

BankFinancial CORP  
Form 10-Q  
October 30, 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 September 30, 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  Accelerated filer   
Non-accelerated filer  Smaller reporting company

Indicate the number of shares outstanding of each of the Issuer's classes of common stock as of the latest practicable date. At October 28, 2013, there were 21,101,966 shares of Common Stock, \$0.01 par value, outstanding.



BANKFINANCIAL CORPORATION

Form 10-Q

September 30, 2013

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## BANKFINANCIAL CORPORATION

## CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

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

|  | September 30,<br>2013 | December 31,<br>2012 |
|--|-----------------------|----------------------|
| <b>Assets</b>  |                       |                      |
| Cash and due from other financial institutions   | \$18,068              | \$20,361             |
| Interest-bearing deposits in other financial institutions  | 225,410               | 255,403              |
| Cash and cash equivalents  | 243,478               | 275,764              |
| Securities, at fair value  | 83,409                | 77,832               |
| Loans held for sale  | 15                    | 2,166                |
| Loans receivable, net of allowance for loan losses:<br>September 30, 2013, \$15,876 and December 31, 2012, \$18,035  | 1,035,331             | 1,030,465            |
| Other real estate owned, net   | 5,403                 | 10,358               |
| Stock in Federal Home Loan Bank, at cost   | 6,068                 | 8,412                |
| Premises and equipment, net  | 36,154                | 38,251               |
| Accrued interest receivable  | 3,576                 | 4,146                |
| Core deposit intangible  | 2,583                 | 3,038                |
| Bank owned life insurance  | 21,881                | 21,645               |
| FDIC prepaid expense   | —                     | 2,658                |
| Other assets   | 4,050                 | 6,457                |
| <b>Total assets</b>  | <b>\$1,441,948</b>    | <b>\$1,481,192</b>   |
| <b>Liabilities</b>   |                       |                      |
| <b>Deposits</b>  |                       |                      |
| Noninterest-bearing  | \$133,094             | \$134,597            |
| Interest-bearing   | 1,116,739             | 1,147,754            |
| <b>Total deposits</b>  | <b>1,249,833</b>      | <b>1,282,351</b>     |
| <b>Borrowings</b>  | <b>2,883</b>          | <b>5,567</b>         |
| Advance payments by borrowers for taxes and insurance  | 5,825                 | 10,705               |
| Accrued interest payable and other liabilities   | 9,096                 | 9,679                |
| <b>Total liabilities</b>   | <b>1,267,637</b>      | <b>1,308,302</b>     |
| <b>Commitments and contingent liabilities</b>  |                       |                      |
| <b>Stockholders' equity</b>  |                       |                      |
| 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;<br>21,101,966 shares issued at September 30, 2013 and 21,072,966 shares at<br>December 31, 2012 | 211                   | 211                  |
| Additional paid-in capital   | 193,567               | 193,590              |
| Retained earnings (deficit)  | (8,425                | ) (9,796 )           |
| Unearned Employee Stock Ownership Plan shares  | (11,501               | ) (12,233 )          |
| Accumulated other comprehensive income   | 459                   | 1,118                |
| <b>Total stockholders' equity</b>  | <b>174,311</b>        | <b>172,890</b>       |
| <b>Total liabilities and stockholders' equity</b>  | <b>\$1,441,948</b>    | <b>\$1,481,192</b>   |

See accompanying notes to the consolidated financial statements.



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## BANKFINANCIAL CORPORATION

## CONSOLIDATED STATEMENTS OF OPERATIONS

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

|  | Three Months Ended<br>September 30, |            | Nine Months Ended<br>September 30, |            |
|--|-------------------------------------|------------|------------------------------------|------------|
|  | 2013                                | 2012       | 2013                               | 2012       |
| Interest and dividend income                                   |                                     |            |                                    |            |
| Loans, including fees  | \$ 11,680                           | \$ 13,978  | \$ 35,812                          | \$ 45,402  |
| Securities   | 241                                 | 342        | 710                                | 1,171      |
| Other  | 186                                 | 148        | 574                                | 353        |
| Total interest income  | 12,107                              | 14,468     | 37,096                             | 46,926     |
| Interest expense   |                                     |            |                                    |            |
| Deposits   | 880                                 | 1,010      | 2,799                              | 3,308      |
| Borrowings   | 2                                   | 26         | 12                                 | 80         |
| Total interest expense   | 882                                 | 1,036      | 2,811                              | 3,388      |
| Net interest income  | 11,225                              | 13,432     | 34,285                             | 43,538     |
| Provision (recovery) for loan losses                           | (437                                | ) 4,453    | 491                                | 7,194      |
| Net interest income after provision (recovery) for loan losses | 11,662                              | 8,979      | 33,794                             | 36,344     |
| Noninterest income   |                                     |            |                                    |            |
| Deposit service charges and fees                               | 520                                 | 548        | 1,528                              | 1,626      |
| Other fee income   | 373                                 | 374        | 1,158                              | 1,142      |
| Insurance commissions and annuities income                     | 106                                 | 125        | 301                                | 359        |
| Gain on sale of loans, net                                     | 32                                  | 210        | 1,445                              | 595        |
| Loss on disposition of premises and equipment, net             | —                                   | (7         | ) —                                | (164       |
| Loan servicing fees  | 112                                 | 124        | 349                                | 371        |
| Amortization and impairment of servicing assets                | (43                                 | ) (55      | ) (152                             | ) (235     |
| Earnings on bank owned life insurance                          | 84                                  | 109        | 236                                | 355        |
| Trust  | 172                                 | 171        | 536                                | 545        |
| Other  | 183                                 | 232        | 513                                | 487        |
|  | 1,539                               | 1,831      | 5,914                              | 5,081      |
| Noninterest expense  |                                     |            |                                    |            |
| Compensation and benefits                                      | 6,143                               | 6,353      | 19,581                             | 19,513     |
| Office occupancy and equipment                                 | 1,797                               | 1,904      | 5,550                              | 6,041      |
| Advertising and public relations                               | 195                                 | 145        | 609                                | 475        |
| Information technology   | 817                                 | 880        | 2,382                              | 2,553      |
| Supplies, telephone, and postage                               | 382                                 | 372        | 1,246                              | 1,124      |
| Amortization of intangibles                                    | 149                                 | 156        | 455                                | 476        |
| Nonperforming asset management                                 | 682                                 | 1,728      | 2,031                              | 4,085      |
| Operations of other real estate owned                          | 476                                 | 2,742      | 1,409                              | 4,985      |
| FDIC insurance premiums  | 476                                 | 642        | 1,445                              | 1,299      |
| Other  | 1,045                               | 1,110      | 3,207                              | 2,961      |
|  | 12,162                              | 16,032     | 37,915                             | 43,512     |
| Income (loss) before income taxes                              | 1,039                               | (5,222     | ) 1,793                            | (2,087     |
| Income tax expense   | —                                   | —          | —                                  | —          |
| Net income (loss)  | \$ 1,039                            | \$ (5,222  | ) \$ 1,793                         | \$ (2,087  |
| Basic earnings (loss) per common share                         | \$ 0.05                             | \$ (0.26   | ) \$ 0.09                          | \$ (0.11   |
| Diluted earnings (loss) per common share                       | \$ 0.05                             | \$ (0.26   | ) \$ 0.09                          | \$ (0.11   |
| Weighted average common shares outstanding                     | 20,048,058                          | 19,914,992 | 20,002,381                         | 19,871,368 |

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|  |            |            |            |            |
|--|------------|------------|------------|------------|
| Diluted weighted average common shares outstanding | 20,054,092 | 19,914,992 | 20,005,197 | 19,871,368 |
|--|------------|------------|------------|------------|

See accompanying notes to the consolidated financial statements.

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## BANKFINANCIAL CORPORATION

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(In thousands) - Unaudited

|  | Three Months Ended |           | Nine Months Ended |           |
|--|--------------------|-----------|-------------------|-----------|
|  | September 30,      |           | September 30,     |           |
|  | 2013               | 2012      | 2013              | 2012      |
| Net income (loss)  | \$1,039            | \$(5,222) | ) \$1,793         | \$(2,087) |
| Unrealized holding gain (loss) arising during the period, net of tax | (215               | ) 210     | (659              | ) 174     |
| Amount reclassified from accumulated other comprehensive income      | —                  | —         | —                 | —         |
| Net current period other comprehensive gain (loss)                   | (215               | ) 210     | (659              | ) 174     |
| Comprehensive income (loss)  | \$824              | \$(5,012) | ) \$1,134         | \$(1,913) |

See accompanying notes to the consolidated financial statements.

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## BANKFINANCIAL CORPORATION

## CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

(In thousands, except per share data) - Unaudited

|  | Common<br>Stock | Additional<br>Paid-in<br>Capital | Retained<br>Earnings<br>(Deficit) | Unearned<br>Employee<br>Stock<br>Ownership<br>Plan<br>Shares | Accumulated<br>Other<br>Comprehen-sive<br>Income | Total     |
|--|-----------------|----------------------------------|-----------------------------------|--|--|-----------|
| Balance at January 1, 2012                                 | \$211           | \$193,801                        | \$17,946                          | \$(13,212 )  | \$ 1,111   | \$199,857 |
| Net loss   | —               | —                                | (2,087 )                          | —  | —  | (2,087 )  |
| Other comprehensive income, net of tax effects             | —               | —                                | —                                 | —  | 174  | 174       |
| Nonvested stock awards-stock-based compensation expense    | —               | 41                               | —                                 | —  | —  | 41        |
| Cash dividends declared on common stock (\$0.03 per share) | —               | —                                | (633 )                            | —  | —  | (633 )    |
| ESOP shares earned   | —               | (88 )                            | —                                 | 733  | —  | 645       |
| Balance at September 30, 2012                              | \$211           | \$193,754                        | \$15,226                          | \$(12,479 )  | \$ 1,285   | \$197,997 |
| Balance at January 1, 2013                                 | \$211           | \$193,590                        | \$(9,796 )                        | \$(12,233 )  | \$ 1,118   | \$172,890 |
| Net income   | —               | —                                | 1,793                             | —  | —  | 1,793     |
| Other comprehensive income, net of tax effects             | —               | —                                | —                                 | —  | (659 )   | (659 )    |
| Nonvested stock awards-stock-based compensation expense    | —               | 62                               | —                                 | —  | —  | 62        |
| Cash dividends declared on common stock (\$0.02 per share) | —               | —                                | (422 )                            | —  | —  | (422 )    |
| ESOP shares earned   | —               | (85 )                            | —                                 | 732  | —  | 647       |
| Balance at September 30, 2013                              | \$211           | \$193,567                        | \$(8,425 )                        | \$(11,501 )  | \$ 459   | \$174,311 |

See accompanying notes to the consolidated financial statements.

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CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands) - Unaudited

|   | Nine Months Ended September |              |
|---|-----------------------------|--------------|
|   | 30,                         |              |
|   | 2013                        | 2012         |
| Cash flows from operating activities  |                             |              |
| Net income (loss)   | \$1,793                     | \$(2,087 )   |
| Adjustments to reconcile to net income (loss) to net cash from operating activities |                             |              |
| Provision for loan losses   | 491                         | 7,194        |
| ESOP shares earned  | 647                         | 645          |
| Stock-based compensation expense  | 62                          | 41           |
| Depreciation and amortization   | 3,285                       | 3,417        |
| Amortization of premiums and discounts on securities and loans                      | (606                        | ) (2,185 )   |
| Amortization of core deposit and other intangible assets                            | 455                         | 476          |
| Amortization and impairment of servicing assets                                     | 152                         | 235          |
| Net change in net deferred loan origination costs                                   | (157                        | ) 81         |
| Net loss (gain) on sale of other real estate owned                                  | 182                         | (126 )       |
| Net gain on sale of loans   | (1,445                      | ) (595 )     |
| Net loss on disposition of premises and equipment                                   | —                           | 164          |
| Loans originated for sale   | (9,876                      | ) (13,806 )  |
| Proceeds from sale of loans   | 10,750                      | 15,768       |
| Other real estate owned valuation adjustments                                       | 471                         | —            |
| Net change in:  |                             |              |
| Accrued interest receivable   | 570                         | 1,178        |
| Earnings on bank owned life insurance   | (236                        | ) (355 )     |
| Other assets  | 3,749                       | 2,380        |
| Accrued interest payable and other liabilities                                      | (583                        | ) (1,462 )   |
| Net cash from operating activities  | 9,704                       | 14,740       |
| Cash flows from investing activities  |                             |              |
| Securities  |                             |              |
| Proceeds from maturities  | 25,422                      | 22,424       |
| Proceeds from principal repayments  | 10,571                      | 15,413       |
| Purchases of securities   | (42,351                     | ) (26,659 )  |
| Loans receivable  |                             |              |
| Principal payments on loans receivable  | 345,906                     | 394,621      |
| Purchases of loans  | —                           | (3,190 )     |
| Originated for investment   | (353,764                    | ) (255,751 ) |
| Proceeds from sale of loans   | 2,868                       | —            |
| Proceeds of redemption of Federal Home Loan Bank of Chicago stock                   | 2,344                       | 7,279        |
| Proceeds from sale of other real estate owned                                       | 7,542                       | 9,872        |
| Purchase of premises and equipment, net   | (24                         | ) (1,885 )   |
| Net cash from (used in) investing activities  | (1,486                      | ) 162,124    |

Continued

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CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands) - Unaudited

|   | Nine Months Ended September |             |
|---|-----------------------------|-------------|
|   | 30,                         |             |
|   | 2013                        | 2012        |
| Cash flows from financing activities                                |                             |             |
| Net change in deposits  | \$(32,518                   | ) \$(54,181 |
| Net change in borrowings  | (2,684                      | ) (2,376    |
| Net change in advance payments by borrowers for taxes and insurance | (4,880                      | ) (3,649    |
| Cash dividends paid on common stock                                 | (422                        | ) (633      |
| Net cash used in financing activities                               | (40,504                     | ) (60,839   |
| Net change in cash and cash equivalents                             | (32,286                     | ) 116,025   |
| Beginning cash and cash equivalents                                 | 275,764                     | 120,704     |
| Ending cash and cash equivalents                                    | \$243,478                   | \$236,729   |
| Supplemental disclosures of cash flow information:                  |                             |             |
| Interest paid   | \$2,849                     | \$3,432     |
| Income taxes paid   | —                           | —           |
| Income taxes refunded   | 461                         | 1,406       |
| Loans transferred to other real estate owned                        | 3,268                       | 6,236       |

See accompanying notes to the consolidated financial statements.

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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, 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- and nine-month periods ended September 30, 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 (“FASB”) 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 three or nine month periods ended September 30, 2013 and 2012.

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## 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.

|   | Three Months Ended |             | Nine Months Ended |             |
|---|--------------------|-------------|-------------------|-------------|
|   | September 30,      |             | September 30,     |             |
|   | 2013               | 2012        | 2013              | 2012        |
| Net income (loss) available to common stockholders  | \$1,039            | \$(5,222)   | \$1,793           | \$(2,087)   |
| Average common shares outstanding   | 21,101,966         | 21,072,966  | 21,087,838        | 21,072,966  |
| Less:   |                    |             |                   |             |
| Unearned ESOP shares  | (1,028,158)        | (1,157,974) | (1,072,180)       | (1,198,988) |
| Unvested restricted stock shares  | (25,750)           | —           | (13,277)          | (2,610)     |
| Weighted average common shares outstanding  | 20,048,058         | 19,914,992  | 20,002,381        | 19,871,368  |
| Add - Net effect of dilutive stock options and unvested restricted stock                      | 6,034              | —           | 2,816             | —           |
| Diluted weighted average common shares outstanding  | 20,054,092         | 19,914,992  | 20,005,197        | 19,871,368  |
| Basic earnings (loss) per common share  | \$0.05             | \$(0.26)    | \$0.09            | \$(0.11)    |
| Diluted earnings (loss) per common share  | \$0.05             | \$(0.26)    | \$0.09            | \$(0.11)    |
| Number of antidilutive stock options excluded from the diluted earnings per share calculation | —                  | 141,000     | —                 | 141,000     |
| Weighted average exercise price of anti-dilutive option shares                                | \$—                | \$17.21     | \$—               | \$17.21     |

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## 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 are shown below.

|   | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair Value |
|---|-------------------|------------------------------|-------------------------------|------------|
| September 30, 2013                                |                   |                              |                               |            |
| Certificates of deposit                           | \$34,533          | \$—                          | \$—                           | \$34,533   |
| Municipal securities                              | 350               | 9                            | —                             | 359        |
| Equity mutual fund                                | 500               | 5                            | —                             | 505        |
| Mortgage-backed securities - residential          | 28,864            | 1,273                        | (111)                         | ) 30,026   |
| Collateralized mortgage obligations - residential | 17,983            | 38                           | (72)                          | ) 17,949   |
| SBA-guaranteed loan participation certificates    | 37                | —                            | —                             | 37         |
|   | \$82,267          | \$1,325                      | \$(183)                       | ) \$83,409 |
| 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 or 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 September 30, 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.

|   | September 30, 2013 |               |
|---|--------------------|---------------|
|   | Amortized<br>Cost  | Fair<br>Value |
| Due in one year or less                           | \$34,703           | \$34,704      |
| Due after one year through five years             | 180                | 188           |
|   | 34,883             | 34,892        |
| Equity mutual fund                                | 500                | 505           |
| Mortgage-backed securities - residential          | 28,864             | 30,026        |
| Collateralized mortgage obligations - residential | 17,983             | 17,949        |
| SBA-guaranteed loan participation certificates    | 37                 | 37            |
|   | \$82,267           | \$83,409      |



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## 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       |
| September 30, 2013                                |                     |            |                   |            |          |            |
| Mortgage-backed securities - residential          | \$3,004             | \$(111 )   | \$—               | \$—        | \$3,004  | \$(111 )   |
| Collateralized mortgage obligations - residential | 11,881              | (72 )      | —                 | —          | 11,881   | (72 )      |
|   | \$14,885            | \$(183 )   | \$—               | \$—        | \$14,885 | \$(183 )   |
| 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.

Certain residential mortgage-backed securities and a collateralized mortgage obligation that the Company holds in its investment portfolio remained in an unrealized loss position at September 30, 2013, but the unrealized losses were not considered significant under the Company's impairment testing methodology. In addition, the Company does not intend to sell these securities, and it is likely that the Company will not be required to sell these securities before their anticipated recovery occurs.

There were no sales of securities during the three and nine months ended September 30, 2013 or 2012.

## NOTE 4 - LOANS RECEIVABLE

Loans receivable are as follows:

|  | September 30,<br>2013 | December 31,<br>2012 |
|--|-----------------------|----------------------|
| One-to-four family residential real estate loans | \$204,205             | \$218,596            |
| Multi-family mortgage loans                      | 375,786               | 352,019              |
| Nonresidential real estate loans                 | 246,524               | 264,672              |
| Construction and land loans                      | 6,429                 | 8,552                |
| Commercial loans                                 | 52,978                | 61,388               |
| Commercial leases                                | 161,822               | 139,783              |
| Consumer loans                                   | 2,561                 | 2,745                |
| Total loans                                      | 1,050,305             | 1,047,755            |
| Net deferred loan origination costs              | 902                   | 745                  |
| Allowance for loan losses                        | (15,876 )             | (18,035 )            |
| Loans, net                                       | \$1,035,331           | \$1,030,465          |



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## 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<br>evaluated<br>for<br>impairment | Purchased<br>impaired<br>loans | Collectively<br>evaluated<br>for<br>impairment | Total    | Individually<br>evaluated<br>for<br>impairment | Purchased<br>impaired<br>loans | Collectively<br>evaluated<br>for<br>impairment | Total       |
| September 30, 2013                                     |  |                                |  |          |  |                                |  |             |
| One-to-four family<br>residential real estate<br>loans | \$41   | \$1                            | \$ 3,804                                       | \$3,846  | \$4,952  | \$405                          | \$198,848                                      | \$204,205   |
| Multi-family<br>mortgage loans                         | 469  | —                              | 4,406  | 4,875    | 12,248   | —                              | 363,538  | 375,786     |
| Nonresidential real<br>estate loans                    | 224  | —                              | 4,569  | 4,793    | 5,358  | 1,611                          | 239,555  | 246,524     |
| Construction and<br>land loans                         | 37   | —                              | 561  | 598      | 1,021  | —                              | 5,408  | 6,429       |
| Commercial loans                                       | 29   | —                              | 910  | 939      | 272  | 22                             | 52,684   | 52,978      |
| Commercial leases                                      | —  | —                              | 728  | 728      | —  | —                              | 161,822  | 161,822     |
| Consumer loans   | —  | —                              | 97   | 97       | —  | —                              | 2,561  | 2,561       |
|  | \$800  | \$1                            | \$ 15,075                                      | \$15,876 | \$23,851                                       | \$2,038                        | \$1,024,416                                    | 1,050,305   |
| Net deferred loan origination<br>costs                 |  |                                |  |          |  |                                |  | 902         |
| Allowance for loan losses                              |  |                                |  |          |  |                                |  | (15,876 )   |
| Loans, net   |  |                                |  |          |  |                                |  | \$1,035,331 |
|  | Allowance for loan losses                      |                                |  |          | Loan Balances                                  |                                |  |             |
|  | Individually<br>evaluated<br>for<br>impairment | Purchased<br>impaired<br>loans | Collectively<br>evaluated<br>for<br>impairment | Total    | Individually<br>evaluated<br>for<br>impairment | Purchased<br>impaired<br>loans | Collectively<br>evaluated<br>for<br>impairment | Total       |
| December 31, 2012                                      |  |                                |  |          |  |                                |  |             |
| One-to-four family<br>residential real estate<br>loans | \$137  | \$5                            | \$ 4,584                                       | \$4,726  | \$5,256  | \$380                          | \$212,960                                      | \$218,596   |
| Multi-family<br>mortgage loans                         | 729  | —                              | 3,851  | 4,580    | 4,801  | —                              | 347,218  | 352,019     |
| Nonresidential real<br>estate loans                    | 401  | 8                              | 5,136  | 5,545    | 11,918   | 2,568                          | 250,186  | 264,672     |
| Construction and<br>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 |

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## 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 are as follows:

|  | Three Months Ended |           | Nine Months Ended |           |
|--|--------------------|-----------|-------------------|-----------|
|  | September 30,      |           | September 30,     |           |
|  | 2013               | 2012      | 2013              | 2012      |
| Beginning balance                                | \$17,097           | \$30,878  | \$18,035          | \$31,726  |
| Loans charged offs:                              |                    |           |                   |           |
| One-to-four family residential real estate loans | (528               | ) (3,145  | ) (1,073          | ) (4,408  |
| Multi-family mortgage loans                      | (902               | ) (2,159  | ) (1,512          | ) (2,848  |
| Nonresidential real estate loans                 | (138               | ) (5,435  | ) (370            | ) (8,070  |
| Construction and land loans                      | (16                | ) (806    | ) (943            | ) (1,038  |
| Commercial loans                                 | (131               | ) (3,536  | ) (363            | ) (3,705  |
| Commercial leases                                | —                  | (68       | ) —               | (68       |
| Consumer loans                                   | (38                | ) (72     | ) (50             | ) (95     |
|  | (1,753             | ) (15,221 | ) (4,311          | ) (20,232 |
| Recoveries:                                      |                    |           |                   |           |
| One-to-four family residential real estate loans | 108                | 7         | 435               | 192       |
| Multi-family mortgage loans                      | 3                  | 11        | 219               | 491       |
| Nonresidential real estate loans                 | 329                | 7         | 451               | 322       |
| Construction and land loans                      | 193                | 6         | 196               | 248       |
| Commercial loans                                 | 335                | 421       | 356               | 610       |
| Consumer loans                                   | 1                  | 26        | 4                 | 37        |
|  | 969                | 478       | 1,661             | 1,900     |
| Net charge-off                                   | (784               | ) (14,743 | ) (2,650          | ) (18,332 |
| Provision (recovery) for loan losses             | (437               | ) 4,453   | 491               | 7,194     |
| Ending balance                                   | \$15,876           | \$20,588  | \$15,876          | \$20,588  |
| 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



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## 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 present loans individually evaluated for impairment by class of loans, excluding purchased impaired loans:

|   |                 |                        |                       |  | Three months ended<br>September 30, 2013      | September 30, 2013               | Nine months ended<br>September 30, 2013       | September 30, 2013               |
|---|-----------------|------------------------|-----------------------|--|---|----------------------------------|---|----------------------------------|
|   | Loan<br>Balance | Recorded<br>Investment | Partial<br>Charge-off | Allowance<br>for Loan<br>Losses<br>Allocated | Average<br>Investment<br>in Impaired<br>Loans | Interest<br>Income<br>Recognized | Average<br>Investment<br>in Impaired<br>Loans | Interest<br>Income<br>Recognized |
| September 30, 2013  |                 |                        |                       |  |   |                                  |   |                                  |
| With no related allowance recorded:                                   |                 |                        |                       |  |   |                                  |   |                                  |
| One-to-four family residential real estate loans                      | \$5,157         | \$ 3,903               | \$ 1,219              | \$ —   | \$3,780                                       | \$ 12                            | \$3,774                                       | \$ 38                            |
| One-to-four family residential real estate loans - non-owner occupied | 614             | 543                    | 40                    | —  | 688   | —                                | 576   | —                                |
| Multi-family mortgage loans   | 8,405           | 7,464                  | 823                   | —  | 7,735   | 20                               | 5,903   | 82                               |
| Wholesale commercial lending  | 990             | 996                    | —                     | —  | 996   | —                                | 398   | 11                               |
| Nonresidential real estate loans                                      | 3,708           | 3,113                  | 113                   | —  | 3,389   | 1                                | 4,212   | 11                               |
| Land loans  | 307             | 294                    | 8                     | —  | 230   | —                                | 188   | —                                |
| Commercial loans - secured  | —               | —                      | —                     | —  | 131   | —                                | 85  | —                                |
| Commercial loans - unsecured  | —               | —                      | —                     | —  | 39  | —                                | 47  | —                                |
|   | 19,181          | 16,313                 | 2,203                 | —  | 16,988  | 33                               | 15,183  | 142                              |
| With an allowance recorded:   |                 |                        |                       |  |   |                                  |   |                                  |
| One-to-four family residential real estate loans - non-owner occupied | 572             | 501                    | 61                    | 41   | 470   | —                                | 381   | 2                                |
| Multi-family mortgage loans   | 4,089           | 2,766                  | 1,300                 | 373  | 2,999   | 8                                | 2,882   | 88                               |
| Wholesale commercial lending  | 1,038           | 982                    | 47                    | 96   | 740   | 2                                | 493   | 21                               |
| Nonresidential real estate loans                                      | 2,611           | 2,223                  | 299                   | 224  | 2,494   | 1                                | 2,464   | 5                                |
| Land loans  | 922             | 724                    | 197                   | 37   | 1,117   | —                                | 1,488   | —                                |
| Commercial loans - secured  | 462             | 273                    | 190                   | 29   | 223   | —                                | 344   | 1                                |
|   | 9,694           | 7,469                  | 2,094                 | 800  | 8,043   | 11                               | 8,052   | 117                              |
| Total   | \$28,875        | \$ 23,782              | \$ 4,297              | \$ 800                                       | \$25,031                                      | \$ 44                            | \$23,235                                      | \$ 259                           |



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## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 4 - LOANS RECEIVABLE (continued)

|  | Loan<br>Balance | Recorded<br>Investment | Partial<br>Charge-off | Allowance<br>for Loan<br>Losses<br>Allocated | Average<br>Investment<br>in Impaired<br>Loans | Interest<br>Income<br>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 -<br>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 -<br>non-owner occupied | 626             | 499                    | 128                   | 137  | 1,996   | 13                               |
| Multi-family mortgage loans  | 3,182           | 2,645                  | 521                   | 729  | 6,562   | 20                               |
| 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 are as follows:

|   | September 30,<br>2013 | December 31,<br>2012 |
|---|-----------------------|----------------------|
| One-to-four family residential real estate loans  | \$405                 | \$380                |
| Nonresidential real estate loans  | 1,611                 | 2,568                |
| Land loans  | —                     | 1,021                |
| Commercial loans  | 22                    | 20                   |
| Outstanding balance   | \$2,038               | \$3,989              |
| Carrying amount, net of allowance (\$1 at September 30, 2013, \$110 at December 31, 2012) | \$2,037               | \$3,879              |



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## 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 are as follows:

|   | Three Months Ended |       | Nine Months Ended |         |
|---|--------------------|-------|-------------------|---------|
|   | September 30,      |       | September 30,     |         |
|   | 2013               | 2012  | 2013              | 2012    |
| Beginning balance                               | \$100              | \$832 | \$196             | \$2,270 |
| New loans purchased                             | —                  | —     | —                 | —       |
| Disposals                                       | —                  | 249   | —                 | 771     |
| Reclassifications from nonaccretable difference | (2                 | ) —   | 1                 | —       |
| Accretion of income                             | 48                 | 179   | 147               | 1,095   |
| Ending balance                                  | \$50               | \$404 | \$50              | \$404   |

For the above purchased impaired loans, the Company decreased the allowance for loan losses by \$51,000 for the three months ended September 30, 2013 and \$109,000 for the nine months ended September 30, 2013. The allowance for loan losses was decreased for the above purchased impaired loans by \$5,000 for the three months ended September 30, 2012 and was increased by \$219,000 during the nine months ended September 30, 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:

|  | September 30,<br>2013 | December 31,<br>2012 |
|--|-----------------------|----------------------|
| Contractually required payments receivable of loans purchased: |                       |                      |
| One-to-four family residential real estate loans               | \$1,143               | \$1,143              |
| Nonresidential real estate loans                               | 1,999                 | 3,884                |
| Land loans   | —                     | 1,600                |
| Commercial loans   | 222                   | 597                  |
|  | \$3,364               | \$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.

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## 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 tables present 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 |
|---|--------------|---------------------|---|
| September 30, 2013  |              |                     |   |
| One-to-four family residential real estate loans                      | \$5,428      | \$4,168             | \$—   |
| One-to-four family residential real estate loans – non owner occupied | 1,372        | 1,230               | 89  |
| Multi-family mortgage loans   | 12,196       | 9,935               | 235   |
| Wholesale commercial lending  | 2,029        | 1,978               | —   |
| Nonresidential real estate loans                                      | 7,292        | 5,335               | 431   |
| Land loans  | 1,229        | 1,018               | 119   |
| Commercial loans – secured  | 461          | 272                 | 5   |
| Commercial loans – unsecured  | —            | —                   | 86  |
| Consumer loans  | 2            | 2                   | —   |
|   | \$30,009     | \$23,938            | \$965                                       |
| 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 \$1.3 million and \$942,000 at September 30, 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.

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## 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 present the aging of the recorded investment of loans at September 30, 2013 by class of loans:

|   | 30-59 Days<br>Past Due | 60-89 Days<br>Past Due | 90 Days or<br>Greater<br>Past Due | Total Past<br>Due | Loans Not<br>Past Due | Total       |
|---|------------------------|------------------------|-----------------------------------|-------------------|-----------------------|-------------|
| One-to-four family residential real estate loans                      | \$1,034                | \$212                  | \$3,205                           | \$4,451           | \$143,459             | \$147,910   |
| One-to-four family residential real estate loans - non-owner occupied | 85                     | 172                    | 1,015                             | 1,272             | 54,770                | 56,042      |
| Multi-family mortgage loans   | —                      | 1,621                  | 9,364                             | 10,985            | 292,774               | 303,759     |
| Wholesale commercial lending  | —                      | —                      | 1,643                             | 1,643             | 68,798                | 70,441      |
| Nonresidential real estate loans                                      | 2,759                  | 400                    | 5,513                             | 8,672             | 235,174               | 243,846     |
| Construction loans  | —                      | —                      | —                                 | —                 | 1,390                 | 1,390       |
| Land loans  | —                      | —                      | 1,137                             | 1,137             | 3,898                 | 5,035       |
| Commercial loans:   |                        |                        |                                   |                   |                       |             |
| Secured   | 84                     | 17                     | 277                               | 378               | 17,821                | 18,199      |
| Unsecured   | —                      | —                      | 84                                | 84                | 3,480                 | 3,564       |
| Municipal loans   | —                      | —                      | —                                 | —                 | 4,222                 | 4,222       |
| Warehouse lines   | —                      | —                      | —                                 | —                 | 3,767                 | 3,767       |
| Health care   | —                      | —                      | —                                 | —                 | 17,176                | 17,176      |
| Other   | —                      | —                      | —                                 | —                 | 6,198                 | 6,198       |
| Commercial leases:  |                        |                        |                                   |                   |                       |             |
| Investment rated commercial leases                                    | —                      | —                      | —                                 | —                 | 122,138               | 122,138     |
| Below investment grade  | —                      | —                      | —                                 | —                 | 8,809                 | 8,809       |
| Non-rated   | —                      | —                      | —                                 | —                 | 28,905                | 28,905      |
| Lease pools   | —                      | —                      | —                                 | —                 | 2,934                 | 2,934       |
| Consumer loans  | 3                      | —                      | 2                                 | 5                 | 2,566                 | 2,571       |
|   | \$3,965                | \$2,422                | \$22,240                          | \$28,627          | \$1,018,279           | \$1,046,906 |
|   | 30-59 Days<br>Past Due | 60-89 Days<br>Past Due | 90 Days or<br>Greater<br>Past Due | Total Past<br>Due | Loans Not<br>Past Due | Total       |
| Purchased impaired loans  |                        |                        |                                   |                   |                       |             |
| One-to-four family residential real estate loans - non-owner occupied | \$—                    | \$—                    | \$405                             | \$405             | \$—                   | \$405       |
| Nonresidential real estate loans                                      | —                      | —                      | 163                               | 163               | 1,446                 | 1,609       |
| Commercial loans – secured  | —                      | —                      | 22                                | 22                | —                     | 22          |
|   | \$—                    | \$—                    | \$590                             | \$590             | \$1,446               | \$2,036     |



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## 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 present the aging of the recorded investment of loans at December 31, 2012 by class of loans:

|   | 30-59 Days<br>Past Due | 60-89 Days<br>Past Due | 90 Days or<br>Greater<br>Past Due | Total Past<br>Due | Loans Not<br>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<br>Past Due | 60-89 Days<br>Past Due | 90 Days or<br>Greater<br>Past Due | Total Past<br>Due | Loans Not<br>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.

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## 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 \$5.3 million of TDRs at September 30, 2013, compared to \$11.2 million at December 31, 2012, with \$94,000 in specific valuation reserves allocated to those loans at September 30, 2013 and \$318,000 in specific valuation reserves allocated at December 31, 2012. The Company had no outstanding commitments to borrowers whose loans were classified as TDRs at either date.

The following table presents loans classified as TDRs:

|   | September 30,<br>2013 | December 31,<br>2012 |
|---|-----------------------|----------------------|
| One-to-four family residential real estate          | \$3,040               | \$2,802              |
| Multi-family mortgage                               | 1,169                 | 1,201                |
| Nonresidential real estate                          | —                     | 5,189                |
| Troubled debt restructured loans – accrual loans    | 4,209                 | 9,192                |
| One-to-four family residential real estate          | 617                   | 767                  |
| Multi-family mortgage                               | 449                   | 938                  |
| Nonresidential real estate                          | —                     | 270                  |
| Troubled debt restructured loans – nonaccrual loans | 1,066                 | 1,975                |
| Total troubled debt restructured loans              | \$5,275               | \$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 A 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 in the above tables as a TDR in the subsequent calendar year.

During the three and nine months ending September 30, 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 September 30,                 |   |                 | 2012  |   |
|--|--|---|-----------------|---|---|
|  | 2013   |   |                 | 2012  |   |
| Number of loans                            | Pre-Modification outstanding recorded investment | Post-Modification outstanding recorded investment | Number of loans | Pre-Modification outstanding recorded investment  | Post-Modification outstanding recorded investment |
| One-to-four family residential real estate | —  | \$ —  | 17              | \$ 1,441  | \$ 1,441  |
|  |  | Due to reduction in interest rate                 |                 | Due to permanent reduction in recorded investment | Total   |
|  |  | Due to extension of maturity date                 |                 |   |   |

For the Three Months ended September 30, 2012

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|  |     |          |     |          |
|--|-----|----------|-----|----------|
| One-to-four family residential real estate | \$— | \$ 1,441 | \$— | \$ 1,441 |
|--|-----|----------|-----|----------|

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 September 30, 2013 and 2012.

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## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 4 - LOANS RECEIVABLE (continued)

|  | Nine Months Ended September 30,<br>2013 |   | 2012   |   | Pre-<br>Modification<br>outstanding<br>recorded<br>investment | Post-<br>Modification<br>outstanding<br>recorded<br>investment |
|--|---|---|--|---|---|--|
|  | Number<br>of loans                      | Pre-<br>Modification<br>outstanding<br>recorded<br>investment | Post-<br>Modification<br>outstanding<br>recorded<br>investment | Number<br>of loans  |   |  |
| One-to-four family residential real estate   | 3                                       | \$ 950  | \$ 950   | 24  | \$ 2,100  | \$ 2,100   |
| Multi-family mortgage                        | —                                       | —   | —  | 1   | 700   | 500  |
| Total  | 3                                       | \$ 950  | \$ 950   | 25  | \$ 2,800  | \$ 2,600   |
|  |   | Due to<br>reduction in<br>interest rate                       | Due to<br>extension of<br>maturity date                        | Due to<br>permanent<br>reduction in<br>recorded<br>investment | Total   |  |
| For the Nine Months Ended September 30, 2013 |   |   |  |   |   |  |
| One-to-four family residential real estate   |   | \$—   | \$950  | \$—   | \$950   |  |
| Total  |   | \$—   | \$950  | \$—   | \$950   |  |
| For the Nine Months Ended September 30, 2012 |   |   |  |   |   |  |
| One-to-four family residential real estate   |   | \$504   | \$1,596  | \$—   | \$2,100   |  |
| Multi-family mortgage                        |   | —   | —  | 500   | 500   |  |
| Total  |   | \$504   | \$1,596  | \$500   | \$2,600   |  |

For the nine months ended September 30, 2013 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 nine months ended September 30, 2012 the TDRs had no impact on interest income, but increased the allowance for loan losses by \$198,000 and resulted in charge-offs of \$470,000.

The following table presents TDRs for which there was a payment default during the nine months ended September 30, 2013 and 2012 within twelve months following the modification.

|  | 2013               |                        | 2012               |                        |
|--|--------------------|------------------------|--------------------|------------------------|
|  | Number<br>of loans | Recorded<br>investment | Number<br>of loans | Recorded<br>investment |
| One-to-four family residential real estate | —                  | \$—                    | 5                  | \$864                  |
| Nonresidential real estate                 | —                  | —                      | 4                  | 3,308                  |
| Total                                      | —                  | \$—                    | 9                  | \$4,172                |

A loan is considered to be in payment default once it is 90 days contractually past due under the modified terms. TDRs that subsequently defaulted increased the allowance for loan losses by \$1.1 million during the nine months ending September 30, 2012.

The terms of certain other loans were modified during the three and nine months ending September 30, 2013 and 2012 that did not meet the definition of a TDR. These loans had a total recorded investment of \$1.1 million and \$328,000 at September 30, 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.

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BANKFINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 4 - LOANS RECEIVABLE (continued)

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/Performing.** Loans categorized as Substandard/Performing 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 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/Performing 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.

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

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## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 4 - LOANS RECEIVABLE (continued)

As of September 30, 2013, based on the most recent analysis performed, the risk category of loans by class of loans are as follows:

|   | Pass       | Special<br>Mention | Substandard/Performing | Nonaccrual | Total        |
|---|------------|--------------------|------------------------|------------|--------------|
| One-to-four family residential real estate loans                      | \$ 143,054 | \$ 325             | \$ 969                 | \$ 3,386   | \$ 147,734   |
| One-to-four family residential real estate loans - non-owner occupied | 54,206     | —                  | 628                    | 1,637      | 56,471       |
| Multi-family mortgage loans   | 281,964    | 7,472              | 5,262                  | 10,310     | 305,008      |
| Wholesale commercial lending  | 64,659     | 2,706              | 1,766                  | 1,647      | 70,778       |
| Nonresidential real estate loans                                      | 213,221    | 10,908             | 15,427                 | 6,968      | 246,524      |
| Construction loans  | 1,388      | —                  | —                      | —          | 1,388        |
| Land loans  | 2,958      | —                  | 1,062                  | 1,021      | 5,041        |
| Commercial loans:   |            |                    |                        |            |              |
| Secured   | 17,761     | —                  | 97                     | 294        | 18,152       |
| Unsecured   | 2,305      | 284                | 964                    | —          | 3,553        |
| Municipal loans   | 4,192      | —                  | —                      | —          | 4,192        |
| Warehouse lines   | 3,747      | —                  | —                      | —          | 3,747        |
| Health care   | 17,159     | —                  | —                      | —          | 17,159       |
| Other   | 6,175      | —                  | —                      | —          | 6,175        |
| Commercial leases:  |            |                    |                        |            |              |
| Investment rated commercial leases                                    | 121,439    | —                  | —                      | —          | 121,439      |
| Below investment grade  | 8,739      | —                  | —                      | —          | 8,739        |
| Non-rated   | 28,722     | —                  | —                      | —          | 28,722       |
| Lease pools   | 2,922      | —                  | —                      | —          | 2,922        |
| Consumer loans  | 2,559      | —                  | —                      | 2          | 2,561        |
| Total   | \$ 977,170 | \$ 21,695          | \$ 26,175              | \$ 25,265  | \$ 1,050,305 |

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## 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 are as follows:

|   | Pass      | Special<br>Mention | Substandard/Performing<br>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).

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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).

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## 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) |            |
| September 30, 2013                                |  |   |   |            |
| Securities:                                       |  |   |   |            |
| Certificates of deposit                           | \$—  | \$34,533                                | \$—                                       | \$34,533   |
| Municipal securities                              | —  | 359                                     | —   | 359        |
| Equity mutual fund                                | 505  | —                                       | —   | 505        |
| Mortgage-backed securities – residential          | —  | 30,026                                  | —   | 30,026     |
| Collateralized mortgage obligations – residential | —  | 17,949                                  | —   | 17,949     |
| SBA-guaranteed loan participation certificates    | —  | 37                                      | —   | 37         |
|   | \$505  | \$82,904                                | \$—                                       | \$83,409   |
| 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   |

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## 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) |            |
| September 30, 2013                               |  |   |   |            |
| Impaired loans:                                  |  |   |   |            |
| One-to-four family residential real estate loans | \$—  | \$—                                     | \$512                                     | \$512      |
| Multi-family mortgage loans                      | —  | —                                       | 3,279                                     | 3,279      |
| Nonresidential real estate loans                 | —  | —                                       | 1,999                                     | 1,999      |
| Construction and land loans                      | —  | —                                       | 687                                       | 687        |
| Commercial loans                                 | —  | —                                       | 244                                       | 244        |
|  | \$—  | \$—                                     | \$6,721                                   | \$6,721    |
| Other real estate owned:                         |  |   |   |            |
| One-to-four family residential real estate loans | \$—  | \$—                                     | \$713                                     | \$713      |
| Nonresidential real estate                       | —  | —                                       | 946                                       | 946        |
| Land   | —  | —                                       | 2,509                                     | 2,509      |
|  | \$—  | \$—                                     | \$4,168                                   | \$4,168    |
| Mortgage servicing rights                        | \$—  | \$—                                     | \$185                                     | \$185      |
| December 31, 2012                                |  |   |   |            |
| Impaired loans:                                  |  |   |   |            |
| One-to-four family residential real estate loans | \$—  | \$—                                     | \$410                                     | \$410      |
| Multi-family mortgage loans                      | —  | —                                       | 1,916                                     | 1,916      |
| Nonresidential real estate loans                 | —  | —                                       | 3,102                                     | 3,102      |
| Construction and land loans                      | —  | —                                       | 2,841                                     | 2,841      |
| Commercial loans                                 | —  | —                                       | 181                                       | 181        |
|  | \$—  | \$—                                     | \$8,450                                   | \$8,450    |
| Other real estate owned:                         |  |   |   |            |
| One-to-four family residential real estate loans | \$—  | \$—                                     | \$1,503                                   | \$1,503    |
| Multi-family mortgage                            | —  | —                                       | 720                                       | 720        |
| Nonresidential real estate                       | —  | —                                       | 3,649                                     | 3,649      |
| Land   | —  | —                                       | 3,496                                     | 3,496      |
|  | \$—  | \$—                                     | \$9,368                                   | \$9,368    |
| Mortgage servicing rights                        | \$—  | \$—                                     | \$208                                     | \$208      |

Impaired loans, including purchased impaired loans, which are measured for impairment using the fair value of the collateral for collateral-dependent loans, with specific valuation allowances, had a carrying amount of \$7.5 million, with a valuation allowance of \$801,000 at September 30, 2013, compared to \$10.0 million, with a valuation allowance of \$1.2 million at June 30, 2013, and \$10.1 million and a valuation allowance of \$1.7 million at December 31, 2012, which had the effect of decreasing the provision for loan losses by \$448,000 for the three months ended September 30, 2013 and \$893,000 for the nine months ended September 30, 2013.



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## 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 September 30, 2013:

|  | Fair Value | Valuation Technique(s) | Significant Unobservable Input(s)              | Range (Weighted Average) |
|--|------------|------------------------|--|--------------------------|
| Impaired loans:                                  |            |                        |  |                          |
| One-to-four family residential real estate loans | \$ 512     | Sales comparison       | Discount applied to valuation                  | 6%-98% (69%)             |
| Multi-family mortgage loans                      | 3,279      | Sales comparison       | Comparison between sales and income approaches | 9%-98% (46%)             |
|  |            | Income approach        | Cap Rate                                       | 6.7% to 12% (7.64%)      |
| Nonresidential real estate loans                 | 1,999      | Sales comparison       | Comparison between sales and income approaches | 3%-99% (57%)             |
|  |            | Income approach        | Cap Rate                                       | 9.25% (9.25%)            |
| Construction and land loans                      | 687        | Sales comparison       | Discount applied to valuation                  | 10%-93% (59%)            |
| Commercial loans                                 | 244        | Sales comparison       | Discount applied to valuation                  | 10%-91% (75%)            |
| Impaired loans                                   | \$ 6,721   |                        |  |                          |
| Other real estate owned:                         |            |                        |  |                          |
| One-to-four family residential real estate       | \$ 713     | Sales comparison       | Discount applied to valuation                  | 7%-34% (18%)             |
| Nonresidential real estate                       | 946        | Sales comparison       | Comparison between sales and income approaches | 7%-29% (16%)             |
| Land   | 2,509      | Sales comparison       | Discount applied to valuation                  | 7% (7%)                  |
| Other real estate owned                          | \$ 4,168   |                        |  |                          |
| Mortgage servicing rights                        | \$ 185     | Third party valuation  | Present value of future servicing income based | 11.5 % - 22.9% (15.34%)  |

|                       |   |     |
|-----------------------|---|-----|
| Third party valuation | on prepayment speeds<br>Present value of future servicing income based on default rates | 12% |
|-----------------------|---|-----|

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

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## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 5 - FAIR VALUE (continued)

|  | Carrying<br>Amount | Fair Value Measurements at<br>September 30, 2013 Using: |              |         | Total        |
|--|--------------------|---|--------------|---------|--------------|
|  |                    | Level 1   | Level 2      | Level 3 |              |
| <b>Financial assets</b>                            |                    |   |              |         |              |
| Cash and cash equivalents                          | \$ 243,478         | \$ 18,068   | \$ 225,410   | \$—     | \$ 243,478   |
| Securities   | 83,409             | 505   | 82,904       | —       | 83,409       |
| Loans held for sale                                | 15                 | —   | 15           | —       | 15           |
| Loans receivable, net of allowance for loan losses | 1,035,331          | —   | 992,939      | 6,721   | 999,660      |
| FHLBC stock  | 6,068              | —   | —            | —       | N/A          |
| Accrued interest receivable                        | 3,576              | —   | 3,576        | —       | 3,576        |
| <b>Financial liabilities</b>                       |                    |   |              |         |              |
| Noninterest-bearing demand deposits                | \$(133,094 )       | \$—   | \$(133,094 ) | \$—     | \$(133,094 ) |
| Savings deposits                                   | (146,685 )         | —   | (146,685 )   | —       | (146,685 )   |
| NOW and money market accounts                      | (690,797 )         | —   | (690,797 )   | —       | (690,797 )   |
| Certificates of deposit                            | (279,257 )         | —   | (279,812 )   | —       | (279,812 )   |
| Borrowings   | (2,883 )           | —   | (2,896 )     | —       | (2,896 )     |
| Accrued interest payable                           | (119 )             | —   | (119 )       | —       | (119 )       |
|  |                    | Fair Value Measurements at<br>December 31, 2012 Using:  |              |         |              |
|  | Carrying<br>Amount | Level 1   | Level 2      | Level 3 | Total        |
| <b>Financial assets</b>                            |                    |   |              |         |              |
| 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          | —   | 1,017,637    | 8,450   | 1,026,087    |
| FHLBC stock  | 8,412              | —   | —            | —       | N/A          |
| Accrued interest receivable                        | 4,146              | —   | 4,146        | —       | 4,146        |
| <b>Financial liabilities</b>                       |                    |   |              |         |              |
| 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.

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

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BANKFINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 5 - FAIR VALUE (continued)

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 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

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Dodd-Frank Act and Basel III, 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

Loan origination activity continued to improve in the third quarter of 2013, especially in the residential loan, multi-family loan and commercial loan categories. Continued improvement in loan origination volumes remains essential to offsetting the ongoing effects of yield compression on our net interest income. Net loan payoffs increased in the third quarter of 2013 due to the reduction of lesser-quality loan balances.

Asset quality improved during the third quarter of 2013 due in part to our focus on accelerated resolution methodologies. In addition, we continued to reduce OREO balances at an acceptable rate with minimal impact to earnings and capital during the quarter.

Noninterest income remained stable in the third quarter of 2013 due to slightly higher deposit services fee income and higher insurance-related revenues.

Noninterest expense declined in the third quarter of 2013 despite the continuing impact of credit resolution expense. As the remainder of 2013 progresses, we expect that noninterest expense related to information technology expense and nonperforming assets management expense will begin to trend downward.

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## SELECTED FINANCIAL DATA

The following summary information is derived from the consolidated financial statements of the Company. For additional information, reference is made to the Consolidated Financial Statements of the Company and related notes included elsewhere in this Quarterly Report.

|                                    | September 30,<br>2013 | December 31,<br>2012 | Change      |
|------------------------------------|-----------------------|----------------------|-------------|
| (Dollars in thousands)             |                       |                      |             |
| Selected Financial Condition Data: |                       |                      |             |
| Total assets                       | \$1,441,948           | \$1,481,192          | \$(39,244 ) |
| Loans, net                         | 1,035,331             | 1,030,465            | 4,866       |
| Loans held for sale                | 15                    | 2,166                | (2,151 )    |
| Securities, at fair value          | 83,409                | 77,832               | 5,577       |
| Core deposit intangible            | 2,583                 | 3,038                | (455 )      |
| Deposits                           | 1,249,833             | 1,282,351            | (32,518 )   |
| Borrowings                         | 2,883                 | 5,567                | (2,684 )    |
| Equity                             | 174,311               | 172,890              | 1,421       |

|   | Three Months Ended<br>September 30,<br>2013 |            |            | Nine Months Ended<br>September 30,<br>2012 |            |            |
|---|---|------------|------------|--|------------|------------|
|   | 2013  | 2012       | Change     | 2013                                       | 2012       | Change     |
| (Dollars in thousands)  |   |            |            |  |            |            |
| Selected Operating Data:  |   |            |            |  |            |            |
| Interest and dividend income                                      | \$12,107                                    | \$14,468   | \$(2,361 ) | \$37,096                                   | \$46,926   | \$(9,830 ) |
| Interest expense  | 882   | 1,036      | (154 )     | 2,811                                      | 3,388      | (577 )     |
| Net interest income   | 11,225                                      | 13,432     | (2,207 )   | 34,285                                     | 43,538     | (9,253 )   |
| Provision (recovery) for loan losses                              | (437 )                                      | 4,453      | (4,890 )   | 491  | 7,194      | (6,703 )   |
| Net interest income after provision<br>(recovery) for loan losses | 11,662                                      | 8,979      | 2,683      | 33,794                                     | 36,344     | (2,550 )   |
| Noninterest income  | 1,539                                       | 1,831      | (292 )     | 5,914                                      | 5,081      | 833        |
| Noninterest expense   | 12,162                                      | 16,032     | (3,870 )   | 37,915                                     | 43,512     | (5,597 )   |
| Income (loss) before income tax<br>expense                        | 1,039                                       | (5,222 )   | 6,261      | 1,793                                      | (2,087 )   | 3,880      |
| Income tax expense  | —   | —          | —          | —  | —          | —          |
| Net income (loss)   | \$1,039                                     | \$(5,222 ) | \$6,261    | \$1,793                                    | \$(2,087 ) | \$3,880    |

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|  | Three Months Ended<br>September 30,<br>2013 |   | September 30,<br>2012 |    | Nine Months Ended<br>September 30,<br>2013 |       | September 30,<br>2012   |    |
|--|---|---|-----------------------|----|--|-------|-------------------------|----|
| Selected Financial Ratios and Other Data:  |   |   |                       |    |  |       |                         |    |
| Performance Ratios:  |   |   |                       |    |  |       |                         |    |
| Return on assets (ratio of net income (loss) to average total assets) <sup>(1)</sup> | 0.29  | % | (1.39)                | )% | 0.16                                       | %     | (0.18)                  | )% |
| Return on equity (ratio of net income (loss) to average equity) <sup>(1)</sup>       | 2.38  |   | (10.20)               | )  | 1.37                                       |       | (1.36)                  | )  |
| Average equity to average assets   | 12.13                                       |   | 13.62                 |    | 12.03                                      |       | 13.40                   |    |
| Net interest rate spread <sup>(1) (2)</sup>  | 3.21  |   | 3.69                  |    | 3.28                                       |       | 3.97                    |    |
| Net interest margin <sup>(1) (3)</sup>   | 3.26  |   | 3.76                  |    | 3.34                                       |       | 4.04                    |    |
| Efficiency ratio <sup>(4)</sup>  | 95.28                                       |   | 105.04                |    | 94.32                                      |       | 89.50                   |    |
| Noninterest expense to average total assets <sup>(1)</sup>                           | 3.38  |   | 4.26                  |    | 3.48                                       |       | 3.81                    |    |
| Average interest-earning assets to average interest-bearing liabilities              | 121.95                                      |   | 123.54                |    | 121.33                                     |       | 123.16                  |    |
| Dividends declared per share   | \$—   |   | \$0.01                |    | \$0.02                                     |       | \$0.03                  |    |
| Dividend payout ratio  | N.M.  |   | N.M.                  |    | N.M.                                       |       | N.M.                    |    |
|  |   |   |                       |    | At September 30,<br>2013                   |       | At December 31,<br>2012 |    |
| Asset Quality Ratios:  |   |   |                       |    |  |       |                         |    |
| Nonperforming assets to total assets <sup>(5)</sup>                                  |   |   | 2.18                  |    | %  | 2.59  |                         | %  |
| Nonperforming loans to total loans   |   |   | 2.47                  |    |  | 2.67  |                         |    |
| Allowance for loan losses to nonperforming loans                                     |   |   | 61.08                 |    |  | 64.39 |                         |    |
| Allowance for loan losses to total loans   |   |   | 1.51                  |    |  | 1.72  |                         |    |
| Capital Ratios:  |   |   |                       |    |  |       |                         |    |
| Equity to total assets at end of period  |   |   | 12.09                 |    | %  | 11.67 |                         | %  |
| Tier 1 leverage ratio (Bank only)  |   |   | 10.10                 |    |  | 9.60  |                         |    |
| Other Data:  |   |   |                       |    |  |       |                         |    |
| Number of full-service offices   |   |   | 20                    |    |  | 20    |                         |    |
| Employees (full-time equivalents)  |   |   | 308                   |    |  | 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 September 30, 2013 and December 31, 2012

Total assets decreased \$39.2 million, or 2.6%, to \$1.442 billion at September 30, 2013, from \$1.481 billion at December 31, 2012. The decrease in total assets was primarily due to a decrease in cash and cash equivalents, other real estate owned, and FDIC prepaid insurance, partially offset by increases in loans receivable and securities. Net loans increased \$4.9 million to \$1.035 billion at September 30, 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 bulk sale of these one-to-four family residential loans was completed in February 2013. Securities increased \$5.6 million to \$83.4 million at September 30, 2013, from \$77.8 million at December 31, 2012. Net cash and cash equivalents decreased by \$32.3 million to \$243.5 million at September 30, 2013, from \$275.8 million at December 31, 2012.

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In December 2009, the Bank was required by an FDIC rule requiring insured depository institutions to prepay their estimated quarterly risk-based assessments in the fourth quarter of 2009, to prepay \$6.8 million in estimated assessments through 2012. On June 29, 2013, the Bank received a \$2.7 million refund, which represented the unused portion of the FDIC prepaid assessments.

Total liabilities decreased by \$40.7 million, or 3.1%, to \$1.268 billion at September 30, 2013, from \$1.308 billion at December 31, 2012. Total deposits decreased \$32.5 million, or 2.5%, to \$1.250 billion at September 30, 2013, from \$1.282 billion at December 31, 2012, primarily due to pricing adjustments that we made on certificates of deposit and other interest-bearing deposits in anticipation of additional excess liquidity resulting from loan payments and bulk loan sales. Certificates of deposit decreased \$26.0 million, or 8.5%, to \$279.3 million at September 30, 2013, from \$305.3 million at December 31, 2012. Core deposits increased to 77.7% of total deposits at September 30, 2013, from 76.2% of total deposits at December 31, 2012. Noninterest-bearing demand deposits decreased \$1.5 million, or 1.1%, to \$133.1 million at September 30, 2013, from \$134.6 million at December 31, 2012. Savings accounts increased \$2.0 million, or 1.4%, to \$146.7 million at September 30, 2013, from \$144.7 million at December 31, 2012. Money market and interest-bearing NOW accounts decreased \$7.0 million, or 1.0%, to \$690.8 million at September 30, 2013, from \$697.8 million at December 31, 2012.

Total stockholders' equity was \$174.3 million at September 30, 2013, compared to \$172.9 million at December 31, 2012. The increase in total stockholders' equity was primarily due to the \$1.8 million net income that we recorded for the nine months ended September 30, 2013, which was partially offset by the \$422,000 in dividends that were paid to our stockholders. The unallocated shares of common stock that our ESOP owns were reflected as a \$11.5 million reduction to stockholders' equity at September 30, 2013, compared to a \$12.2 million reduction at December 31, 2012. Operating results for the three months ended September 30, 2013 and 2012

**Net Income.** We had net income of \$1.0 million for the three months ended September 30, 2013, compared to a \$5.2 million loss for the three months ended September 30, 2012. Earnings per basic and fully diluted share of common stock were \$0.05 for the three months ended September 30, 2013, compared to a loss of \$0.26 per basic and fully diluted share of common stock for the three months ended September 30, 2012.

**Net Interest Income.** Net interest income was \$11.2 million for the three months ended September 30, 2013, compared to \$13.4 million for the same period in 2012. The decrease reflected a \$2.4 million, or 16.3%, decrease in interest income and a \$154,000, or 14.9%, decrease in interest expense.

The decrease in net interest income was primarily attributable to a lower level of average interest-earning assets and a decrease in the yield on interest-earning assets. Total average interest-earning assets decreased \$55.2 million, or 3.9%, to \$1.365 billion for the three months ended September 30, 2013, from \$1.420 billion for the same period in 2012. Our net interest rate spread decreased by 48 basis points to 3.21% for the three months ended September 30, 2013, from 3.69% for the same period in 2012. Our net interest margin decreased by 50 basis points to 3.26% for the three months ended September 30, 2013, from 3.76% 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 the decreased average balance and yields of our interest-bearing liabilities. The yield on interest-earning assets decreased 53 basis points to 3.52% for the three months ended September 30, 2013, from 4.05% for the same period in 2012, and the cost of interest-bearing liabilities decreased five basis points to 0.31% for the three months ended September 30, 2013, from 0.36% for the same period in 2012.

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## 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 September 30,<br>2013                    |           |                           | 2012                              |           |                           |   |
|--|---|-----------|---------------------------|-----------------------------------|-----------|---------------------------|---|
|  | Average<br>Outstanding<br>Balance<br>(Dollars in thousands) | Interest  | Yield/Rate <sup>(1)</sup> | Average<br>Outstanding<br>Balance | Interest  | Yield/Rate <sup>(1)</sup> |   |
| <b>Interest-earning Assets:</b>                                  |   |           |                           |                                   |           |                           |   |
| Loans  | \$ 1,019,402  | \$ 11,680 | 4.55                      | % \$ 1,125,600                    | \$ 13,978 | 4.94                      | % |
| Securities   | 68,109  | 241       | 1.40                      | 74,260                            | 342       | 1.83                      |   |
| Stock in FHLBC   | 6,068   | 5         | 0.33                      | 9,614                             | 8         | 0.33                      |   |
| Other  | 271,046   | 181       | 0.26                      | 210,355                           | 140       | 0.26                      |   |
| Total interest-earning assets                                    | 1,364,625   | 12,107    | 3.52                      | 1,419,829                         | 14,468    | 4.05                      |   |
| Noninterest-earning assets                                       | 75,936  |           |                           | 84,609                            |           |                           |   |
| Total assets   | \$ 1,440,561  |           |                           | \$ 1,504,438                      |           |                           |   |
| <b>Interest-bearing Liabilities:</b>                             |   |           |                           |                                   |           |                           |   |
| Savings deposits   | \$ 147,230  | 38        | 0.10                      | \$ 143,248                        | 37        | 0.10                      |   |
| Money market accounts  | 340,578   | 280       | 0.33                      | 346,523                           | 318       | 0.37                      |   |
| NOW accounts   | 344,571   | 88        | 0.10                      | 335,346                           | 106       | 0.13                      |   |
| Certificates of deposit  | 283,775   | 474       | 0.66                      | 316,738                           | 549       | 0.69                      |   |
| Total deposits   | 1,116,154   | 880       | 0.31                      | 1,141,855                         | 1,010     | 0.35                      |   |
| Borrowings   | 2,813   | 2         | 0.28                      | 7,449                             | 26        | 1.39                      |   |
| Total interest-bearing liabilities                               | 1,118,967   | 882       | 0.31                      | 1,149,304                         | 1,036     | 0.36                      |   |
| Noninterest-bearing deposits                                     | 132,120   |           |                           | 135,352                           |           |                           |   |
| Noninterest-bearing liabilities                                  | 14,684  |           |                           | 14,925                            |           |                           |   |
| Total liabilities  | 1,265,771   |           |                           | 1,299,581                         |           |                           |   |
| Equity   | 174,790   |           |                           | 204,857                           |           |                           |   |
| Total liabilities and equity                                     | \$ 1,440,561  |           |                           | \$ 1,504,438                      |           |                           |   |
| Net interest income  |   | \$ 11,225 |                           |                                   | \$ 13,432 |                           |   |
| Net interest rate spread <sup>(2)</sup>                          |   |           | 3.21                      | %                                 |           | 3.69                      | % |
| Net interest-earning assets <sup>(3)</sup>                       | \$ 245,658  |           |                           | \$ 270,525                        |           |                           |   |
| Net interest margin <sup>(4)</sup>                               |   |           | 3.26                      | %                                 |           | 3.76                      | % |
| Ratio of interest-earning assets to interest-bearing liabilities | 121.95  | %         |                           | 123.54                            | %         |                           |   |

(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.

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## 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 recovery for loan losses totaled \$437,000 for the three months ended September 30, 2013, compared to a provision for loan losses of \$4.5 million for the same period in 2012. The portion of the allowance for loan losses attributable to loans collectively evaluated for impairment decreased \$773,000, or 4.9%, to \$15.1 million at September 30, 2013, compared to \$15.8 million at June 30, 2013. The growth in our loan portfolio is focused on loan types with lower loss ratios based on our historical loss experience. Our loan portfolio increased by \$21.7 million in the quarter; however, all of the loan growth occurred within lower-risk loan types. Accordingly, the improvement in the overall risk composition of the loan portfolio and the reduction in portfolio loss ratios due to the weighted-average aging of loss occurrence timing more than fully funded the allowance required for the loan growth experienced during the quarter. Net charge-offs were \$784,000 for the three months ended September 30, 2013, which was partially offset by the decrease in the reserve established for loans individually evaluated for impairment of \$448,000 for the three months ended September 30, 2013. The allowance for loan losses as a percentage of nonperforming loans was 61.08% at September 30, 2013, compared to 57.05% at June 30, 2013.

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<br>September 30, |         |         |
|---|-------------------------------------|---------|---------|
|   | 2013                                | 2012    | Change  |
|   | (Dollars in thousands)              |         |         |
| Deposit service charges and fees              | \$520                               | \$548   | \$(28)  |
| Other fee income                              | 373                                 | 374     | (1)     |
| Insurance commissions and annuities income    | 106                                 | 125     | (19)    |
| Gain on sale of loans, net                    | 32                                  | 210     | (178)   |
| Loss on disposition of premises and equipment | —                                   | (7)     | ) 7     |
| Loan servicing fees                           | 112                                 | 124     | (12)    |
| Amortization of servicing assets              | (49)                                | ) (61)  | ) 12    |
| Recovery of servicing assets                  | 6                                   | 6       | —       |
| Earnings on bank owned life insurance         | 84                                  | 109     | (25)    |
| Trust income                                  | 172                                 | 171     | 1       |
| Other   | 183                                 | 232     | (49)    |
| Total noninterest income                      | \$1,539                             | \$1,831 | \$(292) |

Noninterest income decreased by \$292,000 to \$1.5 million for the three months ended September 30, 2013, from \$1.8 million for the same period in 2012. Noninterest income for the three months ended September 30, 2013, included a

\$32,000 gain on sale of loans, compared to a \$210,000 gain on sale of loans that was recorded for the same period in 2012.

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## Noninterest Expense

|  | Three Months Ended     |          | Change     |
|--|------------------------|----------|------------|
|  | September 30,          |          |            |
|  | 2013                   | 2012     |            |
|  | (Dollars in thousands) |          |            |
| Compensation and benefits                        | \$6,143                | \$6,353  | \$(210 )   |
| Office occupancy and equipment                   | 1,797                  | 1,904    | (107 )     |
| Advertising and public relations                 | 195                    | 145      | 50         |
| Information technology                           | 817                    | 880      | (63 )      |
| Supplies, telephone and postage                  | 382                    | 372      | 10         |
| Amortization of intangibles                      | 149                    | 156      | (7 )       |
| Nonperforming asset management                   | 682                    | 1,728    | (1,046 )   |
| Loss (gain) on sale other real estate owned      | 64                     | (42      | ) 106      |
| Valuation adjustments of other real estate owned | 241                    | 2,352    | (2,111 )   |
| Operations of other real estate owned            | 171                    | 432      | (261 )     |
| FDIC insurance premiums                          | 476                    | 642      | (166 )     |
| Other  | 1,045                  | 1,110    | (65 )      |
| Total noninterest expense                        | \$12,162               | \$16,032 | \$(3,870 ) |

Noninterest expense decreased by \$3.9 million, or 24.1%, to \$12.2 million for the three months ended September 30, 2013, from \$16.0 million for the same period in 2012. Compensation and benefits expense included \$18,000 in severance expense for the three months ended September 30, 2013, compared to \$89,000 for the same period in 2012. Noninterest expense for the three months ended September 30, 2013 included \$1.2 million of nonperforming asset management and OREO expenses, compared to \$4.5 million for the same period in 2012. Nonperforming asset management expenses decreased \$1.0 million, or 60.5%, to \$682,000 for the three months ended September 30, 2013, compared to \$1.7 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. OREO expenses decreased \$261,000, or 60.4%, to \$171,000 for the three months ended September 30, 2013, compared to \$432,000 for the same period in 2012, primarily due to a significant decline in the OREO portfolio which totaled \$5.4 million at September 30, 2013, compared to \$15.0 million at September 30, 2012. The three months ended September 30, 2013 included a \$241,000 valuation adjustment to OREO properties, compared to a \$2.4 million valuation adjustment to OREO properties for the same period in 2012.

## Income Taxes

For the three months ended September 30, 2013 and 2012, we recorded no income tax expense or benefit due to the full valuation allowance we have established for deferred tax assets.

## Operating results for the nine months ended September 30, 2013 and 2012

**Net Income.** We had net income of \$1.8 million for the nine months ended September 30, 2013, compared to a loss of \$2.1 million for the nine months ended September 30, 2012. Our earnings per basic and fully diluted share of common stock was \$0.09 for the nine months ended September 30, 2013, compared to a loss of \$0.11 per basic and fully diluted share for the same period in 2012.

**Net Interest Income.** Net interest income was \$34.3 million for the nine months ended September 30, 2013, compared to \$43.5 million for the same period in 2012. The decrease reflected a \$9.8 million decrease in interest income and a \$577,000 decrease in interest expense.

The decrease in net interest income was primarily attributable to a lower level of average interest-earning assets and a decrease in the yield on interest-earning assets. Total average interest-earning assets decreased \$65.4 million, or 4.5%, to \$1.372 billion for the nine months ended September 30, 2013, from \$1.438 billion for the same period in 2012. Our net interest rate spread decreased by 69 basis points to 3.28% for the nine months ended September 30, 2013, from 3.97% for the same period in 2012. Our net interest margin decreased by 70 basis points to 3.34% for the nine months ended September 30, 2013, from 4.04% 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 75 basis points to 3.61% for the nine months ended September 30, 2013, from 4.36% for the same period in 2012, and the cost of interest-bearing liabilities decreased six basis points to 0.33% for the nine months ended September 30, 2013, from 0.39% for the same period in 2012.

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## 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.

|  | Nine Months Ended September 30,<br>2013                     |           |                           | 2012                              |           |                           |   |
|--|---|-----------|---------------------------|-----------------------------------|-----------|---------------------------|---|
|  | Average<br>Outstanding<br>Balance<br>(Dollars in thousands) | Interest  | Yield/Rate <sup>(1)</sup> | Average<br>Outstanding<br>Balance | Interest  | Yield/Rate <sup>(1)</sup> |   |
| <b>Interest-earning Assets:</b>                                  |   |           |                           |                                   |           |                           |   |
| Loans  | \$ 1,020,932  | \$ 35,812 | 4.69                      | % \$ 1,181,807                    | \$ 45,402 | 5.13                      | % |
| Securities   | 66,119  | 710       | 1.44                      | 79,877                            | 1,171     | 1.96                      |   |
| Stock in FHLBC   | 6,961   | 17        | 0.33                      | 11,392                            | 21        | 0.25                      |   |
| Other  | 278,480   | 557       | 0.27                      | 164,830                           | 332       | 0.27                      |   |
| Total interest-earning assets                                    | 1,372,492   | 37,096    | 3.61                      | 1,437,906                         | 46,926    | 4.36                      |   |
| Noninterest-earning assets                                       | 79,460  |           |                           | 85,848                            |           |                           |   |
| Total assets   | \$ 1,451,952  |           |                           | \$ 1,523,754                      |           |                           |   |
| <b>Interest-bearing Liabilities:</b>                             |   |           |                           |                                   |           |                           |   |
| Savings deposits   | \$ 147,248  | 113       | 0.10                      | \$ 145,057                        | 111       | 0.10                      |   |
| Money market accounts  | 343,104   | 886       | 0.35                      | 345,097                           | 943       | 0.37                      |   |
| NOW accounts   | 345,834   | 289       | 0.11                      | 333,382                           | 308       | 0.12                      |   |
| Certificates of deposit  | 292,028   | 1,511     | 0.69                      | 335,155                           | 1,946     | 0.78                      |   |
| Total deposits   | 1,128,214   | 2,799     | 0.33                      | 1,158,691                         | 3,308     | 0.38                      |   |
| Borrowings   | 2,954   | 12        | 0.54                      | 8,790                             | 80        | 1.22                      |   |
| Total interest-bearing liabilities                               | 1,131,168   | 2,811     | 0.33                      | 1,167,481                         | 3,388     | 0.39                      |   |
| Noninterest-bearing deposits                                     | 129,563   |           |                           | 134,184                           |           |                           |   |
| Noninterest-bearing liabilities                                  | 16,487  |           |                           | 17,915                            |           |                           |   |
| Total liabilities  | 1,277,218   |           |                           | 1,319,580                         |           |                           |   |
| Equity   | 174,734   |           |                           | 204,174                           |           |                           |   |
| Total liabilities and equity                                     | \$ 1,451,952  |           |                           | \$ 1,523,754                      |           |                           |   |
| Net interest income  |   | \$ 34,285 |                           |                                   | \$ 43,538 |                           |   |
| Net interest rate spread <sup>(2)</sup>                          |   |           | 3.28                      | %                                 |           | 3.97                      | % |
| Net interest-earning assets <sup>(3)</sup>                       | \$ 241,324  |           |                           | \$ 270,425                        |           |                           |   |
| Net interest margin <sup>(4)</sup>                               |   |           | 3.34                      | %                                 |           | 4.04                      | % |
| Ratio of interest-earning assets to interest-bearing liabilities | 121.33  | %         |                           | 123.16                            | %         |                           |   |

(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.

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## Provision for Loan Losses

The provision for loan losses totaled \$491,000 for the nine months ended September 30, 2013, compared to \$7.2 million for the same period in 2012. The portion of the allowance for loan losses attributable to loans collectively evaluated for impairment decreased \$1.3 million, or 7.7%, to \$15.1 million at September 30, 2013, compared to \$16.3 million at December 31, 2012. The growth in our loan portfolio is focused on loan types with lower loss ratios based on our historical loss experience. Our loan portfolio increased by \$2.6 million for the nine months ended September 30, 2013; however, the loan growth occurred within lower-risk loan types. Accordingly, the improvement in the overall risk composition of the loan portfolio and the reduction in portfolio loss ratios due to the weighted-average aging of loss occurrence timing more than fully funded the allowance required for the loan growth experienced during the quarter. Net charge-offs were \$2.7 million for the nine months ended September 30, 2013, compared to \$18.3 million for the same period in 2012. The allowance for loan losses as a percentage of nonperforming loans was 61.08% at September 30, 2013, compared to 64.39% at December 31, 2012.

## Noninterest Income

|   | Nine Months Ended<br>September 30, |         |        |
|---|------------------------------------|---------|--------|
|   | 2013                               | 2012    | Change |
|   | (Dollars in thousands)             |         |        |
| Deposit service charges and fees              | \$1,528                            | \$1,626 | \$(98) |
| Other fee income                              | 1,158                              | 1,142   | 16     |
| Insurance commissions and annuities income    | 301                                | 359     | (58)   |
| Gain on sale of loans, net                    | 1,445                              | 595     | 850    |
| Loss on disposition of premises and equipment | —                                  | (164)   | 164    |
| Loan servicing fees                           | 349                                | 371     | (22)   |
| Amortization of servicing assets              | (193)                              | (197)   | 4      |
| Recovery (impairment) of servicing assets     | 41                                 | (38)    | 79     |
| Earnings on bank owned life insurance         | 236                                | 355     | (119)  |
| Trust income                                  | 536                                | 545     | (9)    |
| Other   | 513                                | 487     | 26     |
| Total noninterest income                      | \$5,914                            | \$5,081 | \$833  |

Noninterest income increased by \$833,000 to \$5.9 million for the nine months ended September 30, 2013, from \$5.1 million for 2012. Noninterest income for the nine months ended September 30, 2013, included a \$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 represented approximately \$1.3 million of the \$1.4 million gain on sale of loans that we recorded for the nine months ended September 30, 2013.

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## Noninterest Expense

|  | Nine Months Ended<br>September 30, |          | Change     |
|--|------------------------------------|----------|------------|
|  | 2013                               | 2012     |            |
|  | (Dollars in thousands)             |          |            |
| Compensation and benefits                        | \$19,581                           | \$19,513 | \$68       |
| Office occupancy and equipment                   | 5,550                              | 6,041    | (491 )     |
| Advertising and public relations                 | 609                                | 475      | 134        |
| Information technology                           | 2,382                              | 2,553    | (171 )     |
| Supplies, telephone and postage                  | 1,246                              | 1,124    | 122        |
| Amortization of intangibles                      | 455                                | 476      | (21 )      |
| Nonperforming asset management                   | 2,031                              | 4,085    | (2,054 )   |
| Loss (gain) on sale other real estate owned      | 182                                | (126 )   | 308        |
| Valuation adjustments of other real estate owned | 471                                | 3,777    | (3,306 )   |
| Operations of other real estate owned            | 756                                | 1,334    | (578 )     |
| FDIC insurance premiums                          | 1,445                              | 1,299    | 146        |
| Other  | 3,207                              | 2,961    | 246        |
| Total noninterest expense                        | \$37,915                           | \$43,512 | \$(5,597 ) |

Noninterest expense decreased by \$5.6 million, or 12.9%, to \$37.9 million for the nine months ended September 30, 2013, from \$43.5 million for the same period in 2012. Compensation and benefits expense included \$161,000 in severance expense for the nine months ended September 30, 2013, compared to \$123,000 for the same period in 2012. Noninterest expense for the nine months ended September 30, 2013 included \$3.4 million of nonperforming asset management and OREO expenses, compared to \$9.1 million for the same period in 2012. Nonperforming asset management expenses decreased \$2.1 million, or 50.3%, to \$2.0 million for the nine months ended September 30, 2013, compared to \$4.1 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. Noninterest expense for the nine months ended September 30, 2013 included a \$471,000 valuation adjustment to OREO properties, compared to a \$3.8 million valuation adjustment to OREO properties for the same period in 2012. OREO expenses decreased \$578,000, or 43.3%, to \$756,000 for the nine months ended September 30, 2013, compared to \$1.3 million for the same period in 2012, primarily due to the decrease in OREO. Noninterest expense for the nine months ended September 30, 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. Noninterest expense for the nine months ended September 30, 2013 included a provision of \$86,000 for the establishment of a mortgage representation and warranty reserve for mortgage loans sold. The amount of the warranty and representation reserve was calculated by applying published Fannie Mae data relating to the percentage of loans that it required to be repurchased due to breaches of warranties and representations to the Bank's outstanding sold loans.

## Income Taxes

For the nine months ended September 30, 2013 and 2012, we recorded no income tax expense or benefit due to the full valuation allowance we established for deferred tax assets.

## 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 September 30, 2013, we had 12 loans totaling \$965,000 in this category.

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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 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 September 30, 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 generally 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 generally apply a 7.0% deduction to determine the expected costs to sell, as expenses for real estate taxes and repairs are expensed when incurred.

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## Nonperforming Assets Summary

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

|   | September 30,<br>2013 | June 30, 2013 | December 31,<br>2012 | Third<br>Quarter<br>Change | Year to Date<br>Change |
|---|-----------------------|---------------|----------------------|----------------------------|------------------------|
| (Dollars in thousands)  |                       |               |                      |                            |                        |
| Nonaccrual loans:   |                       |               |                      |                            |                        |
| One-to-four family residential  | \$5,398               | \$5,399       | \$7,299              | \$(1 )                     | \$(1,901 )             |
| Multi-family mortgage   | 11,913                | 12,204        | 3,517                | (291 )                     | 8,396 )                |
| Nonresidential real estate  | 5,335                 | 7,037         | 8,985                | (1,702 )                   | (3,650 )               |
| Construction and land   | 1,018                 | 1,601         | 2,210                | (583 )                     | (1,192 )               |
| Commercial  | 272                   | 689           | 256                  | (417 )                     | 16 )                   |
| Consumer  | 2                     | 1             | —                    | 1                          | 2                      |
|   | 23,938                | 26,931        | 22,267               | (2,993 )                   | 1,671 )                |
| Loans held for sale   | 15                    | 15            | 1,752                | —                          | (1,737 )               |
| Other real estate owned:  |                       |               |                      |                            |                        |
| One-to-four family residential  | 808                   | 1,316         | 1,760                | (508 )                     | (952 )                 |
| Multi-family mortgage   | 195                   | —             | 720                  | 195                        | (525 )                 |
| Nonresidential real estate  | 1,047                 | 1,757         | 3,504                | (710 )                     | (2,457 )               |
| Land  | 919                   | 933           | 1,323                | (14 )                      | (404 )                 |
|   | 2,969                 | 4,006         | 7,307                | (1,037 )                   | (4,338 )               |
| Nonperforming assets (excluding purchased impaired loans and purchased other real estate owned) | 26,922                | 30,952        | 31,326               | (4,030 )                   | (4,404 )               |
| Purchased impaired loans:   |                       |               |                      |                            |                        |
| One-to-four family residential  | 405                   | 396           | 380                  | 9                          | 25                     |
| Nonresidential real estate  | 1,611                 | 1,607         | 2,568                | 4                          | (957 )                 |
| Construction and land   | —                     | 997           | 1,021                | (997 )                     | (1,021 )               |
| Commercial  | 22                    | 21            | 20                   | 1                          | 2                      |
|   | 2,038                 | 3,021         | 3,989                | (983 )                     | (1,951 )               |
| Purchased other real estate owned:  |                       |               |                      |                            |                        |
| One-to-four family residential  | 201                   | 179           | 320                  | 22                         | (119 )                 |
| Nonresidential real estate  | 372                   | 372           | 462                  | —                          | (90 )                  |
| Land  | 1,861                 | 1,705         | 2,269                | 156                        | (408 )                 |
|   | 2,434                 | 2,256         | 3,051                | 178                        | (617 )                 |
| Purchased impaired loans and other real estate owned  | 4,472                 | 5,277         | 7,040                | (805 )                     | (2,568 )               |
| Total nonperforming assets  | \$31,394              | \$36,229      | \$38,366             | \$(4,835 )                 | \$(6,972 )             |
| Ratios:   |                       |               |                      |                            |                        |
| Nonperforming loans to total loans  | 2.47                  | % 2.91        | % 2.67               | %                          |                        |
| Nonperforming loans to total loans <sup>(1)</sup>   | 2.28                  | 2.62          | 2.29                 |                            |                        |
| Nonperforming assets to total assets  | 2.18                  | 2.48          | 2.59                 |                            |                        |
| Nonperforming assets to total assets <sup>(1)</sup>   | 1.87                  | 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.



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## Nonperforming Assets

Nonperforming assets decreased by \$4.8 million and \$7.0 million, respectively, for the three and nine months ended September 30, 2013. Nonperforming assets totaled \$31.4 million at September 30, 2013, \$36.2 million at June 30, 2013 and \$38.4 million at December 31, 2012. The decrease in nonperforming assets for the nine months ended September 30, 2013 reflected the disposition of \$7.7 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 by the placement of \$16.4 million of loans on nonaccrual status during the nine months ended September 30, 2013. The increase in loans held for sale at December 31, 2012 reflected the impact of a decision that we made in the fourth quarter of 2012 to take affirmative steps to accelerate the resolution certain performing classified and nonperforming multi-family and nonresidential real estate loans. Specifically, we determined that for certain performing classified and nonperforming multi-family and nonresidential 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, coupled with an attempt, in appropriate cases, to negotiate a final resolution in the form of a deed-in-lieu of foreclosure. Of the \$16.4 million in loans placed on nonaccrual in 2013, \$9.0 million related to affirmative expedited resolution cases. Of this amount, \$7.4 million involved multi-family loans to ten unaffiliated borrowers. We are pursuing various actions to attempt to obtain title to these multi-family 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 tables represent the rollforward of OREO and the composition of OREO properties:

|  | Three Months Ended     |          | Nine Months Ended |          |
|--|------------------------|----------|-------------------|----------|
|  | September 30,          |          | September 30,     |          |
|  | 2013                   | 2012     | 2013              | 2012     |
|  | (Dollars in thousands) |          |                   |          |
| Beginning balance                              | \$6,262                | \$17,251 | \$10,358          | \$22,480 |
| New foreclosed properties                      | 512                    | 2,470    | 3,268             | 6,235    |
| Payments received                              | (3                     | ) —      | (28               | ) (198   |
| Valuation adjustments                          | (241                   | ) (2,352 | ) (471            | ) (3,777 |
| Gain (loss) on sale of other real estate owned | (64                    | ) 42     | (182              | ) 126    |
| Proceeds from sales of other real estate owned | (1,063                 | ) (2,417 | ) (7,542          | ) (9,872 |
| Ending balance                                 | \$5,403                | \$14,994 | \$5,403           | \$14,994 |

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|                                   | September 30,<br>2013  | December 31,<br>2012 |
|-----------------------------------|------------------------|----------------------|
|                                   | (Dollars in thousands) |                      |
| One-to-four family residential    | \$808                  | \$1,760              |
| Multi-family mortgage             | 195                    | 720                  |
| Nonresidential real estate        | 1,047                  | 3,504                |
| Land                              | 919                    | 1,323                |
|                                   | 2,969                  | 7,307                |
| Acquired other real estate owned: |                        |                      |
| One-to-four family residential    | 201                    | 320                  |
| Nonresidential real estate        | 372                    | 462                  |
| Land                              | 1,861                  | 2,269                |
|                                   | 2,434                  | 3,051                |
| Total other real estate owned     | \$5,403                | \$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 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 September 30, 2013. As of September 30, 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 September 30, 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

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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.

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 |
|--|--------------|---|--|
| September 30, 2013                               |              |   |  |
| Total capital (to risk-weighted assets)          | 15.58        | % 8.00  | % 12.00  |
| Tier 1 (core) capital (to risk-weighted assets)  | 14.33        | 4.00  | 8.00   |
| Tier 1 (core) capital (to adjusted total assets) | 10.10        | 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   |

The Bank was notified that, as of September 30, 2013 and December 31, 2012, it was considered 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.

In July 2013, the Federal Reserve Board, the Office of the Comptroller of the Currency and the other federal bank regulatory agencies issued a final rule that will revise their leverage and risk-based capital requirements and the method for calculating risk-weighted assets to make them consistent with agreements that were reached by the Basel Committee on Banking Supervision and certain provisions of the Dodd-Frank Act. Among other things, the rule establishes a new common equity Tier 1 minimum capital requirement (4.5% of risk-weighted assets), increases the minimum Tier 1 capital to risk-based assets requirement (from 4% to 6% of risk-weighted assets) and assigns a higher risk weight (150%) to exposures that are more than 90 days past due or are on nonaccrual status and to certain commercial real estate facilities that finance the acquisition, development or construction of real property. The final rule also requires unrealized gains and losses on certain "available-for-sale" securities holdings to be included for purposes of calculating regulatory capital requirements unless a one-time opt-in or opt-out is exercised. The rule limits a banking organization's capital distributions and certain discretionary bonus payments if the banking organization does not hold a "capital conservation buffer" consisting of 2.5% of common equity Tier 1 capital to risk-weighted assets in addition to the amount necessary to meet its minimum risk-based capital requirements.

The final rule becomes effective for the Bank on January 1, 2015. The capital conservation buffer requirement will be phased in beginning January 1, 2016 and ending January 1, 2019, when the full capital conservation buffer requirement will be effective. The final rule also implements consolidated capital requirements for savings and loan holding companies, such as the Company, effective January 1, 2015. Management is in the process of evaluating the expected impact of these new capital requirements on the Company's and the Bank's regulatory capital position.



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Capital Management - Company Total stockholders' equity was \$174.3 million at September 30, 2013, compared to \$172.9 million at December 31, 2012. The increase in total stockholders' equity was primarily due to the \$1.8 million net income that we recorded for the nine months ended September 30, 2013, which was partially offset by the \$422,000 in dividends that were paid to our stockholders. The unallocated shares of common stock that our ESOP owns were reflected as a \$11.5 million reduction to stockholders' equity at September 30, 2013, compared to \$12.2 million at December 31, 2012.

Quarterly Cash Dividends. 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 September 30, 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 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.

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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 September 30, 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 Decrease in NPV |          |    | Decrease in Estimated Net Interest Income |          |    |
|---|---------------------------|----------|----|---|----------|----|
|   | Amount                    | Percent  |    | Amount                                    | Percent  |    |
|   | (dollars in thousands)    |          |    |   |          |    |
| +400                                    | \$ (22,534 )              | (13.72 ) | )% | \$ (5,609 )                               | (13.22 ) | )% |
| +300                                    | (10,295 )                 | (6.27 )  | )  | (4,011 )                                  | (9.45 )  | )  |
| +200                                    | (7,325 )                  | (4.46 )  | )  | (2,584 )                                  | (6.09 )  | )  |
| +100                                    | (3,370 )                  | (2.05 )  | )  | (1,308 )                                  | (3.08 )  | )  |
| 0                                       | —                         | —        | )  | —   | —        | )  |

The Company has opted not to include an estimate for a decrease in rates at September 30, 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 September 30, 2013, in the event of an immediate 200 basis point increase in interest rates, the Bank would be expected to experience a 4.46% decrease in NPV and a \$2.6 million decrease in net interest income. This 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, 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 September 30, 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 September 30, 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 September 30, 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 September 30, 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

Dated: October 30, 2013

By: /s/ F. Morgan Gasior  
F. Morgan Gasior  
Chairman of the Board and Chief Executive Officer

/s/ Paul A. Cloutier  
Paul A. Cloutier  
Chief Financial Officer