

BankFinancial CORP  
Form 10-Q  
August 06, 2013

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

FORM 10-Q

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

For the Quarterly Period ended June 30, 2013

or

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

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

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

Maryland  
(State or Other Jurisdiction  
of Incorporation)

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

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

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

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

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

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

Indicate the number of shares outstanding of each of the Issuer's classes of common stock as of the latest practicable date, at August 2, 2013, there were 21,101,966 shares of Common Stock, \$0.01 par value, outstanding.



BANKFINANCIAL CORPORATION

Form 10-Q

June 30, 2013

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## BANKFINANCIAL CORPORATION

## CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

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

	June 30, 2013	December 31, 2012
Assets		
Cash and due from other financial institutions	\$18,303	\$20,361
Interest-bearing deposits in other financial institutions	293,790	255,403
Cash and cash equivalents	312,093	275,764
Securities, at fair value	53,014	77,832
Loans held-for-sale	276	2,166
Loans receivable, net of allowance for loan losses: June 30, 2013, \$17,097 and December 31, 2012, \$18,035	1,012,316	1,030,465
Other real estate owned, net	6,262	10,358
Stock in Federal Home Loan Bank, at cost	6,068	8,412
Premises and equipment, net	36,830	38,251
Accrued interest receivable	3,750	4,146
Core deposit intangible	2,732	3,038
Bank owned life insurance	21,797	21,645
FDIC prepaid expense	—	2,658
Income tax receivable	—	461
Other assets	5,994	5,996
Total assets	\$1,461,132	\$1,481,192
Liabilities:		
Deposits		
Noninterest-bearing	\$137,146	\$134,597
Interest-bearing	1,124,950	1,147,754
Total deposits	1,262,096	1,282,351
Borrowings		
Advance payments by borrowers taxes and insurance	10,619	10,705
Accrued interest payable and other liabilities	12,248	9,679
Total liabilities	1,287,903	1,308,302
Commitments and contingent liabilities		
Stockholders' equity:		
Preferred Stock, \$0.01 par value, 25,000,000 shares authorized, none issued or outstanding	—	—
Common Stock, \$0.01 par value, 100,000,000 shares authorized; 21,101,966 shares issued at June 30, 2013 and 21,072,966 shares at December 31, 2012	211	211
Additional paid-in capital	193,556	193,590
Retained earnings (deficit)	(9,464	) (9,796
Unearned Employee Stock Ownership Plan shares	(11,748	) (12,233
Accumulated other comprehensive income	674	1,118
Total stockholders' equity	173,229	172,890
Total liabilities and stockholders' equity	\$1,461,132	\$1,481,192

See accompanying notes to the consolidated financial statements.



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## BANKFINANCIAL CORPORATION

## CONSOLIDATED STATEMENTS OF OPERATIONS

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Interest and dividend income				
Loans, including fees	\$ 11,854	\$ 15,312	24,132	31,424
Securities	219	387	469	829
Other	203	125	388	205
Total interest income	12,276	15,824	24,989	32,458
Interest expense				
Deposits	933	1,084	1,919	2,298
Borrowings	2	28	10	54
Total interest expense	935	1,112	1,929	2,352
Net interest income	11,341	14,712	23,060	30,106
Provision for loan losses	206	1,745	928	2,741
Net interest income after provision for loan losses	11,135	12,967	22,132	27,365
Noninterest income				
Deposit service charges and fees	509	521	1,008	1,078
Other fee income	410	383	785	768
Insurance commissions and annuities income	86	112	195	234
Gain (loss) on sale of loans, net	(4	) 118	1,413	385
Loss on disposition of premises and equipment, net	—	(157	) —	(157
Loan servicing fees	114	119	237	247
Amortization and impairment of servicing assets	(76	) (98	) (109	) (180
Earnings on bank owned life insurance	82	120	152	246
Trust	183	190	364	374
Other	205	110	330	255
	1,509	1,418	4,375	3,250
Noninterest expense				
Compensation and benefits	6,686	6,481	13,438	13,160
Office occupancy and equipment	1,805	2,105	3,753	4,137
Advertising and public relations	268	224	414	330
Information technology	816	825	1,565	1,673
Supplies, telephone, and postage	403	362	864	752
Amortization of intangibles	150	157	306	320
Nonperforming asset management	655	1,117	1,349	2,357
Operations of other real estate owned	422	1,691	933	2,243
FDIC insurance premiums	477	309	969	657
Other	886	773	2,162	1,851
	12,568	14,044	25,753	27,480
Income before income taxes	76	341	754	3,135
Income tax benefit	—	(457	) —	—
Net income	\$ 76	\$ 798	\$ 754	\$ 3,135
Basic earnings per common share	\$—	\$0.04	\$0.04	\$0.16
Diluted earnings per common share	\$—	\$0.04	\$0.04	\$0.16
Weighted average common shares outstanding	19,989,757	19,860,419	19,976,964	19,847,846

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Diluted weighted average common shares outstanding	19,990,313	19,860,419	19,977,171	19,847,846
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See accompanying notes to the consolidated financial statements.

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## BANKFINANCIAL CORPORATION

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(In thousands) - Unaudited

	Three Months Ended		Six Months Ended		
	June 30,		June 30,		
	2013	2012	2013	2012	
Net income	\$76	\$798	\$754	\$3,135	
Unrealized holding gain (loss) arising during the period, net of tax	(320	) 19	(444	) (36	)
Amount reclassified from accumulated other comprehensive income	—	—	—	—	
Net current period other comprehensive gain (loss)	(320	) 19	(444	) (36	)
Comprehensive income (loss)	\$ (244	) \$ 817	\$ 310	\$ 3,099	

See accompanying notes to the consolidated financial statements.



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## BANKFINANCIAL CORPORATION

## CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

(In thousands, except per share data) - Unaudited

	Common Stock	Additional Paid-in Capital	Retained Earnings (Deficit)	Unearned Employee Stock Ownership Plan Shares	Accumulated Other Comprehen-sive Income	Total
Balance at January 1, 2012	\$211	\$193,801	\$17,946	\$(13,212 )	\$ 1,111	\$199,857
Net income	—	—	3,135	—	—	3,135
Other comprehensive income, net of tax effects	—	—	—	—	(36 )	(36 )
Nonvested stock awards-stock-based compensation expense	—	41	—	—	—	41
Cash dividends declared on common stock (\$0.02 per share)	—	—	(422 )	—	—	(422 )
ESOP shares earned	—	(119 )	—	487	—	368
Balance at June 30, 2012	\$211	\$193,723	\$20,659	\$(12,725 )	\$ 1,075	\$202,943
Balance at January 1, 2013	\$211	\$193,590	\$(9,796 )	\$(12,233 )	\$ 1,118	\$172,890
Net income	—	—	754	—	—	754
Other comprehensive income, net of tax effects	—	—	—	—	(444 )	(444 )
Nonvested stock awards-stock-based compensation expense	—	38	—	—	—	38
Cash dividends declared on common stock (\$0.02 per share)	—	—	(422 )	—	—	(422 )
ESOP shares earned	—	(72 )	—	485	—	413
Balance at June 30, 2013	\$211	\$193,556	\$(9,464 )	\$(11,748 )	\$ 674	\$173,229

See accompanying notes to the consolidated financial statements.

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CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands) - Unaudited

	Six Months Ended	
	June 30,	
	2013	2012
Cash flows from operating activities		
Net income	\$754	\$3,135
Adjustments to reconcile to net income to net cash from operating activities		
Provision for loan losses	928	2,741
ESOP shares earned	413	368
Stock-based compensation expense	38	41
Depreciation and amortization	2,221	2,283
Amortization of premiums and discounts on securities and loans	(414	) (1,633
Amortization of core deposit and other intangible assets	306	320
Amortization and impairment of servicing assets	109	180
Net change in net deferred loan origination costs	(53	) 127
Net loss (gain) on sale of other real estate owned	118	(84
Net gain on sale of loans	(1,413	) (385
Net loss disposition of premises and equipment	—	157
Loans originated for sale	(7,601	) (9,585
Proceeds from sale of loans	8,182	11,383
Other real estate owned valuation adjustments	230	1,425
Net change in:		
Accrued interest receivable	396	1,046
Earnings on bank owned life insurance	(152	) (246
Other assets	2,237	56
Accrued interest payable and other liabilities	34	(1,963
Net cash from operating activities	6,333	9,366
Cash flows from investing activities		
Securities		
Proceeds from maturities	21,268	21,189
Proceeds from principal repayments	8,724	9,700
Purchases of securities	(3,175	) (13,184
Loans receivable		
Principal payments on loans receivable	228,608	281,548
Purchases of loans	—	(398
Originated for investment	(213,704	) (177,554
Proceeds from sale of loans	2,868	—
Proceeds of redemption of Federal Home Loan Bank of Chicago stock	2,344	6,186
Proceeds from sale of other real estate owned	6,478	7,455
Purchase of premises and equipment, net	(25	) (1,495
Net cash from investing activities	53,386	133,447

Continued

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CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands) - Unaudited

	Six Months Ended	
	June 30,	
	2013	2012
Cash flows from financing activities		
Net change in deposits	\$(20,255	) \$(42,969
Net change in borrowings	(2,627	) 759
Net change in advance payments by borrowers for taxes and insurance	(86	) (178
Cash dividends paid on common stock	(422	) (422
Net cash used in financing activities	(23,390	) (42,810
Net change in cash and cash equivalents	36,329	100,003
Beginning cash and cash equivalents	275,764	120,704
Ending cash and cash equivalents	\$312,093	\$220,707
Supplemental disclosures of cash flow information:		
Interest paid	\$1,951	\$2,378
Income taxes paid	—	—
Income taxes refunded	461	1,115
Loans transferred to other real estate owned	2,756	3,766
Due to broker for purchase of securities not settled	2,535	—

See accompanying notes to the consolidated financial statements.

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BANKFINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

**Principles of Consolidation:** The interim unaudited consolidated financial statements include the accounts of and transactions of BankFinancial Corporation, the Bank, and the Bank’s wholly-owned subsidiaries, Financial Assurance Services, Inc. and BF Asset Recovery Corporation (collectively, “the Company”), and reflect all normal and recurring adjustments that are, in the opinion of management, considered necessary for a fair presentation of the financial condition and results of operations for the periods presented. All significant intercompany accounts and transactions have been eliminated. The results of operations for the June 30, 2013, are not necessarily indicative of the results of operations that may be expected for the year ending December 31, 2013.

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

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

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

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

**Recent Accounting Pronouncements**

In February 2013, the Financial Accounting Standards Board (“FASB”) issued an amendment to improve the reporting of reclassifications out of accumulated other comprehensive income. ASC Topic 220, “Comprehensive Income” amended prior guidance to improve the reporting of reclassifications out of accumulated other comprehensive income by requiring an entity to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, an entity is required to present, either on the face of the statement or in the notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income if the amount reclassified is required under GAAP. The Company adopted this new authoritative guidance on January 1, 2013, and it did not have an impact on the Company’s statements of operations and financial condition as the Company did not have any amounts reclassified during the three or six month periods ended June 30, 2013 and 2012.

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## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 2 - EARNINGS PER SHARE

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

	Three Months Ended June		Six Months Ended	
	30, 2013	2012	June 30, 2013	2012
Net income available to common stockholders	\$76	\$798	\$754	\$3,135
Average common shares outstanding	21,088,263	21,072,966	21,080,657	21,072,966
Less:				
Unearned ESOP shares	(1,084,709 )	(1,209,023 )	(1,096,757 )	(1,221,191 )
Unvested restricted stock shares	(13,797 )	(3,524 )	(6,936 )	(3,929 )
Weighted average common shares outstanding	19,989,757	19,860,419	19,976,964	19,847,846
Add - Net effect of dilutive stock options and unvested restricted stock	556	—	207	—
Diluted weighted average common shares outstanding	19,990,313	19,860,419	19,977,171	19,847,846
Basic earnings per common share	\$—	\$0.04	\$0.04	\$0.16
Diluted earnings per common share	\$—	\$0.04	\$0.04	\$0.16
Number of antidilutive stock options excluded from the diluted earnings per share calculation	—	1,881,053	—	1,881,053
Weighted average exercise price of anti-dilutive option shares	\$—	\$16.58	\$—	\$16.58

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## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 3 - SECURITIES

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

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
June 30, 2013				
Certificates of deposit	\$15,639	\$—	\$—	\$15,639
Municipal securities	350	12	—	362
Equity mutual fund	500	7	—	507
Mortgage-backed securities - residential	29,954	1,439	(127	) 31,266
Collateralized mortgage obligations - residential	5,175	33	(7	) 5,201
SBA-guaranteed loan participation certificates	39	—	—	39
	\$51,657	\$1,491	\$(134	) \$53,014
December 31, 2012				
Certificates of deposit	\$33,456	\$—	\$—	\$33,456
Municipal securities	350	19	—	369
Equity mutual fund	500	28	—	528
Mortgage-backed securities - residential	32,572	1,661	—	34,233
Collateralized mortgage obligations - residential	9,111	95	(2	) 9,204
SBA-guaranteed loan participation certificates	42	—	—	42
	\$76,031	\$1,803	\$(2	) \$77,832

Mortgage-backed securities and collateralized mortgage obligations reflected in the preceding table were issued by U.S. government-sponsored entities or agencies, Freddie Mac, Fannie Mae and Ginnie Mae, and are obligations which the government has affirmed its commitment to support. All securities reflected in the preceding table were classified as available-for-sale at June 30, 2013 and December 31, 2012.

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

	June 30, 2013	
	Amortized Cost	Fair Value
Due in one year or less	\$15,809	\$15,811
Due after one year through five years	180	190
	15,989	16,001
Equity mutual fund	500	507
Mortgage-backed securities - residential	29,954	31,266
Collateralized mortgage obligations - residential	5,175	5,201
SBA-guaranteed loan participation certificates	39	39
	\$51,657	\$53,014



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## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 3 - SECURITIES (continued)

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

	Less than 12 Months		12 Months or More		Total	
	Fair	Unrealized	Fair	Unrealized	Fair	Unrealized
	Value	Loss	Value	Loss	Value	Loss
June 30, 2013						
Mortgage-backed securities - residential	\$2,488	\$(127 )	\$—	\$—	\$2,488	\$(127 )
Collateralized mortgage obligations - residential	—	—	364	(7 )	364	(7 )
	\$2,488	\$(127 )	\$364	\$(7 )	\$2,852	\$(134 )
December 31, 2012						
Collateralized mortgage obligations - residential	\$—	\$—	\$1,956	\$(2 )	\$1,956	\$(2 )

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

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

There were no sales of securities during the six months ended June 30, 2013 or 2012.

## NOTE 4 - LOANS RECEIVABLE

Loans receivable are as follows:

	June 30, 2013	December 31, 2012
One-to-four family residential real estate loans	\$200,181	\$218,596
Multi-family mortgage loans	353,924	352,019
Nonresidential real estate loans	255,429	264,672
Construction and land loans	7,152	8,552
Commercial loans	51,701	61,388
Commercial leases	157,606	139,783
Consumer loans	2,622	2,745
Total loans	1,028,615	1,047,755
Net deferred loan origination costs	798	745
Allowance for loan losses	(17,097 )	(18,035 )
Loans, net	\$1,012,316	\$1,030,465





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## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 4 - LOANS RECEIVABLE

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

	Allowance for loan losses				Loan Balances			
	Individually evaluated for impairment	Purchased impaired loans	Collectively evaluated for impairment	Total	Individually evaluated for impairment	Purchased impaired loans	Collectively evaluated for impairment	Total
June 30, 2013								
One-to-four family residential real estate loans	\$47	\$2	\$ 3,866	\$3,915	\$5,115	\$396	\$ 194,670	\$ 200,181
Multi-family mortgage loans	629	—	4,057	4,686	12,642	—	341,282	353,924
Nonresidential real estate loans	352	—	5,341	5,693	6,750	1,607	247,072	255,429
Construction and land loans	135	50	621	806	1,604	997	4,551	7,152
Commercial loans	34	—	1,071	1,105	651	21	51,029	51,701
Commercial leases	—	—	798	798	—	—	157,606	157,606
Consumer loans	—	—	94	94	—	—	2,622	2,622
	\$1,197	\$52	\$ 15,848	\$17,097	\$26,762	\$3,021	\$998,832	1,028,615
Net deferred loan origination costs								798
Allowance for loan losses								(17,097 )
Loans, net								\$1,012,316
	Allowance for loan losses				Loan Balances			
	Individually evaluated for impairment	Purchased impaired loans	Collectively evaluated for impairment	Total	Individually evaluated for impairment	Purchased impaired loans	Collectively evaluated for impairment	Total
December 31, 2012								
One-to-four family residential real estate loans	\$137	\$5	\$ 4,584	\$4,726	\$5,256	\$380	\$212,960	\$218,596
Multi-family mortgage loans	729	—	3,851	4,580	4,801	—	347,218	352,019
Nonresidential real estate loans	401	8	5,136	5,545	11,918	2,568	250,186	264,672
Construction and land loans	294	96	641	1,031	2,210	1,021	5,321	8,552
Commercial loans	23	1	1,300	1,324	256	20	61,112	61,388
Commercial leases	—	—	666	666	—	—	139,783	139,783
Consumer loans	—	—	163	163	—	—	2,745	2,745
	\$1,584	\$110	\$ 16,341	\$18,035	\$24,441	\$3,989	\$1,019,325	1,047,755

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

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## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 4 - LOANS RECEIVABLE (continued)

Activity in the allowance for loan losses is as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Beginning balance	\$17,453	\$31,638	\$18,035	\$31,726
Loans charged offs:				
One-to-four family residential real estate loans	(176	) (591	) (545	) (1,263
Multi-family mortgage loans	(374	) (135	) (610	) (689
Nonresidential real estate loans	(153	) (2,202	) (232	) (2,635
Construction and land loans	—	(185	) (927	) (232
Commercial loans	(213	) (31	) (232	) (169
Consumer loans	(12	) (11	) (12	) (23
	(928	) (3,155	) (2,558	) (5,011
Recoveries:				
One-to-four family residential real estate loans	85	74	327	185
Multi-family mortgage loans	159	96	216	480
Nonresidential real estate loans	103	284	122	315
Construction and land loans	1	58	3	242
Commercial loans	16	132	21	189
Consumer loans	2	6	3	11
	366	650	692	1,422
Net charge-off	(562	) (2,505	) (1,866	) (3,589
Provision for loan losses	206	1,745	928	2,741
Ending balance	\$17,097	\$30,878	\$17,097	\$30,878

## Impaired loans

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

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



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## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 4 - LOANS RECEIVABLE (continued)

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

					Three months ended June 30, 2013	Three months ended June 30, 2013	Six months ended June 30, 2013	Six months ended June 30, 2013
	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, 2013								
With no related allowance recorded:								
One-to-four family residential real estate loans	\$4,810	\$ 3,807	\$ 951	\$ —	\$2,681	\$ 10	\$2,866	\$ 21
One-to-four family residential real estate loans - non-owner occupied	956	778	142	—	1,683	2	1,450	2
Multi-family mortgage loans	8,834	8,630	4	—	8,237	63	5,605	75
Nonresidential real estate loans	4,372	3,681	253	—	2,776	7	4,245	9
Land loans	454	337	113	—	324	—	185	—
Commercial loans - secured	648	326	19	—	163	—	93	—
Commercial loans - unsecured	485	53	374	—	52	—	52	—
	20,559	17,612	1,856	—	15,916	82	14,496	107
With an allowance recorded:								
One-to-four family residential real estate loans - non-owner occupied	587	509	60	47	298	1	348	1
Multi-family mortgage loans	3,819	3,228	560	567	3,521	61	3,145	67
Wholesale commercial lending	656	647	—	62	820	—	469	7
Nonresidential real estate loans	3,404	3,045	276	352	1,859	4	2,154	6
Land loans	2,499	1,264	1,232	135	1,264	—	1,669	—
Commercial loans - secured	462	272	190	34	553	1	403	1
	11,427	8,965	2,318	1,197	8,315	67	8,188	82
Total	\$31,986	\$ 26,577	\$ 4,174	\$ 1,197	\$24,231	\$ 149	\$22,684	\$ 189

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## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 4 - LOANS RECEIVABLE (continued)

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

## Purchased Impaired Loans

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

	June 30, 2013	December 31, 2012
One-to-four family residential real estate loans	\$396	\$380
Nonresidential real estate loans	1,607	2,568
Land loans	997	1,021
Commercial loans	21	20
Outstanding balance	\$3,021	\$3,989
Carrying amount, net of allowance (\$52 at June 30, 2013, \$110 at December 31, 2012)	\$2,969	\$3,879





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## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 4 - LOANS RECEIVABLE (continued)

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Beginning balance	\$146	\$1,790	\$196	\$2,270
New loans purchased	—	—	—	—
Disposals	—	395	—	522
Reclassifications from nonaccretable difference	3	—	3	—
Accretion of income	49	563	99	916
Ending balance	\$100	\$832	\$100	\$832

For the above purchased impaired loans, the Company decreased the allowance for loan losses by \$49,000 for the three months ended June 30, 2013 and \$58,000 for the six months ended June 30, 2013. The allowance for loan losses was decreased by \$114,000 for the three months ended June 30, 2012 and increased by \$224,000 during the six months ended June 30, 2012.

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

	June 30, 2013	December 31, 2012
Contractually required payments receivable of loans purchased:		
One-to-four family residential real estate loans	\$1,143	\$1,143
Nonresidential real estate loans	2,008	3,884
Land loans	1,600	1,600
Commercial loans	222	597
	\$4,973	\$7,224

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

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## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 4 - LOANS RECEIVABLE (continued)

## Nonaccrual loans

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

	Loan Balance	Recorded Investment	Loans Past Due Over 90 Days, Still Accruing
June 30, 2013			
One-to-four family residential real estate loans	\$5,113	\$4,161	\$—
One-to-four family residential real estate loans – non owner occupied	1,543	1,341	—
Multi-family mortgage loans	12,586	11,788	234
Wholesale commercial lending	656	656	—
Nonresidential real estate loans	8,185	7,565	—
Land loans	2,953	1,609	—
Commercial loans – secured	1,115	906	—
Commercial loans – unsecured	520	146	—
Consumer loans	1	1	—
	\$32,672	\$28,173	\$234
December 31, 2012			
One-to-four family residential real estate loans	\$7,286	\$6,154	\$70
One-to-four family residential real estate loans – non owner occupied	1,420	1,145	—
Multi-family mortgage loans	5,246	3,517	242
Nonresidential real estate loans	12,249	8,985	—
Land loans	3,817	2,210	—
Commercial loans – secured	386	204	—
Commercial loans – unsecured	552	52	17
	\$30,956	\$22,267	\$329

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

The Company's reserve for uncollected loan interest was \$1.2 million and \$942,000 at June 30, 2013 and December 31, 2012, respectively. Except for purchased impaired loans, when a loan is on non-accrual status and the ultimate collectability of the total principal of an impaired loan is in doubt, all payments are applied to principal under the cost recovery method. Alternatively, when a loan is on non-accrual status but there is doubt concerning only the ultimate collectability of interest, contractual interest is credited to interest income only when received, under the cash basis method pursuant to the provisions of FASB ASC 310-10, as applicable. In all cases, the average balances are calculated based on the month-end balances of the financing receivables within the period reported pursuant to the provisions of FASB ASC 310-10, as applicable.

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## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 4 - LOANS RECEIVABLE (continued)

## Past Due Loans

The following tables present the aging of the recorded investment of loans at June 30, 2013 by class of loans:

	30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater Past Due	Total Past Due	Loans Not Past Due	Total
One-to-four family residential real estate loans	\$618	\$413	\$3,051	\$4,082	\$143,283	\$147,365
One-to-four family residential real estate loans - non-owner occupied	509	—	1,204	1,713	50,121	51,834
Multi-family mortgage loans	352	857	9,331	10,540	292,688	303,228
Wholesale commercial lending	—	—	996	996	46,091	47,087
Nonresidential real estate loans	1,465	428	6,659	8,552	242,185	250,737
Construction loans	—	—	—	—	399	399
Land loans	117	31	1,375	1,523	4,209	5,732
Commercial loans:						
Secured	—	76	527	603	18,768	19,371
Unsecured	44	25	85	154	4,796	4,950
Municipal loans	—	—	—	—	4,817	4,817
Warehouse lines	—	—	—	—	1,459	1,459
Health care	—	—	—	—	15,884	15,884
Other	—	—	—	—	5,369	5,369
Commercial leases:						
Investment rated commercial leases	—	—	—	—	118,670	118,670
Below investment grade	—	—	—	—	9,428	9,428
Non-rated	—	—	—	—	26,782	26,782
Lease pools	—	—	—	—	3,652	3,652
Consumer loans	221	—	1	222	2,411	2,633
	\$3,326	\$1,830	\$23,229	\$28,385	\$991,012	\$1,019,397
	30-59 Days Past Due	60-89 Days Past Due	90 Days or Greater Past Due	Total Past Due	Loans Not Past Due	Total
Purchased impaired loans						
One-to-four family residential real estate loans - non-owner occupied	\$—	\$—	\$396	\$396	\$—	\$396
Nonresidential real estate loans	—	—	163	163	1,433	1,596
Land loans	—	—	996	996	—	996
Commercial loans – secured	—	—	22	22	—	22
	\$—	\$—	\$1,577	\$1,577	\$1,433	\$3,010



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## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 4 - LOANS RECEIVABLE (continued)

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

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

## Troubled Debt Restructurings

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

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

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## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 4 - LOANS RECEIVABLE (continued)

The Company had \$6.0 million of TDRs at June 30, 2013, compared to \$11.2 million at December 31, 2012, with \$283,000 in specific valuation reserves allocated to those loans at June 30, 2013 and \$318,000 in specific valuation reserves allocated at December 31, 2012. The Company had no outstanding commitments to borrowers whose loans are classified as TDRs at either date.

The following table presents loans classified as TDRs:

	June 30, 2013	December 31, 2012
One-to-four family residential real estate	\$3,075	\$2,802
Multi-family mortgage	1,185	1,201
Nonresidential real estate	—	5,189
Troubled debt restructured loans – accrual loans	4,260	9,192
One-to-four family residential real estate	813	767
Multi-family mortgage	935	938
Nonresidential real estate	—	270
Troubled debt restructured loans – nonaccrual loans	1,748	1,975
Total troubled debt restructured loans	\$6,008	\$11,167

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

During the three and six months ending June 30, 2013 and 2012, the terms of certain loans were modified and classified as TDRs. The modification of the terms of such loans included one or a combination of the following: a reduction of the stated interest rate of the loan; an extension of the maturity date at a stated rate of interest lower than the current market rate for new debt with similar risk; or a permanent reduction of the recorded investment in the loan.

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## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 4 - LOANS RECEIVABLE (continued)

The following tables present TDR activity:

	Three Months Ended June 30, 2013		2012		Pre- Modification outstanding recorded investment	Post- Modification outstanding recorded investment
	Number of loans	Pre- Modification outstanding recorded investment	Post- Modification outstanding recorded investment	Number of loans		
One-to-four family residential real estate	2	\$ 566	\$ 566	5	\$ 267	\$ 267
		Due to reduction in interest rate	Due to extension of maturity date		Due to permanent reduction in recorded investment	Total

For the three months ended June 30, 2013

One-to-four family residential real estate

\$—

\$ 566

\$—

\$ 566

For the three months ended June 30, 2012

One-to-four family residential real estate

\$ 132

\$ 135

\$—

\$ 267

The TDRs described above had no impact on interest income, resulted in no change to the allowance for loan losses and resulted in no charge offs for the three months ended June 30, 2013. The TDRs described above had no impact on interest income, but increased the allowance for loan losses by \$15,000 and resulted in no charge offs for the three months ended June 30, 2012.

	Six Months Ended June 30, 2013		2012		Pre- Modification outstanding recorded investment	Post- Modification outstanding recorded investment
	Number of loans	Pre- Modification outstanding recorded investment	Post- Modification outstanding recorded investment	Number of loans		
One-to-four family residential real estate	3	\$ 950	\$ 950	7	\$ 659	\$ 659
Multi-family mortgage	—	—	—	1	700	500
Total	3	\$ 950	\$ 950	8	\$ 1,359	\$ 1,159
		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, 2013

One-to-four family residential real estate

\$—

\$ 950

\$—

\$ 950

Total

\$—

\$ 950

\$—

\$ 950

For the six months ended June 30, 2012

One-to-four family residential real estate

\$ 504

\$ 155

\$—

\$ 659

Multi-family mortgage

—

—

500

500



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Total	\$ 504	\$ 155	\$ 500	\$ 1,159
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The TDRs described above had no impact on interest income, resulted in no change to the allowance for loan losses and resulted in no charge offs for the six months ended June 30, 2013. The TDRs had no impact on interest income, but increased the allowance for loan losses by \$198,000 and resulted in charge offs of \$470,000 during the six months ended June 30, 2012.

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## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 4 - LOANS RECEIVABLE (continued)

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

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

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

The terms of certain other loans were modified during the three and six months ending June 30, 2013 and 2012 that did not meet the definition of a TDR. These loans had a total recorded investment of \$506,000 and \$1.7 million at June 30, 2013 and 2012. The modification of these loans involved either a modification of the terms of a loan to borrowers who were not experiencing financial difficulties or a delay in a payment that was considered to be insignificant.

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

**Credit Quality Indicators:**

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

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

**Substandard/Performing.** Loans categorized as substandard continue to accrue interest, but exhibit a well-defined weakness or weaknesses that may jeopardize the liquidation of the debt. The loans continue to accrue interest because they are well secured and collection of principal and interest is expected within a reasonable time. The risk rating guidance published by the Office of the Comptroller of the Currency clarifies that a loan with a well-defined weakness does not have to present a probability of default for the loan to be rated Substandard, and that an individual loan's loss potential does not have to be distinct for the loan to be rated Substandard.

**Nonaccrual.** An asset classified Nonaccrual has all the weaknesses inherent in one classified Substandard/Performing with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.

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



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## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 4 - LOANS RECEIVABLE (continued)

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

	Pass	Special Mention	Substandard/Performing	Nonaccrual	Total
One-to-four family residential real estate loans	\$ 143,242	\$ 126	\$ 903	\$ 3,333	\$ 147,604
One-to-four family residential real estate loans non-owner occupied	50,245	—	643	1,689	52,577
Multi-family mortgage loans	274,715	12,040	8,709	11,353	306,817
Wholesale commercial lending	44,350	—	1,767	990	47,107
Nonresidential real estate loans	191,127	39,449	16,185	8,668	255,429
Construction loans	399	—	—	—	399
Land loans	2,524	—	1,628	2,601	6,753
Commercial loans:					
Secured	16,293	2,325	101	624	19,343
Unsecured	3,574	298	982	85	4,939
Municipal loans	4,751	—	—	—	4,751
Warehouse lines	1,447	—	—	—	1,447
Health care	14,298	1,572	—	—	15,870
Other	5,351	—	—	—	5,351
Commercial leases:					
Investment rated commercial leases	118,010	—	—	—	118,010
Below investment grade	9,349	—	—	—	9,349
Non-rated	26,610	—	—	—	26,610
Lease pools	3,637	—	—	—	3,637
Consumer loans	2,621	—	—	1	2,622
Total	\$ 912,543	\$ 55,810	\$ 30,918	\$ 29,344	\$ 1,028,615

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## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 4 - LOANS RECEIVABLE (continued)

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

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

## NOTE 5 – FAIR VALUE

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

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

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

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

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

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

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

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BANKFINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 5 - FAIR VALUE (continued)

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

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

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

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

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## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 5 - FAIR VALUE (continued)

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

	Fair Value Measurements Using			Fair Value
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
June 30, 2013				
Securities:				
Certificates of deposit	\$—	\$ 15,639	\$—	\$ 15,639
Municipal securities	—	362	—	362
Equity mutual fund	507	—	—	507
Mortgage-backed securities – residential	—	31,266	—	31,266
Collateralized mortgage obligations – residential	—	5,201	—	5,201
SBA-guaranteed loan participation certificates	—	39	—	39
	\$ 507	\$ 52,507	\$—	\$ 53,014
December 31, 2012				
Securities:				
Certificates of deposit	\$—	\$ 33,456	\$—	\$ 33,456
Municipal securities	—	369	—	369
Equity mutual fund	528	—	—	528
Mortgage-backed securities - residential	—	34,233	—	34,233
Collateralized mortgage obligations – residential	—	9,204	—	9,204
SBA-guaranteed loan participation certificates	—	42	—	42
	\$ 528	\$ 77,304	\$—	\$ 77,832



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## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 5 - FAIR VALUE (continued)

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

	Fair Value Measurement Using			Fair Value
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	
June 30, 2013				
Impaired loans:				
One-to-four family residential real estate loans	\$—	\$—	\$513	\$513
Multi-family mortgage loans	—	—	3,246	3,246
Nonresidential real estate loans	—	—	2,693	2,693
Construction and land loans	—	—	2,076	2,076
Commercial loans	—	—	238	238
	\$—	\$—	\$8,766	\$8,766
Other real estate owned:				
One-to-four family residential real estate	\$—	\$—	\$1,081	\$1,081
Nonresidential real estate	—	—	1,656	1,656
Land	—	—	2,638	2,638
	\$—	\$—	\$5,375	\$5,375
Mortgage servicing rights	\$—	\$—	\$195	\$195
December 31, 2012				
Impaired loans:				
One-to-four family residential real estate loans	\$—	\$—	\$410	\$410
Multi-family mortgage loans	—	—	1,916	1,916
Nonresidential real estate loans	—	—	3,102	3,102
Construction and land loans	—	—	2,841	2,841
Commercial loans	—	—	181	181
	\$—	\$—	\$8,450	\$8,450
Other real estate owned:				
One-to-four family residential real estate	\$—	\$—	\$1,503	\$1,503
Multi-family mortgage	—	—	720	720
Nonresidential real estate	—	—	3,649	3,649
Land	—	—	3,496	3,496
	\$—	\$—	\$9,368	\$9,368
Mortgage servicing rights	\$—	\$—	\$208	\$208

Impaired loans, including purchased impaired loans, which are measured for impairment using the fair value of the collateral for collateral-dependent loans, with specific valuation allowances, had a carrying amount of \$10.0 million, with a valuation allowance of \$1.2 million at June 30, 2013, compared to \$10.5 million, with a valuation allowance of \$1.5 million at March 31, 2013, and \$10.1 million and a valuation allowance of \$1.7 million at December 31, 2012, resulting in a decrease in the provision for loan losses of \$282,000 for three months ended June 30, 2013 and \$445,000 for six months ended June 30, 2013.



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## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 5 - FAIR VALUE (continued)

The following table presents quantitative information, based on certain empirical data with respect to Level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis at June 30, 2013:

	Fair Value	Valuation Technique(s)	Unobservable Input(s)	Range (Weighted Average)
Impaired loans:				
One-to-four family residential real estate loans	\$ 513	Sales comparison	Discount applied to valuation	6%-98% (67%)
Multi-family mortgage loans	3,246	Sales comparison	Comparison between sales and income approaches	9%-95% (46%)
		Income approach	Cap Rate	7.5% to 10% (8.37%)
Nonresidential real estate loans	2,693	Sales comparison	Comparison between sales and income approaches	6%-99% (68%)
		Income approach	Cap Rate	7.5%-8.3% (7.69%)
Construction and land loans	2,076	Sales comparison	Discount applied to valuation	10%-93% (33%)
Commercial loans	238	Sales comparison	Discount applied to valuation	5%-91% (70%)
Impaired loans	\$ 8,766			
Other real estate owned:				
One-to-four family residential real estate	\$ 1,081	Sales comparison	Discount applied to valuation	7%-30% (14%)
Nonresidential real estate	1,656	Sales comparison	Comparison between sales and income approaches	7%-29% (21%)
Land	2,638	Sales comparison	Discount applied to valuation	7%-21% (10%)
Other real estate owned	\$ 5,375			
Mortgage servicing rights	\$ 195	Third party valuation	Present value of future servicing income based	11.8 % - 24.4% (16.13%)

Third party valuation	on prepayment speeds Present value of future servicing income based on default rates	12%
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## BANKFINANCIAL CORPORATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

## NOTE 5 - FAIR VALUE (continued)

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

	Carrying Amount	Fair Value Measurements at June 30, 2013 Using:			Total
		Level 1	Level 2	Level 3	
<b>Financial assets</b>					
Cash and cash equivalents	\$ 312,093	\$ 18,303	\$ 293,790	\$—	\$ 312,093
Securities	53,014	507	52,507	—	53,014
Loans held-for-sale	276	—	276	—	276
Loans receivable, net of allowance for loan losses	1,012,316	—	979,631	8,766	988,397
FHLBC stock	6,068	—	—	—	N/A
Accrued interest receivable	3,750	—	3,750	—	3,750
<b>Financial liabilities</b>					
Noninterest-bearing demand deposits	\$(137,146 )	\$—	\$(137,146 )	\$—	\$(137,146 )
Savings deposits	(147,758 )	—	(147,758 )	—	(147,758 )
NOW and money market accounts	(690,185 )	—	(690,185 )	—	(690,185 )
Certificates of deposit	(287,007 )	—	(287,824 )	—	(287,824 )
Borrowings	(2,940 )	—	(2,955 )	—	(2,955 )
Accrued interest payable	(135 )	—	(135 )	—	(135 )
		Fair Value Measurements at December 31, 2012 Using:			
	Carrying Amount	Level 1	Level 2	Level 3	Total
<b>Financial assets</b>					
Cash and cash equivalents	\$275,764	\$20,361	\$255,403	\$—	\$275,764
Securities	77,832	528	77,304	—	77,832
Loans held-for-sale	2,166	—	2,166	—	2,166
Loans receivable, net of allowance for loan losses	1,030,465	—	1,017,637	8,450	1,026,087
FHLBC stock	8,412	—	—	—	N/A
Accrued interest receivable	4,146	—	4,146	—	4,146
<b>Financial liabilities</b>					
Noninterest-bearing demand deposits	\$(134,597 )	\$—	\$(134,597 )	\$—	\$(134,597 )
Savings deposits	(144,726 )	—	(144,726 )	—	(144,726 )
NOW and money market accounts	(697,775 )	—	(697,775 )	—	(697,775 )
Certificates of deposit	(305,253 )	—	(306,859 )	—	(306,859 )
Borrowings	(5,567 )	—	(5,608 )	—	(5,608 )
Accrued interest payable	(157 )	—	(157 )	—	(157 )

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

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

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

based on quoted market prices.

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BANKFINANCIAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

NOTE 5 - FAIR VALUE (continued)

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

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

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

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

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

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

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

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

Cautionary Statement Regarding Forward-Looking Information

Forward Looking Statements

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

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

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



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

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

**Critical Accounting Policies**

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

**Overview**

Continuing the trends commenced in the fourth quarter of 2012, loan origination activity improved in the second quarter of 2013, especially in the multifamily and commercial leasing categories. On a year-over-year comparative basis, loan originations increased by 75% with particular strength in multifamily loan originations, commercial loan originations and commercial lease originations. Continued improvement in loan origination volumes remains essential to offsetting the ongoing effects of yield compression on our net interest income. Net loan payoffs decreased during the course of the second quarter of 2013. Our priority for loan portfolio management continues to be the retention of our highest quality loan exposures while expediting the reduction of lesser-quality loan balances.

Asset quality was essentially constant. In addition, we continued to reduce OREO balances at an acceptable rate with minimal impact to earnings and capital during the quarter.

Beginning in the fourth quarter of 2012, and continuing in 2013, we determined that for certain performing classified and non-performing multifamily and non-residential real estate loans, the most cost-effective and expeditious resolution method was to decline to renew the loans upon maturity or to utilize other remedies provided by our loan documents to accelerate the maturity date of the loans, coupled with an attempt in appropriate cases to negotiate a final resolution in the form of a deed-in-lieu of foreclosure. Of the \$4.7 million in loans placed on non-accrual in the second quarter of 2013, \$2.6 million related to affirmative steps that we took to expedite resolution. We believe this approach has the potential to further reduce classified and non-performing assets more rapidly and with lower litigation costs given the time and expense inherent within the current judicial foreclosure processes.

National economic factors improved slightly in the second quarter of 2013, while the local Chicago metropolitan economic factors declined slightly. Our provision for loan losses increased in the second quarter of 2013 due principally to the growth in the loan portfolio and receipt of updated appraisals on several small loans that are subject to annual impairment testing.

Non-interest income declined in the second quarter of 2013 due to reduced income from mortgage banking and sales of non-performing loans. Income from deposit services and loan fee income improved modestly in the second quarter of 2013.

Non-interest expense declined in the second quarter of 2013 despite the continuing impact of credit collection expense. Advertising expense increased due to expanded loan marketing activity. The Company's full-time equivalent employment levels declined from 347 to 308 during the second quarter of 2013, reflecting the initial implementation of our updated operations review. We expanded our residential and commercial loan originations staffing by 10%

during the second quarter of 2013 as a re-deployment of resources from transaction processing and support functions. As the remainder of 2013 progresses, we expect that non-interest expense related to information technology expense and non-performing assets management expense will begin to trend downward.

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## SELECTED FINANCIAL DATA

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

	June 30, 2013	December 31, 2012	Change
	(Dollars in thousands)		
Selected Financial Condition Data:			
Total assets	\$1,461,132	\$1,481,192	\$(20,060 )
Loans, net	1,012,316	1,030,465	(18,149 )
Loans held-for-sale	276	2,166	(1,890 )
Securities, at fair value	53,014	77,832	(24,818 )
Core deposit intangible	2,732	3,038	(306 )
Deposits	1,262,096	1,282,351	(20,255 )
Borrowings	2,940	5,567	(2,627 )
Equity	173,229	172,890	339

	Three Months Ended June 30,			Six Months Ended June 30,		
	2013	2012	Change	2013	2012	Change
	(Dollars in thousands)					
Selected Operating Data:						
Interest and dividend income	\$12,276	\$15,824	\$(3,548 )	\$24,989	\$32,458	\$(7,469 )
Interest expense	935	1,112	(177 )	1,929	2,352	(423 )
Net interest income	11,341	14,712	(3,371 )	23,060	30,106	(7,046 )
Provision for loan losses	206	1,745	(1,539 )	928	2,741	(1,813 )
Net interest income after provision for loan losses	11,135	12,967	(1,832 )	22,132	27,365	(5,233 )
Noninterest income	1,509	1,418	91	4,375	3,250	1,125
Noninterest expense	12,568	14,044	(1,476 )	25,753	27,480	(1,727 )
Income before income tax expense	76	341	(265 )	754	3,135	(2,381 )
Income tax expense	—	(457 )	457	—	—	—
Net income	\$76	\$798	\$(722 )	\$754	\$3,135	\$(2,381 )

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	Three Months Ended June 30,		Six Months Ended June 30,		
	2013	2012	2013	2012	
Selected Financial Ratios and Other Data:					
Performance Ratios:					
Return on assets (ratio of net income to average total assets) <sup>(1)</sup>	0.02	% 0.21	% 0.10	% 0.41	%
Return on equity (ratio of net income to average equity) <sup>(1)</sup>	0.17	1.56	0.86	3.08	
Average equity to average assets	12.02	13.42	11.98	13.29	
Net interest rate spread <sup>(1)(2)</sup>	3.25	4.04	3.32	4.11	
Net interest margin <sup>(1)(3)</sup>	3.31	4.11	3.38	4.18	
Efficiency ratio <sup>(4)</sup>	97.81	87.07	93.87	82.38	
Noninterest expense to average total assets <sup>(1)</sup>	3.46	3.68	3.53	3.58	
Average interest-earning assets to average interest-bearing liabilities	121.24	123.50	121.02	122.98	
Dividends declared per share	\$0.02	\$0.01	\$0.02	\$0.02	
Dividend payout ratio	N.M.	N.M.	N.M.	N.M.	
			At June 30, 2013	At December 31, 2012	
Asset Quality Ratios:					
Nonperforming assets to total assets <sup>(5)</sup>			2.56	% 2.59	%
Nonperforming loans to total loans			3.03	2.67	
Allowance for loan losses to nonperforming loans			54.78	64.39	
Allowance for loan losses to total loans			1.66	1.72	
Capital Ratios:					
Equity to total assets at end of period			11.86	% 11.67	%
Tier 1 leverage ratio (Bank only)			9.86	9.60	
Other Data:					
Number of full-service offices			20	20	
Employees (full-time equivalents)			308	352	

(1) Ratios annualized.

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

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

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

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

N.M. Not Meaningful

#### Comparison of Financial Condition at June 30, 2013 and December 31, 2012

Total assets decreased \$20.1 million, or 1.4%, to \$1.461 billion at June 30, 2013, from \$1.481 billion at December 31, 2012. The decrease in total assets was primarily due to a decrease in loans receivable and securities. The decrease was partially offset by an increase in cash and cash equivalents. Net loans decreased \$18.1 million to \$1.012 billion at June 30, 2013, from \$1.030 billion at December 31, 2012. In December 2012, we designated certain owner-occupied and investor-owned one-to-four family residential loans with a carrying value of \$7.5 million as "held for sale" in preparation for a bulk sale. The bulk sale of these one-to-four family residential loans was completed in February

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2013. Securities decreased \$24.8 million to \$53.0 million at June 30, 2013, from \$77.8 million at December 31, 2012. Net cash and cash equivalents increased by \$36.3 million to \$312.1 million at June 30, 2013, from \$275.8 million at December 31, 2012.

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

Total liabilities decreased by \$20.4 million, or 1.6%, to \$1.288 billion at June 30, 2013, from \$1.308 billion at December 31, 2012. Total deposits decreased \$20.3 million, or 1.6%, to \$1.262 billion at June 30, 2013, from \$1.282 billion at December 31, 2012, primarily due to deposit pricing adjustments that we made in anticipation of additional excess liquidity resulting from loan payments and bulk sales of loans. Certificates of deposit decreased \$18.2 million, or 6.0%, to \$287.0 million at June 30, 2013, from \$305.3 million at December 31, 2012. Core deposits increased to 77.3% of total deposits at June 30, 2013, from 76.2% of total deposits at December 31, 2012. Noninterest-bearing demand deposits increased \$2.5 million, or 1.9%, to \$137.1 million at June 30, 2013, from \$134.6 million at December 31, 2012. Savings accounts increased \$3.0 million, or 2.1%, to \$147.8 million at June 30, 2013, from \$144.7 million at December 31, 2012. Money market and interest-bearing NOW accounts decreased \$7.6 million, or 1.1%, to \$690.2 million at June 30, 2013, from \$697.8 million at December 31, 2012.

Other liabilities increased \$2.6 million, or 26.54%, to \$12.2 million at June 30, 2013, from \$9.7 million at December 31, 2012 primarily due to the purchase of an investment security not settled at June 30, 2013 for \$2.5 million.

Total stockholders' equity was \$173.2 million at June 30, 2013, compared to \$172.9 million at December 31, 2012. The increase in total stockholders' equity was primarily due to the \$754,000 net income that we recorded for six months ended June 30, 2013. The unallocated shares of common stock that our ESOP owns were reflected as a \$11.7 million reduction to stockholders' equity at June 30, 2013, compared to a \$12.2 million reduction at December 31, 2012.

Operating results for the three months ended June 30, 2013 and 2012

**Net Income.** We had net income of \$76,000 for the three months ended June 30, 2013, compared to \$798,000 for the three months ended June 30, 2012. There were no earnings per share of common stock for the three months ended June 30, 2013, compared to \$0.04 per basic and fully diluted share for the three months ended June 30, 2012.

**Net Interest Income.** Net interest income was \$11.3 million for the three months ended June 30, 2013, compared to \$14.7 million for the same period in 2012. The decrease reflected a \$3.5 million decrease in interest income, partially offset by a \$177,000 decrease in interest expense.

The decrease in net interest income was primarily attributable to a lower level of average interest-earning assets and a decrease in the yield on interest earning assets. Total average interest-earning assets decreased \$66.3 million, or 4.6%, to \$1.374 billion for the three months ended June 30, 2013, from \$1.440 billion for the same period in 2012. Our net interest rate spread decreased by 79 basis points to 3.25% for the three months ended June 30, 2013, from 4.04% for the same period in 2012. Our net interest margin decreased by 80 basis points to 3.31% for the three months ended June 30, 2013, from 4.11% for the same period in 2012. The decrease in the net interest spread and margin was a result of lower yields on interest earning assets, which was partially offset by a lower cost of funds. The yield on interest earning assets decreased 84 basis points to 3.58% for the three months ended June 30, 2013, from 4.42% for the same period in 2012, and the cost of interest bearing liabilities decreased five basis points to 0.33% for the three months ended June 30, 2013, from 0.38% for the same period in 2012.

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## Average Balance Sheets

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

	Three Months Ended June 30,			2012			Yield/Rate <sup>(1)</sup>	%
	2013			Average				
	Average	Interest	Yield/Rate <sup>(1)</sup>	Average	Interest	Yield/Rate <sup>(1)</sup>		
	Outstanding			Outstanding				
	Balance			Balance				
	(Dollars in thousands)							
<b>Interest-earning Assets:</b>								
Loans	\$ 1,014,591	\$ 11,854	4.69	% \$ 1,184,803	\$ 15,312	5.20		%
Securities	57,022	219	1.54	77,077	387	2.02		
Stock in FHLBC	6,809	6	0.35	10,741	9	0.34		
Other	295,433	197	0.27	167,526	116	0.28		
Total interest-earning assets	1,373,855	12,276	3.58	1,440,147	15,824	4.42		
Noninterest-earning assets	79,558			85,479				
Total assets	\$ 1,453,413			\$ 1,525,626				
<b>Interest-bearing Liabilities:</b>								
Savings deposits	\$ 148,568	38	0.10	\$ 146,404	37	0.10		
Money market accounts	343,303	294	0.34	343,415	311	0.36		
NOW accounts	346,457	95	0.11	333,299	104	0.13		
Certificates of deposit	291,966	506	0.70	333,237	632	0.76		
Total deposits	1,130,294	933	0.33	1,156,355	1,084	0.38		
Borrowings	2,865	2	0.28	9,756	28	1.15		
Total interest-bearing liabilities	1,133,159	935	0.33	1,166,111	1,112	0.38		
Noninterest-bearing deposits	128,162			135,252				
Noninterest-bearing liabilities	17,449			19,554				
Total liabilities	1,278,770			1,320,917				
Equity	174,643			204,709				
Total liabilities and equity	\$ 1,453,413			\$ 1,525,626				
Net interest income		\$ 11,341			\$ 14,712			
Net interest rate spread <sup>(2)</sup>			3.25	%		4.04		%
Net interest-earning assets <sup>(3)</sup>	\$ 240,696			\$ 274,036				
Net interest margin <sup>(4)</sup>			3.31	%		4.11		%
Ratio of interest-earning assets to interest-bearing liabilities	121.24	%		123.50	%			

(1) Annualized

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

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

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



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## Provision for Loan Losses

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

The provision for loan losses totaled \$206,000 for the three months ended June 30, 2013, compared to \$1.7 million for the same period in 2012. The provision for loan losses is a function of the allowance for loan loss methodology we use to determine the appropriate level of the allowance for inherent loan losses after net charge-offs have been deducted. Net charge-offs were \$562,000 for the three months ended June 30, 2013, compared to \$2.5 million for the same period in 2012. The allowance for loan losses as a percentage of nonperforming loans was 54.78% at June 30, 2013, compared to 59.24% at March 31, 2013. Loans collectively evaluated for impairment increased \$6.2 million, or 0.6%, to \$998.8 million at June 30, 2013, compared to \$992.6 million at March 31, 2013. The related loan loss decreased \$74,000, or 0.46%, to \$15.8 million at June 30, 2013, compared to \$15.9 million at March 31, 2013.

A loan balance is classified as a loss and charged-off when it is confirmed that there is no readily apparent source of repayment for the portion of the loan that is classified as loss. Confirmation can occur upon the receipt of updated third-party appraisal valuation information indicating that there is a low probability of repayment upon sale of the collateral, the final disposition of collateral where the net proceeds are insufficient to pay the loan balance in full, our failure to obtain possession of certain consumer-loan collateral within certain time limits specified by applicable federal regulations, the conclusion of legal proceedings where the borrower's obligation to repay is legally discharged (such as a Chapter 7 bankruptcy proceeding), or when it appears that further formal collection procedures are not likely to result in net proceeds in excess of the costs to collect.

## Noninterest Income

	Three Months Ended June 30,		
	2013	2012	Change
	(Dollars in thousands)		
Deposit service charges and fees	\$509	\$521	\$(12 )
Other fee income	410	383	27
Insurance commissions and annuities income	86	112	(26 )
Gain (loss) on sale of loans, net	(4 )	118	(122 )
Loss on disposition of premises and equipment	—	(157 )	157
Loan servicing fees	114	119	(5 )
Amortization of servicing assets	(85 )	(67 )	(18 )
Recovery (impairment) of servicing assets	9	(31 )	40
Earnings on bank owned life insurance	82	120	(38 )
Trust income	183	190	(7 )
Other	205	110	95
Total noninterest income	\$1,509	\$1,418	\$91

Noninterest income increased by \$91,000 to \$1.5 million for the three months ended June 30, 2013, from \$1.4 million for the same period in 2012. Noninterest income for the three months ended June 30, 2013, included a \$4,000 loss on sale of loans, compared to a \$118,000 gain recorded for the same period in 2012.



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## Noninterest Expense

	Three Months Ended June 30,		
	2013	2012	Change
	(Dollars in thousands)		
Compensation and benefits	\$6,686	\$6,481	\$205
Office occupancy and equipment	1,805	2,105	(300 )
Advertising and public relations	268	224	44
Information technology	816	825	(9 )
Supplies, telephone and postage	403	362	41
Amortization of intangibles	150	157	(7 )
Nonperforming asset management	655	1,117	(462 )
Loss on sale other real estate owned	49	54	(5 )
Valuation adjustments of other real estate owned	141	1,036	(895 )
Operations of other real estate owned	232	601	(369 )
FDIC insurance premiums	477	309	168
Other	886	773	113
Total noninterest expense	\$12,568	\$14,044	\$(1,476 )

Noninterest expense decreased by \$1.5 million, or 10.5%, to \$12.6 million for the three months ended June 30, 2013, from \$14.0 million for the same period in 2012. Compensation and benefits expense included \$143,000 in severance expense for the three months ended June 30, 2013, compared to \$3,000 for the same period in 2012. Noninterest expense for three months ended June 30, 2013 included \$1.1 million of nonperforming asset management and OREO expenses, compared to \$2.8 million for the same period in 2012. Nonperforming asset management expenses decreased \$462,000, or 41.4%, to \$655,000 three months ended June 30, 2013, compared to \$1.1 million for the same period in 2012, primarily due to the decline in nonperforming assets and a decline in expenses relating to resolutions and accelerated dispositions of nonperforming assets. The three months ended June 30, 2013 included a \$141,000 valuation adjustment to OREO properties, compared to a \$1.0 million valuation adjustment to OREO properties for the same period in 2012. Other noninterest expense for the three months ended June 30, 2013 included a provision of \$86,000 for the establishment of a mortgage representation and warranty reserve for mortgage loans sold. The amount of the warranty and representation reserve was calculated by applying published Fannie Mae data relating to the percentage of loans that it required to be repurchased due to breaches of warranties and representations to the Bank's outstanding sold loans.

## Income Taxes

For the three months ended June 30, 2013, we recorded no income tax expense or benefit due to the full valuation allowance we have established for deferred tax assets, compared to an income tax benefit of \$457,000 for 2012.

## Operating results for the six months ended June 30, 2013 and 2012

**Net Income.** We had net income of \$754,000 for six months ended June 30, 2013 compared to \$3.1 million for the 2012. Our earnings per share of common stock was \$0.04 per basic and fully diluted share, for the six months ended June 30, 2013, compared to \$0.16 per basic and fully diluted share for the same period in 2012.

**Net Interest Income.** Net interest income was \$23.1 million for the six months ended June 30, 2013, compared to \$30.1 million for the same period in 2012. The decrease reflected a \$7.5 million decrease in interest income and a \$423,000 decrease in interest expense.

The decrease in net interest income was primarily attributable to a lower level of average interest-earning assets and a decrease in the yield on interest earning assets. Total average interest-earning assets decreased \$70.6 million, or 4.9%, to \$1.376 billion for the six months ended June 30, 2013, from \$1.447 billion for the same period in 2012. Our net interest rate spread decreased by 79 basis points to 3.32% for the six months ended June 30, 2013, from 4.11% for the same period in 2012. Our net interest margin decreased by 80 basis points to 3.38% for the six months ended June 30, 2013, from 4.18% for the same period in 2012. The decrease in the net interest spread and margin was a result of lower yields on interest earning assets, which was partially offset by a lower cost of funds. The yield on interest

earning assets decreased 85 basis points to 3.66% for the six months ended June 30, 2013, from 4.51% for the same period in 2012, and the cost of interest bearing liabilities decreased six basis points to 0.34% for the six months ended June 30, 2013, from 0.40% for the same period in 2012.

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## Average Balance Sheets

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

	For the Six Months Ended June 30,						
	2013			2012			
	Average			Average			
	Outstanding	Interest	Yield/Rate <sup>(1)</sup>	Outstanding	Interest	Yield/Rate <sup>(1)</sup>	
	Balance			Balance			
	(Dollars in thousands)						
<b>Interest-earning Assets:</b>							
Loans	\$ 1,021,709	\$ 24,132	4.76	% \$ 1,210,376	\$ 31,424	5.22	%
Securities	65,108	469	1.45	82,732	829	2.02	
Stock in FHLBC	7,414	13	0.35	12,296	13	0.21	
Other	282,259	375	0.27	141,690	192	0.27	
Total interest-earning assets	1,376,490	24,989	3.66	1,447,094	32,458	4.51	
Noninterest-earning assets	81,249			86,544			
Total assets	\$ 1,457,739			\$ 1,533,638			
<b>Interest-bearing Liabilities:</b>							
Savings deposits	\$ 147,257	75	0.10	\$ 145,976	74	0.10	
Money market accounts	344,387	607	0.36	344,372	624	0.36	
NOW accounts	346,476	200	0.12	332,384	202	0.12	
Certificates of deposit	296,223	1,037	0.71	344,516	1,398	0.82	
Total deposits	1,134,343	1,919	0.34	1,167,248	2,298	0.40	
Borrowings	3,025	10	0.67	9,471	54	1.15	
Total interest-bearing liabilities	1,137,368	1,929	0.34	1,176,719	2,352	0.40	
Noninterest-bearing deposits	128,263			133,591			
Noninterest-bearing liabilities	17,404			19,501			
Total liabilities	1,283,035			1,329,811			
Equity	174,704			203,827			
Total liabilities and equity	\$ 1,457,739			\$ 1,533,638			
Net interest income		\$ 23,060			\$ 30,106		
Net interest rate spread <sup>(2)</sup>			3.32	%		4.11	%
Net interest-earning assets <sup>(3)</sup>	\$ 239,122			\$ 270,375			
Net interest margin <sup>(4)</sup>			3.38	%		4.18	%
Ratio of interest-earning assets to interest-bearing liabilities	121.02	%		122.98	%		

(1) Annualized

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

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

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

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## Provision for Loan Losses

The provision for loan losses totaled \$928,000 for the six months ended June 30, 2013, compared to \$2.7 million for the same period in 2012. The provision for loan losses is a function of the allowance for loan loss methodology we use to determine the appropriate level of the allowance for inherent loan losses after net charge-offs have been deducted. Net charge-offs were \$1.9 million for the six months ended June 30, 2013, compared to \$3.6 million for the same period in 2012. The allowance for loan losses as a percentage of nonperforming loans was 54.78% at June 30, 2013, compared to 64.39% at December 31, 2012. Loans collectively evaluated for impairment decreased \$20.5 million, or 2.0%, to \$998.8 million at June 30, 2013, compared to \$1.019 billion at December 31, 2012. The related loan loss decreased \$493,000, or 3.0%, to \$15.8 million at June 30, 2013, compared to \$16.3 million at December 31, 2012. A loan balance is classified as a loss and charged-off when it is confirmed that there is no readily apparent source of repayment for the portion of the loan that is classified as loss. Confirmation can occur upon the receipt of updated third-party appraisal valuation information indicating that there is a low probability of repayment upon sale of the collateral, the final disposition of collateral where the net proceeds are insufficient to pay the loan balance in full, our failure to obtain possession of certain consumer-loan collateral within certain time limits specified by applicable federal regulations, the conclusion of legal proceedings where the borrower's obligation to repay is legally discharged (such as a Chapter 7 bankruptcy proceeding), or when it appears that further formal collection procedures are not likely to result in net proceeds in excess of the costs to collect.

## Noninterest Income

	Six Months Ended		
	June 30,		
	2013	2012	Change
	(Dollars in thousands)		
Deposit service charges and fees	\$1,008	\$1,078	\$(70)
Other fee income	785	768	17
Insurance commissions and annuities income	195	234	(39)
Gain on sale of loans, net	1,413	385	1,028
Loss on disposition of premises and equipment	—	(157)	) 157
Loan servicing fees	237	247	(10)
Amortization of servicing assets	(144)	) (136)	) (8)
Recovery (impairment) of servicing assets	35	(44)	) 79
Earnings on bank owned life insurance	152	246	(94)
Trust income	364	374	(10)
Other	330	255	75
Total noninterest income	\$4,375	\$3,250	\$1,125

Noninterest income increased by \$1.1 million to \$4.4 million for the six months ended June 30, 2013, from \$3.3 million for 2012. Noninterest income for the six months ended June 30, 2013, included \$1.4 million gain on sale of loans which included recurring loan sale activity combined with the completion of the sale of the owner-occupied and investor-owned one-to-four family residential loans that we designated as held for sale at December 31, 2012. The completion of this sale represented approximately \$1.3 million of the \$1.6 million gain on sale of loans that we recorded for the six months ended June 30, 2013.

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## Noninterest Expense

	Six Months Ended		
	June 30, 2013	2012	Change
	(Dollars in thousands)		
Compensation and benefits	\$13,438	\$13,160	\$278
Office occupancy and equipment	3,753	4,137	(384 )
Advertising and public relations	414	330	84
Information technology	1,565	1,673	(108 )
Supplies, telephone and postage	864	752	112
Amortization of intangibles	306	320	(14 )
Nonperforming asset management	1,349	2,357	(1,008 )
Loss (gain) on sale other real estate owned	118	(84 )	202
Valuation adjustments of other real estate owned	230	1,425	(1,195 )
Operations of other real estate owned	585	902	(317 )
FDIC insurance premiums	969	657	312
Other	2,162	1,851	311
Total noninterest expense	\$25,753	\$27,480	\$(1,727 )

Noninterest expense decreased by \$1.7 million, or 6.3%, to \$25.8 million for the six months ended June 30, 2013, from \$27.5 million for the same period in 2012. Compensation and benefits expense included \$143,000 in severance expense for the six months ended June 30, 2013, compared to \$35,000 for the same period in 2012. Noninterest expense for six months ended June 30, 2013 included \$2.3 million of nonperforming asset management and OREO expenses, compared to \$4.6 million for the same period in 2012. Nonperforming asset management expenses decreased \$1.0 million, or 42.8%, to \$1.3 million six months ended June 30, 2013, compared to \$2.4 million for the same period in 2012, primarily due to the decline in nonperforming assets and a decline in expenses relating to resolutions and accelerated dispositions of nonperforming assets. The six months ended June 30, 2013 included a \$230,000 valuation adjustment to OREO properties, compared to a \$1.4 million valuation adjustment to OREO properties for the same period in 2012. Noninterest expense for the six months ended June 30, 2013 also included the payment of \$203,000 of settlements concerning two sold mortgage loans. The first settlement was based on our inclusion of an ineligible retirement plan in calculating the borrower's available liquidity, and the second involved a servicing error relating to the premature termination of private mortgage insurance. The six months ended June 30, 2013 included a provision of \$86,000 for the establishment of a mortgage representation and warranty reserve for mortgage loans sold. The amount of the warranty and representation reserve was calculated by applying published Fannie Mae data relating to the percentage of loans that it required to be repurchased due to breaches of warranties and representations to the Bank's outstanding sold loans.

## Income Taxes

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

## Nonperforming Loans and Assets

We review loans on a regular basis, and generally place loans on nonaccrual status when either principal or interest is 90 days or more past due. In addition, the Company places loans on nonaccrual status when we do not expect to receive full payment of interest or principal. Interest accrued and unpaid at the time a loan is placed on nonaccrual status is reversed from interest income. Interest payments received on nonaccrual loans are recognized in accordance with our significant accounting policies. Once a loan is placed on nonaccrual status, the borrower must generally demonstrate at least six months of payment performance before the loan is eligible to return to accrual status. We may have loans classified as 90 days or more delinquent and still accruing. Generally, we do not utilize this category of loan classification unless: (1) the loan is repaid in full shortly after the period end date; (2) the loan is well secured and



there are no asserted or pending legal barriers to its collection; or (3) the borrower has remitted all scheduled payments and is otherwise in substantial compliance with the terms of the loan, but the processing of loan payments actually received or the renewal of the loan has not occurred for administrative reasons. At June 30, 2013, we had one loan totaling \$234,000 in this category.

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We typically obtain new third-party appraisals or collateral valuations when we place a loan on nonaccrual status, conduct impairment testing or conduct a TDR unless the existing valuation information for the collateral is sufficiently current to comply with the requirements of our Appraisal and Collateral Valuation Policy (“ACV Policy”). We also obtain new third-party appraisals or collateral valuations when the judicial foreclosure process concludes with respect to real estate collateral, and when we otherwise acquire actual or constructive title to real estate collateral. In addition to third-party appraisals, we use updated valuation information based on Multiple Listing Service data, broker opinions of value, actual sales prices of similar assets sold by us and approved sales prices in response to offers to purchase similar assets owned by us to provide interim valuation information for consolidated financial statement and management purposes. Our ACV Policy establishes the maximum useful life of a real estate appraisal at 18 months. Because appraisals and updated valuations utilize historical or “ask-side” data in reaching valuation conclusions, the appraised or updated valuation may or may not reflect the actual sales price that we will receive at the time of sale. Real estate appraisals may include up to three approaches to value: the sales comparison approach, the income approach (for income-producing property) and the cost approach. Not all appraisals utilize all three approaches. Depending on the nature of the collateral and market conditions, we may emphasize one approach over another in determining the fair value of real estate collateral. Appraisals may also contain different estimates of value based on the level of occupancy or planned future improvements. “As-is” valuations represent an estimate of value based on current market conditions with no changes to the use or condition of the real estate collateral. “As-stabilized” or “as-completed” valuations assume the real estate collateral will be improved to a stated standard or achieve its highest and best use in terms of occupancy. “As-stabilized” or “as-completed” valuations may be subject to a present value adjustment for market conditions or the schedule of improvements.

As part of the asset classification process, we develop an exit strategy for real estate collateral or OREO by assessing overall market conditions, the current use and condition of the asset, and its highest and best use. For most income-producing real estate, we believe that investors value most highly a stable income stream from the asset; consequently, we perform a comparative evaluation to determine whether conducting a sale on an “as-is”, “as-stabilized” or “as-improved” basis is most likely to produce the highest net realizable value. If we determine that the “as-stabilized” or “as-improved” basis is appropriate, we then complete the necessary improvements or tenant stabilization tasks, with the applicable time value discount and improvement expenses incorporated into our estimates of the expected costs to sell. As of June 30, 2013, substantially all impaired real estate loan collateral and OREO were valued on an “as-is basis.” Estimates of the net realizable value of real estate collateral also include a deduction for the expected costs to sell the collateral or such other deductions from the cash flows resulting from the operation and liquidation of the asset as are appropriate. For most real estate collateral subject to the judicial foreclosure process, we apply a 10.0% deduction to the value of the asset to determine the expected costs to sell the asset. This estimate includes one year of real estate taxes, sales commissions and miscellaneous repair and closing costs. If we receive a purchase offer that requires unbudgeted repairs, or if the expected resolution period for the asset exceeds one year, we then include, on a case-by-case basis, the costs of the additional real estate taxes and repairs and any other material holding costs in the expected costs to sell the collateral. For OREO, we only apply a 7.0% deduction to determine the expected costs to sell, as expenses for real estate taxes and repairs are expensed when incurred.

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## Nonperforming Assets Summary

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

	June 30, 2013	March 31, 2013	December 31, 2012	Quarter Change	Six Months Change
	(Dollars in thousands)				
Nonaccrual loans:					
One-to-four family residential	\$5,502	\$5,988	\$7,299	\$(486)	\$(1,797)
Multi-family mortgage	12,444	10,822	3,517	1,622	8,927
Nonresidential real estate	7,565	6,182	8,985	1,383	(1,420)
Construction and land	1,609	1,575	2,210	34	(601)
Commercial	1,052	883	256	169	796
Consumer	1	11	—	(10)	1
	28,173	25,461	22,267	2,712	5,906
Loans held-for-sale	15	15	1,752	—	(1,737)
Other real estate owned:					
One-to-four family residential	1,316	1,515	1,760	(199)	(444)
Multi-family mortgage	—	—	720	—	(720)
Nonresidential real estate	1,757	2,896	3,504	(1,139)	(1,747)
Land	933	1,144	1,323	(211)	(390)
	4,006	5,555	7,307	(1,549)	(3,301)
Nonperforming assets (excluding purchased impaired loans and purchased other real estate owned)	32,194	31,031	31,326	1,163	868
Purchased impaired loans:					
One-to-four family residential	396	388	380	8	16
Nonresidential real estate	1,607	2,554	2,568	(947)	(961)
Construction and land	997	1,021	1,021	(24)	(24)
Commercial	21	21	20	—	1
	3,021	3,984	3,989	(963)	(968)
Purchased other real estate owned:					
One-to-four family residential	179	205	320	(26)	(141)
Nonresidential real estate	372	372	462	—	(90)
Land	1,705	1,956	2,269	(251)	(564)
	2,256	2,533	3,051	(277)	(795)
Purchased impaired loans and other real estate owned	5,277	6,517	7,040	(1,240)	(1,763)
Total nonperforming assets	\$37,471	\$37,548	\$38,366	\$(77)	\$(895)
Ratios:					
Nonperforming loans to total loans	3.03	% 2.89	% 2.67	%	
Nonperforming loans to total loans <sup>(1)</sup>	2.74	2.49	2.29		
Nonperforming assets to total assets	2.56	2.56	2.59		
Nonperforming assets to total assets <sup>(1)</sup>	2.20	2.12	2.11		

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



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## Nonperforming Assets

Nonperforming assets decreased by \$77,000 and \$895,000, respectively, for the three and six months ended June 30, 2013. Nonperforming assets totaled \$37.5 million at June 30, 2013 and March 31, 2013 and \$38.4 million at December 31, 2012. The decrease three and six months ended June 30, 2013 reflected the disposition of \$3.9 million in OREO, the disposition of the \$1.7 million of one- to four family mortgage loans that we designated as held for sale in the fourth quarter of 2012, and various other nonperforming asset resolutions, including the successful restructuring (followed by a sustained period of performance) of a \$6.1 million total credit exposure that initially consisted of seven loans secured by industrial/flex suburban Chicago commercial real estate owned by a family-owned entity. These actions were partially offset by the placement of \$15.0 million of loans on nonaccrual status during the six months ended June 30, 2013. The increase in loans on nonaccrual status that occurred during the six months ended June 30, 2013 reflected the impact of a decision that we made in the fourth quarter of 2012 to take affirmative steps to accelerate the resolution certain performing classified and non-performing multifamily or non-residential real estate loans. Specifically, we determined that for certain performing classified and non-performing multifamily or non-residential real estate loans, the most cost-effective and expeditious resolution method was to decline to renew the loans upon maturity, or to utilize other remedies provided by our loan documents to accelerate the maturity date of the loans, coupled with an attempt, in appropriate cases, to negotiate a final resolution in the form of a deed-in-lieu of foreclosure. Of the \$15.0 million in loans placed on non-accrual in 2013, \$9.8 million related to affirmative expedited resolution cases. Of this amount, \$7.4 million involved multifamily loans to ten unaffiliated borrowers. We are pursuing various actions to attempt to obtain title to these multifamily properties so that they can be marketed for sale.

## Other Real Estate Owned

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

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

	For the Three Months ended June 30,		For the Six Months Ended June 30,	
	2013	2012	2013	2012
	(Dollars in thousands)			
Beginning balance	\$8,088	\$20,189	\$10,358	\$22,480
New foreclosed properties	2,201	2,639	2,756	3,766
Payments received	(26)	(15)	(26)	(199)
Valuation adjustments	(141)	(1,036)	(230)	(1,425)
Gain (loss) on sale of other real estate owned	(49)	(54)	(118)	84
Proceeds from sales of other real estate owned	(3,811)	(4,472)	(6,478)	(7,455)
Ending balance	\$6,262	\$17,251	\$6,262	\$17,251

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	June 30, 2013	December 31, 2012
	(Dollars in thousands)	
One-to-four family residential	\$1,316	\$1,760
Multi-family mortgage	—	720
Nonresidential real estate	1,757	3,504
Land	933	1,323
	4,006	7,307
Acquired other real estate owned:		
One-to-four family residential	179	320
Nonresidential real estate	372	462
Land	1,705	2,269
	2,256	3,051
Total other real estate owned	\$6,262	\$10,358

## Liquidity and Capital Resources

Liquidity. The overall objective of our liquidity management is to ensure the availability of sufficient cash funds to meet all financial commitments and to take advantage of investment opportunities. We manage liquidity in order to meet deposit withdrawals on demand or at contractual maturity, to repay borrowings as they mature, and to fund new loans and investments as opportunities arise.

Our primary sources of funds are deposits, principal and interest payments on loans and securities, and, to a lesser extent, wholesale borrowings, the proceeds from maturing securities and short-term investments, and the proceeds from the sales of loans and securities. The scheduled amortization of loans and securities, as well as proceeds from borrowings, are predictable sources of funds. Other funding sources, however, such as deposit inflows, mortgage prepayments and mortgage loan sales are greatly influenced by market interest rates, economic conditions and competition. We anticipate that we will have sufficient funds available to meet current loan commitments and lines of credit and maturing certificates of deposit that are not renewed or extended. We generally remain fully invested and utilize additional sources of funds through FHLBC advances. We had no outstanding advances at June 30, 2013.

As a result of the regulatory restructuring occasioned by the Dodd-Frank Act, the Company is subject to Federal Reserve Board Supervisory Letter SR 09-4, which provides that a holding company should, among other things, notify and make a submission to the Federal Reserve Bank prior to declaring a dividend if its net income for the current quarter is not sufficient to fully fund the dividend, and consider eliminating, deferring or significantly reducing its dividends if its net income for the current quarter is not sufficient to fully fund the dividends, or if its net income for the past four quarters, net of dividends previously paid during that period, is not sufficient to fully fund the dividends. The Company will continue to consult with, and seek the prior approval of, the Federal Reserve Bank prior to declaring any dividends.

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

As of June 30, 2013, we were not aware of any known trends, events or uncertainties that had or were reasonably likely to have a material impact on our liquidity. As of June 30, 2013, we had no other material commitments for capital expenditures.

## Capital Management

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

The Bank is subject to regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary, actions by the Office of the Comptroller of the Currency that, if undertaken, could have a direct material effect on the Bank's

financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance-sheet items as calculated under regulatory accounting practices. The Bank's capital amounts and classification are also subject to qualitative judgments by regulators about components, risk weightings, and other factors.

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

The Company and the Bank have adopted Capital Plans that require the Bank to maintain a Tier 1 leverage ratio of at least 8% and a total risk-based capital ratio of at least 12%. The minimum capital ratios set forth in the Capital Plans will be increased and other minimum capital requirements will be established if and as necessary to comply with the Basel III requirements as such requirements become applicable to the Company and the Bank. In accordance with the Capital Plans, neither the Company nor the Bank will pursue any acquisition or growth opportunity, declare any dividend or conduct any stock repurchase that would cause the Bank's total risk-based capital ratio and/or its Tier 1 leverage ratio to fall below the established minimum capital levels. In addition, the Company will continue to maintain its ability to serve as a source of financial strength to the Bank by holding at least \$5.0 million of cash or liquid assets for that purpose.

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

	Actual Ratio		Minimum required to be Well Capitalized Under Prompt Corrective Action Provisions	Minimum Capital Ratios Established under Capital Plans	
June 30, 2013					
Total capital (to risk-weighted assets)	15.74	%	8.00	%	12.00 %
Tier 1 (core) capital (to risk-weighted assets)	14.48		4.00		8.00
Tier 1 (core) capital (to adjusted total assets)	9.86		4.00		8.00
December 31, 2012					
Total capital (to risk-weighted assets)	15.32	%	8.00	%	12.00 %
Tier 1 (core) capital (to risk-weighted assets)	14.07		4.00		8.00
Tier 1 (core) capital (to adjusted total assets)	9.60		4.00		8.00

As of June 30, 2013 and December 31, 2012, the Bank was well capitalized under the regulatory framework for prompt corrective action. There are no conditions or events since those notifications that management believes have changed the Bank's prompt corrective action capitalization category.

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



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

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Capital Management - Company Total stockholders' equity was \$173.2 million at June 30, 2013, compared to \$172.9 million at December 31, 2012. The increase in total stockholders' equity was primarily due to the \$754,000 net income that we recorded for the six months ended June 30, 2013. The unallocated shares of common stock that our ESOP owns were reflected as a \$11.7 million reduction to stockholders' equity at June 30, 2013, compared to \$12.2 million at December 31, 2012.

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

Stock Repurchase Program. Our Board of Directors had authorized the repurchase of up to 5,047,423 shares of our common stock. The repurchase authorization expired on November 15, 2012. The authorization permitted shares to be repurchased in open market or negotiated transactions, and pursuant to any trading plan that may be adopted in accordance with Rule 10b5-1 of the Securities and Exchange Commission. The authorization was utilized at management's discretion, subject to the limitations set forth in Rule 10b-18 of the Securities and Exchange Commission and other applicable legal requirements, and to price and other internal limitations established by the Board of Directors. As of June 30, 2013, the Company had repurchased 4,239,134 shares of its common stock out of the 5,047,423 shares that had been authorized for repurchase. Federal Reserve Board Supervisory Letter SR 09-4 provides that holding companies experiencing financial weaknesses such as operating losses should notify and make a submission to the Federal Reserve Bank before redeeming or repurchasing common stock. The Company has no plans to conduct such discussions with the Federal Reserve supervisory staff or engage in stock repurchases at this time.

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

Qualitative Analysis. A significant form of market risk is interest rate risk. Interest rate risk results from timing differences in the maturity or repricing of our assets, liabilities and off balance sheet contracts (i.e., forward loan commitments), the effect of loan prepayments and deposit withdrawals, the difference in the behavior of lending and funding rates arising from the use of different indices and "yield curve risk" arising from changing rate relationships across the spectrum of maturities for constant or variable credit risk investments. In addition to directly affecting net interest income, changes in market interest rates can also affect the amount of new loan originations, the ability of borrowers to repay variable rate loans, the volume of loan prepayments and refinancings, the carrying value of investment securities classified as available-for-sale and the flow and mix of deposits.

The general objective of our interest rate risk management is to determine the appropriate level of risk given our business strategy and then manage that risk in a manner that is consistent with our policy to reduce, to the extent possible, the exposure of our net interest income to changes in market interest rates. Our Asset/Liability Management Committee ("ALCO"), which consists of certain members of senior management, evaluates the interest rate risk inherent in certain assets and liabilities, our operating environment and capital and liquidity requirements, and modifies our lending, investing and deposit gathering strategies accordingly. The Board of Directors' Asset/Liability Management Committee then reviews the ALCO's activities and strategies, the effect of those strategies on our net interest margin, and the effect that changes in market interest rates would have on the economic value of our loan and securities portfolios as well as the intrinsic value of our deposits and borrowings, and reports to the full Board of Directors. We actively evaluate interest rate risk in connection with our lending, investing and deposit activities. In an effort to better manage interest-rate risk, we have de-emphasized the origination of residential mortgage loans, and have increased our emphasis on the origination of nonresidential real estate loans, multi-family mortgage loans, commercial loans and commercial leases. In addition, depending on market interest rates and our capital and liquidity position, we generally sell all or a portion of our longer-term, fixed-rate residential loans, usually on a servicing-retained basis. Further, we primarily invest in shorter-duration securities, which generally have lower yields compared to longer-term

investments. Shortening the average maturity of our interest-earning assets by increasing our investments in shorter-term loans and securities, as well as loans with variable rates of interest, helps to better match the maturities and interest rates of our assets and liabilities, thereby reducing the exposure of our net interest income to changes in market interest rates. Finally, we have classified all of our investment portfolio as available-for-sale so as to provide flexibility in liquidity management.

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

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

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

Quantitative Analysis. The following table sets forth, as of June 30, 2013, the estimated changes in the Bank's NPV and net interest income that would result from the designated instantaneous parallel shift in the U.S. Treasury yield curve. Computations of prospective effects of hypothetical interest rate changes are based on numerous assumptions including relative levels of market interest rates, loan prepayments and deposit decay, and should not be relied upon as indicative of actual results.

Change in Interest Rates (basis points)	Estimated Increase in NPV			Decrease in Estimated Net Interest Income		
	Amount	Percent		Amount	Percent	
	(dollars in thousands)					
+400	\$ (14,429 )	(8.45 )	)%	\$ (2,361 )	(5.53 )	)%
+300	(5,186 )	(3.04 )	)	(1,591 )	(3.73 )	)
+200	(4,297 )	(2.51 )	)	(965 )	(2.26 )	)
+100	(1,865 )	(1.09 )	)	(498 )	(1.17 )	)
0	—	—		—	—	

The Company has opted not to include an estimate for a decrease in rates at June 30, 2013 as the results are not relevant given the current targeted fed funds rate of the Federal Open Market Committee. The table set forth above indicates that at June 30, 2013, in the event of an immediate 200 basis point increase in interest rates, the Bank would be expected to experience a 2.51% decrease in NPV and a \$965,000 decrease in net interest income. This data does not reflect any actions that we may undertake in response to changes in interest rates, such as changes in rates paid on certain deposit accounts based on local competitive factors, which could reduce the actual impact on NPV and net interest income, if any.

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

**ITEM 4. CONTROLS AND PROCEDURES**

An evaluation was performed under the supervision and with the participation of the Company's management, including the Chairman, Chief Executive Officer and President and the Executive Vice President and Chief Financial

Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) promulgated under the Securities and Exchange Act of 1934, as amended) as of June 30, 2013. Based on that evaluation, the Company's management, including the Chairman, President, and Chief Executive Officer and the Executive Vice President and Chief Financial Officer, concluded that the Company's disclosure controls and procedures were effective.

During the quarter ended June 30, 2013, there have been no changes in the Company's internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II

ITEM 1. LEGAL PROCEEDINGS

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

ITEM 1A. RISK FACTORS

Not applicable.

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

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

(b) Use of Proceeds. Not applicable

(c) Repurchases of Equity Securities.

The Company's Board of Directors had authorized the repurchase of up to 5,047,423 shares of our common stock. The repurchase authorization expired on November 15, 2012. In accordance with this authorization, the Company had repurchased 4,239,134 shares of its common stock as of June 30, 2013. The Company has no plans to engage in stock repurchases at this time.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

ITEM 4. MINE SAFETY DISCLOSURES

ITEM 5. OTHER INFORMATION

None

ITEM 6. EXHIBITS

Exhibit Number Description

31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32	Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002*
101	The following financial statements from the BankFinancial Corporation Quarterly Report on Form 10-Q for the quarter ended June 30, 2013, formatted in Extensive Business Reporting Language (XBRL): (i) consolidated statement of conditions, (ii) consolidated statements of operations, (iii) consolidated statements of cash flows and (iv) the notes to consolidated financial statements.

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

SIGNATURES

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

BANKFINANCIAL CORPORATION

Dated: August 5, 2013

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

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