

BankFinancial CORP  
Form 10-Q  
July 29, 2015

---

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 June 30, 2015

or

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

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

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

Maryland  
(State or Other Jurisdiction  
of Incorporation)

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

15W060 North Frontage Road, Burr Ridge, Illinois 60527  
(Address of Principal Executive Offices)  
Registrant's telephone number, including area code: (800) 894-6900  
Not Applicable  
(Former name or former address, if changed since last report)

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

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

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

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

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

Indicate the number of shares outstanding of each of the Issuer's classes of common stock as of the latest practicable date. At July 27, 2015, there were 20,501,966 shares of Common Stock, \$0.01 par value, outstanding.



BANKFINANCIAL CORPORATION

Form 10-Q

June 30, 2015

Table of Contents

	Page Number
<u>PART I</u>	
Item 1. <u>Financial Statements and Supplementary Data</u>	<u>1</u>
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>28</u>
Item 3. <u>Quantitative and Qualitative Disclosure about Market Risk</u>	<u>44</u>
Item 4. <u>Controls and Procedures</u>	<u>45</u>
<u>PART II</u>	
Item 1. <u>Legal Proceedings</u>	<u>46</u>
Item 1A. <u>Risk Factors</u>	<u>46</u>
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>46</u>
Item 3. <u>Defaults Upon Senior Securities</u>	<u>46</u>
Item 4. <u>Mine Safety Disclosures</u>	<u>46</u>
Item 5. <u>Other Information</u>	<u>46</u>
Item 6. <u>Exhibits</u>	<u>46</u>
<u>Signatures</u>	<u>48</u>

---

Table of Contents

BANKFINANCIAL CORPORATION  
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION  
(In thousands, except share and per share data) - Unaudited

	June 30, 2015	December 31, 2014
<b>Assets</b>		
Cash and due from other financial institutions	\$ 10,591	\$ 9,693
Interest-bearing deposits in other financial institutions	66,835	49,888
Cash and cash equivalents	77,426	59,581
Securities, at fair value	99,137	121,174
Loans receivable, net of allowance for loan losses: June 30, 2015, \$10,810 and December 31, 2014, \$11,990	1,156,667	1,172,356
Other real estate owned, net	5,539	6,358
Stock in Federal Home Loan Bank, at cost	6,257	6,257
Premises and equipment, net	33,502	34,286
Accrued interest receivable	3,885	3,926
Core deposit intangible	1,577	1,855
Bank owned life insurance	22,287	22,193
Deferred Taxes	29,145	31,643
Other assets	4,316	5,781
<b>Total assets</b>	<b>\$ 1,439,738</b>	<b>\$ 1,465,410</b>
<b>Liabilities</b>		
<b>Deposits</b>		
Noninterest-bearing	\$ 190,411	\$ 134,129
Interest-bearing	1,009,815	1,077,584
<b>Total deposits</b>	<b>1,200,226</b>	<b>1,211,713</b>
<b>Borrowings</b>	<b>3,039</b>	<b>12,921</b>
Advance payments by borrowers for taxes and insurance	11,829	11,489
Accrued interest payable and other liabilities	12,896	13,166
<b>Total liabilities</b>	<b>1,227,990</b>	<b>1,249,289</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; 20,501,966 shares issued at June 30, 2015 and 21,101,966 shares issued at December 31, 2014	205	211
Additional paid-in capital	186,601	193,845
Retained earnings	34,106	31,584
Unearned Employee Stock Ownership Plan shares	(9,791	) (10,276 )
Accumulated other comprehensive income	627	757
<b>Total stockholders' equity</b>	<b>211,748</b>	<b>216,121</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 1,439,738</b>	<b>\$ 1,465,410</b>

See accompanying notes to the consolidated financial statements.



Table of Contents

BANKFINANCIAL CORPORATION  
CONSOLIDATED STATEMENTS OF OPERATIONS  
(In thousands, except share and per share data) - Unaudited

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Interest and dividend income				
Loans, including fees	\$ 11,836	\$ 12,085	\$ 23,659	\$ 23,784
Securities	257	287	584	583
Other	100	110	161	201
Total interest income	12,193	12,482	24,404	24,568
Interest expense				
Deposits	689	773	1,373	1,583
Borrowings	2	1	4	3
Total interest expense	691	774	1,377	1,586
Net interest income	11,502	11,708	23,027	22,982
Provision for (recovery of) loan losses	(488	) 957	(1,212	) 1,433
Net interest income after provision for (recovery of) loan losses	11,990	10,751	24,239	21,549
Noninterest income				
Deposit service charges and fees	476	472	931	911
Other fee income	601	593	1,136	1,114
Insurance commissions and annuities income	86	86	149	173
Gain on sale of loans, net	28	44	55	68
Loss on sale of securities (includes \$7 accumulated other comprehensive income reclassifications for unrealized net losses on available for sale securities for the six months ended June 30, 2014)	—	—	—	(7
Gain (loss) on disposition of premises and equipment, net	(1	) 3	(1	) 5
Loan servicing fees	96	104	186	208
Amortization and impairment of servicing assets	(32	) (44	) (57	) (80
Earnings on bank owned life insurance	45	61	94	125
Trust	183	170	357	334
Other	207	171	375	341
	1,689	1,660	3,225	3,192
Noninterest expense				
Compensation and benefits	5,278	5,596	10,859	11,554
Office occupancy and equipment	1,670	1,626	3,365	3,540
Advertising and public relations	222	304	563	466
Information technology	657	691	1,296	1,330
Supplies, telephone, and postage	385	384	796	775
Amortization of intangibles	136	143	278	292
Nonperforming asset management	108	97	199	201
Operations of other real estate owned	92	409	446	666
FDIC insurance premiums	262	470	497	949
Other	1,221	1,262	2,245	2,580
	10,031	10,982	20,544	22,353
Income before income taxes	3,648	1,429	6,920	2,388
Income tax expense	1,424	25	2,710	42

Edgar Filing: BankFinancial CORP - Form 10-Q

Net income	\$2,224	\$1,404	\$4,210	\$2,346
Basic earnings per common share	\$0.11	\$0.07	\$0.21	\$0.12
Diluted earnings per common share	\$0.11	\$0.07	\$0.21	\$0.12
Weighted average common shares outstanding	20,009,358	20,145,809	20,138,045	20,122,362
Diluted weighted average common shares outstanding	20,013,573	20,160,050	20,142,205	20,136,405

See accompanying notes to the consolidated financial statements.

Table of Contents

BANKFINANCIAL CORPORATION  
 CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
 (In thousands) - Unaudited

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2015	2014	2015	2014
Net income	\$2,224	\$1,404	\$4,210	\$2,346
Unrealized holding gain (loss) arising during the period	(128	) (56	) (210	) (26
Tax effect	50	—	80	—
Unrealized holding gain (loss) arising during the period, net of tax	(78	) (56	) (130	) (26
Reclassification adjustment for losses included in net income	—	—	—	7
Other comprehensive income (loss)	(78	) (56	) (130	) (19
Comprehensive income	\$2,146	\$1,348	\$4,080	\$2,327

See accompanying notes to the consolidated financial statements.



Table of Contents

## BANKFINANCIAL CORPORATION

## CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

(In thousands, except per share data) - Unaudited

	Common Stock	Additional Paid-in Capital	Retained Earnings (Deficit)	Unearned Employee Stock Ownership Plan Shares	Accumulated Other Comprehen-sive Income	Total
Balance at January 1, 2014	\$211	\$193,594	\$(7,342 )	\$(11,255 )	\$ 419	\$175,627
Net income	—	—	2,346	—	—	2,346
Other comprehensive loss, net of tax	—	—	—	—	(19 )	(19 )
Nonvested stock awards-stock-based compensation expense	—	34	—	—	—	34
Cash dividends declared on common stock (\$0.01 per share)	—	—	(211 )	—	—	(211 )
ESOP shares earned	—	56	—	486	—	542
Balance at June 30, 2014	\$211	\$193,684	\$(5,207 )	\$(10,769 )	\$ 400	\$178,319
Balance at January 1, 2015	\$211	\$193,845	\$31,584	\$(10,276 )	\$ 757	\$216,121
Net income	—	—	4,210	—	—	4,210
Other comprehensive loss, net of tax	—	—	—	—	(130 )	(130 )
Repurchase and retirement of common stock (600,000 shares)	(6 )	(7,382 )	—	—	—	(7,388 )
Nonvested stock awards-stock-based compensation expense, net of tax	—	52	—	—	—	52
Cash dividends declared on common stock (\$0.08 per share)	—	—	(1,688 )	—	—	(1,688 )
ESOP shares earned	—	86	—	485	—	571
Balance at June 30, 2015	\$205	\$186,601	\$34,106	\$(9,791 )	\$ 627	\$211,748

See accompanying notes to the consolidated financial statements.

Table of Contents

BANKFINANCIAL CORPORATION  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(In thousands) - Unaudited

	Six Months Ended		
	June 30,		
	2015	2014	
Cash flows from operating activities			
Net income	\$4,210	\$2,346	
Adjustments to reconcile to net income to net cash from operating activities			
Provision for (recovery of) loan losses	(1,212	) 1,433	
ESOP shares earned	571	542	
Stock-based compensation expense	52	34	
Depreciation and amortization	1,835	1,932	
Amortization of premiums and discounts on securities and loans	(151	) (257	)
Amortization of core deposit intangible	278	292	
Amortization and impairment of servicing assets	57	80	
Net change in net deferred loan origination costs	(322	) (86	)
Net gain on sale of other real estate owned	(80	) (92	)
Net gain on sale of loans	(55	) (68	)
Net loss on sale of securities	—	7	
Net loss (gain) on disposition of premises and equipment	1	(5	)
Loans originated for sale	(2,324	) (1,986	)
Proceeds from sale of loans	2,379	2,054	
Other real estate owned valuation adjustments	236	77	
Net change in:			
Accrued interest receivable	41	190	
Earnings on bank owned life insurance	(94	) (125	)
Other assets	3,999	1,564	
Accrued interest payable and other liabilities	(270	) 773	
Net cash from operating activities	9,151	8,705	
Cash flows from investing activities			
Securities			
Proceeds from maturities	40,011	29,194	
Proceeds from principal repayments	4,491	3,346	
Proceeds from sales of securities	—	3,663	
Purchases of securities	(22,702	) (34,317	)
Loans receivable			
Loan participations sold	3,350	—	
Principal payments on loans receivable	230,146	221,233	
Originated for investment	(218,045	) (245,967	)
Purchase of Federal Home Loan Bank of Chicago stock	—	(189	)
Proceeds from sale of other real estate owned	1,830	2,067	
Purchase of premises and equipment, net	(282	) (223	)
Net cash from (used in) investing activities	38,799	(21,193	)

Continued



Table of Contents

BANKFINANCIAL CORPORATION  
 CONSOLIDATED STATEMENTS OF CASH FLOWS  
 (In thousands) - Unaudited

	Six Months Ended	
	June 30,	
	2015	2014
Cash flows from financing activities		
Net change in deposits	\$(11,487	) \$(15,368
Net change in borrowings	(9,882	) 13
Net change in advance payments by borrowers for taxes and insurance	340	602
Stock repurchased	(7,388	) —
Cash dividends paid on common stock	(1,688	) (211
Net cash used in financing activities	(30,105	) (14,964
Net change in cash and cash equivalents	17,845	(27,452
Beginning cash and cash equivalents	59,581	160,957
Ending cash and cash equivalents	\$77,426	\$ 133,505
Supplemental disclosures of cash flow information:		
Interest paid	\$1,413	\$1,592
Income taxes paid	26	114
Loans transferred to other real estate owned	1,167	3,460

See accompanying notes to the consolidated financial statements.

Table of Contents

BANKFINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Basis of Presentation:** BankFinancial Corporation, a Maryland corporation headquartered in Burr Ridge, Illinois, 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 six-month periods ended June 30, 2015 are not necessarily indicative of the results of operations that may be expected for the year ending December 31, 2015. 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.

**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, 2014, as filed with the Securities and Exchange Commission.

**Recent Accounting Pronouncements**

In January 2014, the FASB amended existing guidance to clarify when a creditor should derecognize a loan receivable and recognize a collateral asset. An in substance repossession or foreclosure occurs, and a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan, upon either (1) the creditor obtaining legal title to the residential real estate property upon completion of a foreclosure or (2) the borrower conveying all interest in the residential real estate property to the creditor to satisfy that loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. Additionally, the amendment requires interim and annual disclosure of both (1) the amount of foreclosed residential real estate property held by the creditor and (2) the recorded investment in consumer mortgage loans collateralized by residential real estate property that are in the process of foreclosure according to local requirements of the applicable jurisdiction. This amendment is effective for interim and annual reporting periods beginning after December 15, 2014. The adoption of this standard did not have a material impact on the Company’s results of operation or financial position.

In May 2014, the FASB issued an update (ASU No. 2014-09, Revenue from Contracts with Customers) creating FASB Topic 606, Revenue from Contracts with Customers. The guidance in this update affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards (for example, insurance contracts or lease contracts). The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The guidance provides steps to follow to achieve the core principle. An entity should disclose sufficient information to enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. Qualitative and quantitative information is required about contracts with customers, significant judgments and changes in judgments, and assets recognized from the costs to obtain or fulfill a contract. The amendments in this update will become effective for annual periods and interim periods within those annual periods beginning after December 15, 2017. We are currently evaluating the impact of adopting the new guidance on the consolidated financial statements.

In June 2014, the FASB amended existing guidance related to repurchase-to-maturity transactions, repurchase financings, and disclosures (ASU 2014-11, Transfers and Servicing (Topic 860) - Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures). These amendments align the accounting for repurchase-to-maturity transactions and repurchase agreements executed as a repurchase financing with the accounting for other typical repurchase agreements. Going forward, these transactions would all be accounted for as secured borrowings. The guidance eliminates sale accounting for repurchase-to-maturity transactions and supersedes the guidance under which a transfer of a financial asset and a contemporaneous repurchase financing could be

Table of Contents

## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

accounted for on a combined basis as a forward agreement, which has resulted in outcomes referred to as off-balance-sheet accounting. These amendments require a new disclosure for transactions economically similar to repurchase agreements in which the transferor retains substantially all of the exposure to the economic return on the transferred financial assets throughout the term of the transaction. These amendments also require expanded disclosures about the nature of collateral pledged in repurchase agreements and similar transactions accounted for as secured borrowings. These amendments are effective for the first interim or annual period beginning after December 15, 2014. In addition, for public companies, the disclosure for certain transactions accounted for as a sale is effective for the first interim or annual period beginning on or after December 15, 2014, and the disclosure for transactions accounted for as secured borrowings is required for annual periods beginning after December 15, 2014, and interim periods beginning after March 15, 2015. The adoption of this standard did not have a material effect on the Company's operating results or financial condition.

## 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		Six Months Ended	
	June 30,		June 30,	
	2015	2014	2015	2014
Net income available to common stockholders	\$2,224	\$1,404	\$4,210	\$2,346
Average common shares outstanding	20,811,856	21,101,966	20,956,110	21,101,966
Less:				
Unearned ESOP shares	(792,816 )	(937,585 )	(804,864 )	(957,463 )
Unvested restricted stock shares	(9,682 )	(18,572 )	(13,201 )	(22,141 )
Weighted average common shares outstanding	20,009,358	20,145,809	20,138,045	20,122,362
Add - Net effect of dilutive stock options and unvested restricted stock	4,215	14,241	4,160	14,043
Diluted weighted average common shares outstanding	20,013,573	20,160,050	20,142,205	20,136,405
Basic earnings per common share	\$0.11	\$0.07	\$0.21	\$0.12
Diluted earnings per common share	\$0.11	\$0.07	\$0.21	\$0.12

Table of Contents

## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 3 - SECURITIES

The fair value of securities and the related gross unrealized gains and losses recognized in accumulated other comprehensive income are shown below:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
June 30, 2015				
Certificates of deposit	\$69,652	\$—	\$—	\$69,652
Equity mutual fund	500	8	—	508
Mortgage-backed securities - residential	19,872	1,023	(48 )	20,847
Collateralized mortgage obligations - residential	8,070	47	(13 )	8,104
SBA-guaranteed loan participation certificates	26	—	—	26
	\$98,120	\$1,078	\$(61 )	\$99,137
December 31, 2014				
Certificates of deposit	\$86,049	\$—	\$—	\$86,049
Equity mutual fund	500	9	—	509
Mortgage-backed securities - residential	23,433	1,218	(40 )	24,611
Collateralized mortgage obligations - residential	9,936	53	(13 )	9,976
SBA-guaranteed loan participation certificates	29	—	—	29
	\$119,947	\$1,280	\$(53 )	\$121,174

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 U.S. government has affirmed its commitment to support. All securities reflected in the preceding table were classified as available-for-sale at June 30, 2015 and December 31, 2014.

The amortized cost and fair values of securities by contractual maturity are shown below. Securities not due at a single maturity date, if any, 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.

	June 30, 2015	
	Amortized Cost	Fair Value
Due in one year or less	\$69,652	\$69,652
Equity mutual fund	500	508
Mortgage-backed securities - residential	19,872	20,847
Collateralized mortgage obligations - residential	8,070	8,104
SBA-guaranteed loan participation certificates	26	26
	\$98,120	\$99,137



Table of Contents

## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 3 - SECURITIES (continued)

Sales of securities were as follows:

	Three Months Ended		Six Months Ended	
	June 30, 2015	2014	June 30, 2015	2014
Proceeds	\$—	\$—	\$—	\$3,663
Gross gains	—	—	—	—
Gross losses	—	—	—	7

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

	Less than 12 Months		12 Months or More		Total	
	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss
June 30, 2015						
Mortgage-backed securities - residential	\$—	\$—	\$1,761	\$(48)	\$1,761	\$(48)
Collateralized mortgage obligations - residential	—	—	1,527	(13)	1,527	(13)
	\$—	\$—	\$3,288	\$(61)	\$3,288	\$(61)
December 31, 2014						
Mortgage-backed securities - residential	\$—	\$—	\$2,126	\$(40)	\$2,126	\$(40)
Collateralized mortgage obligations - residential	—	—	1,847	(13)	1,847	(13)
	\$—	\$—	\$3,973	\$(53)	\$3,973	\$(53)

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 certain collateralized mortgage obligations that the Company holds in its investment portfolio were in an unrealized loss position at June 30, 2015, 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.

Table of Contents

## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 4 - LOANS RECEIVABLE

Loans receivable are as follows:

	June 30, 2015	December 31, 2014
One-to-four family residential real estate	\$170,146	\$180,337
Multi-family mortgage	480,585	480,349
Nonresidential real estate	224,995	234,500
Construction and land	1,442	1,885
Commercial loans	61,344	66,882
Commercial leases	225,676	217,143
Consumer	1,768	2,051
	1,165,956	1,183,147
Net deferred loan origination costs	1,521	1,199
Allowance for loan losses	(10,810	) (11,990
Loans, net	\$1,156,667	\$1,172,356

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

	Allowance for loan losses			Loan Balances		
	Individually evaluated for impairment	Collectively evaluated for impairment	Total	Individually evaluated for impairment	Collectively evaluated for impairment	Total
June 30, 2015						
One-to-four family residential real estate	\$—	\$1,844	\$1,844	\$3,830	\$166,316	\$170,146
Multi-family mortgage	15	4,442	4,457	3,164	477,421	480,585
Nonresidential real estate	50	2,933	2,983	3,632	221,363	224,995
Construction and land	—	56	56	—	1,442	1,442
Commercial loans	—	541	541	75	61,269	61,344
Commercial leases	—	903	903	—	225,676	225,676
Consumer	—	26	26	—	1,768	1,768
	\$65	\$10,745	\$10,810	\$10,701	\$1,155,255	1,165,956
Net deferred loan origination costs						1,521
Allowance for loan losses						(10,810
Loans, net						) \$1,156,667

Table of Contents

## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 4 - LOANS RECEIVABLE (continued)

	Loan Balances			Loan Balances		
	Individually evaluated for impairment	Collectively evaluated for impairment	Total	Individually evaluated for impairment	Collectively evaluated for impairment	Total
December 31, 2014						
One-to-four family residential real estate	\$8	\$2,140	\$2,148	\$4,174	\$176,163	\$180,337
Multi-family mortgage	226	4,979	5,205	5,282	475,067	480,349
Nonresidential real estate	236	2,704	2,940	4,690	229,810	234,500
Construction and land	—	80	80	—	1,885	1,885
Commercial loans	—	554	554	76	66,806	66,882
Commercial leases	—	1,009	1,009	—	217,143	217,143
Consumer	—	54	54	—	2,051	2,051
	\$470	\$11,520	\$11,990	\$14,222	\$1,168,925	1,183,147
Net deferred loan origination costs						1,199
Allowance for loan losses						(11,990 )
Loans, net						\$1,172,356

Activity in the allowance for loan losses is as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Beginning balance	\$11,576	\$14,181	\$11,990	\$14,154
Loans charged off:				
One-to-four family residential real estate	(99 )	(290 )	(202 )	(346 )
Multi-family mortgage	(161 )	(594 )	(180 )	(684 )
Nonresidential real estate	(252 )	(186 )	(263 )	(766 )
Construction and land	—	(1 )	—	(1 )
Commercial loans	—	—	(98 )	(22 )
Consumer	(4 )	(4 )	(8 )	(10 )
	(516 )	(1,075 )	(751 )	(1,829 )
Recoveries:				
One-to-four family residential real estate	219	97	279	108
Multi-family mortgage	4	6	8	20
Nonresidential real estate	9	264	25	284
Construction and land	—	8	6	258
Commercial loans	6	14	463	22
Commercial leases	—	—	1	—
Consumer	—	—	1	2
	238	389	783	694
Net recoveries (charge-offs)	(278 )	(686 )	32	(1,135 )
Provision for (recovery of) loan losses	(488 )	957	(1,212 )	1,433
Ending balance	\$10,810	\$14,452	\$10,810	\$14,452



Table of Contents

## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 4 - LOANS RECEIVABLE (continued)

## 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 Company held one purchase impaired loan at June 30, 2015 and December 31, 2014, with a recorded investment value of \$52,000.

## 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

The following tables present loans individually evaluated for impairment by class of loans:

					Three months ended June 30, 2015	Six months ended June 30, 2015		
	Loan Balance	Recorded Investment	Partial Charge-off	Allowance for Loan Losses Allocated	Average Investment in Impaired Loans	Interest Income Recognized	Average Investment in Impaired Loans	Interest Income Recognized
June 30, 2015								
With no related allowance recorded:								
One-to-four family residential real estate	\$2,617	\$ 2,685	\$ 690	\$ —	\$2,632	\$ 6	\$2,636	\$ 11
One-to-four family residential real estate - non-owner occupied	1,131	1,132	57	—	1,321	11	1,368	25
Multi-family mortgage	2,220	2,076	330	—	1,637	10	1,823	21
Wholesale commercial lending	515	509	—	—	515	8	516	17
Nonresidential real estate	3,080	2,986	5	—	3,989	18	3,145	50
Commercial loans - secured	76	75	—	—	75	—	75	—
	9,639	9,463	1,082	—	10,169	53	9,563	124
With an allowance recorded:								

Edgar Filing: BankFinancial CORP - Form 10-Q

Multi-family mortgage	554	547	—	15	1,619	18	1,862	25
Nonresidential real estate	639	628	67	50	2,381	20	2,477	20
	1,193	1,175	67	65	4,000	38	4,339	45
Total	\$10,832	\$ 10,638	\$ 1,149	\$ 65	\$14,169	\$ 91	\$13,902	\$ 169

13

---

Table of Contents

## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 4 - LOANS RECEIVABLE (continued)

	Loan Balance	Recorded Investment	Partial Charge-off	Allowance for Loan Losses Allocated	Average Investment in Impaired Loans	Interest Income Recognized
December 31, 2014						
With no related allowance recorded:						
One-to-four family residential real estate	\$3,246	\$ 2,656	\$ 649	\$ —	\$ 2,777	\$ 44
One-to-four family residential real estate - non-owner occupied	1,481	1,425	57	—	745	76
Multi-family mortgage	3,174	2,593	481	—	3,419	120
Wholesale commercial lending	519	513	—	—	401	—
Nonresidential real estate	2,118	2,068	6	—	4,175	72
Commercial loans - secured	76	76	—	—	93	3
	10,614	9,331	1,193	—	11,610	315
With an allowance recorded:						
One-to-four family residential real estate - non-owner occupied	115	78	37	8	202	—
Multi-family mortgage	2,713	2,131	624	226	2,343	48
Nonresidential real estate	2,950	2,605	326	236	1,718	67
	5,778	4,814	987	470	4,263	115
Total	\$16,392	\$ 14,145	\$ 2,180	\$ 470	\$ 15,873	\$ 430

Table of Contents

## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 4 - LOANS RECEIVABLE (continued)

## Nonaccrual Loans

The following tables present the recorded investment in nonaccrual loans and loans past due over 90 days still on accrual by class of loans:

	Loan Balance	Recorded Investment	Loans Past Due Over 90 Days, Still Accruing
June 30, 2015			
One-to-four family residential real estate	\$3,275	\$2,700	\$—
One-to-four family residential real estate – non owner occupied	737	768	—
Multi-family mortgage	2,860	2,382	—
Nonresidential real estate	3,119	2,732	—
Commercial loans – secured	76	75	—
Consumer	1	1	—
	\$10,068	\$8,658	\$—
December 31, 2014			
One-to-four family residential real estate	\$4,793	\$4,210	\$—
One-to-four family residential real estate – non owner occupied	291	198	—
Multi-family mortgage	5,638	4,481	—
Nonresidential real estate	4,023	3,245	—
Commercial loans – secured	76	76	—
Consumer	3	3	—
	\$14,824	\$12,213	\$—

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 \$266,000 and \$464,000 at June 30, 2015 and December 31, 2014, respectively. When a loan is on non-accrual status and the ultimate collectability of the total principal of the loan is in doubt, all payments are applied to principal under the cost recovery method. Alternatively, when a loan is on non-accrual status but there is doubt concerning only the ultimate collectability of interest, contractual interest is credited to interest income only when received, under the cash basis method pursuant to the provisions of FASB ASC 310-10, as applicable. In all cases, the average balances are calculated based on the month-end balances of the financing receivables within the period reported pursuant to the provisions of FASB ASC 310-10, as applicable.



Table of Contents

## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 4 - LOANS RECEIVABLE (continued)

## Past Due Loans

The following tables present the aging of the recorded investment of loans at June 30, 2015 by class of loans:

	30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater Past Due	Total Past Due	Loans Not Past Due	Total
One-to-four family residential real estate	\$103	\$87	\$2,398	\$2,588	\$120,526	\$123,114
One-to-four family residential real estate - non-owner occupied	3	245	768	1,016	45,255	46,271
Multi-family mortgage	—	304	1,666	1,970	325,571	327,541
Wholesale commercial lending	—	—	—	—	148,743	148,743
Nonresidential real estate	537	—	1,812	2,349	219,587	221,936
Construction	—	—	—	—	42	42
Land	—	—	—	—	1,389	1,389
Commercial loans:						
Secured	—	—	75	75	13,595	13,670
Unsecured	—	—	—	—	2,855	2,855
Municipal	—	—	—	—	1,933	1,933
Warehouse lines	—	—	—	—	13,011	13,011
Health care	—	—	—	—	15,923	15,923
Aviation	—	—	—	—	1,034	1,034
Other	—	—	—	—	13,099	13,099
Commercial leases:						
Investment rated commercial leases	68	—	—	68	164,835	164,903
Below investment grade	—	—	—	—	9,293	9,293
Non-rated	—	—	—	—	41,680	41,680
Lease pools	—	—	—	—	11,202	11,202
Consumer	1	—	1	2	1,775	1,777
	\$712	\$636	\$6,720	\$8,068	\$1,151,348	\$1,159,416

Table of Contents

## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 4 - LOANS RECEIVABLE (continued)

The following tables present the aging of the recorded investment of loans at December 31, 2014 by class of loans:

	30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater Past Due	Total Past Due	Loans Not Past Due	Total
One-to-four family residential real estate	\$1,415	\$276	\$3,844	\$5,535	\$126,054	\$131,589
One-to-four family residential real estate - non-owner occupied	320	165	198	683	47,350	48,033
Multi-family mortgage	2,314	1,187	3,363	6,864	334,173	341,037
Wholesale commercial lending	—	—	—	—	135,395	135,395
Nonresidential real estate	376	444	3,245	4,065	227,078	231,143
Construction	—	—	—	—	63	63
Land	—	—	—	—	1,814	1,814
Commercial loans:						
Secured	—	—	76	76	11,863	11,939
Unsecured	—	1	—	1	1,884	1,885
Municipal	—	—	—	—	2,243	2,243
Warehouse lines	—	—	—	—	14,362	14,362
Health care	—	—	—	—	24,154	24,154
Aviation	—	—	—	—	1,111	1,111
Other	—	—	—	—	11,339	11,339
Commercial leases:						
Investment rated commercial leases	426	—	—	426	160,830	161,256
Below investment grade	136	—	—	136	11,246	11,382
Non-rated	8	—	—	8	35,672	35,680
Lease pools	—	—	—	—	10,180	10,180
Consumer	18	1	3	22	2,038	2,060
	\$5,013	\$2,074	\$10,729	\$17,816	\$1,158,849	\$1,176,665

## 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.

The Company had \$2.7 million of TDRs at June 30, 2015, compared to \$3.0 million at December 31, 2014. There were no specific valuation reserves allocated to those loans at June 30, 2015 and \$38,000 in specific valuation reserves allocated at December 31, 2014. The Company had no outstanding commitments to borrowers whose loans were classified as TDRs at either date.



Table of Contents

## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 4 - LOANS RECEIVABLE (continued)

The following table presents loans classified as TDRs:

	June 30, 2015	December 31, 2014
One-to-four family residential real estate	\$1,578	\$1,917
Multi-family mortgage	515	510
Troubled debt restructured loans – accrual loans	2,093	2,427
One-to-four family residential real estate	291	230
Multi-family mortgage	333	346
Troubled debt restructured loans – nonaccrual loans	624	576
Total troubled debt restructured loans	\$2,717	\$3,003

During the three and six months ending June 30, 2015 and 2014, 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 June 30, 2015		2014		Due to permanent reduction in recorded investment	Total
	Number of loans	Pre-Modification outstanding recorded investment	Post-Modification outstanding recorded investment	Number of loans		
One-to-four family residential real estate	—	\$ —	\$ —	1	\$ 19	\$ 19
		Due to reduction in interest rate	Due to extension of maturity date			
For the Three Months Ended June 30, 2015						
One-to-four family residential real estate		\$ —	\$ —		\$ —	\$ —
For the Three Months Ended June 30, 2014						
One-to-four family residential real estate		\$ 19	\$ —		\$ —	\$ 19

The TDRs had no impact on interest income, resulted in no change to the allowance for loan losses allocated and resulted in no charge-offs for the three months ended June 30, 2015 and June 30, 2014.

	Six Months Ended June 30, 2015		2014		Pre-Modification outstanding recorded investment	Post-Modification outstanding recorded investment
	Number of loans	Pre-Modification outstanding recorded investment	Post-Modification outstanding recorded investment	Number of loans		
One-to-four family residential real estate	1	\$ 63	\$ 63	3	\$ 140	\$ 99



Table of Contents

## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 4 - LOANS RECEIVABLE (continued)

	Due to reduction in interest rate	Due to extension of maturity date	Due to permanent reduction in recorded investment	Total
For the Six Months Ended June 30, 2015				
One-to-four family residential real estate	\$—	\$ 63	\$—	\$ 63
For the Six Months Ended June 30, 2014				
One-to-four family residential real estate	\$ 19	\$ 28	\$ 52	\$ 99

The TDRs described above had no material impact on interest income, resulted in no change to the allowance for loan losses allocated and resulted in no charge-offs for the six months ended June 30, 2015. The TDRs decreased interest income by \$1,000, resulted in no change to the allowance for loan losses allocated and resulted in charge-offs of \$41,000 for the six months ended June 30, 2014.

The following table presents TDRs for which there was a payment default during the six months ending June 30, 2015 and 2014 within twelve months following the modification.

	2015		2014	
	Number of loans	Recorded investment	Number of loans	Recorded investment
One-to-four family residential real estate	2	\$ 77	1	\$ 28

A loan is considered to be in payment default once it is 90 days contractually past due under the modified terms.

The TDRs for which there was a payment default resulted in no change to the allowance for loan losses allocated and resulted in no charge-offs during the six months ending June 30, 2015 and June 30, 2014.

There were certain other loan modifications during the three and six months ending June 30, 2015 and 2014 that did not meet the definition of a TDR. These loans had a total recorded investment of \$2.3 million and \$1.9 million at June 30, 2015 and 2014, respectively. The modification of these loans involved either a modification of the terms of a loan to borrowers who were not experiencing financial difficulties or a delay in a payment that was considered to be insignificant.

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

**Credit Quality Indicators**

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

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

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

published by 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.

Table of Contents

## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 4 - LOANS RECEIVABLE (continued)

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

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

As of June 30, 2015, based on the most recent analysis performed, the risk categories of loans by class of loans are as follows:

	Pass	Special Mention	Substandard	Nonaccrual	Total
One-to-four family residential real estate	\$120,314	\$130	\$623	\$2,494	\$123,561
One-to-four family residential real estate - non-owner occupied	45,132	248	433	772	46,585
Multi-family mortgage	324,081	584	4,334	2,405	331,404
Wholesale commercial lending	148,666	—	515	—	149,181
Nonresidential real estate	216,122	1,619	4,506	2,748	224,995
Construction	41	—	—	—	41
Land	671	—	730	—	1,401
Commercial loans:					
Secured	13,586	—	—	75	13,661
Unsecured	2,278	—	571	—	2,849
Municipal	1,908	—	—	—	1,908
Warehouse lines	13,055	—	—	—	13,055
Health care	15,895	—	—	—	15,895
Aviation	1,033	—	—	—	1,033
Other	12,943	—	—	—	12,943
Commercial leases:					
Investment rated commercial leases	163,774	—	—	—	163,774
Below investment grade	9,251	—	—	—	9,251
Non-rated	41,490	—	—	—	41,490
Lease pools	11,161	—	—	—	11,161
Consumer	1,767	—	—	1	1,768
Total	\$1,143,168	\$2,581	\$11,712	\$8,495	\$1,165,956



Table of Contents

## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 4 - LOANS RECEIVABLE (continued)

As of December 31, 2014, based on the most recent analysis performed, the risk categories of loans by class of loans are as follows:

	Pass	Special Mention	Substandard	Nonaccrual	Total
One-to-four family residential real estate	\$126,102	\$615	\$1,046	\$4,228	\$131,991
One-to-four family residential real estate - non-owner occupied	46,253	931	964	198	48,346
Multi-family mortgage	336,557	609	3,430	4,515	345,111
Wholesale commercial lending	134,719	—	519	—	135,238
Nonresidential real estate	223,385	1,170	6,698	3,247	234,500
Construction	60	—	—	—	60
Land	1,212	—	613	—	1,825
Commercial loans:					
Secured	11,863	—	7	76	11,946
Unsecured	1,147	40	698	—	1,885
Municipal	2,213	—	—	—	2,213
Warehouse lines	11,296	—	—	—	11,296
Health care	24,127	—	—	—	24,127
Aviation	1,108	—	—	—	1,108
Other	14,307	—	—	—	14,307
Commercial leases:					
Investment rated commercial leases	160,208	—	—	—	160,208
Below investment grade	11,309	—	—	—	11,309
Non-rated	35,473	—	—	—	35,473
Lease pools	10,153	—	—	—	10,153
Consumer	2,048	—	—	3	2,051
Total	\$1,153,540	\$3,365	\$13,975	\$12,267	\$1,183,147

## NOTE 5 – SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE

Securities sold under agreements to repurchase are shown below.

	June 30, 2015				Total
	Overnight and Continuous	Up to 30 days	30 - 90 days	Greater Than 90 days	
Repurchase agreements and repurchase-to-maturity transactions	\$3,039	\$—	\$—	\$—	\$3,039
Gross amount of recognized liabilities for repurchase agreements in Statement of Condition					\$3,039
	December 31, 2014				Total
	Overnight and Continuous	Up to 30 days	30 - 90 days	Greater Than 90 days	
Repurchase agreements and repurchase-to-maturity transactions	\$2,921	\$—	\$—	\$—	\$2,921
Gross amount of recognized liabilities for repurchase agreements in Statement of Condition					\$2,921



Table of Contents

BANKFINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 5 – SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE (continued)

Securities sold under agreements to repurchase were secured by mortgage-backed securities with a carrying amount of \$6.3 million and \$6.8 million at June 30, 2015 and December 31, 2014, respectively. Also included in total borrowings at December 31, 2014 were advances from FHLB- Chicago of \$10.0 million.

As the securities' values fluctuate due to market conditions, the Company has no control over the market value. The Company is obligated to promptly transfer additional securities if the market value of the securities fall below the repurchase price, per the agreement.

NOTE 6 - 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).

Impaired Loans: The fair value of impaired loans with specific allocations of the allowance for loan losses is generally based on recent real estate appraisals. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income 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 for similar loans and collateral underlying such loans. 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 in accordance with the allowance policy.

Other Real Estate Owned: Assets acquired through or instead of loan 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 which are updated no less frequently than annually. These appraisals may utilize a single valuation approach or a combination of approaches including comparable sales and the income approach with data from comparable properties. Adjustments are routinely made in the appraisal process by the independent appraisers to adjust for differences between the comparable sales and income data available. Real estate owned properties are evaluated on a quarterly basis for additional impairment and adjusted accordingly.

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 2).

Table of Contents

## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 6 - 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)	
June 30, 2015				
Securities:				
Certificates of deposit	\$—	\$69,652	\$—	\$69,652
Equity mutual fund	508	—	—	508
Mortgage-backed securities – residential	—	20,847	—	20,847
Collateralized mortgage obligations – residential	—	8,104	—	8,104
SBA-guaranteed loan participation certificates	—	26	—	26
	\$508	\$98,629	\$—	\$99,137
December 31, 2014				
Securities:				
Certificates of deposit	\$—	\$86,049	\$—	\$86,049
Equity mutual fund	509	—	—	509
Mortgage-backed securities - residential	—	24,611	—	24,611
Collateralized mortgage obligations – residential	—	9,976	—	9,976
SBA-guaranteed loan participation certificates	—	29	—	29
	\$509	\$120,665	\$—	\$121,174

Table of Contents

## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 6 - 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)	
June 30, 2015				
Impaired loans:				
Multi-family mortgage	\$—	\$—	\$532	\$532
Nonresidential real estate	—	—	578	578
	\$—	\$—	\$1,110	\$1,110
Other real estate owned:				
One-to-four family residential real estate	\$—	\$—	\$37	\$37
Multi-family mortgage	—	—	409	409
Nonresidential real estate	—	—	107	107
Land	—	—	409	409
	\$—	\$—	\$962	\$962
December 31, 2014				
Impaired loans:				
One-to-four family residential real estate	\$—	\$—	\$70	\$70
Multi-family mortgage	—	—	1,905	1,905
Nonresidential real estate	—	—	2,369	2,369
	\$—	\$—	\$4,344	\$4,344
Other real estate owned:				
One-to-four family residential real estate	\$—	\$—	\$55	\$55
Multi-family mortgage	—	—	1,265	1,265
Nonresidential real estate	—	—	126	126
Land	—	—	753	753
	\$—	\$—	\$2,199	\$2,199
Mortgage servicing rights	\$—	\$160	\$—	\$160

Impaired loans, which are measured for impairment using the fair value of the collateral for collateral-dependent loans, and have specific valuation allowances, had a carrying amount of \$1.2 million, and a valuation allowance of \$65,000 at June 30, 2015, compared to a carrying amount of \$4.8 million, and a valuation allowance of \$470,000 at December 31, 2014, resulting in a decrease in the provision for loan losses of \$405,000 for the six months ended June 30, 2015, and a decrease in the provision for loan losses of \$280,000 for the six months ended June 30, 2014. Other real estate owned ("OREO"), which is carried at the lower of cost or fair value less costs to sell, had a carrying value of \$1.4 million, and a valuation allowance of \$441,000 at June 30, 2015, compared to a carrying value of \$3.0 million, and a valuation allowance of \$803,000 at December 31, 2014. There were \$236,000 of valuation adjustments of OREO recorded for the six months ended June 30, 2015, and \$77,000 of valuation adjustments of OREO recorded for the six months ended June 30, 2014.

A pre-tax recovery of \$13,000 on our mortgage servicing rights portfolio was included in noninterest income for the six months ended June 30, 2015, compared to a provision of \$10,000 for the same period in 2014.

Table of Contents

## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 6 - 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 June 30, 2015:

	Fair Value	Valuation Technique(s)	Significant Unobservable Input(s)	Range (Weighted Average)
Impaired loans:				
Multi-family mortgage loans	\$ 532	Sales comparison	Comparison between sales and income approaches	3.6% to 21.7% (16%)
		Income approach	Cap Rate	9%
Nonresidential real estate loans	578	Sales comparison	Comparison between sales and income approaches	3.7% to 4.9% (4%)
		Income approach	Cap Rate	10.0%
Impaired loans	\$ 1,110			
Other real estate owned:				
One-to-four family residential real estate	\$ 37	Sales comparison	Discount applied to valuation	-1%
Multi-family mortgage	409	Sales comparison	Comparison between sales and income approaches	-67.7% to 10.4% (-15%)
Nonresidential real estate loans	107	Sales comparison	Comparison between sales and income approaches	58%
Land	409	Sales comparison	Discount applied to valuation	-8%
Other real estate owned	\$ 962			



Table of Contents

## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 6 - 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 December 31, 2014:

	Fair Value	Valuation Technique(s)	Unobservable Input(s)	Range (Weighted Average)
Impaired loans				
One-to-four family residential real estate	\$ 70	Sales comparison	Discount applied to valuation	4.8%
Multi-family mortgage	1,905	Sales comparison	Comparison between sales and income approaches	-2.1%- 43.7% (41%)
		Income approach	Cap Rate	9.6%-13.8% (10%)
Nonresidential real estate	2,369	Sales comparison	Comparison between sales and income approaches	-2.1%-33.9% (24%)
		Income approach	Cap Rate	10%-11% (10%)
	\$ 4,344			
Other real estate owned				
One-to-four family residential real estate	\$ 55	Sales comparison	Discount applied to valuation	6.3%-7.7% (7%)
Multi-family mortgage	1,265	Sales comparison	Comparison between sales and income approaches	-6.6%-13.5% (0.4%)
Nonresidential real estate	126	Sales comparison	Comparison between sales and income approaches	32.3%
Land	753	Sales comparison	Discount applied to valuation	-21.9%-4.2% (-10%)
	\$ 2,199			

Table of Contents

## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 6 - FAIR VALUE (continued)

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

	Carrying Amount	Fair Value Measurements at June 30, 2015 Using:			Total
		Level 1	Level 2	Level 3	
<b>Financial assets</b>					
Cash and cash equivalents	\$77,426	\$10,591	\$66,835	\$—	\$77,426
Securities	99,137	508	98,629	—	99,137
Loans receivable, net of allowance for loan losses	1,156,667	—	1,149,360	1,110	1,150,470
FHLBC stock	6,257	—	—	—	N/A
Accrued interest receivable	3,885	—	3,885	—	3,885
<b>Financial liabilities</b>					
Noninterest-bearing demand deposits	\$190,411	\$—	\$190,411	\$—	\$190,411
Savings deposits	156,436	—	156,436	—	156,436
NOW and money market accounts	625,568	—	625,568	—	625,568
Certificates of deposit	227,811	—	227,504	—	227,504
Borrowings	3,039	—	3,040	—	3,040
Accrued interest payable	49	—	49	—	49
	Carrying Amount	Fair Value Measurements at December 31, 2014 Using:			Total
		Level 1	Level 2	Level 3	
<b>Financial assets</b>					
Cash and cash equivalents	\$59,581	\$9,693	\$49,888	\$—	\$59,581
Securities	121,174	509	120,665	—	121,174
Loans receivable, net of allowance for loan losses	1,172,356	—	1,166,181	4,344	1,170,525
FHLBC stock	6,257	—	—	—	N/A
Accrued interest receivable	3,926	—	3,926	—	3,926
<b>Financial liabilities</b>					
Noninterest-bearing demand deposits	\$134,129	\$—	\$134,129	\$—	\$134,129
Savings deposits	154,532	—	154,532	—	154,532
NOW and money market accounts	690,193	—	690,193	—	690,193
Certificates of deposit	232,859	—	232,588	—	232,588
Borrowings	12,921	—	12,908	—	12,908
Accrued interest payable	89	—	89	—	89

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.

27

---

Table of Contents

BANKFINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 6 - 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) less than anticipated loan growth due to intense competition for high quality loans and leases, particularly in terms of pricing and credit underwriting, or a dearth of borrowers who meet our underwriting standards; (ii) the impact of re-pricing and competitors' pricing initiatives on loan and deposit products; (iii) interest rate movements and their impact on the economy, customer behavior and our net interest margin; (iv) adverse economic conditions in general and in the Chicago metropolitan area in particular 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; (v) declines in real estate values that adversely impact the value of our loan collateral, Other Real Estate Owned

("OREO"), asset dispositions and the level of borrower equity in their investments; (vi) borrowers that experience legal or financial difficulties that we do not currently foresee; (vii) 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; (viii) changes, disruptions or illiquidity in national or global financial markets; (ix) 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

Table of Contents

for loan losses; (x) monetary and fiscal policies of the U.S. Government, including policies of the U.S. Treasury and the Federal Reserve Board; (xi) factors affecting our ability to access deposits or cost-effective funding, and the impact of competitors' pricing initiatives on our deposit products; (xii) the impact of new legislation or regulatory changes, including the Dodd-Frank Act and Basel III, on our products, services, operations and operating expenses; (xiii) higher federal deposit insurance premiums; (xiv) higher than expected overhead, infrastructure and compliance costs; (xv) changes in accounting principles, policies or guidelines; and (xvi) 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, 2014, 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, 2014, and all amendments thereto, as filed with the Securities and Exchange Commission.

**Overview**

Total loans increased modestly due to stronger originations in multi-family loans and national commercial leasing, partially offset by unusually high loan prepayment volume. Commercial loan balances were stable, but we closed approximately \$20 million of new commercial loans for which the initial disbursement activity will occur in the third and fourth quarters of 2015. We remain reasonably optimistic about our ability to resume our typically robust levels of commercial-related loan originations to achieve meaningful loan portfolio growth throughout the second half of 2015. Our average yield on loans remained relatively stable as our loan growth and the further improvement in asset quality offset the impact of loan renewals at reduced market yields and prepayments on higher-yield loans and leases. Our net interest margin also remained relatively stable despite lower yields on our investment securities portfolio. Non-interest income increased due to higher deposit-account related income, higher commercial loan origination fee income and higher loan prepayment fee income. We continued to reduce our core noninterest expense in 2015 and achieved our major goals concerning core operating expense levels.

We also achieved our major goals for asset quality in the second quarter of 2015. Our ratio of nonperforming loans to total loans was 0.74% and our ratio of non-performing assets to total assets was 0.99% at June 30, 2015. As we continue to reduce non-performing assets and non-performing asset expense, we expect to redeploy these resources into additional commercial-related loan originations capacity during the remainder of 2015.

Table of Contents

## 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.

	June 30, 2015	December 31, 2014	Change
	(Dollars in thousands)		
Selected Financial Condition Data:			
Total assets	\$1,439,738	\$1,465,410	\$(25,672 )
Loans, net	1,156,667	1,172,356	(15,689 )
Securities, at fair value	99,137	121,174	(22,037 )
Core deposit intangible	1,577	1,855	(278 )
Deposits	1,200,226	1,211,713	(11,487 )
Borrowings	3,039	12,921	(9,882 )
Equity	211,748	216,121	(4,373 )

	Three Months Ended June 30,			Six Months Ended June 30,		
	2015	2014	Change	2015	2014	Change
	(Dollars in thousands)					
Selected Operating Data:						
Interest and dividend income	\$12,193	\$12,482	\$(289 )	\$24,404	\$24,568	\$(164 )
Interest expense	691	774	(83 )	1,377	1,586	(209 )
Net interest income	11,502	11,708	(206 )	23,027	22,982	45
Provision for (recovery of) loan losses	(488 )	957	(1,445 )	(1,212 )	1,433	(2,645 )
Net interest income after provision for (recovery of) loan losses	11,990	10,751	1,239	24,239	21,549	2,690
Noninterest income	1,689	1,660	29	3,225	3,192	33
Noninterest expense	10,031	10,982	(951 )	20,544	22,353	(1,809 )
Income before income tax expense	3,648	1,429	2,219	6,920	2,388	4,532
Income tax expense	1,424	25	1,399	2,710	42	2,668
Net income	\$2,224	\$1,404	\$820	\$4,210	\$2,346	\$1,864

Table of Contents

	Three Months Ended		Six Months Ended		
	June 30, 2015	2014	June 30, 2015	2014	
Selected Financial Ratios and Other Data:					
Performance Ratios:					
Return on assets (ratio of net income to average total assets) <sup>(1)</sup>	0.61	% 0.39	% 0.58	% 0.33	%
Return on equity (ratio of net income to average equity) <sup>(1)</sup>	4.14	3.15	3.88	2.64	
Average equity to average assets	14.84	12.35	14.96	12.32	
Net interest rate spread <sup>(1)(2)</sup>	3.36	3.37	3.40	3.33	
Net interest margin <sup>(1)(3)</sup>	3.42	3.43	3.45	3.39	
Efficiency ratio <sup>(4)</sup>	76.04	82.15	78.26	85.40	
Noninterest expense to average total assets <sup>(1)</sup>	2.77	3.04	2.84	3.10	
Average interest-earning assets to average interest-bearing liabilities	131.42	122.62	128.03	122.24	
Dividends declared per share	\$0.04	\$0.01	\$0.08	\$0.01	
Dividend payout ratio	37.95	% 15.05	% 40.10	% 9.00	%
			At June 30, 2015	At December 31, 2014	
Asset Quality Ratios:					
Nonperforming assets to total assets <sup>(5)</sup>		0.99	% 1.27	%	%
Nonperforming loans to total loans		0.74	1.03		
Allowance for loan losses to nonperforming loans		124.86	98.17		
Allowance for loan losses to total loans		0.93	1.01		
Capital Ratios:					
Equity to total assets at end of period		14.71	% 14.75	%	%
Tier 1 leverage ratio (Bank only)		10.92	% 11.45	%	%
Other Data:					
Number of full-service offices		19	19		
Employees (full-time equivalents)		264	269		

(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.

#### Comparison of Financial Condition at June 30, 2015 and December 31, 2014

Total assets decreased \$25.7 million, or 1.8%, to \$1.440 billion at June 30, 2015, from \$1.465 billion at December 31, 2014. The decrease in total assets was primarily due to decreases in securities and loans. Partially offsetting this decrease was an increase in cash and cash equivalents of \$17.8 million, or 30.0%, to \$77.4 million at June 30, 2015, from \$59.6 million at December 31, 2014.

Loans decreased \$15.7 million, or 1.3%, to \$1.157 billion at June 30, 2015, from \$1.172 billion at December 31, 2014. At June 30, 2015, our loan portfolio included \$877.2 million of real estate loans, which represented 75.2% of the loan portfolio. The Bank's primary lending area consists of the counties where our branch offices are located, and contiguous counties in the State of Illinois. We derive the most significant portion of our revenues from these geographic areas. We also engage in multi-family lending activities in carefully selected metropolitan areas outside



our primary lending area and engage in certain types of commercial lending and leasing activities on a nationwide basis. At June 30, 2015, \$695.5 million, or 79.3%, of our real estate loans were in

Table of Contents

Illinois, while \$65.2 million, or 7.4%, were in Texas, \$55.0 million, or 6.3%, were in Colorado, and \$22.5 million, or 2.6%, were in Minnesota. This information highlights the location of the collateral, but does not necessarily reflect the location of the borrower.

Total liabilities decreased by \$21.3 million, or 1.7%, to \$1.228 billion at June 30, 2015, from \$1.249 billion at December 31, 2014, primarily due to decreases in borrowings, money market and interest-bearing demand accounts and certificates of deposits. These decreases were partially offset by increases in savings and non-interest bearing demand accounts.

Total deposits decreased \$11.5 million, or 0.9%, to \$1.200 billion at June 30, 2015, from \$1.212 billion at December 31, 2014. Noninterest-bearing demand deposits increased \$56.3 million, or 42.0%, to \$190.4 million at June 30, 2015, from \$134.1 million at December 31, 2014. Money market and interest-bearing NOW accounts decreased \$64.6 million, or 9.4%, to \$625.6 million at June 30, 2015, from \$690.2 million at December 31, 2014. Certificates of deposit decreased \$5.0 million, or 2.2%, to \$227.8 million at June 30, 2015, from \$232.9 million at December 31, 2014. Core deposits (savings, money market, noninterest-bearing demand and NOW accounts) were 81.0% of total deposits at June 30, 2015 and December 31, 2014.

The changes in the balances of noninterest bearing demand deposits and money market and interest-bearing NOW accounts were due in substantial part to efforts we undertook in the first half of 2015 to simplify our deposit account options. As part of this process, we discontinued several older account types and converted the discontinued account types to current account types. During the first half of 2015, we converted approximately 33,500 older account types, totaling \$552.9 million, to current account types. Approximately 21% of the converted accounts, or 7,000 accounts, were interest-bearing demand accounts that were converted to non-interest bearing demand accounts. Approximately \$27 million of the accounts that were converted to non-interest bearing account types have balances that could migrate to interest-bearing accounts if interest rates were to increase materially; accordingly, we have incorporated the possibility of such migration into our various interest-rate risk management scenarios. Three additional account conversions are scheduled to be undertaken in the second half of 2015.

Borrowings decreased \$9.9 million to \$3.0 million at June 30, 2015, from \$12.9 million at December 31, 2014 due to the maturity and payment of an FHLB - Chicago \$10.0 million advance.

Total stockholders' equity was \$211.7 million at June 30, 2015, compared to \$216.1 million at December 31, 2014. The decrease in total stockholders' equity was primarily due to the combined impact of our repurchase of 600,000 shares of our common stock during the six months ended June 30, 2015 at a total cost of \$7.4 million, and our declaration and payment of cash dividends totaling \$1.7 million. These items were partially offset by net income of \$4.2 million that we recorded for the six months ended June 30, 2015. The unallocated shares of common stock that our ESOP owns were reflected as a \$9.8 million reduction to stockholders' equity at June 30, 2015, compared to a \$10.3 million reduction at December 31, 2014.

Operating results for the three months ended June 30, 2015 and 2014

Net Income. We had net income of \$2.2 million and \$1.4 million for the three months ended June 30, 2015 and 2014, respectively. Earnings per basic and fully diluted share of common stock were \$0.11 for the three months ended June 30, 2015, compared to \$0.07 for the three months ended June 30, 2014.

Net Interest Income. Net interest income was \$11.5 million for the three months ended June 30, 2015, compared to \$11.7 million for the three months ended June 30, 2014. The decrease reflected a \$289,000, or 2.3%, decrease in interest income and an \$83,000, or 10.7%, decrease in interest expense.

The decrease in net interest income was primarily attributable to decreases in the yield on interest-earning assets and net average interest-earning assets. Total average interest-earning assets decreased \$22.6 million, or 1.65%, to \$1.348 billion for the three months ended June 30, 2015, from \$1.370 billion for the same period in 2014. Our net interest rate spread decreased by one basis point to 3.36% for the three months ended June 30, 2015, from 3.37% for the same period in 2014. Our net interest margin decreased by one basis point to 3.42% for the three months ended June 30, 2015, from 3.43% for the same period in 2014. The yield on interest-earning assets decreased two basis points to 3.63% for the three months ended June 30, 2015, from 3.65% for the same period in 2014, and the cost of interest-bearing liabilities decreased one basis point to 0.27% for the three months ended June 30, 2015, from 0.28%

for the same period in 2014.

32

---

Table of Contents

## Average Balance Sheets

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

	For the Three Months Ended June 30,						
	2015			2014			
	Average			Average			
	Outstanding	Interest	Yield/Rate <sup>(1)</sup>	Outstanding	Interest	Yield/Rate <sup>(1)</sup>	
	Balance			Balance			
	(Dollars in thousands)						
Interest-earning assets:							
Loans	\$ 1,150,417	\$ 11,836	4.13	% \$ 1,119,255	\$ 12,085	4.33	%
Securities	107,697	257	0.96	112,691	287	1.02	
Stock in FHLBC	6,257	8	0.51	6,224	7	0.45	
Other	83,439	92	0.44	132,221	103	0.31	
Total interest-earning assets	1,347,810	12,193	3.63	1,370,391	12,482	3.65	
Noninterest-earning assets	101,930			74,306			
Total assets	\$ 1,449,740			\$ 1,444,697			
Interest-bearing liabilities:							
Savings deposits	\$ 158,318	41	0.10	\$ 156,045	40	0.10	
Money market accounts	339,281	266	0.31	352,119	284	0.32	
NOW accounts	295,390	91	0.12	349,889	88	0.10	
Certificates of deposit	229,672	291	0.51	256,860	361	0.56	
Total deposits	1,022,661	689	0.27	1,114,913	773	0.28	
Borrowings	2,883	2	0.28	2,651	1	0.15	
Total interest-bearing liabilities	1,025,544	691	0.27	1,117,564	774	0.28	
Noninterest-bearing deposits	185,969			128,460			
Noninterest-bearing liabilities	23,114			20,196			
Total liabilities	1,234,627			1,266,220			
Equity	215,113			178,477			
Total liabilities and equity	\$ 1,449,740			\$ 1,444,697			
Net interest income		\$ 11,502			\$ 11,708		
Net interest rate spread <sup>(2)</sup>			3.36	%		3.37	%
Net interest-earning assets <sup>(3)</sup>	\$ 322,266			\$ 252,827			
Net interest margin <sup>(4)</sup>			3.42	%		3.43	%
Ratio of interest-earning assets to interest-bearing liabilities	131.42	%		122.62	%		

(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.

Table of Contents

## Provision for Loan Losses

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

We had a recovery of loan losses of \$488,000 for the three months ended June 30, 2015, compared to a provision of \$957,000 for the same period in 2014. The provision for or recovery of loan losses is a function of the allowance for loan loss methodology that we use to determine the appropriate level of the allowance for inherent loan losses after net charge-offs have been deducted. The portion of the allowance for loan losses attributable to loans collectively evaluated for impairment decreased \$380,000, or 3.4%, to \$10.7 million at June 30, 2015, from \$11.1 million at March 31, 2015. The reserve established for loans individually evaluated for impairment decreased \$386,000, or 85.6%, to \$65,000 at June 30, 2015, from \$451,000 at March 31, 2015. Net charge offs were \$278,000 for the three months ended June 30, 2015. The allowance for loan losses as a percentage of nonperforming loans was 124.86% at June 30, 2015, compared to 98.17% at December 31, 2014.

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		
	June 30,		Change
	2015	2014	
	(Dollars in thousands)		
Deposit service charges and fees	\$476	\$472	\$4
Other fee income	601	593	8
Insurance commissions and annuities income	86	86	—
Gain on sale of loans, net	28	44	(16)
Gain (loss) on disposition of premises and equipment	(1	) 3	(4)
Loan servicing fees	96	104	(8)
Amortization of servicing assets	(35	) (38	) 3
Recovery (impairment) of servicing assets	3	(6	) 9
Earnings on bank owned life insurance	45	61	(16)
Trust income	183	170	13
Other	207	171	36
Total noninterest income	\$1,689	\$1,660	\$29

Noninterest income totaled \$1.7 million for the three months ended June 30, 2015 and for the three months ended June 30, 2014. Deposit service charges and fees increased \$4,000 and other fee income increased \$8,000, for the three months ended June 30, 2015. Noninterest income for the three months ended June 30, 2015 included a \$28,000 gain on sale of loans, compared to a \$44,000 gain on sale of loans that was recorded for the same period in 2014. Earnings on bank owned life insurance decreased \$16,000 for the three months ended June 30, 2015 to \$45,000, from \$61,000

for the same period in 2014.

34

---

Table of Contents

## Noninterest Expense

	Three Months Ended		
	June 30,		Change
	2015	2014	
	(Dollars in thousands)		
Compensation and benefits	\$5,278	\$5,596	\$(318 )
Office occupancy and equipment	1,670	1,626	44
Advertising and public relations	222	304	(82 )
Information technology	657	691	(34 )
Supplies, telephone and postage	385	384	1
Amortization of intangibles	136	143	(7 )
Nonperforming asset management	108	97	11
Gain on sale other real estate owned	(22 )	(98 )	76
Valuation adjustments of other real estate owned	23	33	(10 )
Operations of other real estate owned	91	474	(383 )
FDIC insurance premiums	262	470	(208 )
Other	1,221	1,262	(41 )
Total noninterest expense	\$10,031	\$10,982	\$(951 )

Noninterest expense decreased by \$951,000, or 8.7%, to \$10.0 million for the three months ended June 30, 2015, from \$11.0 million for the same period in 2014, due in substantial part to decreases in compensation and benefits expense, expense for operations of other real estate owned, and FDIC insurance premiums. Compensation and benefits expense decreased \$318,000, or 5.7%, primarily due to a reduction in full time equivalent employees to 264 at June 30, 2015, from 276 at June 30, 2014. OREO expenses decreased \$383,000, or 80.8%, to \$91,000 for the three months ended June 30, 2015, from \$474,000 for the three months ended June 30, 2014. OREO expense for the three months ended June 30, 2014 included a \$140,000 litigation settlement payment we made relating to a purchased impaired OREO property. OREO expense for the three months ended June 30, 2015 included \$60,000 in expense for real estate taxes and legal fees, compared to \$186,000 for the three months ended June 30, 2014.

## Income Taxes

For the three months ended June 30, 2015, we recorded income tax expense of \$1.4 million, compared to \$25,000 for the three months ended June 30, 2014. Our effective tax rate for the three months ended June 30, 2015 was 39.0%. For the three months ended June 30, 2014, income tax expense consisted solely of expense for state taxes.

Operating results for the six months ended June 30, 2015 and 2014

**Net Income.** We had net income of \$4.2 million for the six months ended June 30, 2015, compared to \$2.3 million for the six months ended June 30, 2014. Our earnings per basic and fully diluted share of common stock were \$0.21 for the six months ended June 30, 2015, compared to \$0.12 per basic and fully diluted share for the same period in 2014.

**Net Interest Income.** Net interest income was \$23.0 million for the six months ended June 30, 2015 and 2014. The \$209,000 decrease in interest expense was offset by a \$164,000 decrease in interest income.

Total average interest-earning assets decreased \$22.6 million, or 1.7%, to \$1.346 billion for the six months ended June 30, 2015, from \$1.369 billion for the same period in 2014. Our net interest rate spread increased by seven basis points to 3.40% for the six months ended June 30, 2015, from 3.33% for the same period in 2014. Our net interest margin increased by six basis point to 3.45% for the six months ended June 30, 2015, from 3.39% for the same period in 2014. The increase in the net interest spread and net interest margin was primarily a result of increased yield on interest-earning assets, partially offset by a lower cost of funds. The yield on interest-earning assets increased four basis point to 3.66% for the six months ended June 30, 2015, from 3.62% for the same period in 2014, and the cost of interest-bearing liabilities decreased three basis points to 0.26% for the six months ended June 30, 2015, from 0.29% for the same period in 2014.





Table of Contents

## Average Balance Sheets

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

	For the Six Months Ended June 30,						Yield/Rate <sup>(1)</sup>	
	2015			2014				
	Average	Interest	Yield/Rate <sup>(1)</sup>	Average	Interest	Yield/Rate <sup>(1)</sup>		
	Outstanding			Outstanding				
	Balance			Balance				
	(Dollars in thousands)							
Interest-earning assets:								
Loans	\$ 1,157,224	\$ 23,659	4.12	% \$ 1,116,858	\$ 23,784	4.29	%	
Securities	114,788	584	1.03	113,884	583	1.03		
Stock in FHLBC	6,257	16	0.52	6,146	12	0.39		
Other	67,941	145	0.43	131,929	189	0.29		
Total interest-earning assets	1,346,210	24,404	3.66	1,368,817	24,568	3.62		
Noninterest-earning assets	102,822			74,871				
Total assets	\$ 1,449,032			\$ 1,443,688				
Interest-bearing liabilities:								
Savings deposits	\$ 157,092	80	0.10	\$ 154,104	78	0.10		
Money market accounts	339,971	536	0.32	349,521	561	0.32		
NOW accounts	321,222	179	0.11	350,596	176	0.10		
Certificates of deposit	230,178	578	0.51	262,946	768	0.59		
Total deposits	1,048,463	1,373	0.26	1,117,167	1,583	0.29		
Borrowings	3,021	4	0.27	2,616	3	0.23		
Total interest-bearing liabilities	1,051,484	1,377	0.26	1,119,783	1,586	0.29		
Noninterest-bearing deposits	158,158			126,792				
Noninterest-bearing liabilities	22,615			19,204				
Total liabilities	1,232,257			1,265,779				
Equity	216,775			177,909				
Total liabilities and equity	\$ 1,449,032			\$ 1,443,688				
Net interest income		\$ 23,027			\$ 22,982			
Net interest rate spread <sup>(2)</sup>			3.40	%		3.33	%	
Net interest-earning assets <sup>(3)</sup>	\$ 294,726			\$ 249,034				
Net interest margin <sup>(4)</sup>			3.45	%		3.39	%	
Ratio of interest-earning assets to interest-bearing liabilities	128.03	%		122.24	%			

(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.

Table of Contents

## Provision for Loan Losses

We recorded a recovery of loan losses of \$1.2 million for the six months ended June 30, 2015, compared to a provision for loan losses of \$1.4 million for the same period in 2014. The portion of the allowance for loan losses attributable to loans collectively evaluated for impairment decreased \$775,000, or 6.7%, to \$10.7 million at June 30, 2015, from \$11.5 million at December 31, 2014. The reserve established for loans individually evaluated for impairment decreased \$405,000 for the six months ended June 30, 2015. Net recoveries of \$32,000 were recorded for the six months ended June 30, 2015, compared to charge-offs of \$1.1 million for the six months ended June 30, 2014. The allowance for loan losses as a percentage of nonperforming loans was 124.86% at June 30, 2015, compared to 98.17% at December 31, 2014.

## Noninterest Income

	Six Months Ended		Change
	2015	2014	
	June 30,		
	(Dollars in thousands)		
Deposit service charges and fees	\$931	\$911	\$20
Other fee income	1,136	1,114	22
Insurance commissions and annuities income	149	173	(24 )
Gain on sale of loans, net	55	68	(13 )
Loss on sales of securities	—	(7 )	7
Gain on disposition of premises and equipment	(1 )	5	(6 )
Loan servicing fees	186	208	(22 )
Amortization of servicing assets	(70 )	(70 )	—
Recovery (impairment) of servicing assets	13	(10 )	23
Earnings on bank owned life insurance	94	125	(31 )
Trust income	357	334	23
Other	375	341	34
Total noninterest income	\$3,225	\$3,192	\$33

Noninterest income was \$3.2 million for the six months ended June 30, 2015 and 2014. Deposit service charges and fees increased \$20,000 and other fee income increased \$22,000 for the six months ended June 30, 2015. Noninterest income for the six months ended June 30, 2015 included a \$55,000 gain on sale of loans, compared to a \$68,000 gain on sale of loans that was recorded for the same period in 2014. Earnings on bank owned life insurance decreased \$31,000 for the six months ended June 30, 2015 to \$94,000, from \$125,000 for the six months ended June 30, 2014.

Table of Contents

## Noninterest Expense

	Six Months Ended		
	June 30, 2015	2014	Change
	(Dollars in thousands)		
Compensation and benefits	\$10,859	\$11,554	\$(695 )
Office occupancy and equipment	3,365	3,540	(175 )
Advertising and public relations	563	466	97
Information technology	1,296	1,330	(34 )
Supplies, telephone and postage	796	775	21
Amortization of intangibles	278	292	(14 )
Nonperforming asset management	199	201	(2 )
Gain on sale other real estate owned	(80 )	(92 )	12
Valuation adjustments of other real estate owned	236	77	159
Operations of other real estate owned	290	681	(391 )
FDIC insurance premiums	497	949	(452 )
Other	2,245	2,580	(335 )
Total noninterest expense	\$20,544	\$22,353	\$(1,809 )

Noninterest expense decreased by \$1.8 million, or 8.1%, to \$20.5 million for the six months ended June 30, 2015, from \$22.4 million for the six months ended June 30, 2014. Compensation and benefits expense decreased \$695,000, or 6.0%, primarily due to a reduction in full time equivalent employees to 264 at June 30, 2015, from 269 at December 31, 2014 and 276 at June 30, 2014. Noninterest expense for the six months ended June 30, 2015 included \$645,000 of nonperforming asset management and OREO expense, compared to \$867,000 of nonperforming asset management and OREO expense for the same period in 2014. Nonperforming asset management and OREO expenses decreased \$222,000, or 25.6% for the six months ended June 30, 2015, primarily due to a decline in nonperforming assets and OREO properties, a decline in expenses relating to resolutions and accelerated dispositions of nonperforming assets, and a \$200,000 reimbursement that we received for legal, receivership and other expenses in connection with the final resolution of certain loans. Noninterest expense for the six months ended June 30, 2015 included a \$236,000 valuation adjustment to OREO properties, compared to a \$77,000 valuation adjustment to OREO properties for the same period in 2014. The OREO valuation adjustments were based on updated appraisals. OREO expense decreased \$391,000, or 57.4%, to \$290,000 for the six months ended June 30, 2015, compared to \$681,000 for the six months ended June 30, 2014. OREO expense for the six months ended June 30, 2014 included a \$140,000 litigation settlement payment concerning a purchased impaired OREO property. OREO expense for the six months ended June 30, 2015 included \$192,000 of real estate taxes and legal fees, compared to \$325,000 of real estate taxes and legal fees for the six months ended June 30, 2014. OREO expense for the six months ended June 30, 2015 also included \$350,000 in rental income, compared to \$216,000 in rental income for 2014.

## Income Taxes

For the six months ended June 30, 2015, we recorded income tax expense of \$2.7 million, compared to \$42,000 for the six months ended June 30, 2014. Our effective tax rate for the six months ended June 30, 2015 was 39.2%. For the six months ended June 30, 2014, income tax expense consisted solely of expense for state taxes.

## 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

Table of Contents

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 June 30, 2015, we had no loans in this category.

We typically obtain new third-party appraisals or collateral valuations when we place a loan on nonaccrual status, conduct impairment testing or conduct a TDR analysis 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-completed” basis is most likely to produce the highest net realizable value. If we determine that the “as-stabilized” or “as-completed” 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 June 30, 2015, 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.

Table of Contents

## Nonperforming Assets Summary

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

	June 30, 2015	March 31, 2015	December 31, 2014	Quarter Change	Six Month Change
	(Dollars in thousands)				
Nonaccrual loans:					
One-to-four family residential	\$3,468	\$3,816	\$4,408	\$(348)	\$(940)
Multi-family mortgage	2,382	3,441	4,481	(1,059)	(2,099)
Nonresidential real estate	2,732	5,931	3,245	(3,199)	(513)
Commercial	75	183	76	(108)	(1)
Consumer	1	—	3	1	(2)
	8,658	13,371	12,213	(4,713)	(3,555)
Other real estate owned:					
One-to-four family residential	471	677	806	(206)	(335)
Multi-family mortgage	2,018	2,242	2,307	(224)	(289)
Nonresidential real estate	1,240	1,169	885	71	355
Land	51	135	135	(84)	(84)
	3,780	4,223	4,133	(443)	(353)
Nonperforming assets (excluding purchased other real estate owned)	12,438	17,594	16,346	(5,156)	(3,908)
Purchased other real estate owned:					
One-to-four family residential	—	325	457	(325)	(457)
Land	1,759	1,768	1,768	(9)	(9)
	1,759	2,093	2,225	(334)	(466)
Total nonperforming assets	\$14,197	\$19,687	\$18,571	\$(5,490)	\$(4,374)
Ratios:					
Nonperforming loans to total loans	0.74	% 1.15	% 1.03	%	
Nonperforming assets to total assets	0.99	1.36	1.27		
Nonperforming assets to total assets <sup>(1)</sup>	0.86	1.22	1.11		

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



Table of Contents

## Nonperforming Assets

Nonperforming assets totaled \$14.2 million at June 30, 2015, \$19.7 million at March 31, 2015, and \$18.6 million at December 31, 2014. Nonperforming assets decreased \$5.5 million and \$4.4 million, respectively, for the three and six months ended June 30, 2015. Although we experience occasional isolated instances of new non-accrual loans, we believe that continuing our aggressive resolution posture will maintain the trends favoring very strong asset quality. We continue to experience modest quantities of defaults on residential real estate loans principally due either to the borrower's personal financial condition or deteriorated collateral value.

## 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 roll-forward of OREO and the composition of OREO properties:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2015	2014	2015	2014
	(Dollars in thousands)			
Beginning balance	\$6,316	\$8,670	\$6,358	\$6,306
New foreclosed properties	578	892	1,167	3,460
Payments received	—	(10	) —	(10
Valuation adjustments	(23	) (33	) (236	) (77
Gain (loss) on sale of other real estate owned	22	98	80	92
Proceeds from sales of other real estate owned	(1,354	) (1,913	) (1,830	) (2,067
Ending balance	\$5,539	\$7,704	\$5,539	\$7,704
			June 30, 2015	December 31, 2014
			(Dollars in thousands)	
One-to-four family residential			\$471	\$806
Multi-family mortgage			2,018	2,307
Nonresidential real estate			1,240	885
Land			51	135
			3,780	4,133
Acquired other real estate owned:				
One-to-four family residential			—	457
Land			1,759	1,768
			1,759	2,225
Total other real estate owned			\$5,539	\$6,358

## 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



Table of Contents

securities and lease payments. 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 FHLBC advances at June 30, 2015.

The liquidity needs of the Company on an unconsolidated basis consist primarily of operating expenses, dividends to stockholders and stock repurchases. The primary source of liquidity for the Company as of June 30, 2015 was \$17.5 million in cash and cash equivalents, and potential future cash dividends from the Bank.

As of June 30, 2015, 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 June 30, 2015, 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.

We are subject to minimum risk-based capital limitations as set forth by federal banking regulations at both the consolidated Company level and the Bank level. Under the risk-based capital guidelines, different categories of assets, including certain off-balance sheet items, such as loan commitments and letters of credit, are assigned different risk weights, based generally on the perceived credit risk of the asset. These risk weights are multiplied by corresponding asset balances to determine a "risk-weighted" asset base. For purposes of the risk-based capital guidelines, total capital is defined as the sum of "Common Equity Tier 1", "Additional Tier 1" and "Tier 2" capital elements. Common Equity Tier 1 is comprised of common stock, related surplus and retained earnings. Additional Tier 1 capital includes, with certain restrictions, noncumulative perpetual preferred stock, certain grandfathered regulatory capital instruments and minority interests in consolidated subsidiaries. Tier 2 capital includes, with certain limitations, perpetual preferred stock not included in Tier 1 capital, subordinate debt, certain maturing capital instruments, and the allowance for loan and credit losses.

In March 2015, the Company implemented the Basel III capital rules that reformed the regulatory capital framework for banking institutions. The U.S. banking regulatory agencies have implemented the reforms which are designed to ensure that banks maintain strong capital positions even in the event of severe economic downturns or unforeseen losses.

Changes that affected the Company include the additional constraints on the inclusion of deferred tax assets in capital, increased risk weightings for nonperforming loans and acquisition/development loans in regulatory capital. Under the new regulations the Company elected a one-time opt-out to exclude Accumulated Other Comprehensive Income (AOCI) from regulatory capital in the first quarter of 2015.

The Company and the Bank have each adopted Regulatory 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 Regulatory Capital Plans may be increased and other minimum capital requirements may be established if and as necessary to comply with the Basel III requirements now applicable to the Company and the Bank. In accordance with the Regulatory Capital Plans, neither the Company nor the Bank will pursue any acquisition or growth opportunity, declare any dividend or conduct any stock repurchase that would cause the Bank's total risk-based capital ratio and/or its Tier 1 leverage ratio to fall below the established minimum capital levels. In addition, the Company will continue to maintain its ability to serve as a source of financial strength to the Bank by holding at least \$5.0 million of cash or liquid assets for that purpose.



Table of Contents

The following table shows the Company's and the Bank's capital amounts and ratios and regulatory thresholds under Basel III at June 30, 2015:

	Risk-based Common Tier 1		Tier 1	Total Capital	Leverage Tier 1	
<b>Company</b>						
Regulatory capital	\$186,337		\$186,337	\$197,151	\$186,337	
Well-capitalized requirement	69,630		85,698	107,123	71,248	
Regulatory capital - excess	\$116,707		\$100,639	\$90,028	\$115,089	
Capital	17.39	%	17.39	% 18.40	% 13.08	%
Minimum capital requirement	4.50	%	6.00	% 8.00	% 4.00	%
Well capitalized requirement <sup>(1)</sup>	6.50	%	8.00	% 10.00	% 5.00	%
<b>Bank</b>						
Regulatory capital	155,586		155,586	166,400	155,586	
Well-capitalized requirement	69,617		85,682	107,103	71,242	
Regulatory capital - excess	\$85,969		\$69,904	\$59,297	\$84,344	
Capital	14.53	%	14.53	% 15.54	% 10.92	%
Minimum capital requirement	4.50	%	6.00	% 8.00	% 4.00	%
Well capitalized requirement <sup>(1)</sup>	6.50	%	8.00	% 10.00	% 5.00	%

The ratios for the well-capitalized requirement are only applicable to the Bank. However, the Company manages (1) its capital position as if the requirement applies to the consolidated entity and has presented the ratios as if they also applied to the Company.

	Consolidated Actual Ratio	BankFinancial F.S.B. Actual Ratio	Required for Capital Adequacy Purposes Pre-Basel III	To be Well-Capitalized Under Pre-Basel III Regulatory Requirements
December 31, 2014				
Total capital (to risk-weighted assets)	18.31	16.21	8.00	% 10.00
Tier 1 (core) capital (to risk-weighted assets)	17.21	15.11	4.00	6.00
Tier 1 (core) capital (to adjusted total assets)	13.04	11.45	4.00	5.00

As of June 30, 2015, the Bank and the Company were well-capitalized with all capital ratios exceeding the well-capitalized requirement. There are no conditions or events that management believes have changed the Bank's prompt corrective action capitalization category.

Capital Management - Company Total stockholders' equity was \$211.7 million at June 30, 2015, compared to \$216.1 million at December 31, 2014. The decrease in total stockholders' equity was primarily due to the combined impact of our repurchase of 600,000 shares of our common stock during the six months ended June 30, 2015 at a total cost of \$7.4 million, and our declaration and payment of cash dividends totaling \$1.7 million during this period. These items were partially offset by net income of \$4.2 million that we recorded for the six months ended June 30, 2015. The unallocated shares of common stock that our ESOP owns were reflected as a \$9.8 million reduction to stockholders' equity at June 30, 2015, compared to a \$10.3 million reduction at December 31, 2014.

Quarterly Cash Dividends. We declared cash dividends of \$0.08 per share for the six months ended June 30, 2015, compared to a cash dividend of \$0.01 per share for the six months ended June 30, 2014.

Stock Repurchase Program. On March 30, 2015, the Company announced that its Board had authorized the repurchase of up to 1,055,098 shares of the Company's common stock, which represents approximately 5% of the Company's issued and outstanding shares of common stock. The authorization will expire on December 31, 2015 unless extended by the Board. As of June 30, 2015, the Company had repurchased 600,000 shares of its common stock out of the

1,055,098 that had been authorized for repurchase in 2015. Since its inception, the Company has repurchased 4,839,134 shares of its common stock.

Table of Contents

## 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.

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.





Table of Contents

Quantitative Analysis. The following table sets forth, as of June 30, 2015, 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			Increase in Estimated Net Interest Income		
	Amount	Percent		Amount	Percent	
	(dollars in thousands)					
+400	\$(43,099	) (19.16	)%	\$13	0.03	%
+300	(30,918	) (13.75	)	64	0.14	
+200	(20,102	) (8.94	)	211	0.46	
+100	(10,337	) (4.60	)	137	0.30	
0	—	—		—	—	

The Company has opted not to include an estimate for a decrease in rates at June 30, 2015 as the results are not considered relevant given the current targeted fed funds rate of the Federal Open Market Committee. The table set forth above indicates that at June 30, 2015, in the event of an immediate 200 basis point increase in interest rates, the Bank would be expected to experience an 8.94% decrease in NPV and a \$211,000 increase 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. Because of the shortcomings mentioned above, management considers many additional factors such as projected changes in loan and deposit balances and various projected forward interest rate scenarios when evaluating strategies for managing interest rate risk. 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 June 30, 2015. 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 June 30, 2015, 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

There have been no material changes to the risk factors disclosed in the Company's Annual Report in Form 10-K for the year ended December 31, 2014.

## 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 following table sets forth information in connection with purchases of our common stock made by, or, on behalf of us, during the second quarter of 2015:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet be Purchased under the Plans or Programs <sup>(1)</sup>
April 1, 2015 through April 30, 2015	—	\$—	—	1,055,098
May 1, 2015 through May 31, 2015	600,000	12.31	600,000	455,098
June 1, 2015 through June 30, 2015	—	—	—	455,098
	600,000		600,000	

On March 30, 2015, the Company announced that its Board had authorized the repurchase of up to 1,055,098 shares of the Company's common stock, which represents approximately 5% of the Company's issued and outstanding shares of common stock. The authorization will expire on December 31, 2015 unless extended by the Board.

## ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

## ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

## ITEM 5. OTHER INFORMATION

None.

## ITEM 6. EXHIBITS

Edgar Filing: BankFinancial CORP - Form 10-Q

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 June 30, 2015, formatted in Extensive Business Reporting Language (XBRL): (i) consolidated statement of conditions, (ii) consolidated statements of operations, (iii) consolidated statements of comprehensive income, (iv) consolidated statements of changes in stockholder's equity, (v) consolidated statements of cash flows and (vi) 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: July 29, 2015

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

/s/ Paul A. Cloutier  
Paul A. Cloutier  
Executive Vice President and Chief Financial Officer