deposit accounts based on local competitive factors. The table also assumes that a particular change in interest rates is reflected uniformly across the yield curve regardless of the duration to maturity or the repricing characteristics of specific assets and liabilities. Accordingly, although the NPV and net interest income table provides an indication of our sensitivity to interest rate changes at a particular point in time, such measurements are not intended to and do not provide a precise forecast of the effect of changes in market interest rates on our net interest income and will differ from actual results.

**ITEM 4. CONTROLS AND PROCEDURES**

An evaluation was performed under the supervision and with the participation of the Company's management, including the Chairman, Chief Executive Officer and President and the Executive Vice President and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) promulgated under the Securities and Exchange Act of 1934, as amended) as of March 31, 2013. Based on that evaluation, the Company's management, including the Chairman, President, and Chief Executive Officer and the Executive Vice President and Chief Financial Officer, concluded that the Company's disclosure controls and procedures were effective.

During the quarter ended March 31, 2013, there have been no changes in the Company's internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.



PART II

ITEM 1. LEGAL PROCEEDINGS

The Company and its subsidiaries are subject to various legal actions arising in the normal course of business. In the opinion of management, based on currently available information, the resolution of these legal actions is not expected to have a material adverse effect on the Company's results of operations.

ITEM 1A. RISK FACTORS

Not applicable.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

(a) Unregistered Sale of Equity Securities. Not applicable.

(b) Use of Proceeds. Not applicable

(c) Repurchases of Equity Securities.

The Company's Board of Directors had authorized the repurchase of up to 5,047,423 shares of our common stock. The repurchase authorization expired on November 15, 2012. In accordance with this authorization, the Company had repurchased 4,239,134 shares of its common stock as of March 31, 2013. The Company has no plans to engage in stock repurchases at this time.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

ITEM 4. MINE SAFETY DISCLOSURES

ITEM 5. OTHER INFORMATION

None

ITEM 6. EXHIBITS

Exhibit Number Description

31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32	Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002*
101	The following financial statements from the BankFinancial Corporation Quarterly Report on Form 10-Q for the quarter ended March 31, 2013, formatted in Extensive Business Reporting Language (XBRL): (i) consolidated statement of conditions, (ii) consolidated statements of operations, (iii) consolidated statements of cash flows and (iv) the notes to consolidated financial statements.

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

BANKFINANCIAL CORPORATION

Date: May 8, 2013 By: /s/ F. Morgan Gasior

F. Morgan Gasior

Chairman of the Board, Chief Executive Officer and President

/s/ Paul A. Cloutier

Paul A. Cloutier

Chief Financial Officer